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BOND MARKET REVIEW

June 28, 2017

Twists and Turns

The 'Trump Bump Slump' had a jump. If one were to try to interpret incoming consumer confidence readings, they might conclude that Americans are confident that things are better – and going to get worse, after they improve. Last week, Bloomberg Consumer Comfort fell .6 to a still–strong 49.4, while Economic Expectations improved from 49.5 to 52. Consumer Confidence, stocks, and interest rates surged out of the election. While stocks are still riding close to all–time highs, bond yields have fallen back to post–election levels as inflation pressures and some economic data have been waning. After consumer confidence measures rose to the highest levels since the financial crisis – with some surveys the best since the early 2000s, they've relaxed off those highs in recent months. The latter, falling rates and confidence, have been termed the 'bump slump.' As for our conclusions, the Conference Board Consumer Confidence reading rose from 117.6 to 118.9 (beating expectations by over 2 points) and their reading on the Present Situation rose a strong 5.7 points to 146.3 – the highest reading since July 2001! However, Expectations (for conditions 6 months out), fell from 102.3 to 100.6. That was the lowest result since January. The survey results for those thinking jobs are plentiful rose to the highest level since August 2001.

The yield curve continued to twist. Short rates are rising – driven by the 4th FOMC hike a few weeks ago (of the campaign that began in December 2015). Long rates have been dropping as some economic data remains sketchy and upside inflationary pressures failed to materialize. Since the end of 2016, Crude Oil prices have fallen nearly 17%. With a large drop in June of 7.33% to date, data for consumer prices will no doubt continue to weaken. The Fed wants to make the case that the current weakness in inflation is transitory, but there's a lack of hard evidence yet to support their opinion. With longer yields dropping and the curve also twisting, the curve is flattening – a phenomena that often accompanies or precedes economic slowdowns as bond–market participants are traditionally the more–savvy investors. It's the 'business' of bond investors to interpret a broader range of market and economic data. Another concern for the U.S economy is the debt crisis in the State if Illinois – on the heels of that of Puerto Rico. Yield spreads indicate troubles ahead for New Jersey and Connecticut (the next two most vulnerable).

Looking Ahead

- Bond yields should make trend–change lows near July 6th/7th and July 26th. A high is due near the 18th.
- The **BMR** equity cycles show increased price swings, with positive influence following July 5th.
- Have a safe and happy 4th! U.S. markets will close early on Monday, and all day on Tuesday (07/04).

Treasuries, Agencies, and MBS

Last week, we reaffirmed our expectations for *"lower rates from the 22nd to the 27th, even if they didn't appreciably rise into the 22nd."* Yields fell into the 26th, and began to rise sharply since then. We had said: *"After that, yields should rise into July 12th, and then make a low near August 9th or the 15th."* We've tweaked those dates a bit, expecting another rally for lower yields into July 6th/7th, a high nearer July 18th, and then lows near July 25th and August 9th. The curve flattened last week twisting 8.5 bps from 2 to 30–years. While yields rose 2.5 and 1.5 bps for the 2 and 5–year sectors, they fell by 1 and 6 bps at 10 and 30–years. That 'unwound' a bit this week, as yields were 1.5, 6.5, 8.5, and 6.5 bps higher for the 2, 5, 10, and 30–year Treasury sectors. An early close is recommended for Monday, July 3rd, at 2:00 pm ET. Bonds will observe our Independence Day holiday on Tuesday (July 4th).

While the market–based odds for the next Fed hike had been in the 40 to 43% range for this December, they rose to 50.7% today for that meeting – or just above a coin toss. Before that, the market had been assuming the next most likely event to be in March 2018. MBS spreads (FNMA 30–year 3%) were unchanged last week.

On Monday (06/26), the U.S. Treasury sold $26 billion 2–year notes at a 1.348% yield. That was the highest yield since the October 2008 auction, which occurred just after the FOMC had cut their funds rate from 1.50% to 1.00%, and before the additional 50 bps cuts on October 29th and December 16th – that took fund rates 'near zero.' Demand was the best since he November 2015 offering, and the group that includes foreign central banks accounted for 56.6% of the issue versus 57.2% in May. On Tuesday (06/27), the Treasury sold $34 billion 5–year notes at 1.828%. Demand was the lowest since February, and the foreign allocation fell from 68.7% in May to 65.2%. Today's $28 billion in 7–year notes came at 2.056%. Demand was the lowest since January, and the allocation to foreign participants rose to 65.4% from 61.2% last month.

