BANES CAPITAL GROUP

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Bond Market Review

Intended for Institutional Clients Only

Delay of Game

A drawback to financial newsletters is extended news cycles that emanate from long rounds of QE and the subsequent often–elongated taper timeline. Another is the quashing of news that is biased and even counterintuitive – such as the still–lingering contention that the higher inflation trend was and remains transitory. That tenet only holds if one continuously redefines the term (or alters the narrative to fit their viewpoint). Nevertheless, the coming Fed QE taper is still a top news story. Having just checked the data, most global central banks are still increasing their balance sheets with active QE asset–purchase programs. Until the Fed completely tapers purchases, we're in the same burgeoning boat. With virus concerns and diminishing growth forecasts upon us, the serotinal succumbs to the autumnal – and so on, but at least the colors are more captivating (and of course there's football – and its colors).

Speaking of the gridiron, not only has the Fed again been called for 'holding', but recent data has caused a 'delay of game' in their plans to taper and end QE. Speaking of tapering asset purchases, in the last **B**ond **M**arket **R**eview, we said: *"The data suggest they'll delay those announcements until their November 3rd meeting – if hiring data indeed improves yielding 'further progress.'"* The August employment numbers were much weaker than anticipated, and our concerns that many workers would opt to quit rather than to cave to vaccine mandates is making the headlines. The mandate was ill timed and the crisis highly preventable – given the alarming issue that large numbers of healthcare workers are in that crowd, making things even worse for people that really need various treatments. There are abundant stories of military, law enforcement, and other crucial services joining in that dissent. Many are resisting even though they've been told they would be denied unemployment benefits. Additionally, employers are not seeing positions filled as they had widely expected upon the expiration of extended benefits 2 weeks ago. That's defying the highly anticipated outcome – especially with nearly 11 million open employment positions (JOLTs data as of July).

Looking Ahead

- Equity cycles show lows near October 4th and the 7th – followed by a rally into October 21st.
- Bond yields should trend lower from October 6th into October 18th.

Nevertheless, with another unanimous vote, the Fed left interest rates unchanged last Wednesday and was forced to hold on their planned taper announcement. Meanwhile, while we see inflation as persistent and the Fed's contention that it's transitory as errant, they continue to hold their language as steady as they do their usage of QE and low interest rates. They said that the sectors most affected by the pandemic have *"improved in recent months"* rather than have *"shown improvement"* but said that a rise in Covid–19 cases *"slowed their recovery."* Instead of saying it had risen, they said *"inflation is elevated"* but attached the now–familiar *"largely reflecting transitory factors."*

There were more hawkish elements present. Instead of saying they would *"continue to assess progress"* in meeting their goals and rolling back QE, they said: *"If progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted."* That's far more of a 'pre–taper announcement' than during previous meetings. As with other recent meetings, Fed Chair Jerome Powell made it clear that the second phase of accommodation removal, the liftoff of interest rates, is not tied to the tapering of QE. Of course, it really is – as it's the natural progression beyond the end of QE. That post–QE event is the carriage behind the horse, and reminders that it's not the other way around, or side–by–side, are unnecessary. Additionally, the member's 'dot plots' or forecasts of expected interest rate hikes were far more aggressive than in June. The FOMC thinks a first move in 2022 is far more likely than they did 3 months ago. The consensus also moved to 3 hikes in each of 2023 and 2024. That's roughly 50 to 75 bps higher than was expected as of June – with short rates at 1.75% near the end of 2024.

With the next FOMC meeting coming early in November (11/03), the Fed will have only one more payroll number to evaluate – that being on October 8th with the September release. If that number is acceptable, the November taper would follow. If not, the Fed would be able to see both October and November payroll numbers by their December 15th meeting – which would provide more than enough data for them to make their case, either way! If the Fed begins paring back purchases in November or December, the projections would be for an end of the program by midyear employing a *"very gradual approach."* Powell said the announcement *"could come as soon as the next meeting"* – stoking those in the November camp. It should be noted that the voters rotating on in 2022 are collectively more dovish than at present. That said, with the exodus of 2 FOMC hawks after concerns of their trading practices, it remains to be seen just how much more dovish Fed voters might be in 2022. Boston's Eric Rosengren and Dallas' Robert Kaplan resigned on Monday. Rosengren cited health reasons for retiring – while cynics would say 'ostensibly not the health of his trading account.' At least they weren't 'fighting the Fed!'

