Monday Morning Update November 13, 2017

The Fed – there continues to be a huge disconnect between the Federal Reserve's targets for short-term rates and the market's expectations for when the markets will actually see these targets. Bloomberg now reports better than a 50% chance we will see the Fed move in March 2018. Fed Funds futures, Libor and Eurodollar futures still suggest the first move won't take place until June/July 2018. Maybe only "tomato / tomatoe". Small increases in 3-month, 6-month and 12-month Libor rates continued last week.

Inflation – this week is a big week for inflation data. New data on PPI (Tues), CPI (Wed) and import prices (Thurs) will help to confuse the direction for longer term bonds. The Five Year Forward moved back to the low end of its 5-month range. This move lower for inflation expectations was not confirmed by the 5-year break evens and the 10-year break evens. Wholesale gasoline prices continue to follow the price of crude oil higher.

Treasuries – the yield on the 2-year Treasury moved 4 bps higher last week. The yield on the 5-year moved higher by 5 bps last week. The yield on the10-year spiked higher by 6 bps on Friday. This spike higher on Friday was surprising, considering the geopolitical noise in Saudi Arabia, Iraq and Yemen and the decline in equities last week. Was the increase in Treasury yields oil related ? Worries about inflation data coming out this week ? Worries about the budget deficit numbers getting larger ?

The S&P 500 – all eyes were on the M&A climate last week. A breakdown in the Sprint/T-Mobile deal, a breakdown in the AT&T/Time Warner deal, a "maybe" deal between Broadcom and Qualcomm. All eyes were also on the House tax reform bill and then the Senate's tax reform bill. For the first time in 9 weeks the S&P closed lower on the week; down only .21% on the week, but down nonetheless. The S&P did hit our oft-mentioned target of 2595 last week. Until clear signs of recession appear, and until clear signs of declining earnings and revenue, versus a slowing of earnings growth and revenue growth appear, the S&P should be higher 6 months from now. Expect the S&P 500 to hit 2750 in 2018, and quite possibly in the 1st half of 2018.

Crude Oil – The "corruption coup" that took place in Saudi Arabia and the missile attack between Yemen and Saudi soil last week were enough to keep crude oil prices high. Analysts and strategists revived their hopes and expectations for $60 a barrel average prices for the next few months. For the first time in 6 weeks the rig count was up. Barron's wrote about conditions that could force oil to move up to $90 a barrel. Oil futures peak at $57.33 a barrel in April 2018; it then drops to $53.40 in Aug 2019.

Municipals – if the House bill, as is, passes and if it is agreed to by the Senate, and if signed by Trump, 50% of the tax-exempt muni market disappears. The other 50% of the demand for the tax-exempt muni market remains, since the top tax bracket for individuals stays put at 39.6%. Any decrease in tax deductions is an automatic decrease in political contributions. Political contributions lead to tax deductions and tax deductions deliver political contributions. The purest of the quid pro quos. So chances are slim for any meaningful tax reform. Just maybe some lowering of the top corporate tax rate. A lower corporate tax rate would normally reduce the demand for corporates, but the high level of maturities and coupon payments will offset any reduction in muni demand.

Corporates --- both Investment Grade and High Yield corporate spreads moved higher last week. IG spreads are up 7 bps from their 12-month lows. HY spreads are up 34 bps from their 12-month lows. A function of intense selling of high yield ETFs ? A function of the deal between HY issuers Sprint and T-Mobile ending ? A function of weak earnings from TEVA and Century Link ? A function of a potential reduction in the deduction for interest payment expenses ? A function of profit taking when spreads were at 12-month lows ? The Russell 2000 has been in a downtrend since the first of October. Normally there is a good inverse relationship between the Russell 2000 and HY corporate spreads. Watch both for sign of a change in the recent moves we have seen.

The US Dollar – even though the USD weakened slightly last week, it is still comfortably above its 50-day moving average. But it did move lower while US Treasury yields moved higher last week; an unusual correlation. And the British Pound is trying to stay above 1.31 versus the USD. Prime Minister May is having a tough time with a Brexit implementation.

Global Rate Policies – The yield on the 10-year UK sovereign rose by 10 bps last week. Its yield is still 100 bp less than the yield of our U.S. 10-year. The yield on the German 10-year moved up by 6 bps last week; it is 200 bps lower than the yield of our 10-year. Italy and Spain yields also moved higher last week. The yield differentials between U.S. bonds and global bonds will remain for a very long time.

Consumer Sentiment – The Univ of Michigan reported slightly weaker consumer sentiment last week, but the readings are still very high. Small Business Optimism comes out this week. So does Homebuilders Sentiment. Investors and traders should not expect any significant changes.