BOND MARKET REVIEW

November 30, 2017

Cyber Bullied

Black Friday and Cyber Monday used to be unique and separate. Recently however, and especially this year, 'Black Friday' pricing started well before Thanksgiving, stores began their Fridays on Thursday, and Cyber Monday started on the weekend – and in some cases extended through today. Just when Americans were conditioned to camp out at the stores and ready for the stampede for those limited 'while supplies last' sale items, the stores opened early – and some had enough supply to stave off at least some of the fist fights and hair pulling. Is it any wonder that online sales continue to make gains on brick and mortar? While it's unclear if all the Cyber Monday results include just those made on that specific day, they rose to a record $6.59 billion – marking a 16.8% increase versus last year! Online sales for 'Black Friday' were up 17% versus last year to $5.03 billion. That data may be skewed a bit, as stores began their sales earlier and some also held them over just to catch a little more of the action.

The spillover is now a part of the times. We all recall the Fed dropping rates near zero and stating: *"Economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period."* Little did we realize just how extended that would be! The supposed 'transitory' inflation turned into what the **B**ond **M**arket **R**eview termed 'extended–transitory' as the assumption of temporary was more opinion and hope – than real world. However, though beset by storms, dark and pessimistic news, and overwhelming negatives, the stock market has rallied, confidence has surged, and economic data has outperformed in a 'Make America Great Again'–type fashion. Yet, Congress has been no help – failing to deliver tax relief and other promised legislation, and they are once again embroiled in debates concerning measures to prevent a government shutdown.

Over the past few days, bank stocks surged 5.95% to their highest levels since October 2007 and the Dow Transports gained 7.08% to new highs. Those indexes had lagged the others! While the Nasdaq made a new high on Tuesday, most other U.S. indices rose to new highs with strong moves this week and especially today – with the Dow gaining over 330 points. Other good news? New Home Sales just 'unexpectedly' rose the highest level since October 2007. Pending Home Sales rose by the most in 8 months. Q3 GDP was revised to a 3–year high of 3.3%. Home starts were the highest in a year, while metro–home prices rose in September by the most since 2014. In another unexpected result, U.S. Consumer Confidence just rose to a 17–year high. And, it's not just in the U.S.! German business optimism just hit a new record, and consumer confidence in the EU nations also just rose to a 17–year high.

Last week, we posed: *"What could go wrong?"* Stocks can go up longer than you can fight them, but they are quite overvalued. If you're not in, you miss the huge moves – or, of course, the staggering drops – though we haven't seen one of those in over a year. It's certainly exhilarating to catch these nice upwaves, but always be aware that things can change in a hurry. Goldman Sachs pointed out that a measure of average valuation is the highest since 1900 for stocks, bonds, and credit. Though the Fed has said low inflation is "transitory", Goldman simply made the case that all good things must come to an end, and that there will be a bear market "eventually." Transitory usually implies short–term and eventually is a term that we read as 'far off.' What if they reverse? Will the upward tear turn to tears?

Over the past 2 weeks, the Fed has released its Beige Book and the Minutes from the November FOMC meeting. The minutes revealed that some members are concerned about the stubbornly–low inflation reaching their goals anytime soon. However, others don't want to get behind the curve given good employment data (even without the usually–accompanying wage pressures). The second guessing on the lack of inflation pressures made the minutes read a tad more dovish than expected. The Beige Book gave us the usual reads on *"modest to moderate"* growth, but made the case that price pressures *"have strengthened."* Labor was described as tight, but with limited wage pressures. They noted the economy had normalized since the storms, and that most outlooks were *"generally optimistic."*

Looking Ahead

- Interest rates should be generally lower into a trend–change near December 22nd.
- The **BMR** equity cycles project a turndown from December 6th into month end (near 12/28).

Treasuries, Agencies, and MBS

FRB Cleveland President Loretta Mester said inflation was below targets, but was on a path to meet the Fed's 2% goal, and agreed with earlier statements by incoming Fed Chair Jerome Powell that a case was building for the already–expected December hike. With other members already in the 'continued gradual increase' camp, the odds for 25 bps hike on the 13th peaked above 98% this week. They had already been in the 97% range, but had dipped near 92% after the Fed's more–dovish–than–expected remarks in the November meeting's minutes. It was announced that Fed Chair Janet Yellen planned to leave the FOMC when Powell takes over, though she could opt to stay.

With the nearly–given December rate increase, on Tuesday the 2 to 10–year yield spread dropped to its most narrow reading since October 2007 – at a very–flat 58 bps! Today, 2–year yields were the highest since October 2008. Into December 17th, the curve flattened significantly with the 2–year yield rising 6.5 bps, the 5–year up .5, the 10–year down 5.5 bps, and the 30–year yield down over 10 bps! The trend continued a bit last week with 2–year yields up 2.5 bps, the 5–year again up .5 bps, the 10–year flat, and 30–year yields 1.5 bps lower. The curve shifted higher into today, rising 3.5, 7.5, 7, and 6.5 bps for the 2, 5, 10, and 30–year sectors. The cycles point to lower yields into December 11th and then into the 22nd (with the 22nd expected to be lower).