Home Prices are Screaming while Confidence is Reeling

Stocks are doing a little bit of both – with other factors at play! If written earlier last week, the market story would have been that stocks broke significant support and uptrend lines in panic selling. Last Monday, the Dow Industrials traded off as much as 972 points or 2.81% before settling down 1.78% for the day. Stocks had their worst one–day pullback since May on worries of a large Chinese company defaulting on huge debt! A 343–point Dow rally on Tuesday was reversed with a 50–point loss for the day. However, on Wednesday and Thursday, stocks staged their best 2–day rally since July. Thus, a few days passed and Monday's selloff was almost a non–event. The never–ending story is that the 'buy all pullbacks' crowd continues to be rewarded. Stock investors are still convinced that the Fed will continue to prop up equity markets. By week's end, the Dow was up .62% and the S&P had gained .51%. Concerns over lawmakers grandstanding instead of dealing with the debt ceiling had the markets wary of a U.S. government default on payments. Stocks lost a lot of ground today with soaring yields and mounting crises.

If you had just signed a rental agreement, the last thing you want to hear is global financial experts telling you higher prices are only transitory. You can see elevated inflation in autos, housing, rents, food, energy and fuel, and most everywhere you look. Apartment rentals surged 2.1% from August to September – the most on record. Rental rates are up 16.4% since the beginning of the year, making the Fed's 2% target look ridiculous. Crude Oil traded over $80/barrel today for the first time in 3 years – rising to a 7–year high. U.S. housing set another record with a 19.7% gain over the past year – for the largest surge in over 30 years. That marked 14 consecutive months of increases in housing. Housing is hot – especially where it's already hot… Phoenix home prices just gained 32.4% year–over–year. Meanwhile, Americans are highly divided on vaccine mandates and confidence just fell to a 7–month low!

China's 'Lehman' Event

Chinese real–estate property–developer 'Evergrande Group' has been in the limelight and was part of the cause for last week's market unrest. They are the world's largest (private) debtor with outstanding debt near $300 billion. The company is widely expected to default on its debt, and it's unlikely that China's politics would allow for an American style company 'bailout.' Further default has the potential to result in a real–estate crash in China.

The U.S. Debt–Limit Fiasco

Yields have risen for the past 2 weeks with a significant jump into Friday's close. With the Fed signaling the sizing down of QE, lawmakers unwilling to control spending or raise the debt ceiling, and interest–rate cycles pointing higher, yields were on the rise. Normally, fear drives yields lower – and events like the default saga of China's Evergrande Group would usually have been accompanied by a global flight to quality. However, when the markets are worried about the U.S. defaulting on debt payments, investors can panic. It's hard to believe the U.S. would default on debt payments, but the government has endured temporary shutdowns before. If lawmakers determine to suspend the debt ceiling, payments would be made but fiscal responsibility would suffer yet another blow.

As we said in a recent **BMR**, from the '80s, I remember warnings that Social Security payments would end with funds running out. So far, so good. (That appears to have been avoided by folks I know sending $10 checks to their representatives and/or lobbyists.) Another warning came earlier this month claiming that Social Security funds would dry up by 2034. Whether it's a warning that the oceans will rise and the polar ice caps would melt, the 'end' seems to always be a mere decade away. I thought I recalled the warnings of an imminent ice age from back in the '70s as well. I remembered 'Spock' covering that coming global freezing, so I Googled 'Leonard Nimoy ice age' and the video was there. To be fair, there were also warnings of global warming back then, but someone's always carrying a sign saying: 'The End is Near.' I've seen them often in New York City – and Covid has them out once again.

Congress has yet to raise the debt ceiling with only a few days left before the ability the U.S. has to make bond payments reaches a critical stage. As usual, both political parties are blaming each other. Two facts remain. 1: The U.S. can't make debt payments without suspending or raising the debt ceiling. 2: There can't be a $3.5 trillion (or more) spending package without a substantial increase.

