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Bond Market Review

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IT

The successful release of the newest Stephen King movie was accompanied by one of the scariest storms ever to threaten the U.S. As Irma approached land, it was the strongest hurricane ever recorded in the Atlantic, and the damage to Florida and the Southeastern U.S. was widely expected to be far worse. The strength of Irma fell sharply after hitting Cuba on Sunday – and though nearly 90% of properties in the Florida Keys sustained damage, the storm surges and destruction to the mainland were far less than forecast. Though its strength was greatly diminished, the hurricane still left over 5 million people without power. The Tampa area was in Irma's crosshairs, but the hurricane shifted northeast at the last minute. Over the past 2 weeks, the much–weakened eyes of Harvey and Irma each passed through Memphis on their final tracks – showing the inland range of the storms.

The Atlanta Fed's GDP 'now cast' for Q3 2017 was initially 4.0%, but dropped to 2.8% last week on weak vehicle sales. Though the forecast ticked back up to 3.0% on Friday (09/08), it's driven by incoming data which has yet to be impacted by the hurricanes that hit Texas, Southeastern states and Florida, and many Caribbean islands. In the last **B**ond **M**arket **R**eview, we said we expected a setback to the economy following hurricane Harvey. With the aftereffects of hurricane Irma now also considered, Q3 growth will be greatly challenged.

The Fed's Beige Book was released last week and once again reported only modest to moderate growth across the U.S. They were concerned with *"limited wage pressures and modest to moderate wage growth"* and also a *"prolonged slowdown in the auto industry."* The storms could lead to better wage growth and an uptick in inflation from energy, labor, and material costs. We still expect the 4th quarter to get a boost from rebuilding efforts, and were reminded by a colleague that vehicle sales could surge due to the enormous numbers of cars that were underwater in Texas and the Southeastern U.S. There were also around 1 million without power in Puerto Rico. Cuba, Puerto Rico, and other Caribbean islands sustained massive damage that will add to the overall demand for supplies, vehicles, and construction. Check the CARFAX! If you do buy a used vehicle from in or around the flooded areas, make sure you check it well.

Stocks sold off after making a high into Labor Day. Our cycles expected *"a downtrend from September 1st into October 20th"*, and the Tuesday after Labor Day saw a 234–point (1.07%) drop in the Dow. The cycles then allowed for a *"possible rise from 9/11 to 9/15"*, and with new sanctions on North Korea and relief that damages from Irma were not as catastrophic as expected, stocks got a huge boost on Monday (09/11) with a 259–point (1.19%) Dow rally. The Dow and Nasdaq had new record closing highs today (just under their recent record highs), while the S&P and many small–cap indexes also made new record highs. Stocks overcame the negatives, and power was restored to over 2.3 million customers in Florida. The Wells Fargo/Gallup Investor and Retirement Optimism Index rose to its highest reading since September 2000. The survey from early August showed 68% were optimistic about stocks over the next year. (Volatility readings had recently shown stock investments to be the safest in 23 years.) Nevertheless, our cycles turn down again from September 15th, and still forecast weakness into the third week of October.

Looking Ahead

- Bond yields should move higher into a peak near October 4th.
- The **BMR** equity cycles show a possible rise into 9/15, but then extreme weakness into October 19th.
- The FOMC will announce their latest stance on interest–rate policy this Wednesday (09/20) at 2 pm ET.

Treasuries, Agencies, and MBS

Last week, MBS spreads (FNMA 30–year 3%) rose 4 bps to fast moving Treasuries. Yields had been sharply lower into the weekend, as there were so many unknowns from incoming–hurricane Irma to continued North Korea weapons development. Yields fell 8, 10.5, 11.5, and 11 bps for the 2, 5, 10, and 30–year sectors. Bonds sold off during this week's 'relief rally', with yields for those sectors rising 8.5, 13.5, 13.5, and 11.5 bps – more than offsetting last week's gains. The market–based odds for the next Fed hike had moved out to September 2018, but pulled all the way back into March today – given a decline in risk factors. That said, we expect no action at next Wednesday's FOMC meeting. As that meeting approached, Fed Vice Chairman announced he would resign in October. Fed Governor Lael Brainard said the Fed should be cautious about tightening until the Fed is *"confident inflation is on track to achieve our target."* However, the most significant comment we saw was from FRB Minneapolis President Neel Kashkari. He said that the existing hikes may be *"doing real harm"* by causing *"slower job growth, leaving more people on the sidelines, leading to lower wage growth, and leading to lower inflation and inflation expectations."*

09/08/17 Treasury Yield Curve	2-Year: 1.264%	5-Year: 1.634%	10-Year: 2.052%	30-Year: 2.670%
Weekly Yield Change:	+.080%	–.105%	–.115%	–.108%
Support:	1.377/ 1.403/ 1.437/ 1.468	1.810/ 1.840/ 1.880/ 1.915	2.225/ 2.267/ 2.307/ 2.348	2.812/ 2.852/ 2.871/ 2.892%
Targets:	1.317/ 1.288/ 1.258/ 1.227	1.776/ 1.741/ 1.710/ 1.680	2.161/ 2.126/ 2.098/ 2.057	2.773/ 2.732/ 2.693/ 2.653%

External market factors kept yields low, but we still expect a rise into October. On Monday, the U.S. Treasury sold $24 billion 3–year notes at 1.433%. Demand was off versus last month, and the yield was the lowest since February. The group that includes foreign central banks bought only 46.2% of the issue – versus 64.1% in August. Though 10–year yields fell below 2.04% last week, Tuesday's $20 billion offering came at 2.18% – still the lowest yield since the November 2016 issue. Demand rose versus last month, and foreign buying eased from 57.9% then to 55.3%. Today's $24 billion supply of 30–year bonds came at 2.79%. That was the lowest yield since last October's auction, and demand fell versus last month's issue. Foreign buying fell from 66.8% in August to 58.8% today.

