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BOND MARKET REVIEW

June 22, 2015

48 Hours

We had not planned on a **BMR** this week, but our 'travel computer' ended up having a few issues that prevented a number of email lists from being sent properly. This June 22 issue is an update to the one released on the 17th, and also contains that content for those that didn't receive that issue. Today, in an emergency summit, EU leaders gave Greek Prime Minister Alexis Tsipras and his government 48 hours come up with a plan that would satisfy creditors. The 5–month standoff has EU leaders nervous over losing Greece as a Euro–currency nation. German Chancellor Angela Merkel said new proposals were a step forward, but *"not yet where we need to be."* International Monetary Fund and EU payments are due by the end of June, and Greece will be in default unless a restructure settlement can be reached. Greek citizens have withdrawn roughly 20% of deposits as they await a solution. That hefty withdrawal of funds is placing Greece's banking system in danger of an imminent collapse. While Tsipras has been dangling some carrots of compromise in front of the EU, we all know the story of the Trojan Horse!

Looking Ahead

- We would sell rallies in bonds, as yields should be generally higher from June 22nd into late July.
- Our stock cycles point to a high in late June.

DeflateGate II

As bubbles unwind – they're often unkind. When the New England Patriots were determined to have been using deflated footballs, they were fined and Tom Brady was suspended for 4 games. We read today that one of the deflated balls was expected to bring at least $25,000 at auction. Brady is now seeking total exoneration as the tests the NFL ran to determine his guilt apparently can't be replicated. What good is scientific data that can't be verified? The testing data reads like economic reports – and is not holding up to challenges. The first read on GDP for the first quarter was mildly positive. Then it was adjusted to a .70% contraction. It's expected to be revised again next Wednesday to reflect only a .30% slide. While not quite as negative, still not growth!

It turns out the real 'DeflateGate' was a global bet that EU prices would be so restrained that the wise choice was to bid bonds to negative yields. With a giant EU QE assist, even as late as April many EU nations had negative yields on short maturity bonds – and a few were close to zero or negative out to 10–years! In the **B**ond **M**arket **R**eview (04/01/15), we noted the *"Bank of England just warning of their first deflation in 5 decades"*, *"the Bank of Japan still trying to wage a decades–long war against the same"*, and the European Central Bank struggling to preserve its member nations *"just months into its own giant QE."* You have to be committed to bid long–term bonds to negative yields, and bund investors are now bearing the brunt of that over optimism.

Point to point, the U.S. bond market had a calm week into the 12th, with yields mixed – and changing only around 1 bps. In the middle of that was some wild volatility with Greece missing (postponing) debt payments and appearing very uncooperative with ECB leaders that were trying to prevent a Greek exodus from the EU common currency. As we said, Greece's own citizens, who voted in leaders that were against austerity measures, were starting to hoard cash as many still think that exit may be inevitable. The next bailout deadline is now June 30th, when Greece needs to make payments on its $352 billion (EU equivalent) debt.

Greece's Prime Minister Alexis Tsipras was called by U.S. Treasury Secretary Jacob J. Lew, who asked him to get serious about reaching an agreement. Tsipras instead went on the offensive arguing that the International Monetary Fund *"bears criminal responsibility for the situation in the country."* He said the ECB methods for seeking Greek concessions were *"financial asphyxiation."* In the wake of all this, and hints of upticks in inflation, EU bond investors have seen yields surge higher. While the German 2–year went from a –.29% to –.16%, that Greek equivalent soared from 17.55% to 29.11% – obviously not on inflation concerns but more on default risk. Germany's 10–year debt surged from .05% to .98%, but settled back a little to .88% given renewed global growth concerns. Greek 10–year debt had climbed from 10.14% to 13.23%, but settled back at 10.138% today given the promise of compromise. Their 2–year recovered back to 22.28%.

Based on previous data and comments by FOMC members, for most of 2014 the presumption was that the first Fed hike since 2008 would come by June 2015. It was assumed 6 months past the end of QE purchases, which originally would have been in December, but instead concluded in October – making even the April 2015 meeting a possibility for liftoff. April fell 'off the table' with negative Q1 GDP. Now both have come and gone!

