Jumanji

It's a jungle out there. Bears and Bulls. Hawks and Doves. Dogs and Roosters. Elephants and Donkeys. And …. Groundhogs? (Oh, my!) The soothsaying weather–predicting groundhog, Punxsutawney Phil, emerged from his burrow on February 2nd and on seeing his shadow forecasted 6 more weeks of market turmoil – or was it winter? He reportedly also said: 'Dilly, Dilly!' Not to be outdone, Staten Island Chuck, another groundhog from New York, forecast an early spring. Apparently, it's now fashionable for the opposition party to release its own dissenting memo!

What about those bulls and bears? The bears had been in hibernation since the end of June 2016, but woke up with a vengeance. St. Louis FRB President James Bullard said: *"This is the most predicted selloff of all time because the markets have been up so much and they have had so many days in a row without meaningful down days."* Predicted? Yes. Predictable? Not so much. Our timing using cycles has been very good over the years, and at times uncanny. However, the unchecked advance left our cycles in the dust, and like Austin Powers – they lost their mojo. We expect the cyclicity of their efficacy and effectiveness to return. We've been talking about stock market optimism being the highest in decades and a clear warning sign. In the **BMR (05/10/17)**, we noted that the market's fear indicator was at a 23–year low. If one had used that condition to short the market, they would have been 5,763 Dow points too early! On October 30th, we noted equity bullishness at a 30–year high. That was another warning for an imminent correction, but likewise 2,405 Dow points too early. In only 7 trading sessions, the Dow Industrials removed all their gains since November 28th. Though rebounding over 1,110 points to Tuesday's low, the Dow had plunged 2,837 points since its high on January 26th. Before that 10.66% drop, the S&P (which dropped 9.74%) had not corrected more than 3% since March, and not over 4% since the 2016 election. They say records are meant to be broken. Into February 5th, the S&P traded for a record–404 trading sessions without correcting by at least 5%. That broke previous records from 1965 (386 sessions) and 1996 (394 sessions).

What of hawks and doves? As expected, the FOMC left rates unchanged on January 31st, but ramped up their price forecast. They said: *"Inflation on a 12–month basis is expected to move up this year and to stabilize around the Committee's 2% objective over the medium term."* The previous language expected inflation *"to remain somewhat below 2% in the near term …"* They said economic conditions *"will evolve in a manner that will warrant further gradual increases in the federal funds rate"* – adding the word *"further",* which made the statement sound a bit more hawkish. As would be expected for a final meeting with an outgoing Chair, the vote with Janet Yellen on the statement was unanimous. After stepping down, Yellen revealed she was *"disappointed not to be reappointed."* Jerome Powell was sworn in as the new Fed chief on Monday (02/05). He pledged to support *"continued economic growth, a healthy job market, and price stability."* Just last week, articles noted Powell was taking over as stocks worldwide were soaring and commodity prices were lifting emerging markets! Not so fast …

Looking Ahead

- Equities have a low due near February 9th/12th, but the cycles are mixed. A high is due around March 6th.
- Interest rates should make a low around February 23rd.
- Valentine's Day is next Wednesday. That's one not to forget.

A few FOMC members commented that the rollercoaster in stocks didn't change their outlook. We view that as puzzling. Last Friday's 665.75–point plunge was the 6th largest in Dow history. It became the 7th, as the Dow lost a record 1,175.21 points on Monday. Nevertheless, Monday's 4.60% loss isn't even in the top 20 of one–day drops given the Dow at a much–loftier level. On October 19th, 1987, the Dow crashed 22.61%. That would have taken over 5,700 points to match given current levels. Still, it would be more prudent to acknowledge the global selloff and at least say it merits monitoring with other incoming data. One of our favorite FOMC members is FRB Minneapolis' Neel Kashkari. On Friday, it was announced that hourly earnings rose by an annual 2.90% rate – the best pace since June 2009. Kashkari said *"we saw a little hint that wages might finally be rising"*, but added *"it could be a blip, but let's not ignore it."* Likewise, we would warn that the stock drop could be a 'blimp', a dirigible not to be ignored.

Last year was the Chinese Year of the Fire Rooster, and global stocks had plenty to crow about. Next Friday ushers in the year of the Earth Dog, which stocks might term 'Mud Dog' so far. As for those Elephants and Donkeys, they're firing off memos and trying to avoid a government shutdown. Considering nothing but a lack of evidence, if the selloff in stocks deepens, it's surely because of a Russian bear! In a move to signal peace, North Korea's Kim Jong Un is sending his sister Kim Yo Jong to the Olympic games in PyeongChang, South Korea. That should be a positive sign – unless he doesn't like his sister! The opening ceremony is Friday night (6 a.m. ET in the U.S.).

