The BMR 2015 Year–End Review and Forecasts for 2016

The Big Short

2015 was a year of ups and downs – though some of the downs weren't bad. The U.S. Unemployment Rate went from 5.6% at the end of 2014 to a flat 5% – a level it held the entire 4th quarter. In our last **BMR**, we noted the S&P and Dow were *"too close to call"* as for 'up or down' with only two trading days to go. The Dow had risen 7.26%, 26.50%, and then 7.52% over the past three years. The **BMR** cycles argued for down. We said stocks should trade off from December 30th to January 11th. From the high on the 30th, the Dow cratered 8.37% into today's low. It turned out that the cycles were spot on, and stocks lost ground the last two days of 2015, giving the Dow and S&P their first losing years since 2011. The Nasdaq ended 5.73% ahead – winning for a 4th year, but the Dow was off by 2.23% and the S&P lost .73%. The broader market (NYSE) lost 6.42% and the Dow Transports tumbled 17.85%.

It was a big down move for Commodities and Crude Oil! Inflation remained a non–event for the most part as Crude Oil fell 30.47% to 12–year lows as a follow up its 45.87% plunge in 2014. Commodities fell 23.40% to multi–decade lows on the heels of their 2014 loss of 17.92%. Falling fuel and commodity prices along with a strong U.S. Dollar gave Americans more spending power, but manufacturing suffered as exports fell. Wages failed to measurably increase, despite the lowest firings in decades and an increase of 2.65 million jobs. Yet, with most other central banks remaining in stimulus mode, and our Fed beginning to hike, the Dollar has been king. Our 16–year record for calling Fed moves remained intact, though in recent years it's been a lot easier – with no reason for a call since 2008! However, the Fed is much more transparent than they used to be! Nonetheless, the stimulus that has propped up the stock market is going away. The December 2015 hike was the first FOMC tightening since June 2006.

Turmoil over sovereign debt, terrorism, Russian power plays, and falling oil, had global yields trading in negative territory for much of 2015. Imagine your stocks falling and negative bond returns to boot! Swiss yields went negative out to 10–years. Germany's inflation rate went negative and their 5–year note traded to negative yields for the first time. U.S. rates also went negative, but only for short instruments. For much of 2015, U.S. bonds caught a bid due to the gap between our debt rates and global alternatives. With our Fed projected to hike rates, the U.S. Dollar remained strong through the year. That strength sapped demand for U.S. exports and further challenged manufacturing. As the world's supplier, it's noteworthy that Chinese manufacturing has seen a large slowdown. There are so many catalysts that could lead to another setback to global growth. German stocks had been up over 26% in 2015, but as of today's close were only .20% better to the end of 2014. Many global equity markets were, as Brazil, down double digits.

Looking Ahead

- Bond yields have lows due between January 20th to the 26th.
- Our stock cycles show the next high near January 22nd, followed by a low into January 27/28.
- The financial markets will close to observe Martin Luther King, Jr. Day on Monday, January 18th.

Stocks started off 2016 with their worst week since September 2011, but the more ominous message was that it was probably the worst beginning week of any year ever. We have a lot of data, and couldn't find a 6% loss for the first week even going back to the 1930's. Overall, the Dow fell over 8% with our December 30th to January 11th cycle. The January barometer and effect, which we'll cover later this month, have some severe handicapping at present levels! The **BMR** still has a longer–term cycle low due in 2016. These 'trough lows' rarely occur without a modest or severe recession. A number of Fed members said our data was good, and that this equity selloff would have little impact on their policy or the American economy. That remains to be seen! The cost of financing the U.S. national debt has been in part hidden by low rates. Higher rates will begin to accelerate the debt level.

Since the financial crisis, somewhere between 500K to 600K global banking jobs have been lost. While there's a part of the population that puzzlingly thinks that's a good thing – and even gloats over it, the **B**ond **M**arket **R**eview has a much different take. Sure, some of the drop has been due to automation, but our read is there are countless millions that no longer have the wherewithal to require banking services. Put another way, bank jobs exist to help people with their money. A staggering number of Americans are one payday away from being on the streets. A large percentage are working limited hours per week as their employers have no ability to pay their healthcare per the mandates for full time employees. U.S. Labor Force Participation fell back to the lowest levels since the '70s. There were a record 94 million Americans of the work force, a record number of women (over 56 million), and teenage males experienced a jobless rate near 20%. In July, teens not in the workforce rose to 41.3% – the worst in the post–WWII era.

Like the frog that doesn't realize he's in slowing boiling water, America is populated with people that are settling for less. Less money, less work hours, less benefits. The U.S. is changing from a manufacturing economy to a service–based one. Making pizzas and sandwiches – as long as you don't put in more than 28 hours a week (per job). Likewise, the financial jobs diminished and service jobs increased. Hopefully, it's not all: 'Do you want fries with that?'

Unfortunately, 2015 saw resumed terror attacks across the globe. Russia renewed border conflicts, and entered the ISIS fight in the Middle East. A nuclear deal was made with Iran – the leadership of which continues to hate the U.S., and has vowed to destroy Israel. The number of Republican presidential candidates entering the 2016 race was amazing – as is the surprisingly–limited Democratic field.

The Fed minutes from the December 15th–16th meeting showed members concerned that the strong Dollar would continue to challenge U.S. exports. Despite plunging Crude Oil prices and Commodities at multi–decade lows, the minutes showed: *"Nearly all participants were now reasonably confident that inflation would move back to 2% over the medium term."* Their view that inflation is transitory is one we don't share – unless the medium term is out 2 to 3 years. We're hoping the Fed is not overly focused on jobs versus inflation – at least until the data starts to show decent wage gains.

