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Bond Market Review

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Front End Alignment

As the Fed is intent on pushing the 'front end' of the Treasury curve higher, longer rates are resisting. Since last December, the spread between 2 and 10–year Treasuries has flattened from 136 bps to 53 bps today. That's the most–narrow (flattest) curve since October 2007 – when rates were screaming a warning of impending economic troubles.

The 'front end' of the FOMC neared completion, as Fed Chair nominee and current FRB Governor Jerome Powell received 22 positive votes (to one negative) from the Senate Banking Committee. The bipartisan support is expected to carry through the full Senate. Powell was appointed to the Fed board by President Obama.

Many in the political opposition, the media, and foreign policy makers are seeking to challenge the 'front end' of America's leadership. This week, the House of Representatives had a forced vote aimed at the impeachment of President Trump. Though it was soundly defeated 364 to 58, there were 58 votes to move ahead. The tax cut plan has not only drawn criticism from the opposition party, but also from foreign trade partners. The EU and China voiced concerns that the legislation might violate international trade and tax laws. (If we've learned anything, President Trump intends to place America first – and doesn't care what they think.) Nevertheless, the Spanish Economy Minister said the tax reform might *"violate World Trade Organization rules"*, and German Finance Minister Peter Altmaier said: *"We need to verify in what way the U.S. proposals affect tax competition."* The **B**ond **M**arket **R**eview would contend we've certainly been on the losing side of 'tax competition' recently – with one of the highest and most onerous corporate tax rates among leading economies. That 35% rate, which could be cut to 20%, has been a cause for the exodus of businesses that might repatriate if the legislation is passed. No wonder they're screaming …

Stocks have seen clear sailing, and America's indexes are leading the 'front end' of the advance. On Monday, bank stocks hit their highest levels since October 2007 – coincidentally the last time the Treasury curve was as flat as it is now. In fact, most U.S. indexes hit record highs on Monday – though the Nasdaq made its high on November 28th, and today hit its lowest lows since November 15th. Global indices are lagging U.S. stocks – some by wide margins.

However, stocks are somewhat overvalued and growing vulnerable to news (real and fake). There was a 'bombshell' report on Bloomberg that was in error. It had been reported that special counsel Robert Mueller had subpoenaed Deutsche Bank records pertaining to the President and his family. The corrected report was that the records *"pertain to people affiliated"* with the President – so it was more a 'shell' than a 'bomb.' Meanwhile, ethics charges are leading to a feeding frenzy across America – across politics, business, the media, sports, education, and celebrities.

Confidence, manufacturing, services, employment, and other sectors are also leading the 'front end' of a continued recovery. In fact, much of the important economic data this year has been beating expectations. Confidence of CEOs across America rose from 84.5 to 96.8 – the most optimistic outlook since 2012. The October Trade Deficit hit its widest levels since January on record imports – a negative which the **BMR** has often viewed as a positive sign of optimism in retail. Last week, we reported that Q3 GDP was revised .3% higher to a 3–year high of 3.3%. Q1 GDP was only 1.2% (and the Fed hiked anyway), but we've now had two quarters of 3.1% and 3.3%. With no annual GDP over 3% in over a decade, that's clearly a welcome sign. The New York Fed is estimating Q4 at 3.93%, and the Atlanta model rose from 2.74% to 3.47% – leading CNBC contributor Joseph LaVorgna to tweet *"there's a risk that growth is even much higher."* The Atlanta Q4 forecast fell back to 3.2% on Monday.

Looking Ahead

- Interest rates should be generally lower into a trend–change near December 22nd.
- The **BMR** equity cycles project a turndown into month end (near 12/28).
- The FOMC is expected to hike interest rates with their policy statement next Wednesday (12/13) at 2 p.m. ET.

Treasuries, Agencies, and MBS

The FOMC is set to announce their interest–rate policy on Wednesday (12/13). The market–based odds for a 25–bps hike have been above 90% since early November, and at 98.3% (or a near lock) all this week. This is most likely the final opportunity for Fed Chair Janet Yellen to hike rates since her term expires on February 3rd, 2018, and a January move would violate the FOMC's 'gradual pace' intentions for removing accommodation. It would also put that 'gradual pace' back into place as many Fed participants had forecast 4 hikes for 2017, and the December meeting is the last chance to get a third in – having skipped any action in September (and since June). Last week, yields rose by 2.5, 5, and 2 bps for the 2, 5, and 10–year Treasury sectors, while 30–year rates dropped .5 bps. Into today, the curve flattened with 2 and 5–year yields rising 3.5 and .5 bps, while 10 and 30–year rates dropped by 3 and 4.5 bps.

