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Bond Market Review

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Year of the Dog

The Chinese New Year begins on February 16th, exiting the year of the Fire Rooster – which was very kind to stocks until the very end. As we enter the year of the Earth Dog, will it be a 'bulldog' year, and if so – does it have legs? That's hard to picture! Or, is the Year of the Dog arriving near the end of a 'dead cat bounce'? Before the rally this week, it appeared equities were participating in the Olympic downhill. Are they now on the 'lift' up to the Super–G? A number of factors are coming to the forefront even as stocks are rebounding off their precipitous drop. Interest rates are rising, and markets are weighing interest–rate derivatives estimated over $540 trillion. Global GDP is roughly $75 trillion. Couple those concerns with the first real pullback in 2 years against overwhelming bullishness, super–low volatility that led to short ETFs 'blowing up' as the market turned, record consumer debt ($13.1 trillion) and the unexpected market drop when global investors were thinking 'peace and safety'. The Q1 Atlanta GDP Now forecast had risen to 5.4% on early data, but fell to 3.2% on weaker retail sales and higher consumer prices.

Looking Ahead

- Equities have downward pressure from February 28th into March 8th, but the cycles are still mixed.
- Interest rates should make a low around February 23rd to the 27th.
- The equity and bond markets will be closed Monday for Presidents Day (02/19).

Treasuries, Agencies, and MBS

Throughout 2017, the **B**ond **M**arket **R**eview led off most issues with stocks making higher and record highs. Though bond yields are far from lofty highs being still relatively and historically low, most Treasury sectors saw yields press to their highest levels in years. It even happened against the backdrop of stocks entering their first correction in 2 years! Today the 2–year rose to 2.21%, the highest since September 2008. The 5–year note reached 2.66%, its highest level since April 2010 – and the 10–year note traded over 2.92% for the first time since January 2014. The 30–year bond traded just under 3.18% on Wednesday, though still just below the post–election high of 3.20%. Yields are closing in on important chart levels as well. As we said last week: *"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."*

That repeated, the market–based odds for a FOMC hike announcement this coming March 21 fell from over 92% to 77% last week, as stocks were enduring their worst week in 2 years (and for a time in 9 years). With many Fed members confirming their stance on the continuation of raising rates at a gradual pace, despite the rout in stocks, the probabilities for a March hike locked in at 100% this week. As he was sworn in on Tuesday, newly installed Fed Chair Jerome Powell said: *"We are in the process of gradually normalizing both interest–rate policy and our balance sheet."* Recognizing the equity selloff without stating any concern, he allowed: *"We will remain alert to any developing risks to financial stability."* Powell said he respects and considers the opinions of those that question FOMC policy. He said: *"There is great value in having thoughtful, well–informed critics."*

Last week, the curve steepened with yields twisting around the 7–year sector. 2 and 5–year yields fell by 7 and 4.5 bps, while yields were 1 and 7.5 bps higher at 10 and 30–years. Into today, the curve flattened with yields rising 11, 11, 6, and 1 bps for the 2, 5, 10, and 30–year sectors. Though back to 72 bps today, on Monday the 2 to 10–year spread rose to 78 bps, its widest reading since the end of October. [Jan 4th marked the least narrow curve in this cycle – since October 2007 (at 50 bps).] Last week, MBS spreads (FNMA 30–year 3%) widened 2 bps.

December saw a $119.3 billion outflow of foreign investments, though longer–term Treasury holdings increased by $27.3 billion. China increased Treasury holdings in 2017 by $126.5 billion – the most since 2010. China is the #1 foreign holder of U.S. debt at $1.18 trillion, while Japan is #2 at $1.06 trillion – though reducing holdings recently. The Treasury had a $49.2 billion surplus in January, but the fiscal gap for the first 4 months rose 11% versus last year (to its widest level since 2013). Last Thursday (02/08), the U.S. Treasury sold $16 billion 30–year bonds at 3.121% – the highest auction yield since last March. Demand fell versus the January offering, and the group that includes foreign central banks accounted for 61.2% of the issue versus 71.5% in January. Bond trading will be closed for Presidents Day this Monday (02/19), and the Treasury will subsequently auction $28 billion 2–year notes on Tuesday (02/20), $35 billion 5–year notes on Wednesday (02/21), and $29 billion 7–year notes on Thursday (02/22).

02/09/18 Treasury Yield Curve	**2-Year: 2.075%**	**5-Year: 2.544%**	**10-Year: 2.852%**	**30-Year: 3.160%**
Weekly Yield Change:	–.068%	–.045%	+.010%	+.073%
Support:	2.204/ 2.221/ 2.257/ 2.297	2.628/ 2.645/ 2.665/ 2.685	2.884/ 2.905/ 2.926/ 2.951	3.132/ 3.144/ 3.155/ 3.167%
Targets:	2.152/ 2.117/ 2.082/ 2.046	2.605/ 2.585/ 2.565/ 2.545	2.844/ 2.824/ 2.805/ 2.789	3.111/ 3.100/ 3.089/ 3.078%