Economic Cycles and the BMR Annual Issue

The annual **B**ond **M**arket **R**eview is our primary reference piece for the year – covering key points and our use of cycles for market swings. Our annual digest covers observations we made for 2015 and years past, and includes some thoughts for 2016. We have always found the study of cycles to be fascinating, and have devoted our efforts to models that uncover the intraweek to decades–long swings from overbought to oversold – and expansion to contraction. Many cycles are static and very predictable – such as tides, seasons, and lunar cycles. Farmers use almanacs to know when they'll have full or new moons, but don't know if there'll be an extra–cold winter or a very–dry growing season. It's the elasticity and flexibility of the multitudes of factors that affect economic cycles that provide such a great challenge – and a worthy and ongoing pursuit. We'll continue to hone our techniques and hope you find them of interest and value.

For those that have asked: In no particular order, we use techniques developed by W.D. Gann, J.M. Hurst, Peter Cogan, and George Lindsay (not Goober) to name a few. We base a lot of our sequence math on the work of Leonardo Fibonacci, Leonhard Euler, and of course Euclid. We use Fourier Transforms with derivative processes and the refinements of numerous mathematicians that sought to remove the 'noise' from data in order to better determine the underlying cyclic components of market or other data sets.

The BMR Forecasts for 2016

- The Fed intends to hike 4 times in 2016. At this juncture, our cycle work leads us to believe we won't see 4 hikes in 2016. The data just may not cooperate.
- We still have a major economic trough due in 2016. For that reason, the global GDP recovery should remain elusive with inflation remaining on the low side. Any real upturn nearer or beyond the Fed's long–run inflation target above 2% should be delayed until after 2016.
- Emerging markets (beyond China) should experience debt–driven crises with their currencies. The spill over could be the catalyst for some of the turbulence we expect and might also serve to give U.S. bonds a boost.
- The added costs of security in the EU combined with continued challenges with low inflation levels will probably lead to additional stimulus measures by the European Central Bank.
- Our cycle work on stocks suggests a high near April 13th and a low near June 8th. Another important low is due in early October.
- We expect bond yields to make lows near April 1st, highs in early June, and a more important low in mid–July. The best buy opportunity could be near the end of November.

Treasuries, Agencies, and MBS

In 2015, short yields rose as the Fed finally began their liftoff – while stocks ended just a bit lower after much volatility throughout the year. For the year, yields rose 38.5, 10.5, 10, and 26.5 bps at 2, 5, 10, and 30–years, with the 10–year the least changed sector versus 2014. However, as of Friday's close 10–year yields were actually 6 bps below the end of 2014! 2016 will prove quite interesting. If the data cooperates and the Fed continues to raise rates, the interest burden will rise for consumers, companies, and governments. The interest burden on the U.S. Government could prove quite onerous. The G7 debt refinancing combined with the BRIC countries (Brazil–Russia–India–China) is projected to be over $7 trillion – with rates beginning to rise. Our shorter–term yield cycles bottom out from January 20 to the 26th. Hopefully we can tweak that as we get closer.

The **BMR** cycles for bonds showed yields rising into year end, and then being lower from the Monday, the 4th of January. Yields matched that cycle quite well, and we surmised a drop would be given an assist from our work on equities. In the **BMR (12/29/2015)**, of that expected drop, we said: *"That would line up with expected cyclic weakness in stocks from December 30th to January 11th (or possibly the 14th). We would cover bond hedging positions near the 4th, and buy bonds for an expected rally."*

So far – so good. For the last week of 2015, yields rose 5, 4.5, 3, and 5.5 bps for the 2, 5, 10, and 30–year Treasury sectors. For the first week of January, bonds had good gains on what was probably the worst annual kick off ever for stocks. Yields for those sectors dropped 11.5, 20, 15.5 and 10.5 bps!

Yields edged a bit higher today as the Dow fought back to finish higher after a 3–day loss of over 800 points. While the 2–year was unchanged, yields rose 3.5, 6, and 6 bps for the 5, 10, and 30–year sectors. The global stock selloff since December 30th has dropped the odds for a March FOMC hike from near 50% steadily down to only 38.6% as of today. Recall that the 'gradual pace' plan for the Fed was to bump rates by 25bps at every other meeting. Thus, the odds for a January increase have been zero – believing that plan. A hold in March might be the first sign of trouble! Of course, much can happen between now and then.

MBS spreads (for FNMA 30–year 3.0%) pulled in 6 bps into the 31st, but then widened 3 bps for the first week of 2016. The U.S. Treasury sold $29 billion 7–year notes on the 30th of December at a 2.161% yield. The auction was rated a below–average (2 of 5) with demand falling to the lowest levels since last March. Foreign buying fell from 55.9% in November to 47.1% for this offering. This week, the Treasury will auction $24 billion 3–year notes on Tuesday (01/12), $21 billion 10–year notes on Wednesday, and $13 billion 30–year bonds on Thursday.

01/08/16 Treasury Yield Curve	**2-Year: 0.934%**	**5-Year: 1.561%**	**10-Year: 2.116%**	**30-Year: 2.910%**
Weekly Yield Change:	–.116	–.200	–.154	–.106%
12/31/15 Treasury Yield Curve	**2-Year: 1.050%**	**5-Year: 1.761%**	**10-Year: 2.270%**	**30-Year: 3.016%**
Weekly Yield Change:	+.050	+.047	+.028	+.055%
Annual Yield Change:	+.384	+.107	+.098	+.264%
Support:	0.96/ 0.99/ 1.03/ 1.07%	1.62/ 1.70/ 1.76/ 1.82%	2.17/ 2.20/ 2.24/ 2.28%	2.97/ 3.02/ 3.06/ 3.11%
Targets:	0.93/ 0.90/ 0.87/ 0.83%	1.56/ 1.50/ 1.44/ 1.38%	2.10/ 2.06/ 2.03/ 2.00%	2.88/ 2.84/ 2.80/ 2.76%