The FOMC text released on June 17th suggested labor and economic growth conditions were improving, albeit moderately. However, other than the headline U.S. Unemployment Rate, there was little concrete data and evidence to support the Fed acting at this time – or even the upcoming July 29 meeting as we see it. The Fed's text was very little changed versus April. Despite the more–upbeat first paragraph, Fed officials downgraded their economic growth forecasts from March's 2.3% to 2.7% to only 1.8% to 2.0%. Thus, the Fed joined the IMF, the World Bank, and the OECD in reducing forecasts (as we covered in our June 10th issue). That sent short rates lower after the FOMC statement was released.

In their post–meeting comments, the Fed was still signaling a liftoff in rates sometime in 2015, and assuring the markets that the path to higher rates would be gradual. Fed Chair Janet Yellen said: *"Since the committee last met in April, the pace of job gains has picked up and labor-market gains have improved further."* She cited *"tentative signs of stronger wage growth."* She said the FOMC viewed first quarter GDP weakness as *"largely transitory."*

Treasuries, Agencies, and MBS

As we said earlier, bonds ended nearly unchanged into the 12th, despite a mid–week global panic concerning Greece's debt. Last week, aided by Greece's possible EU–exit panic, the Fed's reduced growths forecasts, and Janet Yellen's implications that rate hikes could be delayed until later this year, rates dropped nicely. Aided by the Fed's non–aggressive stance, yields fell 11, 17.5, 13.5, and 5.5 bps for the 2, 5, 10, and 30–year Treasury sectors! The Fed's dot–plot charts indicated only one hike this year – supporting the stance of FOMC members that are also a form of guidance calling for only gradual hikes after the initial liftoff. Into the 12th, U.S. 2–year debt had risen 1.5 bps in yield with 5–year yields edging only .5 bps higher. However, yields for 10 and 30–year maturities fell just over 1 bps. Today, Treasuries fell as stocks were advancing and debt payment EU–Greek talks were at least progressing. Yields rose 4, 9.5, 11.5, and 11.5 bps. MBS spreads (for FNMA 30–year 3.0%) pulled in by 2 bps the previous week, but reversed those 2 bps last week. June 22nd is our next trend–change expectation for a low yield.

Thursday, June 11th's $13 billion 30–year bond brought a yield of 3.138% in an auction rated an above–average '4 of 5'. Demand improved versus last month and the yield was the highest since September. Foreign buyers accounted for 52% of the issue versus 50.8% in May. Auctions resume with a new $26 billion 2–year note next Tuesday (06/23), $35 billion 5–year notes on Wednesday, and $29 billion 7–year notes on Thursday.

06/19/15 Treasury Yield Curve	**2-Year: 0.619%**	**5-Year: 1.572%**	**10-Year: 2.259%**	**30-Year: 3.161%**
Weekly Yield Change:	–.109	–.173	–.134	–.055%

06/12/15 Treasury Yield Curve	**2-Year: 0.728%**	**5-Year: 1.745%**	**10-Year: 2.393%**	**30-Year: 3.103%**
Weekly Yield Change:	+.017	+.004	–.015	–.011%
Support:	0.68/ 0.71/ 0.75/ 0.78 %	1.70/ 1.75/ 1.80/ 1.84%	2.40/ 2.45/ 2.49/ 2.53%	3.16/ 3.22/ 3.27/ 3.32%
Targets:	0.62/ 0.61/ 0.58/ 0.55%	1.62/ 1.60/ 1.56/ 1.51%	2.33/ 2.29/ 2.25/ 2.21%	3.10/ 3.05/ 3.00/ 2.96%

Economics

With all components in positive territory, the Leading Index rose .70% in May to repeat April's promising result. Building permits and low jobless claims continued to boost LEI. May Retail Sales rebounded with a 1.20% gain. They rose .70% for the 'control group'. The Import Price Index rose 1.30% in May, but that merely slowed the annual negative pace from a –10.50% to –9.60%. Likewise, Producer Prices rose .50%, and .10% ex food & energy – slowing the annual loss from –1.30% to –1.10%, but lessening the core pace (ex food & energy) from .80% to .60%. Consumer Prices rose .40% in May, though that just raised the annual pace to unchanged (from –.20%). Ex food & energy, CPI was .10% higher – leading the annual core pace down .10% to 1.70%.

