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Bond Market Review

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The Fate of the Furious

Following the November election, stocks surged to new highs, 5–year bond yields hit their highest levels since 2011, and 10–year note yields rose to their highest levels since 2014. Though stocks have fallen from recent highs, the Nasdaq reached a record close today, and yields fell back to their lowest levels since mid–November. The furious pace remained in equities, while bonds circled the track back to near the beginning of the post–election surge.

Consumer confidence has soared – with many components reaching 16 to 17–year highs, and others to the best levels of the recovery. Stocks have somewhat reflected that enthusiasm. However, there are causes for concern. Weak spending and retail sales aren't reflective of the optimism in consumer sentiment. For the Fed, retreats in inflation, weaker than expected March payrolls, and reduced expectations for 1st–quarter GDP growth have got to be challenging to their 'mission accomplished' view.

Retail Sales fell .20% in March, but the February data was revised from up .10% to a .30% drop – leading to a second decline. The results ex autos were flat, attributing most of those declines to the auto industry. In March, Consumer Prices fell .30% – their first drop in since February 2016. That slowed the annual CPI pace from 2.70% to 2.40%. Ex food & energy, prices fell .10%, reducing the annual core CPI pace from 2.20% to 2.00%. The Atlanta GDP–Now forecast came out of the gates with a 3.4% Q1 projection as of February 1st. Those forecasts have steadily declined – reaching .5% this week on the releases of Retail Sales, CPI, and Housing Starts. Once again, there are other factors, but if you loosen to stimulate growth and tighten to pull it back – what would be the FOMC logic for an aggressive campaign of tightening? This recent data certainly argues for a stay at the May FOMC meeting – and raises enough red flags for them to rethink their path of policy! U.S. GDP was 2.1% in the last quarter of 2016, and only 1.6% for the entire year – the lowest since 2011, and well below the 2.5% that former Fed Chair Ben Bernanke said was the required level to sustain the economy. The U.S. economy has not grown over 3% in over a decade!

Looking Ahead

- Bond yields should make an important low near May 15th/19th.
- The **BMR** equity cycles show another low due around April 27th, and a significant high due mid–May.
- The next **B**ond **M**arket **R**eview is set for May 3rd. We will cover that day's FOMC policy statement.

The Fed's Beige Book concluded that Americans were getting into a better position to pick up spending, even though recent economic releases have shown they're somewhat reluctant to do so. The report also bolsters the case that growth is not reaching the pace where it needs to be reined in, but instead remains the now–tired 'modest to moderate' experienced for years. Inflation was modest, with the growth outlook *"equally split between modest and moderate"* for the 12 Fed districts. Nothing 'stellar', but neither 'poor'!

Treasuries, Agencies, and MBS

Treasury yields 5–years and out dropped to their lowest levels since mid–November on Tuesday, though they've since ticked back up a few bps – as stocks recovered into today. On Tuesday and Wednesday, the market–based expectations for a June FOMC hike fell below 50% for the first time in April, after being above 60% for most of the month. The reduced expectations followed a week of disappointing data from retail sales, to weaker inflation, and some slower housing data. As of today, the odds for a hike at the May FOMC meeting stood at 13.3%, while June rose to 56.7%. Last week, yields fell 8, 15, 14.5, and 11.5 bps for the 2, 5, 10, and 30–year Treasury sectors. Data aside, there was also flight to quality on U.S. military interventions in Syria and Afghanistan – and North Korean saber rattling. Into today, though off the lows for the week, they were again (marginally) lower by 2, .5, .5, and 1 bps.

MBS spreads (FNMA 30–year 3%) widened by 1 bps last week. Next week, the U.S. Treasury will auction $26 billion 2–year notes on Tuesday (04/25), $34 billion 5–year notes on Wednesday (04/26), and $28 billion 7–year notes on Thursday (04/27). The following week, the FOMC will update their stance on interest–rate policy following their meeting on May 3rd. Though the consensus of expectations for further hikes this year ranges from 2 to 3, the market–based odds are very low for any important action, much less a hike, during this May meeting. Some recently weaker data has some bond specialists expecting only one more hike this year.

