COMMERCE STREET
Capital Management
1445 ROSS AVENUE
DALLAS, TEXAS 75202
214-545-6800

BOND MARKET REVIEW

July 27, 2017

Moderate Ado about Nothing

Like recent Congressional actions, the FOMC voted to do nothing. However, unlike for Congress, it was unanimous. FRB Minneapolis President Neel Kashkari had voted against the June hike in favor of leaving policy unchanged. This time, as widely expected, the Fed left interest rates alone but signaled their intention to begin to reduce their balance sheet *"relatively soon."* The Fed has been maintaining its $4.5 trillion balance sheet by reinvesting debt assets as they rolled off or matured. With their intention to soon reduce holdings, the FOMC changed their language to: *"For the time being, the Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage–backed securities in agency mortgage–backed securities and of rolling over maturing Treasury securities at auction."* The crafting of the language allows the Fed a lot of latitude in starting the downsizing at any time, or delaying that decision for as long as they please.

Earlier this year, the Fed was expected to hike 4 times in 2017 – in March, June, September, and December. Coming into this week's FOMC meeting, the market–based odds for the next hike were instead biased to March of 2018. The lack of inflation and the evidence that recently weaker price gains appeared to be more than 'transitory' left those odds for more hikes in 2017 at only 41.8% through today. The next two meetings, September and November, would appear to be 'non–events' as well with minimal 4.1% and 4.9% market reads for a hike. Japan has struggled to revive inflation for years, and their central bank participants just downgraded their 'dot plot' equivalents. Their inflation rate is stalling at .40%, while they, like the European Central Bank and our Fed, expect that tighter labor markets will begin to lift wages and inflation. The FOMC changed their statement to reflect that *"overall inflation and the measure excluding food and energy prices have declined and are running below 2 percent."* The previous statement said inflation *"has declined recently"*, implying a more temporary effect. We think the language capitulates to an expected longer time before inflation will run at or above the Fed's previously–stated 2% goal.

The Q2 GDP estimate from the Atlanta Fed GDP–Now forecast rose to 2.8% today on improved Durable Goods Orders and a narrowing trade balance. Until today, it had been 2.5% which was also the current consensus for this Friday's release. That was revised to 2.7% after today's data. GDP for Q1 2017 was originally released at only .70%, but then revised higher to 1.20% and finally 1.40% as the results for personal consumption were upgraded. So, if the economy only grew .35% in Q1 and .675% in Q2, since those are annualized numbers, it just remains in the 'modest to moderate' category. That makes it hard to see what the FOMC is excited about. With those growth numbers and recently–challenged inflation, there appears to be little danger of the Fed 'getting behind the curve' or any risk of the U.S. economy 'overheating'. The Fed may have even 'jumped the gun', but it's clear they wanted to get off of zero. They now have a little ammo if things once again slow down. Though continued foreign demand for U.S. debt could lessen the impact, reducing the Fed's balance sheet would further reduce stimulus – even without additional hikes.

Looking Ahead

- Bond yields should be lower into August 9th and August 15th. We expect yields to rise out of that window.
- The **BMR** equity cycles show better positive energy from July 18th into August 1st.

Treasuries, Agencies, and MBS

The **B**ond **M**arket **R**eview yield cycles point to lows on August 9th and the 15th. That window would be the best time to take profits and/or hedge portfolios for an expected larger increase in yields. Last week, yields fell to their lowest levels since June 28th. Yields dropped by 1.5, 6.5, 9.5, and 11 bps for the 2, 5, 10, and 30–year Treasury sectors. 10–year yields had risen over 10 bps this week, but a post–Fed rally left them higher by only half. Yields were again higher today, leaving them up by 2.5, 5, 7.5, and 11 bps for the 2, 5, 10, and 30–year sectors.

Last week, MBS spreads (FNMA 30–year 3%) widened by 2 bps. Tuesday's 2–year note auction brought the highest yield since the October 2008 offering, with $26 billion coming at 1.395%. Demand was the highest since the November 2015 auction, and foreign accounts (including central banks) accounted for 58.5% of the issue versus 56.6% during the June auction. Wednesday's 5–year note auction brought 1.884% for $34 billion in supply. Demand was the best since May, and foreign buyers were allotted 69.8% of the issue versus 65.2% last month. That was the second highest allotment noted since records began in 2003. Today, the Treasury sold $28 billion 7–year notes at a 2.126% yield – the highest since March. Demand was the best since the May offering, and again foreign buying rose to June – up from 65.4% to 67.7% for this auction.

