BOND MARKET REVIEW

June 28, 2018

Streaks

The 'group stage' of the World Cup is set. While Germany ended a streak and failed to make what Americans would call the 'Sweet 16' for the first time (with no chance to defend their title), global markets indicated that investors were baffled at how to read a potentially–escalating trade war. Since June 18th, Crude Oil has surged 16.42% – closing over $74/barrel for the first time since November 2014. Meanwhile, on Wednesday the spread between 2 and 10–year notes fell to 32 bps – another new low going back to August 2007.

Into last Thursday, the Dow Industrials equaled a 40–year record by closing lower for 8 straight sessions. Banks didn't stop there. While bank stocks have fallen nearly 7% since June 11th, the financial sector ETF (XLF) fell for a record 13 times beginning the 11th. After making a new low today going back to December 2017 – they halted their longest losing streak with a gain, as the Fed cleared 32 of the 35 largest banks to raise dividends. An index of global systemically important banks fell to 14–month lows today – down nearly 22% off their highs, as in another blow to Germany Deutsche Bank failed U.S. stress tests and tumbled to a new multi–decade low on Wednesday. Over the past week, Chinese stocks entered a bear market and through today were 22.4% off their January highs. Additionally, the Chinese Yuan fell 11 sessions in a row and to a new 2018 low versus the Dollar.

However, it looks as if the U.S. could finally end a streak of sub–3% GDP growth for the first time in over a dozen years! Though Q1 GDP was revised .2% lower to 2.0% on a slightly–lower revision to Personal Consumption, the latest Atlanta Fed GDP–Now forecast for Q2 2018 is 4.5% (after twice being projected as high as 4.8%). If Q1 indeed comes in around 4.5%, achieving only 2.8% for the second half of 2018 would give the U.S. its first 3% annual GDP since 2005! That said, the jury is still out on the implications of a trade war.

Looking Ahead

- Equity cycles show stocks weakening from June 25th into July 18th and then again into mid–August.
- Yields should trade lower from another trend–change high near July 2nd into a low near July 11th.
- U.S. markets will be closed on July 4th for the Independence Day holiday. Happy 4th!
- On Tuesday, July 3rd, equities will observe an early close (at 1 pm ET) and bonds will close at 2 pm ET.

Treasuries, Agencies, and MBS

Yields have lows due near July 11th and appeared well on their way with 2–year rates today dropping to the lowest levels since June 8th and yields 5–years and beyond making new lows for June. Last week, yields were modestly lower, falling .5, 3, 2.5, and .5 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today, yields were down another 3, 5.5, 6, and 7.5 bps for those sectors. The market–based odds for an August rate hike eased from 24.8% to 22.7% and September fell from 81.4% to 76.3%. Trade–war fears, falling bond yields, dropping global stocks, and a few rogue FOMC members all played a part. Global central bankers were second guessing the FOMC as well. While the Rupee crashed to a record low, Urjit Patel of the Central Bank of India said the Fed should consider the effect of *"the shortage of dollar liquidity caused by higher U.S. government borrowing."* The **B**ond **M**arket **R**eview agreed with his assessment and that the Fed should *"recalibrate its normalization plan, adjusting for the impact of the deficit."*

Minneapolis FRB President Neel Kashkari said the debate about whether unemployment might be too low to keep inflation stable and call for tight monetary policy is a *"very honest assessment of the confusion"* among central bankers. Kashkari is for moving to a neutral rate, and to then *"just wait and see how inflation evolves."* That would also be a position the **BMR** would favor. St. Louis' James Bullard said he was hearing *"full–throated angst"* over trade–war concerns from businesses in his district – especially from agriculture. Also, speaking of things with which we agree, former U.S. Treasury Secretary Lawrence Summers said he preferred a strategy of letting *"the economy grow as much as possible and respond to inflation problems as they arise."* That is, tight policy may be more of a risk than inflation.

MBS spreads (FNMA 30–year 3.5%) widened by 1 bps last week. On Tuesday, the U.S. Treasury sold $34 billion 2–year notes at 2.538%. The yield and demand were the lowest since the April auction. The group that includes foreign central banks bought 42.3% of the issue versus 39.3% last month. Wednesday's 5–year note offering brought 2.719% for $36 billion in supply. Demand was the strongest since last August and the yield was the lowest since March. Foreign allocations rose from 56.2% in May to 62%. Today's $30 billion 7–year note auction brought 2.809%. That yield was also the lowest since March and demand fell to May. Foreign buying fell from 65.5% last month to 60.6% of this auction.

