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BOND MARKET REVIEW

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The Blame Game

When I was a kid, the radio told us to 'Blame it on the Bossa Nova', and it seemed as good a reason as any – unless there was a guilty sibling nearby. Bob Seger said 'Blame it on midnight' and Garth Brooks sang 'Blame it all on my roots'. On Tuesday, May 16th, the Nasdaq surged to a new high. However, on Wednesday, 15 days of gains were wiped out with the most severe correction of the year. The S&P made a new high on the 16th as well, but Wednesday's downturn erased the wins of the last 16 sessions. In fact, many global markets also hit important or new highs over the past week – only to share in the magnitude of this week's losses as well. The Dow Transports, which topped on March 1st, fell today to the lowest levels since November 17th – breaking important support. The correction was quick enough to relieve some of the overbought condition, but it's probably not over – given the cyclic structure.

You could even blame the **BMR** for the Dow's 372.82–point plunge, as we've been warning of a downturn – in the May 3rd issue saying: *"The stock cycles indicate topping action due in the May 12th–to–16th window – so take care."* Last week, we added: *"Our stock cycles weaken after May 12th to 16th, so we view caution as a wise approach."* Nevertheless, global news services chose to blame the down–move on President Trump's handling of the firing of FBI director James Comey – even though it occurred 8 days before the plunge! Sometimes a catalyst arrives on these important dates, but we thought that was quite a stretch, and the blame driven more by agenda than any other reason. Agenda–driven news is not news at all. It's a blame game – because bad news has to be assigned to someone!

However, cyclically, sometimes it's just time for a turn! We spoke to North Korea's war mongering as being much more threatening and thought it odd that the volatility indexes showed that investors perceived very little risk in equity investments. One of the reasons our long–term cycles were pointing to a top was the seasonality for stocks to turn down near the first of May. Though our work was projecting a high in mid–May, we don't recall hearing or reading the old *"Sell in May, and go away!"* – that usually comes near the end of April. Surely someone said it, but we didn't hear it! Maybe with the odds of a selloff so low, commentators felt the warning didn't apply. The FOMC recently contended that 1st–quarter weakness was temporary or transitory. Last Friday's Retail Sales numbers supported that premise. The March loss of .20% was revised to a .10% gain and was followed in April by a healthier .40% increase. Ex autos, March sales were revised from flat to up .30%, while April's rise matched that .30% gain. The Retail Sales 'Control Group' was adjusted .20% higher to a .70% March gain, followed by a .20% rise in April. Unlike in the first quarter, the Atlanta Fed's GDP Now forecast is showing a rebound. As of Tuesday, their estimate improved from 3.6% to 4.1%. To date, all their second–quarter GDP estimates have been running 3.5% or better.

Looking Ahead

- Bond yields should turn higher from May 22nd.
- The **BMR** equity cycles show increased price swings, with an upcoming buy opportunity in early July.

Treasuries, Agencies, and MBS

The **B**ond **M**arket **R**eview's bond cycles called for lower yields into a May 15th to 22nd 'window', and yields fell into the 17th with the selloff in stocks, pretty much fulfilling downside yield targets. Our longer yield cycles project an upturn from May 22nd. Our conclusion from last week was *"after which yields should rise into the third week of June."* The question remains, which cycle will dominate – yields or equities? If equities weaken into early July, a relational argument could be made that upside in yields would be limited. However, with the Fed determined to go ahead with a June hike, the fundamentals for higher yields would be present. For the past few weeks, the market–based odds for a June hike were 100% or close to it. Those odds dropped to 82.5% on Wednesday, but were back to 93.8% today as a lack of follow through to the downside in equities convinced market makers that stocks were still a 'safe' place to be. Last week, yields fell by 2, 3.5, and 2.5 bps for the 2, 5, and 10–year sectors, but were .5 bps higher at 30–-years. Into today, yields gave back some of Wednesday's drop, but were still lower by 2, 7.5, 9.5, and 9 bps.

Last week, MBS spreads (FNMA 30–year 3%) narrowed by 1 bps. Last Thursday (05/11), the U.S. Treasury sold $15 billion 30–year bonds at a 3.05% yield. Demand was lower versus the April offering, and the yield was the highest since the March issue. Foreign buyers accounted for 59.1% of the auction, versus winning 64.5% last month. Next week, the U.S. Treasury will auction $26 billion 2–year notes on Tuesday (05/23), $34 billion 5–year notes on Wednesday (05/24), and $28 billion 7–year notes on Thursday (05/25).

