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BOND MARKET REVIEW

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Grabel's Law

One of our favorite math tenets (which should be an axiom) is Grabel's Law, which holds: *'2 is not equal to 3, not even for large values of 2.'* Q4 GDP held very close to 3% before failing to accomplish that threshold with a 2.9% final. Recall that the U.S. hasn't seen 3 consecutive quarters of 3% growth since the first quarter of 2005. Grabel's Law says it still hasn't happened. However, with the last 3 quarters of 2017 at least averaging just over 3%, a good Q1 2018 reading could have given us a shot at a 3% GDP on a year–over–year basis. The Atlanta Fed's GDP–Now forecast kicked off Q1 with a surge to 5.4% and held near 4% GDP with early data. It rose from under 2.0% to 2.8% on April 2nd – still holding out a chance for that elusive 3% level, but it's declined since and stood at 2.0% as of today. With most Q1 data now 'in the books', it's looking like the April 27th preliminary Q1 GDP release will once again fall short of 3% – and maybe even 2%.

The Fed has sought a return to 2% inflation levels since the 'great recession' but, from Grabel's standpoint, getting high values of 1% just didn't reach that goal. Over the past decade, EU nations struggled with very low inflation – something troubling Japan for nearly 3 decades. However, we may have reached the tipping point in the U.S. as recent data is finally working its way above 2%. Consumer Prices fell .10% in March, but the annual pace quickened from 2.20% to 2.40%! More importantly to the Fed, though CPI ex food & energy rose .20%, that core annual pace lifted above 2% – rising the most in a year from 1.80% to 2.10%. Producer Prices rose .30%, hiking the annual pace from 2.80% to 3.00%. Core PPI also rose .30%, quickening that annual pace from 2.50% to 2.70%.

FRB New York President William Dudley has been in the '3 to 4 hikes in 2018' camp with most other Fed members including former Fed Chair Janet Yellen. Dudley's been in the news because he's retiring in June, and John Williams, the current FRB San Francisco President, is set to take his place as the New York chief. Probably given the bump in inflation, today Dudley said: *"As long as inflation is relatively low, the Fed is going to be gradual, now, if inflation were to go above 2% by an appreciable margin, then I think the gradual path might have to be altered."* The **B**ond **M**arket **R**eview's opinion would be that he wouldn't make that comment without believing it was a possibility. The Fed's March minutes suggested policy makers were leaning to a faster pace of tightening. Though the data doesn't yet show the U.S. economy as 'overheating', some Fed members see that as a risk. The market–based odds for a June hike are nearly 90%, and the chances for a 4th hike in 2018 have risen closer to 50% over the past few days. Market turbulence and an escalating trade war could thwart those plans.

Looking Ahead

- Equities should make a low into an April 25th–30th window.
- Interest rates have a low due near April 24th. On dips, we would take hedges off and/or buy bonds.

Treasuries, Agencies, and MBS

A 'faster pace of tightening' by the FOMC aside, today the spread between the 2 and 10–year Treasuries fell close to 43 bps for the first time since September 2007. With the June Fed–hike a 'given', we would expect the possibility of a yield–curve inversion between June and September. The compression has come with little movement for longer rates while shorter rates have increased steadily on the expectations of continued Fed tightening. Into April 6th, 2–year rates were flat, but 5, 10, and 30–year sector yields increased by 2.5, 3.5, and 4.5 bps. Last week, in a 'bull flattener', yields rose by 9, 8.5, 5.5, and 1 bps for the 2, 5, 10, and 30–year sectors. The curve twisted even flatter today with 2 and 5–year rates rising 3.5 and 1.5 bps, the 10–year unchanged, and 30–year yields falling .5 bps.

February Treasury flows showed $44.7 billion flowing into U.S. assets in foreign operations. $49 billion flowed into longer–term U.S. debt. Despite trade tensions between the two nations, China's holdings of U.S. Treasuries increased by the most in 6 months. Still the top holder of U.S. debt, they added $8.5 billion in short–to–long maturities to reach holdings of $1.18 trillion. Japan fell from $1.07 trillion to $1.06 trillion to remain second. While tensions do exist, there are few (if any) global alternatives that offer a better combination of safety and returns. In fact, most have negative yields and recently–overvalued currencies. If the U.S. Dollar is near a low, U.S. assets would overperform.

