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BOND MARKET REVIEW

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Rampage

April is traditionally a good month for equities, but the net change for the month was no more than one would often see on a 15–minute bar (chart). There were some wild swings however and they continue! On Tuesday (05/01) there was a time when the Dow Industrials were off by 250 points – and the Nasdaq was up on the day! I don't know that I've ever seen that kind of anomaly. The Dow lost 695.80 points on April 2nd for what was at the time the worst start for that month since 1929! From the low on that first trading day, it surged 1,514.45 points into its high on April 17th. Though dropping even lower, the Dow lost 695.82 points into the end of the month. All that movement – and the Dow gained only 60.04 points or .25% for the month! Counting the Dow's swings of over 500 points, it was on a rampage – moving over 6,780 points in big moves to end up with a net change of less than 1% of that total. The S&P rose .27% in April, and all the Nasdaq could muster was a .04% gain. There was good news and earnings, but the cycles seemed to be forcing the market's hand. Even though the rallies have been impressive, it's no longer the case that investors can buy every pullback with impunity. Though ahead by over 3% in mid–April, the Dow Industrials had their lowest close today since April 2nd – and there is critical support only a hundred points below today's lows.

A Symmetric View

As widely expected, the FOMC left interest rates unchanged and focused on inflation moving closer to their goals. For those wondering what the Fed would do once inflation reached the long–awaited 2% target, the FOMC added language that basically indicates they intend to be patient with inflation going a little over the target – as they expect there will be numerous readings over and under 2% over the coming months. The **B**ond **M**arket **R**eview considers a symmetrical view as 'feeling very strongly both ways', and we read the statement as more dovish than anticipated. In March, they changed their expectation for inflation hitting their goal from *"up this year"* (and to stabilize around their 2% goal) to *"in the coming months."* May turned out to be that 'coming month.' Today's statement was altered to read: *"Inflation on a 12–month basis is expected to run near the 2% objective over the medium term. Risks to the economic outlook appear roughly balanced."* As a result, they dropped their language of *"monitoring inflation developments closely."* (It's hard to know when you truly have a real turn. German inflation just unexpectedly fell from 1.5% to 1.4%.) Without a lot of flair, they removed this March reason for a hike: *"The economic outlook has strengthened in recent months."* However, with a unanimous vote for a stay, the 'gradual pace' for rate increases is still very much in place – and the subsequent market–based odds for an increase in June rose to a 100% 'lock.'

Looking Ahead

- Equities should make cycle lows into May 7th and May 16th.
- Yields should trade lower from May 7th into a low near June 4th.

Treasuries, Agencies, and MBS

While stocks etched out slight gains for April, bonds lost a lot of ground and the 10–year note spent 3 days over 3% for the first time since January 2014. However, we're now getting very similar oversold and overly–bearish sentiment on bonds that compare to the overbought and bullishness on stocks leading into their highs. Granted, stocks were overbought and over–committed for a much longer timeframe, but that extension was longer than normal, bond cycles are arguing for a good May, and equities are still warning of the potential for flight to quality. We think the rally potential in bonds calls for lightening hedges and buying longer maturities. While it's not likely bonds will benefit from 'riding the curve' due to its flatness, there should be value and a trading opportunity. Last week, the curve 'bull flattened' with 2–year yields rising 2.5 bps, the 5–year unchanged, and 10 and 30–year maturity yields dropping .5 and 2 bps. Into today, yields were .5 bps higher at 2–years, .5 bps lower at 5–years, and the 10 and 30–year maturities rose by 1 and 2 bps. We continue to expect strength in the U.S. Dollar to make U.S. debt more attractive to global alternatives – especially after the recent widening spreads versus quality foreign debt.

MBS spreads (FNMA 30–year 3.5%) widened by 1 bps last week. After raising the size of long–term debt offerings last quarter for the first time since 2009, the U.S. Treasury is doing so again for Q2 2018 – upping the quarterly auction amounts of longer–term debt to $73 billion. The Treasury borrowed a first–quarter record $488 billion in Q1 2018. They also announced plans to offer a new 2–month T–Bill. Next week, the U.S. Treasury will auction $31 billion 3–year notes on Tuesday (05/08), $25 billion 10–year notes on Wednesday (05/09), and $17 billion 30–year bonds on Thursday (05/10). All these auction sizes are up $1 billion from the Q1 amounts.