New York FRB President John Williams said the Treasury market is *"the center of the global financial system"* and that a U.S. default would create *"a very negative dynamic, not only in the U.S. but around the world."* Is Powell really concerned? After all, the Fed owns $5.4 trillion in Treasury debt and $2.5 trillion in mortgage–backed securities! Treasury Secretary (and former Fed Chair) Janet Yellen said: *"It is imperative that Congress swiftly addresses the debt limit. If it does not, America would default for the first time in history. The full faith and credit of the United States would be impaired, and our country would likely face a financial crisis and economic recession."* After that dire warning, she said: *"Still, I remain optimistic about the medium–term trajectory of our economy, and I expect we will return to full employment next year."*

Countering that point, Fed Chair Powell said the tests to taper *"is all but met"* but he wants to see another good payroll month. He said our economy is a *"long way"* from meeting the test for maximum employment. Americans are being fired and quitting their jobs in droves. Jobless claims are rising. Powell joined Yellen in telling the Senate Banking Committee today that a U.S. default would have catastrophic consequences. They also maintained their view that elevated inflation is due to temporary supply–chain disruptions and it would ease when those forces mitigated.

Treasuries, Agencies, and MBS

Starting with the mini crash in stocks last Monday (9/20), 10–year yields rose 17 bps from that day's low through Friday. Yields were up again early this week – rising 3, 7, 8.5, and 10.5 bps for the 2, 5, 10, and 30–year sectors in another steepening move (as we had last week). Last week, yields rose by 4.5, 8.5, 9, and 8.5 bps for those sectors. 30–year rates again topped 2%. 2–year rates rose to .32%, hitting the highest levels since March 2020. 5–year rates hit 1.04% – their highest yield since February 2020. 10–year yields hit 1.56% in as return to mid–June levels (this year). The 2.10% 30–year rate today was also the highest since late June. Upside 10–year targets are 1.56% to 1.62%.

The Fed's reverse repo facility continues to see very high usage and new records – hitting a new high today of $1.365 trillion. Over the past 2 weeks, Freddie Mac 30–year mortgage rates fell from 2.88% to 2.86% – and then rose back to 2.88%. Higher bond yields should soon press mortgage rates back up over 3%. With only 1 month remaining in fiscal 2021, the U.S. government had a $170.6 billion deficit in August to extend the 11–month budget shortfall to $2.71 trillion! That's however running 9.865% below 2020's record pace that ultimately grew to $3.13 trillion.

The Treasury auctions changed a lot versus last week. Last Tuesday (09/21), $24 billion 20–year bonds brought 1.795% – which was the lowest yield since January. Demand fell to last month for that reopening of the August 2041 maturity. The buying group that includes foreign central banks bought 64.2% versus 62.3% last month. However, yesterday's $60 billion 2–year note auction was described as soft, ugly, and even 'gruesome.' 2–year yields rose to .31% – levels not seen since March 2020, and demand dropped hard versus August. Foreign buying fell from 60.5% in August all the way down to 45.3%. Also yesterday, the $61 billion 5–year note offering fared better. At .99%, the yield was the highest since February 2020. Demand was slightly better versus August though foreign buying was also less – falling from 62.7% to 54.3%. Today's $62 billion in 7–year notes brought 1.332% with good demand – though dropping versus August. Foreign buying was only slightly lower, dropping 1.0% to 60.1%.

In July, foreign entities moved a small $2 billion into longer–term U.S. assets. However, $126 billion flowed into the broader base of U.S. investment types. China increased bond holdings for the first time in 4 months while foreigners sold the most stocks since 2007.

