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BOND MARKET REVIEW

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Hostiles

You know things are bad when you see 'Hostiles' is set to open this week, and at least for a moment consider the setting could be next week's State of the Union address. Incoming economic data has been very good, and there's plenty to get at least one side of the room excitedly rising to their feet – with great frequency. However, the other side will sit on their hands as if it's their duty. Either way, at least the lights will be on because Congress managed to avoid a prolonged government shutdown – if only by kicking the can for a couple weeks. It's a shame, but the partisanship is unlikely to change. Lest millennials think this is a new phenomenon, it's not! Ask your grandfather!

The first estimates for Q4 2017 GDP growth are due Friday morning, and expected to be at or above 3%. As we said last week, if that happens, it would be the first time in 13 years GDP hit 3% for 3 consecutive quarters (since Q1 2005). So, how good a chance is there? The highly–respected Atlanta Fed GDP–Now forecast for Q4 2017 has been in the 3.3% to 3.4% range since the 12th of January – considering all incoming data over their last 5 reads. All data now considered, either 3.3% or 3.4% would be the strongest single quarter since Q3 2014. The International Monetary Fund projected global growth to be the fastest in 7 years – spurred by U.S. tax cuts and business investment.

Looking Ahead

- Equities have a trend–change high due near February 5th, and a low near February 9th.
- Interest rates have a trend–change low due near February 6th.
- President Trump's State of the Union is set for Tuesday night, January 30th at 9 p.m. ET.
- The FOMC will update their interest–rate policy stance on Wednesday, January 31st at 2 p.m. ET.

Treasuries, Agencies, and MBS

It's a foregone conclusion that the FOMC will hold rates steady this coming Wednesday. Due to that expected non–event and our travel schedule, the next **B**ond **M**arket **R**eview will be issued the week of February 5th. The market–based odds for a January hike have been near zero since the December hike and 2.3% as of today. With the Fed's intentions to continue gradual tightening, and nothing in their way given strong GDP growth and continued vitality in employment, the chances of a March hike have been very high since December – and closed at 94.5% today. Jerome Powell was confirmed by the U.S. Senate as the new Fed Chair this week by an 84–to–12 margin. While we thought Janet Yellen might be taking over the Fed at a precarious time, and former Fed Chairman Ben Bernanke stepped away at the right time, the markets and the economy held up nicely – leaving her a very–healthy legacy. In fact, Trump's numerous detractors are quick to give her any credit for last year's stock gains and economic growth. Yellen's term ends in February, and Powell is taking over the reins when everything is almost 'too' good.

With 2–year yields rising over 2% the previous week, we noted that there was a 2% 'handle' on Treasury rates from 2 to 30–years. Last week, yields shot higher, with the 2, 5, 10, and 30–year Treasury sectors climbing 6.5, 10.5, 11, and 8.5 bps. The 30–year approached 3% this week, but with good auctions, the curve flattened and longer rate eased. Into today, yields rose 2 bps at 2–years, but fell 3, 4, and 5 bps at 5, 10, and 30–years. 2–year yields hit their highest levels today since September 2008, 5–year yields stretched back to their highest since May 2010, and 10–year yields rose to their highest levels since July 2014. Meanwhile, 30–year yields were close to, but still hovering below, last October's highs. Inasmuch as everyone wants to join in on the bear–market bandwagon for bonds, the 30–year still needs to break through the June 2015 highs (of 3.255%) to signal a possible turn. To put things in perspective, we're talking about whether or not bonds are in a bear market – with 30–year U.S. debt still yielding less than 3%!

MBS spreads (FNMA 30–year 3%) narrowed 2 bps for a second week. On Tuesday, the U.S. Treasury sold $26 billion 2–year notes at 2.066%. That was the highest auction yield since September 2008, and demand was the best since the September 2015 offering. The group that includes foreign central banks bought 58.3% of the issue versus only 40% in December. Wednesday's $34 billion in 5–year notes brought 2.434%. The yield was the highest since April 2010, and demand was the best since last September. Foreign buying rose from 58.4% last month to 65% of this issue. Today's 7–year note sold for 2.565% for $28 billion in supply. The yield was the highest since April 2011, and demand improved to the December auction. Foreign buyers took a huge 78.1% versus 60.5% in December. The U.S. Treasury will auction 3–year notes on February 6th, 10–year notes on the 7th, and 30–year bonds on the 8th.

01/19/18 Treasury Yield Curve	2-Year: 2.067%	5-Year: 2.450%	10-Year: 2.660%	30-Year: 2.943%
Weekly Yield Change:	+.067%	+.103%	+.112%	+.085%
Support:	2.125/ 2.155/ 2.190/ 2.220	2.473/ 2.513/ 2.553/ 2.593	2.686/ 2.726/ 2.766/ 2.806	2.943/ 2.987/ 3.033/ 3.079%
Targets:	2.085/ 2.065/ 2.045/ 2.010	2.428/ 2.394/ 2.354/ 2.313	2.615/ 2.570/ 2.528/ 2.487	2.880/ 2.818/ 2.778/ 2.738%

