Commerce Street Capital Management
1445 Ross Avenue
Dallas, Texas 75202
214-545-6800

Bond Market Review

May 10, 2017 – Issue #800

Going in Style

We recognize there's always a possibility of getting behind the curve, after all – the FOMC got ahead of it in 2006! Market participants are so convinced the Fed intends to raise rates in June, that the 'odds' rose to 100% – no matter what happens. 100% means the journey is predetermined despite incoming data, so much so that travel insurance has been deemed unnecessary! Alarmists are warning of imminent war given North Korea's repeated threats. Yet, the market's 'fear factor' is very low – with volatility trading at its lowest levels in over 23 years! How can you have both imminent war and market safety? Using that same logic, unless the Fed's crystal ball is very good, how can the U.S. economy be in danger of overheating with first–quarter GDP coming in at only .7%. It's all based on their future forecast, sort of like every young boy's dilemma – being spanked for what you were going to do!

On May 1st, the Atlanta Fed's GDP–Now forecast for the second quarter of 2017 kicked off at 4.3%. Yesterday, it slipped to 3.6%. The Atlanta Fed said: *"The forecast for second–quarter real consumer spending growth and real private fixed investment growth declined from 3.0% and 6.9% to 2.7% and 5.3% percent, respectively, after the employment situation release by the U.S. Bureau of Labor Statistics on Friday."* Recall their numbers for Q1 began at 3.4% and tumbled to .2% – prior to the first Q1 GDP release of .7%. We're certainly not expecting a second–quarter as weak as .7%, but FOMC members are collectively advocating 2 to 3 more rate hikes for 2017. With June a supposed foregone conclusion, bond traders are increasing bets on a September hike to follow. With that trajectory, a 'gradual pace' could lead to a 4th 2017 hike in December – or every 3 months from December 2016. Shouldn't we see GDP above 2.5%, real wage pressures, and better consumption data instead of just assuming we're heating up?

Looking Ahead

- Bond yields should make an important low near May 15th/22nd.
- The **B**ond **M**arket **R**eview equity cycles show topping action due in the May 12th–to–16th window.

Macro Micro for Macron

Emmanuel Macron won the French presidency by a landslide, but with a low turnout. When Macron, the centrist candidate, appeared to be headed for victory in the French elections, EU stocks and the Euro gained ground as his opponent that might have sought a French exit from the EU (Le Pen) faded in the polls. It turned out to be the classic 'buy the rumor, sell the fact' event as the U.S. Dollar rose sharply and the Euro fell after the votes were in. As conditions in the EU improve, the new French leader is the first in a while (for France and the EU as well) to begin to serve with a 'tailwind' instead of the headwinds of deflation, troubled sovereign debt, and higher jobless rates. He'll even get a great, albeit westernized, natural brand for his policies as 'Macronomics'. It's hard to top that one.

Treasuries, Agencies, and MBS

Our bond cycles are still forecasting lower yields into a window that opens on May 15th, though it's widened to include the 22nd – after which yields should rise into the third week of June. The 5 and 10–year note still specifically target a low near May 19th. Yields rose again last week, rising by 5, 6.5, 7, and 3 bps for the 2, 5, 10, and 30–year Treasury sectors. Yields for those sectors are again higher this week, by 4.5, 5.5, 6.5, and 5.5 bps – as the market odds for a June FOMC rate hike rose to 100%, and traders began to price in a high probability for September as well.

Last week, MBS spreads (FNMA 30–year 3%) narrowed by 3 bps. The Treasury auctioned $24 billion 3–year notes on Tuesday (05/09). The awarded yield of 1.572% was the highest since the March auction, with demand the best since February. The group that includes foreign central banks won 50.8% of the offering, versus 51.8% last month. Today's 10–year note auction brought 2.40% for $23 billion in supply. The yield rose and demand fell to the April offering. Foreign accounts bought 60.7% of the issue versus 65.2% last month. The U.S. Treasury is set to offer $15 billion 30–year bonds on Thursday (05/11).

05/05/17 Treasury Yield Curve	2-Year: 1.312%	5-Year: 1.882%	10-Year: 2.350%	30-Year: 2.984%
Weekly Yield Change:	+.048%	+.067%	+.069%	+.032%
Support:	1.355/ 1.375/ 1.400/ 1.425	1.950/ 1.980/ 2.015/ 2.050	2.415/ 2.435/ 2.455/ 2.475	3.045/ 3.070/ 3.095/ 3.115%
Targets:	1.325/ 1.300/ 1.280/ 1.255	1.910/ 1.875/ 1.850/ 1.805	2.375/ 2.355/ 2.335/ 2.315	3.025/ 3.005/ 2.980/ 2.960%

Economics

We would normally observe the Fed's read on jobs after analyzing the payroll data, but we found their Labor Market Conditions Index Change to be quite puzzling! The March 'dashboard' was revised to show a gain of 3.6 points instead of the anemic .4 reading previously reported. The April payroll gauge ticked up 3.5 points. That alone would make you believe the Fed thought the underlying March payroll data was a bit more impressive than April. Not so!

