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Bond Market Review

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Fast and Furious: The Race to Zero

The markets went from pricing one more 25–bps cut in 2019 to the possibility of as many as 4. The President's disappointment with the Fed's first move coupled with escalating trade wars sent 10–year yields to pre–election levels (October 2016). 30–year yields plunged to 2.12% – within a few bps of their all–time lows from July 2016. The yield curve became the most inverted since 2007 with 10–year yields more than 32 bps below 3–month T–Bills. Moreover, the spread between 2 and 10–year notes narrowed to the lowest levels since June 2007 (under 10 bps). Though not perfect, inversions are often warning signals of coming recessions. The Fed had tried to dance around underlying conditions with Chairman Jerome Powell contending there would be no *"long series of rates cuts"*, referring to last week's easing as a *"mid–cycle adjustment to policy"* and mere insurance against uncertainties. It backfired.

In the race toward zero, the Fed got off to a slow start, but U.S. Treasuries gained at a furious pace. In 6 trading days since the day before the FOMC cut, 10–year yields fell 46 bps. Yields are relative! Treasuries gain due to worries and uncertainty, but they are also driven by foreign alternatives. In mid–July, the German 10–year bund was trading at –.25%. This week, that yield fell to a record negative of –.60%. Swiss 10–year yields fell to –1.00%. Out to 5–years, most quality Eurozone and Japanese debt is trading at negative yields! While our Fed was seeking a modest move to normalize rates, New Zealand and India surprised with large cuts and Thailand made an unexpected cut. Those moves served to place the Fed once again behind the curve as if they had not yet moved at all. On Monday, global financial conditions actually tightened. Though pulling back a bit with today's rally in equities, the market was expecting a 62% chance for another cut on September 18th and a 54.7% chance for yet another on October 30th.

The European Central Bank is on the defensive with lower (even more negative) yields on the way than their current deposit rate of –.40%. That would also serve to place the Fed off course as having rates too high versus their counterparts – pulling yields closer to the point of no return. There's already a stockpile of $15 trillion in debt with a negative yield coming into that expected ECB move! To the President's great displeasure, that would continue to strengthen rather than weaken the dollar. Trump tweeted: *"… one would think that I would be thrilled with our very strong dollar. I am not!"* He again made the case that our interest rates are too high compared to other countries – *"keeping the dollar high"* and making it difficult for U.S. manufacturers to *"compete on a level playing field."*

The **B**ond **M**arket **R**eview has made the case that quality global alternatives will serve as a tether to keep U.S. yields from rising significantly. The ECB is very focused on Germany, its leading economic power. German industrial production slumped in June by the most (down 5.2%) in nearly a decade. German exports dropped the most in 3 years. Even though the trade war has been concentrated on striking a deal with China, which has seen an appreciable slowdown, it's affecting the Eurozone as well. The additional element of more North Korean missile tests and China's difficulty with protests in Hong Kong have led to bonds having a 'field day.'

Looking Ahead

- Equity cycles show choppy trading with trend–change lows due near August 15th and 27th.
- Bond cycles show yields remaining low and making a trend–change trough near August 16th.

Treasuries, Agencies, and MBS

Until today, yields on U.S. 30–year bonds had fallen every session since the FOMC cut rates on July 31st – dropping 46 bps on the journey. There are fundamental and technical factors keeping the **BMR** in the low–rate camp. Last week, yields dropped 14, 19, 22.5, and 21 bps for the 2, 5, 10, and 30–year sectors. That was the largest rally for the 10–year note since June 2012. Though bouncing off much lower levels, yields for those sectors were still 9.5, 11.5, 13, and 16 bps lower through today. It's understandable that U.S. yields are being pulled into the abyss of a global vacuum but puzzling why anyone other than a central bank seeking the ultimate QE would knowingly choose to invest in anything with a negative return (at the outset). Many investments ultimately turn negative, but it seems ridiculous to consciously initiate such a transaction. It conjures up the image of lemmings running off a cliff.

Lower rates helped home refinancings hit the highest levels since 2016. Last week, MBS spreads (FNMA 30–year 3.0%) widened by 3 bps. On Tuesday (08/06), the U.S. Treasury sold $38 billion 3–year notes at 1.562%. The yield was the lowest since September 2017. Demand rose to the July auction and the buying group that includes foreign central banks bought 46.7% of the issue versus 48.5% last month. Wednesday's $27 billion 10–year note auction brought 1.67%. Demand was weaker than recent auctions and foreign allocations fell from 60.8% last month to 55.7% of this offering. Today's 30–year bond auction brought 2.335% for $19 billion in supply. That was the lowest auction yield since August 2016. Demand rose versus July and foreign buying ramped up from 50.0% last month to 61.3%.