MBS spreads (FNMA 30–year 3%) narrowed by 1 bps into April 6th and dropped another 3bps last week. Last Tuesday (04/10), the U.S. Treasury sold $30 billion 3–year notes at 2.45%. Demand fell versus March and the yield was the highest since the May 2007 auction. The group that includes foreign central banks bought 47.6% of the issue versus 50% last month. On Wednesday (04/11) the Treasury reopened the February 2028 10–year note to add $21 billion in supply at 2.795%. Demand also fell versus March and the yield was the lowest since January. Foreign buying fell from 66.2% last month to 53.2% of this auction.

On Thursday (04/12), the February 2048 (30–year) was also reopened to add $13 billion at 3.044% – also the lowest yield since January. Demand rose versus March, and foreign buying increased from 57.9% of that auction to 61%. The 2, 5, and 7–year note auctions come next week with size to be announced on Thursday.

04/13/18 Treasury Yield Curve	**2-Year: 2.359%**	**5-Year: 2.673%**	**10-Year: 2.828%**	**30-Year: 3.028%**
Weekly Yield Change:	+.091%	+.086%	+.054%	+.009%
04/06/18 Treasury Yield Curve	**2-Year: 2.268%**	**5-Year: 2.587%**	**10-Year: 2.774%**	**30-Year: 3.019%**
Weekly Yield Change:	+.000%	+.024%	+.034%	+.045%
Support:	2.433/ 2.473/ 2.514/ 2.553	2.731/ 2.768/ 2.806/ 2.843	2.865/ 2.905/ 2.943/ 2.980	3.037/ 3.074/ 3.112/ 3.150%
Targets:	2.396/ 2.355/ 2.315/ 2.275	2.695/ 2.658/ 2.625/ 2.585	2.830/ 2.794/ 2.757/ 2.721	2.999/ 2.963/ 2.926/ 2.889%

Economics

The employment data coming into March payrolls was mixed but skewed to the negative side. The actual release was only 56% of 185K expected as payrolls rose by 103K – and though 13K were added to February the 2–month revision subtracted 50K jobs. Private payrolls rose by 102K though they were revised 33K higher to 320K in what was a very robust overall report from February! Manufacturing grew by 22K and the U.S. Unemployment Rate remained at 4.10%. However, the Underemployment Rate fell from 8.20% to 8.00%. The Labor Force Participation Rate fell by .10% to 62.90% and Average Weekly Hours were flat at 34.5. There were positives from Average Hourly Earnings rising .30% leading to the annual pace increasing from 2.60% to 2.70%. In a separate release, annual Weekly Earnings rose .90% and Hourly Earnings rose by .40%. Initial Jobless Claims fell 9K to 233K for the first week of April. Continuing Claims rose from 1,818K to 1,871K. JOLTS Job Openings fell from 6.228M to a still–lofty 6.052 million. Retail Sales rebounded off a week February (–.10%) to advance .60% in March. Ex autos, sales rose .20%.

February Wholesale Trade Sales rose 1% and Inventories were also 1% higher. Business Inventories rose by .60%. Bloomberg Consumer Comfort rose from 57.2 to a new 17–year high 58. The University of Michigan surveys cooled in preliminary readings for April. Sentiment fell from 101.4 to 97.8. Expectations eased from 88.8 to 86.8 and Current Conditions fell from 121.2 to 115. NFIB Small Business Optimism fell from 107.7 to 104.7. March Import Prices were flat, but .10% higher ex–petroleum. The annual pace increased from 3.40% to 3.60%. Factory output increased by .10% in March following a revised 1.5% gain for February – which was the best jump since July 2009. Industrial Production overall rose .50% versus a revised–lower–by–.10% 1.00% result for February. Capacity Utilization rose from 77.70% to 78.00%. Empire Manufacturing fell from 22.5 to 15.8.

