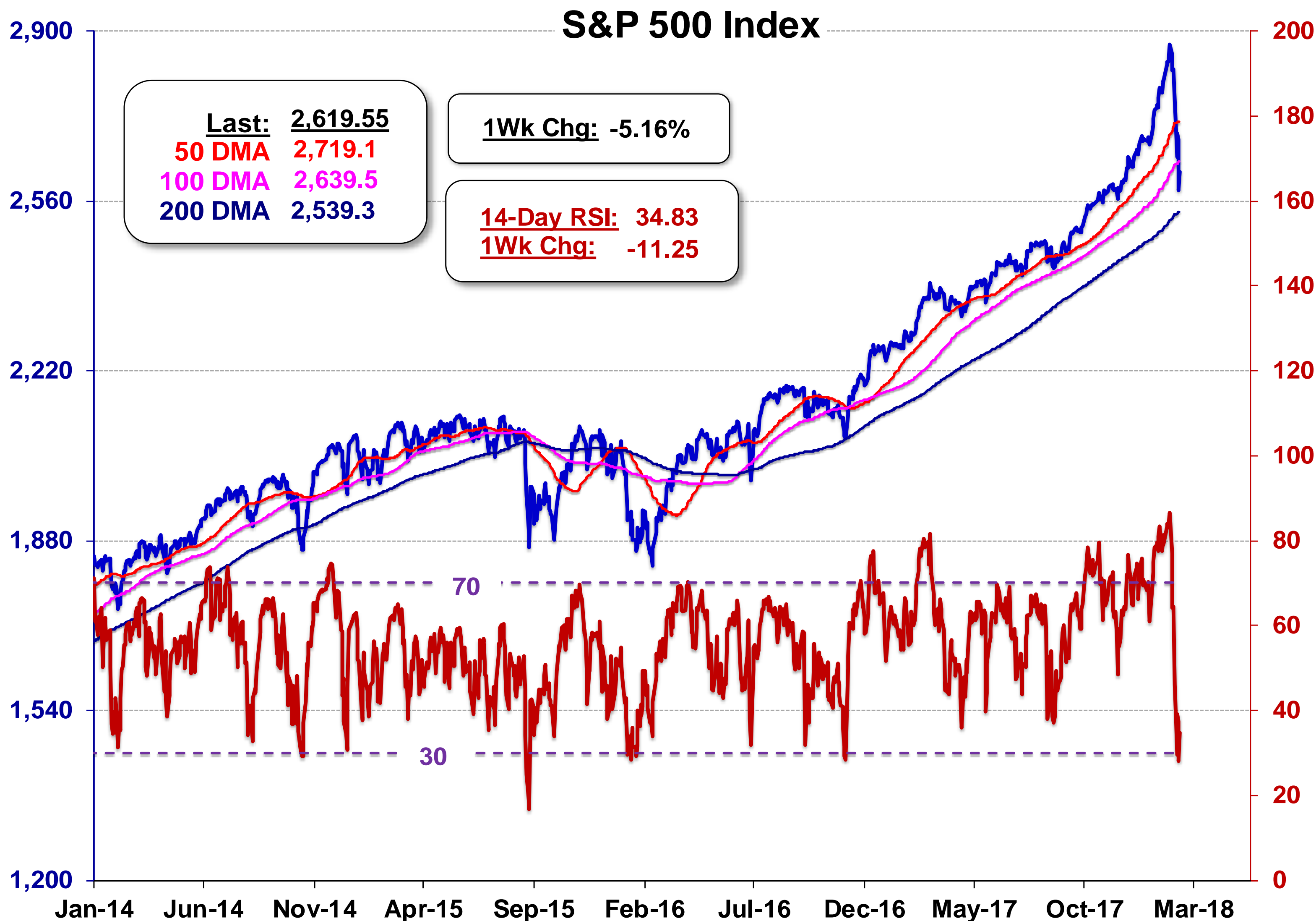
As noted in our first report of the year, the market was likely set for a decline of some not-insignificant magnitude as 10yr yield presses up against long-term (30yr) trend line and as the Fed continues QT and rate hikes. So, is the market retreating because of inflation fears, or because of debt fears in a higher interest rate regime? We'll go through several charts covering these possible culprits in this week's roundup (see pp.9-18). In our estimation, it's largely based on debt fears. For if the economy, as the Fed seems to indicate, is so strong (we certainly have issues with this assertion) then why the market panic as 10yr yield rises to a mere 2.8-2.9%? Short answer: the economy is not nearly as strong as the consensus believes and the market must rely on cheap credit to sustain heightened/excessive equity valuations (see: dividends & buybacks). With the QE spigot turned off and now headed in reverse, this leaves the specter of soaring debt interest payments as the Fed continues with its rate hike plans (for now). Higher interest rates (and reduction of Fed balance sheet) in a low growth and high debt environment is a sure way to spark market turmoil.

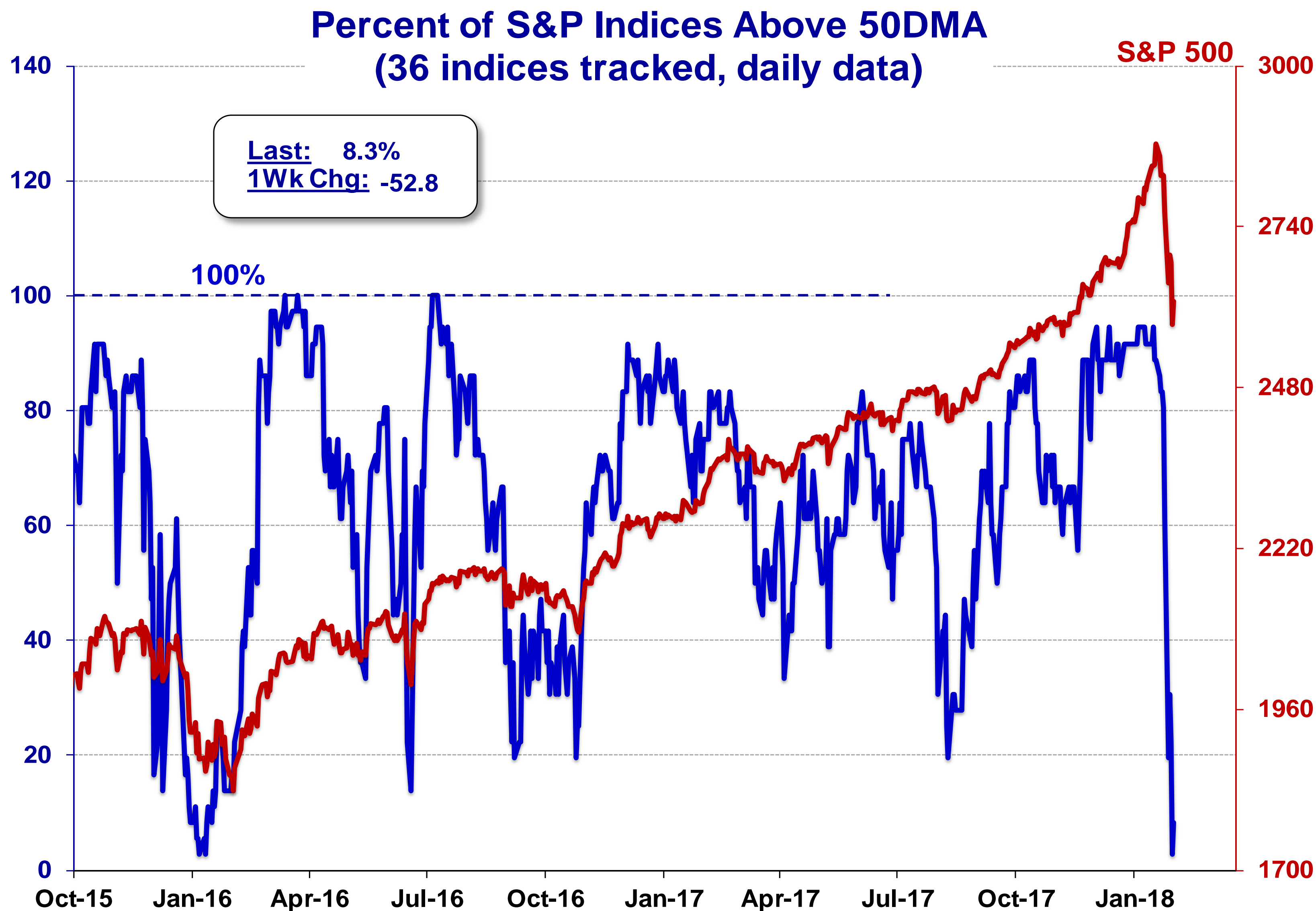
However, Fed officials clearly are not panicking yet whatsoever. On Friday, NY Fed President Dudley made a rather stunning remark, saying the selloff so far was "*small potatoes*", a sentiment essentially echoed by his colleagues who believe economic fundamentals are solid, paving the way for further rate hikes. James Bullard exclaimed "This is the most predicted selloff of all time", citing excessive market gains. Dallas Fed President Kaplan said rising volatility "may be addressing some of the excesses and imbalances in the markets", and from former Dallas Fed President Fisher: "...unless something super-dramatic happens to the economy, they're going to continue on their rate hike path, maybe even four this year" (we've got a couple of beauties in here for Mr. Fisher!, see pp.13-14). Perhaps the Fed's intention is to 'punish' markets for excessive risk, which means they're willing to let quite a bit of wind out of the sails before stepping back in with further accommodation. In our estimation, markets will soon test the Fed's resolve. As such, let's remember a quote from James Bullard in October 2014: "…if the market is right, and this is portending something more serious for the U.S. economy, then the committee would have an option of ramping up QE at that point". Something tells us he may use this line again in the not too distant future.

As we've highlighted for a long time in our reports, there are a wide swath of indicators pointing to a stressed consumer and a domestic economy which, while improving, is a good distance away from where it should be at this stage of the recovery...and likely in no condition to sustain higher interest rates. We will know soon enough.

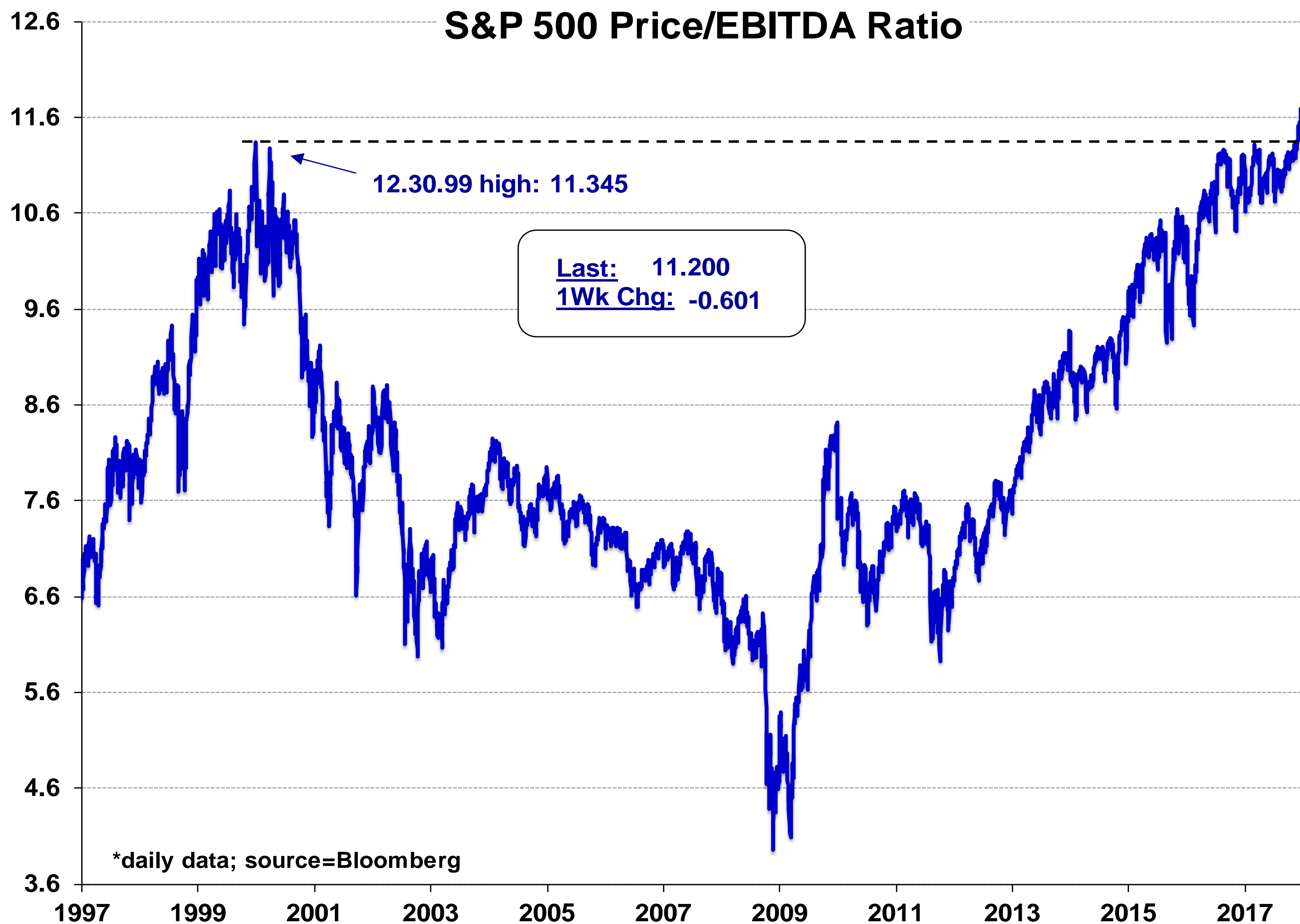
S&P 500 briefly broke below 200DMA on Friday before staging an afternoon rebound; RSI dipped below 30 yet rebounded to finish the week at 34.8.



