BANES CAPITAL GROUP

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Bond Market Review

Intended for Institutional Clients Only

Dazed and Confused

Though the FOMC raised their funds rate with the largest hike since 2000 by a widely expected 50 bps on May 4th, investors were encouraged by Fed Chair Jerome Powell's post–statement comments that increases of 75 bps were *"not something that the committee is actively considering."* The Dow vaulted up 932.27 points with investors heartened by that supposed relief. The following day brought about confusion as those dazed by that encouragement must have come to grips with Powell's other press statement – that there was a *"broad sense on the committee that additional 50–bps increases should be on the table for the next couple of meetings."* The very next day (May 5th), the Dow fell 1,063 points. Through last Thursday, that drop turned into an 8.5% swoon of just over 2,889 points from the close on the 4th. Up a thousand and then down a thousand is not a sign of orderly trading. Bear markets are ugly. The market will rally to yield hope and then continue to grind lower.

The Fed lost a lot of credibility by not addressing inflation sooner, but Mr. Powell has been very transparent concerning the committee's intentions. There's no reason now to expect anything but 50–bps hikes at the next 2 meetings! The **B**ond **M**arket **R**eview thinks it a little odd that the Fed began this new campaign in the wake of a quarter with negative GDP growth! That timing is suspect. We say 'campaign' because we've noticed that the Fed doesn't check their brakes before each journey and often overruns their objectives. The Fed's statement noted that *"economic activity edged down in the first quarter"* but they said that spending remained strong and that job gains have been *"robust in recent months."* As an aside, the **BMR** would contend that recent spending has employed much use of credit cards – and bank lending at the highest levels since March 2021. Consumer lending is the highest since April 2020. If the Fed manages to burst this stock market and housing bubble – as is usually a biproduct of harsh tightening, it should be remembered that during the financial crisis credit card lenders slashed limits down to current–balance levels and then hiked borrowing rates way above 20%. Such a move quickly reveals and disables those using their credit cards to survive on a month–to–month basis. The current consumer–credit numbers are eye–opening.

While it's counterintuitive to believe that Americans would be using adjustable–rate mortgages to finance homes given plenty of time to employ the availability of very–low fixed–rate financing, recent use of variable–rate financing has recently been the highest since 2008! Former Fed Chair Ben Bernanke remembers that market well. However, while it use to be the case that past U.S. presidents and former Fed chairs didn't comment on those currently in office, that decorum has changed over the past decade. We haven't written much about stagflation recently but high inflation and slow growth are 2 of the main drivers. It makes for an ugly scenario. The Atlanta FRB is forecasting current Q2 growth near 2.4% – which would be a great improvement to Q1. Bernanke chose to say that the Fed's leaders were too slow to react to surging inflation – contending that forward guidance slowed their response (part of the transparency Powell has wanted to provide). Bernanke called it a mistake and said the current Fed admits as much.

Bernanke should by no means be immune to criticism. He probably had much to do with causing the financial crisis by practically forcing adjustable mortgages and subprime product into default by overtightening policy. His campaign was brutal with 17 straight 25–bps hikes for which he chaired the final 3 – after replacing Alan Greenspan. In the **BMR (07/18/05)**, we said: *"It's also important to note that the FOMC almost always over tightens and throws the economy into recession. The next one will be Greenspan's going–away present."* In the **BMR (06/05/06)**, we reported that Bernanke said it could take *"from 3 or 4 to as long as 18 months before the full effects of the policy action are felt by the economy."* So why hike every time? He used a sports analogy of saying you have to throw the football *"where the receiver is going to be …"* Everybody thinks it's easy – until you're in the game with a rush and a blitz.

Looking Ahead

- Equity cycles weaken following May 25th. Seasonals are negative.
- The bond yield cycles are mixed. A change in trend is due near May 26th.

Fighting the Fed

The FOMC statement said COVID lockdowns in China were likely to exacerbate supply–chain disruptions and that they were *"highly attentive to inflation risks."* They also addressed plans to reduce their balance sheet but will use a cap of no more than $47.5 billion monthly for the reductions beginning in June. The Fed is a huge buyer to lose – though we would note that the Bank of England and others are continuing their asset–purchase programs. With the 50–bps hike, this statement drew unanimous support – unlike in March when James Bullard had dissented in wanting a 50–bps hike at that time. Selling or shorting stocks when the Fed is easing is referred to as 'Fighting the Fed.' Is buying then a bad idea when they're tightening. So far, it looks that way!