Economics

Initial Jobless Claims fell 7K to 223K last week, just off 45–year lows – while the 4–week average of 224,500 was the lowest since 1973. They rose modestly to 230K this week. Continuing Claims (which lag a week) fell from 1,956K to 1,927K, and then rose to 1,942K. Bloomberg Consumer Comfort shrugged off the drop in stocks and fell only .2 to 54.4 last week – just below the previous week's highest level since 2001 (54.6). Consumers remained optimistic this week as the index rose from 54.4 to 57 – the best reading since February 2001. That was also the largest upmove since 2009. The buying climate was the best since December 2000. NFIB Small Business Optimism rose from 104.9 to 106.9 – very close to November's high of 107.5 that was the best since data going back to 1986. Empire Manufacturing pulled back from 17.7 to 13.1, but the Philadelphia Fed Business Outlook rose from 22.2 to 25.8. Industrial Production declined by .10% for its first drop in 5 months. December's .90% pickup was revised down to .40%. Capacity Utilization was revised .20% lower to 77.70%, and then dropped to 77.50%.

Retail Sales were revised from a .40% gain in December to flat! In January, sales fell .30% – the most since February 2017. Auto dealers saw a 1.3% drop, the largest since August 2017. Ex autos, sales were flat. Average Weekly Earnings rose .40%, and Hourly Earnings rose .80%. With apparel prices rising the most in 30 years, Consumer Prices rose .50% in January. The annual pace remained at 2.10%. Ex food & energy, CPI rose .30% – with the annual core pace also unchanged at 1.80%. Producer Prices rose .40%, increasing the annual pace .10% to 2.70%. Core PPI rose .40% as well, though the annual pace dropped from 2.30% to 2.20%. December Wholesale Inventories rose .40%, and Trade Sales rose 1.20%. Business Inventories also rose .40%. Home Builder confidence (NAHB) remained at 72 in February. Their 6–month sales outlook rose to the highest since 2005. Q4 2017 Mortgage Delinquencies rose from 4.88% to 5.17%. Foreclosures fell from 1.23% to 1.19%. MBA Mortgage Applications fell 4.10% last week.

Friday is set for January Import Prices, Housing Starts, Building Permits, and the University of Michigan sentiment surveys. The markets will be closed on Monday for Presidents Day. Next Wednesday (02/21) brings MBA Mortgage Applications, Existing Home Sales, and the FOMC minutes from their meeting concluded on January 31st.

Equities

Last week, we said: *"What a difference a couple weeks can make!"* That's easily repeatable as stocks rallied last Friday to avoid their worst week in 9 years, but still had their worst drop in 2 years. The Dow had been off as much as 8.47% – which would have been the most since the weekly drops of 7.34% and 18.15% during the first 2 weeks of October 2008. Last week included the top two losses in points for the Dow – as Monday saw a 1,175–point drop and Thursday's loss was 1,033 points. Those displaced the previous Friday's 665.75–point loss from #6 to #8. However, even with 3 of the top–10 losses coming over the past 2 weeks, none are in the top 20 from a percentage standpoint – as the Dow sits near 25,000. Counting just the larger swings, the Dow has traversed over 12,000 points in February alone. The 3,256–point Dow drop from January 26th into February 9th has been followed with an 1,843–point rally through today. Stocks will be closed on Monday (02/19) for Washington's birthday (Presidents Day).

Last week, the Dow lost 1,330.06 points or 5.21% to 24,190.90 in its largest drop since early 2016. The 12.23% drop since January 26th put the Dow in a correction for the first time in 2 years. (A correction is usually defined by a counter move of at least 10%, where a 'bear market' is at least a 20% downturn.) The Dow is 4.17% better this week, up 1,009.47 points! The Nasdaq lost 5.06% to 6,874.49, but is up 5.56% this week. The S&P lost 5.16% to 2,619.55, but is 4.26% better this week. The Dow Transports were down for a 4th week, dropping 5.15%, but have traded 4.14% higher this week. Bank stocks lost 5.43%, but have rallied 5.05% this week.

Resistance:	Dow:	25,432/ 25,593/ 25,751/ 25,914	Nasdaq:	7,319/ 7,363/ 7,405/ 7,448	S&P:	2,753/ 2,778/ 2,805/ 2,832
Support:		25,114/ 24,956/ 24,798/ 24,640		7,234/ 7,191/ 7,148/ 7,106		2,727/ 2,701/ 2,675/ 2,649

Other Markets

Our Crude Oil cycles show upward movement from February 23rd. In a volatile week for many markets, Crude Oil lost 9.55% last week. It's 3.61% higher this week. Commodities lost 4.96%, but are 2.62% better this week. Gold lost 1.54%, but is 2.97% higher this week. The U.S. Dollar gained 1.46%, but is 2.02% lower this week. The Euro had lost 1.69%, but countered with a 2.07% gain into today. The Japanese Yen rose 1.24%, and added 2.45% this week. Corn gained .14%, and is 1.59% higher this week. Cotton lost .80%, and is 1.66% lower this week.

"We play the hands of cards life gives us. And the worst hands can make us the best players." Doc Searls

Additional Information is Available on Request

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