Initial Jobless Claims dropped from 279K to 267K – now 15 weeks below the 300K threshold. They had risen a slight 2K the previous week. Continuing Claims rose from 2,204K to 2,272, and then fell back to 2,222K over the past two weeks. Industrial Production fell .20% and Capacity Utilization dropped from 78.30% to 78.10%. Business Inventories rose .40%. Empire Manufacturing fell from 3.09 to –1.98. University of Michigan Sentiment rose from 90.7 to 94.6, with expectations rising 2.6 to 86.8 and the current conditions read improving from 100.8 to 106.8. Bloomberg Economic Expectations was 3.5 points higher to 47.5 and the Philadelphia Fed Business Outlook rose from 6.7 to 15.2. The Chicago Fed Nat Activity Index edged .02 higher to higher to –.17. The NAHB Housing Market Index showed home builder optimism sharply higher (from 54 to 59). That said, even though Building Permits rose 11.80% to 1,275K, Housing Starts fell 11.1% to 1,036K.

Existing Home Sales for May rose 5.11% to a 5.35M pace. First time homebuyers are contributing to housing's best start since 2009. April saw large inflows into U.S. Treasuries as foreign investments increased by $106.6 billion – with $53.9 billion going into longer–maturities. The Current Account Balance for the first quarter came in a little better than expected, but still a deficit of $113.3 billion.

Wednesday is set for MBA Mortgage Applications (which were down 5.5% last week), and updates for 1st–quarter GDP data. Given a few improvements, GDP is expected to be revised .50% higher to a still–negative –.20%. Thursday brings May Personal Income and Personal Spending, the Fed's key inflation read from the PCE Deflator (Personal Consumption), and jobless claims data. Bloomberg Consumer Comfort is also due. It fell from 40.5 to 40.1, but then rose to 40.9 last week. Friday closes out next week's data with University of Michigan confidence and sentiment survey results. The following Monday (06/29) is set for May Pending Home Sales. Tuesday closes out June trading with S&P/Cash–Shiller home price data and Consumer Confidence. Wednesday (07/01) opens July trading with the first reads on the next Friday's June payroll numbers from Challenger Job Cuts and ADP Employment Change. Also due are Construction Spending, ISM Manufacturing, and June Vehicle Sales.

Equities

Stocks continued higher – rising into our end–of–June cycle for a high (which could be a tradeable top). The key trend–change date for now is June 29th. The Nasdaq finally broke through the March 2000 highs into record territory for the past 3 days! Following 3 weeks of losses, stocks are now working on a third weekly gain. The Dow rose 49.38 points into the 12th and then added 117.11 points or .65% to close at 18,015.95 on Friday. It was up .58% today. The Nasdaq lost 17.36 points into the 12th, but then rose 65.90 points or 1.30% to close the week at 5,117.00. It was .72% higher today. The S&P had risen only .06% the week of June 12, but added 15.88 points or .76% to 2,109.99 last week. It rose .61% today. The Transports fell 1.09% and then .06% over the past two weeks, but rose .81% today. Bank stocks rose 1.61% into the 12th, fell .85% after rates dropped post–FOMC last week, but powered 1.24% higher today!

Resistance:	Dow:	18,166/ 18,232/ 18,300/ 18,369	Nasdaq:	5,170/ 5,188/ 5,205/ 5,242	S&P:	2,132/ 2,143/ 2,155/ 2,166
Support:		17,899/ 17,839/ 17,767/ 17,697		5,104/ 5,025/ 4,991/ 4,977		2,109/ 2,097/ 2,086/ 2,073

Other Markets

Commodities rose .45% and then fell .63% over the past two weeks. They gained .50% today. Crude Oil had risen 1.40% into the 12th, but fell .58% last week, and was then .50% higher today. Gold gained .94% and then 1.93%, but plunged 1.48% today. The U.S. Dollar lost 1.43% and then .75%, but was .26% higher today. The Japanese Yen gained 1.78% and .55% over the past 2 weeks, but was .54% lower today. The Euro rallied 1.37% and .76%, but was off .10% today. Corn lost 2.08%, gained .07%, and then rose 1.91% today. Cotton rose .09% and then fell 1.17%, but was 1.12% higher today.

"If I had my life to live over... I'd dare to make more mistakes next time." Nadine Stair

"Happiness often sneaks in through a door you didn't know you left open." John Barrymore

Additional Information is Available on Request

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