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Bond Market Review

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Apocalypse Now

What could go wrong? The Fed is hiking – and the Chair is changing. Brick and mortar stores are closing at a rapid pace. Politicians and Hollywooders are under investigation for immorality. Subprime auto loans are in crisis – with delinquencies near the 2009 peak! (Subprime didn't work for housing, but surely autos would be OK?) The yield curve is the flattest its been in 10 years, and the tax cut plan has so many losses of deductions it might even lead to increases in tax obligations. Yet, the band played on. Stocks remain near (or at) all–time highs with zealous bullish outlooks – with little perception of downside risk. Consumer confidence is very high, but vitriolic news rules the day.

We read a story on the retail apocalypse, but couldn't find it later – so we used a Google search. Apparently, the term is now a part of what internet sites are deeming as a 'systemic meltdown.' 'Google it' yourself! When you compare the news with jobs, the economy, equities, and confidence, the conclusion might be one we've made before: *"Things are pretty good – for being as bad as they are!"* The current tax legislation proposals are a mess – with the deductibility of state and local taxes, property taxes, and mortgage interest all in jeopardy. (Not to mention some of the concessions bandied about to try to get bipartisan support – such as bringing back insurance–company subsidies.) The October Monthly Budget Statement revealed a $63.2 billion deficit for October – 37.9% greater than last year! That's not a good start, and it will only worsen as the Fed raises rates and the debt service on our roughly $20.5 trillion deficit worsens with each uptick. Those against any sort of tax cuts use the increasing number to ask: 'How are we going to pay for the cuts?', but they never allow taxpayers to ask: 'How are we going to pay for the increases?'

Fed Chair Janet Yellen said Fed communications are challenging *"because individual members of the committee are able and give lots of speeches."* She said so many voices can be confusing to the public. The **B**ond **M**arket **R**eview is thankful for the dissent. Granted it's often hard to get a consensus, but imagine if we had been only given her opinion that low inflation was 'transitory.' In 2011, we said the sluggish economic conditions must instead be *"extended transitory!"* In 2015, Yellen called the still–slow GDP *"largely transitory."* We wrote about 'Fedspeak' in the last **BMR** – and found it refreshing that Fed Chair nominee Jerome Powell likened the FOMC chatter to a 'Far Side' cartoon. In that comic, a man is talking to his dog, but the dog just hears *"blah, blah, blah…!"* He gets it!

One voice with which we agree with more often than not is that of FRB St. Louis President James Bullard. He's like Dragnet's Joe Friday: *"Just the facts!"* Bullard once again said there's no reason to hike with inflation below the Fed's target. He explained: *"Inflation data during 2017 have surprised to the downside and call into question the idea that U.S. inflation is reliably returning toward target."* Meanwhile, data aside, the Fed has overwhelming (internal) support for more hikes – and the odds for a December 13th FOMC rate increase remain above 92%!

Looking Ahead

- Rates should turn lower from a trend–change near November 28th.
- The **BMR** equity cycles project a low near December 1st, and a turndown from the 6th into month end.
- The markets will be closed on Thursday (11/23). Happy Thanksgiving to you and yours!
- The markets will also close early on Black Friday (11/24) – 1 p.m. ET for stocks and 2 p.m. ET for bonds.

Treasuries, Agencies, and MBS

Last week, yields rose 4, 6, 6.5, and 6.5 bps for the 2, 5, 10, and 30–year Treasury sectors in a slight steepening of the curve. Into today, 2–year yields rose 5.5 bps, 5–year yields were 2 bps higher, while 10–year yields fell 2.5 bps, and 30–year bonds dropped by 5.5 bps (also falling into our November 15th cycle). That served to flatten the curve on Wednesday to its most narrow 2–to–10–year spread (under 64 bps) since November 2007. (We provided multiple bullet points last week explaining our thoughts on the flatness in the curve.) In September, foreign accounts withdrew $51.3 billion from short–term U.S. holdings, but moved $80.9 billion into longer–term holdings and equities.

MBS spreads (FNMA 30–year 3%) widened by 1 bps last week. Last Wednesday (11/08), the U.S. Treasury sold $23 billion at 10–year notes at 2.314%. That was the lowest yield since September, with demand also the lowest since that auction. The group that includes foreign central banks accounted for 68.0% of the issue versus 69.1% in October. Last Thursday (11/09), $15 billion 30–year bonds brought 2.801% – also the lowest since the September auction. Demand again fell versus October, and foreign buying dropped from 62.8% to 61.8% of the issue. The Treasury will auction 2–year and 5–year notes on Monday (11/27), and 7–year notes on Tuesday (11/28).