Economics

Some of the data has been quite good, especially for jobs. However, there's too much bad with the good, so we'll have to call it mixed overall. Initial Jobless Claims rose 20K to 287K for the week of Christmas. That was the highest level since July, but still relatively low. Continuing Claims rose 10K to 2,205K. For the last week of December, Initial Jobless Claims fell back 10K to 277K and Continuing Claims rose 25K more to 2,230K. The December jobs picture began to look promising with the release of the ADP Employment Change data which showed a pickup of 257K private–sector jobs versus less than 200K expected. That was followed by Challenger Job Cuts which showed 27.6% less layoffs versus December 2014. The payroll data was good indeed. The rise in Nonfarm Payrolls was 292K – well above the 200K expected. Additionally, 50K jobs were added in a revision for the last 2 months. Private Payrolls rose 275K – confirming the ADP numbers. Manufacturing added 8K jobs versus negative expectations, and November's data was revised from a 1K loss to a 2K gain! Given those numbers, it was a little puzzling that the U.S. Unemployment Rate remained at 5.00% (a level it held throughout the 4th quarter). Part of the reason was Americans reentering the workforce as the Labor Force Participation Rate rose from 62.50% to 62.60%. The Underemployment Rate remained at 9.90%. Average Hourly Earnings were unchanged, which is also a bit inconsistent with the recent pickup in jobs. However, the annual pace for wage gains did bump .20% higher to 2.50%. Average Weekly Hours held steady at 34.5. The Fed's jobs dashboard (Labor Market Conditions Index) rose a strong 2.9 points, and was also revised from a .5 increase in November to a similarly–stronger 2.7.

Vehicle Sales fell from an 18.05M pace to 17.22M in December. Domestic Sales were also well below expectations with a drop from a 13.99M pace to 13.46M. In November, Consumer Credit rose at its slowest rate in 10 months – following a $15.610 billion rise in October to only $13.951 billion. Housing was also losing momentum as Pending Home Sales fell by .90% in November (despite an expected .70% increase). They were still 5.10% higher to last year. Construction Spending fell .40% and October's data was revised from a 1.00% increase to only .30%. ISM Manufacturing contracted the most in 6 years, falling from 48.6 to 48.2 – its weakest reading since June 2009. Declines in commodity prices and a strong U.S. Dollar were partly to blame. ISM Prices Paid fell 2 points to 33.5. ISM New York rose 1.3 points to 62 and ISM Milwaukee rose from 45.34 to 48.53. However, Chicago Purchasing Managers data fell from 48.7 to 42.9.

Bloomberg Consumer Comfort increased from 42.2 to 43.6 into December 27th, and then rose to 44.2 into January 3rd. While 44.2 is the best confidence reading since early October, the survey came before the worst week for equities since September 2011! The Service Sector outlook slipped a little, but was still optimistic (ISM Non–Manufacturing fell from 55.9 to 55.3). November Factory Orders fell .20%, and dropped .30% ex transportation. Orders for Durable Goods were flat for both. Wholesale Trade Sales fell 1.00% in November, and Wholesale Inventories dropped .30%. The U.S. Trade Balance Deficit pulled in from $44.58 billion to $42.37 billion in November. Exports and Imports dropped. It's worth noting that U.S. companies began exporting crude oil last week – lifting a 40–year ban.

Tuesday is set for NFIB Small Business Optimism, November JOLTS Job Openings, and IBD/TIPP Economic Optimism. Wednesday brings MBA Mortgage Applications (which dropped 17.40% and 11.60% over the past few weeks), the Monthly Budget Statement for December, and the Fed's Beige Book. Thursday provides Import Prices, jobless claims data, and Bloomberg Consumer Comfort. Friday is loaded with December Retail Sales, Producer Prices (December PPI), Empire Manufacturing, Industrial Production, Capacity Utilization, Business Inventories, and the University of Michigan confidence surveys. Monday (01/18) is a trading and Federal holiday for Martin Luther King Day. Next Tuesday is set for home–builder outlook (NAHB Housing Market Index) and TIC Flows (foreign Treasury operations). Wednesday brings MBA Mortgage Applications, December Housing Starts & Building Permits, and Consumer Prices (December CPI).

Reviewing the BMR Forecasts for 2015

- Congress should find this year very frustrating if they expect to unwind parts of the health care law or get a pipeline approved. Some of the employer mandates were delayed to 2015, so their effects will now begin to drag on the economy – as well as company growth and earnings.
    - Congress has tried. It's the platform on which most won office. We've become a nation of part–time workers. Hopefully the next Congress and President can hammer out a better process, but we won't know until 2017.
- We think the Fed will begin rate increases at their June meeting. We expect at least three hikes in 2015.
    - The March jobs report and global negative rate crises prevented the Fed from moving until December. They wanted to start in September, but the data just wasn't strong enough at that time.
- We still have a major economic trough due in 2016. For that reason, the global GDP recovery should remain challenged with inflation remaining on the low side. Any real upturn nearer or beyond the Fed's long–run inflation target above 2% should be delayed until after 2016.
    - Inflation is still very low, and could remain that way for a few years – especially if we experience a large pullback in 2016.
- We expect another cold winter and some cooler summer weather as well. Over the coming years, we should see a little rebound to higher temperatures as a correction to the recently very–cold trend – but the cycles show no imminent return to global warming (which actual ended around 1999 to 2001). We instead are in the first interim cold low (trough) – which is one reason we're freezing here!
    - We just had a warm Christmas, but the cold will come… El Nino will affect our weather and may help California's water tables, but that has nothing to do with 'climate change'.
- Our cycle work on stocks suggests lows near January 21st, early June, early September, and mid–November (which should be the lowest for the year). Highs are due near April 22nd, late July, and late October. At present, the April top seems to be the most important.
    - Macro forecasts are given for a roadmap. Some of these calls were good, but we would defer to our micro work throughout the year as it's fine tuned to up–to–date data.
- Bond trend changes are due 2/13/15, 7/24/15, and 12/18/15. We expect the lowest yields in late February to early March, with other lows in early May and late August. Yield highs should be around early April, late July, and late October (which could be the high yield point for 2015).
    - Lowest yield was indeed early February, and the late October cycle hit with the macro forecast. As with our stock forecasts, the fine–tuned micro forecasts during the year were much better.

