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Bond Market Review

September 12, 2019 #896

Age of Dissent

In seeking the efficient frontier for the portfolio, why would one consider zero? The 'new normal' would have left Markowitz scratching his head! With today's stimulus package, the ECB joined the Fed in heavy scrutiny. Fed Chair Jerome Powell had full policy support during every meeting until June. There was one dissent at that meeting desiring a cut at the time, and two in July – preferring to have left rates alone. Powell is struggling for consensus and has been constantly under criticism from President Trump for being *"way too early to raise"* and *"way too late to cut."* For the record, the **B**ond **M**arket **R**eview was clearly in agreement – also seeing the Fed as stubbornly hiking before conditions were optimal. We've also made the case that unnecessary hikes raised debt service and contributed to the national deficit. However, with the current effective funds rate at 2.13%, the latest tweet is overreaching. While Trump is considering the unfair practice of foreign rates being negative or zero, he called for the Fed to engage in a similar practice. He said: *"The Federal Reserve should get our interest rates down to zero, or less …"* He contended the U.S. could then start to refinance its debt. If the Fed ignored calls for a 100–bps cut, it's unlikely they'd soon consider 200 – or more! Nor should they!!! The last two hikes in 2018 were a mistake, but don't expect the Fed to make an even–larger one to the downside. Trump also said the 'near zero' (or negative) rates could refi debt for much–longer maturities. While certainly part of the Bank of Japan and the European Central Bank's coffer, Fed Governor Lael Brainard said: *"I don't see negative interest rates being a very useful part of our arsenal."*

In winding down his leadership of the ECB, President Mario Draghi received unprecedented opposition for going too far with Quantitative Easing. The ECB was expected to drop rates and enter new QE measures in their September meeting, and they did – though not without a fight. Though Draghi ultimately got his way, it was reported that France, Germany, and the Netherlands (representing roughly half the EU's economic output) dissented – along with Austria and Estonia. The ECB lowered their deposit rate from –.40% to –.50%, scrapped calendar–based forward guidance, and will begin new QE asset purchases in November at roughly 20 billion Euro per month (~$22 billion). The Euro tumbled to 1.10 to the Dollar on the news. They also eased bank measures and will extend QE maturities. Draghi's new 'bazooka' is seen as buying some time for incoming President Christine Lagarde – who takes over in December.

Looking Ahead

- Equity cycles show choppy trading with trend–change highs due near September 19th and 24th.
- Bond cycles show yields remaining low into October 9th with downward acceleration from September 18th.
- The FOMC will announce their September interest–rate stance on Wednesday (9/18) at 2 p.m. ET.

Treasuries, Agencies, and MBS

Yields were projected to rise into September 9th, which they did – but they continued to rise into today. The window for a high in equities was September 12th/13th, and bond yields may have joined that cycle. The cycles still argue for low yields into October 9th, with September 18th marking a drop–off point into that expected trough. The 18th is FOMC policy–announcement day and the Fed is widely expected to drop rates by 25 bps. Market expectations point to 3 or 4 cuts yet to come – with a possibility of one at each of the 3 remaining 2019 meetings. Recent manufacturing data pointed to a contraction and the Atlanta Fed's GDP–Now forecast for Q3 fell as low as 1.5% last week before rebounding to 1.9% yesterday. New York was projecting 1.55% but St. Louis is forecasting 2.67%! Last week, yields rose by 3.5, 4.5, 6.5, and 6 bps for the 2, 5, 10, and 30–year Treasury sectors. Through today, yields were significantly higher by 17.5, 20, 21, and 23 bps for those sectors – with bonds nearly wiping out all of their August gains.

Last week, MBS spreads (FNMA 30–year 2.5%) narrowed by 9 bps to fast moving Treasuries. The Treasury's Monthly Budget Statement for August revealed a deficit of $200.3 billion – placing the first 11 months of fiscal 2019 already over $1 trillion (for the first time since 2011). With 1 month to go in the fiscal year, the deficit is running 18.8% ahead of last year's pace through 11 months and 37% ahead of last year's total. On Tuesday, the U.S. Treasury sold $38 billion 3–year notes at 1.573%. Demand rose slightly to last month and the group that includes foreign central banks bought 46.2% (down from 46.7% last month). Wednesday's $24 billion 10–year note brought 1.739% for the reopened August 2029 maturity. Demand was much stronger than August and foreign buying rose from 55.7% then to 62.6% of this offering. Today's $16 billion 30–year bond auction drew 2.27%. That was the lowest auction yield since July 2016 – though long rates had fallen below 1.91% near the end of August. Demand for the reopened August 2049 maturity fell slightly versus last month and foreign buying slipped from 61.3% to 60.3%.

