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BOND MARKET REVIEW

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Trade Wars: The Phantom Menace

President Trump mentions trade tariffs, and the media and world leaders conclude that there's a trade war. If one is to understand negotiations, maybe they should get familiar with the 'arts.' Studying Sun Tzu's 'Art of War' and Trump's own book 'The Art of the Deal' would allow greater understanding of the overall process with far less panic. The President often leads with a preposterous or hard–line position to test the markets or the resolve of his opponent in a negotiation. The tact brings the other party to the table. Anyone who's ever bartered with a street merchant or received a low bid on EBay understands this. It's to start a dialogue, not to end it! Trump makes the case that our existing trade agreements are unfair, and the numbers bear that out. Our monthly trade deficit with China alone has been 'huge' for years. They send us their natural resources in products made with cheap labor, and we trade them Dollars – but few goods. That's how they've become the largest buyer of U.S. debt. Last year, foreign holdings of U.S. securities (including equities) rose to a record $18.4 trillion (as of June). China's risk is a devaluation of the Dollar or a drop in the quality of U.S. debt. That 'tangible goods for paper' program is not fair trade, and it's no surprise that Trump is seeking deals that favor America far better than they have in the past. His position is that we compete with governments and cheaper labor – while at times also providing financial and military aid. We are the world's biggest customer, and that should bring great bargaining power. As a lifelong negotiator, Trump knows this.

As we said, the **B**ond **M**arket **R**eviews sees the President's tactics as bringing the other side to the table – knowing they will have to make a new bargain that's fair to both parties. There's no doubt that our retailers still seek out the cheapest provider, and that's kept inflation low and prices in control, but has also stifled U.S. wages and production. Even given his newly stated tariff intentions, the data strongly confirms the one–sidedness of existing trade numbers. The trade–war prospects may be phantom, but the menace has been real. In January, the merchandise 'goods' trade deficit expanded to its worst gap in 9 years – rising $2.1 billion to $74.4 billion! Additionally, the U.S. trade deficit just widened to a post–recession high – increasing by 5% to $56.6 billion, the widest gap since October 2008. The Trump administration did offer to exclude Mexico and Canada from some of the proposed tariffs in order to speed up Nafta negotiations.

Looking Ahead

- Equities have a low due near March 23rd.
- Interest rates should have downward pressure from March 14th into a low due near the 23rd.
- The FOMC will announce their interest–rate policy on Wednesday, March 21st, at 2 p.m. ET.

The Phantom Strikes Again

Trump's hard line with North Korea seems to have led them to the disarmament table. North Korea screams war, and it's shrugged off. Trump says tariffs, and it's all out war. Everything's an extreme. However, we're sure Japan and South Korea would rather avoid the escalating testing of missiles that could lead to injury, damages, or war. It's probably getting harder to suppress North Korean access (internet or otherwise) to the prosperity of South Korea and Japan. Could it be that a starving nation so focused on a nuclear arms race would rather enjoy some of the wealth and abundance of its neighbors that manufacture some of the world's best technology? The recent Olympics may have played a large part in illuminating the differences between the two Koreas. Recall that North Korea actually sent athletes and cheerleaders to participate. China's leader Xi Jinping got term limits removed to be 'president for life.' Trump 'struck again' clearly joking we should entertain the same for him, and the media just about lost their marbles. One thing is clear. Trump holds the remote control to U.S. programs and policy, and many want to take it away.

Treasuries, Agencies, and MBS

For the last few weeks, longer bond yields stopped advancing and have been congesting under recent highs, while shorter yields continued to test the levels that extend back to September 2008. Into March 2nd, Treasuries were remarkably tame, and failed to trade to higher yields for the first time in 8 weeks – instead netting little change across the curve with a mild flattening. Yields were .5 and 1 bps higher at 2 and 5–years, though .5 and 1.5 bps lower at 10 and 30–years. Yields rose last week, with the 2, 5, 10, and 30–year sectors higher by 1.5, 2, 3, and 2 bps.

Today saw as much change as for last week, but with the curve once again flattening – as yields rose .5 bps at 2–years, but improving by 1.5, 2.5, and 3 bps for the 5, 10, and 30–year sectors. The market–based odds for a Fed hike have been 'stuck' on 100% for weeks, keeping 2–years yields near recent highs. The FOMC meeting is now just over a week away (March 21st) and 25 bps hike is widely expected! Most Fed members are projecting 3 to 4 hikes for 2018 – though there are a few saying we should 'wait and see' what the data holds.

MBS spreads (FNMA 30–year 3%) were flat into March 2nd, and then narrowed 1 bps last week. The Treasury held two auctions today. The $28 billion 3–year note offering brought 2.436%. That was the highest yield since the May 2007 auction. Demand fell versus February, and the group that includes foreign central banks bought 50% of the allocation – up from 49.8% last month. Today's $21 billion in 10–year notes brought 2.889%. That was the highest auction award since January 2014, and demand rose versus last month. The allocation to foreign accounts fell from 67.5% in February to 66.2% of this auction. The Treasury will offer $13 billion 30–year bonds on Tuesday (03/13).

