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BOND MARKET REVIEW

June 21, 2017

Just the Facts

Last week, we 'objected' to the Fed's contention that inflation was 'transitory' as 'facts not in evidence'! It turned out that some Fed members were thinking the same thing. FRB Minneapolis President Neel Kashkari was the lone vote against the June 25 bps hike, preferring to 'maintain the existing target range' of the federal funds rate. On Friday, Kashkari said: *"If we base our outlook for inflation on these actual data, we shouldn't have raised rates this week."* He said the Fed should have waited to see if the recent drop was indeed transitory *"to ensure we are fulfilling our inflation mandate."* A separate paper by the San Francisco Fed explained there was a lower new normal for rates. Kashkari said the Fed was focused on avoiding the high inflation of the '70s, but in doing so might even be repeating some of the mistakes made in that era. He cited the continuously high and errant recent inflation forecasts of FOMC members. Dallas' Robert Kaplan said if inflation were to rear up, the Fed would have to raise rates more aggressively, but he'd (also) like to *"see evidence"* that the recently weaker inflation statistics were transitory. Longer yields are also arguing the case that the slowdown in recent economic and inflation data is real!

Chicago's Charles Evans said the Fed needs to convince the public that they recognize the recently weaker data. While he also said he saw downside risks to the Fed's optimistic outlook of achieving their 2% goal by the end of the year, he said the Fed needed *"to demonstrate a strong commitment to hitting our symmetric inflation objective sooner rather than later."* Fed Chair Janet Yellen's contention is that a hot jobs market will stoke inflation. However, the data's not yet with her, and we think a number of members waiting for evidence on inflation will handcuff the Fed's ability to hike rates and/or reduce the balance sheet until there are hard facts instead of opinions.

Looking Ahead

- Bond yields should move lower from the 22nd to the 27th. A low in rates is expected around August 9th.
- The **BMR** equity cycles show increased price swings, with an upcoming buy opportunity in early July.

Cyclic Update

With a lack of hard news, and the cycles misfiring a bit, it's a good time to talk about our forecasts. When the cycles aren't hitting, we of course recheck the work. Sometimes we become so accustomed to their veracity, that the variance to projections gets puzzling. It's then that we get questions asking if we've changed our mind on the outlook. The truth is, we never set our opinion to begin with. It's not as if we can look at a chart and interpret the next trend, turn, or strength. However, it's obvious when the cycles are out of synch. I've studied technical analysis methods and chart analysis since the late '70s, and determined a few decades ago that good cycle techniques were the best approach to timing – and had the highest percentage of accuracy. Long–time readers know that these techniques have often called nearly every turn for months at a time, and sometimes for far longer. But as we've said before, nothing even approaches 100%. Over my career, I've sought to attain incremental methods that increase success ratios well beyond 50%, and gain great satisfaction with every tweak to that effect – even if only by .1% at a time!

That said, the **B**ond **M**arket **R**eview provides the projections given by our work, and not (or rarely) what we think. Why craft such an elite program, and then throw darts? The dates in the **BMR** are the direct output of the program. They are based on over 2 decades of data for each market, and incorporate a nesting of short, medium, and long–term cycles – from a few days to many years. As such, short–term moves can diverge from expected paths, but the markets usually return or rejoin the projected cycles. The Fed does its 'dot plots', the Atlanta Fed forecasts GDP growth in the current quarter, and our techniques project cycle turns and the potential magnitudes of each next 'wave.' When we stick to our guns, we're really just continuing to provide the forecasts of the model. The cycles do shift, even without a newsworthy catalyst – and improving on that margin of error is akin to seeking the grail. However, the incoming data will often cause the program to alter upcoming trend–change dates. Cycles breathe and float.

Treasuries, Agencies, and MBS

Our bond cycles still project lower rates from the 22nd to the 27th, even if they didn't appreciably rise into the 22nd. After that, yields should rise into July 12th, and then make a low near August 9th or the 15th. Those August dates should be the best time window to refi, take profits, and/or hedge portfolios – with rates subsequently expected (by our models) to trend higher into October. Last week, MBS spreads (FNMA 30–year 3%) widened by 2 bps, and the U.S. Treasury curve flattened with yields falling 2, 2.5, 5, and 8 bps for the 2, 5, 10, and 30–year sectors. The curve 'twisted' flatter into today with yields rising 3.5, 3, and 1 bps for the 2, 5, and 10–year sectors, while falling 5 bps at 30–years. With the Fed tightening last week, the last thing they wanted was for the curve to flatten with long rates failing to rise. Not only do bonds not believe that the Fed is right in not rising, but long rates are going down! Of course, that's flattening the curve even further, and conjuring up former Fed Chair Alan Greenspan's 'conundrum' when debt investors challenged the Fed's prudence in hiking rates in 2005 and 2006.

