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Bond Market Review

Intended for Institutional Clients Only

Firestarter

The Fed may be off to the races, but economic data is slowing – and Q1 GPD was just revised to a greater contraction. Q1 GDP was expected at –1.30% but was revised lower to –1.50%. Maybe that's not overly negative, but the Price Index rose from 8.00% to 8.10% and the Core (ex food & energy) came in .10% better at a still–lofty 5.10% annual rate. Personal Consumption for Q1 was revised .40% higher to 3.10% – but we've learned that much of that spending came from sizeable increases in credit card usage and loans. The Atlanta Fed's GDP–Now forecast had been as high as 2.5% for Q2 but as fallen back to 1.8%. This is not the strong growth that suggests alone the Fed needs to tighten.

April's Leading Index was flashing a red –.30% versus unchanged expectations while the March LEI was revised from .30% down to .10%. Higher mortgage rates and a slowdown in housing are major factors. As of last Friday, the S&P had fallen more than 20% to place it into 'bear market' territory. For now, that 20.93% decline versus January's high has been followed by a nice rally. The drawdown for many indices is the worst since the financial crisis (2008–2009). The S&P lost ground for 7 weeks before its rally this week. That was its worst such streak since March 2001. For the Dow Industrials, 8 down weeks was the worst in 99 years (to May 1923)!

The Fed's minutes were not quite as hawkish and in turn were less alarming to the debt markets. They said nothing of 75–bps hikes, which was welcome news. They hiked 50 bps on May 4th– which is well known but said to expect 50–bps moves for their next 2 meetings and then 125 bps more in hikes by the middle of next year. For those fearful of 75 bps hikes or an extended wave of 50–bps moves beyond the next 2 meetings, the language had a calming effect. Today, 5–year yields dropped to their lowest levels since April 14th. This week, 10–year yields dropped to the lowest levels since mid–April and 30–year rates fell to the lowest levels since late April. The **B**ond **M**arket **R**eview is on record for believing the Fed will be forced to halt this campaign of hikes and possibly reduce rates sometime over the next year as growth slows – possibly leading to recession. We also believe allowing American oil companies freer access to production would do much more to bring down inflation than Fed hikes.

Anyone watching the Olympics in 1976 became very puzzled when Romanian gymnast Nadia Comăneci received a score of 0.00 following a seemingly flawless event. Sports commentators and the crowd had to be told that score was really a perfect 10.00 but the scoring equipment didn't allow for that outcome. She earned 6 more of those 10s during those games. Pump prices again hit new highs this week though that's not exactly news. Even those that have no idea of what's going on in the stock market know all about gas, egg, and milk prices. In this week's sign that the apocalypse is upon us – west–coast gasoline pumps are now being programmed to show amounts above $10/gallon. At the rate things are going, and with no plan for increased domestic production other than to raise rates – $10 and higher is a real possibility. OPEC can't be expected to comply with requests for higher output. Shortly, we'll see no more of those pesky 9 hundredths of a cent on the right. We'll need that digit on the left as we unfortunately pass $10.01.

Looking Ahead

- Equity cycles have a high due near June 3rd.
- The bond yield cycles are mixed. A change in trend is due near June 1st – which might be a low.
- U.S. markets will observe Memorial Day on Monday (05/30). Bonds will close early on Friday 2 p.m. ET.

Fool me once …

The same Fed that denied inflation wants to be on record for saying there will be no recession. When the Fed is in tightening mode and growth is slowing, the markets try to discern if the thud at the resulting 'landing' will be a soft or hard one. FRB San Francisco President Mary Daly said the FOMC wanted to get to a level that neither stimulated nor bridled the economy. We think they may have misread the underlying strength of the economy given the drums of war, a slow first quarter, and continued supply–chain issues. Daly said the economy can *"weather this storm."* While the Fed is saying there won't be a recession (which could come sooner than they think), she said: *"I'm going to put my chips on the 'no recession' side."* Did she mean to say the Fed is gambling on the chances of recession?

