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Bond Market Review

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Focus

Though the technology is improving, small lenses on cell phones limit the depth of focus on snapshots. You may end up with a clear background, foreground, or possibly even what you actually intended to shoot. With the Fed's move towards transparency a few years ago, the markets are supposed to be able to anticipate what the FOMC intends to do over the next few meetings – or at least avoid the volatility and shock of a totally unexpected move. However, as we approach the March 19th FOMC meeting, members have a varying focus for liftoff anywhere from June to as late as 2016. It's like pressing the picture button – while your phone tries to find which face to follow!

As we approach March Madness (and we're by no means implying any reference to the Fed's March 18th statement on interest–rate policy), some of us are already focused on August – and the return of the pigskin and its fickle tumbles and fumbles on the gridiron. The upcoming first hike caused the **BMR** to recall the errant over–tightening exercised by then–Chairman Ben Bernanke into 2006. Into his last hike, he used a football analogy – imagining himself as the quarterback delivering a win for the team. The Fed had tightened 16 times, and it appeared Bernanke thought a 17th was a good idea. It turned out to be the nail in the coffin for the subprime market – the downfall of which was a huge causal part of the ensuing tsunami that resulted in the financial crisis. That was the last hike.

In the **B**ond **M**arket **R**eview (06/05/2006), we wrote that Bernanke that day had said: *"It could take anywhere from 3 to 4 months to as long as 18 months before the full effects of the policy action are felt by the economy."* Speaking to the 17th rate hike which would come on June 29th, we said: *"So what's the hurry?"* At that time he said, even though their policy is *"data driven, it doesn't mean that we look at the latest employment number for example and immediately conclude we should do X, Y, or Z."* He said, *"I like to think of it as the way a quarterback has to lead a receiver going down the football field. You have to throw where the receiver is going to be, not where he is at the current moment. It's the same with the economy."* The **BMR** posed our analysis at that time: *"So, the Fed is running a post pattern no matter what??? What if there's a blitz? What if the receiver runs a buttonhook or a sideline pattern? Are we in a 2–minute offense? More importantly, what experience does he have actually hitting that hypothetical receiver?"* Like the Seahawks in this year's Super Bowl, he passed one time too many!

It's that kind of history that's has some FOMC members cautious, while others want to do away with the language they can be *"patient"* – allowing them to move as early as June. Even Fed Chair Janet Yellen said the FOMC might drop the *"patient"* pledge – even though that wouldn't necessarily imply an imminent hike. New York's William C. Dudley made the case for caution as did Chicago's Charles Evans. Evans argued for holding rates into 2016, and said he didn't expect to *"achieve 2% inflation until 2018."* San Francisco's John Williams, St. Louis' James Bullard, and Cleveland's Loretta Mester all advocated a desire for the flexibility to tighten sooner (if the data warranted). Make no mistake, as it was with former Fed Chairs Alan Greenspan and Ben Bernanke, the opinion that matters most belongs to Janet Yellen. In 2009, while president of the San Francisco FRB, she was one of the few to appreciate the magnitude of the depth of the unfolding economic trials. Despite recent testimony, she's seemed reluctant to start too soon. After all, if they begin to raise short–term rates, and long rates fail to follow (held down due to relative value versus lower–yielding alternatives), the FOMC could end up facing another inverted curve.

Looking Ahead

- Bond yields should dip into March 11th and again into the 24th, but be mostly higher into early April.
- Major stock cycles are positive into a peak due March 9th. We expect a low near March 27th.

Treasuries, Agencies, and MBS

The Fed's Beige Book, issued 8 times a year, and ahead of the FOMC meetings, showed a continuation of growth described as mostly *"moderate"* (in 6 of 12 districts) or *"modest."* Consumer Spending rose in most regions (as was illustrated in the strong 4.2% rise in 4th–quarter Personal Consumption). Wage pressures were moderate and mostly limited to skilled labor. Bonds did well last week, but yields bottomed on the 26th – a day ahead of the **BMR** timing for a *"trough between February 27th and March 5th."* For the week, yields fell 1.5, 8.5, 12, and 12.5 bps for the 2, 5, 10, and 30–year sectors. Into today, rates reversed course with those sectors advancing 3.5, 9, 12.5, and 13 bps. MBS spreads (for FNMA 30–year 2.5%) widened by 3 bps last week. Last Thursday's $29 billion 7–year note auction brought 1.834% with the lowest demand since November 2013 – leading to a '2 of 5' or below–average rating. Foreign investors bought 52.3% of the issue, versus 56.1% in January. Next week, the Treasury will auction $21 billion 3–year notes on Tuesday (03/10), $21 billion 10–year notes (reopened February 2025) on Wednesday, and $13 billion 30–year bonds (reopened February 2045) on Thursday.

