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Bond Market Review

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Communication Breakdown

The Fed has put itself in a no–win situation. They got there by seeking to prove that the Trump administration was not influencing policy. However, the FOMC has become 'Floundering Obfuscating Mixed Communicators' in failing to establish a sound message. In the **BMR (04/24/19)** we said Led Zeppelin was providing some sound advice for the Fed: *"Yes, there are two paths you can go by, but in the long run – There's still time to change the road you're on!"*

They indeed changed paths from hikes, to patience, to cuts. However, the 25–bps cut on Wednesday didn't appease the crowd that thought the Fed had already gone too far in 2018. With no action in June, Jerome Powell picked up his first dissenting vote as the Fed Chair to St. Louis FRB President James Bullard who thought a cut was warranted at that time. With this week's cut, there were two more dissenting votes preferring rather to leave rates alone! Voting against the cut were Kansas City's Esther George and Boston's Eric Rosengren. The actual text of the Fed's statement appeared to have changed more in word usage rather than substance.

The committee cut rates because of *"uncertainties"* and downside risks but sounded rather uncertain of their decision – especially in post–statement remarks. Instead of saying they would *"closely monitor"* incoming data, they said they would look at that data as the committee *"contemplates the future path"* for the funds rate. This made their decision sound indecisive as in – we're not sure why we cut! Powell comes across as if he's finally reacting to the data but trying to prove the Fed is not affected by Trump's pressures. It makes one miss the days of Alan Greenspan. He spoke 'clearly' in 'Green–speak', rarely getting himself in trouble – because you never quite knew what he said! Powell chose to say: *"It is not the beginning of a long series of rate cuts."* How does he know? As the **B**ond **M**arket **R**eview has pointed out many times, the Fed likes to move in 'campaigns' of tightening or easing – often appearing dead set on a mission. Powell then added: *"I didn't say it's just one."* He said the FOMC was thinking of this cut as *"essentially in the nature of a mid–cycle adjustment to policy."* Are we to infer that the larger cycle is still to raise rates – and this is a smaller countertrend move within that structure? Nevertheless, this was the first cut since 2008!

Our analysis is that when you cut and say not to expect much more, you're saying the move is wrong. Mixed signals yield wayward results – and the markets are showing little confidence in the Fed's actions. While Powell's comments were seen as rather 'hawkish' for having just cut rates, the FOMC also decided to end reduction of its balance sheet 2 months ahead of schedule (in August). Powell said that move was just *"a matter of simplicity and consistency"* claiming they *"never take into account"* political considerations when conducting policy. Though we think Trump is in Powell's head all the time, that places the Fed back in reinvestment mode for maturing assets. President Trump was thankful for the end of the balance sheet unwind but, referring to the Chair's comments and the cut, said: *"As usual, Powell let us down."* A few weeks ago, Trump had commented that the U.S. was paying much *"higher interest rates than countries that are no match for us economically"* because of the Fed's *"faulty thought process."* He does have a point, and while central bankers are struggling to find the 'new neutral', each 25–bps hike ultimately added nearly $50 billion per year to the deficit in the way of debt service – while competitors have debt selling at rates that are far lower (or negative). A mid–cycle adjustment is an admission that you are a deer confused by headlights.

Looking Ahead

- Equity cycles show choppy trading with trend–change lows due near August 15th and 27th.
- Bond cycles show yields remaining low but making a trend–change high near August 7th.

Grabel Strikes Again

It turns out Trump was right about the Fed stunting growth in 2018. In the **BMR (11/15/18)**, we said: *"President Trump is clearly 'not happy' with the Fed's exuberance in raising rates and we also question the campaign."* At that time, Trump had said that rate hikes were the "*biggest threat"* to economic growth and trade negotiations. While the Fed was stuck on 'patient mode', GDP stumbled from 3.1% in Q1 to only 2.1% for Q2 2019. However, it's worse than that. Though GDP for 2017 was revised .3% higher to 2.8%, the annual data revisions dropped 2018 growth from 3.0% down to 2.5%! Grabel's law has always provided a humorous take on math. It states: *"2 is not equal to 3, not even for larger values of 2!"* You just can't round it to get there, and that means the U.S. has (once again) still not achieved 3% (or greater) growth since 2005 – and the Fed was wrong about the economy overheating. That takes away what had been a significant achievement for the administration and reveals that the threat caused by the hikes was costly. When the Fed failed to reverse policy earlier, adopting instead a patient approach, the **BMR (02/25/19)** contended: *"The 'campaign' turned from 'out of touch' and 'wearing blinders' into 'patience' and 'wait and see.' Sir Winston Churchill said it best: 'However beautiful the strategy, you should occasionally look at the results.'"*