04/27/18 Treasury Yield Curve	2-Year: 2.485%	5-Year: 2.801%	10-Year: 2.958%	30-Year: 3.125%
Weekly Yield Change:	+.026%	+.000%	–.003%	–.021%
Support:	2.495/ 2.515/ 2.550/ 2.590	2.781/ 2.802/ 2.821/ 2.841	2.961/ 2.987/ 3.019/ 3.033	3.140/ 3.158/ 3.184/ 3.207%
Targets:	2.470/ 2.432/ 2.392/ 2.353	2.763/ 2.743/ 2.273/ 2.684	2.930/ 2.899/ 2.867/ 2.839	3.096/ 3.051/ 3.029/ 3.003%

Economics

The Atlanta Fed's GDP–Now forecast for Q1 2018 had been as high as 5.4% but fell to 2.0% in the final estimate. The data came in at 2.30%, beating consensus estimates (also at 2.0%). While not stellar, the economy managed a respectable showing and averted a sluggish 1st quarter that had been the trend in recent years – this being the best since Q1 2015. The Q4 result was 2.90%. Personal Consumption dropped from Q4 2017's 4.00% to only 1.10%. While noting they were also very high for their early Q1 projections, Atlanta's preliminary forecasts for Q2 kicked off at 4.10%. The Employment Cost Index increased by .80%, and total compensation rose by an annual 2.70% – the best wage gains since Q3 2008. Private sector wages also improved the most since Q3 2008, rising 2.90% year–over–year. The ADP Employment Change data reported 204K private–sector jobs created versus 198K expected. However, that was the lowest gain since November and ISM Employment cooled from 57.3 to 54.2. The GDP Price Index rose 2.00%, though the core PCE was an annual pace of 2.50%. In March, the PCE Deflator was flat – though the Personal Consumption Expenditures quickened from 1.70% to a 2.00% annual pace. Core PCE rose .20%, and the annual pace rose from 1.60% to 1.90%. This is one of the Fed's favorite inflation gauges, and both were right on (or near) their 2% goal.

University of Michigan Sentiment cooled from 101.4 in March to 98.8 in April (rising .8 from preliminary data). Their Current Conditions survey fell from a record 121.1 to 114.9, and Expectations eased from 88.8 to 88.4. Americans reversed trends from early 2018 by once again becoming non–savers. In March, Personal Incomes rose .30%, but Personal Spending increased by .40%. ISM Manufacturing fell from 59.3 to a 9–month low of 57.3 in April. A measure of production dropped the most in a year back to the lowest level since November 2016. ISM Prices Paid rose for a 5th month (from 78.1 to 79.3) and New Orders cooled from 61.9 to 61.2. Dallas Fed Manufacturing Activity fell from 22.8 to 21.8 and Chicago Purchasing Managers rose .2 to 57.6. Though expected to rise by .70%, Pending Home Sales rose only .40% in March. They were off 4.40% versus last year. Construction Spending fell by 1.70% in March.

Thursday yields a few more clues into Friday's April payroll numbers from Challenger Job Cuts and jobless claims data for the last full week of the month. Also due are Q1 Nonfarm Productivity & Unit Labor Costs, the March trade Balance (deficit), the service–sector outlook (ISM Non–Manufacturing), Bloomberg Consumer Comfort, Factory Orders, and orders for Durable and Capital Goods. Friday gives us April payrolls and related data such as the U.S. Unemployment Rate – which is expected to fall from 4.10% to 4.00%. Next Monday (05/07) brings March Consumer Credit. Q1 Mortgage Delinquencies & MBA Mortgage Foreclosures are due sometime during the week. Tuesday is set for NFIB Small Business Optimism and JOLTS Job Openings. Wednesday follows with MBA Mortgage Applications (which fell 2.50% last week), Producer Prices (April PPI), and Wholesale Trade Sales & Inventories.

Equities

The bearish scenario we've laid out into May 7th and May 16th continues to 'play out.' To use FOMC language, we are 'closely monitoring the situation.' Last week, the Dow Industrials lost 151.75 points or .62% to 24,311.19. They are 1.59% lower this week. The S&P lost .23 points or .01% to 2,669.91 and is 1.28% lower this week. The Nasdaq fell 26.33 points or .37% to 7,119.80 and is .27% lower this week. The Dow Transports lost .28% and are 2.50% lower this week. Bank stocks gained .89% but are 1.96% lower this week.

Resistance:	Dow:	23,829/ 23,991/ 24,148/ 24,306	Nasdaq:	7,069/ 7,110/ 7,153/ 7,195	S&P:	2,625/ 2,638/ 2,651/ 2,664
Support:		23,534/ 23,379/ 23,229/ 23,077		6,987/ 6,945/ 6,903/ 6,860		2,600/ 2,588/ 2,575/ 2,563

Other Markets

Recall that our Crude Oil cycles were positive into April 25th, and to date prices reached a high on the 24th that was retested on the 30th. Crude should trade higher from the 4th/7th into May 21st, down into the 29th, and then peak into June 6th which is projected to be an important high at this time. Last week, Crude lost .41% after a 2–week gain of 10.18%. Prices are off by .25% this week. Commodities fell .26% but are .11% better this week. Gold lost .99% and is 1.35% lower this week. The U.S. Dollar gained 1.41% and is up another 1.09% this week. The Japanese Yen lost 1.29% and is .72% lower this week. The Euro dropped 1.29% and is 1.48% lower this week. Corn gained 3.45% and is 1.67% better this week. Cotton lost .16% and is off another .38% this week.

"One doesn't discover new lands without consenting to lose sight of the shore for a very long time." Andre Gide

Additional Information is Available on Request

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