Global debt rose to a record $237 trillion at the end of 2017. U.S. Consumer Credit confirmed weaker early–2018 sales data as it rose only $10.601 billion in February for the weakest increase in 5 months. January data was revised higher from $13.906 billion to $15.594 billion. Revolving credit rose the least since November 2013. Though tax receipts grew 1.6%, increased spending led to a $208.7 billion shortfall in the Treasury's Monthly Budget Statement for March. That widened the 2018 deficit to $600 billion 6 months into the fiscal year, roughly 13.8% higher versus 2017 at this point.

Home–builder sentiment fell for a 4th month as the NAHB Housing Market Index dropped from 70 to a 5–month low of 69. Their 6-month sales outlook dropped a point to 77, and the current outlook for single–family home sales fell to the lowest since October. After that result came in, data beat forecasts in March as Housing Starts rose 1.85% from 1,295K to a pace of 1,319K annual units. That was up 9.64% versus March 2017. Single family homes currently under construction are the highest since 2008, and data including all home types is the highest since July 2007. Building Permits rose 2.50% from 1,321K to 1,354K, and were up 7.46% year–over–year.

Wednesday is set for MBA Mortgage Applications (which fell 1.90% last week) and the release of the Fed's Beige Book. Thursday brings jobless claims data, the Philadelphia Fed Business Outlook, the Leading Index for March, and Bloomberg's Consumer Comfort and Economic Expectations. Next Monday (04/23) is set for March Existing Home Sales and the Chicago Fed National Activity Index. Tuesday brings home price data, New Home Sales, Richmond Manufacturing, and Board Consumer Confidence.

Equities

Equities were holding with the 'script' as they bounced nicely from the cycle low on April 2nd, and then held their rally through Friday the 13th. Trading higher through Tuesday stretched the cyclic outlook, though we still expect stocks to trade off into a low due between April 25th and the 30th. The next two lows are due on May 7th and May 16th, and if the low into the end of April plays out, we would hold out on buying positions until one of those dates.

Strikes against Syria were timed not to interfere with global markets, and for the most part they didn't. After the weekend global equities made gains. The Dow Industrials lost 170.35 points or .71% into April 6th but rose 427.38 points or 1.79% last week to close at 24,360.14. The Dow is 1.75% higher this week. The S&P fell 1.38% but then rose 51.83 points or 1.99% to 2,656.30 last week. The S&P is up 1.89% this week. The Nasdaq lost 2.10% into the 6th, rose 191.54 points or 2.77% to 7,106.65 last week, and gained 2.45% through today. The Dow Transports lost 2.41%, gained 2.20%, and then rose 2.15% so far this week. Bank stocks lost 1.33% into the 6th, gained 1.24% last week, but then fell .84% into today.

Resistance:	Dow:	24,858/ 25,177/ 25,495/ 25,795	Nasdaq:	7,309/ 7,412/ 7,481/ 7,566	S&P:	2,739/ 2,765/ 2,794/ 2,817
Support:		24,547/ 24,253/ 23,959/ 23,537		7,181/ 7,080/ 7,017/ 6,888		2,687/ 2,661/ 2,635/ 2,612

Other Markets

We've said Crude should be trending higher into April 25th, and Friday's high rose over $67.50/barrel for the first time since December 2014. Crude Oil fell 4.43% into April 6th but surged 8.59% higher last week. Crude fell 1.29% into today. Commodities fell 1.59% and then rose 3.87%. They're off by .16% this week. Gold rose .69% and then added .97% last week. Gold is .18% higher this week. The U.S. Dollar lost .03% and .31% over the past 2 weeks and is off again by .31% this week. The Japanese Yen fell .47% into the 6th and then lost .39% last week. It's up .33% this week. The Euro lost .15% and then rose .41%. It's better by .32% this week. Corn rose .19%, lost .58%, and then lost another 1.55% into today. Cotton rose 1.33% and then 1.05% over the past 2 weeks. It's off by .34% this week.

"We all have a few failures under our belt. It's what makes us ready for the successes." Randy K. Milholland

"The one good thing about repeating mistakes is you know when to cringe." D. Joseph Creighton

Additional Information is Available on Request

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