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BOND MARKET REVIEW

April 05, 2018

Pacific Rim Uprising

No one yet knows how proposed tariffs might lead to a real trade war, but there's been plenty of speculation on that occurrence and it's even been called a catalyst for the market's recently–increased volatility. While there's probably some validity to that assertion, stocks were extremely overvalued and topped roughly 6 weeks before steel tariffs were mentioned. Now there are stories everyday about warnings of countermeasures considered by other countries. With the U.S. being China's largest 'client', and also being a net importer from many nations, it's possible that trade retaliations might backfire. You don't try to antagonize your best customer, and hope for great results. The initial tariffs were designed to prevent nations from dumping steel below cost – which was deemed as being harmful to U.S. production. Ultimately, China has numerous moves they can consider. They hold the key to dealing with North Korea, and they sell the U.S. so much more than steel. They also have a trillion–dollar hammer. We said China owned $1.17 trillion in U.S. Treasuries as of January, and they could weaponize those holdings by dumping U.S. debt and upending global markets. However, that would hurt their trade and lead to massive price losses on their holdings.

Looking Ahead

- Equities are consolidating but should trade lower from April 13th into a window near the 25th–30th.
- Interest rates have a low due near April 24th. On dips, we would take hedges off and/or buy bonds.

Weird Science

While there's a lot of science involved in our forecasting techniques, there's also a lot of guesswork – such as which indicators to give additional consideration. That's what keeps market forecasting, economics and weather prediction in the same camp. We have great confidence that our tools will work 70 to 80% of the time. You just never know when that 20 to 30% chance of error is going to hold sway. I didn't wash that heavy green coat of Memphis allergens off my cars last weekend because of the near–100% chance of a deluge. It didn't happen!

In the **B**ond **M**arket **R**eview (02/07/18), we provided the woodchuck weather outlooks. We said: *"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!"* That said, with each taking one part of the 50%–50% coin toss – only one could be right. No wonder Phil also said 'Dilly, Dilly!' The New York hog missed the call for his own area as it endured a rare 4 nor'easters of winter storms.

Our cycles have been hitting nicely. For stocks, we expected a low on the 23rd, a high near the 27th, and then another drop into April 2nd. In one of those rare occurrences, those moves all happened to the day. Bonds required a little guesswork. We expected low yields on March 29th, and they dropped to the lowest levels since Early February. However, we said: *"If equities continue lower into April 2nd, that should keep longer yields in check until any developing market panic begins to dissipate."* Equities did trade down into the 2nd, with the Dow trading to the lowest levels since mid–November, and the 10–year note followed suit by trading to its lowest yields since late January. Last week, we said: *"We should get a bounce from a low due near April 2nd."* Into today, the Dow recovered over 1,277 points from Monday's low – and 10–year yields rose over 11 bps. However, the patterns we talked about last week indicate some further stairsteps to lower equity prices which should give an assist to bonds.

2018 Bank Conference & GOLF TOURNAMENT

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

The Atlanta Fed's GDP–Now forecast for Q1 2018 rose from 1.8% on March 23rd to 2.8% earlier this week but dropped back to 2.3% today. Even 2.3% would remain on a good pace given the past 3 quarters averaging just over 3%, and Q1 2017 having only been 1.2%. The Fed's read remains about the same – with most members expecting 2 additional rate hikes in 2018. The markets are placing only a 27.8% chance on a FOMC move on May 2nd but over 81% for a hike on June 13th. Last week, the curve flattened with 2–year note yields rising by 1 bps, while yields fell by 3.5, 7.5, and 9 bps at 5, 10, and 30–years. Into today, after having been much lower into Monday (04/02), yields were 3.5, 7.5, 9.5, and 10 bps higher for the 2, 5, 10, and 30–year sectors as equities recovered from Monday's lows.

On March 29th, at 47 bps the 2–year/10–year spread was the lowest since October 2007. MBS spreads (FNMA 30–year 3%) widened by 1 bps last week. Next week, the U.S. Treasury will auction $30 billion 3–year notes on Tuesday (04/10), $21 billion 10–year notes on Wednesday, and $13 billion 30–year bonds on Thursday.

03/29/18 Treasury Yield Curve	2-Year: 2.268%	5-Year: 2.563%	10-Year: 2.740%	30-Year: 2.974%
Weekly Yield Change:	+.012%	–.037%	–.074%	–.088%
Support:	2.310/ 2.350/ 2.430/ 2.510	2.621/ 2.640/ 2.658/ 2.681	2.795/ 2.815/ 2.832/ 2.853	3.045/ 3.068/ 3.090/ 3.113%
Targets:	2.250/ 2.230/ 2.199/ 2.129	2.582/ 2.562/ 2.542/ 2.523	2.775/ 2.755/ 2.736/ 2.719	3.023/ 3.001/ 2.978/ 2.956%

Economics

[*Though the data herein is from April 5th, March payrolls came in early on the 6th with only a 103K gain. The Unemployment Rate remained at 4.1% and labor Force Participation dropped .1% to 62.9%. We'll cover this in detail next week.]