Treasuries, Agencies, and MBS

Though it seemed a delayed reaction to yesterday's rate cut, markets began to believe in a 'campaign' over Powell – and drove yields to their lowest levels since 2016. The markets are clearly pricing in at least one more 25–bps cut in 2019. 10–year yields traded lower into the July 25th cycle and again into today following yesterday's 25–bps rate cut by the Fed. Though the cycles call for rates to remain low, they should trade higher into August 7th and then lower again into the 15th. Last week, yields traded higher by 3.5, 3.5, 1.5, and 1.5 bps for the 2, 5, 10, and 30–year sectors. Into today, yields for those sectors had plunged by 12, 16.5, 17.5, and 15 bps – sending 10 and 30–year yields to their lowest levels since 2016. It should be noted that our interest–rate drop pressures the rest of the globe to do so as well! The European Central Bank has already signaled a rate cut and additional QE measures as the outlook in the EU has worsened. Germany's 10–year yield fell to a record–low –.45% this week. That's a long time to lock in such a loss! Additionally, the International Monetary Fund once again cut global growth forecasts last week.

Last week, MBS spreads (FNMA 30–year 3.0%) narrowed by 1 bps. On July 23rd, the U.S. Treasury sold $40 billion 2–year notes at 1.825%. Demand fell to recent auctions and the group that includes foreign central banks bought 43.5% of the issue (the lowest since February) versus a prior 48.5%. The $41 billion 5–year note auction on the 24th brought 1.824%. Demand was again lower versus recent auctions and foreign buying was 53.4% of the issue versus 57.1% in June. The $32 billion 7–year note auction on the 25th brought 1.967%. Demand was the weakest since 2016 though foreign buying rose from 55.5% in June to 59.4% of this offering.

Auctions resume next week with the Treasury offering $38 billion 3–year notes on Tuesday (08/06), $27 billion 10–year notes on Wednesday (08/07), and $19 billion 30–year bonds on Thursday (08/08). Note that the 10 and 30–year offerings are increasing by $3 billion in size versus the July auctions.

07/26/19 Treasury Yield Curve	**2-Year: 1.854%**	**5-Year: 1.849%**	**10-Year: 2.071%**	**30-Year: 2.593%**
Weekly Yield Change:	+.033%	+.033%	+.015%	+.013%
07/19/19 Treasury Yield Curve	**2-Year: 1.821%**	**5-Year: 1.816%**	**10-Year: 2.056%**	**30-Year: 2.580%**
Weekly Yield Change:	–.027%	–.056%	–.067%	–.067%
Support:	1.769/ 1.804/ 1.839/ 1.874	1.708/ 1.743/ 1.778/ 1.814	1.882/ 1.916/ 1.951/ 1.985	2.425/ 2.465/ 2.505/ 2.545%
Targets:	1.700/ 1.669/ 1.639/ 1.610	1.648/ 1.617/ 1.589/ 1.558	1.848/ 1.812/ 1.777/ 1.743	2.389/ 2.346/ 2.305/ 2.266%

Economics

Q2 GDP was better than expected with a 2.10% gain, though annual revisions reduced 2018 growth from 3.00% to only 2.50%. Trump said 2.10% was *"not bad considering we have the very heavy weight of the Federal Reserve anchor wrapped around our neck."* The Employment Cost Index increased by .60% for Q2 2019. That was the slowest advance since 2017 and certainly won't help the Fed reach their inflation targets. Personal Income rose .40% in June and Personal Spending increased by .30%. Spending is roughly 70% of the U.S. economy and Personal Consumption rose at a healthy 4.30% annual pace in Q2. The GDP Price Index rose at a 2.40% annual pace and Core (ex food & energy) prices rose at an annual 1.80% pace. Last week, Initial Jobless Claims fell from 216K to a 3–month low 207K. Though rising to 215K this week, remaining near multi–decade lows – the numbers continue to show a strong labor market. Continuing Claims fell 12K to 1,677K but then rose to 1,699K in data released this week. ADP Employment Change showed a 156K increase in private payrolls for July – with 10K add to June's numbers. Negatives for Friday's July report came from Challenger Job Cuts which rose 43.20% (more cuts) versus July 2018 and ISM Employment, which dropped from 54.5 to 51.7.

U.S. Manufacturing rose .4 to 50.4 and the ISM Manufacturing number fell from 51.7 to 51.2. However, both are above 50 showing at least a modest expansion. Prices Paid fell from 47.9 to 45.1 while New Orders rose from 50 to 50.8. Orders for Durable Goods rose 2.00%. Ex transportation, they rose 1.20%. Capital Goods Orders rose 1.90%.

