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BOND MARKET REVIEW

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A Pause for the Claws

The Fed is not seeing any worthwhile inflationary forces to buttress their stance on the completion of their mission, nor for the continuance of rate hikes. In fact, even those seeking higher rates are capitulating to a lack of supportive data. The hawks are losing their talons! Most Fed members are very happy with the currently–low unemployment numbers, but can't quite reconcile the lack of wage pressures given that state of affairs. Atlanta FRB President Raphael Bostic voiced the concern that has other FOMC members also a bit befuddled. That is that the strong jobs market *"has not translated into the sustained level of inflation that all of our economic models say should exist."* (Sometimes those textbooks don't have all the answers!) He said his view was without that kind of inflation, the Fed should be *"more hesitant in moving stridently in any direction."* Bostic said: *"I actually am worried about the inflation number."* Like a few others, he's in favor of *"wait and see!"* Into July, the 5–month core gain in consumer prices was the lowest since 2010. New vehicle prices fell by .5% – the most since 2009, and hotel costs plunged 4.2% – a record monthly loss. The Fed's June minutes detailed much concern for the lack of (or lagging) inflation.

May Day after Labor Day?

Over the years, we've observed the high probability for the stock market to rally one or two weeks into Labor Day. While it's not 100% (nothing is), it's usually dependable that stocks will rally into Labor Day. Stocks often hold up through Labor Day before selling off, and sometimes peak very near the holiday (for a small or larger move). Since 2003, that seasonal effect has been evident in every year except for a selloff into 2013. We bring it up because it's statistically significant – but also because our equity cycles just turn plain ugly after September 1st. Cycles are our passion, and an intellectual pursuit we've engaged for 38 years. Some years have provided monumental progress, while others yielded only minute gains in our formulas and processes. It's a good use of the calculus, differential mathematics, and physics that would have otherwise gone dormant. That said, work that you enjoy is the best kind! There are cycles of all different timeframes, so markets have countertrend waves along larger trends. Our equity cycles are projecting weakness for the rest of 2017. When we run our analysis, we get a read on the fit of the numerous short–to–long waves comprising each forecast. A downtrend is expected from September 1st into October 20th. After some backing and filling, there's a stronger down–wave projected for December 6th to the 28th. If that all 'pans out', late December could offer one of those rare buy opportunities that come only once every few years.

Looking Ahead

- Bond yields should be higher into September 7th, and then peak near October 4th.
- The **BMR** equity cycles are positive from August 23rd into month end, and then very weak.
- The next **B**ond **M**arket **R**eview is scheduled for the last week of August.

Treasuries, Agencies, and MBS

Our bond cycles lead us to conclude that higher inflation targets will continue to elude the Fed! After a peak near October 4th, the cycles project that yields could be lower into February 2018. We had expected yields to drop into an August 9th to 15th window, and saw yields drop to 6–week lows into the 11th. While the catalyst for market events is sometimes apparent beforehand, North Korea's threats to destroy America were taken lightly by global debt and equity markets. However, when they threatened the U.S. territory of Guam last week, the markets conceded that might be within their capability – which contributed to a selloff in stocks and a 'flight to quality' in Treasuries.

The Treasury curve continued to flatten last week, with yields dropping 5.5, 7, 7.5, and 5.5 bps for the 2, 5, 10, and 30–year sectors. On Friday, yields dropped to their lowest levels since the end of June. Yields had spiked higher into Tuesday with the stock market also rallying after the plunge into last Friday's close. 10–year yields had risen 9.5 bps. However, with stocks once again breaking to (or through) last week's lows, another terrorist attack in Europe (Barcelona, Spain), and domestic violence – bonds were once again the beneficiary of a safe–haven bid. Into today, yields were .5 bps higher at 2 and 5–years, but the curve flattened a bit more with 10 and 30–year rates falling .5 and 1 bps. Last week, MBS spreads (FNMA 30–year 3%) widened by 2 bps to faster moving Treasuries. The U.S. Treasury will auction 2 and 5–year notes on Monday (08/28), and 7–year notes on Tuesday (08/29). Into June, China increased holdings for a 5th month and are once again the largest holder of U.S. debt ($1.15 trillion). Foreign entities placed a net $7.7 billion into U.S assets in June, with a net $34.4 billion flowing into longer maturities.

08/11/17 Treasury Yield Curve	2-Year: 1.296%	5-Year: 1.744%	10-Year: 2.190%	30-Year: 2.786%
Weekly Yield Change:	–.057%	–.072%	–.073%	–.057%
Support:	1.320/ 1.355/ 1.370/ 1.395	1.755/ 1.805/ 1.835/ 1.865	2.205/ 2.245/ 2.280/ 2.320	2.780/ 2.820/ 2.860/ 2.905%
Targets:	1.285/ 1.275/ 1.260/ 1.245	1.735/ 1.700/ 1.670/ 1.640	2.170/ 2.140/ 2.105/ 2.070	2.740/ 2.700/ 2.665/ 2.620%