09/06/19 Treasury Yield Curve	2-Year: 1.543%	5-Year: 1.434%	10-Year: 1.561%	30-Year: 2.026%
Weekly Yield Change:	+.036%	+.047%	+.063%	+.062%
Support:	1.812/ 1.881/ 1.950/ 2.020	1.728/ 1.797/ 1.868/ 1.937	1.872/ 1.941/ 2.012/ 2.083	2.380/ 2.458/ 2.540/ 2.618%
Targets:	1.742/ 1.676/ 1.615/ 1.555	1.663/ 1.603/ 1.541/ 1.483	1.804/ 1.734/ 1.668/ 1.607	2.300/ 2.225/ 2.154/ 2.085%

Economics

August payrolls came in below expectations (of 160K) with 130K Nonfarm jobs added – and gave FOMC doves some additional cause to cut rates. That number was somewhat distorted to the upside as it included the hiring of over 25K temporary government workers to prepare for the 2020 census. There was also a 2–month revision of 20K fewer jobs than previously reported. While ADP data had reported companies hiring a 4–month high of 195K, private payrolls grew by only 96K – a 3–month low versus 150K expected. Though Manufacturing added 3K jobs, the July gain was reduced from 16K down to 4K. The U.S. Unemployment Rate was steady at 3.7% for a third month, though the Labor Force Participation Rate improved from 63.0% to 63.2%. The Underemployment Rate rose from 7.0% to 7.2%. Wage data saw some improvement with Average Hourly Earnings up .40% and 3.20% versus August 2018. Weekly Hours rose from 34.3 to 34.4. Initial Jobless Claims fell from 219K to 204K – the lowest level in nearly 5 months. Continuing Claims fell 4K to 1,670K. JOLTs Job Openings fell from 7,248K to 7,217K in July – showing available jobs still well over the number of unemployed by over 1.15 million!

Bloomberg Consumer Comfort eased .2 lower to 63.2 but the gauge of personal finances equaled a 19–year high. NFIB Small Business Optimism fell 1.6 points to a 5–month low 103.1. Hiring and profits showed increases. In July, Consumer Credit rose from $13.781 billion to $23.294 billion – the most since 2017, as consumption continued to drive the economy. Credit Card balances (and other revolving debt) rose by $10 billion, the most since November 2017. Inflation data surprised to the upside. Producer Prices rose .10% and edged .10% higher to 1.80% annually. Core PPI (ex food & energy) rose .30% accelerating the annual pace from 2.10% to 2.30%. Consumer Prices also rose .10% but eased annually from 1.80% to 1.70%. However, annual core CPI also accelerated from 2.20% to 2.40% – the quickest pace since 2008 due to a rise in goods prices! Real Average Weekly Earnings rose 1.20% year–over–year (from July's .90%) and Hourly Earnings rose 1.50% to August 2018 (versus July's 1.40%). Wholesale Inventories rose .20% and Trade Sales grew by .30%.

Friday (the 13th) is set for August Import Prices, Retail Sales, the University of Michigan sentiment surveys, and Business Inventories. On Monday (09/16) Empire (New York) Manufacturing is due. Tuesday follows with August Industrial Production and Capacity Utilization, homebuilder sentiment (NAHB Housing Market Index), and Treasury International Capital flows. Wednesday brings MBA Mortgage Applications (which rose 2.00% last week), August Housing Starts & Building Permits, and the Fed's September–meeting policy statement on interest rates.

Equities

The equity cycles performed well with the August 15th low representing the lowest level since early June and the August 27th trend–change serving as an acceleration point for the current rally. The cycles called for stocks to trade higher into the September 12th/13th window – which they have. While the cycles remain 'choppy', we expect upside momentum to fade. There are subsequent highs also due September 19th and the 24th, which we would use to hedge portfolios or to take profits. While we will have many updates along the way, longer cycles call for stocks to fall into October 7th and November 11th. After a 461–point 1.72% loss in August, the Dow Industrials are 779 points or 2.95% better for September – and have rallied 1,967 points or 7.76% to that cycle low on August 15th!

Last week, the Dow gained 394.18 points or 1.49% to 26,797.46. It's up 1.44% this week and has been within .34% of a new record high. The Nasdaq rose 1.76% and is 1.13% higher this week. The S&P gained 1.79% and is 1.04% better since Friday – and today was only .24% from a new record high. The Dow Transports rose 1.74% and have surged 3.99% higher this week. Bank stocks gained 1.62% and have outperformed with a 6.49% thrust this week.

Resistance:	Dow:	27,308/ 27,393/ 27,559/ 27,725	Nasdaq:	8,227/ 8,273/ 8,318/ 8,365	S&P:	3,019/ 3,033/ 3,047/ 3,061
Support:		27,064/ 26,900/ 26,736/ 26,366		8,138/ 8,094/ 8,048/ 8,004		2,993/ 2,967/ 2,939/ 2,909

Other Markets

Crude Oil gained 2.58% last week but reversed 2.53% lower into today. As we said last 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 1.33% and have added 1.06% this week. Gold lost .92% last week and is off another .54% this week. The U.S. Dollar lost .50% and is .05% lower this week. The Japanese Yen dropped .60% and then tumbled 1.10% this week. The Euro gained .43% and is .33% higher this week. Corn lost 4.33% but rallied 3.50% into today. Cotton lost .54% but has surged 5.99% this week.

"In politics, absurdity is not a handicap." Napoleon Bonaparte

Additional Information is Available on Request

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