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BOND MARKET REVIEW

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Systole and Diastole

The U.S. economy is pumping along, but there are yins and yangs to consider. Most of the incoming news is very good. Many U.S. stock indices went ahead for 2018 this week and the U.S. Unemployment Rate fell to 3.9% – the lowest since 2000! Earnings for Apple, Amazon, and Facebook all surprised to the upside. It's interesting that the number of job openings in March rose to a record 6.55 million, nearly as many available jobs as there were unemployed (at 6.585 million in March). Workers may need to move, or gain some skills, but the jobs are out there.

The U.S. economy added 164K non–farm jobs in April, up from March's 135K gain – with 30K being added in a 2–month revision. Private payrolls grew by 168K. According to government data, there are 6.346 million unemployed Americans. However, the report wasn't all it was hyped up to be! The Labor Force Participation Rate fell from 62.90% to 62.80%, 236K workers dropped out of the workforce, and the number not in the labor force grew by 410K. The data also showed that 1.338 million more Americans were categorized as 'not in the labor force' since April 2017. Manufacturing has been steadily growing and added 24K workers. Note that into January 2010, manufacturing lost workers for 41 months (pre–revisions). April payrolls were also setback by lukewarm wage gains.

Remember when California was 'on paper' the world's 6th largest economy? The state now ranks number 5 globally, having passed the United Kingdom's $2.625 trillion GDP with a $2.747 trillion reading. California had fallen to #10 in 2012. The effect of cancelling the Iran nuclear deal is expected to be far less an obstacle than it would have been years ago. Ask anyone who waited in gas lines in the '70s to fill their Vista Cruiser (or pretty much any other gas guzzler of the period). This week, Citigroup reported that the U.S. was expected to pass Saudi Arabia over the next year to become the world's largest exporter of crude and oil products. (Note the inclusion of oil products!) Last week, U.S. export levels rose to 8.3 million barrels per day. In January, Saudi Arabia was at 9.3 million bpd and Russia stood at 7.4 million bpd. As of May 4th, the U.S. (Baker Hughes) oil rig count was up 155 versus last year to 1,032.

There's a lot of concern about trade tariffs having a negative effect, but there's no slowdown yet. In theory, tariffs are in a way similar to Fed hikes. Each are to slow the trajectory of a growth pattern and/or correct an imbalance. Yet, the U.S. deficit with China is widening – and grew by 16% to $91.1 billion in the 1st quarter. The administration is seeking to hammer out a better deal. The trade balance deficit (overall) declined from $57.7 billion in February to $49 billion in March. Imports fell the most in 2 years, with OPEC and Germany contracting, and exports rose the most since November. Tax cuts aside, at $214.3 billon, the U.S. Treasury had its largest April surplus on record! The budget deficit is still running 12% deeper than fiscal 2017 (versus 13.8% in March) – due to rampant spending!

Looking Ahead

- Equities have a low due near May 16th, a high near May 22/23, and another low near May 30th.
- Yields should trade down into a cycle low due in the May 31st to June 4th window.
- Don't forget Mother's Day this Sunday May 13th!

Treasuries, Agencies, and MBS

The shorter–term bond cycles have been off by a few days recently, though the downturn in yields we expected to start on the 7th may have instead begun on May 9th. Either way, the medium and longer–term yield cycles are pointing lower into month end – so counterintuitively, bonds may be the place to be for the next 3 weeks. The year–end **B**ond **M**arket **R**eview (01/11/2018) forecast: *"The highest yields should come in near early May, late July, and early October."* The market–based odds for a June rate increase remain at 100%.

While it's easy to focus on rising 2–year yields, to date, longer rates peaked on April 25th. With the potential for longer yields declining, the 2–to–10–year spread narrowed today to its flattest level (at 43 bps) since September 2007. Yields beyond 3–years have now declined for a second week. Last week, though 2–year yields rose 1.5 bps, they fell by 1.5, .5, and .5 bps for the 5, 10, and 30–year sectors. Into today, yields were higher by 3.5, 4.5, and 1 bps at 2, 5, and 10–years, but 1.5 bps lower at 30–years. MBS spreads (FNMA 30–year 3.5%) were unchanged last week.