05/12/17 Treasury Yield Curve	2-Year: 1.292%	5-Year: 1.848%	10-Year: 2.327%	30-Year: 2.989%
Weekly Yield Change:	–.020%	–.034%	–.023%	+.005%
Support:	1.290/ 1.315/ 1.335/ 1.365	1.805/ 1.835/ 1.875/ 1.920	2.305/ 2.340/ 2.380/ 2.420	2.920/ 2.960/ 3.015/ 3.060%
Targets:	1.255/ 1.240/ 1.220/ 1.205	1.775/ 1.730/ 1.705/ 1.670	2.260/ 2.225/ 2.190/ 2.155	2.880/ 2.845/ 2.845/ 2.800%

Economics

The Jobless Claims numbers continue to show good health in labor conditions, even though wage increases have not benefited much. Initial Claims fell 2K to 236K last week, and dropped 4K to 232K this week – riding the lowest lows since the early '70s. Continuing Claims are the lowest in over 40 years, having dropped from 1,979K last week to 1,920K, and then down to 1,898K this week. Most confidence data was little changed. The Philadelphia Fed Business Outlook rose from 22 to 38.8 and the Leading Index (April LEI) was up 30%. Empire Manufacturing fell from 5.2 to –1. Bloomberg Consumer Comfort fell from 50.9 to 49.7 last week, but was .5 higher to 50.2 this week. Their gauge of Economic Expectations fell from 53.5 to 49.5. University of Michigan Sentiment rose from 97 to a 4–month high of 97.7, and their Expectations survey rose from 87 to 88.1. Current Conditions were unchanged at 112.7.

Consumer Prices rose .20% in April (following a .30% drop in March). The annual pace, however, slowed from 2.40% to 2.20%. Ex food & energy, CPI rose .10%, slowing the annual core pace from 2.00% to 1.90%. 'Real' Average Weekly Earnings rose .30% in April, while Hourly Earnings were .40% higher. Producer Prices rose a stronger .50%, quickening the annual rise from 2.30% to 2.50%. Core PPI rose .40%, also leading to an increased annual pace from 1.60% to 1.90%. Business Inventories rose .20% in March. Home Builder optimism rose from 68 to 70. That's the second–best outlook since 2005! However, Housing Starts showed some weakness – dropping 2.58% in April (from 1,203K units to 1,172K). Building Permits fell 2.46% (from 1,260K to 1,229K), but are up 8.76% annually. Internal data is also improving as MBA Mortgage Foreclosures fell from 1.53% to only 1.39% for Q1 2017. Mortgage Delinquencies dropped from 4.80% to 4.71%. Factories showed improvement as output (Industrial Production) rose the most in over 3 years (by 1.00%). Capacity Utilization rose from 76.10% to 76.70% – the highest since August 2015. Even though foreign investors moved $59.8 billion into longer Treasury positions in March, overall there was a net outflow of $.7 billion.

Next Monday (05/22) is set for the Chicago Fed National Activity Index. Tuesday follows with New Home Sales for April and the Richmond Fed Manufacturing Index. Wednesday brings MBA Mortgage Applications (which fell 4.10% last week), the FHFA House Price Index, the House Price Purchase Index for the first quarter, Existing Home Sales for April, and the minutes from the FOMC meeting that was held on May 3rd.

Equities

In recent issues of the **BMR**, we noted our cycles were pointing to a top in this timeframe. Last week, we said: *"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 nothings 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."* We have trend–change lows due June 6th, 14th, and 22nd, but don't expect sustained upside until a more–important low (and buy opportunity) that is due July 3rd/5th. We first expect wider price swings, and another larger drop from June 20th into that early July window.

Last week, the Dow lost 110.33 points or .53% to 20,896.61. It's 1.12% lower this week after suffering a 372.82–point drop on Wednesday. The S&P lost 8.39 points or .35% to 2,390.90, and is 1.05% lower this week. The Nasdaq rose for a fourth week, adding 20.47 points or .34% to 6,121.23. It's 1.08% lower this week as very few equities were spared in Wednesday's downturn – which was the worst of 2017. The Dow Transports fell 2.05%, and dropped another 2.03% into today. Bank stocks lost 1.27%, and are 2.43% lower this week.

Resistance:	Dow:	20,872/ 20,949/ 21,025/ 21,095	Nasdaq:	6,115/ 6,140/ 6,169/ 6,192	S&P:	2,391/ 2,403/ 2,416/ 2,428
Support:		20,734/ 20,662/ 20,579/ 20,504		6,075/ 6,036/ 5,998/ 5,927		2,379/ 2,367/ 2,354/ 2,345

Other Markets

Crude Oil continued higher with our cycle, and the next downturn shouldn't occur until around May 26th. Crude rose 3.50% last week, and is 3.16% better this week. Commodities rose 2.12% and were .45% better into today. Gold gained .07% last week, but surged 2.04% higher this week. The U.S. Dollar rose .61%, but is 1.37% lower this week! The Japanese Yen lost .59%, but is 1.67% higher this week. The Euro countered the Dollar's gain with a .61% loss, but is 1.57% better this week – outpacing the Dollar. Corn was unchanged last week, and 1.17% higher into today. Cotton gained 3.03%, but has fallen 3.58% so far this week.

"The only time to buy these is on a day with no 'y' in it." *Warren Buffett*

Additional Information is Available on Request

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