Banes Capital Group, LLC
6410 Poplar Ave. Suite 500
Memphis, TN 38119 (901) 261–5900
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Bond Market Review

Intended for Institutional Clients Only

Multiverse of Madness

Friday was painful enough, but nearly every asset class got clobbered on Monday. Bonds had their worst 2–day drop since 1987. Stocks, bonds, gold, and silver traded lower. Bitcoin has lost another 26% since the release of Consumer Prices (CPI). That left the cryptocurrency 67% lower since November! One of the only ways to perform even worse would have been to hold assets in a foreign currency. The U.S. Dollar traded to its best levels since 2002 – with the Japanese Yen doing the worst since then. The Euro has been closing in on parity versus the dollar – after having held a 60% premium in 2008. The U.S. spent trillions on stimulus – and the Euro lost 37%? Bond yields hit new multi–year highs and stocks fell to multi–year lows. The S&P closed in the clutches of bears, as it was 22.5% off its January highs to the lowest levels since March 2021 (with 20% used as a bear–market watermark). The Dow Industrials have traded 18.4% off their January highs to the lowest levels since February 2021. The Nasdaq continued lower to its worst showing since November 2021 and has retreated by 33.5%. For bonds, the 2 and 30–year all flattened to highs near 3.44% – the highest since Novembers 2007 and 2018. The 5–year note inverted the curve to 3.60% – which was the highest yield since June 2008. At 3.49%, the 10–year rose to its highest levels since April 2011.

The internals are flat out ugly. We run spreadsheets of volume, advances versus declines, and new highs to new lows on stocks. Monday's oversold result was the lowest (most oversold) we've seen – under half of the readings reached in March 2009 and March 2020. In the **B**ond **M**arket **R**eview (5/18) we said: *"Bear markets are ugly. The market will rally to yield hope and then continue to grind lower."* We were so accustomed to Fed accommodation that most investors thought every pullback could be bought with impunity. The Dow rallied 2,636 points but then lost it in days.

Many thought Consumer Prices had probably topped as the Fed began tightening, but that is not the case to date. CPI instead rose 1.00% in May – which accelerated the annual pace from 8.30% to a fresh 40–year high of 8.60%! The worst news from the CPI report is that the Fed will most likely step up its campaign of inflicting economic damage in an effort to bring inflation down. Some bond traders are speculating that a 75–bps move is probable – even though Fed Chair Jerome Powell has tried to be transparent and already signaled another 50–bps is coming Wednesday. To maintain openness, they could hike 50 bps and then signal 75 bps for the next meeting. The previous hikes can't possibly be showing up yet in the data. This battle will not be easily won as there's a huge risk that fuel prices will continue even higher – while housing drops and the economy falls into recession. The best laid plans of mice and men often go awry – especially for central bankers! This will spill over globally.

If your only tool is a hammer – then every problem looks like a nail. To central bankers, every problem appears to be one solvable by using monetary policy to ease or tighten. Can they slow inflation and growth without destroying the economy? We're going to find out across the globe. Is that elusive 'soft landing' even possible? The Fed hopes that continued increases of their funds rate will eventually lead to less inflation. We question that logic – along with the cause and effect. When prices were deflating, central banks lowered rates near zero – with very little success. We don't believe you can lower fuel prices by raising interest rates – and we still see fuel costs as the chief inflationary culprit. Increasing supply would really make a difference here. Decreasing demand instead through onerous rate manipulation may not work – unless Americans have to choose between groceries, fuel, and house payments.

Looking Ahead

- Equity cycles have a low due near June 15th and a high due near June 23rd.
- The bond yield cycles show a possible rate peak near June 16th.
- The FOMC will update interest–rate policy on Wednesday (06/15) at 2 p.m. ET. They could hike 75 bps!
- U.S. markets will be closed for the Federal holiday of National Independence Day on Monday, June 20th.

The state of Tennessee is offering a tax holiday on groceries for the month of August. Tennessee already had a tax moratorium over the past year on hunting supplies like safes. But … just how many cans of Dinty Moore Beef Stew can we afford, and how many will even fit inside the safe?

Do the haves have naught? A survey of Americans earning $250,000 per year revealed that over a third were living paycheck to paycheck – with costs eating up their entire salary. In the last **BMR**, we reported that gas pumps on the west coast were being reprogrammed to roll over $10/gallon. We may need them updated all across the U.S. as average pump prices rose above $5/gallon last week for the first time on record. Most of us have seen cycles of fuel prices rising and falling, but I don't recall such a relentless and unchecked campaign like we're experiencing now. It hasn't been unusual to see prices rising 10 to 15 cents a day – often for several days. Prices seem to level out but then they go up again. There's no more any confidence in waiting for prices to ease before filling up.