04/13/17 Treasury Yield Curve	2-Year: 1.207%	5-Year: 1.770%	10-Year: 2.238%	30-Year: 2.893%
Weekly Yield Change:	–.082%	–.150%	–.145%	–.115%
Support:	1.200/ 1.220/ 1.240/ 1.265	1.785/ 1.810/ 1.855/ 1.880	2.255/ 2.290/ 2.330/ 2.380	2.905/ 2.925/ 2.945/ 2.970%
Targets:	1.180/ 1.160/ 1.135/ 1.120	1.730/ 1.700/ 1.680/ 1.655	2.220/ 2.200/ 2.180/ 2.150	2.865/ 2.842/ 2.820/ 2.800%

Economics

Last week, Initial Jobless Claims fell 1K to 234K, still riding the lowest levels since 1973 – and this week they rose 10K to 244K. Continuing Claims dropped 7K to 2,028K, and then fell to 1,979K this week – the least receiving those benefits since April 2000. These results speak to job stability. Last week, Bloomberg Consumer Comfort rose for the 6th time in the last 7 weeks, with a .8 gain to 51. Sentiment on the economy reached the highest level since August 2001. Results fell 1.1 this week to 49.9. Bloomberg Economic Expectations fell .5 to 53.5. Last week's University of Michigan Sentiment data rose from 96.9 to 98, and their survey on Current Conditions rose from 113.2 to 115.2 – reaching the highest level since November 2000. Expectations rose .4 to 86.9. The Philadelphia Fed Business Outlook dropped from 32.8 to 22, and Empire Manufacturing fell from 16.4 to 5.2. The Leading Index (March LEI) rose .40% (doubling expectations). Industrial Production rose .50%, and Capacity Utilization increased from 75.70% to 76.10%. Business Inventories rose .30% in February.

Producer Prices fell .10%, their first drop since August 2016. The annual PPI pace however, rose by .10% to 2.30%. Core PPI rose .10%, and the annual pace increased from 1.50% to 1.60%. As of March, Real Average Weekly Earnings were flat for the year, though Real Average Hourly Earnings rose .30%. Home builder outlook slipped from 71 to 68 as the NAHB Housing Market Index fell off its highest level since June 2005. March Housing Starts fell 6.75% to a 4–month low of 1,215K, though Building Permits rose 3.62% to 1,260K. In February, a net $19.3 billion of foreign funds flowed into Treasuries. $53.4 billion funds were invested or reallocated into longer–term Treasuries.

Friday is set for the 'Markit' reads on manufacturing and services, and Existing Home Sales for March. Next Monday (04/24) brings the Chicago Fed National Activity Index and Dallas Fed Manufacturing Activity. Tuesday follows with the FHFA House Price Index (for February), S&P Case–Shiller home price data, New Home Sales for March, Richmond Fed Manufacturing, and Board Consumer Confidence. Wednesday is set for MBA Mortgage Applications (which fell by 1.80% last week). Thursday gives us Wholesale & Retail Inventories for March, Durable & Capital Goods Orders, jobless claims data, and Pending Home Sales. Friday is the last trading day in April, and data includes the first read on 1st–quarter GDP and the University of Michigan sentiment surveys. The following Wednesday (05/03) is set for the May FOMC meeting. As is also widely the consensus, we don't foresee any significant action taking place at that time.

Equities

Stocks rallied impressively today, with the Dow at one time up over 225 points before closing 174.22 points higher. However, the Dow has been making a series of lower lows – which is confirmation of a downtrend. That's not the case for the Nasdaq – which today closed at a new record (though it didn't make a new high). Last week, the Dow lost 202.85 points or .98% to 20,453.25. It's .61% better this week, but only after today's .85% recovery. The S&P lost 26.59 points or 1.13% to 2,328.95, and is 1.15% higher this week. The Nasdaq lost 72.66 points or 1.24% to 5,805.15, but is 1.92% higher this week. The Dow Transports lost 2.53% last week, but have surged 2.83% this week. Bank stocks dropped 3.18%, but have recovered 2.68% so far this week. We were expecting stocks to rise from April 17th, which they have. Unlike most other indices, the Dow made a lower low on the 19th, but joined the rally today – with that cycle. Stocks have another trend–change low due near April 27th, but should generally be higher into a more important high due in the May 12th to 16th window. This is one of those times where, given the cyclic outlook, we would not choose to be long (or would be hedged) after mid–May.

	Dow:	Nasdaq:	S&P:
Resistance:	20,632/ 20,670/ 20,742/ 20,813	5,935/ 5,958/ 5,978/ 5,997	2,359/ 2,365/ 2,371/ 2,377
Support:	20,530/ 20,455/ 20,385/ 20,315	5,900/ 5,881/ 5,862/ 5,843	2,347/ 2,341/ 2,335/ 2,329

Other Markets

Commodities rose .36% last week, but are 2.52% lower this week – as Crude Oil rose 1.80%, but then tumbled 5.47% this week to a 2–week low. Gold rose 2.52%, but fell .31% into today. The U.S. Dollar is showing some weakness, falling .65% last week and another .77% this week. The Japanese Yen surged 1.80% last week, but is off .21% this week. The Euro gained .21%, and is a strong .98% higher this week. Corn rose 3.20%, but is 3.57% lower this week. Cotton gained 2.94%, and has risen 5.88% this week.

"The cure for anything is salt water – tears, sweat, or the sea." Isak Dinesen

Additional Information is Available on Request

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