Treasuries, Agencies, and MBS

Despite falling equities, bonds lost ground as well. Since the last **B**ond **M**arket **R**eview, 2–year yields hit the highest levels (2.186%) since September 2008, 5–year yields rose to 2.62% (the highest since April 2010), 10–year yields hit 2.86% (the highest since January 2014), and 30–year bonds broke through and held above 3% – hitting 3.12%, the highest since last March (2017). Our technical levels to turn the trend for bonds to neutral are 3.04% for the 10–year note and 3.255% for the 30–year bond. However, we would note that similar breakouts occurred in 2013, only to have yields turn again to new lows. The curve flattened a bit into January 26th. Yields were 5 bps higher at 2–years and 2 bps higher at 5–years. Yields were flat at 10–years, and 2 bps lower at 30–years. Last week, yields ran higher as the FOMC came off as more hawkish with *"further"* gradual rate increases on the way. The curve steepened with yields rising 2.5, 12, 18, and 17.5 bps for the 2, 5, 10, and 30–year Treasury sectors.

At 71 bps, the 2–to–10–year curve is now the widest since November 13, but still the most–narrow since November 2007. Jan 4th marked the least narrow curve in this cycle – since October 2007 (at 50 bps). MBS spreads (FNMA 30–year 3%) widened 1 bps into January 26th, and then narrowed 2 bps last week. On Tuesday, the U.S. Treasury auctioned $26 billion 3–year notes at 2.28%. That was the highest yield since the May 2007 offering, and demand was the lowest since this past November. The group that includes foreign central banks accounted for 49.8% of the issue versus 54.9% in January. Today's 10–year note auction brought 2.811% for $24 billion in supply. The yield was the highest since the January 2014 offering, and demand weakened versus last month. Foreign buying fell from 71.4% last month to 67.5% of this auction. On Thursday (02/08), the Treasury will auction $16 billion 30–year bonds.

02/02/18 Treasury Yield Curve	**2-Year: 2.143%**	**5-Year: 2.589%**	**10-Year: 2.842%**	**30-Year: 3.087%**
Weekly Yield Change:	+.025%	+.118%	+.181%	+.175%

01/26/18 Treasury Yield Curve	**2-Year: 2.118%**	**5-Year: 2.471%**	**10-Year: 2.661%**	**30-Year: 2.912%**
Weekly Yield Change:	+.051%	+.021%	+.001%	–.022%
Support:	2.151/ 2.186/ 2.220/ 2.256	2.586/ 2.619/ 2.661/ 2.702	2.845/ 2.864/ 2.884/ 2.905	3.167/ 3.212/ 3.257/ 3.301%
Targets:	2.082/ 2.046/ 2.010/ 1.975	2.546/ 2.507/ 2.465/ 2.427	2.805/ 2.786/ 2.766/ 2.744	3.078/ 3.033/ 2.988/ 2.944%

Economics

Coming into the January payroll release, jobs data continued to be solid. Initial Jobless Claims fell 1K to 230K, but was still hovering just above 45–year lows. Continuing Claims rose 13K to 1,953K. The ADP Employment Change release beat expectations of 185K with 234K private sector jobs added. Challenger Job Cuts revealed 2.80% less 'cuts' versus January 2017. The ISM Employment number cooled from 58.1 to 54.2, but the data was better as Nonfarm Payrolls rose 200K versus 180K expected, and 12K were added to December – upping that total to 160K. Private Payrolls rose 196K (15K better than expected) and 20K were added to December, raising the total to 166K. Manufacturing added 15K jobs, and December's gain was revised 4K lower to 21K. The Unemployment Rate remained at 4.10%, though the Underemployment Rate rose .10% to 8.20%. Though Average Weekly Hours fell from 34.5 to 34.3, Hourly Earnings rose .30% – and the annual pace quickened from 2.70% to a respectable 2.90%, the most since June 2009. Reinforcing that data, the Employment Cost Index for the 4th quarter increased by .60%. (That data tightened the Fed's case for hiking rates – contributing to selling in equities.) The Labor Force Participation Rate remained at 62.70%. The number of outstanding jobs remained plentiful in December, but did fall from 5.978M to a 7–month low 5.811M. The service–sector outlook expanded by 59.9 versus 56 in December. That was the best outlook in a decade.

Real Personal Spending rose .30% in December. Personal Income rose .40%, as did Personal Spending – leaving little for savings. The savings rate fell to 2.4%, which was the lowest since September 2005 – when we were all buying homes we couldn't afford with little down payment and very low or no documentation and stated income. Confirming the spending spree, the Merchandise Trade Deficit rose to the highest level since 2008 (at $71.6 billion). Likewise, the December Trade Balance deficit was also the most since 2008 – increasing from $50.4 billion to $53.1 billion as optimistic retailers stocked their shelves with imported goods. In December, Consumer Credit dropped to $18.447 billion from a huge $31.019 billion in November as Americans bought early and often – on credit!

Nonfarm Productivity fell .10% in the 4th quarter. That was the first drop since early 2016, and Unit Labor Costs rose 2.00%. Though expected above 3%, Q4 GDP rose only 2.60%. We wouldn't be surprised to see some upward revision. Personal Consumption rose a strong 3.80%, and the GDP Price Index rose 2.40%. The core rate for Personal Consumption Expenditures was 1.90%. The Atlanta Fed GDP–Now forecast for Q1 2018 had risen to 5.4% on manufacturing data, but fell back to 4.0% on auto sales and recent data.