This Fed, and those that have gone before, claim there will be no recession despite evidence to the contrary. They are still overcoming the credibility problem from being inflation deniers for so long. Additionally, the administration and the Fed still believe high inflation was brought about more by excessive stimulus than by energy policy.

Though Treasury Secretary Janet Yellen doesn't see a recession coming now, she defended last year's stimulus before the Senate Finance Committee. However, she said it might have been too much – preferring $1.3 trillion instead of Biden's $1.9 trillion. Last year, she contended that a problem with inflation *"was unlikely to result from stimulus."* She grouped herself with Powell in saying they erred in forecasting that higher inflation wouldn't persist. As the economy was recovering from the pandemic last year, she explained: *"In designing a policy there are various risks that need to be taken into account. Of course inflation was one of them, but the overwhelming risk was that Americans would be scarred by a deep and long recession."* Danger then – but not now? Be careful out there!

If the FOMC intends to beat inflation by raising the misery level – recession will surely follow and may be at hand. Q1 had a modest contraction but will Q2 have enough upside to bypass recession for now? The last Q2 GDP estimate from the Atlanta Fed showed only .9% growth. That's not the kind of gain that requires checking with policy! St. Louis FRB President James Bullard wants to get rates to 3.5% to halt inflation and to subsequently be in the position to cut rates again in 2023 or 2024. They were trying to get inflation up to 2% – and only missed by 400%!

The ongoing debate considers if high inflation is the fault of the Fed, Chairman Powell, President Biden, Congress, or Vladimir Putin. The answer is clearly yes! All have played a part. The Fed for ignoring it, Biden for fuel policies, and Putin for the war in Ukraine and the resulting additional supply disruptions. Those thinking the fight won't lead to recession are saying we might have a little 'r' recession. It's just another way to be a little 'w' wrong!

The Fed's Beige Book that the FOMC is considering this week said: *"Four districts explicitly noted that the pace of growth had slowed since the prior period."* It continued: *"Eight districts reported that expectations of future growth among their contacts had diminished; contacts in three districts specifically expressed concerns about a recession."* They noted continued supply–chain disruptions from the war in Ukraine and the ongoing pandemic. They described labor as still 'tight.' Consumer sentiment just fell to a record low – which should be a concern as well.

In the 'what could go wrong' category, market turmoil aside – consumers have been buying, but heaping on credit card usage to do so! Borrowing rose an annual 10.1% in April as Consumer Credit expanded by $38.07 billion – following the record $47.34 billion in March. Credit Card accounts jumped by 31 million versus last year to 537 million. Mortgage originations were the lowest in almost 2 years. We don't yet know what Q2 will bring, but American's saw a $544 billion decline in net worth in Q1. That drop in Q1 was the first decline since the pandemic recovery began. Hold on to your hats!

Treasuries, Agencies, and MBS

Before the CPI release on Friday, yields had traded to their highest levels since 2018 – with last week's Treasury auction awards coming at the highest rates since November 2018. Treasury yields surged higher on Friday as Consumer Prices broke to even higher inflation readings, convincing the markets that the Fed would not only consider 2 more 50–bps increases in June and July – but possibly another in September or even a 'shock and awe' move. The failure of the policy measures to move the needle on inflation to date has market participants thinking the Fed might even consider a 75 or 100–bps move. Last week, yields rose by 41, 32.5, 22, and 10.5 bps in a twisting move to flatten the curve for the 2, 5, 10, and 30–year Treasury sectors. However, Friday was not the story! Stocks and bonds were again crushed on Monday. Yields for those sectors rose another 29.5, 22.5, 20.5 and 15.5 bps (the worst 2–day jump since 1987). Through today, yields for those sectors were even higher (by 36.5, 33, 32, and 23 bps).

May has shown only one budget surplus in the past 68 years, though in light of recent history the $66.2 billion deficit for last month seems rather tame. It was roughly half of last May's (2021) shortfall and placed the federal deficit at $426.23 billion for the first 8 months of fiscal 2022. With no large stimulus packages this year, fiscal 2022 is running 79.35% below the pace of fiscal 2021 (through the first 8 months).

