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Bond Market Review

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Beanie Babies, Bitcoins, and Berkshire

Which would you choose for your Christmas gift, if you could have only one? Due to almost–deliberate scarcity, shoppers would often pay 10 times the value to buy Beanie Babies as the tech–bubble exploded into the late '90s. For a while, sales of Beanie Babies accounted for nearly 10% of the total volume on E–Bay. Back in 1983, retailers passed out tickets for Cabbage Patch Dolls to escape riots and 'free for alls' – as customers stampeded the isles to grab one before the short supplies ran out (in the face of huge demand). And – that was to pay retail, unlike the lines and campers waiting outside the stores in recent times to buy heavily–discounted specials on Black Friday.

Despite what the Fed has deemed 'stubbornly low' inflation, one 'Bitcoin' has traded from just over $800 to over $19,000 in only a year. FRB Minnesota President Neel Kashkari said it's hard to know what information crypto–currencies are trading on, and what markets are betting on – other than just the price moves. He said: *"I don't really understand the fundamentals of it, to know how to even value it. I have no idea."* Most of us are in that boat. (After all, if Bitcoins are such a great investment, why not buy them on margin? Maybe that's next, but there have to be some limits somewhere!) Kashkari said: *"I think of it a little bit like Beanie Babies. If they were jumping in price by 1000 times, or $10,000 each, what would we make of Beanie Babies being priced where they are?"*

There are times to be invested, and times to be in cash. Nevertheless, you have to be 'in it to win it' – or you end up walking around the office marveling at huge price gains in things you don't own. The opposite is true as well. When people are low on cash, you can't take advantage of deals. There's a saying on the Mississippi. 'If they were selling steam boats for a dime apiece, all I could do is walk up and down the riverbank saying: 'Man, that's cheap!''

So, what's the answer? Berkshire Hathaway stock hit $300,000 this week, so barring any really insane move by Bitcoin, we'd take a share of Berkshire over Beanies and Bitcoins. (Unless Bitcoins rise another 24 times this next year – pushing them over $450,000 each.) The **B**ond **M**arket **R**eview sees most of us having to settle for a Beanie in the real world. Before Amazon and other online retailers became efficient, a parent often spent hours going to many different retailers in an attempt to find that one missing toy or game on the list. I know I did! There was some intrigue, and some adrenaline, but other than knowing you had your hands secured on that elusive pick – the 'new way' is certainly more time and fuel efficient!

Looking Ahead

- U.S. debt and equity markets will be closed on December 25th and January 1st.
- The next **BMR** will be issued in 2018. Merry Christmas and Happy New Year!

Treasuries, Agencies, and MBS

Is the Tax Bill a sign of the 'Age of Betrayal?' According to one Washington Post article, the passage marked 'a day of disgrace and dishonor.' We leave it to you to Google such vitriol – if you choose. The **BMR** thinks differently! While there's always one side that is set on completely destroying the politics of the other side, we think the finally–passed GOP tax bill could lead to something that's been missing for years – wage inflation! Dropping the corporate tax rate to 21% should allow companies more room to compete for, and reward employees – and could also lead to many additional jobs as companies repatriate. Chicago's Charles Evans said he dissented to the FOMC vote last week thinking a lower funds target would help inflation reach the Fed's goals sooner. Neel Kashkari said his dissent was motivated by low inflation, continued weakness in wages, and the flatness of the yield curve. He also said undue hikes could shorten the expansion, and questioned if the FOMC was treating 2% as a ceiling – instead of a target!

Debt markets will also observe a 2 p.m. ET early close on the Fridays preceding Christmas and New Year's (12/22 and 12/29). Though we don't expect the move right away, the breakout of rates to higher highs over the past week has given us a 2.73%–to–2.80% target for 10–year yields. The 10–year closed at 2.48% today, and there is short–term support near 2.52%. We expect rates to be lower from January 3rd into the 12th, and think there's (at least) one more opportunity for lower rates, refinancing, and hedging into a cyclic trough due near March 23rd.

Last Friday, the curve traded at its flattest level (2 to 10–year at 51.5 bps) since October 2007. The curve had flattened significantly with 2 and 5–year yields rising 4 and 1.5 bps, while 10 and 30–year rates fell by 2.5 and 8 bps. That seems so long ago now, as rates surged 4, 9, 13, and 15.5 bps higher this week for the 2, 5, 10, and 30–year Treasury sectors in 'breakout' fashion. Today, the 2–year hit the highest levels since September 2008, the 5–year to April 2011, and the 10–year (only) to earlier this year in March. MBS spreads (FNMA 30–year 3%) narrowed by 3 bps last week. Next week, the U.S. Treasury will auction $26 billion 2–year notes on Tuesday (12/26), $34 billion 5–year notes on Wednesday, and $28 billion 7–year notes on Thursday.

