Monday Morning Update April 23, 2018

The Fed – the only question that remains for Fed policy for the remaining of the year is whether this is Powell's FOMC or is this a "group" FOMC. The Dot Plot map shows a majority of voting members prefer four rate adjustments in 2018, not three. Powell is in the three-moves-in-2018 camp. Will the others convince him to move in December ? Bloomberg suggests less than a 30% probability of a fourth move in December. If this percentage gets to 60% or higher, Powell will be hard pressed not to follow the sentiment.

Inflation – traders will see GDP price data this week. And traders will also see employment costs data this week. A continued move higher in oil prices is playing havoc with breakeven rates on inflation and the Fed's Five Year Forward inflation crystal ball. Suffice it to say that inflation fears are still somewhat muted, with a bias toward higher inflation concerns. But not much above a 2.00%-2.15%% rate of inflation currently being forecast.

Treasuries – The yield of the 2-year Treasury increased by 10 bps last week, a huge move. The yield on the 5-year moved 13 bps higher. And the 10-year yield also moved higher by 13 bps on the week. A steepening yield curve provided little comfort to equities on Thursday and Friday. The yield on the 2-year is 80 bps above target Fed Funds; the average spread in a rising rate environment is around +40 bps. The 2-year is way ahead of the Fed, and definitely projecting two more moves by the Fed. This may be the week the yield on the 10-year finally hits 3.00%.

The S&P 500 – retail sales data out last week is consistent with an economy growing around 2.50%, not 3.50%. Housing starts and building permits recent data last week also suggest a 2.50% economy, not a 3.50% economy. Traders will see PMI data on both goods and services this week, along with consumer confidence updates and durable goods updates. Most importantly will be data on 1st qtr GDP; expectations are for a low 2% annual growth rate. Difficult to average 3.00% - 4.00% for the year if the 1st qtr comes in at a low 2% growth rate. Treasury Sec. Mnuchin is using a 2% handle on GDP expectations for the foreseeable future when he speaks, not a 3% handle. Next upside target on the S&P is 2705, a gap made on the charts from last Thursday's opening. The S&P can't seem to stay above its 50-day moving average. The 50-day has to be the new floor, not the 200-day moving average. It could easily take 6 months to retest the old high in the S&P, according to what data mining shows for retests after a 10-15% selloff from the highs. We are three months since the old high of 2873.

Crude Oil – With West Texas crude still trading at 40-month highs, targets are still being set as high as $80 a barrel. First oil needs to close above, and stay above $73 a barrel. This could easily happen. Barron's' wrote this weekend about dwindling supply and steady to slightly higher demand for oil. The rig count continues to move higher.

Municipals – 5-year munis are still very expensive, relative to Treasury yields. And 10-year muni ratios are near a 12-month low, also implying a very expensive sector, relative to Treasuries. No reason to expect any diminished demand for Federal tax-free interest income, with extreme safety of principal as an additional benefit.

Corporates – the appetite for risk remains high, as evidenced by the performance of corporate spreads. High Yield spreads have moved 40 bps lower/tighter the past 3 weeks. But HY products like the HYG and JNK (ETFs) are getting very little movement higher in their prices; these products still are disconnected from the overall HY market, as evidenced by price action against the HY indices. Investment Grade spreads are only 4 bps lower/tighter the past 3 weeks. IG bonds have seen more upgrades than downgrades, with HY bonds seeing the opposite from the credit rating agencies in 2018.

The US Dollar – The USD closed at its midpoint trading range last week. The USD has basically been trading sideways against a basket of currencies the past 3 ½ months. The Euro is also range bound, between 122.50-125.00 versus the USD. The BP is in an uptrend against the USD. Traveling to the UK from the USA makes goods in the UK almost 65% more expensive than goods priced here.

Global Rate Policies – Yields on the 10-year UK sovereign are near 12-month highs. Yields on Spain and Italian 10-year sovereign debt are just above 12-month lows. China yields are near 3-month lows. Canada and Mexico sovereign 10-year debt yields are near 12-month highs. The ECB meets this Thursday. All ears will be on Draghi's comments about the timing to a reduction in their QE stance.

Consumer Sentiment – Traders will see fresh reports on consumer confidence and consumer expectations this week. No reason to expect any significant reversals from high levels seen the past 12 months.

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