Bond Market Review

July 07, 2017

Treasuries see a June Swoon

Treasuries appeared headed for gains last month, but a 'June swoon' hit after a low in rates on June 26th. Yields rose for 7 of the last 8 trading sessions, as bond traders seemed to capitulate to better data and news. Coming into the end of June, the Treasury curve had flattened – with short rates rising and long rates falling. The difference between 2 and 10–year notes had fallen 46 bps since March 13th. Into Friday, 19 bps of that move was reversed. Yields on 10–year Treasury notes rose 16 bps the last week of June, and another 8 bps this week, resulting in a 2–week move of 24 bps to the upside – instead steepening the curve. Over that time, the market–based odds for another Fed hike in 2017 rose above 50–50% for December – and remained there.

GDP for the first quarter saw another uptick, rising from 1.20% to 1.40%. (It had originally been reported at only .70%.) Exports were revised higher (from 5.8% to 7.0%), and the largest part of the economy, personal spending, was nearly doubled (Personal Consumption rose from .60% to 1.10%). However, that 1.10% pace is the slowest growth rate for any quarter since 2013. Better results for foreign trade and the service sector outlook led the Atlanta Fed to raise its Q2 2017 forecast to 2.70% from a low of 2.60%. The ISM Non–Manufacturing (service sector) outlook rose from 56.9 to 57.4. The initial prediction from the highly–regarded Atlanta GDP nowcast was 4.3%. It is worth noting that St. Louis is expecting a much–lower 2.22% (versus 2.70%), while New York is forecasting only 2.0%.

June payrolls surprised to the upside with the largest increase in jobs in 4 months. The economy not only added 222K nonfarm–payroll jobs, but there was a 47K upward revision for the previous 2 months. As of June, a record 153.168 million Americans were employed. Coming into the reports, ADP Employment Change was expected to come in at 188K, but was only 158K – with a 23K downward revision for May. However, Private Payrolls grew by 187K, more in line with those previous expectations, and there was a 12K upward revision for May. More indicative of the gains, Challenger Job Cuts reported 19.30% less firings versus June 2016, and the ISM Employment gauge jumped from 53.5 to 57.2. Manufacturing jobs rose 1K, but were revised from a 1K to 2K loss for May. While the Unemployment Rate rose from 4.30% to 4.40%, that was also a positive as Labor Force Participation grew from 62.70% to 62.80%! The Underemployment Rate rose from 8.40% to 8.60%. Another good sign was the Average Weekly Hours rising from 34.4. to 34.5. The downside to the report was that wage gains are not rising as expected given the supposed 'full employment' statistics. Average Hourly Earnings rose .20%, but were revised from .20% to only .10% for May. The annual pace was 2.50% versus 2.60% expected, and May's data was revised from 2.50% to 2.40%.

One of the Fed's favorite inflation gauges, the PCE Deflator, fell .10% in May. The annual pace dropped from 1.70% to 1.40%. The core result (ex food & energy) for Personal Consumption Expenditures rose .10%, and the annual pace slowed from 1.50% to 1.40%. Though expected at 2.20%, the GDP Price Index for Q1 2017 was 1.90%. The core number for Q1 was 2.00% (versus 2.10% expected). The position of Fed Chair Janet Yellen has been that a hot labor market would spark inflation to higher numbers, and that the recent weakness in price and wage gains should be viewed as 'transitory.' The Fed's view that their mandates had been met, and that 4 hikes should happen in 2017 along with the beginning of a reduction in their balance sheet has been rattled in recent months. The minutes from the June 14th FOMC meeting revealed that members were divided on when to begin unwinding balance sheet asset positions. Some members prefer to wait for more data on *"economic activity and inflation."* There was also mixed concern about the slowing of inflation data.

Looking Ahead

- Bond yields should make a high in the July 14th to 19th timeframe.
- The **BMR** equity cycles show better positive energy from another low due near July 18th.

Treasuries, Agencies, and MBS

In the **B**ond **M**arket **R**eview (06/21), we said we expected *"lower rates from the 22nd to the 27th, even if they didn't appreciably rise into the 22nd."* Yields fell into the 26th, and have moved aggressively higher 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 had tweaked the cycles a little given incoming data, but should have left them alone. There is a high for yields due in the 14th to 19th timeframe, followed by what should be a low near the 24th. After that, the August 9th to 15th time–window appears to be the best time to hedge portfolios for a larger up move in rates. For the last week of June, yields rose by 4, 13, 16, and 12 bps for the 2, 5, 10, and 30–year Treasury sectors. This week, yields were again higher by 1.5, 6, 8, and 12 bps – and interest rates on short–term T–Bills rose to the highest levels since 2008!

MBS spreads (FNMA 30–year 3%) narrowed by 4 bps into June 30th, and then pulled in another 3 bps last week. This coming week, the U.S. Treasury will auction $24 billion in 3–year notes on Tuesday (07/11), $20 billion 10–year notes on Wednesday (07/12), and $12 billion 30–year bonds on Thursday (07/13).

