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Bond Market Review

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Market Structure and Infrastructure

The nation was so focused on the senseless loss of life in Las Vegas that most other news and economic data faded in importance. Our hearts and prayers are with all affected! The nation has endured cascading woes since hurricane Harvey hit Texas. Unfortunately, we're still in storm season. Tropical Storm Nate is expected to become a hurricane, and there are current projections that the Gulf Coast could be in its path – possibly New Orleans (as early as Sunday).

Sometimes stocks climb a wall of worry – while at others they 'go with the flow.' Despite the economic challenges brought by the storms, confidence has returned – to stocks, to manufacturing, and to the services industries. Incoming data has been good enough for the Atlanta Fed's model to project Q3 GDP closer to 3%. While only 2.1% last week after New and Existing Home Sales data faltered in August, incoming numbers on services and manufacturing bumped the forecasts up as high as 2.9% this week. The U.S. factory index rose from 58.8 to 60.8 signaling the best increase in manufacturing in 13 years! The services outlook rose to its highest level since August 2005 (12–years).

There are still plenty of 'additional' things that can go wrong out there, providing a catalyst for a sudden reversal in the markets. However, last Friday marked the third week of a rising U.S. Dollar, equities, and bond yields. Through today, yields, stocks, and the Dollar were all working on a 4th 'up week.' On Tuesday, bank stocks hit their highest levels since November 2007, and today saw record highs for the Dow Industrials and most other indexes. Small caps are indeed participating! Yesterday, the Dow Transports and the German DAX hit a new high, Japan was the highest since August 2015, and Hong Kong index hit its highest levels since mid–2015.

Rebuilding and recovery will be more of a challenge in Puerto Rico and other storm–affected islands than for Texas and Florida, as their infrastructure was more severely compromised – inhibiting the delivery of supplies and assistance. Roads were washed away, and many bridges are undependable. Cell services are only minimally restored and, though rescue supplies are at distribution centers, the means for delivery is lacking. From a market–structure standpoint, stocks are in patterns suggesting an important topping process. It certainly doesn't mean they will turn tomorrow, but they've reached a point where that probability is increasing.

Looking Ahead

- Bond yields could pull back into a low near October 16th, and then peak near October 20th.
- The **BMR** equity cycles project a downtrend from October 12th to the 20th.

Treasuries, Agencies, and MBS

The **B**ond **M**arket **R**eview's bond cycles had projected higher yields into October 4th, and 2–year yields rose today to their highest levels since October 2008. 5 and 10–year yields were the highest since early July. After breaking key support last week, yields continued higher with the 2, 5, 10, and 30–year Treasury sectors increasing by 5.5, 7.5, 8.5, and 8 bps. Yields are modestly higher this week, with those sectors rising another .5, 1, 1.5, and 3 bps. Yields still have cyclic 'room' to rise into October 20th. If they are indeed peaking near that date, we would be advocates of accumulation and recommend lightening hedge activity. Even though there are Fed members still in favor of waiting on more evidence of inflation and economic improvement, others are wary of falling behind the curve and some think rates are still overly accommodative. Last week, FRB San Francisco President John Williams said *"2.5% is about the new normal."* If so, that still leaves room for 4 to 6 25–bps hikes. There is still fear that the economy will overheat, which after nearly a decade of 'modest and moderate' would seem welcome – and bring along some of the higher inflation statistics the Fed covets. FRB Boston's Eric Rosengren said the Fed should be raising rates in a *"regular and gradual"* fashion despite inflation–weakness conditions that he said were *"widely expected to be temporary."* We think 'regular and gradual' is supposed to mean 'every other meeting', though the Fed had to skip September. They are now indicating December and another 'intentional' November pass. Bonds are showing signs of 'believing the dots', and the market odds for a December Fed hike have been hovering near 70%, while today rising to 73.3%.

Many names have surfaced for the next Fed Chair. President Trump has met with current Chair Janet Yellen, Gary Cohn, Jerome Powell, and Kevin Warsh. Stanford's John Taylor is also said to be on the list. The **BMR** vote would go to Minneapolis' Neel Kashkari as we think he is the most data–focused, and least likely to waver on short–term movements. He thinks recent hikes have been *"an important factor driving inflation expectations lower."* Unlike Yellen, he would choose to wait for core PCE hitting 2% or a removal of labor market slack before hiking again.

09/29/17 Treasury Yield Curve	2-Year: 1.486%	5-Year: 1.937%	10-Year: 2.334%	30-Year: 2.860%
Weekly Yield Change:	+.053%	+.075%	+.083%	+.080%
Support:	1.530/ 1.545/ 1.565/ 1.580	2.021/ 2.056/ 2.090/ 2.125	2.395/ 2.435/ 2.475/ 2.515	2.923/ 2.945/ 2.968/ 2.990%
Targets:	1.495/ 1.470/ 1.455/ 1.435	1.950/ 1.918/ 1.867/ 1.815	2.315/ 2.275/ 2.243/ 2.202	2.897/ 2.880/ 2.860/ 2.820%

Though Columbus Day (Monday 10/09) is a federal holiday, equities and some fixed income markets will be open for trading. Last week, MBS spreads (FNMA 30–year 3%) narrowed for a third week – pulling in by 4 bps. The U.S. Treasury will auction $24 billion 3–year notes and $20 billion 10–year notes on Wednesday (10/11). On Thursday (10/12), the 30–year bond auction will take place with $12 billion in supply.