09/24/21 Treasury Yield Curve	**2-Year: 0.271%**	**5-Year: 0.949%**	**10-Year: 1.453%**	**30-Year: 1.985%**
Weekly Yield Change:	+.047%	+.087%	+.089%	+.084%
09/17/21 Treasury Yield Curve	**2-Year: 0.224%**	**5-Year: 0.862%**	**10-Year: 1.364%**	**30-Year: 1.901%**
Weekly Yield Change:	+.010%	+.045%	+.020%	–.034%
Support:	0.304/ 0.319/ 0.334/ 0.349	1.014/ 1.038/ 1.064/ 1.088	1.535/ 1.565/ 1.595/ 1.625	2.099/ 2.134/ 2.164/ 2.193%
Targets:	0.300/ 0.275/ 0.260/ 0.247	0.990/ 0.965/ 0.940/ 0.915	1.506/ 1.476/ 1.446/ 1.416	2.030/ 1.995/ 1.960/ 1.925%

Economics

Initial Jobless Claims just rose in consecutive weeks for the first time since April. Mostly blamed on Hurricane Ida and in southern states, claims rose from 312K to 335K into September 11th and then increased to a 7–week high 351K into the 18th. States like New York will lose a lot of health care talent due to vaccine mandates. Since those folks have been threatened with a lack of unemployment benefits as well, we expect heavy relocations to less–restrictive states. That will enhance some areas at the expense of others. Signing bonuses and 'job poaching' are also causing high 'quits' rates which stack up the numbers from the firings. Job candidates are getting multiple offers and are often 'no shows' to employers that thought they had made hires. Continuing Claims fell from 2,852K to 2,714K, but then rose back to 2,845K. The Atlanta Fed's GDP–Now forecast for Q3 was hovering above 6% in early August but is now down to 3.2%.

Consumer Comfort dropped for a 3rd week to a 6–week low, falling .2 and then 1.4 over 2 weeks to 56.3. Personal Finances fell by .4 and 1.4 to a 7–week low 69. The Buying Climate also fell to a 6–week low. In preliminary surveys, University of Michigan Sentiment rose .7 to 71 but remained near the lowest levels in almost 10 years. Expectations were 2 points higher to 67.1 but Current Conditions dropped 1.4 points to 77.1. Inflation expectations rose .10% to 4.70%. The Conference Board Consumer Confidence survey saw a drop from 115.2 to a 7–month low of 109.3! The result was expected to have been a slight increase. The Present Situation fell from 148.9 to a 5–month low of 143.4 and Expectations plunged from 92.8 down to 86.6 – down over 20 points to recent data. However, NFIB Small Business Optimism rose from 99.7 to 100.1. 56% were 'upbeat' about future business.

The Leading Index rose by .90% in August and Industrial Production rose by .40%. Capacity Utilization increased from 76.20% to 76.40%. The Chicago Fed National Activity Index fell from .75 to .29. Empire Manufacturing increased from 18.3 to 34.3 (with prices elevated) and the Philadelphia Fed Business Outlook improved from 19.4 to 30.7. However, Richmond Fed Manufacturing fell from +9 to –3, Kansas City dropped 7 points to 22, and Dallas fell from 9 to 4.6. Wholesale Inventories rose by .6% in July and Trade Sales rose by 2.00%. Business Inventories rose .5%. Orders for Durable Goods rose by 1.80% in August, but the core was low – with ex transportation rising only .20%. Orders for Capital Goods rose by .50% – showing business equipment improving for a 6th month. Retail Sales beat expectations of a .70% drop in August with a .70% increase. However, July's result was revised .70% lower – clouding that gain. Ex autos, sales rose 1.80% but there was also a .60% downward revision for July.

Consumer Prices rose .30% in August and the annual CPI pace slowed from 5.40% to 5.30%. Core CPI (ex food & energy) saw its lowest increase since February at .10%. The annual core CPI pace dropped from 4.30% to 4.00%. Used car prices fell for the first time since February. Adjusted for inflation, Real Average Hourly Earnings dropped by .90% on a year–over–year basis. Real Average Weekly Earnings fell by .90% annually. Producer Prices rose by .70% in August and were .60% higher for the core rate (ex food & energy). The annual pace for PPI accelerated from 7.80% to 8.30% and the core increased from 6.20% to 6.70%. Import Prices fell by .30% in August and the annual pace dropped from 10.30% to 9.00%. Export Prices rose .40% with an annual drop from 17.00% to 16.80%. The merchandise trade deficit remained near $90 billion – widening from $86.8 billion to $87.6 billion (Advance Goods Trade Balance). The Current Account Balance for Q2 widened from a $189.4 billion deficit to $190.3 billion.

