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

Bond Market Review

June 14, 2012

Gimme Three Steps

'And I'm tellin' you son, well it ain't no fun…' We never thought we'd use this 'Skynyrd' title, but the EU hits just keep on coming. Yesterday, Moody's Investors Service downgraded Spain's credit rating by 'three steps' as they warned of problems stemming from their increased debt burden and economic weakness. Their main concern was in Spain calling for a bailout. Bloomberg reported that Kathrin Muehlbronner, an analyst with their London office said: *"In our view, that's not a sign of strength, it's a sign of weakness."* Spain's debt was cut from A3 to Baa3 as they requested roughly $126 billion from the EU to recapitalize their banking system. They are the fourth Euro nation to request a bailout, though their Prime Minister had denied they would seek one just a few weeks ago. (We're skeptical that Italy claims it won't need a bailout. They may be *next*.) Nevertheless, Italy's yields (borrowing costs) have risen substantially, and Spain's have risen to Euro–era highs. The **B**ond **M**arket **R**eview would ask: 'If bailouts are bullish, then wouldn't not needing bailouts be bearish?' The logic escapes us, but a stay of execution does sometimes (not always) lead to reprieve. Still, there was some at least temporary relief, and that optimism led stocks higher on Monday – as they made a high with our cycle that was due on the 11th.

Citing political risks in *"the direction of fiscal policy"* and with our fiscal performance and debt burden, S&P said the U.S. could be further downgraded by 2014. They confirmed their negative outlook for U.S. debt. 'Show me the backdoor…' As the markets prepare for Greek elections on Sunday (that will go a long way in determining if they will remain in the EU currency–wise), the Bank of England's Mervyn King revealed how they were 'ready to act' if Europe's debt crisis worsens. Building a case for more stimulus, he cautioned that a *"black cloud"* might arise out of the Eurozone. Last week, Finland's Prime minister said that he met with Treasury Secretary Geithner and Fed Chairman Bernanke. He said: *"They were very worried about what's going on."* This, Sunday's elections in Greece should lead to another *'manic Monday'*, but that's a different tune.

Central Bank Thespians

All over the globe – central bankers stand 'ready to act'. Fed Chairman Ben Bernanke testified before the Joint Economic Committee of Congress last week, and assured them the Fed could still provide stimulus – but stopped short of providing any specificity. Speaking to signs of U.S. slowdown and the ever–present risks in Europe, he said: *"If we decide that further action is required, then of course we have to decide what action is appropriate or what communications are appropriate. … We do have options that we can consider."* European Central Bank President Mario Draghi said their policy makers *"monitor all development closely and we stand ready to act"*, but left their benchmark rate unchanged at a record low. Even China cut rates (albeit only from 6.56% to 6.31%) for the first time since 2008. Australia cut on June 5th. Everyone's trying to get *"into the act"* (as Jimmy Durante said decades ago). The Fed will announce its updated posture on interest rates and the economy as they conclude their 2–day meeting next Wednesday (June 20th). We expect them to discuss, but not exercise any new easing measures – keeping that same 'stand ready to act' language in their best attempt to assure the markets some stability.

Looking Ahead

- The stock market is still subject to the headwinds of jobs, housing, and EU debt.
- Bonds look to be in the final stages of their bull market, and should turn before stocks bottom out.
- The Fed will announce their decision on interest rate policy on June 20th (12:30 p.m. EDT).

Treasuries, Agencies, and MBS

Though yields have risen since the plunge into June 1st, they're still low enough for record lows to be set in longer–term auctions of U.S. debt. Last week, yields were flat at 1–year, and then steeper by 2, 9, 18, and 23 bps for the 2, 5, 10, and 30–year Treasury sectors. Most sector yields were slightly higher this week, as the 2, 5, and 10–year rose 3, 2.5, and 1 bps. However, the 1–year was still flat, and yields were a half bps better at 30–years.

Agencies were 2 bps better at 2–years, and matched MBS spreads in being 6 bps better at 10 years. Tuesday's 3–year auction of $32 billion notes came at .387%. Demand fell to May, and foreign bidders accounted for 27% of the issue versus a previous 35.7% then. Yesterday, the Treasury sold $21 billion 10–year notes (a reopening of last month's May 2022 offering) at a record low yield of 1.622%. Demand was better to last month and foreign buyers accounted for 42% of the bonds (compared to a 38.7% allotment in May). Today the Treasury reopened the May 2042 long bond to add $13 billion. These bonds also set a record auction low at 2.72%. Demand was weaker to last month, and foreign buyers took 32.5% versus 33.8% in May.