Economics

ISM Manufacturing expanded from 58.8 to 60.8 – rising to the fastest pace in 13 years. Prices Paid rose from 62 to 71.5 (the highest since May 2011), and New Orders rose from 60.3 to 64.6 (the best since February). The service–sector outlook surged to a 12–year high (from 55.3 to 59.8). Though the ADP Employment Change showed the fewest private–sector jobs added in almost a year at 135K, the employment gauges for manufacturing rose to .4 to 60.3 (the best in over 6 years) and that measure for services improved from 56.2 to 56.8 (the best since May). Challenger Job Cuts were down 27% versus September 2016, and Initial Jobless Claims fell from 272K to 260K. Continuing Claims were only 2K higher to 1,938K. All this data shows underlying strength in employment, even though September payroll gains are expected to be lower due to the storms. Construction Spending rose .50% in August – and should be higher in the coming months. August Factory Orders rose 1.20% and were .40% higher ex transportation. Durable Goods Orders were 2.00% higher, and up .50% ex transportation. Orders for Capital Goods rose a solid 1.10%.

University of Michigan Sentiment was off .2 to 95.1, and Current Conditions fell from 113.9 to 111.7. However, Expectations rose a point to 84.4. Bloomberg Consumer Comfort also dropped, as those post–Las Vegas tragedy results fell from 51.6 to 49.9. The Chicago Purchasing Managers index rose from 58.9 to 65.2. The Fed's favorite inflation gauge, the PCE Deflator, rose .20% in August, leaving the annual pace at only 1.40%. The ex food & energy result for Personal Consumption Expenditures rose .10%, resulting in the core annual pace dropping .10% to 1.30%. (We all know fuel prices rose in September, and will affect this data going forward!) August Personal Income rose .20%, though Spending was only .10% higher. 'Real Personal Spending' dropped by .10%. September Vehicle Sales rose from 16.03M to a stout 18.47M annual pace – no doubt that many storm damaged vehicles had to be replaced! Domestic sales increased from 12.48M to a 14.33M annual pace. The Trade Balance Deficit for August dropped from $43.6 billion to an 11–month low $42.4 billion on improved exports.

Friday is set for September payrolls, the U.S. Unemployment Rate, and related data – which are expected to be challenged due to the storms. Also due are Wholesale Trade Sales & Inventories, and August Consumer Credit. Next Tuesday (10/10) brings NFIB Small Business Optimism. Wednesday follows with MBA Mortgage Applications (which fell .40% last week), JOLTS Job Openings, and the minutes from the FOMC's September meeting.

Equities

Stocks are hitting levels with patterns that are almost 'bubble like.' Small caps were leading the way last week as the Dow Industrials rose only .25% or 55.50 points to 22,405.09. The Dow is 1.65% higher this week. The S&P gained 17.14 points or .68% to 2,519.36, and is 1.30% better this week. The Nasdaq gained 69.04 points or 1.07% to 6,495.96, and is 1.38% higher this week. While stocks rose for a third week, and are headed for a fourth, the Dow Transports rose 2.16% to mark 6–week streak of gains. They were a modest .05% lower through today, after making new highs. Bank stocks rose 2.29% to gain 10.08% over the past 3 weeks. They are 1.34% better this week!

Resistance:	Dow:	22,795/ 22,870/ 22,946/ 23,023	Nasdaq:	6,593/ 6,634/ 6,675/ 6,716	S&P:	2,553/ 2,566/ 2,578/ 2,590
Support:		22,645/ 22,568/ 22,404/ 22,256		6,552/ 6,514/ 6,472/ 6,433		2,538/ 2,528/ 2,516/ 2,503

Other Markets

Commodities fell .26% last week, and were .08% lower into today. More–volatile Crude Oil rose 1.99%, but fell 1.70% into today. Gold lost .91%, and is headed for a 4th loss – off .91% this week. The U.S. Dollar gained a solid 1.00% last week and is .99% higher this week – as the markets are believing the Fed will reduce asset reinvestments in October and hike rates again in December! The Japanese Yen fell .46%, and is .28% lower this week. The Euro lost 1.15% last week, and is off another .87% this week. Catalonia's attempt to break away from Spain is causing more EU tension. Corn rose .50%, but is 1.62% lower this week. Cotton fell .01%, and is off .26% this week.

"The important thing is this: to be able at any moment to sacrifice what we are for what we could become."
Charles Du Bos

Additional Information is Available on Request
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