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Bond Market Review

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R–E–S–P–E–C–T

Politicians want it, but few can garner more than 50%. It's also true that even popular celebrities have their share of critics and detractors. However, relatively few reach the level of nearly–universal love and admiration. Aretha did! When it came to respect, Aretha Franklin had it, sang about it, and was one of the most popular artists in U.S. history – truly a national treasure. She passed away today at 76, losing her battle with pancreatic cancer. The 'Queen of Soul' was born in Memphis in 1942, but she moved to Detroit with her family in 1946 and was 'on the scene' as Motown music began taking the country by storm. The **B**ond **M**arket **R**eview was a big fan and of course loved her role in 'The Blues Brothers.' What a voice! In 1987 Aretha became the first woman inducted to the Rock and Roll Hall of Fame. In 2005, she was awarded the Presidential Medal of Freedom alongside former Fed Chair Alan Greenspan.

While the Congressional Budget Office showed a little less respect in dropping their 2018 GDP growth forecast from a previous 3.3% (in April) down to 3.1% – and said they expected growth to slow to 2.4% in 2019, Atlanta's GDP–Now forecast held steady! Atlanta's analysts continued to expect 4.3% Q3 growth after Industrial Production, CPI, Retail and other incoming data continued to support the economy's strong trajectory. The trade wars and other global concerns have many concerned, but recent economic data and company earnings have been impressive.

Turkish currency got little respect over the past week. While Turkey had been one of the United States' most dependable allies for decades, President Erdogan has drifted away and has exercised politics that are neither friendly nor fiscally responsible. His imprisonment of an American pastor on espionage charges has the U.S. ready to apply additional sanctions. Turkey provided important military bases for the U.S. that served to fend off Russian aggression during the cold war. (Google the 'Cuban missile crisis' and you will discover that Turkey was the back story to the end of a most–dangerous standoff.) However, this new Turkish government is becoming more pro–Russia. Turkey's currency crashed nearly 17% last Friday – leading to a devaluation of over 40% for the year. The contagion of other emerging–market currencies joining in the selloff was part of the catalyst for the volatility in the markets over the past two weeks. Trading–partner Georgia's currency dropped 5% versus the Dollar wiping out this year's gains. The currencies of Argentina, Mexico, Indonesia, Chile, South Africa and Brazil are all vulnerable to further weakness.

Turkey also joined Russia in dropping off the list of top U.S. creditors. Their U.S. debt holdings have fallen by 42% for the first half of 2018. The floor for a 'major' holder as viewed by the Treasury is $30 billion, and Turkey's U.S. debt holdings fell to $28.8 billion as of June. Russia fell off the list as a top–10 creditor in May and held at $14.9 billion in June. President Trump raised tariffs on steel and aluminum to pressure our Turkish allies to release the aforementioned pastor. That led to the Turkish President calling for a boycott on iPhones and other U.S. electronics. What followed was news stories of supportive Turks stomping on and smashing iPhones in the streets. (Wonder if the screens were already cracked – or they were older models???) China continued as the highest holder of U.S. debt, dropping only $4.4 billion to $1.18 trillion while #2 Japan dropped to a 6–year–plus low of $1.03 trillion. Overall, foreign investment into longer Treasuries rose by $114.5 billion while total flows shrank by $36.5 billion.

Looking Ahead

- Our equity cycles show increasing weakness after a trend–change near August 23rd.
- Yields should be lower into August 29th.

Treasuries, Agencies, and MBS

Even though stocks surged today, regaining most of last week's losses, bonds appeared to be following the **BMR** cycles for lower yields and 'bear flattened.' By the end of the day, the spread between 2 and 10–year Treasury note yields was only 25 bps – tied for the second–lowest level since August 2007! Global concerns over the weakness in emerging–market currencies – especially the Turkish Lira, sent yields lower for the week. We expect smaller changes in short rates out to 2 years, as the market–based odds for a September 26th hike by the FOMC remain at 100%. Thus, if longer yields follow our forecasts, more flattening is on the way – eventually leading to yield–curve inversion.

Last week, yields dropped 4, 6.5, 7.5, and 6 bps for the 2, 5, 10, and 30–year Treasury sectors. Yields were higher by 1 bps at 2–years into today, while dropping by .5 bps beyond 2 years. Our position remains: "*Lightening hedges and buying pullbacks should be favorable on dips.*" MBS spreads (FNMA 30–year 3.5%) widened by 4 bps last week to fast moving Treasuries.

