BOND MARKET REVIEW

March 29, 2017

Hidden Figures

Over the years, the study of cycles has been the most dependable approach we've discovered for market forecasting. While cyclic analysis is a technical read on price activity, we of course study market fundamentals as well. The **BMR** approach is short–term technical, while we mix in fundamentals for the medium and longer–term. We openly cover the comments of various FOMC officials, but rarely get 'political.' Cycles are up and down – not left or right. Clearly the markets were disappointed with the way the new healthcare legislation was handled (or wasn't), leading many to question the expected tax reforms as well. It's evident that things are as politically divided as they've ever been.

That said, it's hard to reconcile the presidential polling numbers with consumer confidence. Some polls had President Trump's first 100–day approval ratings at the lowest of any president since Harry S. Truman. Meanwhile Consumer Confidence is skyrocketing. Given the choice, I'd certainly take the latter. Tuesday's report from the New York Conference Board showed Consumer Confidence surging from 116.1 in February to 125.6 – the highest since December 2000. Those are the kinds of results that are pro stocks, good for the Dollar, and welcome news to bond bears and FOMC hawks. The gauge of Present Conditions increased from 134.4 to 143.1 – the best reading since August 2001. Another measure showed that Consumer Expectations rose from 103.9 to 113.8 – the best outlook for 6 months out since September 2000. Those expecting job availability to increase in the near future rose from 20.9% to 24.8%. That's the highest since November 1983! Bloomberg Consumer Comfort rose from 51 to 51.3, hitting the highest level since early 2007. So far, the 'Trump' stock rally has had only one major hiccup, and that was last week's worst selloff in 6–months.

There's even more in the hidden numbers, or those not in the headlines. The percentage expecting improving business conditions rose from 23.9% to 27.1% – hitting the highest level since December 2003. Those expecting their incomes to increase over the next 6 months rose to the highest level since 2006. The numbers remind us of the election. Folks wouldn't admit they were going to vote for Trump, but they did. As a piece of satire, those reading only the polling data would think Trump's doing the worst job in decades, while the nearly all the confidence readings argue strongly to the contrary.

Looking Ahead

- Bond yields should be higher into April 3rd/4th, and then fall to an important low near May 15th/19th.
- The **BMR** equity cycles show an interim low due around April 5th.

Treasuries, Agencies, and MBS

Despite a lot of FOMC member commentary – with some still calling for 3 or maybe more hikes in 2017, for nearly 2 weeks the market odds have remained 'stuck' on 13.3% for the May 3rd meeting. Likewise, the June 14th chances have remained at 50.2% since the last **B**ond **M**arket **R**eview – basically no hike and then a 'toss up' for the next two meetings. St. Louis FRB President James Bullard said he thought raising rates at the Fed's projected pace might be *"potentially overkill."* With Bullard and Minneapolis' Neel Kashkari in the 'wait and see' camp, the consensus still seems to be an expectation of 2 more hikes in 2017. As an aside, the Atlanta Fed's GDP–Now forecast for Q1 2017 has been in the .9% to 1.0% range for the last few weeks. That would probably keep a damper on the May meeting.

Yields fell by 6, 7.5, 9, and 9.5 bps for the 2, 5, 10, and 30–year Treasury sectors last week. Though bond yields, equities, and the U.S. Dollar all fell Monday morning as the markets began to question how soon a new healthcare bill and tax cuts would come. Though yields came up off those lows, they were still mixed into today. The 2–year was 1.5 bps higher, though partially due to the new maturity from Monday's auction. Considering the 'old' 2–year, yields were only fractionally higher. Otherwise, yields were lower by 2, 3.5, and 3 bps into today for the 5, 10, and 30–year sectors.

MBS spreads (FNMA 30–year 3%) widened by 2 bps last week. On Monday (03/27), the U.S. Treasury sold $26 billion 2–year notes at 1.261%. Demand was the lowest since the January auction, and the yield the highest since December's 1.28%. The foreign–bank buying group bought 53.6% of the issue, versus 49.8% in February. On Tuesday (03/28), the Treasury sold $34 billion 5–year notes at 1.95%. Demand was the best since January, and the yield also the highest since that auction's 1.988%. Foreign buyers accounted for 68.9% of the offering, versus 58.2% last month.

Today's 7–year note auction brought 2.215% for $28 billion in supply. Demand was the best since the November auction, and the yield the highest since January's 2.335%. Foreign buyers accounted for 71.1% versus a previous 63.8% in February.