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

"Talent hits a target no one else can hit; Genius hits a target no one else can see." Arthur Schopenhauer

"When you go to buy, use your eyes, not your ears." Czech Proverb

Equities

Our medium–term equity cycles showed a peak or 'top' near December 4th, and from November 19th we said: *"We would not want to be long after the 4th!"* Since that peak on the 4th, the Dow tumbled over 1,600 points or over 9% into today's low. On December 29th, we said our shorter–term *"stock cycles now show a down trend from December 30th to January 11th."* If only they all worked that well! That cycle was confirmed with the worst equity weekly performance since September 2011, and the worst kickoff ever for any year (per our records) as the Dow fell 8.37% in that 12/30–01/11 window. The next high is due around January 22nd, and the next low around the 27th–28th.

The Dow fell .72% for the last week of 2015, and dropped 1,078.58 points or 6.19% to 16,346.45 for the first week of 2016. It was .32% higher today after making a lower low with the cycle. The S&P lost .83% and then fell 121.91 points or 5.96% to 1,922.03 last week. It rose .09% today. The Nasdaq fell .81% to end 2015, and then plunged 363.78 points or 7.26% last week to 4,643.63. It lost another .12% today. The Transports fell 1.49%, and then tumbled 7.49% to kick off 2016. They were off another .46% today. Bank stocks lost 1.42% and then fell 9.14% last week. They were .20% higher today. The Santa Claus rally came, but the Grinch was lingering.

Resistance:	Dow:	16,652/ 16,918/ 17,183/ 17,434	Nasdaq:	4,711/ 4,804/ 4,887/ 5,007	S&P:	1,947/ 1,968/ 1,991/ 2,014
Support:		16,142/ 15,888/ 15,638/ 15,389		4,574/ 4,507/ 4,441/ 4,374		1,903/ 1,881/ 1,859/ 1,837

Other Markets

It should prove interesting that the 40–year ban on crude oil exports ended late in 2015, and U.S. oil companies began shipments to foreign buyers last week. As we said earlier, Crude Oil and Commodities fell hard in 2014 and 2015! Crude Oil fell 2.78% into year end, and then fell 10.48% to start off 2016. Crude fell another 5.28% today alone. Commodities rose .03% the last week of 2015, and then fell 4.30% last week. They were also lower – by 2.58% today. Gold fell 1.58% to end 2015, and then rose 3.56% last week. Gold eased .15% lower today. The U.S. Dollar rose 8.93% in 2015, while the Yen lost .37% and the Euro tumbled 10.22%. That strength in the Greenback is challenging exports. The Dollar rose .74% the last week of 2015, fell .15% last week, and gained .19% today. The Japanese Yen rose .17% and 2.46% over the past 2 weeks. It fell .43% today. The Euro lost .92% to end 2015, rose .55% last week, and gave that back with a .58% loss today. Corn lost 1.58% and then .49% last week. It fell 1.47% today. Cotton lost .60% and then another 2.97% for the first week of 2016. It rose .16% today.

2015 – The Year in BMR Quips, Quotes, and Key Economic Thoughts

These excerpts from last year's **BMR** are highly abridged to cut down on content (especially as noted with '…'). We did not focus on individual data, but rather our commentary for selected weeks. As always, back issues of the **B**ond **M**arket **R**eview are available on request.

Fear of the Great Unwind – BMR (01/08/2015)

The Fed is under pressure to begin a tightening phase, while also keenly aware of the fragility of the global economy. … If our hypothesis has been that the Fed greatly aided the rise in stocks, what kind of tantrum will the markets have when the Fed pulls the zero–rate rug from under the markets? Can they perform the magic where the tablecloth is pulled without toppling the glasses and the increasingly less–spiked punchbowl – or does everything go flying in disarray? At a time when the Fed may begin tightening by April or June, the economy is getting a lift from cheaper gasoline. Since a large part of America spends (or overspends) every paycheck, less fuel expense means more money to go to other sectors.

Deflategate – BMR (01/28/2015)

As Super Bowl weekend draws closer, the persistent story remains the alleged use of underinflated footballs by the New England Patriots in the AFC Championship game (as if one or more referees don't handle the ball on each play). However, the more–serious deflation problem is global. While underinflated balls probably had a limited effect in the Patriots 45–7 victory over the Indianapolis Colts, a lack of inflation has everything to do with a worldwide economy still struggling to rebuild the momentum of the mid–2000s. It's the reason the Fed is still 'stuck on zero' despite the U.S. outpacing the growth of global competitors. … In fact, Swiss 10–year rates are –.082%! The Swiss 2–year rate is –1.005%. 2–year notes for Sweden (–.015%), France (–.096%), Germany (–.175%), and the Netherlands (–.12%) are all negative. Japan's 2–year is yielding –.017%.

Stocks rose for a 4th day into the 22nd (last Thursday) for their best streak of the year as the ECB entered its new round of QE – inspiring global markets. It appeared the QE baton could just be passed from one central bank to another – and send stocks soaring. Apparently, it doesn't really matter who's minding the printing press – and relatively 'free' money just pours into equities. With many global short rates near zero or negative, there are few alternative investments.

A Most Violent Year – BMR (02/04/2015)

From blizzards to stock swings and crude oil prices, the beginning of 2015 has been extra volatile. Even the groundhog, Punxsutawney Phil, came out and predicted 6 more weeks of winter. Clearly Phil is not Al Gore's favorite marmot. … Global demand for U.S. debt escalated, given negative or near–zero yield alternatives. Similar European Central Bank targets of 2% inflation are likely to be even more elusive than for the Fed. While we discussed many short–to–medium term bond yields being negative in last week's **B**ond **M**arket **R**eview, Germany's inflation rate just went negative in January for the first time in over 5 years – leading to the yield on their 30–year bond falling under 1% for the first time ever.