06/23/17 Treasury Yield Curve	2-Year: 1.342%	5-Year: 1.757%	10-Year: 2.143%	30-Year: 2.716%
Weekly Yield Change:	+.025%	+.013%	–.009%	–.060%
Support:	1.380/ 1.405/ 1.435/ 1.455	1.875/ 1.910/ 1.945/ 1.980	2.295/ 2.340/ 2.380/ 2.420	2.840/ 2.880/ 2.925/ 2.970%
Targets:	1.350/ 1.320/ 1.305/ 1.285	1.840/ 1.805/ 1.770/ 1.735	2.260/ 2.225/ 2.190/ 2.170	2.800/ 2.780/ 2.765/ 2.725%

Economics

Last week, Initial Jobless Claims rose from 238K to 241K (still less than 15K above 43–year lows). Continuing Claims rose 8K to 1,944K. These low levels continue to show stability in the U.S. labor market. The Leading Index for May came in at .30% (as expected). April LEI was revised .1% lower to .2%. Richmond Fed Manufacturing rose from 1 to 7, and Kansas City rose from 8 to 11. However, Dallas fell from 17.2 to 15, and the Chicago Fed National Activity Index dropped from .57 to –.26. In May, orders for Durable Goods fell by 1.10%, and April dropped .1% more than previously reported at –.90%. Ex transportation, orders rose .1%. Orders for Capital Goods fell .20%.

Despite recently better (lower) rates, MBA Mortgage Applications fell by 6.2% last week. New Home Sales rose 2.87%, from 593K to 610K units – an annual increase of 6.64%. Pending Home Sales dropped for a third month – by .80% in May, and were revised lower (from –1.3% to a –1.7% decline in April). The annual pace rose only .5%. The FHFA House Price Index rose .70% in April. Metro home prices rose .28% in April (S&P Case–Shiller 20–City), but were revised from .87% down to .53% for March. That led to a slowing in the annual pace from 5.88% to 5.67%. The annual pace of their Home Price Index also fell back from 5.63% to 5.50%. In May, Wholesale Inventories rose .30%, and Retail Inventories rose .60%.

Thursday is set for an update to Q1 GDP and Personal Consumption data. Also due are jobless claims data and Bloomberg Consumer Comfort. Friday closes out June trading (and the second quarter) with Personal Income & Spending for May, the PCE Deflator (one of the FOMC's favorite inflation measures), Chicago Purchasing Managers, and the full complement of University of Michigan consumer sentiment surveys. Next Monday (07/03) kicks off July with June Vehicle Sales, May Construction Spending, ISM Manufacturing, ISM New Orders, ISM Prices Paid, and the first gauge of June payrolls (due next Friday) from ISM Employment. Following early closes on Monday, the markets will be closed on Tuesday for the July 4th holiday – with no data releases. On Wednesday (07/05) scheduled releases are May orders for Durable and Capital Goods, and the minutes from the FOMC's June 14th meeting.

Equities

Stocks opened strongly last week, but faded into Friday. They appeared to be destined for the same fate this week, and the Dow broke to the lowest levels since June 16th on Tuesday. However, a nice rally today put stocks back in the black! The Dow Transports have lagged other indices, but closed in on March 2nd levels for their 4th highest close to date. The Dow gained 10.48 points or .05% to 21,394.76 last week, but is .28% ahead this week. The Nasdaq rose a strong 113.49 points or 1.84% last week to 6,265.25, but is .49% lower this week. The S&P rose 5.15 points or .21% to 2,438.30, and is .10% higher this week. The Dow Transports lost .27% last week, but are rallying this week with a 1.37% gain. Bank stocks fell 2.35% last week, but are the strongest of these sectors this week with a 3.10% gain. We would prefer for stocks to trade lower into our key trend–change dates for a low, and equities still have a low due near July 5th. We recognize that stocks are overbought and in some cases overvalued, but positive cyclic forces begin next week – and could continue through August. An early close is recommended by the NYSE for Monday, July 3rd, at 1:00 pm ET. Stocks will observe our Independence Day holiday on Tuesday (July 4th).

Resistance:	Dow:	21,307/ 21,383/ 21,455/ 21,529	Nasdaq:	6,121/ 6,160/ 6,198/ 6,238	S&P:	2,418/ 2,430/ 2,443/ 2,454
Support:		21,201/ 21,163/ 21,091/ 21,016		6,088/ 6,044/ 6,003/ 5,966		2,405/ 2,394/ 2,381/ 2,369

Other Markets

After 5 weeks of losses culminating with a 3.87% drop, Crude Oil is 4.02% better this week. We consider the better buying opportunities to be from lows due near July 25th and August 7th. As we said last week: *"Those should be accumulation points for a reversal to higher prices into late September."* Commodities fell 3.07% last week, but are 1.93% higher this week. Gold gained .18%, but is .65% lower this week. The U.S. Dollar was .21% lower, and has tumbled 1.24% this week to the lowest levels since the spike low of Election Week 2016. The Japanese Yen lost .36% last week, and fell another .92% into today. The Euro was .04% lower, but has surged 1.64% this week. With the U.S. possibly slowing down future hikes and the European Central Bank seeking to cut back stimulus, the Euro is gaining on the Dollar. Corn plunged 6.84% last week, and is .28% lower this week. Cotton rose 1.07%, and is 2.42% better this week.

"The time to stop talking is when the other person nods his head affirmatively but says nothing."
Henry S. Haskins

Additional Information is Available on Request
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