Domestic Vehicle Sales cooled from 13.72M to a 13.10M annual pace in January. Total sales slumped from 17.76M to 17.07M. The consumer confidence numbers were very good, but they are mostly from surveys taken before stocks sold off. Bloomberg Consumer Comfort rose from 53.7 to 54.6 – the highest reading since March 2001. Conference Board Consumer Confidence rose from 123.1 to 125.4, near 17–year highs. The Present Situation (conditions) fell from 156.5 to 155.3, and Expectations improved from 100.8 to 105.5. University of Michigan Sentiment eased from 95.9 to 95.7. Current Conditions dropped from 113.8 to 110.5. Expectations improved from 84.3 to 86.3.

ISM Manufacturing dropped from 59.3 to 59.1, but was still near the best pace since 2004. Prices Paid rose 72.7 versus 68.3 in December. ISM New Orders fell from 67.4 (the highest level in nearly 14 years) to 65.4. Wholesale and Retail Inventories each grew by .20% in December. Dallas Fed Manufacturing Activity rose from 29.7 to 33.4, though Chicago Purchasing Managers eased from 67.8 to 65.7. December Construction Spending rose by .70%. Orders for Durable Goods increased the most in 6 months with a 2.80% rise following November's 1.70% advance. Ex transportation, orders rose .70%. Capital Goods Orders fell .60%. Factory Orders rose 1.70% in December, beating expectations by .20%. November data was revised .40% higher to 1.70% as well. Ex transportation, orders rose .70% (and were revised .30% higher to 1.10% for November).

Pending Home Sales rose .50% in December, for a third increase. Metro Home Prices (S&P Case–Shiller 20–city index) rose .75% in November, quickening the annual pace of increase from 6.32% to 6.41%. The national house price index increased from 6.10% to 6.21%.

Thursday is set for jobless claims data and Bloomberg Consumer Comfort. Q4 data for MBA Mortgage Foreclosures and Mortgage Delinquencies is due this week. Friday brings Wholesale Inventories & Trade Sales. Next Monday is set for January's Monthly Budget Statement. Tuesday gives us NFIB Small Business Optimism. Wednesday brings MBA Mortgage Applications (which fell 2.60% and then rose .70% for the past 2 weeks), Consumer Prices (January CPI), Retail Sales, earnings data, Business Inventories (for December), and time with your Valentine.

Equities

What a difference a couple weeks can make! Over the past year and a half, most of the time we've reported new highs on the day of each **BMR**, or within a few days. Actually, most U.S. indexes made new record highs on January 26th – the day after the last **BMR**. That parade didn't last as long, and within 7 trading days the gains since November were gone – if only for a few hours. The Dow gained 1,430.17 in January, but tumbled 2,838 points in 7 trading sessions before rebounding 1,114 points. It lost 10.66% off its record high, but closed today off a lesser 6.47% to that mark. Global stocks followed suit, but lost longer–term gains – as they hadn't run pari passu to the upside with U.S. markets. For example, despite new highs in January, the Japanese Nikkei dropped to October 2017 levels, French and German stocks sank to early–September lows, and U.K. stocks fell all the way back to December 2016 levels.

The Dow Industrials gained 544.99 points or 2.09% into January 26th, but lost 1,095.75 points or 4.12% to 25,520.96 last week. Though much lower this week (as much as 6.83%), they were off a lesser 2.46% into today. The S&P gained 2.23%, lost 3.85%, and ended today off 2.91% for the week. The Nasdaq gained 2.31%, lost 3.53%, and is 2.61% lower so far this week. The Dow Transports fell 1.59% and 3.94%, and are down 1.18% this week – which would be a 4th loss. Bank stocks rose 1.99%, fell 1.74%, and are 2.97% lower this week.

Resistance:	Dow:	24,722/ 25,037/ 25,288/ 25,675	Nasdaq:	6,993/ 7,078/ 7,161/ 7,247	S&P:	2,649/ 2,675/ 2,702/ 2,727
Support:		24,099/ 23,790/ 23,481/ 23,176		6,828/ 6,747/ 6,664/ 6,581		2,598/ 2,573/ 2,548/ 2,523

Other Markets

Commodities are following other markets. They were 2.57% higher into January 26th, 1.08% lower last week, and down another 3.03% into today. Crude Oil rose 4.37%, lost 1.04%, and then dropped 5.59% this week. Gold rose 1.43%, fell 1.36%, and is 1.66% lower since Friday. The U.S. Dollar lost 1.64%, gained .16% last week, and is ahead by 1.22% this week. The Japanese Yen surged 1.98%, lost 1.46%, and then rose .76% into today. The Euro gained 1.68%, added .29% last week, and then fell 1.60% into today. Corn broke the chain, gaining 1.13% and 1.40%, and then adding 1.04% this week. Cotton ran the other way, losing 3.52% and 3.95%, and another 1.73% this week.

"98% of the adults in this country are decent, hard–working, honest Americans. It's the other lousy 2% that get all the publicity. But then – we elected them!" Lily Tomlin

Additional Information is Available on Request

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