Freddie Mac 30–year rates once again rose near the higher end of recent data with a 13–bps increase to 5.23% over the past 2 weeks. Of course, this week could prove very bad – with Treasury rates surging roughly 44 bps since that update. 15–year mortgage rates rose 7 bps to 4.38%. Applications for mortgages just fell to a 22–year low. Housing affordability was reported to reach a record low as 30–year rates were hitting 6.1% this week. On a median priced home, the 30–year payment is about 40% higher (on the same balance) versus the start of the year. Maybe we'll get only 5 calls a week trying to buy our homes – instead of the usual 15. (And if we're not selling, do we have any other properties? Do we know any for sale?) Last week, it was 'we're in your area buying homes.' My thought was – not with that (360) area code, you're not! This bubble is about to pop … again.

06/10/22 Treasury Yield Curve	**2-Year: 3.065%**	**5-Year: 3.259%**	**10-Year: 3.158%**	**30-Year: 3.196%**
Weekly Yield Change:	+.409%	+.324%	+.221%	+.107%

06/03/22 Treasury Yield Curve	**2-Year: 2.656%**	**5-Year: 2.935%**	**10-Year: 2.937%**	**30-Year: 3.089%**
Weekly Yield Change:	+.178%	+.217%	+.197%	+.123%

Last Tuesday, the U.S. Treasury sold $44 billion 3–year notes at 2.927% – the highest yield since November 2018. Demand fell from the May offering and the buying group that includes foreign central banks dropped from a 62.0% allocation to 51.5%. Wednesday's $33 billion 10–year note auction brought 3.03% – also the highest yield since November 2018. Demand fell from May for this reopening of the May 2032 maturity. Foreign buying fell from 70.3% in May to 63.6% – the lowest share since July 2021. Thursday's $19 billion 30–year (reopened May 2052 maturity) auction brought 3.185% – again the highest yield since November 2018. Demand was off slightly versus May and foreign buying was a slight .7% lower to 69.0% for the new supply. The 20–year bond auction won't come until Wednesday, June 22nd.

Economics

Initial Jobless Claims fell from 211K to 200K for the last week of May, but they then rose to 229K with the largest jump since July – hitting the highest levels since February. Continuing Claims fell from 1.343 million to 1.309 million – and then dropped to 1.306 million in successive pandemic lows. Challenger Job Cuts fell by 15.80% in May (less cuts). The ADP Employment Change data was 128K in private payroll hiring but that was far less than the 300K expected. April's data was revised 45K lower to 202K. JOLTS Job Openings fell from their March record of 11.855 million but at 11.4 million still exceed unemployed Americas by nearly double (1.9 jobs for each without one).

May payrolls beat estimates of 318K with a 390K increase but that was a 13–month low – and the 2–month revision showed 22K less jobs than previously reported. Private payrolls grew by 333K and Manufacturing added 18K jobs. The U.S. Unemployment Rate maintained 3.60%. Average Hourly Earnings were .30% higher in May but slowed from 5.50% to 5.20% annually. Average Weekly Hours were unchanged at 34.6. The Labor Force Participation Rate rose .10% to 62.30% and the Underemployment Rate rose from 7.00% to 7.10%.

Conference Board Consumer Confidence fell from 108.6 to a 3–month low 106.4. The Present Situation fell from 152.9 to 149.6 and Expectations dropped from 79 to 77.5. The University of Michigan Sentiment dropped from 65.2 to 58.4 but preliminary data for June plunged to 50.2 – a record low. We see things as bad enough without the Fed driving the final wounds to bear. If oil production was instead allowed to increase, the Fed could sit on their collective hands. Current Conditions fell from 69.4 to 63.3 but tanked to 55.4 in early–June data. Expectations fell from 62.5 to 55.2 but then plunged to 46.8 – showing Americans are deeply troubled by Fed policy and high prices. Consumers were already expecting higher inflation even if others were not. After all, they're seeing it live at the grocery store and the gas pump. While many were thinking inflation had peaked, the Michigan survey rose from 5.30% to 5.40%. NFIB Small Business Optimism fell a slight .1 to 93.1.

ISM Manufacturing saw an increase from 55.4 to 56.1. Prices Paid retreated from 84.6 to 82.2 and New Orders rose from 53.5 to 55.1. The Employment reading fell from 50.9 to 49.6. Q1 Nonfarm Productivity fell 7.30% and Unit Labor Costs rose from 11.60% to 12.60%. Growth slowed in the service sector as the ISM Services Index declined from 57.1 to 55.9. MNI Chicago PMI (purchasing managers) rose from 56.4 to 60.3. Dallas Fed Manufacturing Activity dropped from +1.1 to –7.3. Auto sales fell badly in May – dropping from 14.29 million to an annual pace of 12.68 million units. In what we see as a reverse indicator, the trade balance deficits are narrowing. The merchandise trade deficit (Advance Goods Trade Balance) for April narrowed from $125.9 billion to $105.9 billion. The Trade Balance deficit narrowed from $107.7 billion to $87.1 billion. Components could be expectations for diminishing retail sales or further supply disruptions. Factory Orders rose .30% in April and were up the same ex transportation. Orders for Durable Goods rose .50% and were .40% higher ex transportation. Orders for Capital Goods rose by .40%.