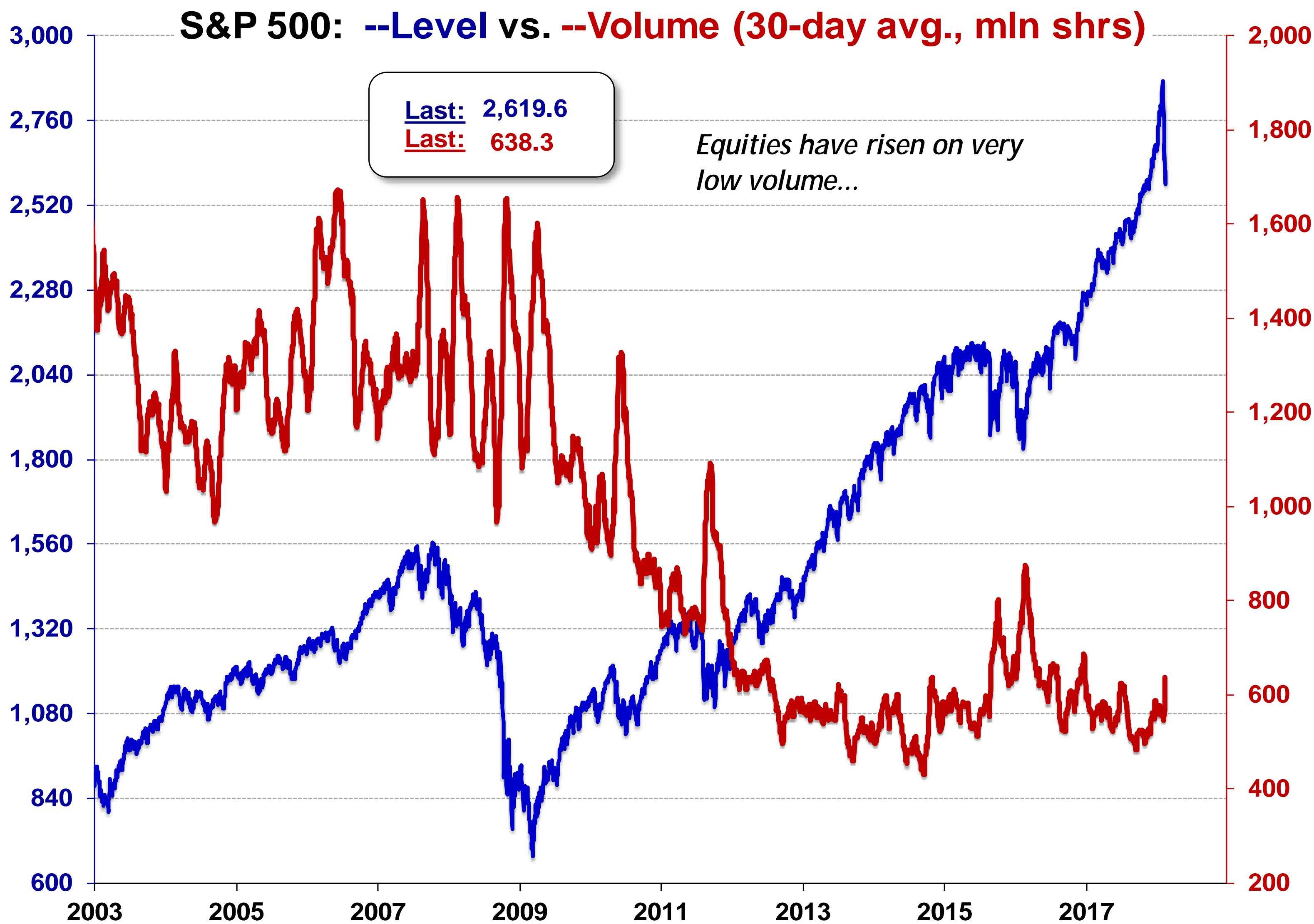
Percent of S&P Indices above 50DMA crashes to lowest since January 2016



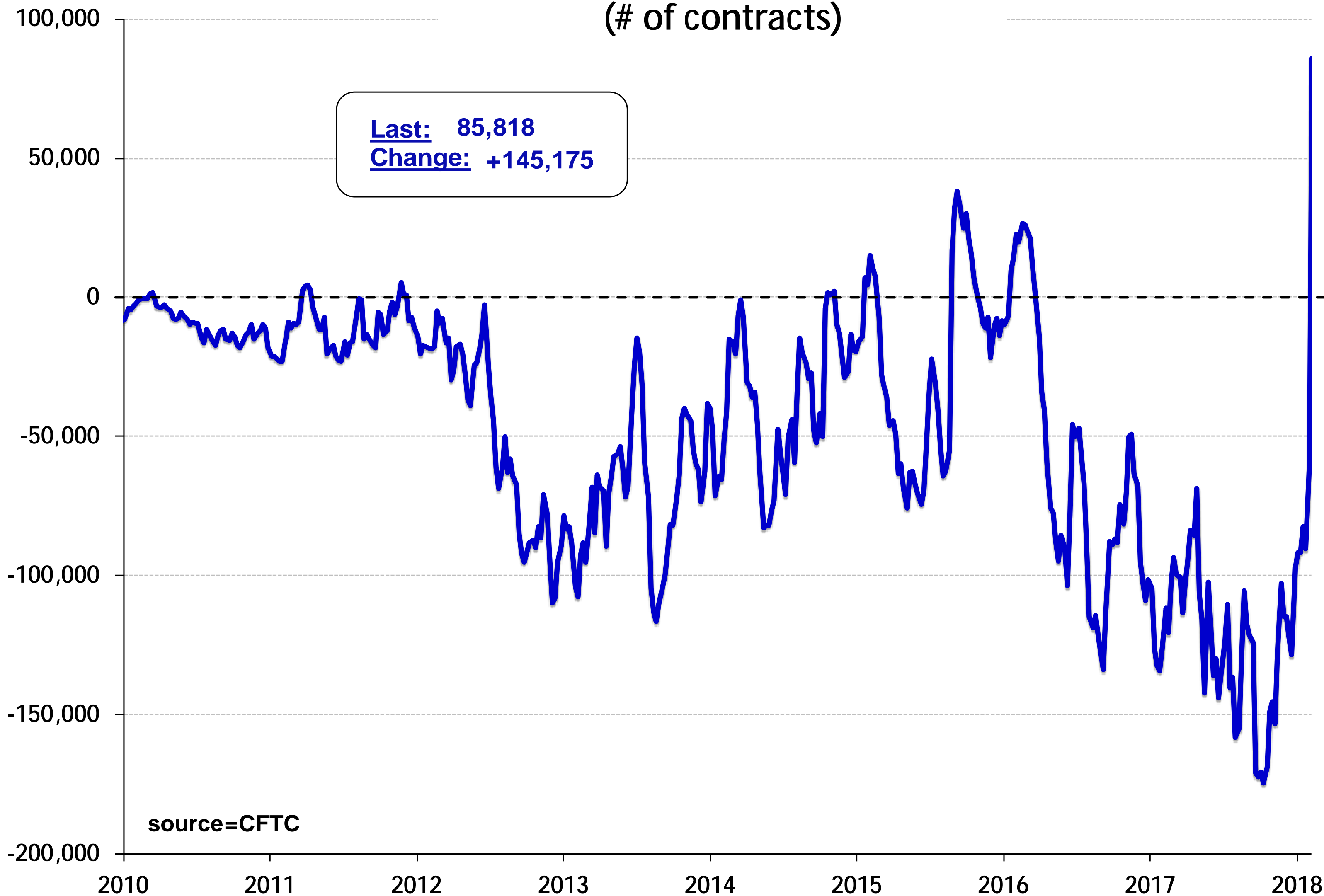
While Price/EBITDA Ratio has retreated in last couple of weeks, it remains elevated…slightly below previous (1999) record high.



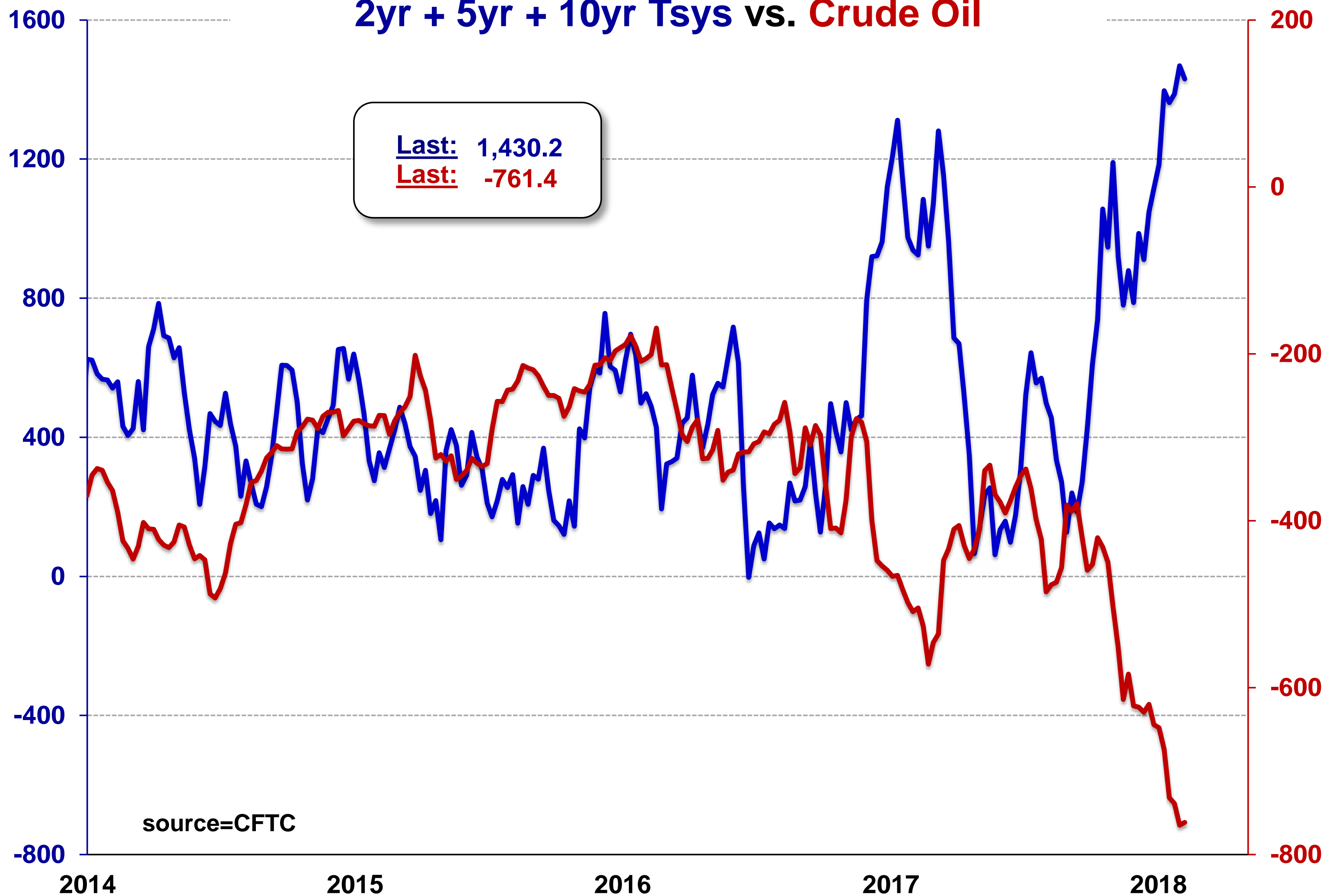
The market decline has been sharp, yet volume has been relatively low compared to prior selloffs, perhaps a signal the market retreat is just warming up.