03/24/17 Treasury Yield Curve	**2-Year: 1.259%**	**5-Year: 1.946%**	**10-Year: 2.413%**	**30-Year: 3.014%**
Weekly Yield Change:	–.059%	–.073%	–.088%	–.096%
Support:	1.285/ 1.305/ 1.335/ 1.395	1.965/ 2.000/ 2.035/ 2.075	2.415/ 2.455/ 2.495/ 2.535	3.045/ 3.065/ 3.090/ 3.115%
Targets:	1.265/ 1.235/ 1.205/ 1.180	1.930/ 1.895/ 1.860/ 1.825	2.380/ 2.350/ 2.300/ 2.260	3.000/ 2.975/ 2.960/ 2.930%

Economics

Though rising from 246K to 261K, Initial Jobless Claims remained well below 300K – and the 4–week average was only 1K higher. Continuing Claims fell from 2,025K to 1,990K. The Richmond Fed Manufacturing Index rose from 17 to 22, and Kansas City was 6 points higher to 20. However, Dallas fell from 24.5 to 16.9. The U.S. 'Markit' outlooks also fell. Manufacturing dropped from 54.2 to 53.4, and Services fell from 53.8 to 52.9. The Composite PMI fell from 54.1 to 53.2. Orders for Durable Goods beat expectations by .30%. Orders rose 1.70% in February, and were revised .30% higher to 2.30% for January. Ex transportation, orders rose .40%, and were revised from flat to a .20% gain for January. Orders for Capital Goods fell .10%. The Advance Goods Trade Balance deficit was a little less than expected, coming in at $64.8 billion in February. Wholesale and Retail Inventories each rose .40%.

The housing sector is showing continued improvement, save for the lack of supply of pre–owned homes. New Home Sales rose 6.09% to 592K in February, hitting a 7–month high. They were also up 14.07% versus last year's level. However, the median sales price dropped 4.9% to last year. Pending Home Sales rose 5.50%, jumping the most since 2010. Metro home prices rose .86% in January, accelerating the annual pace of gain from 5.66% to 5.87% (the highest since 2014) for the S&P Case–Shiller 20–city index.

Thursday is set for the third estimate for Q4 GDP, Personal Consumption, Core PCE, and the GDP Price Index. Other scheduled releases include jobless claims data and Bloomberg Consumer Comfort. Friday closes out March trading with Personal Income and Personal Spending for February, the PCE Deflator, Chicago Purchasing Managers, and the University of Michigan sentiment surveys. Next Monday (04/03) brings ISM Manufacturing, Prices Paid, New Orders, and a first look into March jobs from ISM Employment. Vehicle Sales and February Construction Spending are also due Monday. Tuesday is set for February data for the Trade Balance (deficit), and Durable Goods Orders, Capital Goods Orders, and Factory Orders. Wednesday brings MBA Mortgage Applications (which fell .80% last week), the service–sector outlook (ISM Non–Manufacturing), the minutes from the March 15th FOMC meeting, and another look into next Friday's March payroll data from ADP Employment Change (private payrolls).

Equities

Stocks couldn't recover from last Tuesday's drop – which for the Dow was the steepest in 6 months. After opening weaker with the U.S. Dollar on Monday morning following Congress' failure to come up with a healthcare replacement bill, stocks were higher into today. Last week, the Dow Industrials dropped 317.90 points or 1.52% to 20,596.72. The Dow is .30% higher this week, after having been down over 183 points. The Nasdaq lost 72.26 points or 1.22% to 5,828.74, but is 1.18% higher this week. The S&P fell 34.27 points or 1.44% to 2,343.98, but is .73% better this week. The Dow Transports fell 2.37%, but have recovered 1.64% this week. Bank stocks also fell hard, losing 4.72%. They rose .64% into today.

Resistance:	Dow:	20,757/ 20,829/ 20,900/ 20,975	Nasdaq:	5,915/ 5,934/ 5,954/ 5,973	S&P:	2,370/ 2,376/ 2,382/ 2,388
Support:		20,624/ 20,540/ 20,469/ 20,416		5,896/ 5,877/ 5,858/ 5,832		2,359/ 2,353/ 2,347/ 2,341

Other Markets

Commodities lost .55% as Crude Oil fell 1.66%. With Crude up 3.21% into today, they were .95% better. Even though OPEC producers had cut output to support prices, U.S. rig counts have grown steadily – pressuring prices. Gold gained 1.49% last week, and added another .42% since Friday. The U.S. Dollar lost .67% last week, and after trading .91% lower Monday morning was .40% better into today. The Japanese Yen rose 1.21%, and is .27% higher this week. The Euro gained .56% last week, but is .30% lower since Friday. Corn lost 3.06%, but is .63% higher this week. Cotton fell 1.14%, and was another 1.72% lower through today.

"We are continually faced with a series of great opportunities brilliantly disguised as insoluble problems."
John W. Gardner

Additional Information is Available on Request
Doug Ingram, Managing Director – Commerce Street Capital Management