COMMERCE STREET
Capital Management
1445 ROSS AVENUE
DALLAS, TEXAS 75202
214-545-6800

BOND MARKET REVIEW

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Thank You for Your Service

Despite accolades for her service, President Trump decided against renewing Janet Yellen as Fed Chair. Trump said Yellen was *"a wonderful woman who's done a terrific job!"* However, determined to make his 'own mark', and as was widely expected, Trump ultimately decided on Fed Governor Jerome Powell to lead the FOMC going forward. CNBC's Ron Insana said Powell would be the most like Yellen – which would give the market continuity. However, earlier in October, Insana had said: *"If it ain't Yellen, I'll be sellin'"* He since backtracked from those remarks and said – *"with the exception of Jay Powell."* With the stock market not having a 3% correction since March, and only a 5.02% drop just before the election, there are some jitters there. Even though not in contention, in the **BMR (10/05/2017)**, we said: *"The **BMR** vote would go to Minneapolis' Neel Kashkari as we think he is the most data–focused, and least likely to waver on short–term movements."* On Friday, Kashkari said he thought *"Governor Powell will do a great job as chair."* He said he didn't anticipate a big change in policy, and we obviously trust his view. He did pose the question: *"Why are we tapping the brakes?"* That's our point as well. We just hit 3% GDP for 2 quarters for the first time since 2014, and haven't had annual 3% GDP growth for over a decade – so what are we trying to stop – or slow? Powell's confirmation hearing isn't expected until after Thanksgiving. Powell is a law–school graduate, and would be the first non–Ph.D.–economist to hold the chair since Paul Volcker in 1979. Trump said: *"Jay will bring extensive private–sector experience and real–world perspective to our government."*

I've always enjoyed including some of the jokes from the late–night comedians – as they often give us a window into the pop culture of the times. Lately, they're incredibly hard to read as they are 24/7 mocking the Trump presidency and any other easy political target that might not have a politically correct view on gun control, global warming, etc. News and comedy shouldn't have to be about 'sides.' We were reminded recently how much we miss Tim Russert. Tim was a moderator for 'Meet the Press' for 16 years. He was a great reporter, and in our view treated both sides fairly – while pulling no punches. We haven't seen his kind since he passed in 2008.

Yellen was refreshing from that standpoint. She kept politics out of the equation and spoke clearly to the Fed's concerns and direction. We didn't agree on what 'transitory' meant, but in our opinion, Janet Yellen did a better job of voicing her views on FOMC policy than former Chairs Alan Greenspan and Ben Bernanke. Greenspan was the master of 'Greenspeak.' He could explain something so clearly that no one understood it! I recalled a book by Bob Woodward back in 2001, where he noted that Greenspan's wife didn't realize she'd been proposed to until the third occurrence. In the **BMR (01/29/2001)**, we said: *"Apparently, she didn't understand 'Greenspeak' either."*

Things turned upside down for Ben Bernanke within 2 years of his tenure. He became the Fed Chair in January 2006, and presided over 3 25–bps hikes into June 2006 that took short rates to 5.25%. The **B**ond **M**arket **R**eview has taken the position that aggressive hikes in the face of easy credit for high–LTV adjustable–rate mortgages led to the magnitude of the ensuing debacle. (Our contention was that slower hikes would not have caused so many mortgages to quickly reset to payments that borrowers couldn't manage – leading to the massive numbers of subprime defaults.) Bernanke got a chance to exercise textbook solutions of dropping helicopters of cash on a financial crisis – leading to the Fed's ballooning $4.5 trillion balance sheet. Congress and the Fed attacked the crisis by printing money and borrowing. Within 2 years of Bernanke's term, Fed rates were dropped from 5.25% to 3.00% – and would eventually become 'almost zero' by December 2008, and throughout the rest of his tenure.

Yellen took over the job when it seemed things could turn very ugly. She had been FRB San Francisco President from 2004 to 2010, and Vice Chair of the Fed from October 2010 through 2014 – taking over as Chair on February 3, 2014. She presided over (and endured) the market's 'taper tantrums' with the reduction and then end of QE asset purchases, a reversal of rate accommodation, and the beginning of the great unwind of the Fed's $4.5 trillion balance sheet. Of course, she also had a lot to do with the implementation all of those policies that are attributed to have staved off a potentially–worse financial crisis than was endured. Powell doesn't inherit a crisis, but still a mess.

Looking Ahead

- Our bond cycles show yields generally lower into November 15th.
- The **BMR** equity cycles project a high near November 13th, and a major low near December 28th.

Blade Runner

The yield curve traded at its lowest level since November 2007 today as the spread of 2–year to 10–year Treasury debt narrowed below 69 bps! (Recall that stocks topped in October 2007, and then toppled into 2009!) Flat and inverted curves often point to economic slowdowns or recessions. Should we be concerned?

