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Bond Market Review

November 08, 2018

Rockin' to the Gridlock

Dave Mason sang: *"There ain't no good guys, there ain't no bad guys. There's only you and me and we just disagree."* To paraphrase – there was no blue wave, there was no red wave … and all we do is disagree. When you end up combining equal parts of blue and red, you get purple. (Even that annoying purple dinosaur Barney had a kinder message than we've been hearing.) The U.S. does have big problems in store because representatives of Congress have announced their intent to 'investigate instead of legislate.' Democrats gained control of the House but lost ground to Republicans in the Senate. It seems pretty clear that both Houses can start investigations but neither can get anything done without cooperation. As Will Rogers said nearly a century ago: *"This country has come to feel the same when Congress is in session as when the baby gets hold of a hammer."* Mark Twain was less kind, as over a century ago he concluded: *"It could probably be shown by facts and figures that there is no distinctly American criminal class except Congress."* It's amazing to most outsiders that elected officials so eagerly seek the benefits, power, rewards, and retirement that now come with the higher offices – only to announce their intent to do battle instead of their jobs. Though the amount pales to current levels, in 'Grin and Bear It', Lichty and Wagner said: *"Oh, I don't blame Congress. If I had $600 billion at my disposal, I'd be irresponsible, too."*

However, it's no secret that markets love gridlock and the post–election rally has been impressive. It's way too early to tell just how much follow through will take place but U.S. equities surged over 2% following Election Day – adding to the rebound out of the **B**ond **M**arket **R**eview's October 26th–29th cycle low. The markets fully expect Congress to follow through on their plans to make things miserable for the White House. Nevertheless, the markets also expect this President to fight back. For at least 2 years, no great moves will take place without compromise. Historically, markets have thrived on the gridlock resulting from the inability of either party to push forward a singular agenda. It's amazing that such a divided electorate can have such high consumer confidence levels and optimism.

A Hawkish Stay

President Trump has not been happy with the FOMC's current campaign of raising rates, and while the Fed held rates steady today as widely expected – they did nothing to alter course for their expectations that *"further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2% objective over the medium term."* Unlike for the political landscape, the FOMC's recent decisions have been by unanimous vote! While today's statement was mostly unchanged from September's, the FOMC noted the unemployment rate had declined and that business fixed investment had *"moderated from its rapid pace earlier in the year."* Though stocks have rebounded from their lows into October 26th–29th, most U.S. markets made significant corrections into that trough – with some only points away from entering bear markets (as emerging markets and some large globals have already). The FOMC chose to ignore that weakness which we viewed as hawkish in itself. The market–based odds for a December hike were 78.2% before today's meeting and 74.4% after. Shrinking the balance sheet is going to be tough and there's still over $4 trillion to unwind. That's a lot of tightening in itself – and strain on the bond market as well.

Looking Ahead

- Stock cycles are mixed but equities should rise from a low near November 16th into a high near the 28th.
- Yields should be lower into November 19th, bounce higher, and then drop into December 12th.
- Veterans Day will be observed on Monday (11/12). The **BMR** salutes all who have served!

Treasuries, Agencies, and MBS

Monday is a federal holiday to observe Veterans Day. Banks are mostly closed and the debt markets (fixed income) will not trade. However, the stock exchanges are scheduled to be open. With equities rallying strongly off last week's lows, yields rose by 9.5, 12.5, 13.5, and 14.5 bps for the 2, 5, 10, and 30–year Treasury sectors. Yields continued to rise this week with the 2, 5, and 10–year notes higher by 6, 6, and 2.5 bps though 30–year bond rates dropped 2 bps.

MBS spreads (FNMA 30–year 3.5%) narrowed 3 bps last week. Q3 Mortgage Delinquencies rose from 4.36% to 4.47% (from Q2) but MBA Mortgage Foreclosures dropped from 1.05% to .99%. The 3, 10, and 30–year auctions were held earlier this week with the U.S. Treasury bringing $37 billion 3–year notes at 2.983% on Monday (11/05). Demand was off versus October and the yield was a little lower as well. The group that includes foreign central banks bought 49.1% versus 46.9% of the October offering. Tuesday's (11/06) 10–year note auction brought 3.209% for $27 billion supply. Demand rose versus October and foreign buying rose from 64.5% then to 73.8% this week. On Wednesday (11/07), $19 billion 30–year bonds came at 3.418%. Demand was weaker to recent auctions and the yield was the highest since June 2014. Foreign buying fell from 64.4% last month to 59.1% of this offering.