Conspiracy Theory – BMR (02/11/2015)

We'll use **BMR #700** to revisit some very–long cycles – our primary area of interest! We follow cycle extremes, even beyond financial data. Without going into great detail, over the last week stories surfaced concerning data being intentionally skewed to promote Global Warming. Our thoughts on the subject were shaped by observing long series of data and realizing the concern was exacerbated near the peak of the warming part of that cycle years ago. Since then, no matter how much the data has failed to support the premise, temperatures have been dropping! Try convincing anyone willing to accept empirical evidence that temperatures are still on a rise in the Northeast. The Boston area just had record snowfall for a 30–day period. Nevertheless, the subject has become political – and most folks have an opinion that won't be altered either way. No matter how cold it is…

Another issue is a distortion in the Unemployment Rate. We're near statistical data supporting full employment – with roughly 30 million Americans not working! We trust Gallup for much of the poll data and stats the company gathers. Speaking to that number, last week Gallup CEO and Chairman Jim Clifton said they were *"either out of work or severely underemployed."* He said: *"Trust me, the vast majority of them aren't throwing parties to toast "falling" unemployment."* Gallup said: *"The number of full-time jobs, and that's what everybody wants, as a percent of the total population, is the lowest it's ever been. … The other thing that is very misleading about that number is the more people that drop out, the better the number gets. In the recession we lost 13 million jobs. Only 3 million have come back. You don't see that in that number."* In January, the Unemployment Rate rose, but for a good reason. Some of those folks reentered the work force! What's our conclusion? Global warming is greatly exaggerated to the upside, and the U.S. Unemployment Rate is grossly understated.

BMR (02/18/2015) – However, what if all the central bank intervention ultimately makes things worse than they would have been if left alone to market forces? We know individuals can't (shouldn't) borrow their way out of trouble. Governments, moreover central banks, have nevertheless convinced themselves they can escape a day of reckoning.

The Imitation Game – BMR (02/25/2015)

If one were to consider only raw unemployment data and stocks breaking to record highs, they might conclude that the financial crisis is well behind us and the U.S. economy is mostly healed – or even vibrant. … Someone asked me what I thought of the economy last week. Conjuring up my best Fed–speak, I said: *"Interest rates are very low, stocks are making record highs, and the economy just added 1 million jobs over the past 3 months – the best 3–month tally in 17 years! Inflation is not an issue, and the payroll data shows the U.S. is very close to full employment."* Though straight faced, my comments were met with staggering incredulity – and they looked at me as if I'd swallowed the Kool–Aid! It was like the scene from Jim Carrey's 'Liar Liar' when Fletcher realizes he can't even write something he knows isn't true. I was forced to lose my stoic expression and come clean – I'm just a bit skeptical as well (maybe more so).

This week, Germany's 5–year notes traded at negative yields for the first time. The Netherlands, Finland, and Swiss 5–year notes also have negative yields. At 1.96%, U.S. 10–year notes are trading over most EU country's 10–year equivalent – including Italy and Spain! Portugal's 10–year is yielding roughly the same as ours, while Swiss 10–year notes are yielding only .014%. Recall the derogatory term 'PIGS' attributed to the economies of Portugal, Italy, Greece, and Spain during the sovereign–debt crisis only a few years ago? Now only the bonds of Greece are demanding a higher yield premium versus the U.S.!

BMR (03/11/2015) – The ECB's Ewald Nowotny said their bond buying would get their yields positive. So, buying bonds makes yields go up? It worked for the Fed! (Growing the balance sheet is what does it.)

"My pessimism extends to the point of even suspecting the sincerity of the pessimists." Jean Rostand

"My bed is a magical place where I suddenly remember everything I was supposed to do!"

Proactive Inactivity – BMR (03/18/2015)

The Fed felt pressured to remove the word 'patient' from their statement concerning when to begin raising rates. They made sure the markets knew that that wasn't a signal they would be instead be 'impatient' once they began. In fact, they said so! Fed Chair Janet Yellen said: *"Just because we removed the word patient from the statement doesn't mean we are going to be impatient."* As we've said before, it's not liftoff that concerns investors so much as the trajectory! … There are reasons to hike. From our master cycle work, the **B**ond **M**arket **R**eview still expects a major economic trough in 2016 – and it would allow the FOMC the resource of having some ammo for the next downturn. Even though inflation is not presently an issue, the economy has produced enough jobs to send the Unemployment Rate down to the Fed's zone for 'full employment'. The **BMR** doesn't buy that the economy is anywhere near full employment or even mildly overheating.

Furious 7 – BMR (04/01/2015)

The Fed runway to takeoff is in its 7th year, but rates have taxied with no great urgency to rise. What has been furious – is the response of stocks to seven years of unprecedented stimulus! Equity bears have always been told 'don't fight the Fed!' Those that chose the challenge have encountered an also–unprecedented alliance of central banks. Every time the bears have sharpened their claws, another round of stimulus in the form of rate cuts or QE slapped them back into hibernation. Never mind the Bank of England just warning of their first deflation in 5 decades, or the Bank of Japan still trying to wage a decades–long war against the same, the European Central Bank has seen its struggles in preserving its member nations and is just months into its own giant QE. As Australia and others have still recently been cutting rates to record lows, the U.S. seems like the only nation contemplating a reversal – if only to claim victory in recovery (or store up some ammo for future disappointment).

Not only did stocks rise for the past 9 quarters, but bonds extended their longest streak of quarterly gains since 1998! Bond yields had risen into the end of 2013 to the highest levels since July–August 2011. Since then, yields have fallen for the last 5 quarters! … Fed Chair Janet Yellen said rates may increase sometime this year. She said there was no *"predetermined course of tightening"* and *"the actual path of policy will evolve as economic conditions evolve, and policy tightening could speed up, slow down, pause, or even reverse course depending on actual and expected developments in real activity and inflation."* Isn't that a bit like saying 'interest rates, stocks, and the economy could rise, fall, or mark time'? It's Greenspanesque!