Back in February 2005, Fed Chair Greenspan said long rates failing to rise with short rates *"remains a conundrum."* Yield curves get flat, or sometimes invert, for a number of reasons, and they're not always the same. One reason that developed during the financial crisis, is still with us. Japanese and EU rates continue to be very low and in many cases still negative! These are our thoughts on reasons for long rates not being in a hurry to rise significantly:

- The **BMR** has contended that the spreads between U.S. debt and that of alternative leading economies would continue to make Treasuries and U.S. assets attractive. The resulting bid for U.S. debt versus negative to very–low EU and Japanese rates will *"hold as a tether to keep U.S. rates from moving significantly higher."*
- Bond investors don't necessarily believe growth will continue given the Fed's 'braking', and will remain more in the 'modest to moderate' range – having not been robust for over a decade.
- With our short rates higher, the Dollar has more value versus other currencies – again making our longer debt a better value to alternatives.
- The markets don't believe inflation will rise as soon or by as much the Fed anticipates. They also don't see the lowness of inflation as being necessarily 'transitory.'
- The debt markets aren't impressed with the stance the Fed has on having reached full employment, as wage gains are not impressive and labor force participation continues to be challenged.
- Some question or have low confidence in the ability of the FOMC to emerge cleanly and/or unwind their balance sheet following a decade of accommodation.
- Even if Governor Powell's policies and leadership remain on a 'Yellen course', there is a change – and markets are highly resistant to anything that rocks the boat.
- Powell is not seen as a hawk, and would not be on a mission or campaign to higher rates in a textbook fashion as was Bernanke. He would most likely continue a gradual pace of hikes at most.
- Vice Chairman Stanley Fischer retired in October, and FRB New York President William Dudley is said to be close to retiring as well. That's even more change, and there are at least 3 open seats on the Fed's board.
- We're not in a vacuum. North Korean and other threats could keep rounds of 'flight to quality' pushing down the long end of the Treasury curve.
- Finally, there's the 'new normal.' No one really knows what it is, but medium to longer rates could be in a phase where the higher part of the channel is 3 to 4%, instead of the 5 to 7% that some expect.

Treasuries, Agencies, and MBS

Just as Governor Powell was expected to be Trump's nominee to succeed Janet Yellen as Fed Chair, the FOMC met last Wednesday and was not expected to raise rates. The Fed indeed held rates steady, as market expectations were near zero percent for a move coming into the November meeting. December is a different story! The odds for a hike rose from roughly 83% last week to over 92% for a 25–bps increase for that meeting. In their statement, the FOMC said *"economic activity has been rising at a solid rate despite hurricane–related disruptions."* (The key word there being 'solid' as that reinforces the plans for a December move.)

They said: *"Although the hurricanes caused a drop in payroll employment in September, the unemployment rate declined further."* That's something we find hard to celebrate – and it showed up again in October as the Unemployment Rate dropped from 4.20% to 4.10%, while Labor Force Participation fell from 63.10% to 62.70%. They noted that storm disruptions would *"continue to affect economic activity, employment, and inflation in the near term, but past experience suggests that the storms are unlikely to materially alter the course of the national economy over the medium term."* They reiterated: *"Inflation on a 12–month basis is expected to remain somewhat below 2% in the near term."* We wonder again, just how long is 'transitory?' The only other item we saw of note was their text stating: *"The balance sheet normalization program initiated in October 2017 is proceeding."* No surprises!

As we covered earlier, with a few related thoughts, the curve flattened last week post–FOMC meeting – with 2–year yields rising 2.5 bps, while yields fell 4, 7.5, and 10.5 bps at 5, 10, and 30–years! Into today, yields again twisted flatter – rising 1.5 bps at 2–years, while falling .5, 2, and 3.5 bps for the 5, 10, and 30–year sectors. MBS spreads (FNMA 30–year 3%) were unchanged last week. Today's 3–year note auction came at 1.75% for $24 billion supply. That yield was the highest since the April 2010 issue – as short rates are following the Fed's direction even though longer rates are reluctant to budge. Demand fell versus the October offering, and the group that includes foreign central banks bought 53.5% of the issue versus 54.3% last month. The Treasury will auction $23 billion 10–year notes on Wednesday (11/08) and $15 billion 30–year bonds on Thursday (11/09).

11/03/17 Treasury Yield Curve	2-Year: 1.615%	5-Year: 1.991%	10-Year: 2.333%	30-Year: 2.814%
Weekly Yield Change:	+.025%	–.038%	–.074%	–.104%
Support:	1.635/ 1.665/ 1.690/ 1.715	1.994/ 2.013/ 2.033/ 2.064	2.325/ 2.346/ 2.365/ 2.386	2.806/ 2.827/ 2.847/ 2.866%
Targets:	1.600/ 1.575/ 1.540/ 1.500	1.977/ 1.959/ 1.942/ 1.925	2.305/ 2.286/ 2.226/ 2.245	2.767/ 2.747/ 2.726/ 2.708%