On Tuesday (05/08), the U.S. Treasury sold $31 billion 3–year notes at 2.664%. Demand was the lowest since November and the yield was the highest since May 2007. The group that includes foreign central banks bought 45.6% of the issue (versus 47.6% last month). On Wednesday, $25 billion 10–year notes drew a yield of 2.995%. The yield was the highest since the January 2014 auction – which at 3.009% was the last over the 3% threshold. Demand rose versus April and foreign buying rose from 53.2% to 63%! Today's 30–year bond brought 3.13% for $17 billion in supply. That yield was the highest since March 2017 and demand fell versus April, but it was higher than the average of the last 3 offerings. Foreign allocations rose from 61% last month to 62.7% for this auction.

05/04/18 Treasury Yield Curve	2-Year: 2.499%	5-Year: 2.785%	10-Year: 2.951%	30-Year: 3.123%
Weekly Yield Change:	+.014%	–.016%	–.007%	–.002%
Support:	2.545/ 2.582/ 2.622/ 2.663	2.846/ 2.866/ 2.886/ 2.908	2.981/ 3.004/ 3.025/ 3.048	3.140/ 3.160/ 3.184/ 3.207%
Targets:	2.502/ 2.463/ 2.424/ 2.383	2.828/ 2.808/ 2.787/ 2.768	2.959/ 2.937/ 2.914/ 2.866	3.096/ 3.073/ 3.052/ 3.029%

Economics

The Atlanta Fed GDP–Now forecast kicked off Q2 2018 at 4.1% and hasn't changed much over the past 2 weeks. It stood at 4% today. Initial Jobless Claims rose 2K to 211K and then remained there this week – riding levels not seen since 1969! Continuing Claims (which lag a week) fell from 1,834K to 1,760K, and then rose to 1,790K. Challenger Job Cuts revealed 1.40% less cuts versus April 2017. The Underemployment Rate fell from 8.00% to 7.80%. Speaking to the Fed's 2% inflation target being achieved, last week FRB New York President William Dudley said: *"I wouldn't quite declare victory yet."* That may be true. Incoming data was somewhat tame! In April, Average Hourly Earnings rose only .10% and they were revised from .30% down to .20% for March. Year–over–year, they decelerated from 2.70% to 2.60%. Weekly Hours remained at 34.5. Eight of the 13 sectors saw declines in wages. However, manufacturing, education and health services, and financial activities made up most of the contraction. Construction and retail rose.

This week's inflation data failed to follow through on the previous week's PCE Deflator increases. Consumer Prices rose .20%, quickening the annual pace from 2.40% to 2.50%, but CPI ex food & energy rose only .10% stalling the annual core pace at 2.10%. Auto prices declined and airfares fell the most in 4 years. Used car prices dropped the most since 2009. Weekly Earnings (year–over–year) fell from .90% to .40% and Hourly Earnings dropped from .30% to .20%. Producer Prices rose only .10% in April, contracting the annual pace from 3.00% to 2.60%. PP rose .20% ex food & energy, dropping that annual core pace from 2.70% to 2.30%.

Inflation in the European Union fell to 1.2% in April, and the core rate dropped to .7% – the lowest in more than a year. That indicates the low–inflation battle isn't over, and the European Central Bank will most likely continue stimulus – holding global rates down. The ECB also warned of trade protectionism undermining the global economy and said the U.S. would be among the worst–affected. German factory orders fell for a third month, raising concern in the EU. The Bank of England held interest rates unchanged and cut forecasts for growth and inflation. Meanwhile, Argentina had 3 rate hikes last week. On Friday, they hiked from 33.25% to 40%. A week ago, they stood at 27.25%. Their inflation rate is 25% and they're targeting 15% with higher rates. Ours is 2% and we're targeting 2% – with higher rates!