The Longest Ride – BMR (04/16/2015)

What do you do when you can't hit your targets? You move them – or remove them! Pressed to come up with the conditions that would call for an end to stimulus back in 2011, then–Chairman Ben Bernanke's Fed adopted a 5.5% unemployment goal and a 2% inflation target in January 2012. Rates had already been 'near zero' since December 2008. When we dropped to 5.5% unemployment in February, and for a number of months coming into that number, it was obvious there was more slack than the number itself revealed. Concurrent with the results, labor force participation fell to the lowest since the late '70s. The number of workers that that require 2 or more jobs to get to full–time hours is still very high – partially due to employer health care mandates – and those workers still have to buy their own health insurance. This week Bernanke said: *"I don't see anything magical about targeting 2% inflation."* There certainly hasn't been! The U.S. has now missed that target for 34 months.

The Reluctant Astronaut – BMR (04/22/2015)

If you watched the 'Andy Griffith Show' years ago, one of your favorite characters was undoubtedly Deputy Barney Fife – one of the funniest roles ever on TV! Actor Don Knotts played the nervous but over–serious character very well, which led him to do a few movies like 'The Shakiest Gun in the West.' Just a few months ago, global markets were convinced the FOMC would begin to raise their benchmark rate by June. However, recent data led to a few Fed members urging caution – and that spurred memories of Don's character in 'The Reluctant Astronaut.' In that movie, he's a small town man that's deathly afraid of heights, but through a series of events – mainly to please his father – he ends up as the first lay person that NASA will send into space. If you can picture Knott's expressions and his reluctance to 'lift off', the Fed may be right there with him. Most folks don't mind takeoff, it's the landing or crashing that puts us on edge! NASA prefers to wait on the best possible launch conditions, and a number of FOMC members are similarly calling for a delay to the countdown.

BMR (05/06/2015) – While one quarter of negative GDP does not a recession make, it's troubling for the FOMC – which is striving to get U.S. rates 'off zero' – if only to store up ammo in the event a real economic slowdown comes to pass. The Fed had been under pressure from Congress to establish a rules–based approach for interest rate policy. On Friday, FRB San Francisco President John Williams said: *"Mechanically following one type of standard policy rule designed to work well under one set of assumptions can yield very poor economic outcomes when those assumptions are violated."*

Zeppelinomics – BMR (05/20/2015)

The **B**ond **M**arket **R**eview considered the FOMC minutes, inflation, and the stock market – and reasoned we were still at a crossroads. In the early '70s, rockers Led Zeppelin put it like this: *"Yes, there are two paths you can go by, but in the long run – There's still time to change the road you're on!"* As with their statement, the minutes from the April 28–29th FOMC meeting were optimistic but carefully crafted. Fed Chair Janet Yellen no doubt considered the dot–plot *"sign on the wall but she wants to be sure, 'cause you know sometimes words have two meanings."* While inflation has been in check and growth has been challenged, stocks have risen with only a few corrections since March 2009. We see the meaning in *"a new day will dawn for those who stand long!"* The Nasdaq is up over 300% to that low – and very close to its record highs of March 2000. The Dow is up 185%, and hit new record highs this week. The same goes for the S&P, which is 220% higher since March 2009. However, the Dow Transports are on 'that other path' – having fallen today to the lowest levels in over 6 months!

Tomorrowland – BMR (05/27/2015)

What does tomorrow hold? Though backing off a June hike, the Fed seems committed to a hike sometime in 2015. Though a few are still calling for better data before lifting off, last week Fed Chair Janet Yellen reaffirmed a hike *"will be appropriate at some point this year."* … She said labor was *"not there yet"* in returning to full strength, while the **B**ond **M**arket **R**eview sees those conditions as much further away. The quality of jobs, number of hours worked, and participants in the workforce are all things we don't see being remedied in 2015 (or 2016 for that matter). To that end, this week Vice Chairman Stanley Fischer posed the question for the rate liftoff: *"Which is better, early and gradual or late and steep?"* … The **BMR** is leaning to 'late and gradual' given incoming data! Fischer said: *"If we raise the rate from zero it will be harder to go back to zero if there is a problem. Our processes are not date–determined, they are data–determined."* (Other than for the current fixation on action in 2015.)

BMR (06/03/2015) – Fed Vice Chairman Stanley Fischer hoped the markets would accept his semantics lesson. He said the term *"liftoff"* that has been used to describe the exit from near–zero rates *"is the most misleading word you can imagine."* He said: *"Liftoff says we're going straight up with the interest rate."* As the **B**ond **M**arket **R**eview noted earlier – that has been their modus operandi – for nearly two decades! He said their plan was to go *"up, then along, and then another little jump."* Fischer said: *"That's not liftoff, that's crawling."*

DeflateGate II – BMR (06/17/2015)

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.

Terminator – Genisys – BMR (07/06/2015)

If you were fortunate enough to have visited the open–pit bidding floors in the New York or Chicago Mercantile Exchange, or other such venues, you got to see the hand signals and feel the excitement of a commodity trading floor. Most of us recall the Frozen Orange Juice pit from the movie 'Trading Places', where, after losing a fortune, the Duke brothers wanted to 'turn those machines back on – turn those machines back on!' They got their wish. After 167 years, most floor trading came to a screeching halt – ending forever today as the markets closed. Though, for now, floor trading for the S&P is still taking place, the machines have mostly taken over. Another advance for Skynet …

A Retraction of the Contraction – BMR (08/05/2015)

U.S. growth for the first quarter had been first estimated at only .20%, but revised to a .70% contraction, and then lessened to only a .20% drop in last month's revision. Second–quarter GDP showed a rebound of 2.30%. While that was a little less than expected, the previous first–quarter contraction was redacted to instead show .60% growth. Improved Consumer Spending is leading the way. Consumer Spending grew to 2.9% in the second quarter, following 1.8% for Q1 2015. However, there were also subtractions in revisions to previously–reported annual statistics. For the 3 years ending in 2014, GDP was shaved by .3 points to 2.1% (rather than 2.4%). 2013 GDP was only 1.5%, compared to the 2.2% result reported in 2014. That placed 2013 as the lowest–growth year since 2009.

