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BOND MARKET REVIEW

June 01, 2017

Traction

Many U.S. and global equity indexes hit new highs today (or the highest levels in a year or more). Following suit, Americans are overwhelmingly optimistic about the economy, their finances, and their belief that things will continue to improve. Bloomberg Consumer Comfort rose from 50.2 to 50.9 last week, and then to 51.2 today – the second–best outlook since 2001! The gauge of personal finances was the best since before the financial crisis (to May 2007).

Economic data is going in the right direction, and if the Fed is looking for confirming data for their upcoming June meeting and expected hike, they've no doubt been pleased with nearly everything except inflation. While the FOMC has a basic dual mandate of seeking full employment and to manage an inflation target nearer 2%, there are scores of other components that have to be considered. That said, the Atlanta Fed's GDP–now forecast is not losing ground as it did in the first quarter. In Q1, data weakened throughout the first quarter – leading to an advance GDP estimate of only .70%. However, mostly due to Consumer Spending being revised up to .6% (from .3%), Q1 GDP was recast at 1.20%. Better, but not great. The Fed's Beige Book revealed what has been the trend for most of the recovery. Growth continued *"modestly"* or *"moderately"* in most of the Fed's 12 regions. Housing expanded slowly, labor markets tightened, and consumer spending softened. The Atlanta GDP model has been more resilient for Q2 with the lowest reading coming in at a 3.5% growth forecast. As of today, better manufacturing data put the newest estimate at a solid 4.0% – a good reason for optimism.

In our opinion, Fed Reserve Governor Lael Brainard was a major force in holding the FOMC back from quickening their hiking pace last year. Last week, she said the global economy *"is probably brighter today than it has been for the last few years."* Speaking to the Fed's other mandate this week, she said: *"If the soft inflation data persist, that would be concerning and, ultimately could lead me to reassess the appropriate path of policy."* She's in our camp, believing the *"neutral rate is very low"*, and that the Fed is *"not far at all from neutral"* – expecting that rates don't need to rise rapidly from where they are at present. The Fed's preferred measure of inflation is the PCE (Personal Consumption Expenditures) Deflator. Though rising .20% in April, the annual pace slowed from 1.90% to 1.70% – backing away from the Fed's 2.0% goal. Ex food & energy, PCE rose .20% – though also reducing the annual pace (from 1.60% to 1.50%). Price wars within the mobile–phone markets have been a key contributor. Earlier this week, European Central Bank President Mario Draghi said that they are *"firmly convinced that an extraordinary amount"* of stimulus is required to restore stable inflation. They were very concerned about a lack of wage inflation.

Flattening Curves and Soaring Stocks

The media is replete with coverage of the supposed mistakes made by the Trump administration – including backing out of the Paris accord on climate change. That agreement was never ratified by Congress, and with a business mind, President Trump viewed it as a 'bad deal' – with the United States' responsibilities onerous in terms of cost (especially given the lack of financial support by many participants). Our point is not to debate that decision, or others, but to note that stocks and consumer confidence don't support the negative narrative.

Bonds are another story. When the curve is flattening, it usually indicates that bond investors have concerns about economic data or geopolitical forces. Bonds aren't always right, and there are times when stock investors 'clean up' as equities rise – unchecked by fears or news. The **B**ond **M**arket **R**eview is siding with bonds in terms of caution, though we might be instead missing the rally. Both markets are 'fighting' the cycles, as stocks have extended past a top that was already due, and we still expect yields to make another high into June 19th to the 22nd. A few weeks ago, in the **BMR** (05/10/17), we noted that volatility was trading at a 23–year low – indicating that being long equities was safe. Through today, that's been true. Nevertheless, it's worth noting that bonds are signaling caution!

Looking Ahead

- Bond yields should move higher into a trend–change top due around June 19th to 22nd.
- The **BMR** equity cycles show increased price swings, with an upcoming buy opportunity in early July.

Treasuries, Agencies, and MBS

Last week, yields rose a modest 2.5, 1, 1, and 1.5 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today, yields were lower in a curve 'flattener' by .5, 3, 3.5, and 5 bps. Last week, MBS spreads (FNMA 30–year 3%) narrowed by 1 bps. Last Thursday (05/25), the U.S. Treasury sold $28 billion 7–year notes at 2.06% yield. Demand was the lowest since February and the yield the lowest since the October 2016 offering. The group that includes foreign buyers and central banks bought 61.2% off the issue versus a hefty 81.7% reward in April. The market–based odds for another FOMC hike on June 14th had been seen as a 'sure thing' at 100%. Today they stood at a still–high 88.4%.

