BOND MARKET REVIEW

March 31, 2016

Un–Lonesome Dove

While the Fed had its share of members arguing to stay the course on rate increases – even if only gradually, Fed Chair Janet Yellen was not the 'lone stranger' in the dove camp. One of the quotes from 'Lonesome Dove' was: *"Yesterday's gone on down the river, and you can't get it back."* GDP growth over 3% vanished 10 years ago and any tangible inflation hasn't returned since the financial crisis. Living off bond interest has become a thing of the past, and a number of global rates are still negative – some out to 10 years! A few Fed members spoke against relying on the 'dot plot' chart (reflecting the member's collective forecasts of where rates might be over the next 3 years). While those dot plots are traditionally a bit optimistic (at least to us), the markets believed the March numbers which indicated only 2 more hikes for 2016. Whether or not the intent, that's what the markets read into them! St. Louis FRB President James Bullard said he'd even considered *"dropping out unilaterally from the whole exercise,"* believing that the projections lead to uncertainty.

The quarterly gain for stocks was not that impressive, but the recovery within the quarter was nothing short of amazing! On March 1st, the S&P gained 2.93%. Though it rose 6.60% in March, it was only .77% higher for the quarter (and for the 2016). However, in early February, it was off by 11.44%! The dovish tone set by the dot charts, and comments by Yellen and other Fed members, have resulted in the U.S. Dollar plunging, bond yields falling, and stocks recovering for a quarterly gain after falling by 10% (or more) for the first time since 1933. For her part, Yellen said *"caution is especially warranted"* given low rates and the Fed's ability to respond to economic disturbances. She had said: *"I consider it appropriate for the committee to proceed cautiously in adjusting policy."* Global markets had been worried about one of those Fed campaigns where they relentlessly tighten at every meeting until they quit. Those participants had been placated by the announced 'gradual approach', indicating every other meeting, but turmoil still hit when that campaign was viewed as reality. Before Yellen's comments, the odds for an April hike were 6%, with July at 47.9% and September at 57.3%. As of today, the market saw the odds for April at zero, July at 32.8% and September only 40.9%. In fact, the market is currently placing the first hike with a over 50% chance as December! Joining Yellen in the dove camp, Chicago's Charles Evans said: *"A very shallow path – such as the one envisioned by the median FOMC participant in March – is the most appropriate path for policy normalization over the next 3 years."* We read into that, uber–gradual, affirming the dot plot, and for quite a while (3 years).

The U.S. Dollar had rallied strongly since May 2014 as the Fed was removing asset purchases and considering imminent rate hikes – while its global counterparts were fighting tougher disinflation forces and growth problems, and pointing to additional stimulus. With the Fed backing off, or the perception that they are, the Dollar had its worst quarterly loss since 3Q 2010 – and its worst monthly loss in 5 years! Bond yields had been expected to rise, but the supposed dovish shift (and other factors) have given Treasuries their best quarter since 2Q 2012.

Looking Ahead

- Our bond cycles have yield lows due April 1st and 7th, with a subsequent rise into April 26th.
- Our equity cycles are calling for a drop into an April 4th–to–7th window.

Treasuries, Agencies, and MBS

It was a huge quarter for bonds, despite the Fed's hike in December. The **B**ond **M**arket **R**eview's cycle work kept us on the right side for most of the 'corners.' While 10–year yields fell sharply as equities cratered into early February, they rose as stocks began to rally, but retained a good portion of their gains despite a number of U.S. indices reaching new 2016 highs this week – and going back positive for the year. Though yields were only modestly changed in March, they recovered a lot of ground from the middle of the month spike to recapture the gains of the first 2 months of 2016. In the 1st quarter, 2, 5, 10, and 30–year yields dropped by 32.5, 55.5, 50, and 40.5 bps! Just as March saw little net changes in yield, last week the 2, 5, and 10–year rates rose 3.5, 4.5, and 2.5, while 30–year yields were flat.

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The cycles had called for yields to drop from March 21st into April 1st, and bonds have rallied as expected. While yields could pull back again into April 7th, after that they project higher into a turning point due April 26th. Into today, with our cycles lower into April 1st, the 2, 5, 10, and 30–year yields dropped a strong 15, 17.5, 13, and 6 bps.

MBS spreads (for FNMA 30–year 3.0%) widened another 4 bps last week. This week's 2, 5, and 7–year note auctions were all rated an average '3 of 5'. On Monday, the U.S. Treasury sold $26 billion 2–year notes at a .877% yield. Demand was off to last month, and foreign participation fell from 55.8% in February to 47.4%. Tuesday's $34 billion 5–year note sale brought 1.335%, with the weakest demand since the December 2015 offering. Foreign buyers accounted for only 53.9% of the auction, compared to 67.3% in February. On Wednesday, the $28 billion supply of 7–year notes brought 1.606%, with the best demand since January. Foreign buying increased to 57.8% of this issue, versus 53.5% last month.

