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BOND MARKET REVIEW

February 26, 2018

How Much Farther is Further?

There comes a time when you can no longer dunk a basketball, run a long race, hit a home run, or drive a golf ball 300 yards. However, those things don't even compare to the limited population that can perform a skating triple axel or lutz. (I felt like a triple 'klutz' running hurdles.) Snowboard halfpipe moves such as a backside triple cork 1,440 leave us in awe. Unlike in a rink, they could also fall dozens of feet! Thank goodness for curling! It's the one thing, other than sitting in the back of a bobsled, that most off us at least ponder: 'I could do that…' The U.S. had never won gold in Olympic Curling or Cross–Country Skiing, but ended that drought this past week. Those were long shots.

However, the market–based odds for Fed hike on March 21st have been 'stuck' on 100% for weeks now. Bond yields spiked into last Wednesday (02/21) as the FOMC released the minutes from their January meeting. The minutes were initially interpreted as being even a little more hawkish than the January policy statement. When the FOMC changed their text to read *"further gradual adjustments in the stance of monetary policy"*, it sounded like further meant faster and more down the road. They liked the word and said they expected that *"economic conditions will evolve in such a manner that will warrant further gradual increases in the federal funds rate."* What about the minutes? The word 'further' was used 26 times in the minutes, so it's a new favorite along with 'gradual'. It's clear to the **BMR**. Further means more, and March is 'in the books'. We continue to favor FRB Minneapolis President Neel Kashkari. He said: *"I think 'further' is intended to say continuing on the current path we're on."* That sounds most reasonable, and he's an insider. Most Fed members seem to be considering 3 or 4 hikes for 2018. Philly's Harker says 2! San Francisco's John Williams said: *"It makes sense to think about 3 or 4 rate increases in 2018."* With the March meeting only about 3 weeks away, and the aforementioned market odds, we though it a little humorous that Williams said: *"We should be moving ahead with a rate increase relatively soon, in the near future."* Why not just say March?

Looking Ahead

- Equities have downward pressure from February 28th and March 6th, and a larger low due March 23rd.
- Interest rates should make downturns from March 2nd and March 14th, with an important low near the 23rd.

St. Louis' John Bullard said *"everything would need to go perfectly"* for 4 hikes. That certainly added a little dovishness to the mix, but things are improving! Friday, the Fed reported: *"The labor market in early 2018 appears to be near or a little beyond full employment."* The glass is not half full or half empty – it runneth over! In Tokyo, Fed Governor Randal Quarles was also upbeat, saying: *"The U.S. economy appears to be performing very well and, certainly, is in the best shape that it has been in since the crisis and, by many metrics, since well before the crisis."*

Treasuries, Agencies, and MBS

As the **B**ond **M**arket **R**eview observed, while we had been accustomed to stocks hitting higher highs each week, bond yields are now leading the way to their highest levels in years. Last Wednesday (02/21), 2–year yields hit 2.28% for the first time since September 2008, and 5–year yields hit 2.68% for the first time since April 2010. 10–year notes rose to 2.94% for the first time since January 2014 – closing in on critical support at 3.04%. 30–year bonds hit 3.22%, finally breaking through the 2016 highs to the highest levels since July 2015. They are very close to their critical support of 3.255%. Breaking those levels would turn the charts neutral, but bonds are oversold so we may see another break to lower yields before a larger move to the upside. The channel target for a greater 10–year move would be 4.15% into early 2021, so we don't foresee one of those dreaded up 300 bps moves even in a bearish scenario.

The U.S. Treasury curve flattened into February 16th, as yields rose 11.5, 8.5, and 2.5 bps at 2, 5, and 10–years, but dropped 3 bps at 30–years. Yields were mixed this past week. The 2 and 30–year rose 5 and 2.5 bps, while the 5 and 10–year sectors dropped 1 bps. The small drop in 10–year yields did snap a 7–week streak of higher moves with a rise of 47 bps. Yields fell by 1.5, 1, .5, and .5 for the 2, 5, 10, and 30–year sectors to begin this week.

MBS spreads (FNMA 30–year 3%) narrowed by 2 bps into February 16th, and then another 1 bps last week. Last Tuesday (02/20), the U.S. Treasury sold $28 billion 2–year notes at 2.255%. That was the highest auction yield since August 2008, and demand fell to the lowest level since December. Allocations to the group that includes foreign central banks fell to 46.3% from 58.3% in January.

Wednesday's 5–year note brought 2.658% for $35 billion in supply. That yield was the highest since December 2009, and demand dropped versus last month. Foreign accounts bought 58% of that issue versus 65% in January. Thursday's 7–year note auction brought 2.839% for $29 billion in supply. That was the highest yield going back to March 2011, and demand was off for this offering as well. Foreign buying dropped from 78.1% in January to 62.2% of this auction.

02/23/18 Treasury Yield Curve	**2-Year: 2.240%**	**5-Year: 2.619%**	**10-Year: 2.868%**	**30-Year: 3.157%**
Weekly Yield Change:	+.048%	–.011%	–.008%	+.025%

02/16/18 Treasury Yield Curve	**2-Year: 2.192%**	**5-Year: 2.630%**	**10-Year: 2.876%**	**30-Year: 3.132%**
Weekly Yield Change:	+.117%	+.086%	+.024%	–.028%
Support:	2.240/ 2.280/ 2.320/ 2.360	2.618/ 2.638/ 2.657/ 2.678	2.882/ 2.903/ 2.926/ 2.947	3.175/ 3.198/ 3.220/ 3.243%
Targets:	2.207/ 2.172/ 2.136/ 2.102	2.598/ 2.578/ 2.559/ 2.539	2.844/ 2.820/ 2.802/ 2.768	3.132/ 3.109/ 3.086/ 3.064%