Personal Income rose by .40% in April while Spending rose by .90% – indicating little savings and heavy use of credit. The savings rate fell to the lowest level since the financial crisis. The FHFA House Price Index rose 1.50% in March. The S&P Case–Shiller annual home price index rose from 20.01% to 20.55%. Housing inventories rose for the first time since 2019. The House Price Purchase Index rose 4.60% in Q1 2022. Metro Home Prices rose a strong 2.42% in March – sending the annual pace up from 20.26% to a record 21.17%. Construction Spending rose by .20%.

The Fed has plenty of inflation data to consider before they update their policy on Wednesday. Unfortunately, there's been no slowdown yet. The Fed's favorite inflation gauge rose .20% in April and that PCE Deflator decelerated a bit annually (from 6.60% to 6.30%). The core (ex food & energy) rose .30% with the annual core pace down .30% to 4.90%. However, that data remained near 40–year highs.

Things were different for Consumer Prices as grocery prices rose the most since 1979 and many sector increases were in double digits – from a record 15.3% for vehicle parts to a 37.8% annual increase for airfares. CPI rose by 1.00% in May and quickened from 8.30% to 8.60% annually (the most since 1981). The higher CPI print was said to have assured a September Fed hike of 50 bps as well (as assumed for June and July) and to some put a 75–bps move or more on the table. Core CPI rose .60% with the annual pace slowing from 6.20% to 6.00%. Real Average Hourly Earnings (adjusted for inflation) fell from –2.60% to –3.00%. Weekly Earnings dropped from –3.40% to –3.90%. Producer Prices rose for a 25th month. May PPI rose .80%. The annual PPI pace slowed moderately – from 10.90% to 10.80%. The core rose .50%. The annual core pace fell from 8.60% to 8.30%.

Wednesday is set for MBA Mortgage Applications (which fell 2.30% and then 6.50% over the past 2 weeks), Empire (New York) Manufacturing, Retail Sales for May, Import Prices, TIC Flows (foreign flows into U.S. assets), homebuilder outlook (NAHB Housing Market Index), and the June FOMC update on interest–rate policy. Thursday follows with jobless claims data, Housing Starts & Building Permits for May, and the Philadelphia Fed Business Outlook. Friday gives us Industrial Production & Capacity Utilization for May and the Leading Index (May LEI). Following the Monday holiday on June 20th, Tuesday brings the Chicago Fed National Activity Index and Existing Home Sales for May.

Equities

Looking for a bounce? We have a target for the S&P of 3,577. Beyond that, the next major target is 3,261 but it's not due until October. For many U.S. markets, prices fell to new bear–market lows this week. The Dow Industrials lost 1,506.91 points or 4.58% last week to 31,392.79. They fell 2.79% Monday and were off 3.27% through today. The 2,636–point rally into June 1st was followed by a 3,128–point drop. The S&P dropped 5.05% last week and then fell 3.88% on Monday and 4.24% through today. The Nasdaq dropped 5.60% last week before losing another 4.68% on Monday. It rose a little today to close the early–week loss to 4.51%. The Dow Transports plunged 7.45% last week and then dropped another 3.03% on Monday but rallied today to stand .97% lower for the week. Bank stocks lost 7.84% last week and were off another 4.21% as of today.

Other Markets

Crude Oil gained 1.51% last week for a 7th successive gain. Crude is 1.44% lower this week. Commodities gained .78% last week but fell 3.11% through today. Gold gained 1.41% but is 3.31% lower this week – along with most other asset classes. Silver is 4.45% lower since Friday. The U.S. Dollar surged 1.95% and is 1.14% higher this week on the prospect of higher U.S. rates. The Japanese Yen fell 2.70% last week and is .79% lower this week. The Dollar is the highest since 2002 and the Yen the lowest since then! The Euro plunged 1.87% and lost another .98% through today. At 1.04 to the Dollar, the Euro is in danger of falling to parity. Corn gained 6.36% (which offset the previous week's 6.47% loss) and then fell .65% through today. Cotton gained 4.98% but is 1.09% lower this week.

"Intuition isn't the enemy, but the ally, of reason." John Kord Lagemann

"There is nothing so useless as doing efficiently that which should not be done at all." Peter Drucker

Doug Ingram, Financial Economist
Additional Information is Available on Request