03/24/16 Treasury Yield Curve	2-Year: 0.871%	5-Year: 1.379%	10-Year: 1.901%	30-Year: 2.674%
Weekly Yield Change:	+.034	+.045	+.027	–.002%
Support:	0.77/ 0.82/ 0.86/ 0.89%	1.26/ 1.31/ 1.35/ 1.38%	1.81/ 1.84/ 1.87/ 1.91%	2.63/ 2.65/ 2.67/ 2.69%
Targets:	0.74/ 0.72/ 0.70/ 0.67%	1.21/ 1.19/ 1.13/ 1.10%	1.76/ 1.73/ 1.70/ 1.67%	2.58/ 2.56/ 2.54/ 2.52%

Economics

The job gains over the past few years have been relatively consistent, with only a few surprises. ADP said their March Employment Change for private sector jobs rose 200K. That's holding with recent levels. Challenger Job Cuts for March showed 31.70% more layoffs versus last year. Initial Jobless Claims rose 6K the previous week to 265K, but came in 11K higher today – reaching a 2–month high of 276K. Continuing Claims fell from 2,218K to 2,180K two weeks ago, and fell to 2,173K last week. The third estimate for 4Q 2015 GDP rose to 1.40% from previous estimates of .70% and then 1.00%. Personal Consumption rose 2.40% versus a previous 2.00%, elevating the GDP result. The GDP Price Index was steady at .90%, and 4Q Core PCE (Personal Consumption Expenditures) held steady at 1.30%.

Economic news concerning growth remains mixed as corporate profits fell 11.5% for the 4th quarter versus 4Q 2014 – the largest drop since 2008. Pre–tax earnings dropped 3.1% in 2015, which was the largest fall in 7 years. Wal–Mart stores said annual revenues fell in 2015 for the first time ever! While the Consumer Confidence Index rose from 94 to 96.2, Bloomberg Consumer Comfort had fallen from 44.3 to 43.6 last week, and then to 42.8 this week. ISM Milwaukee rose from 55.22 to 57.78, and Chicago Purchasing Managers rose from 47.6 to 53.6. Kansas City Fed Manufacturing Activity was less negative at –6 versus –12 last month, as was Dallas increasing from –31.8 to –13.6.

Durable Goods Orders fell 2.80% in February, with a 1.00% drop ex transportation. January results were revised .50% lower for each to a still–strong 4.20% and 1.20%. While Personal Income rose .20% in February, Personal Spending rose only .10% – and was revised from a .50% increase to only .10% for January, as consumers were pushing funds into savings at a 1–year high. Real Personal Spending was up .20%, but revised from up .40% to zero for January. The PCE Deflator fell .10% in February, decreasing one of the Fed's favored inflation measures from 1.20% to a flat 1% year–over–year. The core result (ex food & energy) rose .10%, leaving the annual pace at 1.70%. Pending Home Sales rose 3.50% in February, jumping the most in a year. They rose 5.10% versus last year, and increased in 3 regions in February – while falling .20% in the Northeast. The S&P/Case–Shiller Home Price Index rose .52% in January, while metro prices (20–city index) rose .80% The annual pace quickened from 5.34% to 5.43%, while that metro–home measure rose .10% to 5.75%.

Friday kicks off April with March payroll data including the unemployment rates, labor participation, hours worked, and wage statistics. Also due are ISM Manufacturing, Prices Paid, New Orders, Construction Spending, University of Michigan Sentiment surveys, and April Vehicle Sales. Monday (04/04) brings the Fed's jobs dashboard (Labor Market Conditions Index Change), ISM New York, February Factory Orders, and Durable Goods Orders. Tuesday provides the Trade Balance deficit for February, the service–sector outlook (ISM Non–Manufacturing Composite), IBD/TIPP Economic Optimism, and JOLTS Job Openings. Wednesday supplies MBA Mortgage Applications (which dropped 1.00% last week), and the minutes from the March FOMC Meeting.

Equities

While stocks broke a string of 5 weekly wins with modest losses last week, they've risen this week aided by Janet Yellen's dovish comments. The cycles say stocks should drop into next week. As we said last week, stocks should find strength from a base near April 4th to the 7th for a rise into *"another high near April 14th, which could line up with another surge by Crude Oil (into April 12th)."* Last week, the Dow lost 86.57 points or .49% to 17,515.73. It's .97% better this week, having gone ahead for 2016 to the highest levels for the year. The S&P lost 13.64 points or .67% to 2,035.94, and is up 1.17% this week. The Nasdaq fell 22.14 points or .46% last week to 4,773.51, and is a stout 2.02% better this week. The Dow Transports dropped 1.85% last week, but are up .23% since Friday. Bank stocks lost 1.59%, and are off another .88% this week.

	Dow:	Nasdaq:	S&P:
Resistance:	17,682/ 17,787/ 17,917/ 18,051	4,869/ 4,905/ 4,939/ 4,975	2,059/ 2,072/ 2,095/ 2,118
Support:	17,519/ 17,406/ 17,252/ 17,127	4,800/ 4,765/ 4,735/ 4,701	2,026/ 2,006/ 1,992/ 1,971

Other Markets

Though the U.S. Dollar snapped a 3–week skid last week with a 1.11% gain, it's off 1.66% this week to the lowest levels since October. Commodities fell 2.36%, and are down another .96% this week. Crude Oil had a 6th weekly gain of a modest .02%, but is 2.84% lower this week. Gold fell for a 3rd week, losing 2.61%, but is 1.03% higher this week. The Euro fell .85% last week, but is surging 1.84% since Friday. The Japanese Yen lost 1.21%, but is .29% higher so far this week. Corn gained .82%, but has plunged 5.00% this week. Cotton rose .98%, and is 1.25% better so far this week.

"Those who cannot remember the past are condemned to repeat it." George Santayana

"The great thing about democracy is that it gives every voter a chance to do something stupid." Art Spander

Additional Information is Available on Request

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