



TUESDAY MAY 17, 2016

	PRICE	CHANGE	VOLUME	UP/DN %	UP/DN VOL %
Dow:	17,529.98	-180.73	4.11	58	70
Nasdaq:	4,715.73	-59.73	1.93	36	40
S&P 500:	2,047.21	-19.45			
10 yr note:	1.76%	+1bps			
Volatility:	15.57	+0.89			
EUR-USD:	1.132	unch	Crude Oil:	48.31	+0.59
USD-JPY:	109.13	+0.18	CRB-Com:	185.86	+1.27

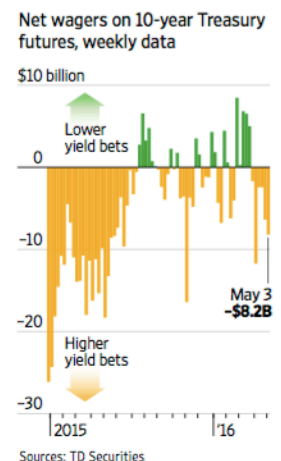


Markets fall as rate hike fears increase. Stronger economic data coupled with hawkish Fed comments send the Nasdaq (-1.3%), Dow (-1%) and S&P 500 (-0.9%) all lower. Volatility gains 6%, in-line with a 1% move in the S&P 500. Despite today's higher volume, the market's lower BB will provide support tomorrow, stemming any further decline.

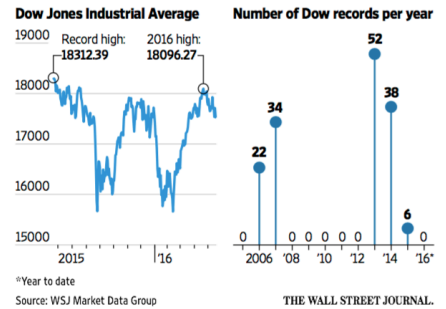
Both John Williams and Dennis Lockhart mentioned a June rate hike was "live," causing rate hike odds for that meeting to gain 11bps to 15% and December odds to gain 13bps to 71% (CME Group, WSJ). Despite higher rates the dollar was relatively unchanged while oil (+1.2%) continued to rally, hitting a 7-month high.

Treasuries have become increasingly risky, as the duration of US government bonds hit a 15-year high last week at 6.29 (Barclays PLC, WSJ). Risking 6.29% if yields were to rise 1% for a paltry 1.75% annual return highlights the perverse incentives of a bubble, as traders neglect rationality for capital gains. The Treasury Index has gained 3.44% so far this year (total return), versus 1.96% for the S&P 500 (total return). Negative foreign interest rates also fuel the bubble, with asset managers left with no other choice now that 80% of government bonds in the developed world yield less than US treasuries. A total of \$9 trillion of government and corporate bonds outside the US now yield below 0% (JP Morgan, WSJ). Foreign demand is apparent: a record 73.5% of bids for last Wednesday's \$23 billion 10-year auction were indirect.

The 2-10 yield curve flattened to 0.94 percentage point, the flattest since December 2007 (see page 3). While the yield curve traditionally flattens during the early stages of a Fed tightening cycle, increasing demand for longer dated notes, as well as a diminished Treasury supply, has exacerbated this effect.



The Dow (-4.3%) and S&P 500 (-3.9%) still rest below their record highs hit nearly a year ago (May 19 and 21, 2015, respectively). Weak earnings, less stock buybacks and higher rates have held the market back. With 460 of the S&P 500 reporting a 7% drop in earnings from a year ago, earnings are set for their 4th consecutive quarterly decline (FactSet). Furthermore the market trades at 18.5 trailing 12 month earnings, above its 15.8 10-year average. Companies authorized \$276.7 billion in stock buybacks this year, a 38% decline from the 447.4 billion authorized at this point last year (Birinyi Associates, WSJ). Nevertheless the past 12 months of buybacks since April (\$732 billion) is still the 3rd largest since data began in 1985.



Downbreakout worked well today.



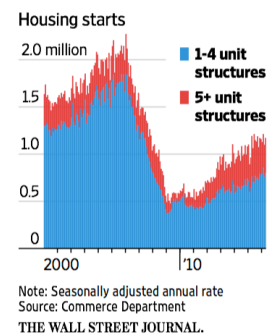
ECONOMIC REPORTS:

April CPI: +0.4%, +0.2%. Mirroring import and producer prices recently, consumer prices gained the most since February 2013 last month as gasoline prices (+8.1%) jumped. Core prices are 2.1% higher over the past year, their 5th month of annual 2+% growth, the longest streak in 4 years (WSJ). Nevertheless the Fed preferred PCE gauge is less optimistic on inflation, only 0.8% higher annually while its core component is up 1.6%.

April Housing Starts: +6.6%. Despite jumping in April housing starts are still 1.7% below their year-ago level. Building permits gained 3.6% in April, but they too also below their year ago level (-7.2%). Low inventories of homes have curtailed new home sales, a trend that will persist until housing starts show sustained growth.

April Industrial Production: +0.7%. Industrial production rose the fastest since November 2014 last month (See figure on next page). Growth in manufacturing (+0.3%) and utilities (+6%) offset a decline in mining activity (-2.3%). A weaker dollar is bringing life back into the dormant manufacturing sector so far during the second quarter.

1Q E-Commerce Retail Sales: Online sales continue to replace brick and mortar store sales just like mobile computing is replacing traditional personal computers. E-sales rose 3.7% in the first quarter and 15.2% over the past year. As a percentage of total sales, e-commerce gained 30bps to 7.8%.



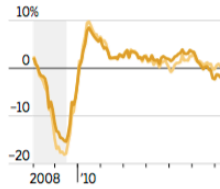
Consumer-price index
change from a year earlier

■ All Items
■ All items except food and energy

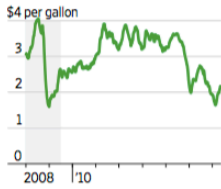


Industrial-production index
change from a year earlier

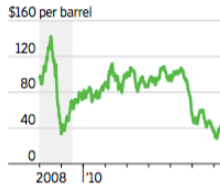
■ All industries
■ Manufacturing only



Retail gas prices
weekly, regular, conventional
\$4 per gallon



Crude-oil prices
weekly
\$160 per barrel



Sources: Labor Department via Federal Reserve Bank of St. Louis (CPI, production);
U.S. Energy Information Administration (gas, oil)

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