Sharp rise in volatility leads Speculators to not only cover their entire short position, but turn record net long. A stunning and historic reversal.

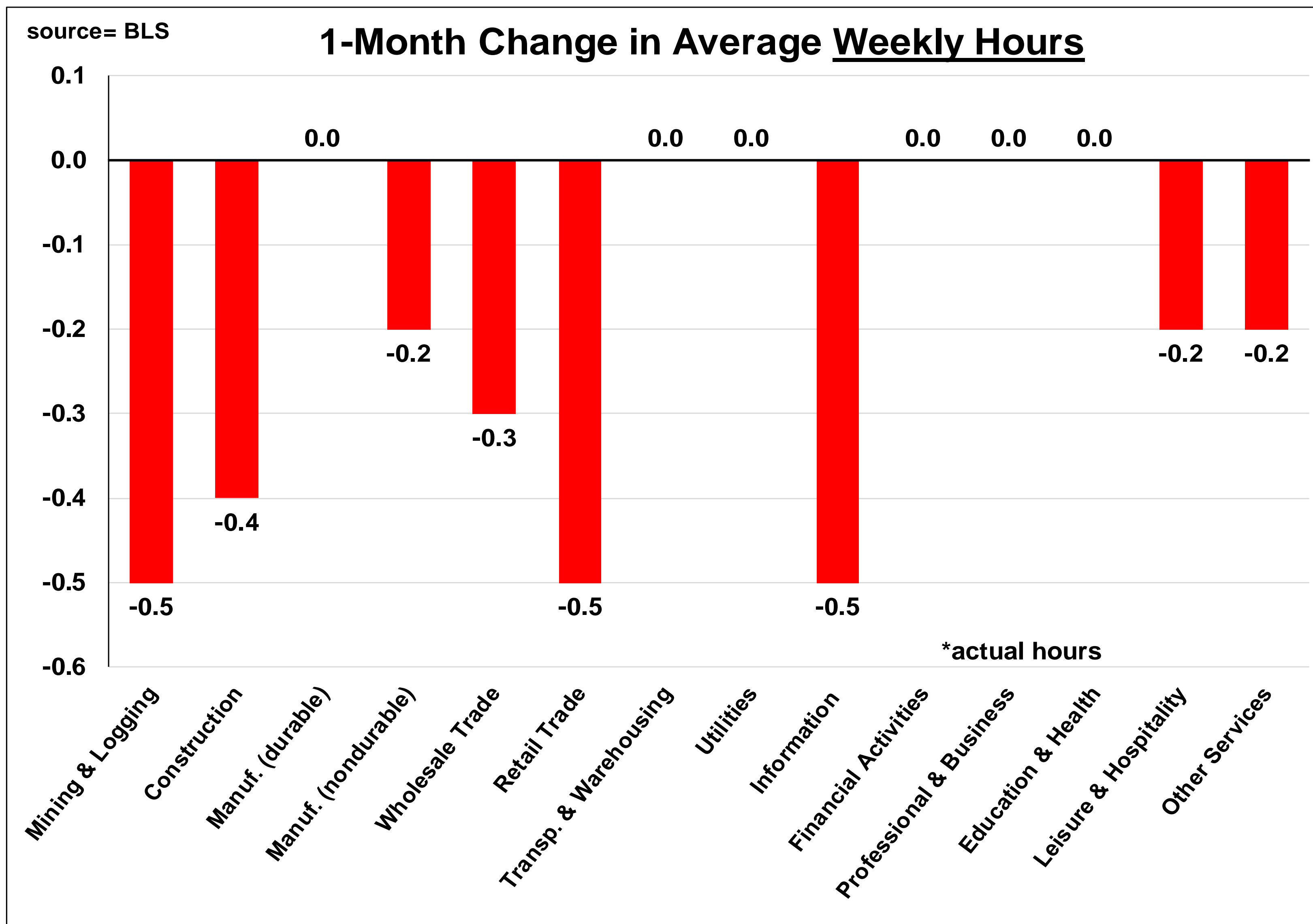


As of Tuesday CFTC data, we still find Commercial traders remain near record long the Treasury complex and near record short Oil. If equities are set for a deeper correction, the bond bull market will soon resume and Commercial positions will unwind.

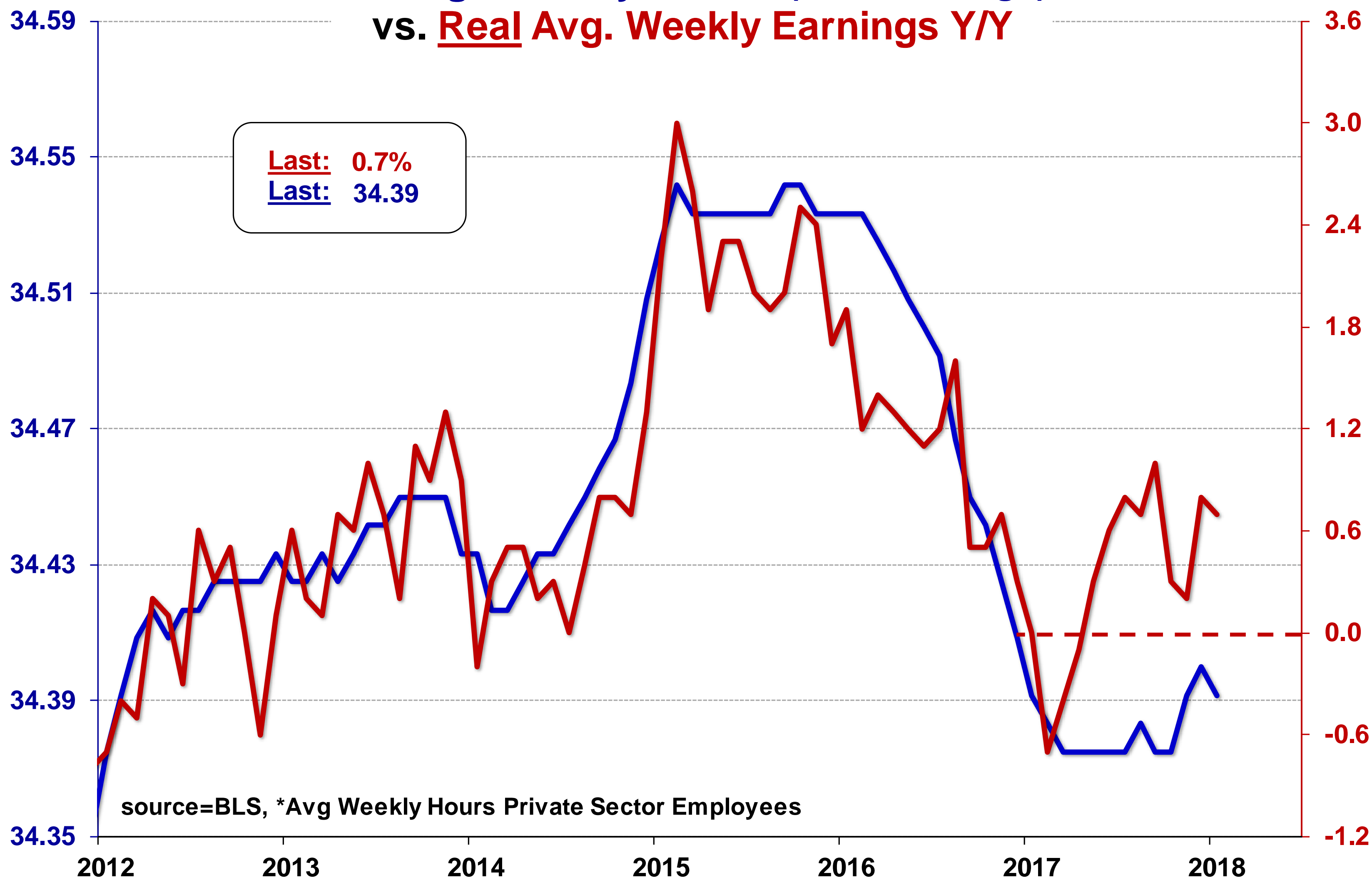


From our January report *The Good, The Bad, and The Ugly*: As 10yr yield pushes up against long term trend, "***we anticipate a stock market retreat of some not-insignificant magnitude is nearing as a 'rate hike tantrum' takes hold***'. With 10yr Yield having now broken above long-term trend, the market is clearly spooked. The last time 10yr yield broke above trend was late June/early July '07 which marked the first peak of the S&P double-top before start of market downturn 3 months later. Note: Fed Funds rate in July 2007: 5.3%; today: 1.42%.

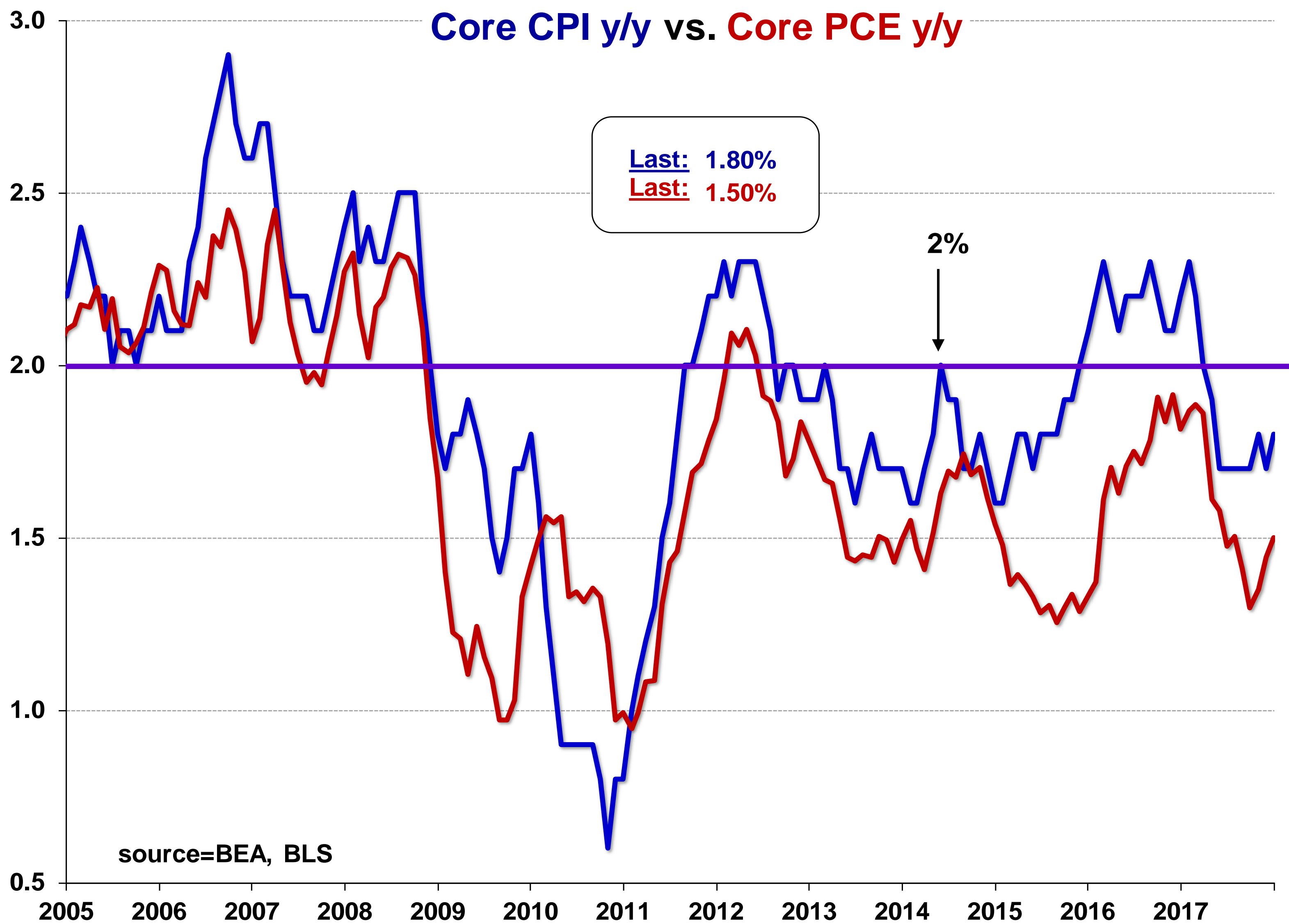
Wage inflation fears? Latest employment report showed Average Hourly Earnings y/y jumping to 2.9%, highest since June 2009. **Now the bad news**: Weekly Hours declined in 8 of 14 major employment groups while the rest were unchanged.