Economics

In July, Retail Sales rose the most this year with a .60% advance to a June number that was revised from a .20% loss to a .30% pickup! Excluding autos, sales rose .50%, and were revised from a .20% drop in June to a .10% gain. There were gains in 10 of the 13 major retail sectors. Initial Jobless Claims fell from 244K to 232K – the lowest reading since February, and barely above that 43–year low (of 227K). Continuing Claims fell 3K to 1,953K. Bloomberg Consumer Comfort fell .2 to 51.2, just off its 16–year high from last week. Bloomberg Economic Expectations surged from 47 to 54. Industrial Production rose .20% in July, but the Factory Output component fell by .10%. Auto production fell 3.6% for a 4th drop in the last 5 months. Capacity Utilization maintained 76.70%. The Philadelphia Fed Business Outlook fell from 19.5 to 18.9, though Empire Manufacturing rose from 9.8 to 25.2. The annual pace of wholesale–price inflation slipped .10%, and Consumer Prices also failed to show any hint of real gains with a modest .10% rise in July. CPI ex food & energy also rose .10%. However, the annual pace for CPI was only .10% higher to 1.70%, while the annual core rate remained at 1.70%. Real Average Weekly Earnings dropped from a 1.20% annual pace to 1.10%, and Hourly Earnings fell from a .90% annual gain to only .70%! Import prices rose .10% in July, and were flat less petroleum. The annual pace of gains for import prices remained at a modest 1.50%.

Home–builder sentiment rose 4 points to a 3–month high of 68, and the expectations for 6–month sales rose from 73 to 78. Housing Starts fell 4.78% to an annual 1,155K pace – though single–family starts were only .5% lower and multi–-family starts fell 15.3%, dragging the overall percentage result much lower. Building Permits fell 4.08% to a 1,223K annual pace. The Leading Index rose .30% in July, and Business Inventories rose .50% in June.

Friday is set for the University of Michigan sentiment surveys. Next Monday (08/21) is set for the Chicago Fed National Activity Index. MBA Mortgage Foreclosures and Delinquencies are scheduled for release sometime during the week. Tuesday provides the FHFA House Price Index for June, the Q2 House Price Purchase Index, and the Richmond Fed Manufacturing Index. Wednesday brings MBA Mortgage Applications (which rose a slight .10% last week) and New Home Sales for July. Thursday includes jobless claims data, Existing Home Sales for July, and Kansas City Fed Manufacturing Activity. Friday the 25th provides Durable and Capital Goods Orders for July. The following Monday (08/28) brings Wholesale and Retail Inventories for July, and Dallas Fed Manufacturing Activity. Tuesday (08/29) follows with S&P Case–Shiller home price data and the Conference Board Consumer Confidence surveys. Wednesday (08/30) updates to Q2 GDP and Personal Consumption, and yields the first look into August payrolls from ADP Employment Change data. The next **BMR** is scheduled for the last week of August.

Equities

The Dow Industrials made a record high on August 8th – the same day hitting the **BMR** upside target of 22,138 (with a high of 22,179), before closing down 33 points at 22,085. The August 7th close of 22,118.42 remains the highest to date, with stocks falling hard late last week on North Korea's threats, and then the S&P suffering its second–worst day of the year today – breaking to the lowest levels since July 11th. On May 17th, the S&P fell 1.82% and the Dow lost 1.78%. Today, the S&P and Dow fell 1.54% and 1.24% – and they had been off by 1.45% and .93% last Thursday (08/10). The cycles are forecasting a low near the 23rd, followed by a 'Labor Day rally' into month end.

Last week, the Dow dropped 234.49 points or 1.06% to 21,858.32. It's .49% lower this week, but also 1.52% off Wednesday's high. The S&P lost 35.51 points or 1.43% to 2,441.32, and is .46% lower this week. The Nasdaq dropped 95.01 points or 1.50% to 6,256.56, and is .55% lower since Friday. The Dow Transports lost .85% last week, and were .51% lower into today. Bank stocks plunged 3.56% last week, and were another .58% lower through today.

Resistance:	Dow:	21,846/ 21,938/ 22,005/ 22,086	Nasdaq:	6,215/ 6,293/ 6,333/ 6,374	S&P:	2,438/ 2,450/ 2,462/ 2,474
Support:		21,684/ 21,611/ 21,537/ 21,465		6,215/ 6,176/ 6,137/ 6,098		2,413/ 2,401/ 2,389/ 2,377

Other Markets

Crude Oil fell 1.53% last week, and was 3.54% lower into today – headed for a 3rd weekly loss. Our Crude cycles call for a rally from August 22nd into September 11th. Commodities lost .60%, and are 2.07% lower this week. Gold gained 2.34%, but is .10% lower this week. The U.S. Dollar lost .49% last week, but is .62% better this week. The Euro had gained .41%, and then fell .83% into today. The Japanese Yen surged 1.36%, but is .35% lower this week. Corn lost 1.57%, and is off another 2.84% this week. Cotton lost 2.47%, and is off 2.59% so far this week.

"I have always thought the actions of men the best interpreters of their thoughts." John Locke (1632–1704)

Additional Information is Available on Request

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