06/08/12 Treasury Yield Curve	**2-Year: 0.266%**	**5-Year: 0.712%**	**10-Year: 1.635%**	**30-Year: 2.745%**
Weekly Yield Change:	+.020	+.091	+.183	+.226%
Support:	0.30/ 0.33/ 0.35/ 0.37%	0.77/ 0.79/ 0.85/ 0.89%	1.69/ 1.75/ 1.81/ 1.86%	2.80/ 2.85/ 2.90/ 2.97%
Targets:	0.26/ 0.24/ 0.22/ 0.20%	0.70/ 0.65/ 0.62/ 0.59%	1.56/ 1.53/ 1.49/ 1.44%	2.69/ 2.65/ 2.59/ 2.53%

Economics

With Crude Oil falling 25% off its February high to the lowest levels since October, overall price pressures have eased. The cost of living fell the most in 3 years as May Consumer Prices were down .3% – not threatening Fed policy from an inflation standpoint. Ex food & energy, prices rose .2%. The annual pace of CPI lessened .5% to a 1.7% rise, and the core remained at 2.3%. Producer Prices fell a full percent in May, though core prices were .2% higher. The annual pace for PPI fell from 1.90% to .70%, and the core rate remained at 2.70%. Import Prices fell 1% in May, and dropped .30% versus last year. Last week, Initial Jobless Claims fell 9K (after having been revised 6K higher) to 380K. This week, they rose to 386K – remaining at the high range for recent data. Continuing Claims rose from 3,259K to 3,311K last week, and were then off to 3,278K in today's data. Confidence slackened as the RBC Consumer Outlook Index fell 1.5 to 46.1, NFIB Small Business Optimism was .1 lower to 94.4, and IBD/TIPP Economic Optimism was off 1.8 to 46.7. Bloomberg Consumer Comfort, which last week improved 1.7 points to –37.6, rose another 1.2 to –36.4. Retail Sales fell .2% in May, and were revised .2% lower for April as well. A contributing factor was falling gasoline prices (not necessarily a huge negative economically). Less autos, sales fell .40%. Not affected by gas prices (for which lower costs might lead to consumers getting out more), ICSC Chain Store Sales rose 1.70%. Consumer Credit was just over half consensus with a $6.515 billion expansion in April, and revised March data was cut almost in half to $12.368 billion. April Business Inventories rose .40%, and Wholesale Inventories rose .60%. The Current Account Balance deficit for the first quarter widened more than expected with a $137.3 billion outflow. April's Trade Deficit certainly maintained that trend as the deficit came in at $50.1 billion. May's Monthly Budget Statement showed a deficit of $124.6 billion (in line with expectations).

Friday brings Empire Manufacturing, TIC Flows (foreign investment flows into, or out of, U.S. Treasuries), Industrial Production and Capacity Utilization for May, and University of Michigan Confidence. Monday (06/18) updates builder sentiment (the NAHB Housing Market Index) and Tuesday (06/19) brings JOLTs Job Openings, and Housing Starts & Building Permits for May. Wednesday (06/20) gives us MBA Mortgage Applications (up a strong 18% last week), and the Fed's decisions on stimulus and interest rate policy. Happy Father's Day Sunday!

Equities

Last week, we saw a mirror formation forming in stocks that pointed to large swings with a high due Monday the 11th. (It can be seen with a focal point of June 4th in the intraday chart of the S&P or Dow.) In the 'Mirror Mirror' section we placed a '%' sign where 'points' should have been – so there was also 'errata errata', but the similarly huge down and up days were a sign of the unfolding sequence. It seems like every other day stocks move as much as the 5–year note yields for a year, often the 10–year, and last week nearly as much as the 30–year! Stocks did sell off after a high on the 11th, but the Dow surpassed that mark today to new June highs, and the S&P was very close. Cycles begin to turn up between now and the 18th, so more upside is likely. 1,307 remains key support on the S&P for now. Last week, the Dow rose 435.63 points or 3.59% to 12,554.20. After a big 1.24% gain today, it's .78% higher for the week. The S&P gained 47.62 points or 3.73% to 1,325.66, and was up .26% through today. The Nasdaq rallied 110.94 points or 4.04% to 2,858.33, but was .77% lower into today. The Transports gained 3.06%, and are lower by .10% since Friday. Bank stocks gained 4.01%, and added another 1.01% so far this week.

Resistance:	Dow:	12,722/ 12,745/ 12,916/ 12,989	Nasdaq:	2,853/ 2,883/ 2,931/ 2,985	S&P:	1,335/ 1,353/ 1,366/ 1,377
Support:		12,453/ 12,313/ 12,210/ 12,035		2,802/ 2,782/ 2,742/ 2,724		1,307/ 1,296/ 1,285/ 1,267

Other Markets

Commodities rose for the first time in 6 weeks. They were 1.70% higher, and then .30% lower into today – as Crude Oil rose 1.05% and then fell .23%. Gold lost 1.88% last week, but was 1.78% higher through today. For the first week in six, the U.S. Dollar also lost (.50%), and it was then off another .70% into today. The Japanese Yen lost 1.88%, and then rose .18%. The Euro gained .67%, and then another .93% on the hope of further debt bailouts for Spain and other EU debt–saddled nations. Corn rose 8.43% and Cotton was 6.28% higher.

"Experience is a hard teacher because she gives the test first, the lesson afterwards." Vernon Sanders Law

Additional Information is Available on Request

Doug Ingram, Financial Economist