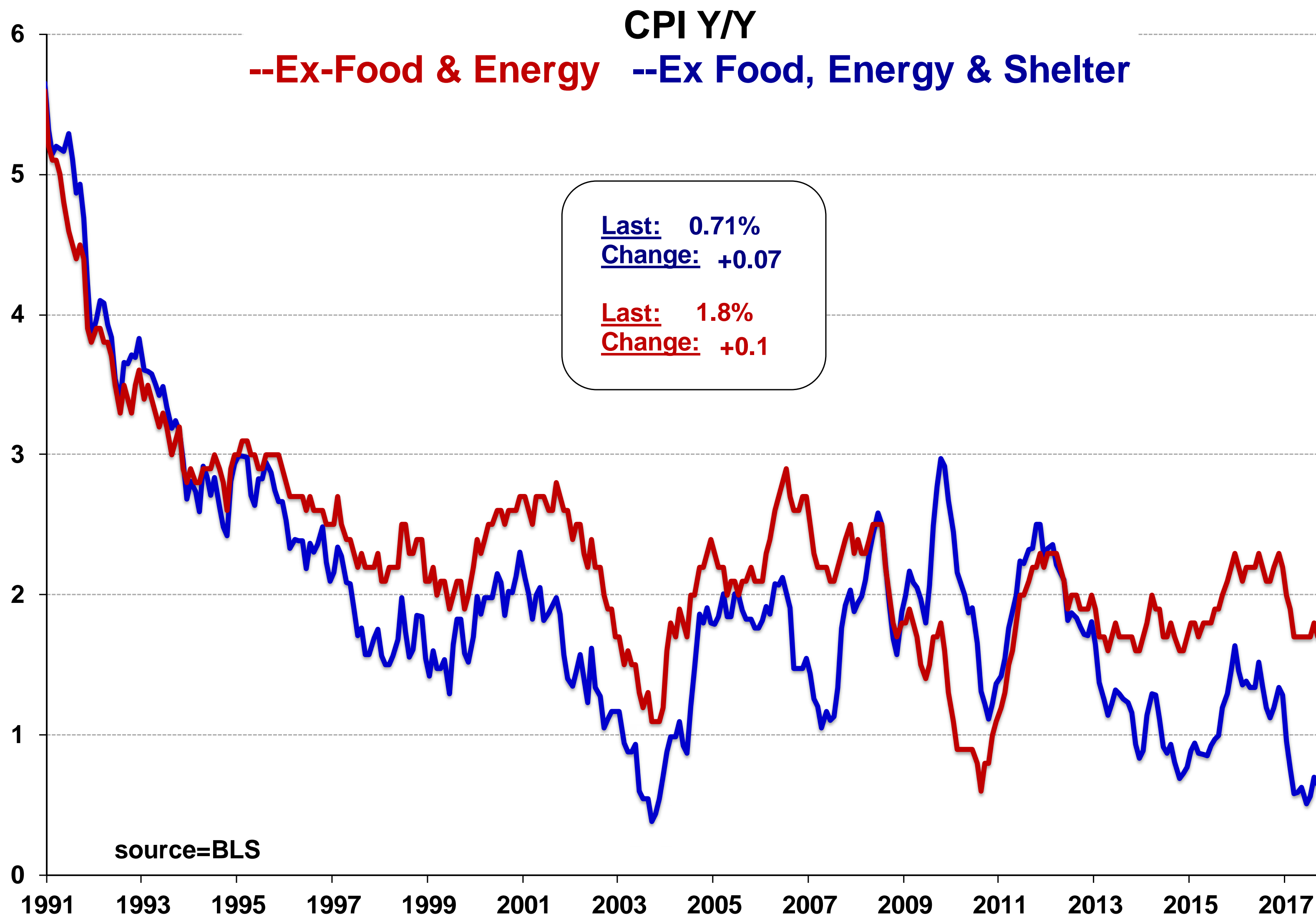
12-month average of Weekly Hours remains at lowest level since 2012. This Wednesday we will see the updated Real Weekly Earnings data along with the CPI release. Even should CPI come in at the expected 1.9%, this will push up the real earnings data only slightly (likely still a sub-1% y/y reading), a very weak level.



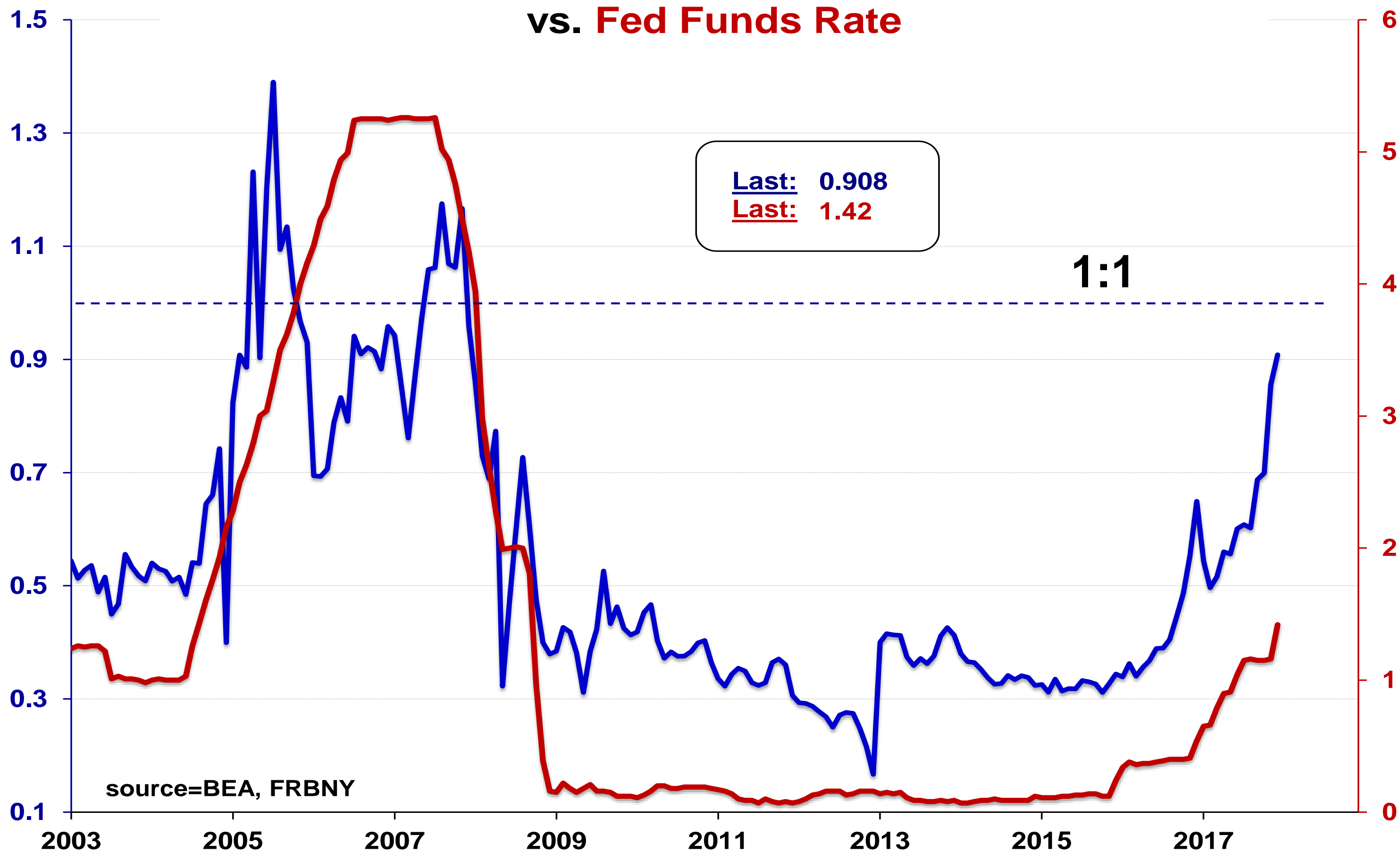
Inflation fears? Outside of a brief blip above 2% in late 2011/early 2012, **Core PCE (the Fed's preferred inflation measure) has been below 2% since October 2008.**



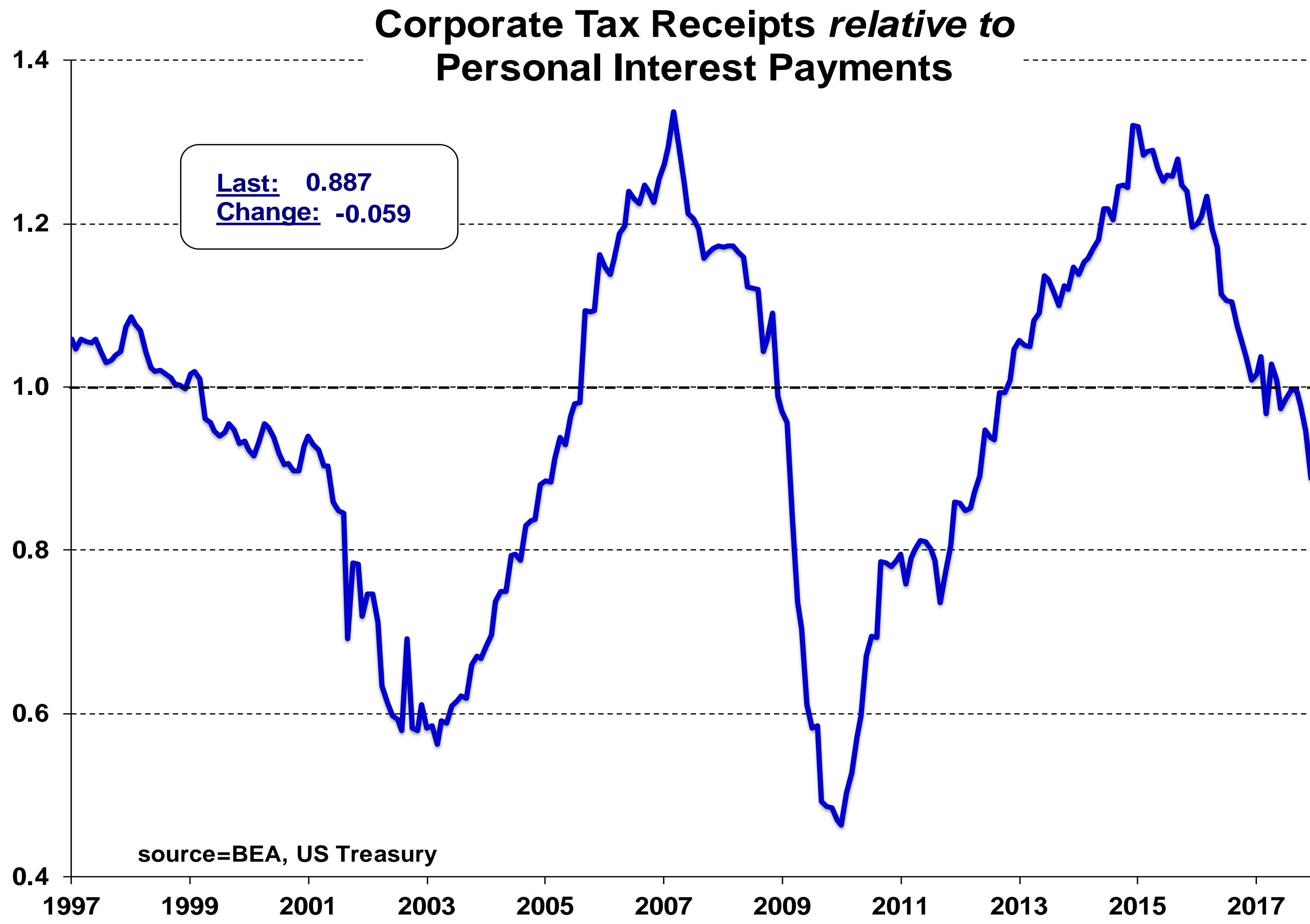
Inflation fears? CPI ex-Food, Energy & Shelter: 0.7% y/y…**one of lowest prints on record**. Note: Shelter largely comprised of Housing, Utilities, Health & other Insurance, plus other mostly 'mandatory' service outlays. As such, this index essentially shows core Goods inflation…which is near historic lows.



