Banes Capital Management, LLC.

6410 Poplar Ave., Suite 320 – Memphis, TN 38119 – (901) 261-5900 Fax: (901) 261-5999

Bond Market Review

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The June Swoon

Great payroll data for February led investors to believe a June rate hike was baked in the cake. Bond yields rose sharply on Friday – and stocks tumbled. You could almost see the headlines: 'U.S. Economy Reaches Full Employment!.' After all, you must blindly trust the data, because you don't want to confuse it with logic. With the Unemployment Rate falling from 5.70% to 5.50%, it entered the zone that the Fed has long considered full employment. We're glad folks are finding jobs, and we're not saying the glass is half empty or half full – we're just saying it's *not* full! After all, besides gaining a considerable 295K jobs in February, the labor force retreated .10% to 62.80% – enabling the result. Still, a number of FOMC members used the data to point to a June liftoff for rates.

At this point, we know we're stretching our readership in referring back to the Honeymooner's Jackie Gleason for an analogy, but after all – he was also in 'Smokey and the Bandit.' Jackie's big line was: *"How sweet it is!"* In its simplicity, it speaks to a heightened level of elation and satisfaction. That's what came to mind when we read about Chicago Fed economists referring to 5.2% to 5.5% as the 'sweet spot' for employment. However, even considering Mr. Gleason using his 'trade line', it just doesn't seem like we're there yet. Chicago FRB President Charles Evans made the case that the new normal rate *"might be something more like 5.0%."* Hopefully, we can approach that result with rising labor participation – then we'll buy it! That would be some Chicago 'Walter Payton Sweetness!'

Think the Dow is volatile now? The Industrials are being 'remixed' by taking out AT&T (T) – which has been trading near its lower range of the last 3 years, and replacing it with Apple (AAPL) – a company that has added 142% in less than 2 years. 300–point days may become commonplace. The changeover will occur on March 18th – which is also 'Fed day', so expect some fireworks. The only action we expect from the FOMC meeting is to drop the word *"patient"* in their consideration for leaving rates low.

Looking Ahead

- Bond yields should be mostly higher into early April, with a peak near (03/20) and a low into (03/25).
- Stocks should trade off into an interim low near March 27th. We could see a bounce near the 18th.
- The FOMC will release their March interest–rate policy decision on Wednesday (03/18), at 2 pm EST.

Treasuries, Agencies, and MBS

Last week, yields rose 10.5, 19.5, 25, and 25 bps for the 2, 5, 10, and 30–year Treasury sectors. The **B**ond **M**arket **R**eview cycles had yields dipping into March 11th (plus or minus a day) – after yields last bottomed a day early with our previous cycle (into February 26th). We got the nice dip we were looking for as yields made a top on the 6th and headed lower into today. Into today, yields fell 4.5, 9, 13.5, and 15.5 for the 2, 5, 10, and 30–year sectors.

That said, Treasuries performed much better this week as stocks fell and the ECB began buying bonds. The 10–year note auction brought the most foreign demand in 3 years. Even as relatively low as yields are, the lower and even negative–yield euro land offerings make U.S. bonds attractive. The spread versus German bunds is at 25–year highs! Foreign investors in U.S. bonds have also seen benefits from the Dollar soaring to 12–year highs versus the Euro (and multi–year highs versus other key currencies). The yield on whatever maturity Treasury aside, Dollar–bond investors have seen an additional currency–arbitrage return of over 7% since early February, over 14% since mid December, over 18% since mid October, or over 21% since last May. Investors in those negative–yield Swiss or Euro–area bonds may also be trying to participate in a possible unwinding of the Dollar versus those currencies – thinking the Dollar is overbought, and ripe for a correction. The ECB's Ewald Nowotny said their bond buying would get their yields positive. So, buying bonds makes yields go up? It worked for the Fed! (Growing the balance sheet is what does it.)

MBS spreads (for FNMA 30–year 2.5%) narrowed by 5 bps last week. This week's 3 and 10–year Treasury auctions were each rated an above–average '4 of 5'. Tuesday's 3–year offering of $24 billion brought 1.104% – the highest yield since April 2011. Demand was off to February, though foreign investors took 51.4% of the issue versus 48.9% last month. Today's $21 billion 10–year note brought 2.139% in a reopening of the February 2025 maturity. Demand was the best since December, and foreign accounts took a healthy 58.6% of the offering, falling slightly from 59.5% last month.