12/15/17 Treasury Yield Curve	**2-Year: 1.838%**	**5-Year: 2.155%**	**10-Year: 2.354%**	**30-Year: 2.688%**
Weekly Yield Change:	+.041%	+.014%	–.023%	–.081%
Support:	1.895/ 1.915/ 1.950/ 1.985	2.250/ 2.271/ 2.291/ 2.310	2.497/ 2.518/ 2.537/ 2.557	2.850/ 2.874/ 2.889/ 2.911%
Targets:	1.845/ 1.825/ 1.800/ 1.775	2.220/ 2.173/ 2.152/ 2.112	2.478/ 2.458/ 2.438/ 2.419	2.830/ 2.810/ 2.789/ 2.769%

Economics

GDP for Q3 2017 was revised down from 3.3% to a still–healthy 3.2% – remaining the fastest pace since 2015. The forecast for Q4, according to the latest Atlanta GDP–Now estimate is 3.3%, which could lead to the first time U.S. GDP would exceed 3% for 3 straight quarters since Q1 2006. Personal Consumption was revised a notch lower to 2.20% (from 2.30%), and the GDP Price Index remained at 2.10%. However, Core PCE was also revised lower from 1.40% to 1.30%. Initial Jobless Claims rose 20K to a 5–week high 245K (the biggest jump since the hurricanes). Continuing Claims rose from 1,889K to 1,932K. Bloomberg Consumer Comfort fell from 51.3 to 50.8 and their Economic Expectations survey dropped from 53 to 47. The Leading Index for November came in at .40% (compared to October's 1.20%). The Philadelphia Fed Business Outlook rose from 22.7 to 26.2, though Empire Manufacturing fell from 19.4 to 18, and the Chicago Fed National Activity Index fell from .76 to .15. Industrial Production slowed to a .20% rise in November (following October's 1.20% increase). Capacity Utilization rose .10% to 77.10%.

MBA Mortgage Applications fell by 4.90% last week, but Home Builder optimism rose from 69 to an 18–year high of 74 (NAHB Housing Market Index). The gauge of Current Sales was the highest since 1999, and Future Sales hit the best reading since 2005. Single–Family Housing Starts hit the best pace since September 2007. Overall starts rose 3.26% to a 1,297K annual pace and Building Permits fell 1.37% to 1,298K. November sales of Existing Homes rose 5.64% to a 5.81M pace – the highest in nearly 11 years. Median prices rose 5.8% and inventories fell to the second lowest level since records going back to 1999. The FHFA House Price Index rose .50% in October. Total foreign currency inflows totaled $151.2 billion in October, with $23.2 billion invested into longer–term U.S. securities.

Friday is set for November Personal Income & Spending, the PCE Deflator, Orders for Durable & Capital Goods, New Home Sales, Kansas City Fed Manufacturing, and the University of Michigan sentiment surveys. By the 26th, we'll know if we've been good – or not. Until the list comes out, you never know! On Tuesday, Metro Home Prices (S&P/CaseShiller 20–City) & Home Price Indexes, and Richmond and Dallas Manufacturing are due. Wednesday brings Consumer Confidence and Pending Home Sales. Thursday (12/28) is the last day of the year for most scheduled economic releases. Included are jobless claims data, Wholesale & Retail Inventories, Bloomberg Consumer Comfort, and Chicago Purchasing. Following the next Monday's New Years holiday, the December FOMC minutes are due on Wednesday and December payrolls on Friday. There will not be a **BMR** on Christmas week.

Equities

The equity cycles haven't performed for any high turns since the 'buy opportunity' in early July. Stocks, however, have not disappointed! Through today, the S&P was 10.91% higher for the year, and 25.47% better since Election Day 2016. Cyclic models don't perform as well when markets are in extended up or down moves. There continues to be positive energy from a trend–change date near December 28th, and we'll continue to update the data and projections. Today, bank stocks hit their highest levels since October 2007, and the NYSE and Dow Transports also rose to new highs. (London's FTSE index did as well – outpacing most globals.) Most other U.S. indices hit new highs on Monday. Last week, the Dow Industrials rose 322.58 points or 1.33% to 24,651.74. The Dow is .53% better this week. The S&P rose 24.31 points or .92% to 2,675.81, and is .33% higher this week. The Nasdaq gained 96.50 points or 1.41% to 6,936.58, and is .41% higher this week. Though the Dow Transports lost .09% last week after 3 solid gains, they are 2.28% higher this week. Bank stocks retreated .38% last week, but are 1.76% higher this week.

Resistance:	Dow:	24,853/ 25,010/ 25,169/ 25,328	Nasdaq:	6,993/ 7,020/ 7,041/ 7,062	S&P:	2,692/ 2,704/ 2,717/ 2,730
Support:		24,696/ 24,542/ 24,378/ 24,231		6,936/ 6,894/ 6,854/ 6,812		2,679/ 2,666/ 2,652/ 2,640

Other Markets

Crude Oil bottomed with our December 14th cycle, and should get a push from today's date for positive energy into January. Crude Oil lost .10% last week, but is 1.85% higher this week. Commodities lost .27%, but have gained 1.74% this week. Gold gained .73%, and added 1.04% into today. The U.S. Dollar gained .06% last week, but has tumbled 1.14% this week. The Japanese Yen rose .78%, but is since .65% lower. The Euro lost .20%, but is 1.06% better this week. Corn rose 2.21%, and is 1.08% higher this week. Cotton surged 2.98%, and is 2.66% higher since.

"The shortest route to getting things done is just do it." Takayuki Ikkaku

Additional Information is Available on Request

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