08/02/19 Treasury Yield Curve	**2-Year: 1.713%**	**5-Year: 1.659%**	**10-Year: 1.847%**	**30-Year: 2.383%**
Weekly Yield Change:	–.141%	–.190%	–.224%	–.210%
Support:	1.644/ 1.706/ 1.776/ 1.845	1.587/ 1.647/ 1.710/ 1.779	1.723/ 1.787/ 1.855/ 1.933	2.266/ 2.314/ 2.390/ 2.504%
Targets:	1.586/ 1.525/ 1.465/ 1.405	1.503/ 1.467/ 1.416/ 1.348	1.660/ 1.599/ 1.540/ 1.479	2.195/ 2.125/ 2.054/ 1.986%

Economics

The FOMC 'dissenters' contended that strong U.S. labor markets didn't dictate a move in July. That data continued to look good. JOLTS Job Openings were a little lower in June, falling from 7.384M to 7.348M. Those levels are still healthy for labor and 1.37 million above the number of reported unemployed Americans that month (5.975M). Initial Jobless Claims fell from 217K to 209K – remaining near 49–year lows and a sign that U.S. labor is resilient despite other signs of a global slowdown. Continuing Claims fell 15K to 1,684K. The U.S. Unemployment Rate held at 3.70% even as the Labor Force Participation Rate improved from 62.90% to 63.00% and the economy added 164K jobs in July. Those were all positives, though there was a 2–month downward revision of 41K jobs. Private Payrolls rose 148K and Manufacturing added 16K jobs (the best since January). The Underemployment Rate fell from 7.20% to 7.00%. Average Hourly Earnings rose .30% and the annual pace improved by .10% to 3.20%. However, Average Weekly Hours fell .1 to 34.3 – the lowest since 2011. Retail employment fell for a 6th month to a 3–year low.

June Consumer Credit came in at $14.596 billion, falling from $17.793 billion in May. Bloomberg Consumer Comfort fell the most in nearly 10 months, dropping from 18–year highs of 64.7 to 62.9. The University of Michigan surveys were only slightly changed. Sentiment improved by .2 to 98.4 and Expectations rose from 89.3 to 90.5. However, Current Conditions slipped from 111.9 to 110.7. Services improved from 52.2 to 53.0 though the outlook fell from 55.1 to 53.7 (ISM Non–Manufacturing). Factory Orders rose .60% but only .10% higher ex transportation. Orders for Durable Goods rose 1.90% and 1.00% ex transportation. Business investment (Capital Goods Orders) rose 1.50%. Wholesale Trade Sales fell .30% in June and Inventories were flat. The Trade Balance for June narrowed modestly from $55.3 billion to $55.2B. While China's economic growth has been challenged by the trade wars and they are cutting imports, the U.S. continues to run huge monthly deficits with them.

Friday is set for Producer Prices (July PPI). Next Monday (08/12) reveals the U.S. Treasury's Monthly Budget Statement for July. Q2 Mortgage Delinquencies and MBA Mortgage Foreclosures are due sometime next week. Tuesday follows with NFIB Small Business Optimism, Consumer Prices (July CPI) and related earnings data. Wednesday brings MBA Mortgage Applications (which rose 5.30% last week) and July Import Prices.

Equities

Stocks had their worst week since December – followed by a Monday tumble that saw the Dow Industrials plunge over 767 points for a 2.90% loss to start this week. Significant rallies with two 300–point gains still left the Dow .40% lower through today. We don't think the lows for this cycle have been made, though stocks hit 2–month lows earlier this week. Again: *"Our stock cycles remain choppy with lows due near August 15th and the 27th."*

Last week, the Dow tumbled 707.44 points or 2.60% to 26,485.01. The Nasdaq lost 3.92% though it is .44% higher this week (after falling 4.26% on Monday). The S&P fell 3.10% but is .21% higher this week. The Dow Transports fell 3.73% and are .48% lower this week (but were off 4.00%). Bank stocks lost 4.97% and are off 3.18% this week.

Resistance:	Dow:	26,390/ 26,746/ 27,078/ 27,408	Nasdaq:	7,950/ 8,038/ 8,130/ 8,219	S&P:	2,938/ 2,966/ 2,992/ 3,017
Support:		25,782/ 25,464/ 25,146/ 24,830		7,861/ 7,776/ 7,686/ 7,598		2,886/ 2,859/ 2,831/ 2,804

Other Markets

Crude Oil lost .96% and is 5.61% lower this week. Commodities lost 2.15% and are since off another 1.75%. Gold gained 1.85% and tacked on 3.60% through today – trading over $1,500/oz. for the first time since April 2013. The U.S. Dollar was .10% higher but lost .43% into today. China retaliated to the latest trade pressures by halting U.S. crop imports and devaluing their currency to the lowest level since 2008 – leading the administration to accuse them of *"currency manipulation."* The Japanese Yen surged 1.92% and is .49% higher this week. The Euro lost .18% but is .65% higher this week. Corn lost 3.62% but is 2.88% better this week. Cotton lost 8.25% but has gained back 1.02% through today.

"Health nuts are going to feel stupid someday, lying in hospitals dying of nothing." Redd Foxx

Additional Information is Available on Request
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