03/06/15 Treasury Yield Curve	2-Year: 0.725%	5-Year: 1.695%	10-Year: 2.242%	30-Year: 2.841%
Weekly Yield Change:	+.105	+.195	+.248	+.250%
Support:	0.69/ 0.71/ 0.73/ 0.77%	1.62/ 1.68/ 1.74/ 1.81%	2.14/ 2.20/ 2.26/ 2.34%	2.74/ 2.79/ 2.83/ 2.87%
Targets:	0.65/ 0.62/ 0.59/ 0.56%	1.55/ 1.50/ 1.44/ 1.34%	2.04/ 1.98/ 1.90/ 1.84%	2.63/ 2.60/ 2.54/ 2.47%

Economics

Thursday's data was a little shaky for the jobs picture, but Friday's releases beat expectations anyway. Initial Jobless Claims rose 7K to a 9–month high of 320K – though that result was deemed to be skewed by inclement weather. Continuing Claims rose from 2,404K to 2,421K. Challenger Job Cuts rose 20.90% (more cuts) versus February 2014. The data ended up showing a 295K pickup in February payrolls (versus 235K expectations). There was a slight 2–month adjustment of 18K less jobs versus previous reports. Private payrolls rose 288K, and Manufacturing added 8K jobs. The U.S. Unemployment Rate fell from 5.70% to 5.50% – the lowest in nearly 7 years. Though partly due to the gains in jobs, the .20% drop to 5.50% was also attributable to the Labor Force Participation Rate falling from 62.90% to 62.80%. Average Hourly Earnings rose .10% in February, but the annual pace slowed from 2.20% to only 2.00%. Average Weekly Hours remained at 34.6 and the Underemployment Rate fell .30% to 11.00%. (That rate was only 8.8% in December 2007.) It's also the case that those out of work for 27 weeks or longer is 31.1%, roughly twice as high as when the turndown began to unfold. The FOMC's Labor Market Conditions Index Change rose 4 points, though as a combination of many gauges – it's hard to know the significance (other than the gain). JOLTS Job Openings rose from 4,877K to 4,998K. At nearly 5 million open jobs, that's the highest 'jobs available' level in 14 years! That report also showed more people quit their jobs in January than for any month since April 2008 – supposedly optimistic about finding a better job.

NFIB Small Business Optimism was .1 higher to 98. Nonfarm Productivity fell 2.20% in the 4th–quarter of 2014, and Unit Labor Costs rose 4.10%. The January Trade Balance deficit shrank from $45.6 billion to $41.8 billion, possibly reflecting cheaper oil, but maybe also reflecting the recent drops in retail sales. Spending on Consumer Credit fell from $17.871 billion in December to $11.562 billion in January. Factory Orders fell .20% in January. Wholesale Inventories rose .30% in January, but Wholesale Trade Sales fell by 3.10%.

Thursday is set for February Retail Sales, jobless claims data, January Business Inventories, the February Monthly Budget Statement, Import Prices, and Bloomberg Consumer Comfort (which last week rose from 42.7 to 43.5). Friday brings Producer Prices (February PPI), and University of Michigan Confidence data. Monday (03/16) gives us Empire Manufacturing, Industrial Production & Capacity Utilization for February, homebuilder outlook (NAHB Housing Market Index), and January net Treasury (TIC) flows. Tuesday is set for February Housing Starts and Building Permits. Wednesday gives us MBA Mortgage Applications (off 1.30% last week), and the FOMC decision on interest rate policy.

Equities

We thought a high due into March 9th would indicate good payroll data on the 6th. However, Friday ended with the steepest drop in 2 months as investors saw the good payroll numbers as all but insuring the Fed would begin to hike rates within the next 2 to 3 meetings. Monday the 9th still got a positive move from the last of that cycle, which now points mostly lower into March 27th (with a bounce due around March 18th). However, with all the cycles turned over for now, Tuesday saw the largest drop since January 5th. For the week, the Dow lost 275.92 points or 1.52% to 17,856.78. It's 1.24% lower this week. The Nasdaq fell 36.16 points or .73% to 4,927.37, and is 1.57% lower since Friday. The S&P lost 33.24 points or 1.58% to 2,071.26, and is off 1.50% this week. The Transports fell 1.30%, and are .11% lower this week. Bank stocks gained 1.04%, but are 1.19% lower this week.

	Dow:	Nasdaq:	S&P:
Resistance:	17,894/ 18,028/ 18,163/ 18,291	4,903/ 4,940/ 4,984/ 5,009	2,062/ 2,079/ 2,088/ 2,102
Support:	17,626/ 17,496/ 17,364/ 17,231	4,848/ 4,810/ 4,763/ 4,735	2,039/ 2,027/ 2,016/ 2,005

Other Markets

The Dollar rose to a 12–year high versus the Euro as the ECB began QE purchases. Commodities fell 1.76%, and lost 1.93% into today – as Crude fell .30%, and then tumbled 2.90%. The strong Dollar also weakened Gold – which lost 4.02%, and then another 1.18% this week. The Dollar surged 2.40% and is 2.23% higher this week. The Japanese Yen lost 1.00%, and is .51% lower this week. The Euro cratered 3.14%, and is off 2.74% this week. Corn lost 1.37%, but was 1.25% better into today. Cotton lost 2.75%, and is 4.16% lower since Friday.

"Life's a tough proposition, and the first hundred years are the hardest." Wilson Mizner

Additional Information is Available on Request

Doug Ingram, Financial Economist

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