05/26/17 Treasury Yield Curve	2-Year: 1.296%	5-Year: 1.790%	10-Year: 2.247%	30-Year: 2.912%
Weekly Yield Change:	+.024%	+.009%	+.012%	+.015%
Support:	1.290/ 1.305/ 1.325/ 1.340	1.775/ 1.810/ 1.845/ 1.875	2.215/ 2.250/ 2.290/ 2.330	2.880/ 2.920/ 2.950/ 3.010%
Targets:	1.265/ 1.245/ 1.220/ 1.205	1.705/ 1.670/ 1.645/ 1.615	2.165/ 2.145/ 2.110/ 2.075	2.800/ 2.760/ 2.720/ 2.680%

Economics

Data coming into Friday's May–payroll data has been good. Private payrolls from the ADP Employment Change were expected to rise by 180K, but 253K additions were posted. For the past two weeks, Initial Jobless Claims rose 2K to 235K, and then were 13K higher to 248K. However, those results remained in the lower range of recent data showing stability in the labor force. Continuing Claims rose 26K to 1,924K, and then fell to 1,915K – likewise representing the lows of recent data, and also going back over 40 years. ISM Employment was 1.5 points higher to 53.5 for May. Nevertheless, Challenger Job Cuts rose 71.40% versus last May, though that was mostly due to a layoff announcement by Ford Motor Company. Q1 GDP was revised .50% higher to 1.20% and Personal Consumption was doubled to .60%. The GDP Price Index fell .10% to 2.20%, though the core rate rose .10% to 2.10%.

Confidence data fell a bit, but remained very high. Board Consumer Confidence fell from 119.4 to 117.9, though the Present Situation survey rose from 140.3 to 140.7. Their Expectations component fell from 105.4 to 102.6. University of Michigan Sentiment fell from 97.7 to 97.1 and Current Conditions dropped a point to 111.7. Expectations fell .4 to 87.7. Dallas Fed Manufacturing Activity rose from 16.8 to 17.2 and Kansas City was 1 point higher to 8. Chicago Purchasing managers rose from 58.3 to 59.4. May Vehicle Sales dropped from a 16.81M pace to 16.58M. Domestic Sales fell from 13.12M to a 12.84M pace. April Wholesale and Retail Inventories each fell .30%. Orders for Durable Goods fell .70% (following a March revision up from .90% to 2.30%). Ex transportation, they fell .40% (after being revised from flat to up .80% for March). Orders for Capital Goods were unchanged. Personal Incomes rose .40% in April, and Spending matched that pace. ISM Manufacturing remained solid, up from 54.8 to 54.9 – and Prices Paid fell from 68.5 to 60.5. New Orders rose 2 points to 59.5. Construction Spending fell 1.40% in April, but March was revised to up 1.10% from a .20% loss. April Pending Home Sales fell 1.30% on lean inventories and higher prices. They were off 5.40% to last year. Metro Home Prices rose .87% in March (S&P Case–Shiller 20–city), upping the annual pace from 5.85% to 5.89%. The Home Price Index quickened from 5.69% to 5.75%.

Friday reveals May payroll data and employment statistics. The April Trade Balance (deficit) is also due. Next Monday (06/05) is set for Nonfarm Productivity and Unit Labor Costs for the first quarter, the service–sector outlook (ISM Non–Manufacturing Composite), the Fed's jobs dashboard (Labor Market Conditions Index Change), and April data for Factory, Durable, and Capital Goods Orders. Tuesday gives us JOLTS Job Openings and my 62nd celebration of D–Day. Wednesday reveals MBA Mortgage Applications (down 3.40% last week) and April Consumer Credit.

Equities

June got off to a great start with many U.S. indices rising to new highs. The key S&P and Nasdaq indexes certainly did, and the Dow hit a record close – though only less than 25 points away from its March 1st high. Yes, our cycle work still points to a tradeable low in early July – it's just clear that a top has not yet been made. The Dow Industrials rallied 275.44 points or 1.32% last week to close at 21,080.28. They're .30% higher this week. The Nasdaq surged 126.49 points or 2.08% to 6,210.19, and is .59% higher this week. The S&P gained 34.09 points or 1.43% to 2,415.82, and is also .59% better since Friday. The Dow Transports rallied 3.35% last week, and another 1.10% this week. Bank stocks rose .90%, but have since lost that gain – falling .91% since Friday.

	Dow:	Nasdaq:	S&P:
Resistance:	21,240/ 21,313/ 21,386/ 21,459	6,285/ 6,325/ 6,365/ 6,406	2,441/ 2,454/ 2,466/ 2,479
Support:	21,094/ 21,021/ 20,950/ 20,879	6,246/ 6,207/ 6,159/ 6,129	2,416/ 2,404/ 2,392/ 2,380

Other Markets

We had a high due for Crude Oil on May 26th, but it began trading lower on the 25th. Crude should rebound from June 7th to the 15th, but a more–important low is due around July 25th. Crude lost 1.05% last week, and was 2.89% lower into today. In turn, Commodities lost 1.66% last week, and were 1.60% lower through today. Gold gained 1.16%, but fell a slight .09% into today. The U.S. Dollar rose .34% last week, but was .23% weaker into today's close. The Japanese Yen lost .06%, and lost another .04% into today. The Euro lost .21%, but is .27% stronger this week. Corn rose .47%, and then lost 1.00%. Cotton fell 2.97%, but is .70% better this week.

"I didn't mind getting old when I was young. It's the being old now that's getting to me." John Scalzi

Additional Information is Available on Request

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