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Strategies / December 30, 2021 #979

Bond Market Review

Intended for Institutional Clients Only

Pivots and Divots

2021 will end having seen huge pivots in the markets, Fed policy, politics, and economic recovery. The Fed finally capitulated that inflation is more permanent and finally retired the use of 'transitory.' They are as hawkish as they've been since the pandemic began and most Fed members are of the opinion that there should be 3 hikes in 2022 and 3 more in 2023 – starting as soon as March (2022). Back in March 2021, Chicago's Charles Evans said: *"I suspect that it might be 2024 before we actually raise our interest–rate target."* That's now history! We do have Fed Chair Jerome Powell's statement that the Fed will not hike rates until the completion of asset purchases. With the Fed doubling up on tapering purchases down, that could be as early as March. The Manchin pivot ended government stimulus for now.

The 'Scariant' variant failed to deter the Santa rally! As of this week, the that rally enabled the Dow and S&P to recover all of the Omicron–induced selloff and to surge to new highs as well. Our forecast going back to November was for a more–major low in stocks to occur near December 3rd – with that low representing a buy opportunity. Stocks indeed jumped out of that date – and also hit a high trend–change into December 16th which saw the worst 3–day decline going back to May. On Wednesday, the Dow was 2,000 points higher for December and 5,882 points or 18.22% higher for the year. It backed up 90 points today. Over the past few trading sessions, the S&P and Dow Industrials hit new highs. The Russell 1,000 and 3,000 also joined in – as did the mainline French and U.K. indices. However, banks, the Dow Transports, the Nasdaq, NYSE stocks, Small–caps, Midcaps and other indexes are lagging. Hong Kong is 25.88% off its high and Brazil is down by 20.10%. Bitcoin has retreated over 30% to its high. Yields on the U.S. 2–year note are the highest since March 2020 (at .73%). The 5–year note is trading at its highest yield since February 2020. Given a recent drop in longer yields, the Treasury curve is now the flattest it's been since the end of 2020. It seems that sometimes the markets make sense of all the diverse news by making no sense at all.

Speaking to December's FOMC meeting, in the last **B**ond **M**arket **R**eview, we said: *"To maintain consistency with their recent narrative, they need to double down on tapering – which should wind up purchases in time to gear up for rate hikes by May – if not sooner."* We were not disappointed! Citing improvement in the labor market and 'inflation developments', the FOMC doubled their tapering pace and we expect a complete wind down of QE to be outlined with January's meeting. The Fed's Dot Plot showed their target rate moving 75 bps higher in both 2022 and 2023 – with another 50 bps to be added in 2024. They said Covid and its variants still pose risks to the economic outlook. Their vote was again unanimous. Powell said his renomination played no part in his hawkish pivot.

Looking Ahead

- Equity cycles have a high trend–change near January 7th. We'll update the major cycles in the next **BMR**.
- Bond yield cycles are sideways and then lower from January 6th into January 21st.
- The bond market will close early on New Year's Eve (Friday 12/31). Happy New Year!

The Manchinian Candidate

In a world where the Senate is split 50–50, the White House casts the deciding vote with the Vice President tilting the scales. That makes good or bad legislation passable with no consent from the 'other side.' Yet, the White House's new stimulus package was put on hold when West Virginia Senator Joe Manchin stepped up to exercise some fiscal responsibility. Congress did step up to raise the debt ceiling, but it might not come into play as quickly as forecast. While stimulus funds to date helped many Americans, billions were wasted, stolen, or given to those that didn't need them. The new plan targeted $500 billion worth of funds to go to green energy as incentives for wind turbines, solar panels, and electric vehicles – which would line the corporate pockets of those participating in those industries at the expense of the coal and fossil fuel industries in West Virginia, Texas, and other energy–producing states.

That corporate stimulus often finds its way back to Congressional pockets. Early politicians in American history served for one or two terms and then returned to their homes and prior vocations. These days, even those going to Washington with modest wealth manage instead to overstay and return with millions. They seldom have to abide by the mandates, healthcare plans, or rules they make for the rest of us. Earlier this month, the Senate voted to overturn business vaccine mandates which were thought to be an overreach by the White House. However, we've still lost soldiers, first responders, police, healthcare workers, and many others simply because those mandates were in effect.