This may be one of those times when that additional fundamental of hikes outweighs market technicals. If only to trouble the waters, Cleveland FRB President Loretta Mester said 75–bps hikes cannot be ruled out forever. Powell was just confirmed to his second term as Fed Chair. This week, he said the Fed is determined to get inflation back down to its 2% goal and won't stop until there's *"clear and convincing"* evidence it's coming down. He said there could be *"some pain"* involved in restoring price stability. He also said they *"won't hesitate"* to hike above the neutral rate if needed. No one at the Fed seems to be able to quantify where that 'neutral rate' might be! Former NY FRB President William Dudley said the Fed was *"sugarcoating"* the upside targets and said it could be *"4 to 5% or higher"* to cool price pressures. It's been said that those with no clear destination cannot hope for a favorable wind. We can't solve supply and consumption problems with higher rates – in fact they will make them worse, and we think the Fed will be forced to stop hikes sooner than they expect as they are merely band–aids on open wounds.

Since no one wants to say it – we will. Allowing American companies to obtain new oil leases and drilling sites while also reducing red tape would turn inflation around more quickly than the most brilliant FOMC strategy. Not only are oil and diesel prices continually hitting new record highs that cripple American households and destroy family budgeting, they're also adding to costs of goods in higher trucking and delivery prices. Those costs have to be passed on to the consumer – resulting in an upward spiral for prices. Air fares also just went much higher as a result. Nothing the Fed does is going to bring all those costs down unless they so badly hamstring the economy that the unaffordability of goods forces consumption to nosedive. Then what have we accomplished? The **BMR** doesn't cover individual stocks or companies but suffice it to say that two of America's top retailers just reported some ugly results. They're not able to provide 'always low prices' and for now we can't 'expect more' and 'pay less.' Lower delivery and driving costs would provide a quicker solution – for homes and enterprises.

Treasuries, Agencies, and MBS

Yields continued to rise into Monday (05/09) following the Fed's 50–bps hike on the 4th. Though off timing with the stock–market's reaction by at least a day, yields rose into May 6th and then reversed lower into the 13th. Into May 6th, yields rose by 2, 12, 19.5, and 23 bps for the 2, 5, 10, and 30–year sectors. Last week, yields were instead lower by 15.5, 21, 21, and 14.5 bps for those Treasury sectors. The curve twisted flatter though today. Yields rose by 8.5 and 2.5 bps at 2 and 5–years but fell by 3.5 and 1 bps at 10 and 30–years. The 10–year note hit its 3.07% target and then rose very close to the next 3.18% target before pulling back to 2.82%. 3.18% and 3.36% remain what should be healthy support. Resistance is near 2.66% (and is also a downside yield target) and then 2.32% lies beyond. Freddie Mac 30–year mortgage rates rose from 5.10% to 5.30% over the past 2 weeks. 15–year rates rose from 4.40% to 4.48%. Mortgage delinquencies fell from 4.65% in Q4 2021 to 4.11% in Q1 2022. The Mortgage Foreclosure Rate rose from .42% in Q4 2021 to .53% in Q1 2022.

In April, U.S. Treasury budget and tax receipts hit a monthly record of $864 billion. That allowed for monthly record surplus of $308.2 billion. April is historically a surplus month, but heavy spending and rate hikes could make this the last one of this fiscal year. The deficit for Fiscal 2022 now stands at $360 billion. That's down over 81.3% versus this point 7 months in for Fiscal 2021 (which stood at $1.93 trillion due to heavy government stimulus and ended the fiscal year with a deficit of $2.78 trillion).

In March, foreign investors sold the most stocks on record. Holdings were cut by $25.4 billion in February, but net sales rose to $94.3 billion in March. $23.1 billion was channeled into longer U.S. debt. China sold $15.2 billion in Treasuries to drop their holdings to the lowest since 2010. We found it interesting that bond buying from the Cayman Islands at $18 billion was incredibly high – and more than China sold, but who knows who's buying in a Cayman Island account? Largest holder Japan sold $73.9 billion Treasuries but still holds nearly $200 billion more than #2 holder China ($1.232 trillion versus $1.040 trillion).

Last week on Tuesday, the U.S. Treasury auctioned $45 billion 3–year notes at 2.809%. Demand was the best since March 2021 and the yield was the highest since November 2018. The 20% dealer award was the lowest on record and the buying group that includes foreign central banks accounted for 62% of the supply versus 53.4% in April. Last Wednesday's $36 billion 10–year note brought 2.943% with slack demand that did improve versus April. The yield was also the highest since November 2018 and foreign buying rose from 64.3% in April to 70.3%. Last Thursday, $22 billion 30–year bonds brought 2.997% (the highest yield since March 2019). Demand was moderate but improved to April. Foreign buying rose from 65.2% to 69.7% for this auction. Today's 20–year bond brought 3.29% for $17 billion in supply. Demand was good but well below that of April's auction. Foreign buying fell from April's 75.9% to 70.6% of this offering. Next week, the U.S. Treasury will offer 2–year notes on Tuesday (05/24), 5–year notes on Wednesday (05/25), and 7–year notes on Thursday (05/26).

