Yields Climb as Buyers Retreat in Front of Fed Meeting

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Bond yields continue to increase at an unprecedented pace as Fed officials meet this week to discuss the most appropriate strategy to combat a spike in inflation expectations. The entire curve has shifted abruptly higher over the last three weeks, with the majority of the sell-off occurring over just the past several days. The most recent trigger was Friday's release of the May CPI report which showed inflationary pressure was building instead of fading. This shouldn't have been too big a surprise as it was apparent that everyday prices for gasoline, groceries, apartment rent, airfare and autos were still climbing.

Three days ago, the futures market was pricing in 50 bp rate hikes for both the June and July FOMC meetings, mirroring the policy stance Fed officials had telegraphed for weeks. After the CPI report, at least one Wall Street firm decided a 75 bp move on June 15th was more appropriate. At the time, this raised eyebrows. Just two days later, the futures market has fully priced-in a 75 bp hike for June and nearly 75 bps for July as well. The 12-month Treasury bill, normally a stable investment subject to minimal market risk, was yielding 1.96% on May 30th, 2.26% before the CPI report three days ago, and 3.02% this morning.

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Purely in terms of economic data, it's hard to justify a market reaction of this magnitude, but from a psychological viewpoint it makes more sense – *there simply aren't enough buyers*. This gets compounded by the fact that QE has started to unwind itself. The Fed is no longer buying securities to support the market, and in fact has now begun to shrink their massive bond portfolio. Investors are expected to absorb the excess market supply, a difficult task when bond yields are grinding higher day by day.

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Market Indications as of 11:17 A.M. Central Time

DOW	Down -215 to 30,302 (HIGH: 36,800)
NASDAQ	Up 13 to 10,822 (HIGH: 16,057)
S&P 500	Down -8 to 3,742 (HIGH: 4,797)
1-Yr T-bill	current yield 3.05%; opening yield 2.87%
2-Yr T-note	current yield 3.42%; opening yield 3.39%
3-Yr T-note	current yield 3.54%; opening yield 3.51%
5-Yr T-note	current yield 3.54%; opening yield 3.50%
10-Yr T-note	current yield 3.43%; opening yield 3.38%
30-Yr T-bond	current yield 3.41%; opening yield 3.35%