U.S. Taxable Fixed Income Markets

Monday Morning Comments

Joe Tamburo
Trader, Taxable
Managing Director
joe.tamburo@hilltopsecurities.com

Overnight

Global equities are mostly higher this morning, with U.S. futures currently higher, as well. Core sovereigns are modestly lower as NY opens, with Treasuries also a basis point or two worse. 2yr Treasuries are back above 4%, at 4.02% at the moment, and 10yrs are opening near 3.50%.

Last week's economic data continued to be mixed.

CPI was not quite as strong as expected, with the YoY headline coming in at 4.9% vs 5.0%. The Senior Loan Officer Opinion Survey showed slowing credit in banking. Weekly Jobless Claims continued their march higher. Now at 264k, that's the highest since October of 2021.

PPI also came in a bit weaker with the YoY headline at 2.3% v 2.5% expected and 2.7% in March. The YoY Core dropped to 3.2%. Friday's preliminary U of Michigan surveys for May showed a drop in Consumer Sentiment, but more importantly, also showed expectations for inflation rose dramatically. The 5-10yr Inflation survey showed an increase to 3.2% from 3.0% in April, and vs an expectation of 2.9%. The Fed pays attention to these forward-looking expectations to determine how sticky inflation might be.

Rates Markets

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2yrs rallied from 4.06% Wednesday morning before the data release and continued to rally to 3.81% with the weaker PPI and climbing Jobless Claims on Thursday. That sharp rally was faded later Thursday and again Friday with the higher inflation expectations in the U of Michigan surveys. On the week, the issue put in a 26bp range, and actually finished 7bps higher in yield to close at 3.99%. Since reaching 5.08% on March 7th, just before the Silicon Valley Bank crisis, 2yrs have rallied as much as 153bps, reaching 3.55% on March 24. With the market now expecting the Fed to pause its rate hikes, the question becomes, how long will they pause before cutting rates. The market has settled into a range for now, with 2s trading between 4.40-3.55%. 50% of that range works out to be 3.98%, very close to Friday's close.

Fed Funds futures finished the week showing less likelihood of Fed rate cuts after similar gyrations. The October contract put in a 10bp range, but the likelihood of the first 25bp cut in rates coming in September only dropped by about 4bps, ending the week with an 85% probability. The December contract put in a 22bp range, but closed 6bps higher in yield to end the week with 68bps of Fed cuts priced in by year end.

Please see disclosure starting on page 3.

Further out the curve, **10yr** yields also rose early in the week, only to rally on the CPI / PPI. The yield got as high as 3.53% on Tuesday afternoon before rallying to 3.34% Thursday morning (a 19bp range). The late week reversal saw the issue close at 3.46%, just 2.5bps higher in yield for the week and very close to the midpoint of the range from March 13 between 3.25-3.70%, which comes in at 3.475%. 10yrs have moving sideways over the past two months as the market awaits the next catalyst.

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The 2s10s curve flattened 5bps to finish the week at -53bps, and that's right in the middle of the range since March 10, after the banking liquidity crisis essentially put an end to market thoughts of rate hikes and flatter curves. The 50 and 100DMAs have curled up toward steepening, while the 200DMA is slowly flattening out. Expect the 50 & 200DMAs to cross this week.

Rates Vol traded either side of unchanged most of the week until Friday's selloff, finishing the week slightly lower. The MOVE Index closed near the lowest since early March, pre-SBV. Swaption Vol seemed relatively subdued, trading back and forth with the rates action, and finishing the week mixed but slightly lower, with some of the 1yr lock structures modestly higher.

U.S. Equity Markets

U.S. Equity markets were mixed last week: S&P -0.3%, Dow -1.1%, Nasdaq +0.4%, with the VIX finishing near unchanged at 17, higher than the early May lows, but not far off some of the lowest levels in a year and a half.

Looking ahead this week

Looking ahead this week, markets will be focused on the outlook for the Debt Ceiling, as a U.S. failure to meet its debt obligations would send markets into more turmoil. Treasury Secretary Yellen has estimated the Fed will run out of cash in the next few weeks. I believe negotiations are set to resume tomorrow.

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This week will be a little lighter on top tier data. The highlight will probably be the April Retail Sales release tomorrow, which is expected to show a rebound from March's decline. That data will have implications for Q2 GDP.

For supply, Treasury will auction 3 & 6 month TBills this morning, and 1yr Tbills tomorrow, along with a 154day Cash Management Bill. Wednesday will be 4 month Tbills and then a new 20yr Bond. Thursday's auctions will be 4 & 8 week Tbills, as well as the 10yr TIPS reopening.

There will be no shortage of Fed officials speaking this week. I count 19 media opportunities on the schedule so far, including Fed Vice Chairman for Supervision Michal Barr testifying in front of Congress tomorrow and Thursday. The Atlanta Fed is also hosting a financial markets conference beginning this morning. Chairman Powell and Vice Chair Williams will be speaking Friday at a monetary policy research conference hosted by the Fed in DC. Keep your eyes on the tape.

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