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Bond Yields Rise as Another Round of Strong Data Adds Fuel to First Quarter Growth Story

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Bond yields continued to climb this morning as economic numbers indicate Q1 growth is gaining momentum. When the year began, the widely-held expectation was that GDP growth for the first few months would be anemic as the U.S. focused on corralling the virus. Growth would then accelerate later in the year as a critical mass of Americans were vaccinated and service sector jobs returned. However, this story is suddenly unfolding *at a much faster pace*.

The number of daily covid cases is down 75% from the January peak, and the average number of daily vaccine shots has climbed to 1.5 million. At the same time, economic data has been better-than-expected. This morning, durable goods orders, forecasted to rise by +1.1% in January, actually jumped +3.4%, while December orders were revised from a +0.5% gain to +1.1%. Also this morning, initial jobless claims for the week ending Feb. 20 showed a significant decline in the number of Americans filing for first-time unemployment benefits. At 730k, the number of weekly filings is still historically high, but it's more than 100k below the previous week's total, indicating labor market healing.

While the economy improves and the virus threat appears to be fading, more stimulus is barrelling down the pike. The administration's bold $1.9 trillion proposed package is likely two to three weeks away from passing. This government cash injection is expected to add fuel to an economic fire that's already a little warmer than most had anticipated. Long bond yields have reacted to stronger economic numbers, rising inflation expectations and the possibility that Fed officials could be forced to tighten monetary policy sooner than they expect.

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As yields rise, homeowners lose incentive to refinance their home loans, which means that mortgage-backed securities (MBS) experience slower prepayments causing portfolio durations for MBS investors to extend. MBS investors are then forced to sell longer Treasury holdings to maintain their overall duration. This whole process *feeds on itself* as the selling pushes mortgage rates higher and further discourages refinancing activity. The 10-year Treasury yield has climbed from 1.08% to 1.47% in February with most of the damage coming in just the last week.

The primary inflation indicators are still well behaved despite expectations for stronger growth ahead. However, there is already a significant amount of price pressure in the big ticket items many Americans are actually buying. Edmunds.com reported earlier this week that the average price for a new vehicle in January jumped +6% over the same period a year ago to a record $40,578, while the average price of a used vehicle soared almost +14% to over $23,000 during the same period. On the housing front, the S&P CoreLogic Case-Shiller 20-city home price index rose +10.1% year-over-year in December, the biggest annual gain in almost seven years.

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Food price are also on the rise. According to USDA data for the 12-month period ending in December, food-at-home prices increased +3.5%, and food-away-from-home prices rose +3.4%. The CPI for all food was up +3.4% year-over-year, a sharp gain from 2018 (0.4%) and 2019 (0.9%). Significant increases were found in dairy and other meats (+4.4%) and beef and veal (+9.6%). Fresh fruit prices were the only major category to fall last year (-0.8%). Global food prices in December were the highest for any month in the last six years, according to the FAO Food Price Index.

Overall commodity prices are rising quickly, but several key materials have registered particularly large gains over the past year, and will likely show up in the prices of final goods in 2021. Over the past year, according to the Wall Street Journal, lumber prices are up +117%, copper +56% and soybeans +54%. On a related note, the Journal reported freight prices have risen a whopping +215%. The financial markets had previously discounted the expected rise in inflation as a short-term blip, but are now rethinking the severity and the Fed's possible reaction.

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The markets are navigating unchartered waters and the path is unclear. What does appear certain at this point is that 2021 growth is likely to be stronger. This implies that aggressive monetary and fiscal policy might not be necessary. The fact that congress and the Fed are undeterred and still adding stimulus has caused the bond markets to stumble.

Market Indications as of 10:50 A.M. Central Time

DOW	Down 274 to 31,688 (HIGH: 31,962)
NASDAQ	Down 248 to 13,350 (HIGH: 14,095)
S&P 500	Down 41 to 3,884 (HIGH: 3,934)
1-Yr T-bill	current yield 0.08%; opening yield 0.07%
2-Yr T-note	current yield 0.15%; opening yield 0.12%
5-Yr T-note	current yield 0.71%; opening yield 0.60%
10-Yr T-note	current yield 1.45%; opening yield 1.38%
30-Yr T-bond	current yield 2.28%; opening yield 2.23%

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