

# BondWorks

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The bond market remained in the 140-145 trading range on the bond futures. This week, we tested the top of the recent trading range again, but the blockbuster employment report pulled the bonds back to the middle of the channel again.

Last week, it was the much better than expected Employment Report that knocked the market back, this week is light on economic data but the long bond auction cycle and a strong negative seasonality should keep a lid on the market. Bonds will be supported as they become cheaper and cheaper versus stocks however. Currently stocks are close to 2 standard deviations expensive to bonds so we will be retaining and building on our negative bias toward stocks and looking to come out with a long position following the 30 year Treasury auction on Thursday. Only a convincing break of 140 support on the bond futures will convince us to become more defensive on an intermediate time horizon.

Just a couple of side notes on some events that may have slipped under the radar. While there is still no deal in Greece, European sovereign debt markets have settled down for now. Italian 10 year yields have declined close to 200 basis points (2%) to 5.66%. Canadian federal politicians are actually attempting to do the prudent thing by reigning in spending and planning for a rainy day. Not so much in the good old USA: not sure if anyone noticed but the debt ceiling was quietly raised another \$1 trillion last week. One trillion is a million million. Before you know it, we will be talking about some serious coinage here. After all the partisan belly aching about the debt ceiling through most of 2011, it was refreshing to see that the bloody thing just got done without much fanfare. That ought to last into the fall anyways.

**NOTEWORTHY:** The economic news was mixed last week. Personal Income grew by a solid 0.5% in December, but Personal Spending was flat. The increase in Personal Income was certainly positive, but the unchanged Spending number was overdue as the increased consumer spending during the second half of 2011 was mostly driven by a drawdown of saving as opposed to increases in incomes. Manufacturing appears to be in a rebound mode for now. The Dallas Fed manufacturing Index jumped 18 points to +15, while the ISM Manufacturing Index moved up a point to 54. Mind you, this data series would have been pretty much unchanged if it wasn't for the downward revision of the previous month's number. In spite of the good news on a number of fronts along with the stock market rally that started back in early December, consumer confidence is diverging badly. The Conference Board Confidence Survey tanked 4 points to 61 (versus market forecast of 68), while the RBC Consumer index declined a point to 45. Weekly Initial Jobless Claims dropped 12k to 367k from an again upwardly revised previous number. The monthly Employment Report exceeded expectations by a wide margin. The Unemployment Rate dropped from 8.5% to 8.3%, while Non-Farm Payrolls increased 243k versus expectations of a 140k increase. In addition, the previous months' data was revised up a total of 60k and the annual revisions were also slightly positive. The rest of the details were also solid. This is the type of data that will get confidence and the economy going on a more sustainable growth path. In Canada, the Employment Report was not so positive. The Unemployment Rate ticked up

from 7.5% to 7.6%, while only 2,300 jobs were created last month. This week's economic schedule will include the consumer credit report as well as the trade balances in various countries.

**INFLUENCES:** Our trader sentiment surveys were slightly higher last week. On a scale of 0-10, the survey average is just above 6.5, which is in overbought territory and therefore a slight headwind. The sentiment metrics have been remarkably stable: we have been stuck in the 6-7 range for months now. The Commitment of Traders report showed that Commercial traders hold a long position of 117k 10 year Treasury Note futures equivalents – down 97k from last week. This metric is neutral. Seasonal influences are negative as far as the eye can see now. The technical picture remains neutral, as bonds are stuck in the recent 140-145 range still. The fundamental outlook remains massively supportive, and it looks like the Fed remains committed to do just about anything to prevent yields from rising. Range trading remains in effect until we break out of the recent loop.

**RATES:** The US Long Bond future was down a point to 142-13, while the yield on the US 10-year note increased 3 bps to 1.92% during the last week. The Canadian 10 year yield increased 3 basis points to 2.02%. The Canada-US 10 year spread was unchanged last week. The US 10 year yield is trading 10 bps lower than the Canadian 10 Year yield. The US yield curve was 1 basis point steeper, with the difference between the 2 year and 10 year Treasury yield rising to 169 basis points.

**BOTTOM LINE:** Bond yields were higher in the long end, while the yield curve was practically unchanged. The fundamental backdrop remains supportive for bonds. Trader sentiment is a tad overbought and the Commitment of Traders data is neutral, while seasonal influences are negative again with month end out of the way. We continue to maintain a neutral positioning right now and trade on the day to day news.

**Summary:**

Sector	US	Canada	Comments
Short term rates	Neutral	Neutral	Both the Fed and the BOC made it clear recently that they don't have immediate plans to hike rates
Long term rates	Neutral	Neutral	2% is the happy spot on the 10 year yield – for now.
Corporate spreads	Negative	Negative	Spreads are narrower
Canada-US 10 year spread	Range	Bound	Trading 25 bps either side of even yield.

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