COMMERCE STREET
Capital Management
1445 ROSS AVENUE
DALLAS, TEXAS 75202
214-545-6800

BOND MARKET REVIEW

March 28, 2018

A Wrinkle in Time

Back on February 26th, the **B**ond **M**arket **R**eview said: *"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."* Stocks traded a little higher on the 27th, and then the cycles took over – lining up nicely as stocks traded down into March 23rd as forecast. The energy was so strong it sent the Dow to its lowest close since November 22nd, and stocks to their worst week in over 2 years (since that ugly kickoff in 2016). After that, we expected stocks to have *"another down–leg from March 27th to April 2nd."* The Dow rallied 937 points off Friday's low into a high on the 27th, and then reversed 737 points lower. Following the 23rd, Monday's 669–point gain was the largest (point gain) since 2008. On Tuesday, the Dow was 243 points higher before losing momentum and closing 344 points lower. These latest moves set up a very negative scenario, where we expect stocks to stairstep lower into an important low. The next low is due on Monday, April 2nd but it seems unlikely the downside pattern can complete by then. While a low is expected on the 2nd, we'd be cautious and use rallies to sell rather than buying dips until the bearish pattern is more complete. Early indications point to a better low near early to mid–May.

Looking Ahead

- Equities should have another low near April 2nd.
- Interest rates should have a low around March 29th but could also follow a drop in equities into the 2nd.
- The markets will be closed for Good Friday (March 30th), and bonds have an early close Thursday (2 ET).

As for bonds, our cycles had yields *"falling into March 23rd"*, and the 10–year note fell to 2.80% today for the first time since March 1st. We said: *"We expect another drop in yields into March 29th, before they advance again. A lot depends on stocks. If equities continue lower into April 2nd, that should keep longer yields in check until any developing market panic begins to dissipate."* So far, those scenarios are holding true as medium to long–term yields fell to their lowest levels since early February, and 30–year bonds fell under 3% to print their first '2 handle' since February 1st. The Fed considers incoming economic data to develop policy, but markets often fail to cooperate. As with former Fed Chairman Alan Greenspan's *"conundrum"*, the bond market at times fails to follow the FOMC, and instead calls their policy into question. Is it a self–fulfilling scenario? Inverted or very–flat yield curves often precede or 'predict' recessions, while the Fed is raiding rates to prevent the economy from overheating. Today, the 2–to–10–year Treasury yield spread fell below 50 bps for the first time since October 2007. We have longer–term lows for yields due around April 24th and June 4th – and think yields could remain pressured by concern about the equity markets. Currently, the stock and bond cycles are confirming each other – each pointing to additional downside.

You are cordially invited to attend the 16th Annual Bank Conference to be held Tuesday, April 10th, 2018 at the Four Seasons Resort & Club, in Irving, Texas. Contact Susan Tomcko at (214) 545-6824 or stomcko@cstreetcap.com for details.

Treasuries, Agencies, and MBS

Fundamentally, the news is pretty good. If GDP had hit 3% for Q4 2017, it would have marked the first time in 13 years (to Q1 2005) that the U.S. had 3 consecutive quarters of 3% or better growth. Though expected to be revised from 2.5% to 2.7%, the final reading for Q4 GDP was better at 2.90%. As Maxwell Smart used to say: *"Missed it by that much!"* The Atlanta Fed is projecting 1.8% for Q1 2018. The jobs numbers continue to look good and jobless claims and benefits are the lowest since the early '70s. The Fed's intentions to maintain a 'gradual pace' of rate increases appear unaltered with the markets expecting 2 more hikes in 2018. Yields fell by 3.5, 4.5, 3, and 1.5 bps last week for the 2, 5, 10, and 30–year Treasury sectors. Into today, partly due to a new 2–year note, yields rose 3 bps at 2–years, but fell by .5, 3, and 4 bps to flatten the rest of the curve to its lowest 2–10 spread since October 2007.

MBS spreads (FNMA 30–year 3%) widened by 1 bps last week. On Tuesday (03/26), the U.S. Treasury sold $30 billion 2–year notes at 2.31%. That was the highest auction yield since August 2008, and demand was the highest since January. The buying group that includes foreign central banks accounted for 44.5% of the sale, versus 46.3% last month. Wednesday's 5–year note sale brought 2.612% for $35 billion in supply. Demand was the best since last September and the yield was less than last month's 2.658% award. Foreign buying was 63.5% compared to 58% last month. Today's $29 billion 7–year note auction came at 2.72%, well under February's 2.839%. Demand fell versus last month, and foreign allocations were 55.8% versus 62.2% in February.