03/09/18 Treasury Yield Curve	**2-Year: 2.260%**	**5-Year: 2.651%**	**10-Year: 2.895%**	**30-Year: 3.158%**
Weekly Yield Change:	+.017%	+.022%	+.030%	+.018%
03/02/18 Treasury Yield Curve	**2-Year: 2.243%**	**5-Year: 2.629%**	**10-Year: 2.865%**	**30-Year: 3.140%**
Weekly Yield Change:	+.003%	+.010%	–.003%	–.017%
Support:	2.280/ 2.320/ 2.360/ 2.375	2.638/ 2.652/ 2.672/ 2.691	2.871/ 2.891/ 2.913/ 2.936	3.135/ 3.154/ 3.176/ 3.198%
Targets:	2.255/ 2.240/ 2.220/ 2.195	2.618/ 2.592/ 2.573/ 2.552	2.851/ 2.830/ 2.812/ 2.796	3.109/ 3.087/ 3.065/ 3.042%

Economics

Initial Jobless Claims fell from 220K to 210K for the last week of February. That was the lowest reading since December 1969! Though they rose by 21K last week (the most in 6 months) to 231K, they are still relatively low. Continuing Claims rose from 1,875K to 1,934K, and then fell to 1,870K. The service–sector outlook (ISM Non–Manufacturing) eased .4 to 59.5, but is still very strong and near the post–recession highs (over 50 is expansion). ISM Manufacturing was also quite strong, as the factory index rose from 59.1 to 60.8 – expanding at the best pace since May 2004. New Orders fell from 65.4 to 64.2 and Prices Paid rose from 72.7 to 74.2. ISM Employment rose from 54.2 to a 4–month high 59.7, hinting at good February numbers. ADP Employment Change did as well, reporting 235K private–sector jobs added in February, and 10K added to January for 244K. Additionally, Challenger Job Cuts showed 4.3% less cuts versus last year.

The stage was set, and Nonfarm Payrolls rose 313K versus only 205K expected for the best gains since mid–2016. 39K jobs were added in revisions for January and there was a net 54K pickup for the past 2 months. Private Payrolls rose 287K, and January numbers were revised up 42K to 238K. Manufacturing doubled expectations in adding 31K jobs, and 10K were added to January for a 25K gain. The Unemployment Rate remained at 4.10% for a 5th month, largely due to Labor Force Participation rising the most since 2010 – from 62.7% to 63.0%, the highest level since last September! That was also seen as putting a damper on wage pressures. Average Hourly Earnings rose only .10% in February, and the annual paced actually cooled from 2.80% to 2.60%. Average Weekly Hours bumped .1 to 34.5. The Underemployment Rate was unchanged at 8.20%.

Bloomberg Consumer Comfort fell .4 to 56.2, and then rose to 56.8 – only .2 below the post–expansion high. The Conference Board's Consumer Confidence reading rose from 124.3 to 130.8, the highest since November 2000. Their Present Situation survey rose to the best since 2001 (from 154.7 to 162.4). Jobs and lower taxes were contributing factors. Expectations reached a 3–month high, rising from 104 to 109.7. The University of Michigan readings were similar. Sentiment rose from 95.7 to 99.7 – the second–best level since 2004. Current Conditions rose from 110.5 to 114.9, and Expectations rose from 86.3 to 90. The Chicago Purchasing Managers report fell from 65.7 to 61.9, while Richmond Fed Manufacturing improved from 14 to 28.

Q4 GDP cooled from 2.60% to 2.50% in a revision. The Atlanta GDP–Now forecast for Q1 2018 had begun at 4.2%, and been as high as 5.4%, but slipped to its lowest projection of 2.5% – after the very–good February payroll numbers! Q4 Personal Consumption remained at 3.80%. The GDP Price Index rose at a 2.30% pace in Q4 and the core rate was 1.90%. U.S. Household Debt rose at a 5.2% rate in the fourth quarter – the most since the end of 2007. Consumer Credit grew by $13.906 billion in January. That was the least in 4 months, but it was post holidays and a very cold month. In January, Personal Income rose .40%, but Spending only increased by .20% – flipping recent trends.

Though again recognizing that it was very cold and rates were rising, January Pending Home Sales plunged 4.70% to the lowest levels since 2014. The House Price Purchase Index rose 1.60% in the fourth quarter, and the FHFA House Price Index rose .30% in December. Metro home prices rose .64% in December, though the S&P Case–Shiller 20–City index slowed a little bit year–over–year, declining from 6.36% to 6.30%. However, the annual House Price Index pace rose from 6.13% to 6.27% (the most since 2004). Construction Spending was unchanged in January.

