

U.S. Taxable Fixed Income Markets

## Monday Morning Comments

### Overnight

Global equities are mixed and U.S. futures are slightly lower. Global Sovereigns are lower across the board with Treasuries lower, as well. 2yrs are 5bps worse at 4.55% and 10yrs are 6bps worse at 3.75%.

*Joe Tamburo**Managing Director, Rates Trading  
joe.tamburo@hilltopsecurities.com*

### Last Week

Last week the market tone changed a bit as the debt ceiling deal was agreed to and finally signed into law Saturday, ending months of uncertainty.

**U.S. Equity markets** rallied, with the S&P trading to the highest level since last August led by tech companies, and the Nasdaq composite making a 52wk high: S&P +1.8%, Dow +2.0%, Nasdaq +2.0%.

**In the Data**, Consumer Confidence for May improved. The JOLTS data showed job openings jumped back above 10mm again. ADP came in hotter than expected, showing a gain of 278k jobs vs +170k expected, but that was down from April's +291k. Manufacturing gauges were still mostly showing weakness. Unit Labor Costs and ISM Prices Paid both showed significant cooling.

Friday's Headline NFP exceeded the highest estimates, showing +339K job gains for May and continued strength in the Labor market, but the Household survey showed a rise in the Unemployment Rate to 3.7% from 3.4%. Average hourly earnings moderated a bit to +0.3% from +0.4% in April which may give the Fed some comfort that wage inflation may be coming off the boil.

*Global equities are mixed and U.S. futures are slightly lower. Global Sovereigns are lower across the board with Treasuries lower, as well. 2yrs are 5bps worse at 4.55% and 10yrs are 6bps worse at 3.75%.*

The Labor Force Participation Rate remained steady at 62.6%, but still well below the pre-Covid rate of 63.3%. The Fed has pointed to the participation rate as one of its gauges of labor slack, but Bloomberg had a chart showing Prime Age workers are back at pre-Covid levels. The 55yo+ demographic however, is still a couple of percentage points lower. Remember a couple of decades ago when everyone was wondering what would happen when all the baby boomers retired? The youngest Boomers are now 59 1/2. I'm not an economist, but I think this is what the Labor Force is going to look like going forward. Service sector jobs, particularly in healthcare, will be in high demand. Fed officials gave us more conflicting opinions last week.

**Fed officials** gave us more conflicting opinions last week. Cleveland Fed President Master told us she sees no compelling reason to pause and of course, St Louis Fed President Bullard wants the Fed to continue tightening.

Fed Governor and Vice Chair nominee Jefferson said he prefers a pause to assess the data and tighter credit conditions. Philadelphia Fed President Harker also endorsed a skip, though oddly called for rate hikes at every other meeting.

I continue to think the Fed will pause next week despite some of the stronger data. There is clearly uncertainty about the outlook. They would still have the option of hiking again in July if inflation persists, and the economy remains robust. Let's not forget about the ongoing quantitative tightening as well as tighter bank credit conditions. I think it makes sense to wait another six weeks to see any further effects of the Fed's 500 basis points of tightening on the economy.

*I continue to think the Fed will pause next week despite some of the stronger data. There is clearly uncertainty about the outlook.*

The path of rates coming to the end of this tightening cycle should set up a vigorous debate at the meeting next week and it will be interesting to see if there are any dissenting votes.

The Fed will also release its new DOT plot at this meeting and that will also be a focus for markets. Back in March they raised their year-end PCE inflation projections to 3.3% and Core to 3.6%. Since then, the PCE Deflator has dropped to 4.4% from 5.4%, but the Core is unchanged at 4.7%. A slower return to their 2% target would mean higher rates for a longer period. Either a hike or a skip next week should push the Fed's year end Funds target higher, as they have already reached their 5.125% average estimate.

## Rates Markets

Rates markets had begun to sell off before the holiday in anticipation of the debt limit deal. Treasuries rallied early last week on weaker data out of China and Europe and into month end, then rallied some more on Thursday morning's WSJ article making the case for a Fed Pause. Most of that rally reversed, however, on Friday's strong headline NFP.