11/10/17 Treasury Yield Curve	2-Year: 1.656%	5-Year: 2.052%	10-Year: 2.399%	30-Year: 2.880%
Weekly Yield Change:	+.041%	+.061%	+.066%	+.066%
Support:	1.725/ 1.750/ 1.780/ 1.815	2.070/ 2.087/ 2.105/ 2.122	2.345/ 2.365/ 2.383/ 2.406	2.809/ 2.833/ 2.847/ 2.868%
Targets:	1.690/ 1.665/ 1.610/ 1.570	2.035/ 2.195/ 2.000/ 1.983	2.327/ 2.306/ 2.286/ 2.267	2.770/ 2.750/ 2.730/ 2.710%

Economics

Retail Sales rose a modest .20% in October, but that was on the heels of data that was revised even higher for September. That previous month had seen a 1.60% gain boosted by storm–related sales that was revised to a 1.90% increase! Auto sales rose .70% after surging 4.60% in September. Ex autos, sales rose .10% following a (.20% higher) 1.20% result. Initial Jobless Claims rose 10K to 239K, and then another 10K to 249K for last week – still near the lower band of recent data (that was the lowest since the early '70s). Continuing Claims rose from 1,884K to 1,904K, and then fell to 1,860K in data that lags a week. Bloomberg Consumer Comfort fell .2 to 51.5 and then rose to 52.1 this week (just under the 16–year highs of 53.3 from August). Economic Expectations rose from 47.5 to 53. University of Michigan Sentiment fell from 100.7 (the highest since January 2004) to 97.8. Current Conditions fell from 116.5 to 113.6 and Expectations dropped from 90.5 to 87.6. All those results had been expected to increase.

NFIB Small Business Optimism rose from 103.0 to 103.8. However, Empire Manufacturing fell from 30.2 to 19.4 and the Philadelphia Fed Business Outlook dropped from 27.9 to 22.7. Homebuilder optimism (NAHB Housing Market Index) rose from 68 to an 8–month high of 70 – the second–best reading since 2005. Factory Output increased by 1.3% in October. That jump was the same as in April – which was the best rise since 2010. Industrial Production rose .90% and Capacity Utilization increased from 76.40% to 77.00%.

Consumer Prices rose .10% in October, leading the annual pace to drop from 2.20% to 2.00%. However, the core CPI rate rose by .20%, sending the annual pace for that ex food & energy result up for the first time since January – as it rose from 1.70% to 1.80%. Producer Prices rose .40%, accelerating the annual pace of gain from 2.60% to 2.80%. Core PPI also rose .40%, and that annual pace increased from 2.20% to 2.40%. Annualized Real Average Weekly Earnings fell from .60% to .40% in October, and Real Average Hourly Earnings fell from .60% to .40%. Import Prices rose .20%, though the annual pace slipped from 2.70% to 2.50%. In September, Wholesale Inventories rose .30% and Trade Sales rose 1.30%. Business Inventories were unchanged.

Friday is set for Kansas City Manufacturing Activity, and October Housing Starts & Building Permits. Mortgage Delinquency data for Q3 2017 is also due. Next Monday (11/20) brings the Leading Index (October LEI). Tuesday follows with the Chicago Fed National Activity Index and Existing Home Sales for October. Wednesday provides the FOMC minutes from their November 1st Meeting. MBA Mortgage Applications (which were flat and then up 3.10%) continue a busy pre–holiday schedule which also includes jobless claims, orders for Durable and Capitol Goods, Bloomberg Consumer Comfort, and University of Michigan sentiment surveys. Though the markets close early on Friday, October New Home Sales and Dallas Fed Manufacturing Activity are scheduled for that morning.

The next **BMR** will be issued the week after Thanksgiving and we wish everyone a wonderful long weekend. We hope you get some rest and time with family. The next round of data begins the following Tuesday (11/28) with Retail and Wholesale Inventories, the FHFA House Price Index, Metro Home Prices (S&P/Case–Shiller 20–city), Richmond Fed Manufacturing, and Conference Board Consumer Confidence. Wednesday follows with Q3 GDP, October Pending Home Sales, and the Fed's Beige Book. (The latest Atlanta Fed Q4 GDP estimate is 3.2%.)

Equities

Stocks fell into the 15th, but rose nicely today. Though other indices lagged earlier–month highs, the Nasdaq hit a new record today. Last week, the Dow Industrials fell after 8 straight weekly gains – losing 116.98 points or .50% to 23,422.21. It's .15% better this week. The S&P lost 5.54 points or .21% to 2,582.30, and is up .13% this week. The Nasdaq lost 13.50 points or .20% to 6,750.94, but is leading the way – up .63% this week. The Dow Transports lost 2.60% (for a 3rd weekly loss), but are .97% better this week. Bank stocks lost 4.45%, but are 1.52% higher this week.

Resistance:	Dow:	23,414/ 23,491/ 23,569/ 23,645	Nasdaq:	6,806/ 6,847/ 6,888/ 6,931	S&P:	2,583/ 2,590/ 2,596/ 2,602
Support:		23,339/ 23,263/ 23,187/ 23,111		6,765/ 6,723/ 6,683/ 6,643		2,577/ 2,571/ 2,565/ 2,559

Other Markets

Crude Oil rose 1.98% last week, but checked its advance over $58/barrel and just under the **BMR** targets. Crude is off 2.82% this week. Commodities rose 1.20%, but are 1.77% lower this week. Gold gained .39%, and is up another .31% this week. The U.S. Dollar lost .61% after 3 weekly gains, and is .45% lower this week. The Japanese Yen rose .47%, and is up .41% this week. The Euro gained .49%, and has surged .90% higher this week. Corn lost 1.36%, and is 2.04% lower this week. Cotton gained .48%, and is .23% better since Friday.

"Happiness makes up in height for what it lacks in length." Robert Frost

Additional Information is Available on Request

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