One of the Fed's favorite inflation gauges, the PCE Deflator, rose .40% in January. The annual pace remained at 1.70%. Core Personal Consumption Expenditures (ex food & energy) rose .30%, but also showed no inflation threat with the annual pace flat at 1.50%. The Fed's Beige Book once again noted *"modest to moderate"* expansion, but also said that was leading to *"moderate inflation"* in most districts and a *"brisk demand for qualified workers."* On the foreign front, German inflation turned lower to its weakest reading since 2016. The European Central Bank was also concerned about a trade war with the U.S., but they just removed some long–standing stimulus language from their policy statement – in effect taking out the 'will do whatever it takes' intention.

February Vehicle Sales fell from a 17.07M pace to 16.96M. Domestic Sales dropped from 13.10M to 12.94M. Orders for business equipment fell for a second month as Capital Goods Orders dropped .30%. Factory Orders were off by 1.40%, but .40% higher ex transportation. Orders for Durable Goods fell 3.60%, and were .30% lower ex transportation. Nonfarm Productivity was flat in the fourth quarter. Unit Labor Costs rose at a 2.50% pace. In January, Wholesale Inventories rose .80%, but Trade Sales dropped by 1.10%. Retail Inventories also rose by .80%.

The government's fiscal deficit is running a stout 11.5% deeper versus 2017 as February's Monthly Budget Statement revealed a $215.2 billion shortfall. Tax receipts were modestly lower, but spending is still very high and debt service is increasing! For the 5 fiscal months to date, tax receipts are 2.5% higher, but spending has grown by 4.4%.

Tuesday is set for NFIB Small Business Optimism, Consumer Prices (February CPI), and data for weekly and hourly earnings. Wednesday follows with February Retail Sales, Producer Prices (PPI), January Business Inventories, and MBA Mortgage Applications (which rose 2.70% and then .30% over the past 2 weeks). Thursday includes jobless claims data, Empire Manufacturing, the home–builder outlook, the Philadelphia Fed Business Outlook, Bloomberg Consumer Comfort, February Import Prices, and net international Treasury operations (flows). Friday is set for February Housing Starts & Building Permits, Industrial Production & Capacity Utilization, JOLTS Job Openings for January, and the University of Michigan sentiment surveys. The following Wednesday brings the FOMC interest–rate policy decision with its expected 25 bps hike, and Existing Home Sales for February.

Equities

The Dow Industrials had a lot of movement over the past 2 weeks, but not much change. After falling 771.93 points into March 2nd, they rose 797.68 points last week to a 2–week net gain of 25.75 points. Percentage wise, the Dow lost 3.05% and then gained 3.25% to 25,335.74. It was .62% lower today. The S&P lost 2.04%, but then rose 3.54% to 2,786.57. It was .13% lower today. The Nasdaq was the only major index to break to new record highs. It lost 1.08% into the 2nd, but then rallied 4.17% last week to 7,560.81 – and was .36% higher today. The Dow Transports lost 2.32%, and then rose 3.94% last week. They were .31% lower today. While most U.S. and global indexes besides the Nasdaq are well off their late–January or all–time highs, bank stocks have been resilient in their comeback and were only .52% off their recent decade–highs today. Banks stocks lost 2.04% into the 2nd, and then rose 3.75% last week. They were .50% lower today.

Resistance:	Dow:	25,323/ 25,484/ 25,643/ 25,804	Nasdaq:	7,625/ 7,694/ 7,782/ 7,871	S&P:	2,792/ 2,805/ 2,818/ 2,832
Support:		24,904/ 24,693/ 24,538/ 24,379		7,521/ 7,434/ 7,348/ 7,262		2,767/ 2,753/ 2,741/ 2,724

Other Markets

Our Crude Oil cycles are generally positive from March 20th into April 25th. Most commodities saw similar reversals to stocks – down into the 2nd, and then up into the 9th. Commodities were .96% lower into the 2nd, and then .53% higher last week. They were .32% lower today. Crude Oil lost 3.62% and then gained 1.29%. Crude lost 1.10% today. Gold was off .36%, but then .05% higher last week. Gold fell .24% today. The U.S. Dollar rose .11% and then .18% over the last 2 weeks. It fell .22% today. The Japanese Yen rose 1.07% and then lost 1.10%, but it added .37% today. The Euro gained .18% and then fell .08%, but it rose .22% today. Corn gained 3.00% and 1.52%, and then added .33% today. Cotton gained 1.56% and 2.18%, but it fell 1.47% today.

"Goodness is the only investment that never fails." Henry David Thoreau

"It is a mistake to try to look too far ahead. The chain of destiny can only be grasped one link at a time."
Sir Winston Churchill

Additional Information is Available on Request
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