Alternate energy sources and battery technologies are making progress, but it's not time to sign a bill that could greatly harm your state in the present – when carbon neutrality could be 30 years or more away. Senator Manchin opted not to vote for such. He caught great heat from his party but probably accolades from his constituents.

Manchin issued a statement that read: *"I have always said, 'If I can't go back home and explain it, I can't vote for it.'"* He stated: *"My Democratic colleagues in Washington are determined to dramatically reshape our society in a way that leaves our country even more vulnerable to the threats we face. I cannot take that risk with a staggering debt of more than $29 trillion and inflation taxes that are real and harmful to every hard–working American at the gasoline pumps, grocery stores and utility bills – with no end in sight."* Those things should concern us all.

We wrote about the projected costs in the CBO report in the last **BMR**. Manchin continued: *"The American people deserve transparency on the true cost of the Build Back Better Act. The non–partisan Congressional Budget Office determined the cost is upwards of $4.5 trillion which is more than double what the bill's ardent supporters have claimed. They continue to camouflage the real cost of the intent behind this bill."* Most importantly to West Virginia and the rest of the country, Manchin said: *"If enacted, the bill will also risk the reliability of our electric grid and increase our dependence on foreign supply chains."*

Just as rejoining the global climate accords cost the U.S. billions while only a few nations were taking the steps to comply, the largest climate offenders of China, India, and Russia aren't about to go along. Our funds end up lining the coffers of nations with no interest in anything but the money. The U.S. was doing its part without that payola.

Treasuries, Agencies, and MBS

Something will have to give. U.S. and global rates are still at low extremes – and remain negative for much of Europe and Japan. China just cut rates for the first time in 20 months. Those conditions are going to make it difficult for U.S. yields to rise significantly. The additional burden placed on U.S. debt service with each hike is another stumbling block. Each new stimulus package raises the national debt and further devalues our currency. While Senator Manchin stopped some of that process for now, it will go on. Raising the debt ceiling, deficit spending, and the wasteful part of stimulus do not trouble politicians as they once did. Many try to explain the process away or simply contend (without evidence) that there won't be a great cost to these programs, but each new stimulus package raises the national debt – perpetuating the problem. There is no forecast of a surplus in sight.

Nevertheless, inflation rates are the highest in decades – and the last time they were this high, yields were much higher! The long–term spread of 10–year U.S. debt to CPI had been 1.5% to 2.5% (for the years coming into the financial crisis). For core CPI, that would indicate a 10–year yield of around 6.40% – and for headline CPI nearer to 8.30%. Nothing close to even that lower range seems possible in the near future due to many varying forces.

In the last **BMR**, we said: *"Yields should drop for a few sessions and then rise into the 23rd/28th."* Bonds followed those cycles with longer yields sitting near 1–month highs today. Yields fell across the board into the 17th and then rose by 5, 6.5, 9, and 10 bps for the 2, 5, 10, and 30–year Treasury sectors last week (into the 23rd). Yields for those sectors were higher by 3.5, 2, 1.5, and 1 bps through today. This past week, lending at U.S. banks rose to the highest levels since September – rising up to 47.08% of total assets.

Freddie Mac 30–year mortgage rates fell from 3.12% to 3.05% last week but rose to 3.11% this week. 15–year rates fell 4 bps to 2.30% and then rose to 2.33% this week. The Current Account Balance showed a $214.8 billion deficit in Q3 – almost $10 billion wider than expected. In October, foreign funds poured into U.S. assets to the tune of $143 billion. $7.1 billion was channeled into longer–term bonds.

On December 21st, the U.S. Treasury sold $20 billion 20–year notes at a 1.942% yield. Demand was very good for that reopening of the November 2041 maturity and again improved to recent offerings. The buying group that includes foreign central banks accounted for 64.8% of the issue versus 60.2% last month. Dealer allocations hit a record low. On Monday, $56 billion 2–year notes were sold at .769% – the highest yield since February 2020. Demand was again very good with foreign buying rising from 45.6% last month to 61.4% of this issue. Tuesday's $57 billion 5–year note brought 1.263%. Demand again rose versus the last offering and foreign buying increased from 56.9% to 65.7%. They couldn't all be good though. Wednesday's $56 billion 7–year note was described as having 'ugly' internals. Demand was weaker versus recent offerings though foreign demand was steady at 59.3% of the offering.