"Wisdom is what's left after we've run out of personal opinions." Cullen Hightower

"Inspiration does exist, but it must find you working." Pablo Picasso

Pachydermal Infusion – BMR (08/13/2015)

Traction and momentum are things not accomplished by modest or moderate growth, but the Fed is still signaling a September liftoff for rates. The economy added 215K jobs in July, leaving the Unemployment Rate at 5.30%. FRB Vice Chairman Stanley Fischer said the economy was near full employment with that sector rising *"pretty fast"*, and indicated that inflation was *"very low."* Atlanta's Dennis Lockhart said 5.3% was *"just a little above"* what is considered full employment, and maintained that *"the point of liftoff is very close."* However, the **B**ond **M**arket **R**eview sees more than one elephant in the room! We understand the optimism of the glass is half full, but to say it is indeed full – when it can't be – is to us a mix of uber–optimism and denial. Yes – things are better, and maybe the Fed will hike in September, but weaker oil threatens our economy and the Labor Force Participation Rate is at a 38–year low of 62.60%. We added 215K jobs, but 144K left the workforce – leaving those not in the workforce at a staggering record 93,770,000 Americans! The July statistic for teens not in the workforce was 41.3% – the worst in the post–WWII era. … While we're watching for elephants, how has the Federal debt ceiling mysteriously been frozen near $18.113 trillion for 150 days – while the government continues to run a deficit?

No Escape – BMR (08/26/2015)

What's the Fed to do? The FOMC got overly 'invested' in the success of their policies, and set market expectations for a September liftoff. While transparency has its pluses, inflation and global equity markets decided to show up with their minuses. Last week, the **B**ond **M**arket **R**eview surmised that bond traders were telling the markets a Fed move could be premature – and that a 2015 hike could possibly even lead to a reversal, with a subsequent cut back to the current near–zero levels.

War Room – BMR (09/10/2015)

What strategy will we see next week from the battle–weary Fed? The FOMC is data dependent at this point, and three questions arise employing various semantics of the word 'lies.' We want to know what data lies ahead? What lies within the data? And, what lies are in the data? The August employment numbers were a little disappointing – or soft, but they continued a recent trend. The economy created jobs, though under expectations at 173K and at the slowest pace since March. The number of Americans out of the labor force grew to a new record (over 94 million) – leaving labor force participation at its lowest levels since the late '70s. The Unemployment Rate dropped .2% to 5.1% – the lowest since April 2008! Thus, according to the data, nearly everyone that wants a job – has one. Though the bar has been moving, the economy once again reached the Fed's goals to satisfy the measure of full employment! That said, for a number of other reasons, even the 'holdouts' are starting to believe there'll be no rate liftoff in September! Since the Fed's release of their minutes for the July meeting (on August 19th), the odds have fallen from a 50–50 chance for a September liftoff to only 26% over the past few days. A survey of economists is still closer to 50-50. The **B**ond **M**arket **R**eview is of the opinion that they should hold off for more confirming data.

Failure to Launch – BMR (09/17/2015)

What do you say – after one of the most anticipated financial moves in recent history becomes a 'non–event?' We're OK – you're not? Global markets ate our homework? The FOMC chose to look beyond U.S. growth and job creation, and capitulate to weak global growth and the IMF plea for more time. The Fed reworded the top of their statement to say household and business fixed investment spending were *"increasingly moderately."* While leaving intact their text of expectations for economic activity to expand at a moderate pace *"with appropriate policy accommodation"*, they used a global view to leave rates 'near zero' – where they've been since December 2008. If you were a sophomore in high school at that time, you'd be graduating college with the same prime rate for the entire period. This statement added: "*Recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term."*

We've also been skeptical of the jobs number, and found yet another insider that shares our concerns. Andrew Levin was an advisor to Ben Bernanke and Janet Yellen from 2010 to 2012. On Tuesday, he said: *"We're not even close to full employment."* Levin said it could take 2 years to reach full employment based on his calculation of around 2.2% 'slack' in the potential labor force. He put the 'real' unemployment rate closer to 7.25% – a number the **BMR** would believe. (That would leave only one solid quarter of GDP as a reason to lift rates, and that's just not enough!) Levin said: *"Initiating monetary tightening at this juncture would be a serious policy error."* For now – they didn't choose that path. Skipping the October meeting, the new liftoff would supposedly be in December, so we've months more modest–to–moderate growth and tame inflation to endure.

You can't put a price on your children's happiness, but they've provided me a detailed spreadsheet.

"*I believe in getting into hot water; it keeps you clean." G. K. Chesterton*

A Space Odyssey – BMR (09/30/2015)

The space of time the Fed's spent with 'near zero' stimulus is hard to fathom – especially considering the global volatility, and trillions of Dollars in gains and losses since December 2008. While the target rate's been tethered to zero, the journeys of global rates, equities, currencies, and commodities have been anything but. Since then, the S&P rose 142% – and even after a 10% drop, it's still 118% higher. Since then, the U.S. 10–year note traded from 2.04% to 4.01%, to 1.39%, to 3.04%, to 1.65%, and it's at present only a few bps from where the journey began. Despite the Fed's drive to get off zero, India just had a surprise rate cut, Japanese and German inflation just went negative, and the European Central Bank is entertaining more stimulus (or QE). Central bankers want to say inflation is slowing, transitory, low, or that there's disinflation. Negative inflation or falling prices is deflation, but they are reluctant to use that term. The cash helicopter isn't quite what it was dreamed to be! (Despite adding $7.55 trillion in debt.)