05/13/22 Treasury Yield Curve	**2-Year: 2.582%**	**5-Year: 2.867%**	**10-Year: 2.921%**	**30-Year: 3.083%**
Weekly Yield Change:	–.154%	–.212%	–.210%	–.145%

05/06/22 Treasury Yield Curve	**2-Year: 2.763%**	**5-Year: 3.079%**	**10-Year: 3.131%**	**30-Year: 3.228%**
Weekly Yield Change:	+.018%	+.122%	+.194%	+.228%

Economics

Retail Sales rose by .90% in April, a little less than expectations, but were revised up from .50% to a strong 1.40% for March. Given high inflation readings, one has to wonder if sales were up 9.9% versus last year – if that was for the same basket of goods? Consumption numbers might be viewed in that same light. (The quarterly annualized spending estimate as of April was 8.9%.) Ex autos, sales rose .60% in April. Consumer credit numbers showed heavy reliance on cards for spending. The March Trade Balance deficit surged to a record $109.8 billion. The February deficit had been $89.8 billion. Merchandise imports were nearly $300 billion. Imports of petroleum were the highest since 2014. As we said earlier, Consumer Credit is expanding and hit a record as Americans may be maxing out their credit cards. March consumer credit was more than double expectations of $25 billion with a surge to $52.435 billion. With total consumer debt approaching $16 trillion, what could go wrong?

Although still historically relatively low, over the past 2 weeks Initial Jobless Claims have risen to fresh 3–months highs with a 21K jump to 202K and then a 1K rise to 203K. For the last 2 weeks of April, Continuing Claims dropped to fresh pandemic lows with a 19K drop to 1.384 million followed by a 34K drop to 1.343 million. A few other 'warnings' for payrolls came from other data. ADP Employment Change showed private payroll jobs increasing by 247K, but that was well below expectations of 383K – and the least in gains since the COVID lockdowns. A larger concern came in Challenger Job Cuts showing the largest increase in firings in months – with a 6% rise versus April 2021 and a 14% increase to March data. However, in March, a record 4.5 million Americans quit their jobs for various reasons including finding something better – as JOLTs Job Openings in March vaulted to a record 11.549 million. That sent the ratio of available jobs versus unemployed Americans up to 1.9!

Nevertheless, April payrolls proved resilient with 428K jobs added versus expectations of 380K. The 2–month net revision was a decrease of 39K fewer jobs than had been previously reported. Private payrolls 'beat' the ADP data with a 406K increase and manufacturing added 55K. The U.S. Unemployment Rate maintained 3.60% as the Labor Force Participation Rate declined from 62.40% to 62.20% (a negative component for employment statistics). The Underemployment Rate rose from 6.90% to 7.00%. Average Hourly Earnings rose by .30% which softened the annual gains from 5.60% to 5.50%. With gasoline pump prices hitting new highs a number of times over the past 2 weeks and CPI at 8.30% (core 6.20%), wages are failing to maintain pace with inflation causing Americans to cut spending or borrow more heavily. Average Weekly Hours remained at 34.6.

Inflation data remains uncomfortably high and is outpacing wage increases but April data did slow marginally. In April, Consumer Prices rose by .30% (after rising 1.20% in March), slowing the annual pace from 8.50% to 8.30%. The core (ex food & energy) saw a .60% increase which decelerated the annual pace from 6.50% to 6.20%. Net of inflationary forces, Real Average Hourly Earnings for April tied the March results at –2.60% (year over year). Real Average Weekly Earnings were a little less negative at –3.40% versus an annual –3.50% from March. Producer Prices rose by .50% (versus 1.60% in March) – and also softened on an annual basis from 11.50% to 11.00%. Core PPI rose by .40% and cut back from an annual pace of 9.60% to 8.80%. April Import Prices were flat which pared back the annual pace from 13.00% to 12.00%. Export Prices rose .60% and declined annually from 18.60% to 18.00%.

NFIB Small Business Optimism was unchanged at 93.2 – though the lowest level since April 2020. April Vehicle Sales rose from 13.33 million to 14.39 million (annual units). The preliminary University of Michigan sentiment numbers were not promising in falling to new decade lows. Sentiment dropped from 65.2 to 59.1, Current Conditions fell from 69.4 to 63.6, and Expectations plunged from 62.5 to 56.3. Empire (New York) Manufacturing fell from 24.6 to –11.6 – for the second drop in the last 3 months. The readings are the lowest since the COVID drop. The ISM Services Index fell from 58.3 to 57.1 but the internals are indicating stagflation with slowing orders and higher prices.