St. Louis' James Bullard had a different tact. He wants to hike more quickly and reach a 3.5% funds rate by year end. That would explain why he still believes a 75–bps hike can't be ruled out as an option. He says that the 3.5% is higher than some of his colleagues want to see but might get inflation under control more quickly. He too believes the chances of recession are low but made the argument that faster hikes would allow for possible cuts in 2023 and 2024. It seems that members of the Fed know that they may need to reverse course in 2023! The journey to 'neutral' remains undefined, but Bullard wants to get there faster. The Fed also discussed the dangers from higher commodity prices.

Midway to the Longest Day

I'm of the generation that remembers the great admiration and respect that was due those that fought in World War II. Many young Americans left to fight for freedom – and never returned. The losses were incredibly high. I also try to watch 'Midway' because that battle happened in early June and turned the tide of the War in the Pacific in 1942. I try to watch 'The Longest Day' or 'Saving Private Ryan' which cover D–Day – also in early June (6/6/1944), as that led to the end of the war in Europe. There are so many other movies and books that cover the reasons for Memorial Day from all the conflicts we've endured. The list is too long to include. There were young soldiers that saw brothers in arms fall while they lived into their 90s. I've had many conversations with a number of them.

I pay great homage to those young men and women that never had the chance to marry, to have children and grandchildren, and/or to live out to a longer life. While we observe Monday's holiday and the Memorial Day weekend beginning with Friday's early close for bond trading, we should all be reverently thankful for those that, young and old, never had that chance – or certainly the years to enjoy it. Instead, these valiant men and women paid the cost of freedom with what President Abraham Lincoln termed that *"last full measure of devotion."*

Treasuries, Agencies, and MBS

Last week, yields were slightly higher at 2–years, but lower by 6.5, 14, and 9.5 bps for the 5, 10, and 30–year Treasury sectors. Through today, yields were lower by 10.5, 9, 3.5, and .5 bps for those sectors. Freddie Mac 30–year rates fell 5 bps last week to 5.25% for their first decline in May. This past week, they dropped 15 bps to 5.10% for their largest decline since April 2020. Housing data has been adversely affected by higher rates so maybe that sector will see a little jump. 15–year mortgage rates fell from 4.448% to 4.43% and then to 4.31% over the past 2 weeks.

On Tuesday, the U.S. Treasury sold $47 billion 2–year notes at 2.519% – down from April's 2.585%. Demand was solid, though down from the April offering. The buying group that includes foreign central banks accounted for 62.6% of the issue versus a prior 66.0%. Dealers won only 15.4% – among record lows. On Wednesday, $48 billion 5–year notes brought 2.736% – down from April's 2.875%, and the first drop since December. Demand rose to the April auction and foreign buying dropped from 64.0% to 62.9%. Today's 7–year note brought 2.777% for $42 billion in supply. Demand was very solid and the best since March 2020. Foreign buying surged from 65.0% in April to 77.9% – near the best previous result as the primary dealer award of 6.4% was an all–time low.

05/20/22 Treasury Yield Curve	2-Year: 2.584%	5-Year: 2.801%	10-Year: 2.783%	30-Year: 2.989%
Weekly Yield Change:	+.002%	–.066%	–.138%	–.094%

Economics

Initial Jobless Claims rose from 197K to 218K and then fell back to 210K over the past 2 weeks. 218K was a 4–month high. Continuing Claims fell from 1.342 million to a new pandemic low of 1.315 million last week and then edged back up to 1.346 million. Continuing Claims for state benefits was recently the lowest since 1969.

Manufacturing data was mixed but leaning to the downside. The Chicago Fed National Activity Index rose from .36 to .47. However, the Philadelphia Fed Business Outlook tumbled from 17.6 to 2.6. Kansas City Manufacturing Activity edged lower from 25 to 23 while Richmond Manufacturing plunged from 14 to –9. Preliminary data showed April Orders for Durable Goods rose .40% and were .30% higher ex transportation. Orders for Capital Goods were also below expectations with a .30% increase.

