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Bond Market Review

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Fickle Down Economics

While the S&P lost 1.81% in August, it's up by 1.69% to kick off September. However, there are 2 seasonal factors to consider. Stocks tend to rally into Labor Day (and often a week past), but September is typically one of the worst months for equity performance. To date, stocks have rallied out of the last 2 trend–change lows (on August 15th and the 27th). This market is most fickle! Any good or bad news about trade with China has been met with the associated and expected rally (or decline) in stocks. Good signs and news are promising – but far from a 'done deal.'

The news that China and the U.S. would resume talks placed the markets in a very optimistic mode. Japan and the U.S. are seeking to finish a trade deal by month end. Stocks gapped higher today and rose the most since mid–August. Conversely, yields at one time today had risen the most in a decade as the 2–year rates were 14 bps higher. Since the rally began in early November, there have been few setbacks – leaving bond bulls to buy pullbacks with impunity. Earlier this week, 2–year yields fell to 1.43% – the lowest since September 2017 and 5–year yields dropped to 1.31% – the lowest since November 2016. 10–year yields fell to 1.43% – the lowest since July 2016 and 30–year yields dropped to a new record low of 1.91%. Today, 30–year yields rose above 2% for the first time since August 26th.

As we approach the next FOMC policy statement due on September 18th, the entire yield curve is still inverted to the Fed's effective funds rate of 2.13% – in the classic sense continuing to signal a recession. It doesn't seem imminent for the U.S., though there has been a global slowdown that has affected many economies far more dramatically. U.S. jobs and consumption remain fairly strong! The markets continue to expect a 25–bps cut as an absolute lock and had been forecasting an even larger move. Unless we see some negative turns in the news or equities, a 25–bps cut seems the likely outcome. The **B**ond **M**arket **R**eview expects at least 2 more cuts in 2019 and at least one more to follow.

The U.S. economy seems more resilient than most. Growth may be slower, but we're not contracting! Q2 GDP was revised to 2%. While the Atlanta Fed's GDP–Now estimates for Q3 were ticking at 2.3% a few weeks ago, they've dropped steadily to 1.5% as of yesterday. Still growing – but slowing. The Fed's Beige Book outlook remained the same as in previous releases, reporting that the economy *"expanded at a modest pace."* Since 2009, most reports had the economy improving at a modest or moderate pace. (It should be noted that the same language was used throughout 2018 while GDP was hovering above 3%.) The effects of trade tariffs were viewed as minimal with a chance to be more onerous in the coming months. There are plenty of factors such as Hurricane Dorian that might hamper growth.

On the global front, the Bank of Japan and the European Central Bank are seen as stepping up Quantitative Easing measures. Even before these upcoming moves, global debt trading at negative yields topped $17 trillion. Treasury Secretary Steven Mnuchin said the issuance of ultra–long U.S. debt was *"under very serious consideration."* Imagine the opportunity to lock in very little return for 50 or 10 years! Normal rate cycles over that horizon would offer many opportunities to buy those bonds for pennies on the dollar. Even before making their next move, incoming ECB President Christine Lagarde said there's more room to cut rates – though their deposit rate already sits at a record–low –.40%. She said the ECB has a broad tool kit and that past stimulus actions have been *"effective and successful."* The most troubling developments are the slowdown in Germany (the EU's leading economy) nearing the brink of recession and the still–unknown effect of Brexit (though a no–deal move was just defeated again this past week).

Looking Ahead

- Equity cycles show choppy trading with a trend–change high due near September 12th/13th.
- Bond cycles show yields remaining low into October 9th with a trend–change high near September 9th.

Treasuries, Agencies, and MBS

We have rates turning once again lower near September 9th and continue to expect yields to remain low. Last week, yields dropped by 2.5, 3, 4, and 6 bps for the 2, 5, 10, and 30–year sectors. Mostly from today, this week yields for those sectors have risen by 2, 4, 6, and 8.5 bps. Last week, MBS spreads (FNMA 30–year 2.5%) narrowed by 4 bps.

Last Thursday (08/29), the Treasury sold $32 billion 7–year notes at 1.489%. Demand fell versus recent auctions and the yield was the lowest since the September 2016 offering. The group that includes foreign central banks bought 50.2% off the issue versus 59.4% in July. Next week, the U.S. Treasury will offer $38 billion 3–year notes on Tuesday (09/10), $24 billion to be added to the reopened August 2029 10–year note on Wednesday (09/11), and $16 billion to be added to the reopened August 2049 30–year bond on Thursday (09/12).