11/02/18 Treasury Yield Curve	**2-Year: 2.905%**	**5-Year: 3.034%**	**10-Year: 3.213%**	**30-Year: 3.455%**
Weekly Yield Change:	+.097%	+.126%	+.137%	+.144%
Support:	2.976/ 3.005/ 3.050/ 3.094	3.057/ 3.080/ 3.092/ 3.102	3.207/ 3.229/ 3.251/ 3.273	3.409/ 3.420/ 3.432/ 3.443%
Targets:	2.916/ 2.874/ 2.833/ 2.793	3.036/ 3.013/ 2.991/ 2.970	3.184/ 3.162/ 3.144/ 3.111	3.388/ 3.376/ 3.365/ 3.354%

Economics

The number of available jobs (JOLTS Job Openings) fell 284K from 7.293M in August to 7.009M for September. With openings roughly one million above the levels of those unemployed (5.964M in September) the ‘quits rate’ (those voluntarily leaving existing jobs) remained at 2.4% – the highest since 2001. Initial Jobless Claims fell 1K to 214K, still near the lower range of data going back to the late ‘60s. Continuing Claims fell from 1.631M to 1.623M – the lowest since July 1973. That data was certainly consistent with better than expected payroll gains in October. Nonfarm Payrolls surprised with a 250K increase versus 200K expected. While September gains were revised down by 16K from 134K to 118K, the 2–month net revision was unchanged. Private Payrolls increased by 246K and the manufacturing sector added 32K. That left the Unemployment Rate steady at 3.7% – the lowest since 1969, but for a good reason as the Labor Force Participation Rate rose from 62.70% to 62.90%. The Underemployment Rate fell from 7.50% to 7.40%. Average Weekly Hours rose from 34.4 to 34.5. Though Average Hourly Earnings rose by .20% (versus .30% in September) the annual pace quickened from 2.80% to 3.10%. That was the first time the annual increase rose above 3% since 2009.

Bloomberg Consumer Comfort rose from 60.3 to 61.3 (near 17–year highs). Current views of the economy hit the highest levels since January 2001 and personal finances were the best since February 2001. The Atlanta Fed GDP–Now forecast for Q4 2018 dropped from 3.0% to 2.9% after last Friday’s data. The service–sector outlook (ISM Non–Manufacturing Index) fell from 61.6 to 60.3. Orders for Capital Goods fell .10% in September. Factory Orders rose .70% and .40% ex–transportation. Durable Goods Orders rose .70% but were flat ex–transportation.

Consumer Credit fell off the $22.877 billion August level to only $10.923 billion in September – the lowest increase in 3 months. Credit card debt fell by $312 million – for the 3rd decrease in 6 months. Though the Trump administration is still seeking to negotiate more favorable trade, the U.S. continues to import far more than it exports. The September Trade Balance deficit rose $700 million to a 7–month high $54 billion.

Friday is set for Producer Prices (October PPI), November Wholesale Inventories & Trade Sales, and the University of Michigan sentiment surveys. Monday (11/12) is set for the observance of Veterans Day and is a Federal and bank holiday. The bond markets will be closed but the stock markets will be open. Tuesday follows with NFIB Small Business Optimism and the Treasury’s Monthly Budget Statement for October. Wednesday brings MBA Mortgage Applications (which fell by 4.00% last week), Consumer Prices (October CPI), and Earnings data.

Equities

So far, our October 26th cycle proved to be right on the trough of the correction and subsequent rally. The Dow is off to a 4.28% gain for November and the S&P has risen 3.51%. Our cycles and technical work conclude that there’s more weakness to follow even though the bounce off the lows has been very impressive (with the Dow and S&P gaining over 8% to last week’s trough). The Dow gained 582.52 points or 2.36% last week to 25,270.83 and is 3.64% better this week. The S&P gained 64.37 points or 2.42% to 2,723.06 and is up 3.08% this week. The Nasdaq rose 2.65% to 7,356.99 and is 2.36% higher this week. The Dow Transports rose 4.02% (after 6 weekly losses) and are 2.84% higher this week. Bank stocks surged 4.79% and are 2.50% higher this week.

	Dow:		Nasdaq:		S&P:
Resistance:		26,129/ 26,276/ 26,452/ 26,614		7,398/ 7,442/ 7,501/ 7,531	2,789/ 2,814/ 2,842/ 2,868
Support:		25,808/ 25,640/ 25,486/ 25,328		7,355/ 7,313/ 7,269/ 7,227	2,764/ 2,739/ 2,712/ 2,686

Other Markets

Crude Oil has been weaker than expected with little cyclical relief. We still expect a low near November 16th. Crude tumbled 6.58% last week and lost 3.91% into today. Commodities lost 1.64% and 1.35%. Gold rose .06% but was .66% lower into today. The U.S. Dollar rose .22% and is .21% better this week – possibly headed for a 4th gain. The Japanese Yen dropped 1.15% and fell another .77% into today. The Euro lost .13% and is .22% lower this week. Corn gained .95% and added .61% this week. Cotton rose .33% and was .28% higher into today.

“The ignorance of one voter in a democracy impairs the security of all.” President John F. Kennedy

Additional Information is Available on Request
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