Last week, Initial Jobless Claims fell from 227K to 218K – near the lowest level since January 1973. However, they rose this week to 242K – the highest in nearly 3 months. Continuing Claims, which lag a week, rose from 1,836K to 1,872K, and then fell to 1,808K. The ADP Employment Change data for private payrolls looked good for April with 241K jobs added. The other 2 indicators going into Friday's numbers were negatives. ISM Employment fell from 59.7 to 57.3 and Challenger Job Cuts rose 39.40% (more cuts versus March 2017) affirming the high jobless claims results. Bloomberg Consumer Comfort was unchanged near a 17–year high at 56.8 last week but this week rose to a new 17–year high (to February 2001) of 57.2. Personal finances were the highest since May 2007 and the buying climate the best since 2000. University of Michigan Sentiment rose from 99.7 to 101.4, the best since 2004. Their survey of Current Conditions rose from 114.9 to a record high 121.2, though Expectations fell from 90 to 88.8. Personal Income rose .40% in February. After a 4th–quarter surge, Personal Spending lagged behind income for a second month rising only .20%. ISM Manufacturing waned from 60.8 to 59.3 in March, while Prices Paid rose from 74.2 to 78.1 and New Orders dropped from 64.2 to 61.9. The service sector cooled for a second month as ISM Non–Manufacturing dropped from a lofty 59 to 58.8. The Chicago Purchasing Manager's report fell from 61.9 to 57.4.

Construction Spending rose .10% in February. Factory Orders rose 1.20% but ex transportation were only .10% higher. Orders for Durable Goods rose 3.00% and by 1.00% ex transportation. Orders for Capital Goods rose 1.40%. The PCE (Personal Consumption Expenditures) Deflator rose .20% in February, quickening the annual pace from 1.70% to 1.80%. One of the Fed's favorite inflation gauges, ex food & energy PCE also rose .20% raising the core annual pace from 1.50% to 1.60%. March Vehicle Sales showed improvement, rising from a 16.96M annual pace to 17.40M. Domestic sales rose from a 12.94M annual pace to 13.42M. The U.S. Trade Balance widened for a 6th month (the longest streak since 2000) as the pre–tariff numbers were still increasing. The February deficit rose to 9–year high of $57.6 billion versus January's $56.7 billion.

Friday is set for March Payrolls, the Unemployment Rate, earnings data, and February Consumer Credit. Next Tuesday (04/10) brings NFIB Small Business Optimism, Producer Prices (March PPI), and February Wholesale Trade Sales and Inventories. Wednesday follows with MBA Mortgage Applications (which fell 3.30% last week), Consumer Prices (March CPI), Weekly and Hourly Earnings, the March Monthly Budget Statement, and the minutes from the FOMC March meeting.

Equities

We thought we'd see a low into April 2nd, and a bounce from there. The Dow tumbled Monday to its lowest level since mid–November, and then surged more than 1,277 points off that low! As of Monday, with the S&P down 2.23%, stocks had their worst April start going since 1929! Normally, April is a seasonal uptrend for stocks – after which you 'sell in May and go away!' The Dow gained 569.91 points or 2.42% last week to 24,103.11 after plunging 5.67% into the 23rd. It's ahead 1.67% this week, despite a 3.30% drop into Monday's low. The S&P gained 52.61 points or 2.03% to 2,640.87 and is .83% better this week. The Nasdaq rose 70.78 points or 1.01% to 7,063.45 and is only .19% higher this week with tech stocks seeing more aggressive selling versus other sectors. The Dow Transports gained 2.29% last week and are .55% higher this week. Bank stocks gained 2.46% and are 1.40% higher this week.

	Dow:	Nasdaq:	S&P:
Resistance:	24,315/ 24,627/ 24,942/ 25,259	7,060/ 7,145/ 7,229/ 7,316	2,650/ 2,671/ 2,710/ 2,728
Support:	24,003/ 23,696/ 23,389/ 23,084	6,978/ 6,895/ 6,813/ 6,729	2,624/ 2,599/ 2,575/ 2,549

Other Markets

Crude Oil lost 1.43% last week and was off another 2.16% into today, leading Commodities off .46% and .80% lower this week. Gold lost 2.01% but is .11% higher this week. The U.S. Dollar improved by .87% and added .38% into today. The Japanese Yen lost 1.61% and is off another .90% this week. The Euro fell .43% last week and was .49% lower into today. Corn rose 2.78% and then added .45% this week. Cotton lost .45% but rose 1.36% into today.

"Anything not worth doing – is worth not doing well. Think about it!" Elias Schwartz

Additional Information is Available on Request

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