08/30/19 Treasury Yield Curve	2-Year: 1.507%	5-Year: 1.387%	10-Year: 1.498%	30-Year: 1.964%
Weekly Yield Change:	–.027%	–.031%	–.038%	–.062%
Support:	1.581/ 1.611/ 1.640/ 1.671	1.459/ 1.490/ 1.520/ 1.549	1.579/ 1.608/ 1.638/ 1.668	2.052/ 2.086/ 2.121/ 2.156%
Targets:	1.522/ 1.492/ 1.463/ 1.432	1.401/ 1.371/ 1.341/ 1.311	1.548/ 1.520/ 1.489/ 1.460	2.017/ 1.982/ 1.951/ 1.913%

Economics

New York FRB President John Williams said the consumer was carrying much of the weight for growth going forward. He's right! Q2 GDP was revised down from 2.10% to 2.00% but Personal Consumption rose from 4.30% to 4.70%! The GDP Price Index remained at 2.40% though Core PCE fell from 1.80% to 1.70%. In July, Personal Income rose .10% but Spending surged .60%. (So much for the savings rate.) As we come into Friday's August jobs numbers, most employment data have held up well. Initial Jobless Claims rose 211K to 216K last week, and then rose to 217K this week. Continuing Claims rose from 1,676K to 1,701K but then fell to 1,662K. Challenger Job Cuts showed 39% more layoffs than August 2018 and ISM Employment dropped from 51.7 to 47.4. However, ADP data showed that companies added 195K jobs in August – the most in 4 months and much higher than the 148K expected.

Bloomberg Consumer Comfort rose a point to 62.5 last week and then advanced to a 5–week high 63.4 in today's release. Though the Conference Board's Current Conditions hit the highest level in nearly 19–years, University of Michigan Sentiment tumbled the most since 2012 – dropping from 98.4 to 89.8. Their Current Conditions survey fell from 110.7 to 105.3 – the lowest since October 2016. Expectations fell from 90.5 to 79.9. ISM Manufacturing fell from 51.2 to 49.1 – contracting (below 50) for the first time since 2016. Prices Paid rose from 45.1 to 46. New Orders fell from 50.8 to 47.2. However, MNI Chicago PMI (purchasing managers) rose from 44.4 to 50.4 and the service sector (ISM Non–Manufacturing) surged from 53.7 to a 3–month high of 56.4. Nonfarm Productivity rose by 2.3% in Q2 2019. Unit Labor Costs rose 2.60%. Factory Orders rose 1.40% in July. They were up .30% ex transportation. Orders for Durable Goods rose 2.00% but fell .40% ex transportation. Capital Goods Orders rose .20%.

Retail Inventories rose .80% and Wholesale Inventories rose .20%. Pending Home Sales fell 2.50% in July for the worst drop in over a year. The PCE Deflator rose .20% in July. The annual pace for the that favorite inflation gauge of the Fed rose from 1.30% to 1.40%. Ex food & energy, Core PCE rose .20% – with the annual pace flat at 1.60%. Construction Spending rose .10% in July. August Vehicle Sales rose from a 16.82M annual pace to 16.97M. The merchandise trade deficit contracted a little in July – from $74.2 billion to $72.3 billion. The Trade Balance deficit also pulled in from $55.5 billion to $54.0 billion.

Friday is set for August payrolls including the U.S. Unemployment Rate. Monday (09/09) brings Consumer Credit for July. Tuesday follows with NFIB Small Business Optimism and July JOLTS Job Openings. Wednesday is set for MBA Mortgage Applications (which fell by 3.10% last week), Producer Prices (August PPI), and Wholesale Trade Sales & Inventories. Thursday reveals jobless claims, Consumer Prices (CPI), and the Monthly Budget Statement.

Equities

The Dow Industrials rose 774.38 points or 3.02% last week to 26403.28, finishing August off by 1.72% (after having been down by 5.68% into the 15th). The Dow is up 1.23% this week. The S&P gained 2.79% and is 1.69% higher this week. The Nasdaq gained 2.72% and is 1.93% better this week. The Dow Transports rallied 3.98% last week and are up 2.40% this week. Bank stocks gained 3.93% and are 1.94% better this week. However, bank stocks still lost 8.76% in August.

Resistance:	Dow:	26,836/ 27,002/ 27,166/ 27,327	Nasdaq:	8,131/ 8,224/ 8,312/ 8,406	S&P:	2,982/ 2,994/ 3,021/ 3,049
Support:		26,509/ 26,368/ 26,187/ 25,864		8,044/ 7,955/ 7,884/ 7,780		2,966/ 2,940/ 2,913/ 2,889

Other Markets

Crude Oil rose 1.72% and is 2.18% higher this week. Crude should peak near September 19th, pull back into the 26th, and then make a higher high near October 8th. After that, we expect a much–larger retreat. Commodities rose 1.04% and added 1.17% through today. Gold lost .24% and is .26% lower this week. Gold should make a tradeable low near September 18th before another advance. The U.S. Dollar gained a healthy 1.36% last week but is .48% lower this week. The Euro lost 1.45% last week but was up .48% through today. The Japanese Yen dropped .84% and is off another .62% this week. Corn lost .49% and is 3.21% lower this week. Cotton rose 1.86% last week and added .19% into today.

"Nothing is as far away as one minute ago." Jim Bishop

"Opportunity is missed by most people because it is dressed in overalls and looks like work." Thomas A. Edison

Additional Information is Available on Request

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