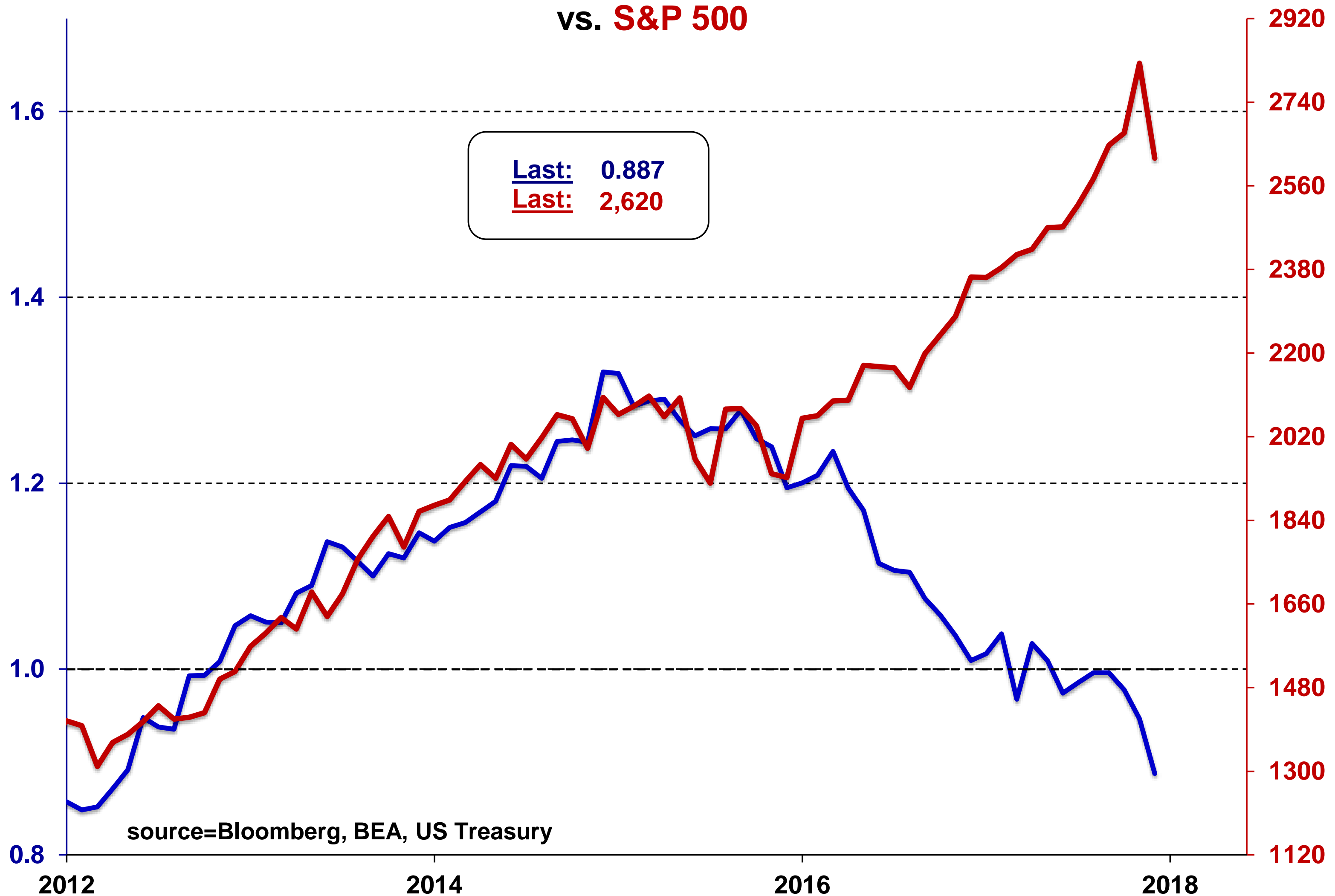
Meanwhile, on the debt side: as banks have been slow to raise interest rate on savings deposits yet quick to raise rates across the consumer loan spectrum, we find Personal Interest Payments are set to exceed Savings for just the 4th time in history. Will wages rise to the challenge, allowing for reduction of consumer debt and increase in spending? Given the above earnings data, we've our doubts. As noted in our previous Macro Weekly, bonuses are good; ***increases in wages and hours*** are obviously far better and we've yet to see this materialize. In short: if the average consumer is paying more in loan interest than they are saving, outlook for spending (and the economy) is not encouraging. Further rate hikes will certainly do consumers no favors in this regard.



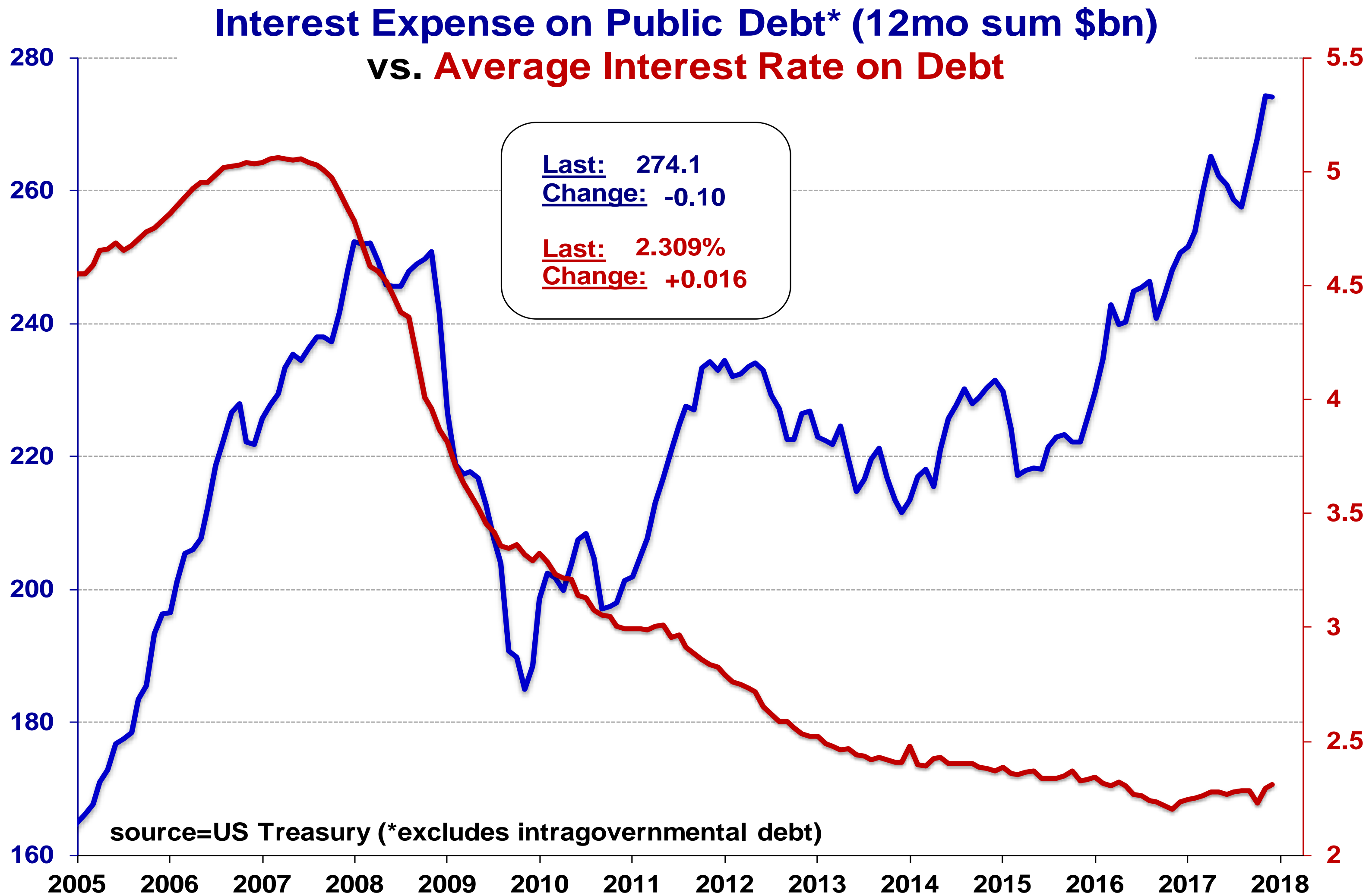
To add insult to injury for indebted consumers, **Personal Interest Payment outlays now comfortably exceed total US Corporate Tax Receipts.** Tax cut implementation had better benefit the workforce in a big way, and tout suite, or this has recession written all over it. Yet, will tax relief and/or wage increases be enough to offset rise in consumer debt servicing in a higher interest rate regime? This in addition to rising Healthcare & Housing expenses of course….all pointing to persistent headwinds for the consumer.



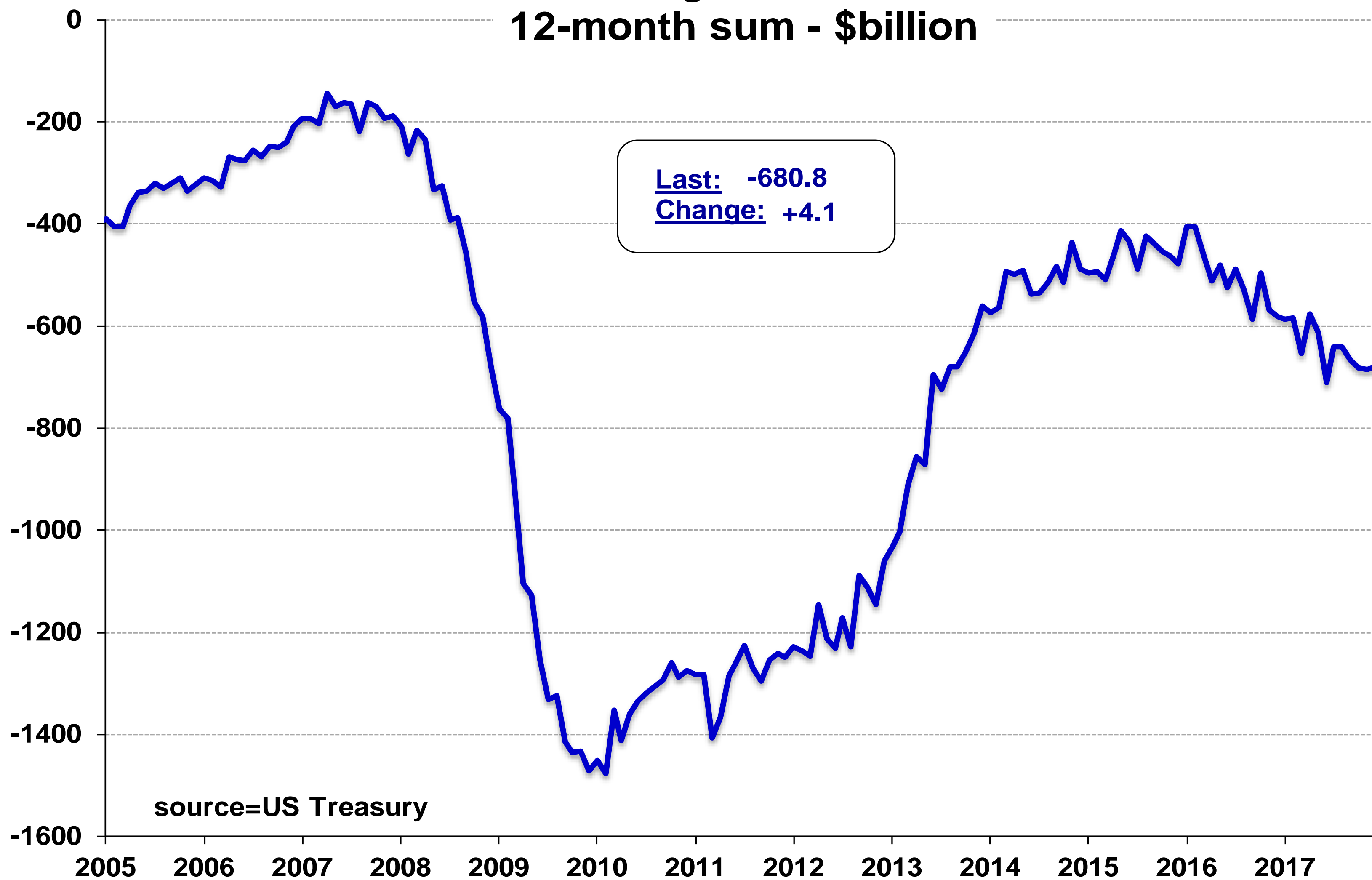
Declining Corporate Tax Receipts and soaring Personal Interest payments make for a bad cocktail. To say the market has extended well-out over its skis (as we've pointed out on more than a few occasions) is an enormous understatement.