12/23/21 Treasury Yield Curve	**2-Year: 0.690%**	**5-Year: 1.243%**	**10-Year: 1.494%**	**30-Year: 1.907%**
Weekly Yield Change:	+.050%	+.067%	+.090%	+.099%
12/17/21 Treasury Yield Curve	**2-Year: 0.640%**	**5-Year: 1.176%**	**10-Year: 1.404%**	**30-Year: 1.808%**
Weekly Yield Change:	–.016%	–.076%	–.081%	–.072%
Support:	0.747/ 0.767/ 0.787/ 0.807	1.268/ 1.283/ 1.298/ 1.313	1.522/ 1.537/ 1.552/ 1.567	1.933/ 1.951/ 1.968/ 1.986%
Targets:	0.707/ 0.687/ 0.667/ 0.647	1.253/ 1.238/ 1.223/ 1.209	1.493/ 1.478/ 1.463/ 1.448	1.899/ 1.882/ 1.864/ 1.847%

Economics

Initial Jobless Claims rose from their 52–year low of 188K to 206K and then dropped back to 198K in today's release. Continuing Claims dropped 11K and then fell another 140K to 1.716 million – reaching pre–pandemic levels for the first time since it began! Consumer Comfort has declined for the past 2 weeks. The Overall Index lost 2.1 points match October's low at 47.9. The State of the Economy fell 2.9 points to 39.3. Personal Finances dropped 1 point to 63.1 and the Buying Climate fell 2.4 points to 41.4 – also the lowest since October. There was no update today.

The monthly confidence measures fared better. Conference Board Consumer Confidence rose from 111.9 to 115.8 for the largest gain since June. Expectations improved from 90.2 to 96.9 though the Present Situation fell from 144.4 to 144.1. University of Michigan Sentiment rose from 67.4 to 70.4. Current Conditions rose .6 points to 74.2 and Expectations jumped from 63.5 to 68.3. The outlook for inflation fell back from 4.90% to 4.80%. NFIB Small Business Optimism was .2 points higher to 98.4. The Leading Index for November rose 1.10%.

Manufacturing indicators were once again mixed. Factory Output rose .70% and Industrial Production was .50% higher. Capacity Utilization rose from 76.50% to 76.80%. Capacity at factories was the highest since December 2018. A big Boeing sale led to orders for Durable Goods rising the most in 6 months – by 2.50% in November. Ex transportation, orders rose .80%. Business Investment weakened with Capital Goods Orders falling by .10%. The Chicago Fed National Activity Index fell from .75 to .37. MNI Chicago PMI (purchasing managers) rose from 61.8 to 63.1. Empire (New York) Manufacturing rose from 30.9 to 31.9 while the Philadelphia Fed Business Outlook declined from 39 to 15.4. The Richmond Fed Manufacturing Index rose from 12 to 16. Kansas City was flat at 24 and Dallas fell from 11.8 to 8.1.

Q4 GDP has been clicking along at a good pace. The Atlanta Fed GDP–Now forecast had been as high as 9.7% but was most recently a very respectable 7.6%. GDP rose .2% in the final Q3 revision to 2.30%. Personal Consumption tacked on .30% from earlier estimates to 2.00%. The GDP Price Index edged .10% higher to 6.00% and Core PCE for Q3 rose from 4.50% to 4.60%. Inflation just keeps on smoking. The Fed's favorite inflation gauge rose to near 40–year highs. That PCE Deflator rose .60% in November – which elevated the annual pace of Personal Consumption Expenditures from 5.10% to 5.70%. That's the highest reading since June 1982! (Recall that Consumer Prices were also accelerating at their fastest pace since 1982.) The Core PCE Deflator jumped .50% which accelerated the annual pace from 4.20% to 4.70%. Personal Income rose .40% in November while Spending increased by .60%. Personal Income net of inflation, or the 'real' result instead fell by .2%. Producer Prices aren't helping. They jumped .80% in November leading annual PPI to surge from 8.80% to a record jump of 9.60%. Ex food & energy, Core PPI rose .70% – which increased that annual pace from 7.00% to 7.70%. Import Prices rose by .70% in November. The annual pace increased from 11.00% to 11.70%. Export Prices rose 1.00% – taking the annual pace from 18.00% to 18.20%.