April Nonfarm Payrolls improved by 211K, while March numbers were revised from 98K to only 79K. Recall from last week that ADP data showed 177K private–sector jobs being created in April. Private Payrolls actually rose 194K, but were also revised lower for March (from 89K to 77K). Manufacturing did change a little for the better, as the March numbers were adjusted 2K higher to 13K, but in April only 6K jobs were added versus 10K expected. While the U.S. Unemployment Rate fell from 4.50% to 4.40%, it was partially due to the Labor Force Participation Rate dropping from 63.0% to 62.9%. Nevertheless 4.40% is the lowest jobless rate since May 2007. The only factors remaining to explain the positives in the jobs dashboard would be improvements in hours or earnings! While Average Hourly Earnings rose .30% in April, they were cut in half to .10% for March. The annual pace of wage gains was revised from 2.70% in March to 2.60%, and then down to 2.50% in April – providing a Greenspan–worthy conundrum for both months. The pace of gains is dropping! However, Average Weekly Hours did improve by .1 to 34.4.

Coming into the report, Initial Jobless Claims fell from 257K to 238K (near the lows of recent data), and Continuing Claims fell from 1,987K to 1,924 – back to early–2000 lows, with the 4–week average at 43–year lows. Another positive came from Challenger Job Cuts, showing 42.90% less cuts versus April 2016. The Underemployment Rate fell from 8.90% to 8.60%. Additionally, March JOLTS Job Openings showed employers having 5.743 million jobs available! NFIB Small Business Optimism fell .2 to 104.5.

Nonfarm Productivity fell the most the beginning of 2016, as first–quarter data showed a drop of .60%. Unit Labor Costs (for Q1) rose 3.00%. March Factory Orders rose .20%, but were .30% lower ex transportation. Orders for Durable Goods rose .90%, but were unchanged ex transportation. Orders for Capital Goods rose .50%. March Wholesale Inventories rose .20%, while Trade Sales were flat. April Import Prices rose .50%, but the annual pace slowed from 4.30% to 4.10%. Consumer Credit expanded by $16.431 billion in March, but was revised lower (from $15.206 billion to $13.748 billion) for February. The March Trade Balance deficit was very steady, at $43.7 billion versus February's $43.8 billion. April provided a large monthly budget surplus of $182.4 billion to the U.S. Treasury's coffers. That surplus brought the comparative year–to–date deficit 2.4% below fiscal 2016. April is traditionally the largest tax–collection month.

Thursday is set for Producer Prices (April PPI), jobless claims data, and Bloomberg Consumer Comfort (which rose .1 to 50.9 last week). Friday brings Consumer Prices (April CPI), Real Average Weekly & Hourly Earnings, April Retail Sales, the University of Michigan consumer sentiment surveys, and March Business Inventories. Next Monday (05/15) is set for Empire Manufacturing, home–builder sentiment (NAHB Housing Market Index), and TIC Flows (net foreign Treasury operations). Tuesday follows with Housing Starts and Building Permits for April, Industrial Production, and Capacity Utilization. Wednesday provides MBA Mortgage Applications (up 2.40% last week).

Equities

Stocks scored more record highs. The S&P and Nasdaq hit new highs on Tuesday, with record closes today. The S&P 100 made a new high yesterday, but closed lower today. Our stock cycles weaken after May 12th to 16th, so we view caution as a wise approach. The cycles argue for profit taking and/or hedging. While nothing is even close to 100%, we dance with the cycles we brought. That said, this one could turn ugly. This bear could have claws into July.

Last week, the Dow Industrials gained 66.43 points or .32% to close at 21,006.94. The Dow is .30% lower this week. The S&P added 15.09 points or .63% to 2,399.29, and is a slight .01% higher this week. The Nasdaq gained 53.15 points or .88% to 6,100.76, and has been one of the strongest indices – also up .47% this week. The Dow Transports rose 1.01%, but are 1.28% lower this week. Bank stocks rose 1.53%, but are a modest .04% lower this week.

	Dow:	Nasdaq:	S&P:
Resistance:	20,905/ 20,977/ 21,049/ 21,121	6,132/ 6,180/ 6,210/ 6,249	2,400/ 2,406/ 2,412/ 2,418
Support:	20,831/ 20,759/ 20,687/ 20,589	6,075/ 6,054/ 6,015/ 5,975	2,382/ 2,376/ 2,370/ 2,361

Other Markets

Crude Oil plunged 6.30% last week, but is 2.40% better this week – leading Commodities to lose 2.09% and then rise by .89% into today. Gold fell 3.26% last week, and is .65% lower this week. The U.S. Dollar lost .37%, falling for a 4th week, but is 1.05% better this week. The Euro gained .95%, but is 1.18% lower since the French elections this past weekend. The Japanese Yen lost 1.09%, and is off 1.39% this week – most likely headed for a 4th weekly loss. Corn gained 1.05%, and is .97% higher this week. Cotton lost .59%, and is off a hard 4.10% this week.

"If you really do put a small value upon yourself, rest assured that the world will not raise your price." Anonymous

Additional Information is Available on Request

Doug Ingram, Managing Director – Commerce Street Capital Management