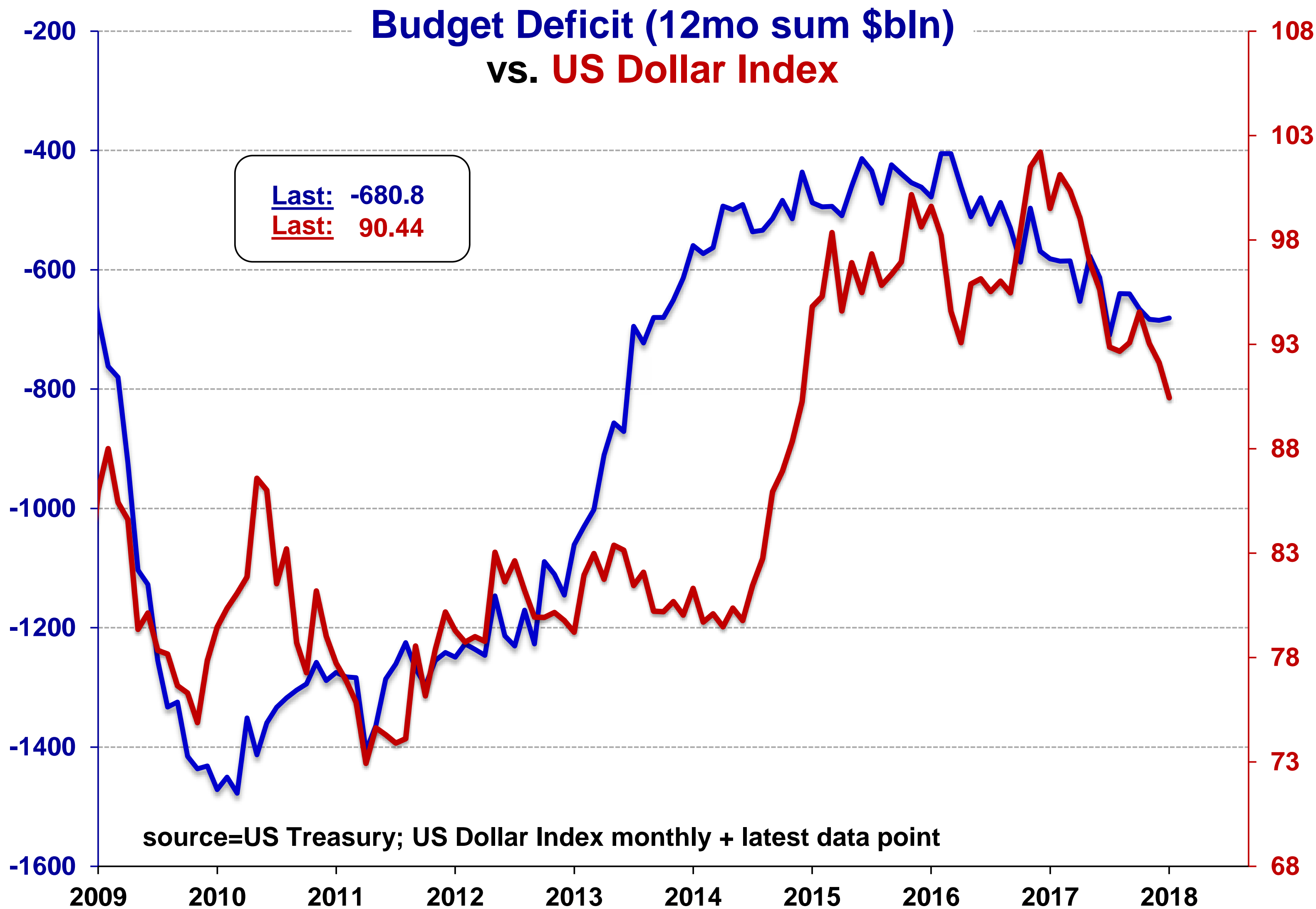
Interest Expense on Public Debt (excluding intragovernmental debt) sits at record highs with Average Interest Rate on Debt barely above record lows. According to CBO, debt interest rate is set to rise to a mere 3.5% by 2027 which equates to $820 billion in annual interest expense…thus making it the second largest Federal outlay behind Social Security. This would be an entirely unsustainable situation, of course only leading to more borrowing.



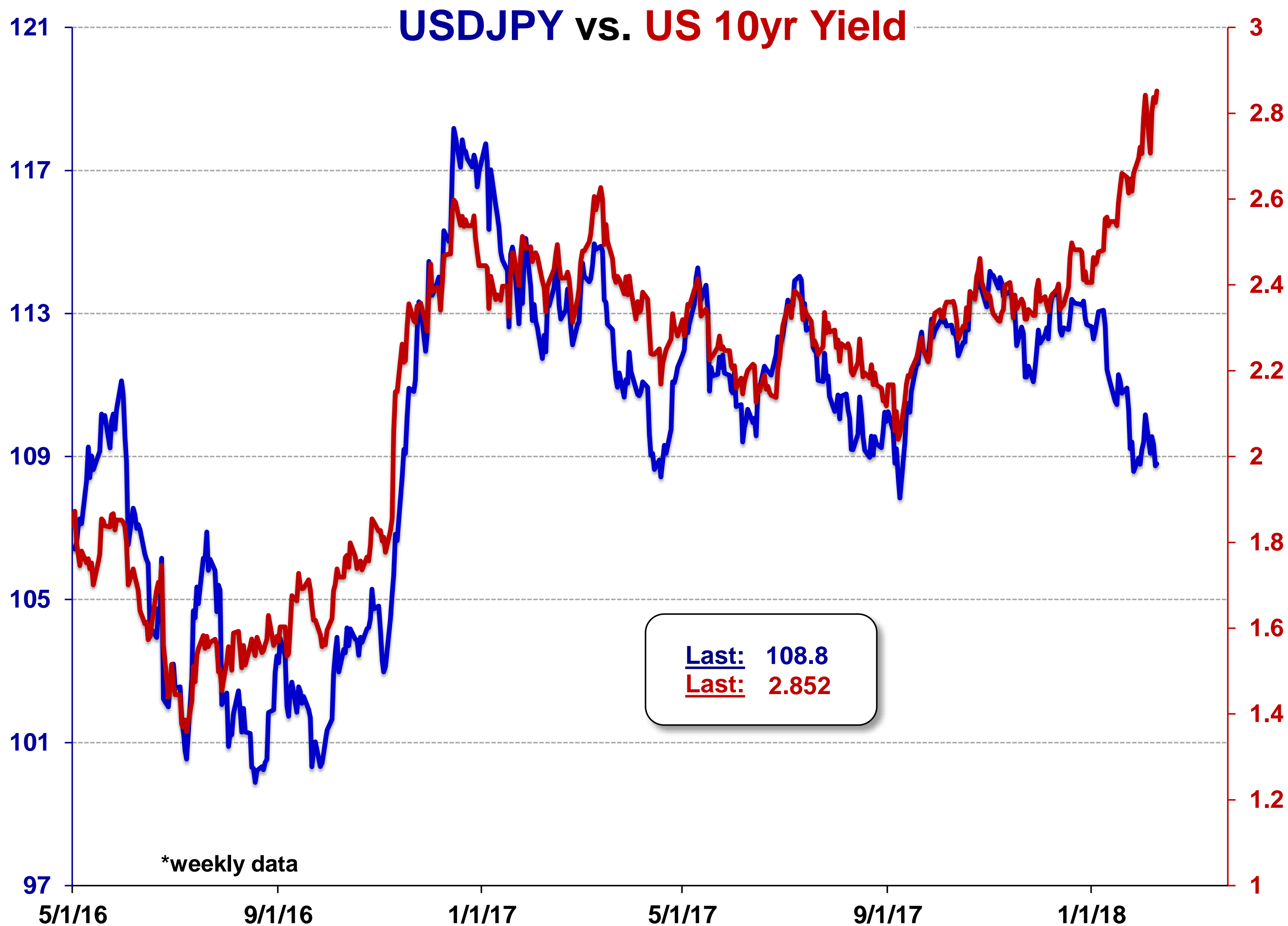
Latest CBO Budget Projections show 10-year (2027) deficit at just over $1.3 trillion, exactly double where it stands today…and this before reviews of latest Tax Cut effect and before seeing what an Infrastructure Bill will add to deficit worries. One thing is clear: nobody in DC is talking about ways to reduce the national debt.



As such, we see no positive scenario for the Dollar going forward outside of periodic fluctuations. Lower highs followed by lower lows seems all but inevitable.

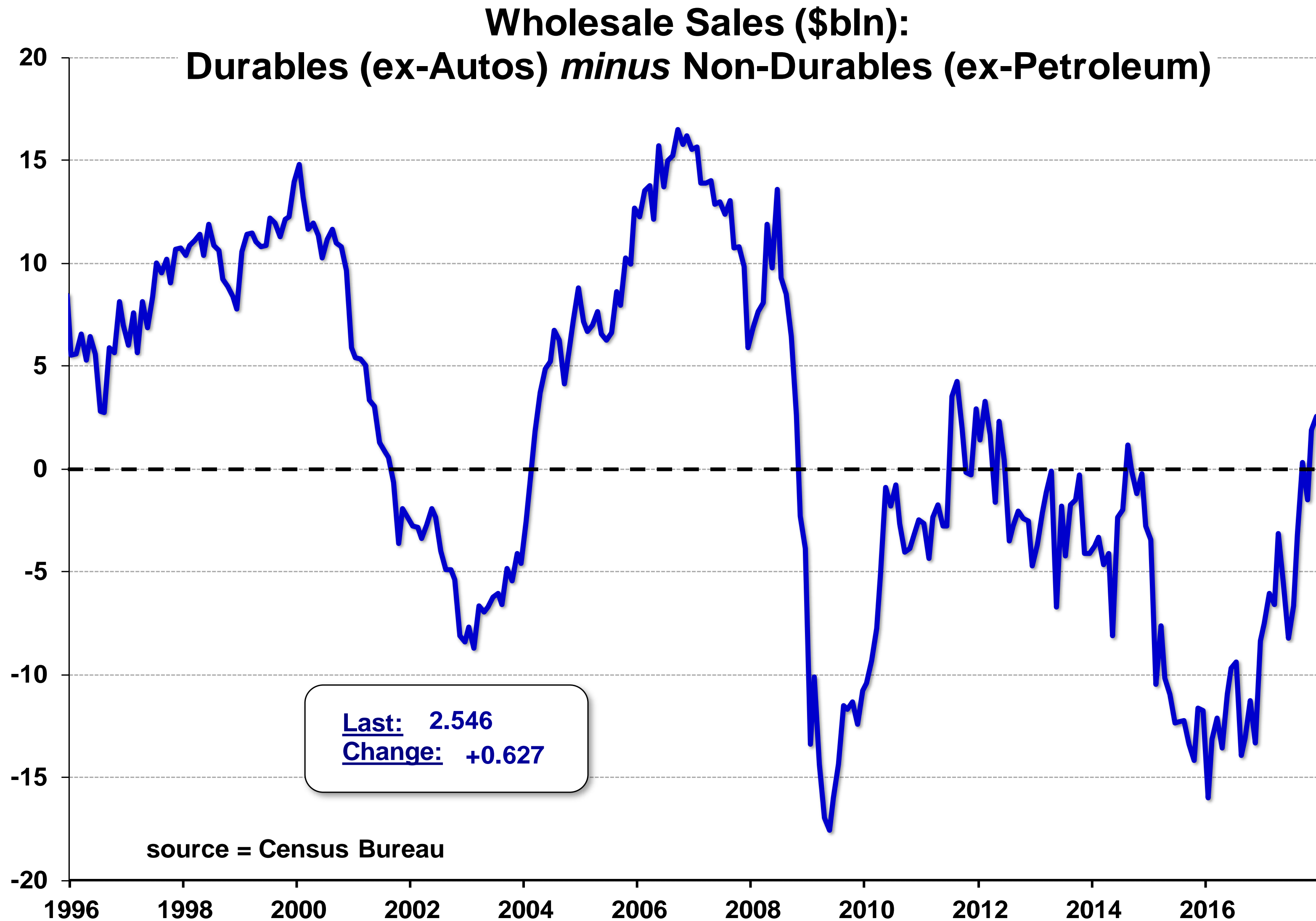


Should the market correction continue (which seems likely), there's little doubt the Fed will eventually change their tune and begin discussion of further accommodation. And with that, yields will swiftly reverse course and have to catch down to a rapidly falling dollar.

