U.S. Taxable Fixed Income Markets

Tuesday Morning Comments

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Overnight

Over the weekend, a tentative agreement to suspend the U.S. debt limit was reached, punting the issue past the next Presidential election and into early 2025. The deal will be brought up for a vote in the House as soon as tomorrow, with Treasury Secretary Yellen saying the government may run out of money as early as June 5.

U.S. markets were closed for holiday yesterday. Global equities are mixed but mostly higher this morning. U.S. futures are generally higher, as well. European Sovereigns are rallying as are Treasuries. The belly of the curve is leading with 10yrs nearly 9bps better at 3.71%. 2yrs have rallied back near 4.50%.

Last Week's Data

Last week's Data seems to be showing the Consumer is still in solid shape while Manufacturing slows, but Inflation is not falling fast enough.

The preliminary May Services and Composite PMIs both came in stronger than expected and remain in expansionary territory, while the Manufacturing Index showed a contraction. Weekly Jobless Claims came in much lower than expected with a big downward revision for the previous week. GDP was revised 2 tenths higher to +1.3% for Q2. Personal Consumption was also revised higher. For April, Personal Income rose 0.4% and Spending rose 0.8%, which was more than expected and much higher than the +0.1% for March.

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On the Inflation front, the April PCE deflator rose +0.4% MoM v 0.1% in March. The YoY rose 4.4% v 4.2%. The Core MoM rose +0.4% v 0.3% last and the Core YoY is now up 4.7% v 4.6% last. The final read on the U of Michigan Surveys for May showed improvement in Sentiment and Expectations. The 1yr Inflation expectation dropped to 4.2% from 4.6% in April. The longer term 5-10yr inflation survey showed an uptick to 3.1% from 3.0%.

Comments from Fed Officials

Comments from Fed officials indicate they believe there is more work to be done to bring down the persistent inflation, but they want to leave themselves the "optionality" to hike or pause, as their policy tightening works its way through the economy. So far, the economy has been resilient, led by the Consumer and the Labor market, but Manufacturing has been slowing and Credit is tightening. Fed members have pointed to this potentially tighter bank credit as a reason to slow rate hikes. They just don't know how long these lags will take.

Governor Waller said he does not support stopping rate hikes unless they get clear evidence that inflation is moving down towards the 2% objective.

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St. Louis Fed President Bullard said he's thinking two more rate hikes this year, but he doesn't know exactly when those would be. SF Fed President Daly and Atlanta Fed President Bostic seemed in favor of a pause, as did Chairman Powell in his last public comments. I think Minneapolis Fed President Kashkari summed it up well when he said, if inflation stays high, the Fed going to have to keep interest rates high for longer, but he did admit it's a close call between raising another time in June or skipping. An important takeaway from his comments was that he said what's important to him is not signaling they are done.

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Rates

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It seems like the market is finally coming around to the Fed's message that they are not done tightening. **Fed Funds futures** closed Friday pricing in nearly a 70% chance of a hike in June and a full 25bp hike was priced in by July. The rate for year end backed up 36bps last week to close right at 5%. So, basically just about all the Fed easing that was priced in for this year has now been reversed.

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The Markets' optimism on the debt ceiling deal last week reversed the selloff in the early June **TBills** back to the 5.50% area. That's down from about ~7% at one point. This morning they seem to be trading below 5.25%. The rest of the Bill curve seems to be reflecting the possibility of more hikes, with rates closing Friday as high as 5.40% in the 4-6month maturities.

The **2yr Note** sold off the most last week, closing nearly +30bps higher in yield at 4.56%, after trading to 4.63% Friday morning. That could open the door back to the 4.72-80% area with the cycle high yield at 5.08% from early March (pre-Silicon Valley Bank) behind that.

The **10yr Note** sold off +12.5bps last week to close at 3.80%, after trading to 3.85% Friday. That's also the highest yield since the March banking liquidity issues. The chart for 10s looks a bit different though. The maturity hit its cycle peak last October at 4.33% and then topped out at 4.09% in March. 3.89-92% looks like a convergence of support in the near term, with that 4.09% behind it.

With the front end leading the selloff last week, the **2s10s curve** continued its inversion, closing -17bps flatter to -76bps. That, again, is a level not seen since early March. The market turmoil around that time left a gap in the charts from -82bps to -87.5bps. A bit more Fed tightening talk should see that gap filled. The extreme inversion reached in early March at -111bps is the most since 1981.

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Rates Vol

Rates Vol climbed last week on the selloff, with the MOVE Index closing at its highest level since early April.
Swaption Vol was also higher across the board, with short locks jumping the most.
Yesterday Vol retreated a bit off Friday's highs, however.

Looking ahead, markets will be volatile again, as the Debt Ceiling agreement will need to be passed by Congress.

U.S. Equity markets

U.S. Equity markets sagged but managed to rebound late last week, with the tech sector outperforming: S&P +0.3%, Dow -1.0%, Nasdaq +2.5%.

Looking Ahead

Looking ahead, markets will be volatile again, as the Debt Ceiling agreement will need to be passed by Congress. That's always a challenge. There will be important Jobs data on the calendar, and Month end flows will likely influence trading this week, as well.

Highlights of the economic data will be this morning's Consumer Confidence survey for May. The JOLTS Job Openings report for April will be released tomorrow morning and is expected to show another drop to 9.4mm. The Fed's Beige Book will be coming out tomorrow afternoon. The ADP Employment report will be released Thursday morning and is expected to show a slowing in Job gains to +165k from 296k in April. Then, Friday's NonFarm Payrolls are also expected to show a slowing to 190k jobs added, from 253k in April. The Unemployment Rate is expected to tick up to 3.5%.

Treasury supply will be limited to the usual TBill auctions this week.

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