07/07/17 Treasury Yield Curve	2-Year: 1.401%	5-Year: 1.948%	10-Year: 2.386%	30-Year: 2.929%
Weekly Yield Change:	+.017%	+.059%	+.081%	+.094%

06/30/17 Treasury Yield Curve	2-Year: 1.384%	5-Year: 1.889%	10-Year: 2.305%	30-Year: 2.835%
Weekly Yield Change:	+.042%	+.132%	+.162%	+.119%
Support:	1.405/ 1.430/ 1.455/ 1.480	1.985/ 2.025/ 2.055/ 2.095	2.420/ 2.460/ 2.500/ 2.540	2.970/ 3.010/ 3.060/ 3.100%
Targets:	1.380/ 1.350/ 1.320/ 1.305	1.920/ 1.885/ 1.850/ 1.815	2.345/ 2.305/ 2.265/ 2.230	2.885/ 2.845/ 2.795/ 2.765%

Economics

Initial Jobless Claims rose 2K to 244K last week, and were 4K higher to 248K this week. They continue to hover just above the 43–year low of 227K. Continuing Claims were 3K higher to 1,945K, and then 11K higher to 1,956K. The Bloomberg Consumer Comfort (confidence) measure fell from 49.4 to 48.6 last week, but was only .1 lower to 48.5 this week. Most confidence measures have fallen off their post–election highs, but are still positive. University of Michigan Sentiment was .6 higher to 95.1, and Current Conditions rose 2.9 points to 112.5. However, Expectations for 6–months out have fallen (easing from 84.7 to 83.9). Chicago Purchasing Managers was sharply higher, rising from 59.4 to 65.7. ISM Manufacturing rose from 54.9 to a strong 57.8, while Prices Paid fell from 60.5 to 55. ISM New Orders rose from 59.5 to 63.5. Those were June numbers. In May, orders for Durable Goods fell .80%, but were .30% higher ex transportation. Factory Orders also fell .80%, and were also .30% lower ex transportation. Capital Goods Orders rose .20%. Construction Spending was flat for May. The Trade Balance deficit gap was $1.1 billion lower for May (to $46.5 billion) as U.S. Exports rose to their highest levels in 2 years.

In May, Personal Income rose .40%. Personal Spending was only .10% higher – indicating more saving. Vehicle Sales fell in June, dropping from a 16.58M pace to 16.41M. Domestic sales fell from 12.84M to a 12.79M pace.

Monday (07/10) is set for the Fed's report card on the June payroll numbers (Labor Market Conditions Index Change) and Consumer Credit for May. Tuesday follows with NFIB Small Business Optimism and Wholesale Inventories (and Trade Sales) for May. Wednesday updates MBA Mortgage Applications (which rose 1.40% last week) and the Federal Reserve's Beige Book (the outlook for the Fed's 12 districts). Thursday provides jobless claims data, the Monthly Budget Statement for June, and more inflation data from Producer Prices (June PPI). Friday is loaded with June data for Consumer Prices (June CPI), Retail Sales, Industrial Production, and Capacity Utilization. Also scheduled are May Business Inventories and the University of Michigan sentiment surveys.

The following Monday (07/17) gives us Empire Manufacturing. Tuesday brings June Import Prices, May Treasury International Capital flows, and home–builder outlook (the NAHB Housing Market Index). Wednesday (07/19) is set for Housing Starts and Building Permits for June. The next **BMR** will follow Wednesday's data.

Equities

While stocks seem to be trading ever higher ever longer, the momentum of the rally has faded. The Dow made a new high on Monday, in a shortened session just before the July 4th holiday, but the highest close to date was on June 19th. Despite that ceremony, the last 3 weeks have been a .05% gain, a .21% loss, and then a .30% gain this week. Thus, Friday was the highest weekly close, but not impressively so! The Dow gained 64.71 points or .30% this week to 21,414.34. The Nasdaq lost 1.99% in the last week of June, but rose 12.66 points or .21% this week to 6,153.08. Thursday's low was the lowest level since May 19th, so the Nasdaq and Dow Industrials are diverging. Thursday's close for the S&P was the lowest since May 24th, so it's more in tune with the Nasdaq. The S&P lost .61% into June 30th, and gained only 1.77 points or .07% to 2,425.18 this week. For most stocks, only a strong Friday rally erased losses or what had been far worse into Thursday. With failing momentum, energy for a better buying opportunity in equites appears to have shifted to a low due near July 18th. There could be a turn lower in the middle of the week.

A bright spot was the Dow Transports. They had trailed the other major indices, and had not challenged their high made on March 1st – following a hard drop of 9.28% in May 18th. However, back–to–back gains of 1.86% and 1.37% led other sectors and allowed the Transports to finally join the Dow in making new highs last week. Friday's close and highs hit new record territory! Banks stocks were also impressive, with gains of 4.44% and 1.60%. However, bank stocks are still 19.60% off their early–2007 highs, and also lower to their March 1st highs – but within striking distance (now only 2.37% below those levels).

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Resistance:	Dow:	21,527/ 21,673/ 21,824/ 21,970	Nasdaq:	6,187/ 6,227/ 6,265/ 6,304	S&P:	2,432/ 2,444/ 2,457/ 2,470
Support:		21,237/ 21,089/ 20,945/ 20,802		6,108/ 6,069/ 6,031/ 5,997		2,420/ 2,408/ 2,395/ 2,383

Other Markets

After five weeks of lower prices, Crude Oil surged 7.04% in a great rebound to close out June and the second quarter. However, Crude fell 3.93% this week. Commodities had risen 4.19% the last week of June, but were 1.27% lower this week. Gold lost 1.11%, and was off again this week – losing 2.62%. It was curious that Gold lost ground the previous week, given a 1.57% plunge in the U.S. Dollar – especially on such a large move. The Dollar hadn't fallen that much since the week of May 19th (and that week it lost 2.12% while Gold countered with a 2.11% gain – more in line with its counter–Dollar nature). The Dollar rose .39% this week. The Japanese Yen lost 1.00% and then 1.36% over the past 2 weeks. The Euro surged 2.07% the last week of June, and then lost .22% this week. Corn gained 3.56% and 3.17%, while Cotton rose 3.66% and then eased .03% lower this week.

"Indecision may or may not be my problem." Jimmy Buffett

Additional Information is Available on Request

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