MBS spreads (FNMA 30–year 3%) were unchanged last week. Next week, the U.S. Treasury will auction $24 billion 3–year notes and $20 billion 10–year notes Monday (12/11), and $12 billion 30–year bonds on Tuesday (12/12) – to get ahead of Wednesday's FOMC statement.

12/01/17 Treasury Yield Curve	2-Year: 1.773%	5-Year: 2.114%	10-Year: 2.362%	30-Year: 2.762%
Weekly Yield Change:	+.026%	+.050%	+.019%	–.003%
Support:	1.815/ 1.835/ 1.860/ 1.875	2.138/ 2.173/ 2.208/ 2.243	2.356/ 2.376/ 2.395/ 2.416	2.737/ 2.777/ 2.817/ 2.857%
Targets:	1.790/ 1.770/ 1.750/ 1.735	2.105/ 2.069/ 2.039/ 2.005	2.317/ 2.297/ 2.277/ 2.257	2.698/ 2.658/ 2.618/ 2.578%

Economics

The preliminary reads going into Friday's November payrolls release were ADP Employment Change down from 235K to a 190K increase, and ISM Employment (which fell a tick to 59.7). November's numbers are expected to be down 66K from October's 261K gain. The service sector (ISM Non–Manufacturing Composite) dropped off a 12–year high of 60.1 to 57.4 – cooling a bit. ISM Manufacturing also eased, falling from 58.7 to 58.2. Production was the highest since March 2011 and New Orders rose from 63.4 to 64.0. Prices Paid fell from 68.5 to 65.5. Nonfarm Productivity rose 3.00% in the third quarter, and Unit Labor Costs fell .20%. Factory Orders dropped .10% in October, but were .80% higher ex transportation. Orders for Durable Goods were .80% lower, but were also higher (by .90%) ex transportation. Capital Goods Orders rose .30%.

The October Trade Balance deficit widened from $44.9 billion to $48.7 billion (the widest since January). October Construction Spending rose 1.40% (the most in 5 months). Vehicle Sales fell for a second month following the September post–storm surge. Sales fell from 17.98M to a 17.35M annual pace, with domestic sales dropping from 13.95M to 13.38M (annually).

Thursday is set for Bloomberg Consumer Comfort, October Consumer Credit, and 2 more clues into November payrolls from jobless claims (down 2K to 238K last week) and Challenger Job Cuts. Friday brings November payrolls, the Unemployment Rate, Labor Force Participation, and earnings statistics. The University of Michigan sentiment surveys, and Wholesale Inventories and Trade Sales are also due. Next Monday (12/11) updates JOLTS Job Openings. Tuesday gives us NFIB Small Business Optimism, Producer Prices (November PPI), and November's Monthly Budget Statement. Wednesday brings MBA Mortgage Applications (which rose 4.70% last week), Consumer Prices (November CPI), annual earnings–growth numbers, and the FOMC interest–rate policy statement.

Equities

Last week, the Dow surged 673.60 points or 2.86% to 24,231.59. It's .37% lower this week. The Nasdaq diverged with a 41.57–point .60% loss to 6,847.59. The Nasdaq is weaker this week as well – off 1.04%. The S&P rose 39.80 points or 1.53% to 2,642.22, but is off .49% this week. The Dow Transports outperformed with a 5.89% gain, and are .40% higher this week. Bank stocks also excelled, rising 5.82% and 'winning the week' with a .64% gain. We still expect a low near the end of December. Our models are using recent data and updated often, but that hasn't yet altered the near–term and medium–term cycles.

Resistance:	Dow:	24,260/ 24,412/ 24,566/ 24,725	Nasdaq:	6,831/ 6,862/ 6,899/ 6,945	S&P:	2,641/ 2,652/ 2,665/ 2,678
Support:		24,101/ 23,947/ 23,795/ 23,639		6,781/ 6,740/ 6,698/ 6,658		2,626/ 2,613/ 2,601/ 2,584

Other Markets

Crude Oil continued to fall after trading just above $59/barrel on the 24th – fulfilling our near–term $58.85 target. The next trend–change low is due near December 14th. Crude fell 1.00% last week, and was 4.11% lower into today. Gold fell .66%, and dropped another 1.25% this week. Commodities, in turn, dropped .80%, and are off another 3.13% so far this week. The U.S. Dollar rose .14%, not much – but that broke a 3–week skid with large losses each week for a 2.27% total fall. The Dollar has rallied .80% this week. The Japanese Yen lost .57% and is .11% lower this week – following a 3–week gain. The Euro fell .31%, and is .84% lower this week. Corn gained .73% (after 4 losses), but is off 1.60% this week. Cotton gained for a 6th week, rising 4.43%, but is .34% lower this week.

"Time is the most valuable thing a man can spend." Theophrastus

"Tax cuts are coming, despite the opposition – and the imposition – parties."

Additional Information is Available on Request

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