Sales of Existing Homes fell in April by 2.43% to 5.61 million annual units. That was the 3rd straight decline and the lowest result since June 2020 (nearly 2 years). Sales of New Homes fared no better in a crushing 16.64% tumble to 591K annual units – the lowest since April 2020. That result would have been even worse if March data hadn't been revised lower from 763K to 709K. That a was a 4th decline in sales – the worst such streak since October 2020 and the worst drop since the onset of the COVID lockdowns. Pending Home Sales dropped for a 6th month. That marked the worst falloff since 2018 and to the lowest levels since June 2020. Sales fell 3.90% and were 11.50% lower on a year–over–year basis.

Friday is set for April's merchandise trade deficit (Advance Goods Trade Balance), Personal Income & Spending, the University of Michigan sentiment surveys, and the PCE Deflator (the Fed's primary inflation gauge). Monday (05/30) is of course Memorial Day – the day set aside to honor those that gave 'the last full measure of devotion.' All U.S. markets will be closed. Tuesday closes out May trading with home price data, MNI Chicago PMI (purchasing managers), Dallas Fed Manufacturing, and the Conference Board's consumer confidence surveys.

Wednesday kicks off June data and trading with MBA Mortgage Applications (which fell 1.20% last week), May Construction Spending, May Vehicle Sales, ISM Manufacturing, JOLTs Job Openings, and the Fed's Beige Book (report of activity in their 12 districts). Thursday follows with Challenger Job Cuts and ADP Employment Change (private payrolls) for May, jobless claims data, Q1 Nonfarm Productivity & Unit Labor Costs, and April data for Factory Orders as well as orders for Durable and Capital Goods. Next Friday gives us May payrolls including the U.S. Unemployment Rate and other related data along with the ISM Services Index. The Trade Balance deficit and Consumer Credit for April follow the next Tuesday (06/07).

Equities

Stocks are making a great comeback this week after the worst streak of losses in 99 years for the Dow Industrials which fell for an 8th week. It had been 21 years since the S&P fell for 7 weeks! The Dow dropped 934.76 points or 2.90% last week to 31,261.90. It was 4.40% higher through today. The S&P lost 3.05% but is 4.01% higher this week. The Nasdaq plunged 3.82% but is 3.40% higher this week. The Dow Transports tumbled 6.68% but have surged 4.82% this week. Bank stocks fell .75% but have jumped 7.80% this week!

Other Markets

Crude Oil rose 2.48% last week and is back to the March highs with a .76% gain this week. Commodities gained 1.34% and are 1.90% better this week. Gold gained 1.87% after 4 weeks of losses and is .30% higher this week. The U.S. Dollar lost 1.38% and is 1.27% lower this week. The Japanese Yen surged 1.04% and is .59% higher this week. The Euro gained 1.46% last week and is 1.52% higher this week. Corn lost 1.98% last week and is another 1.77% lower this week. Cotton lost 2.02% and is also lower by 1.17% this week.

“O beautiful for heroes proved – In liberating strife,
Who more than self their country loved, And mercy more than life!”
Katharine Lee Bates

“It is rather for us to be here dedicated to the great task remaining before us - that from these honored dead we take increased devotion to that cause for which they gave the last full measure of devotion - that we here highly resolve that these dead shall not have died in vain – that this nation, under God, shall have a new birth of freedom – and that government of the people, by the people, for the people, shall not perish from the earth.”
Abraham Lincoln

“It is the Soldier, not the reporter who has given us freedom of press.
It is the Soldier, not the poet who has given us freedom of speech.
It is the Soldier, not the campus organizer who gives us freedom to demonstrate.
It is the Soldier who salutes the flag, who serves beneath the flag, and whose coffin is draped by the flag, who allows the protester to burn the flag.”
Father Dennis Edward O'Brien

Doug Ingram, Financial Economist
Additional Information is Available on Request