MBS spreads (FNMA 30–year 3%) were flat into the 17th, but narrowed by 1 bps last week. On Monday, the U.S. Treasury sold $26 billion 2–year and $34 billion 5–year notes. The 2–year notes came at 1.765%, the highest yield since the September 2008 offering. Demand was the lowest since March, and the group that includes foreign central banks bought 41.9% versus a previous 48.2%. The 5–year brought 2.066%, with the best demand since September's auction. The yield was the highest since April 2011, and foreign buying rose from 61.6% last month to 65.8% for this auction. Tuesday's $28 billion 7–year notes brought 2.23%. The yield was the lowest since September, and demand fell versus last month. Foreign buying fell from 63.4% last month to 58.6% of this auction.

11/24/17 Treasury Yield Curve	**2-Year: 1.747%**	**5-Year: 2.064%**	**10-Year: 2.343%**	**30-Year: 2.765%**
Weekly Yield Change:	+.024%	+.006%	–.001%	–.013%
11/17/17 Treasury Yield Curve	**2-Year: 1.723%**	**5-Year: 2.058%**	**10-Year: 2.344%**	**30-Year: 2.778%**
Weekly Yield Change:	+.067%	+.006%	–.055%	–.102%
Support:	1.795/ 1.820/ 1.845/ 1.875	2.184/ 2.219/ 2.255/ 2.294	2.437/ 2.457/ 2.476/ 2.497	2.869/ 2.890/ 2.915/ 2.937%
Targets:	1.770/ 1.750/ 1.735/ 1.705	2.115/ 2.115/ 2.080/ 2.044	2.398/ 2.364/ 2.340/ 2.312	2.833/ 2.813/ 2.777/ 2.748%

Economics

The Atlanta Fed's GDP Now Forecast had been hovering near 3.4% for Q4 over most of November. The forecast fell to 2.7% today on personal income and cooled spending. Nevertheless, Q3 GDP was revised from 3.00% to 3.30% – for the best growth since Q3 2014! Personal Consumption was revised .10% lower to 2.30%, but that weakened from 3.3% in the 2nd quarter. Business equipment spending rose at a 10.4% pace, which marked a 3–year high. Fed Chair Janet Yellen said the expansion is *"increasingly broad based across sectors."* The Q3 GDP Price Index rose 2.10% with the core (ex food & energy) rate rising from 1.30% to 1.40%.

The Fed's key inflation gauge rose .10% in October, with the PCE Deflator dropping the annual pace from 1.70% to 1.60%. The core (Personal Consumption Expenditures) rose .20%, and the annual core pace remained at 1.40% – each well below Fed targets. The **BMR** still wonders – so why is the Fed still tapping the brakes? Personal Income rose .40% in October, but Spending lagged at .30% – dropping from September's .90% rise. 'Real' Personal Spending showed more 'cooling' as it rose only .10%.

Initial Jobless Claims fell from 252K to 240K, and then eased to 238K this week (dropping nearer the lows from the early '70s, and recovering from a small storm–driven spike). Continuing Claims (which lag a week), rose from 1,868K to 1,915K, and then rose again to 1,957K. After the storms, Puerto Rico lost the most workers in 21 years (to 1996). Bloomberg Consumer Comfort fell from 52.1 to 51.7, and then eased .1 to 51.6 – still very high, but below the 16–year high of 53.3 reached in August. Board Consumer Confidence rose from 126.2 to a 17–year high of 129.5 (well exceeding expectations of 124)! The Present Situation survey rose from 152 to 153.9 – the best reading since June 2001. Expectations were the highest since September 2000, rising from 109 to 113.3. The University of Michigan surveys were a little less optimistic. Their Sentiment dropped from a 13–year high of 100.7 to 98.5. Current Conditions fell 3 points to 113.5 and Expectations dropped from 90.5 to 88.9. The Leading Index for October was up by 1.20%. September LEI was revised from a .20% drop to a .10% rise.

The Chicago Fed National Activity Index rose from .36 to .65 and Richmond Fed Manufacturing increased from 12 to 30. However, others dropped as the Chicago Purchasing Managers report fell from 66.2 to 63.9, Kansas City Fed Manufacturing Activity fell from 23 to 16, and Dallas dropped from 27.6 to 19.4. Durable Goods Orders fell 1.20% in October (after a 2.2% increase in September). That was the first drop since June. Ex–Transportation, they rose .40%. Orders for Capital Goods fell .50%. Wholesale Inventories dropped .40% in October and Retail Inventories fell .10%. The Advance Goods Trade Balance for October increased to the widest deficit in 2 years, rising from $64.1 billion to $68.3 billion. While some of the increase was from Crude Oil, some reflected replacing depleted inventories and stocking shelves in what could be viewed as retail optimism.

