Bond Yields Surge on Indications of Persistent Economic Strength

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2012
greg.warner@hilltopsecurities.com

First quarter GDP was revised sharply higher this morning, adding to a flurry of surprisingly strong economic releases and driving U.S. bond yields higher. The +2.0% quarterly/annualized economic growth rate was well above the previously reported +1.3% as well as the +1.4% median forecast. On a year-over-year basis, Q1 GDP was revised higher from +1.6% to +1.8%, *now double the +0.9% growth pace from the previous quarter.*

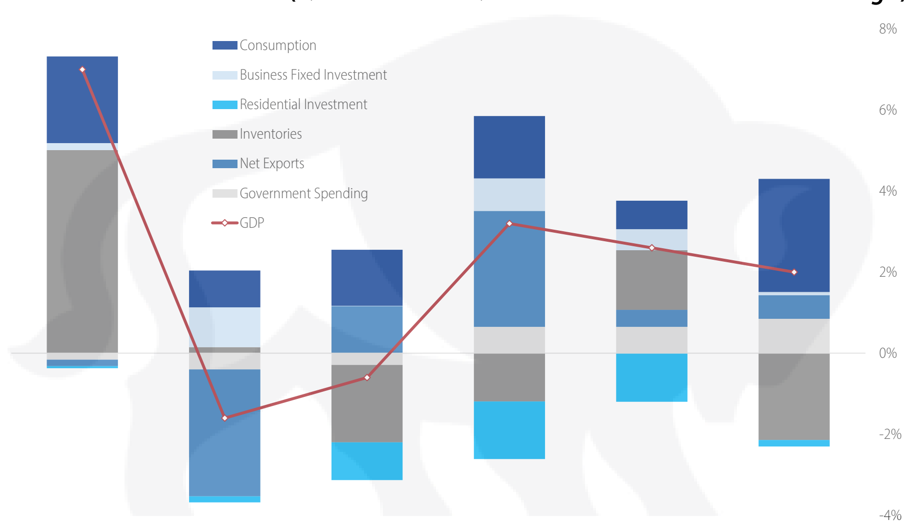
Within the Q1 headline, household spending was revised upward from +3.8% to +4.2%, *the strongest pace of personal consumption in almost two years* and well above the +1.0% rise in the final quarter of 2022. Considering how hard Fed officials have worked to stifle consumer demand, this persistent strength is a head-scratcher.

Admittedly, first quarter GDP data has grown stale, but there have been few signs of slowing in recent months. Second quarter GDP, according to the Atlanta's Fed's *GDPNow* measure was tracking at a solid +1.8% pace as of Monday. Indications of economic resiliency are nudging growth expectations higher and dismissing any near-term recession hopes/fears.

Indications of economic resiliency are nudging growth expectations higher and dismissing any near-term recession hopes/fears.

Earlier this week, durable goods orders for May rose +1.7% on increased aircraft and auto orders. It was the third straight monthly increase and +5.4% above the same period a year ago. Non-defense capital goods shipments increased +3.4%, the biggest gain since late 2020. This indicates U.S. businesses are gaining confidence and willing to spend. At the same time, the Conference Board reported June *consumer* confidence had managed to climb to its highest level since November 2021. Given historically low unemployment, rising wages, moderating inflation and continued stock market gains, improved consumer spirits seem like a pretty reasonable response.

Gross Domestic Product (Quarter-over-Quarter Annualized Percent Change)



Given historically low unemployment, rising wages, moderating inflation and continued stock market gains, improved consumer spirits seem like a pretty reasonable response.

Source: Bureau of Economic Analysis

Please see disclosure starting on page 2

On the residential side, new home sales unexpectedly climbed +12.2% in May to a 14-month high of 763k annual units. The third straight increase drew down the available inventory of new homes from 7.6 months to 6.7 months. It now appears that residential spending is no longer an economic drag while poised to make its first positive contribution to GDP since 2021.

Powell doesn't expect core inflation to reach the Fed's 2% goal until 2025 and believes the first rate cut is still a long way away.

Fed Chairman Jay Powell, speaking yesterday on a panel hosted by the ECB, said U.S. monetary policy may not be restrictive enough to slow demand while acknowledging that the FOMC could increase the overnight target at consecutive meetings in both July and September. Powell doesn't expect core inflation to reach the Fed's 2% goal until 2025 and believes the first rate cut is still a long way away. *The bond market is listening*.

Bond yields are significantly higher after absorbing the latest batch of economic numbers and anticipating that Fed officials will be forced to tighten further in order to maintain downward pressure on inflation. Stocks are up in early trading in response to an economy that's signaling an increased possibility of the fabled soft-landing.

Market Indications as of 11:59 A.M. Central Time

DOW	Up 254 to 34,107 (HIGH: 36,800)
NASDAQ	Down -11 to 13,581 (HIGH: 16,057)
S&P 500	Up 20 to 4,397 (HIGH: 4,797)
1-Yr T-bill	current yield 5.42%; opening yield 5.29%
2-Yr T-note	current yield 4.88%; opening yield 4.71%
3-Yr T-note	current yield 4.51%; opening yield 4.33%
5-Yr T-note	current yield 4.15%; opening yield 3.97%
10-Yr T-note	current yield 3.86%; opening yield 3.71%
30-Yr T-bond	current yield 3.92%; opening yield 3.81%