Economics

The October employment picture began showing promise as the ADP (private sector) Employment Change rose a 7–month best 235K versus 200K expected. The ISM Employment number fell from 60.3 to a still–healthy 59.8, and Challenger Job Cuts were off 3.00% (less cuts) versus last year. Initial Jobless Claims fell from 234K to 229K – just above 4–decade lows, and Continuing Claims fell from 1.899M to 1.884M to fresh 4–decade lows. Puerto Rico claims were nearly 3 times their normal (recent) numbers. Payrolls rose by 261K in October (versus 313K expected), and September's results were bumped from a 33K loss to an 18K gain! The Two–Month Payroll Net Revision was an increase of 90K jobs. Private Payrolls, confirming the ADP numbers, rose by 252K. and were adjusted 55K higher to a 15K gain for September. Manufacturing jobs rose 24K and were revised from a 1K loss to a 6K gain for September. The Unemployment Rate fell .10% to 4.10% – a new 17–year low, but the labor pool fell from 63.10% to 62.70%. It was also a bit troubling that hourly earnings were flat, hours were unchanged at 34.4, and wage gains slowed from 2.80% to 2.40% annually. The Underemployment Rate dropped from 8.30% to 7.90%. JOLTS Job Openings were steady at good levels with available positions rising from 6.090M to 6.093M in September. The Employment Cost Index rose .70% in the 2rd quarter. Nonfarm (worker) Productivity rose the most in 3 years as Q3 results were up an annual 3.00%! Unit Labor Costs were only .50% higher, but did increase from an annual .30% pace. The Employment Cost Index rose .70%. September Factory Orders rose 1.40%, and ex transportation were up .70%. Orders for Durable Goods rose 2.00%, and also .70% ex transportation. Orders for Capital Goods rose 1.70%.

The Conference Board's Consumer Confidence measure rose from 120.6 to 125.9 (the best since December 2000). Their Present Situation result rose from 146.9 to 151.1 – the highest since 2001, and Expectations hit a 7–month high – improving from 103 to 109.1. Chicago Purchasing Managers rose from 65.2 to 66.2. ISM Manufacturing slowed from a 13–year high 60.8 to 58.7. Prices Paid fell from 71.5 to 68.5 and New Orders fell from 64.6 to 63.4 The service sector (ISM Non–Manufacturing) rose from 59.8 to 60.1 – its 94th month of expansion! Construction Spending was .30% higher in September. Metro home (S&P Case–Shiller 20–city Index) prices rose .45% on tight inventories, increasing the annual pace from 5.83% to 5.92%. The annual pace for their Home Price Index quickened from 5.88% to 6.07%. Vehicle Sales fell off September's storm–surge annual pace of 18.47M to 17.98M. Domestic Sales fell off from 14.33M to 13.95M (annually). The September Trade Balance deficit widened from $42.8 billion to $43.5 billion. Consumer Credit also got a storm boost in September, rising from August's $13.141 billion to $20.830 billion!

Wednesday is set for MBA Mortgage Applications which fell 2.60% last week. Thursday brings jobless claims data, Bloomberg Consumer Comfort (which rose .7 to a 7–week high 51.7), and Wholesale Inventories & Trade Sales. Friday yields the University of Michigan sentiment surveys. Next Monday (11/13), is set for the Monthly Budget Statement for October. Q3 MBA Mortgage Foreclosures and Mortgage Delinquencies are set for release next week.

Equities

Stocks continued to rise with the cycle that bottomed on the 20th of October – and also pulled back into the 2nd before rising to new highs today. The next trend–change date for a high occurs near November 13th. With an important low due near December 28th, we'd view the 13th as a time to hedge stocks and/or take profits – as time is running out in this move. The Dow rose 105 points or .45% last week to 23,539.19, and is up a modest .08% this week. The Nasdaq was 63.17 points or .94% higher to 6,764.44, and is .05% better this week. The S&P gained 6.77 points or .26% to 2,587.84, and is up .11% this week. The Dow Transports fell 1.78%, and are headed for a third loss with a .85% drop through today. Bank stocks fell .10% last week, and are 2.40% lower so far this week.

Resistance:	Dow:	23,557/ 23,637/ 23,715/ 23,791	Nasdaq:	6,795/ 6,841/ 6,882/ 6,923	S&P:	2,591/ 2,597/ 2,603/ 2,609
Support:		23,484/ 23,407/ 23,330/ 23,256		6,758/ 6,719/ 6,678/ 6,637		2,585/ 2,578/ 2,572/ 2,566

Other Markets

Crude Oil surged toward the **BMR** targets this week, rising over $57.25/barrel on news that Saudi Arabia had seen the arrest of multiple princes and ministers on charges of bribery and money laundering. They also blamed Iran for an incoming missile that was deemed a potential act of war. Recall we said: *"We have a $58.85 short–term target for Crude Oil, and our longer term is in the $74.90 to $76 range."* One rarely anticipates the catalyst for such a move. Crude Oil rose 3.23% last week and is 2.80% better this week, leading Commodities higher by 1.33% and 1.30%. Gold rose .06%, and added .52% into today. The U.S. Dollar gained .04%, but is .06% lower this week. The Japanese Yen fell .35%, but is .05% better this week. The Euro was flat, but is .18% lower this week. Corn lost .14%, and is off another .14% this week. Cotton gained .76%, but lost .95% into today.

"History is the version of past events that people have decided to agree upon." Napoleon Bonaparte

Additional Information is Available on Request

Doug Ingram, Managing Director – Commerce Street Capital Management