Economics

Initial Jobless Claims fell 7K to 222K, back near 45–year lows and continuing to show resilience and strength in the labor market. Continuing Claims dropped from 1,948K to 1,875K – hitting a 6–week low in the largest decline since 2015. Consumers seemed to shake off the recent stock rout. University of Michigan Sentiment rose from 95.7 to 99.9 (the best level since October's 13–year high). Current Conditions rose from 110.5 to 115.1, and Expectations improved from 86.3 to 90.2. Bloomberg Economic Expectations rose from 52.5 to 54.5 – the second highest reading since 2002. Their Current View survey of the economy rose from 61 to 61.7, the highest reading since Feb 2001. Bloomberg Consumer Comfort dropped from 57 (the highest since Feb 2001) to 56.6. The Leading Index rose 1.00% in January. The Chicago Fed Nat Activity Index eased from .14 to .12. Kansas City Manufacturing Activity rose from 16 to 17, and Dallas rose from 33.4 to 37.2. Import Prices rose 1.00% in January, but only .50% ex petroleum. However, the annual pace increased from 3.20% to 3.60%.

Though blamed more on low inventories than on the recently frigid winter conditions, in January sales of existing homes fell 3.24% to a 4–month–low 5.38M (annual) units. Inventories are the lowest since records began in 1999 and prices were up 5.8% versus last year. New Home Sales declined by 7.78% to a 593K annual pace – the lowest since last August. Housing Starts rose 9.66% to 1,326K (annual units), and Building Permits rose 7.38% to 1,396K.

Tuesday (02/27) is set for Conference Board Consumer Confidence, Wholesale and Retail Inventories for January, Durable and Capital Goods Orders, the House Price Purchase Index for Q4 2017, the FHFA House Price Index for December, metro–home prices (S&P Case–Shiller 20–City Index), and Richmond Fed Manufacturing. Wednesday closes out February trading with MBA Mortgage Applications (which fell by 6.6% last week), Q4 Personal Consumption and an update for Q4 GDP, Chicago Purchasing Managers, and January Pending Home Sales.

Thursday ushers in March trading with Personal Income & Spending for January, the PCE Deflator (inflation gauge), jobless claims data, ISM Manufacturing, Bloomberg Consumer Comfort, Construction Spending, and Vehicle Sales. Friday brings University of Michigan sentiment surveys. Next Monday (03/05) is set for ISM Non–Manufacturing (the service–sector outlook). Tuesday follows with Factory Orders. Wednesday provides the Fed's Beige Book, Nonfarm Productivity, Unit Labor Costs, the Trade Balance deficit, Consumer Credit, and a look into February payrolls from ADP Employment Change.

Equities

Into February 16th, stocks had their best week in nearly 5 years! Of course, that followed 2 treacherous weeks that included a selloff of 12.23% in the Dow Industrials, 11.84% in the S&P, and 11.66% in the Nasdaq. Only a huge Friday turnaround on the 9th left stocks with their worst week in 2 years instead of 9! Stocks were again lower last week, until another substantial Friday rally that instead left them instead with gains. A large gain into today left stocks with a move that could be closing in on the completion of a counter rally to the larger selloff. Thus, we stand at a junction. With cycles calling for lows in stocks and yields near March 23rd, we're leaning to more downside before the thought of retesting or taking out the record highs of January.

Into the 16th, the Dow surged 1,028.48 points or 4.25%. Last week, with a 347–point Friday, the Dow closed 90.61 points or .36% higher to 25,309.99. The Dow was 1.58% higher today with a 399.28–point gain. The S&P rose 4.30% and then .55% to close at 2,747.30 on Friday. It's 1.18% better this week. The Nasdaq gained 5.31% and 1.35% to 7,337.39. It rose 1.15% today. The Dow Transports gained 3.61% and .73%, and then tacked on 1.80% today. Bank stocks rose 5.12% and .45% over the past 2 weeks, and then added another .94% in today's session.

Resistance:	Dow:	25,795/ 25,953/ 26,115/ 26,278	Nasdaq:	7,423/ 7,466/ 7,509/ 7,552	S&P:	2,792/ 2,805/ 2,819/ 2,832
Support:		25,632/ 25,473/ 25,309/ 25,154		7,338/ 7,295/ 7,252/ 7,208		2,767/ 2,747/ 2,728/ 2,709

Other Markets

Our Crude Oil cycles remain positive with possible buying dips into March 5th and 20th. Prices appear generally higher into April 25th. Crude Oil reversed much of the 9.55% loss the week of the 9th, with gains of 4.19% and 3.03% over the past 2 weeks. Crude was .57% higher today. Commodities gained 2.69% and 1.25%, and then added .39% today. Gold gained 3.05%, lost 1.85%, and then gained .19% today – largely countering the U.S. Dollar, which lost 1.46%, gained .89%, and was off .02% today. The Japanese Yen surged 2.38%, lost .64%, and was .04% lower today. The Euro gained 1.26%, lost .89% last week, and then rose .18% today. Corn gained 1.52%, lost .34%, and was then .61% higher today. Cotton lost 1.25%, surged 7.57%, and then added .31% into today.

Contrasting the U.S. consumer confidence readings – which remain the highest going back to the crisis and much earlier (to 2001), business confidence in Germany just fell the most in more than 5 years. Some EU readings have fallen to 2016 levels.

"God has given us two hands, one to receive with and the other to give with."

"Mountaintops are for views and inspiration, but fruit is grown in the valleys."

"The only time my prayers are never answered is on the golf course."

Billy Graham (1918–2018)

Additional Information is Available on Request
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