08/10/18 Treasury Yield Curve	2-Year: 2.606%	5-Year: 2.746%	10-Year: 2.874%	30-Year: 3.031%
Weekly Yield Change:	–.038%	–.067%	–.076%	–.058%
Support:	2.637/ 2.677/ 2.717/ 2.757	2.747/ 2.767/ 2.786/ 2.806	2.865/ 2.885/ 2.907/ 2.930	3.030/ 3.053/ 3.075/ 3.098%
Targets:	2.598/ 2.558/ 2.518/ 2.478	2.728/ 2.709/ 2.689/ 2.669	2.846/ 2.826/ 2.806/ 2.786	3.008/ 2.986/ 2.965/ 2.942%

Economics

Initial Jobless Claims fell from 214K to 212K – still just above the lowest levels since December 1969. Continuing Claims fell from 1,760K to 1,721K. NFIB Small Business Optimism improved from 107.2 to 107.9. Bloomberg Consumer Comfort fell .4 to 58.9 – retreating off 17–year highs though Economic Expectations rebounded with a 3.5–point increase to 57. Empire Manufacturing rose from 22.6 to a 10–month high 25.6 but the Philadelphia Fed Business Outlook fell from 25.7 to 11.9 – the worst drop since mid–2016 (potentially attributable to the developing 'trade wars'). Most other results didn't reflect that narrative as Nonfarm Productivity rose 2.90% in the second quarter to reach the best pace in 3 years (to Q1 2015). Unit Labor Costs fell .90% (in the biggest falloff since 2014). Nevertheless, Productivity rose a modest 1.30% year–over–year and Unit Labor Costs rose an also–modest 1.90% (YOY). Factory Output rose .30% in July and Industrial Production rose .10% (to a revised .40% better 1.00% in June). Capacity Utilization was unchanged at 78.10%. Business Inventories rose .10% in June.

Retail Sales were revised .30% lower to a .20% advance in June but rose a healthy .50% in July – beating forecasts. Ex autos, sales rose .60%. While consumption remained healthy, wage growth was still challenged. Average Weekly Earnings rose only .10% after a .30%–higher .50% revision for June. However, Average Hourly Earnings were flat in June but fell .20% in July. Delinquent Household Debt fell to 4.52% in Q2 – the lowest since records began in 2003. Homebuilder outlook dropped from 68 to 67 (as the NAHB Housing Market Index was the lowest since last September), while Q2 Mortgage Delinquencies slowed from 4.63% to 4.36% and Q2 MBA Mortgage Foreclosures slowed from 1.16% to 1.05%. Housing Starts rose .86% to a 1,168K annual pace but were off 1.85% year–over–year. Building Permits rose 1.47% to a 1,311K annual pace and were 6.59% higher to last year.

Consumer Prices rose .20% in July – maintaining an annual pace of 2.90%. Ex food and energy, prices rose .20%, hiking core CPI .10% to 2.40% – the fastest pace since 2008! However, the data suggested that ex rental costs, inflation actually decreased. Import Prices were flat but down .10% ex–petroleum. Export prices fell .50%. July's Treasury (Monthly Budget Statement) shortfall was $76.9 billion compared to $42.9 billion last year. Overall, fiscal 2018 is running 21% ahead of 2017's deficit at $684 billion (versus $566 billion through July 2017).

Friday is set for the Leading Index (July LEI) and the University of Michigan sentiment surveys. Next Monday and Tuesday are 'data light.' Wednesday brings MBA Mortgage Applications (which dropped by 2.00% last week), Existing Home Sales for July, and the minutes from the Fed's meeting held on August 1st.

Equities

Stocks fell into August 13th with our cycles and emerging–currency contagion as a catalyst. They made a lower low on Wednesday the 15th, and then had a significant rally today as the cycles are up into the 23rd before turning down with potentially greater force. Would we get out of some positions or hedge? Yes! Last week, the Dow Industrials fell 149.44 points or .59% to 25,313.14. They are .97% higher this week. The Nasdaq rose .35% to 7,839.11 but is .42% lower this week. The S&P lost .25% to 2,833.28 but made up that loss with a .26% gain into today. The Dow Transports lost .06% but are .90% better this week. Bank stocks lost 1.11% but are .65% higher this week.

Resistance:	Dow:	25,687/ 25,816/ 25,977/ 26,138	Nasdaq:	7,821/ 7,843/ 7,865/ 7,889	S&P:	2,846/ 2,860/ 2,874/ 2,887
Support:		25,200/ 25,025/ 24,864/ 24,709		7,756/ 7,734/ 7,712/ 7,689		2,834/ 2,821/ 2,807/ 2,794

Other Markets

Crude Oil fell into our August 16th trend–change for a low and has another low due near the 28th. We expect good bounces from these dates. Crude fell 1.26% last week and could be headed for a 7th loss as it is 3.21% lower this week. Commodities fell .80% and are 1.73% lower this week. Gold dropped .26% and is 2.88% lower this week. Those losses would point to a higher U.S. Dollar – and it rose 1.32% for a 13th gain in the last 17 weeks! It's .33% better this week. The Japanese Yen rose .38% but is .06% weaker since Friday. The Euro slumped 1.34% and is .32% lower this week. Not only are quality EU yields negative, the currency has lost 10% to the U.S. Dollar since February! Corn fell 3.25% but is 2.10% better this week. Cotton lost 3.17% and is off another 4.34% this week.

"I sing to the realists; people who accept it like it is." Aretha Franklin

James Brown was once pulled over for speeding, though his passenger told the police he couldn't be ticketed because as the 'Ambassador of Soul' – he had diplomatic immunity.

Additional Information is Available on Request

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