07/21/17 Treasury Yield Curve	2-Year: 1.342%	5-Year: 1.804%	10-Year: 2.238%	30-Year: 2.809%
Weekly Yield Change:	–.016%	–.063%	–.095%	–.111%
Support:	1.380/ 1.405/ 1.430/ 1.455	1.870/ 1.890/ 1.920/ 1.955	2.325/ 2.345/ 2.365/ 2.385	2.940/ 2.965/ 2.990/ 3.010%
Targets:	1.365/ 1.340/ 1.320/ 1.305	1.840/ 1.820/ 1.785/ 1.750	2.290/ 2.260/ 2.250/ 2.230	2.920/ 2.895/ 2.875/ 2.855%

Economics

Initial Jobless Claims rose from 234K to 244K – but remain near multi–decade lows. Continuing Claims fell 17K to 1,960K. Consumer Confidence surged after the 2016 election, but had eased over the past few months. Though revised lower from 118.9 to 117.3 for June, the Conference Board confidence readings surged to a 4–month high of 121.1 – beating expectations by nearly 5 points. Expectations 6 months out rose from 99.6 to 103.3. The impressive measure was Present Conditions, which rose from 143.9 to a 16–year high of 147.8. At least temporarily, the surge is back. After hitting a 9–month low or 47 a few weeks ago, Bloomberg Consumer Comfort rose to 47.6 and then 48.6 this week – also confirming those better sentiment readings. The Chicago Fed National Activity Index rose from –.30 to +.13, and Richmond Fed Manufacturing improved from 11 to 14. Kansas City dropped 1 point to 10. Wholesale and Retail Inventories each rose .60% in June. Orders for Durable Goods rose 6.5% in June, after being revised to only a .10% drop for May instead of .80%. Ex Transportation, orders rose .20%, and were revised (and doubled) from .30% to .60% for May. Capital Goods Orders fell .10%.

New Home Sales improved by .83% in June to 610K, but only because May data was revised down from 610K to 605K. However, turnover is improving as new homes spent less time on the market than for another May since records began. Sales of Existing Homes fell 1.78% in June to a 5.52M unit pace – and were also .90% lower versus last June. The median sales price rose to a record $263,800. The FHFA House Price Index rose .40% in May. Metro home prices were only .10% higher, slowing the annual pace of the S&P Case–Shiller 20–City index from 5.77% to 5.69%. The annual pace of home price gains also pared back from 5.65% to 5.58%.

Friday is set for the first release of Q2 GDP and Personal Consumption, and the University of Michigan sentiment surveys. Monday (07/31) closes out July trading with Pending Home Sales for June, Chicago Purchasing Managers, and Dallas Fed Manufacturing Activity. Tuesday kicks off August with Personal Income and Spending for June, July Vehicle Sales, June Construction Spending, the PCE Deflator (one of the Fed's favorite inflation gauges), and ISM data for the Manufacturing–sector outlook, Prices Paid, New Orders, and Employment (a first look into July payrolls). Wednesday gives us MBA Mortgage Applications (which last week rose by .40%) and a second look into next Friday's July payroll numbers from ADP Employment Change (private payroll data).

Equities

Another day, and more record highs for U.S. stocks. While the Dow was 85.54 points higher today, the Nasdaq and S&P made new highs only to reverse lower – with the Nasdaq experiencing the largest loss. Most indices closed lower, although the NYSE was only down by .01%. Longer cycles are showing an important top due near August 31st, and a large selloff for the last 3 weeks of December with a major low due near the 28th. After that, we should rally into early March.

Last week, the Dow Industrials lost 57.67 points or .27% to 21,580.07 while most other indexes saw gains. The roles are reversed this week, with the Dow leading the way 1.00% higher. The S&P rose 13.27 points or .54% to 2,472.54, and is .12% better this week. The Nasdaq gained 75.29 points or 1.19% to 6,387.75, but is .09% lower this week. The Dow Transports lost 2.79%, and are 2.97% lower this week. Bank stocks lost 1.58%, but were .77% better into today.

	Dow:	Nasdaq:	S&P:
Resistance:	21,794/ 21,866/ 21,941/ 22,014	6,398/ 6,438/ 6,478/ 6,518	2,484/ 2,496/ 2,509/ 2,521
Support:	21,719/ 21,647/ 21,571/ 21,498	6,358/ 6,320/ 6,278/ 6,238	2,460/ 2,447/ 2,429/ 2,409

Other Markets

After surging 5.22% into July 14th, Crude Oil lost 1.65% last week. However, it's up another 7.14% this week – reaching the highest levels since the end of May (to $49.04/barrel). Commodities rose .21%, but have risen 2.54% this week on the strength in Crude. Gold gained 2.23%, and is .41% better this week. The U.S. Dollar fell 1.32%, reaching the lowest lows since June 2016. It's .04% higher this week. The Japanese Yen gained 1.24%, but is .12% lower this week. The Euro rose 1.68%, and is .12% higher this week. Corn gained 3.97%, but is 1.45% lower this week. Cotton rose 2.92%, and has added 1.97% this week (though it fell 10.77% 2 weeks ago!).

"It is better to sleep on things beforehand than lie awake about them afterward." Baltasar Gracian

Additional Information is Available on Request

Doug Ingram, Managing Director – Commerce Street Capital Management

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