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The housing sector has exited the summer storms with a lot of promise! Housing Starts rose 13.66% to an annual 1,290K pace – the best in a year. Building Permits rose 5.88% to 1,297K, with single family starts hitting 839K (the best annual pace since September 2007). October Sales of Existing Homes rose 2.05% to 5.48M – a 4–month high. Available property inventories fell to the lowest since 1999 (when those records began). New Home Sales rose 6.20% to 685K, the highest since October 2007! Supply hit the lowest levels since July 2016. Pending Home Sales rose 3.50% – the most in 8 months, and were higher primarily in the south following the storms. The FHFA House Price Index rose .30% in September, while the House Price Purchase Index was up 1.40% in the 3rd quarter. In September, metro home prices (S&P Case–Shiller 20–city) rose .52% – the most since 2014. Seattle and Las Vegas rose the most. The annual pace quickened from 5.82% to 6.19%. The overall home price index rose from 5.95% to an annual 6.15% – keeping pace with metro prices. MBA Mortgage Foreclosures dropped from 1.29% to 1.23% in the 3rd quarter, but Mortgage Delinquencies rose from 4.24% to 4.88% (usually an early warning).

Friday kicks off December with October Construction Spending, November Vehicle Sales, ISM Manufacturing, Prices Paid, New Orders, and a first 'feel' for November payrolls from ISM Employment. Next Monday (12/04) is set for Factory Orders, and Durable and Capital Goods Orders for October. Tuesday follows with the October Trade Balance (deficit) and the service–sector outlook (ISM Non–Manufacturing). Wednesday brings MBA Mortgage Applications (which rose .10% and then fell 3.10% over the past 2 weeks), Q3 Nonfarm Productivity & Labor Costs, and then another key read into next Friday's November payrolls from ADP Employment Change.

Equities

As we said earlier, stocks have been on a tear. The Dow rose 972 points or 4.34% in October and 895 points or 3.83% in November. Though the Dow lost .27% the week of the 17th, the Industrials added 199.75 points or .86% to close at 23,557.99 after Thanksgiving. The Dow has surged 3.03% this week on good economic news and promising holiday sales. The S&P lost .13% into the 17th, but gained 23.57 points or .91% last week to 2,602.42, and is 1.74% higher this week – joining the Dow and most other indexes in rising to record highs today. It's worth noting that most key foreign indices are lagging U.S. stocks by not rising to (or in cases even near) new highs. The Nasdaq rose .47% and 1.57% over the past 2 weeks, leading most indices, but is .22% lower this week after having risen to a record high on Tuesday (and then falling hard on Wednesday – off 1.27%). The Dow Transports lost .19% and then gained 1.45% last week. With a healthy 6.80% gain into today, they also hit new highs. Bank stocks had risen 1.63%, but then fell .26% last week. A 5.71% upside thrust this week sent bank stocks to their highest levels since October 2007! Our stock cycles led us to stand aside in consideration of an expected drop into the end of December. That's still in play, and we still expect a downturn from a high near December 6th.

Resistance:	Dow:	24,412/ 24,572/ 24,726/ 24,887	Nasdaq:	6,888/ 6,913/ 6,960/ 7,001	S&P:	2,656/ 2,671/ 2,684/ 2,697
Support:		24,101/ 23,945/ 23,793/ 23,639		6,835/ 6,795/ 6,753/ 6,721		2,634/ 2,628/ 2,619/ 2,603

Other Markets

Crude Oil reached the **BMR** target (near term) of $58.85 with a rise just over $59/barrel the day after Thanksgiving! Crude lost .33% into the 17th, but then rose 4.24% last week to 2–year highs. It's 2.63% lower this week. We expect Crude to trade off into a low near December 14th before resuming higher prices. Commodities lost .66%, gained .96%, and then fell 1.58% into today (with Crude). Gold had gained 1.75% and lost .71% for the past 2 weeks, and then fell 1.10% into today. The U.S. Dollar lost .75% and then .93% (for a 3rd weekly loss), but is .32% higher this week. The Japanese Yen rallied 1.26% and .51% over the past 2 weeks, but is .91% lower this week. The Euro gained 1.07% and 1.21%, but is also off this week (by .24%). Whether right – or not, the world needs Dollars to buy runaway U.S. equities. Corn lost .15% and .22%, and is working on a 5th loss with a .15% drop into today. Cotton, however, rose 1.06% and 3.51%, and is up for a 6th week with a 3.89% rise into today.

"If you do not conquer self, you will be conquered by self." Napoleon Hill

Additional Information is Available on Request

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