NFIB Small Business Optimism ticked up from 104.7 to 104.8, but Bloomberg Consumer Comfort declined from 57.5 to 56.5 last week, and then to a 14–week low 55.8 today – on concerns over higher fuel prices and a 4th lower week of the personal finances measure. ISM Non–Manufacturing dropped from 58.8 to 56.8 as growth in the service sector fell to a 4–month low. The Employment Index fell from 56.6 to a year–low 53.6. Q1 Productivity rose a modest 1.3% and Non–farm Productivity grew by .70%. Unit Labor Costs rose 2.70%. March Factory Orders rose 1.60% and were up .30% ex transportation. Orders for Durable Goods rose 2.60% but only .10% ex transportation. Capital Goods Orders declined by .40%. In March, Wholesale Inventories and Trade Sales each rose .30%. Consumer Credit dropped from $13.639 billion (in February) to only $11.622 billion in March. Outstanding revolving credit dropped by $2.6 billion.

Friday is set for April Import Prices and the University of Michigan sentiment surveys. Q1 Mortgage Delinquencies & MBA Mortgage Foreclosures are due sometime next week. Next Tuesday (05/15) brings April Retail Sales, and March data for Business Inventories and foreign Treasury flows. Also due are Empire Manufacturing and home–builder optimism (NAHB Housing Market Index). Wednesday follows with MBA Mortgage Applications (which fell .40% last week), April Housing Starts & Building Permits, Industrial Production, and Capacity Utilization.

Equities

Many equity indexes forged ahead for 2018 this week. Though the Dow is up only .08%, the S&P is 1.85% higher and the Nasdaq is up by 7.27%. Stocks didn't trade down into May 7th but did get a boost from that shorter cycle. May 16th is the next key date for a low. For the bigger picture, we think Dow 23,930 is key over the next week. Breaking that level before the 16th would be detrimental. However, holding above that level into and beyond the 16th should be constructive.

"Sometimes I get the feeling the whole world is against me, but deep down I know that's not true. Some smaller countries are neutral." Robert Orben

Last week, most stock indices were modestly lower. But, the journey was far from routine! To close only 48.68 points lower, the Dow Industrials rose 178 points, plunged 967 points, and then rallied 731 points! That .20% loss left the Dow at 24,262.51. After 2 losing weeks, it's 1.97% higher since Friday. Following a similarly bumpy path, the S&P lost 6.49 points or .24% to 2,663.42. It's 2.24% better this week. The Nasdaq gained 89.82 points or 1.26% to 7,209.62 and is up 2.71% this week. The Dow Transports lost 1.70% but rose 2.27% into today. Bank stocks lost 1.71% but rallied 4.00% into today – to also rise 3.80% for the year.

Resistance:	Dow:	24,921/ 25,078/ 25,235/ 25,396	Nasdaq:	7,409/ 7,453/ 7,495/ 7,538	S&P:	2,742/ 2,750/ 2,763/ 2,781
Support:		24,759/ 24,542/ 24,291/ 23,930		7,367/ 7,324/ 7,280/ 7,238		2,717/ 2,699/ 2,672/ 2,657

Other Markets

Crude Oil is back with a positive cycle and hit nearly $71.5/barrel today – partially on Iran's firing of missiles into northern Israel this week. History is constantly repeating! We spoke of oil surging near our primary target in the **BMR** (11/07/2017) as we said Saudi Arabia *"blamed Iran for an incoming missile that was deemed a potential act of war."* Recall our price objectives from the **BMR** (10/30/2017). We said: *"We have a $58.85 short–term target for Crude Oil, and our longer term is in the $74.90 to $76 range."* That target is certainly in range at present!

Crude Oil rose 2.38% last week and is 2.35% better this week. Commodities gained .93% and are .62% higher this week. Gold fell for a 3rd week (by .66%) but is .58% higher this week. In turn, the U.S. Dollar rose for a 3rd week – gaining 1.17% and is another .12% higher this week. The Japanese Yen lost .06% and is .26% lower this week. The Euro tumbled 1.40% and is off another .38% this week. Corn gained 2.37% but lost 1.00% into today. Cotton rose 1.20% last week but is 2.07% lower this week.

"An undefined problem has an infinite number of solutions." Robert A. Humphrey

"My life has no purpose, no direction, no aim, no meaning, and yet I'm happy. I can't figure it out. What am I doing right?" Charles M. Schulz

Additional Information is Available on Request
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