02/27/15 Treasury Yield Curve	2-Year: 0.620%	5-Year: 1.500%	10-Year: 1.994%	30-Year: 2.591%
Weekly Yield Change:	–.014	–.086	–.119	–.124%
Support:	0.66/ 0.68/ 0.70/ 0.73%	1.62/ 1.68/ 1.74/ 1.81%	2.14/ 2.21/ 2.28/ 2.37%	2.74/ 2.78/ 2.82/ 2.86%
Targets:	0.62/ 0.59/ 0.56/ 0.53%	1.55/ 1.50/ 1.44/ 1.34%	2.07/ 2.00/ 1.94/ 1.85%	2.70/ 2.66/ 2.60/ 2.55%

Economics

Consumer Prices were very tame (and non–FOMC threatening) with a .70% drop. Ex food & energy, prices rose .20%. That took annual CPI to a negative (–.10%), but left the core rate unchanged at 1.60%. Initial Jobless Claims once again rose above 300K with a 31K lift to 313K. Continuing Claims fell 21K to 2,401K. ADP Employment Change was up 212K, but slowed from January's 250K rise. 4th–quarter GDP was 2.20%, with a very–healthy 4.20% rise in Personal Consumption – the best gain in 4 years. The GDP Price Index rose only .10%. Personal Income was .30% higher in January, but Personal Spending fell by .20%. January's PCE Deflator fell by .50% to an annual inflation rate of only .20%. The core rate rose .10%, with the annual pace steady at 1.30%. Durable Goods Orders rose 2.80% in January, and were .30% higher ex transportation. The FHFA House Price Index rose .80% in December, and the 4th–quarter House Price Purchase Index was up 1.40%. Pending Home Sales rose 1.70% in January, but slowed from 7.70% to 6.50% year–over–year.

IBD/TIPP Economic Optimism rose from 47.5 to 49.1, and University of Michigan Sentiment fell from 98.1 to 95.4. The service–sector outlook (ISM Non–Manufacturing Composite) rose .2 to 56.9. While ISM New York rose from 44.5 to 63.1, other data faltered. ISM Manufacturing fell .6 to 52.9 and ISM Prices Paid was unchanged. ISM Milwaukee fell from 51.6 to 50.32, Kansas City Fed Manufacturing Activity dropped from 3 to 1, and Chicago Purchasing Manager slumped from 59.4 to 45.8. January Construction Spending fell 1.10%. In February, the pace of auto sales slowed from 16.56M to 16.16M. Domestic vehicle sales fell from 13.31M to 12.87M.

Thursday is set for another key into February payrolls from Challenger Job Cuts and jobless claims data. Also due are 4Q Nonfarm Productivity & Unit Labor Costs, January Factory Orders, and Bloomberg Consumer Comfort (which last week fell from 44.6 to 42.7). Friday gives us February payroll data and the Unemployment Rate. Also due are January's Trade Balance (deficit) and Consumer Credit. Next Monday (03/09) provides the FOMC update on their 'labor dashboard' (Labor Market Conditions Index Change). Tuesday is set for NFIB Small Business Optimism, January Wholesale Inventories & Trade Sales, and JOLTS Job Openings. Wednesday brings MBA Mortgage Applications (up .10% last week) and February's Monthly Budget Statement.

Equities

While stocks didn't reach new highs today, they did on Monday! The Nasdaq finally broke 5,000 for the first time since March 27th, 2000. Monday's 5,008.57 high was just 2.41% off the highest record of 5,132.52 reached on March 10th, 2000 (and 40.05 points or .79% away from the highest close – also on that day). That's quite a vault from the 2002 low of 1,108.49, and the 2009 low of 1,265.52 – as it's nearly 300% higher since then! February was also the best month for the Nasdaq since 2012 as Apple rose 9.6% leading to the index's gain of 7.08%. The S&P's gain of 5.49% was the best since October 2011 (following its worst month in a year). That said, last week the Dow lost 7.74 points or .04% to 18,321.70. It's .20% lower this week. The S&P lost 5.80 points or .27% to 2,104.50, and is .28% lower this week. The Nasdaq gained 7.56 points or .15% to 4,963.53, and is .07% better this week. The Dow Transports lost 1.17%, and were off .08% into today. Bank stocks were .19% lower, but .35% higher so far this week. We're expecting a tradable peak near March 9th, with downward pressure following into March 27th.

Resistance:	Dow:	18,210/ 18,296/ 18,434/ 18,568	Nasdaq:	5,009/ 5,045/ 5,080/ 5,116	S&P: 2,109/ 2,120/ 2,131/ 2,143
Support:		18,028/ 17,896/ 17,766/ 17,642		4,940/ 4,906/ 4,869/ 4,810	2,088/ 2,074/ 2,060/ 2,042

Other Markets

The Euro fell to an 11.5–year low as the European Central Bank began their policy meeting. The Euro lost 1.63% last week, and was 1.05% lower into today. The U.S. Dollar gained 1.04%, and has tacked on .70% since Friday. The Japanese Yen fell .50%, and is off .04% this week. Commodities fell .30%, and are .39% lower this week. Crude Oil fell 1.15%, but is 3.56% better this week. Gold gained .72%, but is 1.01% lower this week. Corn fell .19%, and is .78% lower this week. Cotton rose .09%, but tumbled 1.73% into today.

"Better shun the bait, than struggle in the snare." John Dryden (1631 - 1700)

Additional Information is Available on Request

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