*Treasuries rallied early last week on weaker data out of China and Europe and into month end, then rallied some more on Thursday morning's WSJ article making the case for a Fed Pause. Most of that rally reversed, however, on Friday's strong headline NFP.*

In the **Fed Funds futures** market, the probability for June hike dropped almost 10bps last week, but the likelihood of a hike by July was still around 80%. Rate cuts for this year have mostly been reversed and held fairly steady last week near the current effective rate.

**2 year Treasuries** had rallied 25bps by Thursday morning to 4.31%, but reversed Friday to close near 4.50%, 6.5bps better on the week. 4.635% was the high yield the previous week and highest since early March. 4.72/80% is the next support area before the 5.08% cycle high. That 4.31% level is 50% of the rally from 5.08% to 3.55%.

**10 year Treasuries** put in a similar move, rallying 24bps to 3.56% Thursday morning, and then selling off Friday to close at 3.69%. Nearly 11bps better for the week. The range since early March has been 3.35-4.09%. 3.67% is the midpoint there, with the issue closing right near there on Friday. 3.79%, 3.86%, 4.09% look to be support. 3.62%, 3.55%, 3.39% look to be resistance.

There was no Term Treasury supply last week and none again this week, so that should be supportive of the Treasury market.

*With 10yrs leading the rally last week, the 2s10s curve continued its inversion, closing -5bps flatter to -81.5bps.*

With 10yrs leading the rally last week, the **2s10s curve** continued its inversion, closing -5bps flatter to -81.5bps. The curve got to -83bps briefly on Friday. The gap from early March at -82bps to -87.5bps remains in striking distance.

**Rates Vol** fell steadily last week as the debt ceiling issue got settled, with the MOVE index dropping to its lowest level in two weeks.

**Swaption Vol** also got hammered all week, with the short lockouts faring the worst.

**The VIX** dropped dramatically last week on the equity rally, closing below 15 for the first time in over 3 years.

The new market concern is the rebuilding of the U.S. Treasury balance sheet now that the debt limit has been suspended. The treasury cash balance fell to \$22.9 billion on June 1, which was down from about \$580bn at the beginning of the year. Including Friday's cash management TBills that settle today, Treasury will be raising about \$89 billion new cash this week. That cash runoff had the effect of adding liquidity to the market and economy, but now this upcoming debt issuance binge will be removing that liquidity. We'll see how much of an effect that has on market funding.

## Looking Ahead

Looking ahead, this will be a bit quieter week for market moving events (we hope). The Fed will be in it's pre-FOMC meeting blackout period. Treasury supply will be light with just TBills.

Data will be on the lighter side, as well. Today we will get Services PMI's and the ISM Services index, along with Factory Orders. Wednesday we get Consumer Credit.

There will be a Reserve Bank of Australia meeting tomorrow. The Bank of Canada is expected to keep rates unchanged on Wednesday.

The big CPI report for May will be released next week on June 13 and the FOMC meeting is next week on June 13/14.

*Looking ahead, this will be a bit quieter week for market moving events (we hope). The Fed will be in it's pre-FOMC meeting blackout period. Treasury supply will be light with just TBills.*

*The paper/commentary was prepared by HilltopSecurities (HTS). It is intended for informational purposes only and does not constitute legal or investment advice, nor is it an offer or a solicitation of an offer to buy or sell any investment or other specific product. Information provided in this paper was obtained from sources that are believed to be reliable; however, it is not guaranteed to be correct, complete, or current, and is not intended to imply or establish standards of care applicable to any attorney or advisor in any particular circumstances. The statements within constitute the views of HTS as of the date of the document and may differ from the views of other divisions/departments of affiliate Hilltop Securities Inc. In addition, the views are subject to change without notice. This paper represents historical information only and is not an indication of future performance. This material has not been prepared in accordance with the guidelines or requirements to promote investment research, it is not a research report and is not intended as such. Sources available upon request.*

*Hilltop Securities Inc. is a registered broker-dealer, registered investment adviser and municipal advisor firm that does not provide tax or legal advice. HTS is a wholly owned subsidiary of Hilltop Holdings, Inc. (NYSE: HTH) located at 717 N. Harwood St., Suite 3400, Dallas, Texas 75201, (214) 859-1800, 833-4HILLTOP*

©2023 Hilltop Securities Inc. | All rights reserved | MEMBER: NYSE/FINRA/SIPC