Economics

We expected a storm–driven surge in Initial Jobless Claims, and more than 50K job losses from Texas spurred a jump from 236K to 298K. That trend could continue for a while. Continuing Claims, delayed a week, fell from 1,945K to 1,940K. In July, JOLTS Job Openings rose from 6.116M to a record 6.170M positions waiting to be filled. The restaurants and hotels sectors posted a record jobs availability of 769K. The service sector outlook (ISM Non–Manufacturing) saw a nice gain to 55.3 from its 11–month low of 53.9 in July. Nonfarm Productivity for Q2 rose 1.50% and Unit Labor Costs rose a modest .20%. NFIB Small Business Optimism was .1 higher to 105.3. Consumer Credit rose $18.499 billion in July (beating expectations by nearly $3.5 billion). Wholesale prices rose sharply on energy costs that rose the most since January as the Producer Price Index rose .20%, and the annual pace quickened from 1.90% to 2.40%. Ex food & energy, PPI rose .10% – and the annual core pace increased from 1.80% to 2.00%.

Factory Orders fell 3.30% in July, but had risen 3.20% in June – leaving the data only slightly lower for the 2 months. Ex transportation, orders rose .50% (with June revised .10% higher from a .20% loss). Durable Goods Orders fell 6.80% in July, but had surged 6.40% in June on strong aircraft orders. Ex transportation, orders rose .60%. Capital Goods Orders rose 1.00%. Wholesale Inventories rose .60% in July, as Trade Sales dropped by .10%. MBA Mortgage Applications rose 3.30% and 9.90% over the past 2 weeks. The U.S Trade Balance deficit for July came in $1 billion less than expected at $43.7 billion. The Monthly Budget Statement for August showed a deficit of $107.7 billion, roughly $11 billion better than expected. The fiscal–2017 deficit is running 8.8% over 2016 with 1 month to go.

Thursday is set for jobless claims data, Consumer Prices (August CPI), Hourly & Weekly Earnings, and Bloomberg Consumer Comfort – which last dropped to 52.6, breaking a string of 7 gains to a 16–year high of 53.3. Friday gives us Empire Manufacturing, August Retail Sales, Industrial Production, Capacity Utilization, July Business Inventories, and the University of Michigan sentiment surveys. Next Monday (09/18) is set for home–builder optimism (NAHB Housing Market Index) and Treasury International Capital flows. Tuesday follows with August Housing Starts & Building Permits, Import Prices, and the Current Account Balance for Q2 2017. Wednesday brings August Existing Home Sales and the FOMC interest–rate decision for September.

Equities

Though last week's losses mostly occurred on Tuesday (09/05), stocks lost ground with the Dow Industrials falling 189.77 points or .86% to 21,797.79. It's 1.65% better this week and closing in on new highs. The Nasdaq lost 75.14 points or 1.17% to 6,360.19, but is 1.57% higher this week. The S&P lost 15.12 points or .61%, but has risen 1.50% this week. The Dow Transports gained .30%, and may be headed for a 4th weekly rise as they are 1.57% higher this week. Bank stocks plunged 3.75%, but have rebounded 4.11% this week! The cycles expect a high near Friday (9/15).

Resistance:	Dow:	22,216/ 22,291/ 22,366/ 22,440	Nasdaq:	6,459/ 6,501/ 6,539/ 6,581	S&P:	2,498/ 2,510/ 2,522/ 2,535
Support:		22,067/ 21,993/ 21,930/ 21,846		6,419/ 6,381/ 6,340/ 6,301		2,485/ 2,465/ 2,448/ 2,435

Other Markets

After 5 weekly losses, Crude Oil gained .40% last week and is up a sharp 3.83% this week. Commodities rose .13%, and are .94% better this week. Gold had risen 3 weeks with a 1.56% gain last week, but lost 1.71% into today as event fears declined. The U.S. Dollar tumbled 1.56% to the lowest levels since June 2016 (and lowest to the Euro since January 2015). However, the Dollar is 1.29% better this week. The Japanese Yen surged 2.19% last week, but has plunged 2.46% this week. The Euro jumped 1.48%, but is 1.25% lower this week. Corn rose 1.25%, but is 1.67% lower this week. Cotton also shared the reversal trend in gaining 4.19% last week, but then losing 7.42% into today.

"I'm against picketing, but I don't know how to show it." Mitch Hedberg

Additional Information is Available on Request

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