Retail Sales disappointed in November with a .30% increase that was expected nearer .80%. Ex autos, Retail Sales also rose by .30%. Holiday sales were estimated to have jumped by 8.5% versus 2020. The merchandise trade deficit (Advance Goods Trade Balance) showed stores were still stocking shelves as November widened from $83.2 billion a month earlier to a record $97.8 billion. Exports decreased and Imports hit a record $67 billion. Wholesale Inventories rose 1.20% and Retail Inventories rose by 2.00%. Business Inventories rose by 1.20%.

Homebuilder sentiment (NAHB Housing Market Index) rose from 83 to 84 – the highest in many months. The FHFA House Price Index rose a hefty 1.10% in October. Metro home prices (S&P Case–Shiller 20–city index) rose .92% in October. The annual pace for metro home prices slowed from 19.09% to a still–torrid 18.41%. The annual home price index slowed for a 3rd month – from 19.66% to 19.08%. After dropping for 2 months, Housing Starts rose by 11.78% in November to 1.679 million annual units for the quickest pace in 8 months. Building Permits jumped by 3.57% to 1.712 million annual units. Existing Homes Sales improved for a 3rd month with a 1.89% gain that was below expectations to 6.46 million annual units. Inventories remained low. Median prices rose 13.9% annually to $353,900. New Home Sales rose by 12.39% to a 7–month high 744K annual units. Median prices rose by 18.8% to a record $416,900. Unlike other housing sales data, Pending Home Sales instead plunged 2.20% in November. Low supply was a problem, and they had been expected to rise by .80%.

Friday has no major data releases – so they are 'wrapped up' for 2021. Next Monday (01/03/2022) kicks off the New Year with November Construction Spending. Tuesday follows ISM Manufacturing and related data, JOLTS Job Openings for November, and December Vehicle Sales. Wednesday brings MBA Mortgage Applications (which fell by 4.0% and then .60% over the past 2 weeks), ADP Employment Change (December private payrolls), and the Minutes from the FOMC meeting that concluded on December 15th. Thursday holds Challenger Job Cuts, jobless claims data, November's Trade Balance (deficit), the ISM Services Index, Factory Orders, as well as orders for Durable and Capital Goods. Friday reveals December payrolls with the U.S. Unemployment Rate and related data. November Consumer Credit is also due.

Equities

Stocks surged out of the December 3rd cycle low and hit the brakes for a few days with the December 16th trend change – for the largest 3–day drop since May. They then resumed their uptrend and wiped out all of the Omicron selloff. With one session left in 2021, the S&P is 25.82% higher for another remarkable year with another low–rate assist from the Fed. The Dow Industrials lost 1.68% into December 17th and then gained 585.12 points or 1.65% to 35,950.56 this past week. They're 1.24% higher this week having made new record highs with the S&P. The S&P dropped 1.94% but then rose 2.28% last week. It added 1.12% this week. The Nasdaq lost 2.95% and then rose 3.19% last week. It's .56% higher this week.

The Dow Transports lost 3.51% and then gained 2.26% last week. They're up by 1.20% this week. Bank stocks lost 2.87% and then rose 1.41% last week. Banks are .75% higher this week.

Resistance:	Dow:	36,405/ 36,500/ 36,596/ 36,692	Nasdaq:	15,730/ 15,762/ 15,793/ 15,825	S&P:	4,784/ 4,792/ 4,801/ 4,811
Support:		36,310/ 36,206/ 36,121/ 36,026		15,668/ 15,637/ 15,606/ 15,575		4,768/ 4,759/ 4,751/ 4,742

Other Markets

Crude Oil fell 1.13% and then rose 4.13% last week. Crude is 4.34% higher this week. Commodities fell .34% and then rose 2.56% over the past 2 weeks. They were 1.33% higher through today. Gold gained 1.17% and .41% over those 2 weeks and added .16% this week. The U.S. Dollar rose .47% and then lost .58% last week. The Dollar slipped by .02% this week. The Japanese Yen lost .17% and .66% over the past 2 weeks. It's down another .61% this week. The Euro lost .65% but then gained .70% last week. It's .05% higher this week. Corn gained .81% and 2.11% over the last 2 weeks. Corn is 1.61% lower this week. Cotton gained 1.01% and 1.70% – and has surged 4.78% this week.

"Self–praise is for losers, be a winner. Stand for something. Always have class and be humble." John Madden

"Save a little money each month and at the end of the year you'll be surprised at how little you have."
Ernest Haskins

"Life's a tough proposition, and the first hundred years are the hardest." Wilson Mizner

Doug Ingram, Financial Economist
Additional Information is Available on Request