Real estate values jumped by $1.2 trillion in the second quarter, driving Household Net Worth up 4.3% or $5.8 trillion to $141.7 trillion. Shares in equities rose from 25.6% in 2019 up to 29.5% for this report. Homebuilder optimism (NAHB Housing Market Index) rose for the first time in 5 months with a 1–point increase to 76. There are still many supply challenges and shortages. The FHFA House Price Index rose by 1.40% in July after being bumped up by .1% to 1.7% for June. The S &P Case–Shiller Home Price Index jumped from 18.73% to an annual (and record) 19.70%. Metro Home Prices rose by 1.55% – accelerating the annual pace from 19.14% to a record 19.95% (for data going back 30 years). Many cities saw gains exceeding 20%. August Housing Starts improved by 3.93% to an annual pace of 1.615 million units (from data that was bumped 20K higher for July). Building Permits rose 6.01% to an annual pace of 1.728 million units. Sales of Existing Homes fell by 2% in August to a 5.88 million annual unit pace. Despite annual gains of 14.9% to $356,700, the median home price dropped in August. Sales of New Homes saw a 1.51% gain in August to 740K annual units. That was also to a healthy 21K upward revision for July.

Wednesday is set for MBA Mortgage Applications (which rose by .30% and then 4.90% over the past 2 weeks) and Pending Home Sales for August. Thursday closes out September trading with the releases of jobless claims data, a Q2 GDP update, and MNI Chicago PMI (purchasing managers). Though Friday is the first day of October, it’s too early to get September payroll data – which will come the next Friday (10/08). Friday’s releases include Personal Income & Spending for August, the PCE Deflator, Construction Spending, ISM Manufacturing, Vehicle Sales (September), and the University of Michigan final sentiment surveys. Next Monday (10/04) holds August Factory Orders, and orders for Durable and Capital Goods.

Equities

After an ugly Tuesday, stocks were down for the week after the Dow Industrials had been higher on Monday. The Dow lost .07% into the 17th but rose 213.12 points or .62% to 34,798.00 last week after a huge 971–point drop to begin the week last Monday. The Dow is 1.43% lower this week. The S&P lost .57% and then gained .51% over the past 2 weeks. It was 2.31% lower through today. The Nasdaq lost .47% and then gained .02% but is off by 3.33% this week. The Dow Transports lost .69%, gained .53%, and were .16% lower through today. Bank stocks gained .98% and then 3.07% last week. They were 1.56% higher through today.

Resistance:	Dow:	34,677/ 35,050/ 35,426/ 35,803	Nasdaq:	14,841/ 15,085/ 15,332/ 15,580	S&P:	4,386/ 4,419/ 4,452/ 4,485
Support:		34,305/ 33,937/ 33,620/ 33,160		14,546/ 14,426/ 14,306/ 14,067		4,349/ 4,316/ 4,283/ 4,250

Other Markets

Crude Oil gained 3.23% and then 2.79% last week for a 4th gain. Crude is 1.77% higher this week. Commodities gained .76% and 1.44% over those 2 weeks and are 1.46% better this week. Gold lost 2.26% and then gained .02%. It’s .79% lower this week to 6–week lows. Gold should make a low near October 11th. The U.S. Dollar gained .63% and then .17% for a 3rd win – and is .48% higher this week. The Japanese Yen gained .01%, lost .73%, and is down another .70% this week. The Euro lost .75% and then fell .04% last week. It’s off by .32% this week. Corn rose 3.87% but then fell .09%. It’s 1.09% better this week. Cotton lost 2.01% but then gained 3.78% last week. It’s 4.19% higher this week. We’re trying cycle work on crypto–currencies and expect a low into October 27th.

“You’ve got to make a conscious choice every day to shed the old - whatever 'the old' means for you.”
Sarah Ban Breathnach

Doug Ingram, Financial Economist
Additional Information is Available on Request

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