06/22/18 Treasury Yield Curve	2-Year: 2.543%	5-Year: 2.768%	10-Year: 2.896%	30-Year: 3.040%
Weekly Yield Change:	–.005%	–.030%	–.025%	–.007%
Support:	2.574/ 2.595/ 2.636/ 2.675	2.737/ 2.758/ 2.776/ 2.797	2.863/ 2.883/ 2.899/ 2.914	2.984/ 3.005/ 3.027/ 3.045%
Targets:	2.495/ 2.477/ 2.437/ 2.397	2.719/ 2.698/ 2.679/ 2.641	2.843/ 2.825/ 2.804/ 2.785	2.962/ 2.940/ 2.917/ 2.894%

Economics

Initial Jobless Claims rose from 218K to 227K and Continuing Claims fell from 1,726K to 1,705K. Q1 GDP was revised .2% lower to 2.0% and Personal Consumption dropped from 1.00% to .90%. The GDP Price Index rose from 1.90% to 2.20% and core PCE remained at 2.30% for Q1. Conference Board Consumer Confidence dropped from 128.8 to 126.4 and the Present Situation ticked .1 lower to 161.1. Expectations fell from 107.2 to 103.2 – the lowest for 2018. However, Bloomberg Consumer Comfort rose from 56.5 to a 2–month high 57.3, with the buying climate hitting a 9–week high, current views the best since March, and personal finances the highest since April. Dallas Fed Manufacturing Activity rose from 26.8 to 36.5 and Richmond increased from 16 to 20. However, Kansas City fell a point to 28 and the Chicago Fed National Activity Index fell from .42 to –.15.

In May, New Home Sales rose 6.66%, from 646K to a 6–month high 689K annual units. However, Pending Home Sales slumped .50% and were off 2.80% versus May 2017. Metro home prices rose .20% in April, slowing the annual increase from 6.73% to 6.56% (S&P Case–Shiller 20–city index). The annual Home Price Index fell from 6.49% to 6.41% and MBA Mortgage Applications dropped by 4.90%. May Wholesale Inventories rose .50% and Retail Inventories were .40% higher. The merchandise trade balance narrowed in May from $67.3 billion to $64.8 billion. Preliminary data for May Durable Goods showed a .60% drop and a .30% decrease ex transportation.

Friday closes out June trading with the University of Michigan sentiment surveys, the PCE Deflator (the Fed's favorite inflation gauge), Chicago Purchasing, and Personal Income & Spending for May. Monday (07/02) kicks off July with May Construction Spending and ISM data for Manufacturing, Prices Paid, New Orders and a first look into June payrolls from ISM Employment. Tuesday follows with June Vehicle Sales, and Factory, Durable, and Capital Goods orders for May.

U.S. markets will close early on Tuesday and all day on July 4th for the Independence Day holiday. Thursday brings the FOMC minutes from their June 13th meeting, Bloomberg Consumer Comfort, the service–sector outlook (ISM Non–Manufacturing Composite) – and three more clues the June payroll numbers from jobless claims, Challenger Job Cuts, and ADP Employment Change (private payrolls). Friday is set for the May Trade balance (deficit) and the full June payroll report including labor participation and unemployment numbers. With July 4th falling in the middle of the week, and Fed minutes and June payrolls coming late in the week, the next **BMR** will await that data for the next issue.

Equities

The Dow Industrials dropped 509.59 points or 2.03% to 24,580.89 last week and was 1.48% weaker into today. The S&P fell 24.78 points or .89% to 2,754.88 and is 1.40% lower this week. The Nasdaq lost 53.56 points or .69% to 7,692.82 and is down 2.46% since Friday. The Dow Transports dropped 2.72% and have plunged 4.32% since Friday. Bank stocks fell .91% and are off another 2.46% this week.

	Dow:	Nasdaq:	S&P:
Resistance:	24,661/ 24,806/ 24,978/ 25,294	7,638/ 7,678/ 7,718/ 7,768	2,755/ 2,770/ 2,782/ 2,791
Support:	24,374/ 24,037/ 23,729/ 23,420	7,523/ 7,474/ 7,420/ 7,335	2,718/ 2,705/ 2,694/ 2,679

Other Markets

We expected Crude Oil to approach the **BMR** target range of $74.90 to $76.00 nearer June 20th, but it instead rose above $74/barrel today for the first time since November 2014. Crude rose 5.41% last week and added 7.10% into today. Commodities rose .66% and .69%. Gold lost .56% and was off 1.29% into today. The U.S. Dollar lost .64% for only its 2nd down week in the past 10, but it's .97% higher this week. The Japanese Yen rose .62% but is .47% lower this week. The Euro gained .35% but is .70% lower this week. Corn fell 1.11% and is 3.43% lower this week. Cotton lost 5.83% and is .59% lower since Friday.

"Freedom of the press is limited to those who own one." A. J. Liebling

"A child of five would understand this. Send someone to fetch a child of five." Groucho Marx

Additional Information is Available on Request

Doug Ingram, Managing Director – Commerce Street Capital Management