03/23/18 Treasury Yield Curve	2-Year: 2.256%	5-Year: 2.600%	10-Year: 2.814%	30-Year: 3.062%
Weekly Yield Change:	–.037%	–.043%	–.031%	–.016%
Support:	2.310/ 2.350/ 2.430/ 2.510	2.586/ 2.607/ 2.627/ 2.643	2.775/ 2.800/ 2.832/ 2.852	3.005/ 3.022/ 3.044/ 3.067%
Targets:	2.230/ 2.199/ 2.129/ 2.058	2.568/ 2.551/ 2.529/ 2.509	2.745/ 2.716/ 2.695/ 2.675	2.978/ 2.956/ 2.935/ 2.912%

Economics

The Conference Board Consumer Confidence survey fell for the first time this year, dropping from 130 to 127.7. However, that 130 reading was the highest since late 2000! Their Present Situation survey also backed off, slipping from 161.2 to 159.9. Expectations relaxed from 109.2 to 106.2. Retail stores are still stocking shelves at a good pace. The U.S. merchandise–trade deficit rose from $75.3 billion to a 9–year high $75.4 billion in February. Wholesale Inventories rose 1.10% and Retail Inventories rose .40%. As we said earlier, Q4 GDP was revised from 2.50% to 2.90%. Representing the largest sector of the economy, Personal Consumption was also revised higher, increasing from 3.80% to 4.00%. The GDP Price Index was steady at a 2.30% annual pace, and core PCE (Personal Consumption Expenditures) was flat at an annual 1.90% increase. The Chicago Fed National Activity Index rose from .02 to .88, though Dallas Fed Manufacturing Activity fell from 37.2 to 21.4 and Richmond dropped from 28 to 15. After 2 months of lower results, Durable Goods Orders rose by 3.10% in February – nearing doubling expectations. With a 3.50% drop in January, orders were a bit flat on the whole. Ex transportation, Durable Goods Orders rose 1.20% versus a .20% drop in January – making for a much better pace. Cap Goods Orders (non–military) rose 1.80% – the biggest increase since September.

There continues to be a good appetite for housing, and Metro Home Prices rose .75% in January, even though housing was challenged by weather and rising interest rates. The annual pace for that S&P Case–Shiller 20–City index quickened from 6.31% to 6.40%. The overall home price index actually slipped from an annual 6.28% to 6.18%. New Home Sales fell for a 3rd month, dropping by .64% to 618K (annual units). The median sales price jumped the most since December 2016 (up 9.7% versus last February). New Home inventories rose to 305K (the highest since March 2009). Pending Home Sales rose 3.10% in February but were off 4.40% to last year.

Thursday rounds out March trading and the last data reporting day of the month. Scheduled data releases for Thursday are jobless claims, Personal Income & Spending for February, the PCE Deflator, Chicago Purchasing, Bloomberg Consumer Comfort, and the University of Michigan sentiment surveys. The stock and bond markets will be closed for Good Friday on March 30th, and the bond market will close early on Thursday as well (2 p.m. ET). Next Monday (04/02) brings February Construction Spending and the ISM Manufacturing reports. Tuesday is set for March Vehicle Sales. Wednesday includes MBA Mortgage Applications (which rose 4.80% last week), the service sector outlook (ISM Non–Manufacturing), and Factory Orders – as well as those for Durable and Capital Goods. Monday's ISM Employment, Wednesday's ADP Employment Change, and Thursday's data for jobless claims and Challenger Job Cuts will all provide some initial reads into next Friday's release of March payrolls.

Equities

Culminating with the March 23rd cycle low, stocks had their worst losses since the first week of 2016 (over 2 years). The Dow tumbled 1,413.31 points or 5.67% to 23,533.20. It was 1.34% higher into today but had been up over 3.88% at Tuesday's high. The S&P lost 163.75 points or 5.95% to 2,588.26 but was .65% better into today. The Nasdaq fared worse, losing 489.32 points or 6.54% to 6,992.67. It's also lower this week, by .62%. Bank stocks were one of the weakest sectors, dropping 7.95% last week. They've risen 1.14% this week. The Dow Transports lost 4.87% but are .24% better this week. We should get a bounce from a low due near April 2nd.

	Dow:	Nasdaq:	S&P:
Resistance:	24,295/ 24,450/ 24,606/ 24,684	7,088/ 7,172/ 7,257/ 7,340	2,638/ 2,664/ 2,690/ 2,712
Support:	23,983/ 23,830/ 23,675/ 23,522	7,004/ 6,921/ 6,837/ 6,756	2,613/ 2,594/ 2,563/ 2,538

Other Markets

Crude Oil gave up some ground the last 3 days but should be trending higher with our cycle into April 25th. Crude rose 5.68% last week but is 2.28% lower this week. Commodities gained .93% last week but likewise lost 1.00% on weakness in Crude and Gold this week. Gold had risen 2.87% but was 1.90% lower into today. The U.S. Dollar tumbled 1.31% last week but is .77% higher this week. The Japanese Yen rose 1.20% but has plunged 2.01% so far this week. The Euro gained .51% last week but fell .36% into today. Corn lost 1.44% and was off another .99% into today. Cotton dropped 1.23% and lost another 1.33% this week.

"However beautiful the strategy, you should occasionally look at the results." Sir Winston Churchill

Additional Information is Available on Request

Doug Ingram, Managing Director – Commerce Street Capital Management

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