In another 'recalculation', the FOMC is now placing full employment at a 4.9% jobless rate – just .2% below the current 5.1%. It seems the FOMC's full employment measure is as transitory as their stance on inflation. … However, a puzzling space 'oddity' is the chasm between the market's and the Fed's perceptions concerning future inflation. The Treasury market is pricing inflation at its lowest level in 6 years, just as the Fed is ready to hike on what we believe to be suspect 'full employment' and their contention that the lack of inflation is only transitory. Missing either point could lead to an errant first move.

Our Brand is Crisis – BMR (11/03/2015)

If we weren't still in crisis–management mode, why would the Fed continue to hold rates near zero? Though there were no great surprises in the FOMC statement last Wednesday (10/28), the Fed was a bit more upbeat than expected. The Fed adopted a more hawkish tone, and was clearly interested in beginning to raise rates during their December meeting. Many Fed members have stated their desire for a 2015 liftoff, and the December meeting is obviously their last chance. With stocks having their best month in 4 years, the committee was empowered to be a little less cautious in crafting the wording for their policy.

Spectre – BMR (11/09/2015)

Fed Chair Janet Yellen is the 'M' in this bond story, and the spectre looming over the markets is the first FOMC hike in nearly a decade (and the first liftoff since June 2004). While the 'Q' is still there in the form of existing or even stepped up QE by other central banks, many market participants are concerned that once the Fed begins to move, they will embark on one of their relentless tightening campaigns as they did just over 11 years ago. Knowing that perception exists, some Fed members have tried to reassure the markets that a liftoff would not be followed by hikes at each subsequent meeting. Back in September, Yellen said: *"Most FOMC participants, including myself, currently anticipate that achieving these conditions will likely entail an initial increase in the federal funds rate later this year, followed by a gradual pace of tightening thereafter."* The Fed now has the data they needed and, bar any incoming data that would throw them off track, appears ready to fulfill their plans for a last–2015–chance December move.

A Foregone Conclusion – BMR (11/19/2015)

Though much of the incoming data is still poor, challenged, or showing only modest improvement, the October jobs report beat expectations and has the Fed moving forward with plans for their first rate increase since June 2006. The odds of a move in December have been holding above a 2 out of 3 chance since that last jobs report. Where the doves held a clear majority in the past meetings, they're becoming scarce – and the minutes from the last meeting show that the FOMC has been doing their best to signal an upcoming increase. With less than a month until the December 16th decision date, Fed members have also been signaling that it would take some sort of very–negative event or surprise to delay the countdown to that expected liftoff. While in the past the Fed has many times cloaked their language, they have recently sought to be very open in their transparency – in an effort to avoid a market shock.

Up the Down Staircase – BMR (12/10/2015)

The last major hurdle to a Fed rate hike this coming week would have been poor payroll numbers. Last week, we said: *"It appears that only dismal November payroll numbers this Friday would be enough to sway the FOMC to delay their liftoff until January or March 2016."* There were no such downside surprises! The Unemployment Rate remained at 5%, payrolls rose more than expected with upside revisions to the last two months, and labor force participation improved. The Beige Book reassured the Fed that growth is still at least moderate in most districts, though there are some challenges within the manufacturing sector. The committee will get a last minute view on inflation forces with producer and consumer price index updates coming before their announcement on Wednesday.

"It is through creating, not possessing, that life is revealed." Vida D. Scudder

"Better shun the bait, than struggle in the snare." John Dryden (1631 - 1700)

One thing not lately mentioned by apologists for higher rates is that the Fed typically hikes rates to slow the economy. With only modest growth and a recent downturn in manufacturing, that can't be the goal here. Neither are current inflation levels a present threat. It seems the largest argument is that 'it's time', or at the very least to store up ammo for another cut when and if needed. … What remains to be seen is, should she choose to go with the launch, whether or not Yellen can persuade a unanimous vote for liftoff with the current Fed vote holders? There are certainly plenty of 'yea' votes standing at the ready.

The Force Awakens! – BMR (12/17/2015)
FOMC moves are normally no big deal, but there hadn't been a change in their key rate since it hit 'near zero' near the end of 2008, there'd been no increases since June 2006, and the last liftoff dated back to June of 2004. In fact, this move had been so trumpeted, the FOMC actually risked some credibility had they not kicked off with a 25 bps hike on Wednesday. The Fed's been talking up a gradual pace of rate increases for quite a while. … While the Fed has 8 meetings scheduled in 2016, their dot–plot forecasts are 'signaling' only 4 hikes. Yellen said: *"We really need to monitor over time actual inflation progress to make sure that it is conforming, it is evolving in the manner that we expect."* Retaining some license and mystery, she said not to expect equally spaced hikes. Given some of our cycle work and economic assessments, the **B**ond **M**arket **R**eview is leaning to the <u>under</u> on those projections of 4 hikes.

Despite Crude Oil and Commodities tumbling to their lowest levels in over a decade, the FOMC said: *"Inflation is expected to rise to 2% over the medium term as the <u>transitory</u> effects of declines in energy and import prices dissipate and the labor market strengthens further."* Even a first–year law student might object to deeming free–falling commodities and low inflation as transitory – citing the assumption of facts not in evidence!

Point Break – BMR (12/29/2015)
With the Fed's first rate hike since June 2006, the tether holding short rates down has been removed – and the loosening stakes are allowing the economic winds to now lift rates. Over the past week, U.S. 2–year Treasury yields broke above 1% for the first time since April 2010. However, the spread between 2 and 30–year yields just fell to the lowest level since this past April.

"Always go to other people's funerals. Otherwise, they won't come to yours."
"I never said most of the things I said!" Lawrence Peter 'Yogi' Berra (5/12/1925–9/22/2015)

"When someone tells you something defies description, you can be pretty sure he's going to have a go at it anyway."
Clyde B. Aster

"First say to yourself what you would be; and then do what you have to do."
Epictetus

"You can't do anything about the length of your life, but you can do something about its width and depth!"
Evan Esar

Additional Information is Available on Request
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