In March, Factory Orders rose 2.20% and they were up 2.50% ex transportation. Orders for Durable Goods rose by 1.20% and were 1.40% higher ex transportation. Capital Goods Orders showed business investment rising by 1.30%. Q1 Nonfarm Productivity fell at a 7.5% annualized rate for the worst such drop since 1947. Unit Labor Costs rose by 11.60%. However, the Industrial Production increase of 1.10% for April showed a 3rd advance and better results than for Q1. Capacity Utilization jumped from 78.20% to 79.00%.

With higher interest rates, homebuilder sentiment hit the skids and dropped the most since April 2020. The NAHB Housing Market Index plunged from 77 to 69. Five months of declines have taken optimism to the lowest levels since June 2020. Mortgage rates are the highest since 2009. Current sales dropped 8 points and buyer traffic fell to the lowest levels since 2020. April Housing starts were revised down from 1.793M to a 1.728 million annual pace for March – and then fell .23% to 1.724 million (annual units). Building Permits fell 3.19% to 1.819 million annual units.

Thursday is set for jobless claims data, the Philadelphia Fed Business Outlook, Existing Home Sales for April and the Leading Index. Next Monday (05/23) gives us the Chicago Fed National Activity Index. Tuesday brings the Richmond Fed Manufacturing Index and New Home Sales for April. Wednesday follows with MBA Mortgage Applications (which rose by 2% and then fell 11% over the past 2 weeks), April Durable and Capital Goods Orders, and the release of the minutes from the FOMC meeting that concluded on May 4th.

Equities

Following an 8.80% loss in April for the S&P, it's now lower by 5.04% for the month of May – which is often a seasonal negative for stocks. Before a 3.56% loss on May 5th, the post–Fed (May 4th) 2.99% gain was the best since May 2020. A 2.39% rebound on Friday the 13th saved last week from being even worse.

With 10% being the usual measure for a correction, and 20% often the guideline for a reversal to a bull or bear market, the S&P's pullback of 19.92% into Thursday (from the January high) was very close – though just a number. The S&P rebounded 4.28% off that low to end the week 2.41% lower – having been off by 6.41%. The Nasdaq has fallen 31.48% to its November high to place it squarely in a bear market while the Dow Industrials have so far dropped 15.49% versus their January high. Friday's rally aside, with weekly declines across the board, stocks lost ground for a 6th week – the longest such stretch since June 2011.

The Dow Industrials lost .24% into May 6th and then dropped 702.71 points or 2.14% last week to 32,196.66. The Dow is 2.19% lower this week after today's 3.57% 1,164.52–point tumble. The Nasdaq dropped 1.54% and 2.80% for the last 2 weeks. It's off another 3.28% through today. The S&P lost .21% and 2.41% for the past 2 weeks and traded below 4,000 for the first time since March 2021. The S&P is 2.49% lower this week. The Dow Transports rose .24% and then lost 2.98% over the past 2 weeks. The Transports have crashed 5.29% lower this week. Bank stocks were up 2.22% into May 6th and then down by 4.61% last week. Bank stocks have traded 30% lower versus their January high and fell .24% through today after a sharp 3.89% rally on Tuesday and a 2.88% drop today.

Other Markets

The U.S. Dollar continued its upward trek into Friday – marking the highest levels since 2002. Part of the reason for softness in some assets such as precious metals is a stronger Dollar raising its purchase power. That's not holding for Crude Oil – which is rising back near the March highs even as gasoline and diesel fuel prices have been rising to new successive records over the past 2 weeks. Many areas have seen 30 to 50–cent hikes at the pump over the past week. Crude Oil rose 4.85% and .66% over the past 2 weeks and was 3.36% higher on Monday but reversed that gain and is now down .81% for the week.

Commodities gained .99% but then lost .88% last week. Commodities are .26% better this week. Gold lost 1.51% and 3.96% – falling for a 4th week. Gold is .43% higher this week. Silver also lost ground for the last 4 weeks and as of Friday was 22.93% lower to its April 18th high – and 32.72% off its February 2021 high. Crypto was again clanged – trading off 57% since November and 29% since March.

The U.S. Dollar gained .71% and then .89% to mark a 5th and 6th weekly gain. The Dollar is .56% lower this week. The Euro gained .06% and then lost 1.32% last week. It's .51% higher this week. The Japanese Yen fell .66% and then surged 1.03% last week. The Yen is up another .77% this week. Corn fell 3.18% and then rose .28% last week. Corn is flat this week. Cotton lost 3.58% and then 1.14% over the past 2 weeks. It's .69% lower this week.

"Real success is finding your lifework in the work that you love." David McCullough

"Don't ever take a fence down until you know the reason it was put up." G. K. Chesterton

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Additional Information is Available on Request

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