The Conference Board's Consumer Confidence survey rose from 124.3 to just under last October's 18–year high at 135.7. Their Present Situation survey improved from 164.3 to 170.9 and Expectations rose from 97.6 to 112.2. The University of Michigan surveys were little changed. Sentiment rose from 98.2 to 98.4. Current Conditions fell from 111.9 to 111.1 but Expectations rose from 89.3 to 90.1. Bloomberg Consumer Comfort fell off its 18–year high of 64.7 to 63.7 last week but matched that high rising once again to 64.7 this week. Kansas City Fed Manufacturing fell from 0 to –1 and Richmond dropped from 2 to –12. MNI Chicago PMI fell from 49.7 to 44.4. The Chicago Fed National Activity Index was less negative at –.02 versus –.03 as was Dallas Fed Manufacturing rising from –12.1 to –6.3. The Fed's favorite inflation gauge rose .10% in June, leaving the PCE Deflator unchanged at an annual 1.40% pace. Ex food & energy, it rose .20% moving the annual core pace .10% higher to 1.60%.

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The FHFA House Price Index rose .10% in May. New Home Sales rose 6.95% in June to a 646K annual pace. It was the first gain in 3 months, and purchases were revised downward for each of the 3 previous months. Sales of Existing Homes fell by 1.68% to a 5.27M annual pace. Pending Home Sales rose by 2.80%. Metro Home Prices (S&P Case–Shiller 20–City) rose by .14% in May. Price gains slowed from 2.53% (annually) to 2.39%. The pace of increase for the Home Price Index slowed from 3.52% to 3.43% – dropping for a 14th month.

The merchandise trade deficit remained at higher levels despite tariffs – as the Advance Goods Trade Balance narrowed slightly from $75.0 billion to $74.2 billion. Wholesale Inventories rose .20% in June while Retail Inventories dropped by .10%. Construction Spending fell by 1.30%. July Vehicle Sales undershot estimates, falling from 17.30M in June to 16.82M annual units.

Friday reveals July payrolls including the U.S. Unemployment Rate and Labor Force Participation. Other data includes the June Trade Balance (deficit), Factory, Durable and Capital Goods Orders, and the University of Michigan sentiment surveys. Monday (08/05) is set for the service–sector outlook (ISM Non–Manufacturing). Tuesday follows with JOLTS Job Openings. Wednesday brings MBA Mortgage Applications (which fell by 1.40% last week) and June Consumer Credit.

Equities

Wednesday's 333–point 1.23% loss for the Dow Industrials wiped out most of July's gains – leaving the index only .99% higher for the month. It was also the first 1% loss for stocks since May. For July, the S&P rose 1.31% and the Nasdaq gained 2.11%. Bank stocks rose 4.12% and, with June's 6.71% gain, came very close to recovering May's 10.18% loss. Our stock cycles remain choppy with lows due near August 15th and the 27th.

Last week, the Dow edged 38.25 points or .14% higher to 27,192.45. large losses over the past few days have the Dow 2.24% lower for the week. The Nasdaq gained 2.26% last week and gave that gain back with a 2.63% loss through today. The S&P gained 1.65% last week and ended the day 2.39% lower for this week. The Dow Transports rose 1.63% but have lost 3.18% so far this week. Bank stocks rallied 4.00% last week but lost 4.66% through today.

	Dow:	Nasdaq:	S&P:
Resistance:	26,417/ 26,581/ 26,744/ 26,907	8,047/ 8,137/ 8,227/ 8,311	2,941/ 2,968/ 2,995/ 3,017
Support:	26,256/ 26,094/ 25,933/ 25,773	7,958/ 7,869/ 7,782/ 7,693	2,915/ 2,888/ 2,861/ 2,835

Other Markets

Crude Oil gained 1.02% last week and then lost 4.00% into today – after having been 4.66% higher on Wednesday! Commodities lost .80% last week and have now fallen 2.46% through today. Gold lost .52% but added .11% since Friday. The U.S. Dollar is working on a third gain, having risen .96% last week and another .40% into today. Trump was hoping the Fed's policy would instead weaken the Dollar. The Japanese Yen dropped .90% last week but has vaulted 1.23% higher this week. The Euro lost .83% and fell another .39% into today. Corn lost 3.77% and fell another 5.25% into today. Cotton rose 3.20% but is 3.74% lower this week.

"Of course the game is rigged. Don't let that stop you – if you don't play, you can't win."
Robert Heinlein

Additional Information is Available on Request

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