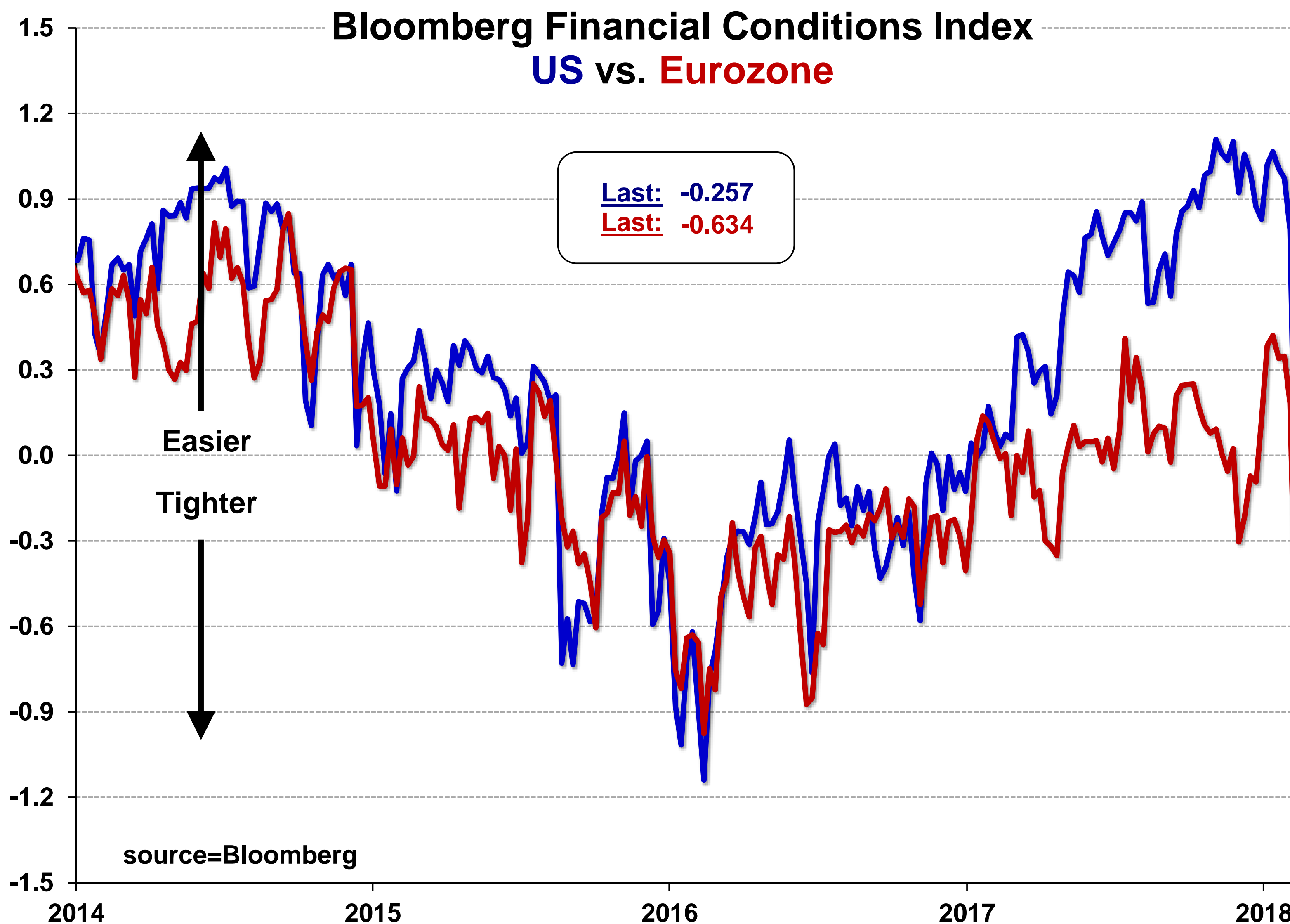


On to other charts of the week…

Good news: our 'ex-autos & petroleum' look at Wholesale Sales data reveal Durables minus Non-Durables continues into positive territory. Still a weak level, yet moving in the right direction.



US Financial Conditions Index tumbles into negative territory. While this does signal tighter conditions, it is still above Feb. 2016 low of -1.35 and well above October 2008 reading of -12.5.



Since the start of the Fed's QT (quantitative tightening) program in October, total Fed Bank Credit is down a mere -1% ($44bln); Treasury Securities down -1.2% ($29bln). If the market continues to react as it has to this scant reduction in Fed Credit, one wonders what's in store for markets if they follow-through with accelerated reductions.

All data from Federal Reserve H.4.1 Weekly Statistical Release

Factors Affecting Reserve Balances of Depository Institutions ($billion)

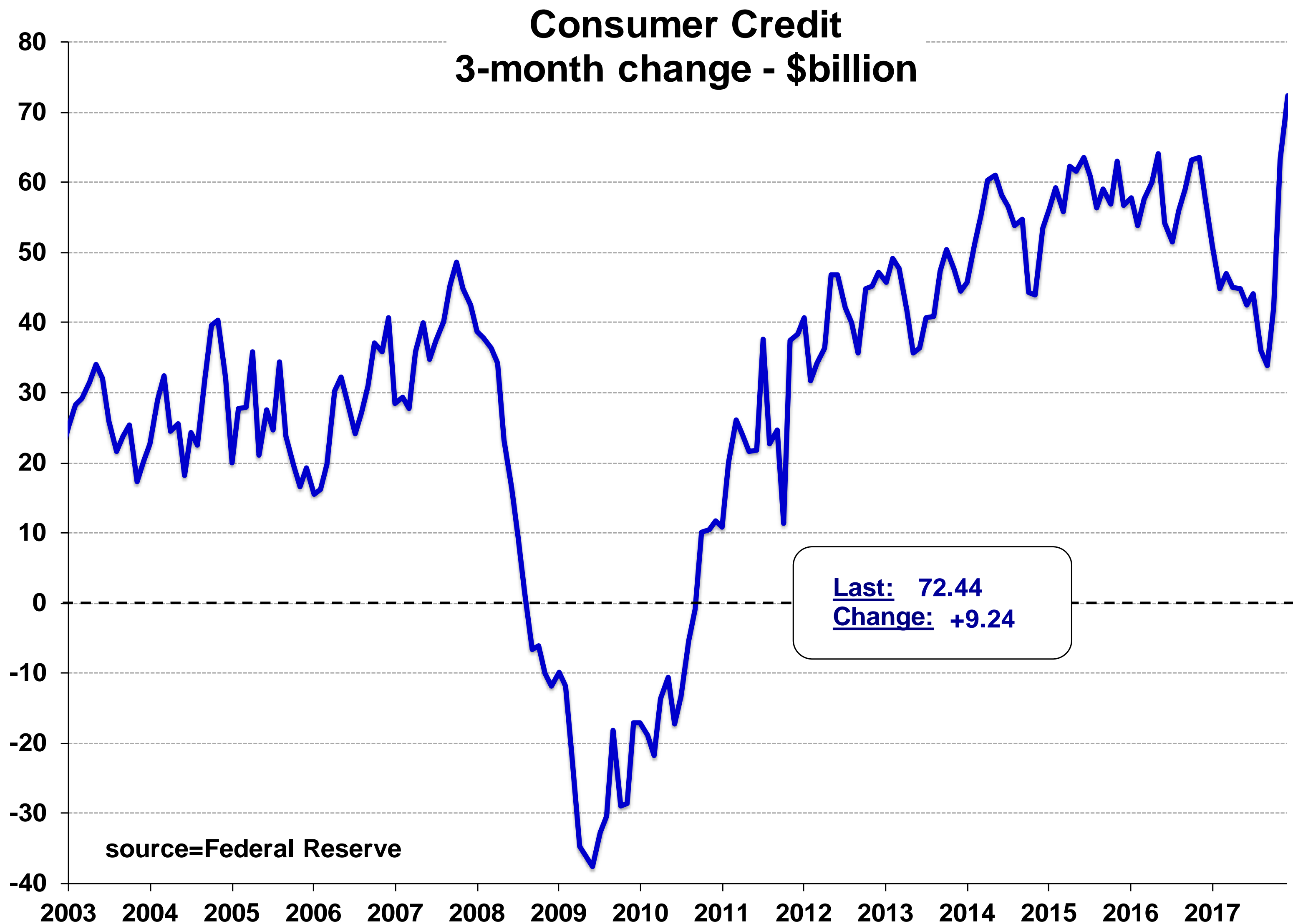
	Week Ending 2/7/18	Change from Prior Week	% Change From Prior Week	Change From October 2017	% Change From October 2017
Total Reserve Bank Credit	4,379.46	-8.543	-0.19%	-44.314	-1.00%
Securities Held Outright	4,201.33	-9.268	-0.22%	-45.001	-1.06%
--US Treasury Securities	2,436.20	-9.268	-0.38%	-29.235	-1.19%
Bills	0.00	0.000	0.00%	0.000	0.00%
Notes & Bonds (nominal)	2,307.59	-10.894	-0.47%	-29.735	-1.27%
Notes & Bonds (inflation-indexed)	109.41	+1.637	+1.52%	+0.001	+0.00%
Inflation Compensation	19.194	-0.012	-0.06%	+0.498	+2.66%
--Agency Debt Securities	4.391	0.000	0.00%	-2.366	-35.02%
--Mortgage-Backed Securities	1,760.74	-0.001	-0.00%	-14.261	-0.80%
Unamortized Premiums	157.16	-0.276	-0.18%	-5.700	-3.50%
Unamortized Discounts	-14.07	-0.007	+0.05%	+0.387	-2.68%
Repurchase Agreements	0.00	0.000	0.00%	0.000	0.00%
Loans	0.017	-0.054	-76.06%	-0.216	-92.70%
--Primary Credit	0.008	-0.055	-87.3%	+0.001	+14.3%
--Secondary Credit	0.00	0.000	0.00%	0.000	0.00%
--Seasonal Credit	0.009	+0.001	+12.50%	-0.217	-96.02%
--Other Credit Extensions	0.00	0.000	0.00%	0.000	0.00%
Net Portfolio Holdings of Maiden Lane	1.715	+0.001	+0.06%	+0.007	+0.41%
Float	-0.146	+0.238	-61.98%	+0.161	-52.44%
Central Bank Liquidity Swaps	0.039	-0.634	-94.2%	+0.002	+5.4%
Other Federal Reserve Assets	33.413	+1.458	+4.56%	+6.907	+26.06%
Foreign Currency Denominated Assets	22.047	-0.089	-0.40%	+0.741	+3.48%
Gold Stock*	11.04	0.000	0.00%	0.000	0.00%
Special Drawing Rights Certificate Account	5.20	0.000	0.00%	0.000	0.00%
Treasury Currency Outstanding	49.451	+0.014	+0.03%	+0.294	+0.60%
Total Factors Supplying Reserve Funds	4,467.20	-8.618	-0.19%	-43.279	-0.96%