The spread between 10–year and 2–year yields was over 1.35% after the December 14th (2016) hike. Despite 2 more 25 bps hikes in March and June, that spread had 'flattened' to .80% this past week. Through today, the market–based odds for another hike this year had fallen to 41.3%. The next meeting with odds over 50% now is March 2018. Next week, the U.S. Treasury will auction $26 billion 2–year notes on Monday (06/26), $34 billion 5–year notes on Tuesday (06/27), and $28 billion 7–year notes on Wednesday (06/28).

06/16/17 Treasury Yield Curve	2-Year: 1.317%	5-Year: 1.744%	10-Year: 2.152%	30-Year: 2.776%
Weekly Yield Change:	–.020%	–.023%	–.049%	–.080%
Support:	1.360/ 1.385/ 1.405/ 1.435	1.770/ 1.795/ 1.840/ 1.875	2.190/ 2.225/ 2.250/ 2.275	2.755/ 2.795/ 2.835/ 2.875%
Targets:	1.320/ 1.305/ 1.285/ 1.270	1.735/ 1.705/ 1.675/ 1.640	2.145/ 2.110/ 2.075/ 2.040	2.715/ 2.675/ 2.635/ 2.600%

Economics

Last week, Initial Jobless Claims fell 8K to 237K – just 10K above 43–year lows. The 'Fed–blackout–delayed' jobs gauge (Labor Market Conditions Index Change) rose 3.7 in April, but added only 2.3 points (versus 3 expected) in May. Consumer confidence data has continued to fall away from the 'Trump bump' that rose to the highest since the recession, and in some cases back to 2001. University of Michigan Sentiment fell from 97.1 to 94.5, just above the November 2016 reading. Their expectations survey fell from 87.7 to 84.7 – a little less than the November result, but well above October's 76.8. Current Conditions fell from 111.7 to 109.6, also above November's survey.

Late last week, the Atlanta Fed's Q2 GDP now forecast fell below 3.0% for the first time with the releases of Industrial Production and Housing Starts. While initially forecast at 4.3% in the beginning of May, their Q2 projection closed out last week at only 2.9%. Housing Starts fell 5.54% in May to 1,092K units. That was a 3.79% drop versus last year. Building Permits fell 4.89% to 1,168K. Existing Home Sales rose 1.08% to 5.62M units.

Thursday is set for jobless claims data, the FHFA House Price Index for April, Bloomberg confidence surveys, Kansas City manufacturing, and the Leading index for May. Friday brings New Home Sales for May. Next Monday (06/26) supplies May orders for Durable and Capital Goods, and Chicago and Dallas manufacturing activity. Tuesday gives us S&P Case–Shiller home price data, the Board Consumer Confidence surveys, and the Richmond Fed Manufacturing Index. Wednesday follows with MBA Mortgage Applications (up .60% last week), May data for Wholesale and Retail Inventories, and Pending Home Sales (also for May).

Equities

The **BMR** equity cycles have been projecting stocks to trend lower into July 3rd to the 5th. To date, the Dow made a new record high on the 20th, while the S&P and most major U.S. indices set a record on the 19th – and the Nasdaq is still a bit lower to its high made on June 9th. Last week, the Dow gained 112.31 points or .53% to 21,384.28. It's still .12% better this week. The S&P rose only 1.38 points or .06% to 2,433.15, and is .10% higher this week. The Nasdaq lost 56.16 points or .90% to 6,151.76, but is 1.34% higher this week. The Dow Transports have been moving the other way. They gained .92% last week, but are 1.29% lower this week. Bank stocks fell .05% last week, and are .85% lower this week.

Resistance:	Dow:	21,460/ 21,531/ 21,677/ 21,825	Nasdaq:	6,270/ 6,310/ 6,341/ 6,389	S&P:	2,444/ 2,453/ 2,468/ 2,481
Support:		21,391/ 21,262/ 21,094/ 20,947		6,231/ 6,189/ 6,153/ 6,113		2,431/ 2,419/ 2,406/ 2,394

Other Markets

Crude Oil continued to trade lower out of our top due on May 26th. After a possible uptick from here, the next lows are due July 25th and August 7th. Those should be accumulation points for a reversal to higher prices into late September. Crude Oil fell for a 4th week, losing 2.38% – and is well on its way to a 5th, down 4.94% this week. In turn, Commodities lost 2.10%, and are 3.25% lower this week – also apparently headed for a 5th loss. Gold lost 1.14%, and is off .85% this week. While one would expect strength in the U.S. Dollar given the moves above, it lost .10% last week, and is only .07% higher this week. The Japanese Yen lost .51%, and is off .45% this week. The Euro lost .24%, and is unchanged so far this week. Corn dropped .97% last week, and is 3.97% lower this week. Cotton tumbled 5.03% last week, and is 1.38% lower this week – potentially headed for a 6th weekly decline!

"To live a creative life, we must lose our fear of being wrong." Joseph Chilton Pearce

Additional Information is Available on Request

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