Economics

Initial Jobless Claims rose by 17K, but that was from a revised 4K–lower level of 216K – the least in nearly 45 years. Continuing Claims fell from 1,965K to 1,937K. Bloomberg Consumer Comfort fell a tenth of a point to 53.7, just under last week's high of nearly 17 years. The preliminary University of Michigan sentiment survey fell from 95.9 to a 6–month low 94.4. Their read on Current Conditions dropped from 113.8 to 109.2 (the lowest since November 2016). However, Expectations moved higher – from 84.3 to 84.8. The Leading Index (December LEI) rose .60%. The Chicago Fed National Activity Index rose from .11 to .27 and Kansas City Fed Manufacturing Activity was 2 points higher to 16. Richmond dropped 6 points to 14. The FHFA House Price Index rose .40%. Existing Home Sales fell in December for the first time in 4 months. The 3.63% decline to 5.57M units was attributed to record low inventories and rising prices (up 5.8% annually). New Home Sales dropped the most since August 2016, falling by 9.29% to 625K annual units – but 2017 was still the best year since 2007. Prices were 2.6% higher versus last year.

Friday is set for December's Advance Goods Trade Balance, Wholesale & Retail Inventories, the first estimate of Q4–2017 GDP, Personal Consumption, and orders for Durable and Capital Goods. Next Monday (01/29) brings Personal Income & Spending, the PCE Deflator (the Fed's favorite inflation gauge), and Dallas Fed Manufacturing Activity. Tuesday is set for S&P Case–Shiller's Home Price Index and metro (20–city) price data, the Board Consumer Confidence surveys, and President Trump's State of the Union address. Wednesday winds up January trading with MBA Mortgage Applications (which rose 4.50% last week), the Q4 Employment Cost Index, a first look into next Friday's January payrolls from ADP Employment Change, the Chicago Purchasing Managers report, December Pending Home Sales, and the FOMC interest rate policy statement.

Thursday kicks off February with 3 more clues into January payrolls from Challenger Job Cuts, jobless claims data, and ISM Employment. Also due are Q4 Nonfarm Productivity & Unit Labor Costs, Bloomberg Consumer Comfort, December Construction Spending, ISM Manufacturing data, and Vehicle Sales for January. Friday gives us January payrolls rather early in the month. Data includes the pickup in jobs, the Unemployment Rate, Labor Force Participation, Earnings Rates, and Average Weekly Hours. Also due are December Factory Orders, updates on Durable and Capital Goods Orders, and the University of Michigan sentiment surveys. The following Monday (02/05) gives us the service–sector outlook, and the next **BMR** will focus on the FOMC meeting and January payrolls.

Equities

Onward and upward. The Dow Industrials rose to a new record high today, while most U.S. indices rose to new highs yesterday – but failed to follow the Dow. The Nasdaq hit a new high on Wednesday but has closed lower for the last two sessions. Stocks and yields are climbing a 45–degree ramp on their charts – with few bumps in the road. The Dow followed its back–to–back 500–plus point weeks with a 268.53 point or 1.04% gain to 26,071.72. It's again higher this week – by 1.23%. The S&P rose 24.06 points or .86% to 2,810.30 and is 1.03% better since Friday. The Nasdaq gained 1.04% along with the Dow last week, rising 75.32 points to 7,336.38. Despite closing lower for the last 2 sessions, the Nasdaq is still up 1.02% for the week. Conversely, the Dow Transports lost .60%, and are 2.63% lower this week. Bank stocks rose .96%, and are working on a 4th up week – rising 1.26% into today.

Resistance:	Dow:	26,477/ 26,640/ 26,803/ 26,969	Nasdaq:	7,503/ 7,546/ 7,589/ 7,633	S&P:	2,861/ 2,887/ 2,914/ 2,941
Support:		26,303/ 26,153/ 25,987/ 25,826		7,418/ 7,379/ 7,333/ 7,289		2,834/ 2,808/ 2,781/ 2,755

Other Markets

Crude Oil had a setback last week, dropping 1.45%, but continues to climb as well – rising 3.38% this week to $65.51 per barrel. Commodities lost .28%, but are also higher by 1.97%. In the same contra–Dollar boat, Gold fell .13%, but is 2.24% higher this week. The U.S. Dollar dropped for a 5th week, losing .40%, and is again lower by 1.26% this week. Other economies don't like the U.S. tax cuts, and the selloff in bonds has also hurt the Dollar. However, the European Central Bank left rates unchanged and ECB President Mario Draghi seemed reluctant to end QE measures just yet. The Euro is the strongest it's been since December 2014, and the additional purchasing power is once again driving prices lower – just what they don't want, another inflation battle. While the Fed's rate hikes would normally make the Dollar more attractive, there are other forces at work. The 'cheaper' Dollar could actually improve investment in the U.S. and make our goods more attractive (increasing exports). The Euro gained .16% last week, and has surged 1.42% higher this week – working on a 6th gain. The Japanese Yen rose .26%, and is 1.23% better this week. Corn gained 1.81%, and is up another .78% this week. Cotton gained 2.13%, but is 1.85% lower this week.

"Life isn't about whether your glass is half full or half empty; it's about filling it up! Samuel Adams (commercial)

Additional Information is Available on Request

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