*note: Gold Stock valued at $42.22/oz since end of gold standard in 1971

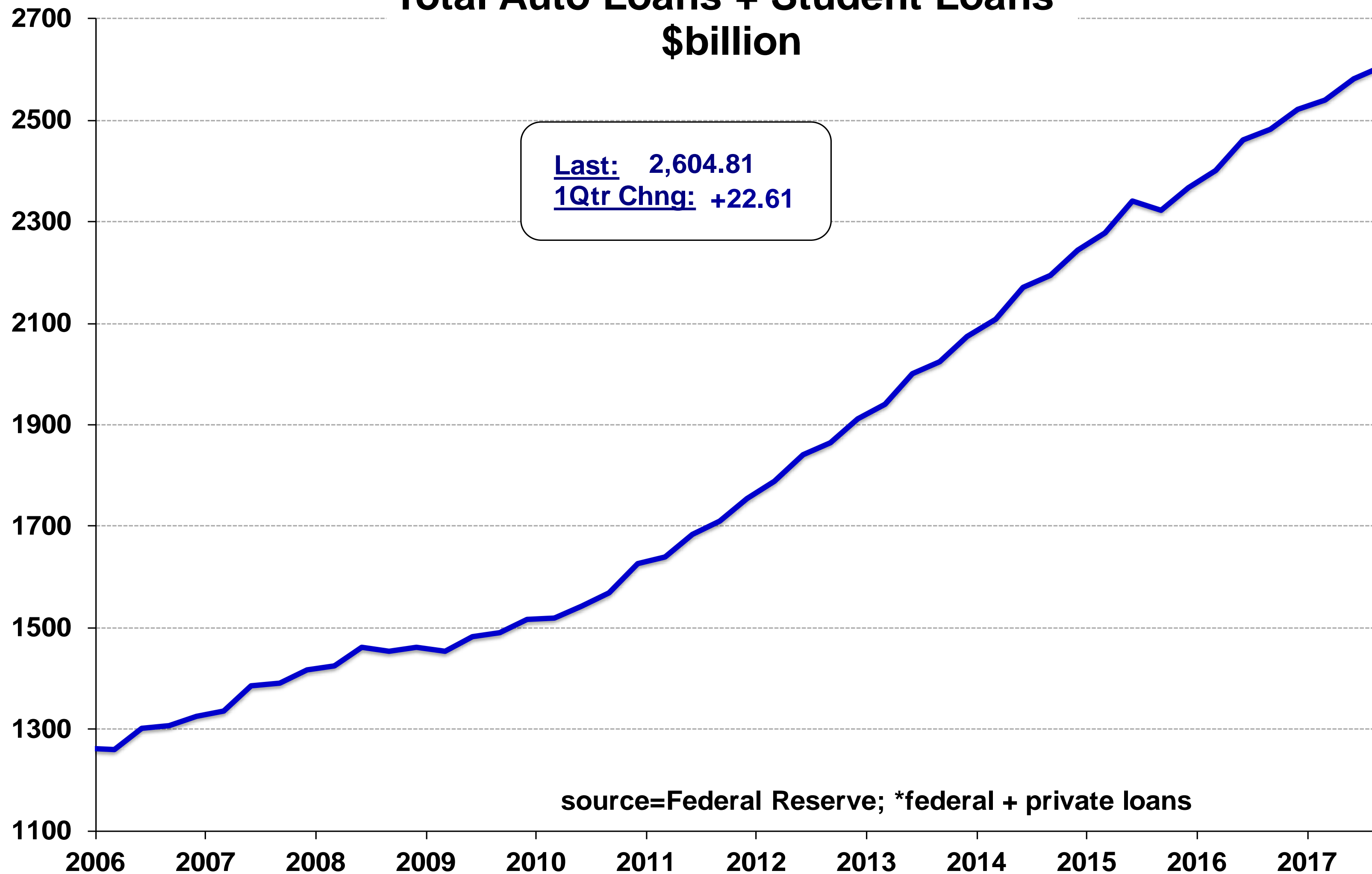
Gold has dropped -3% from recent (late January) high of $1358/oz, yet the steady recovery since December 2015 is certainly intact and, given the trajectory of debt, deficits and the dollar, we expect higher prices are ahead.

Meanwhile, gold miners continue to struggle. HUI has not only given up all gains since Gold's surge began in December, but finished Friday at lowest level since December 2016. The HUI/Gold ratio sits at one of the lowest readings on record, lower than when Gold was ~$265/oz in 2000. While we expect the recent miner rout to turn around in coming days, once gold breaks above the $1400-$1450 level the miners will surely surge higher.

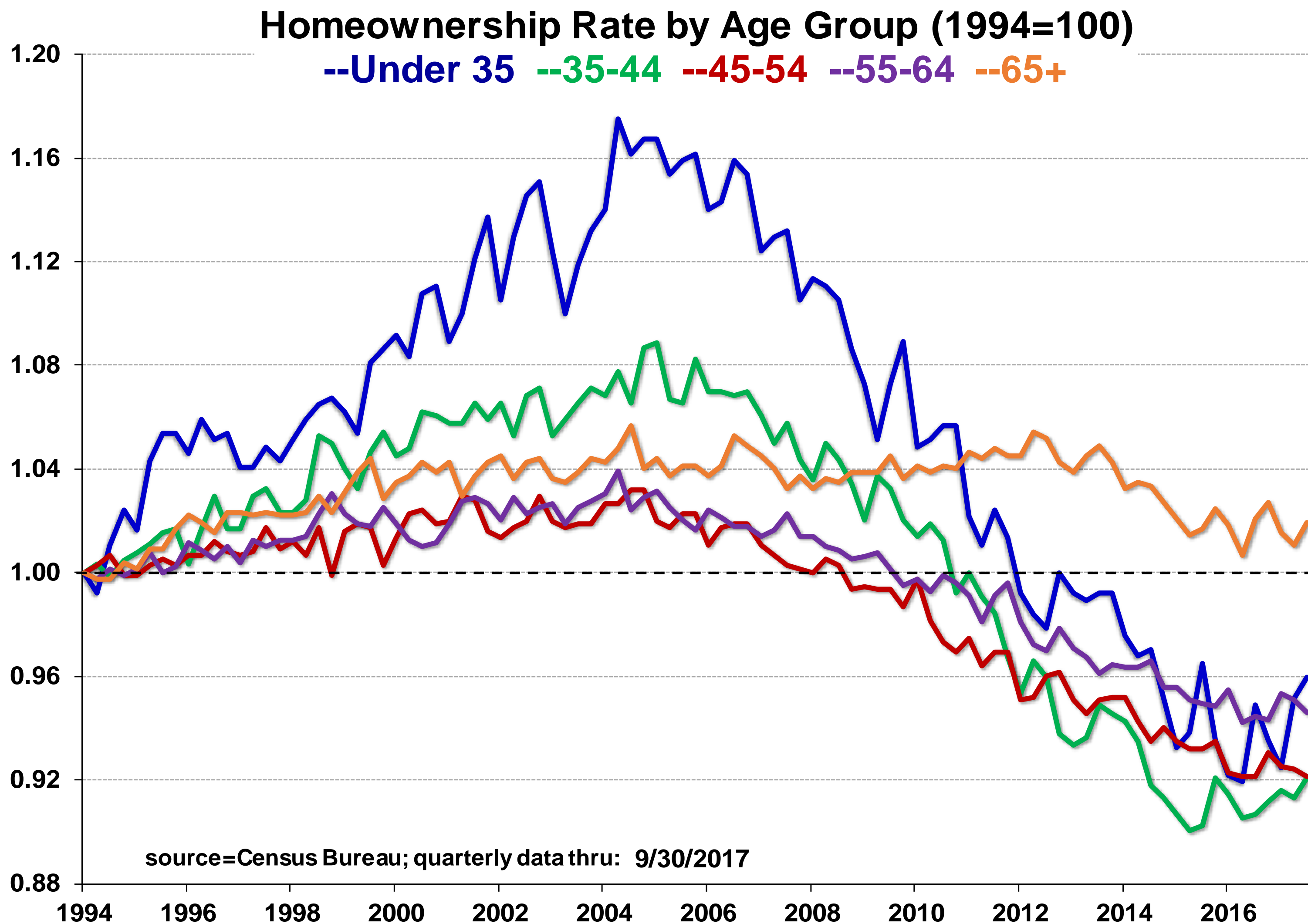
Total Credit rises $18.45bln in December vs. expectations of +$20bln; November revised higher from $28bln to +$31bln. **3-month change in total credit rises to highest on record: +$72.4 billion**



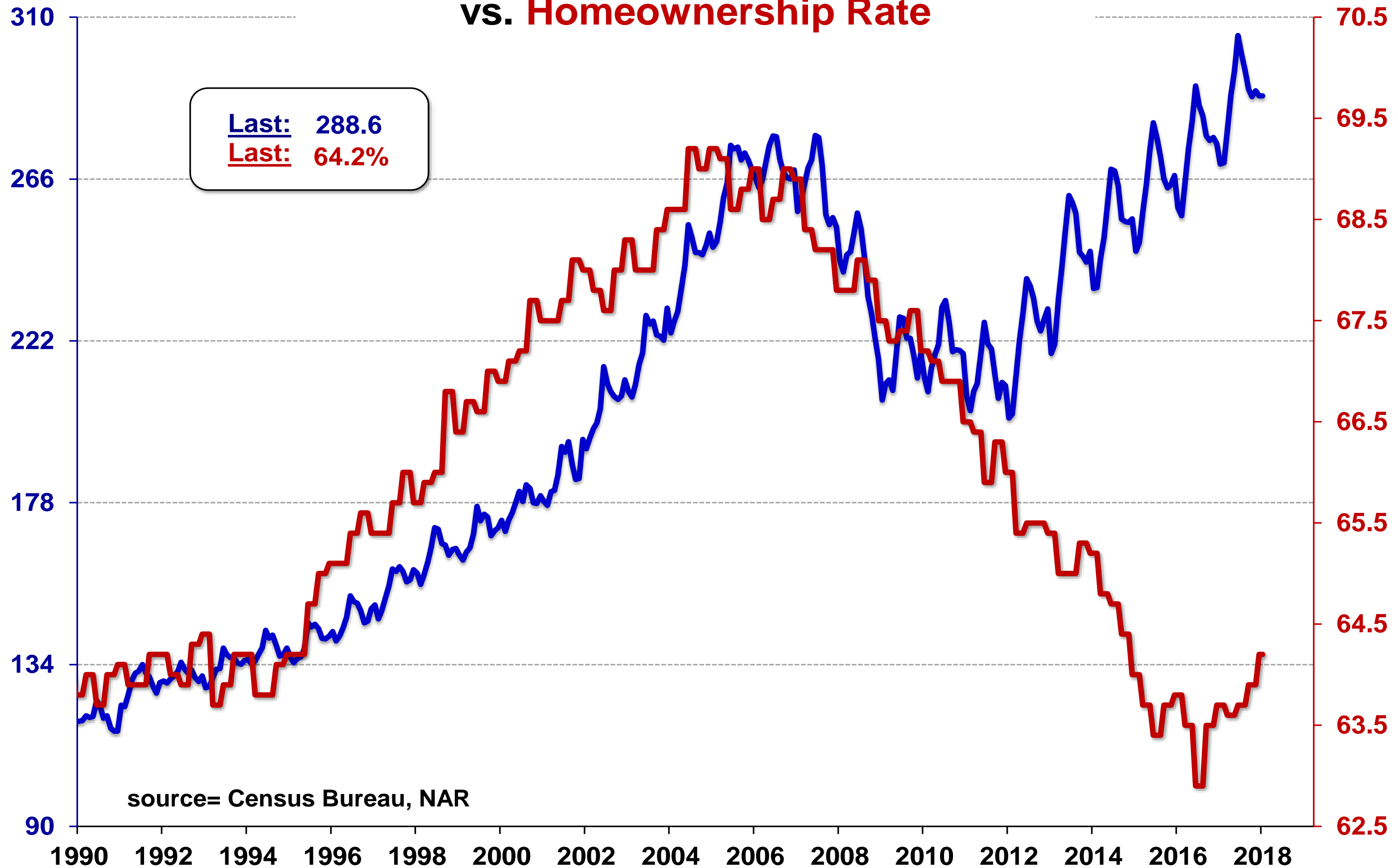
Total Auto + Student Loans now exceed $2.6 Trillion (Q4 data)



From a recent WSJ piece: "*The U.S. homeownership rate rose in 2017 for the first time in 13 years, driven by young buyers who overcame rising prices, tight supply and strict lending conditions to purchase their first homes*". Yes, homeownership rate rose to 64.2% in Q4 2017 (posting first y/y rise since 2004), however this chart tells the bigger story: homeownership by age range reveals only 65+ years of age group is above 1994 levels…



…and we'll likely need to see much higher wages and/or lower house prices (or perhaps a return to NINJA loans!) to bring the homeownership rate up for all age groups. For now, homeownership rate remains at lowest level since Q1 1995.



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