

U.S. Taxable Fixed Income Markets

Wednesday Morning Comments

Overnight

Global equities are lower overnight after trading a bit lower yesterday. U.S. futures are following in the red after trading marginally higher on Monday. Core sovereigns are mostly better overnight after being mixed in yesterday's trading. Treasuries are twisting slightly steeper from Monday's close with the 2yr a couple bps better at 4.915% and the 10yr 1bp worse at 3.865%.

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Last Week

Last week's data showed more strength in the economy. The Housing market showed additional signs of a rebound as New Home Sales for May surprised with a +12% rise vs an expectation of a -1% drop. That came after a +21% jump for May Housing Starts. Pending Home Sales fell, however.

Consumer Confidence for June exceeded expectations and posted its highest level since Jan 2022.

An upward revision to Q1 Consumption showed the economy grew faster than initially reported. That drove a big upward revision to Q1 GDP to 2.0% from 1.3%.

Initial Jobless Claims came in a lot lower than expected.

Personal Income for May was slightly firmer than expected at +0.4%. Personal Spending showed slowing and came in slightly weaker than expected at +0.1%. Both were revised down for April.

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On the Inflation picture, price gains are continuing to show slowing. The headline PCE Deflator for May came in as expected at +0.1% MoM and +3.8% YoY. Both of those levels were lower from April. The Core MoM came in as expected at +0.3%, which was down from +0.4% in April. The Core YoY was slightly lower than expected at +4.6%, down from 4.7%. Core Services ex-housing slowed to +0.2% from +0.4%.

Fed officials continued their hawkish tone. At the ECB Central Bank forum in Portugal, Chairman Powell repeated that most Fed officials thought another 50 bps in hikes would likely be warranted this year. He also didn't rule out consecutive hikes at the next 2 FOMC meetings. He said the Fed doesn't have a recession in their forecast and he thinks it will take until 2025 for inflation to come back down to their 2% target.

The data certainly has seemed stronger than expected lately (aside from manufacturing) and the rising equity market has been creating more of a wealth effect. These aren't helping the Fed to curb consumption or employment and with the Core PCE still at 4.6%, the Fed feels like it still has plenty of work to do. The Market is now starting to look for maybe more than 1 more rate hike this year.

By the end of last week, **Fed Funds Futures** were pricing in an 81% chance of a hike at the July 26 FOMC meeting. That was up a couple of basis points from the previous week. The Terminal Rate in November had moved up 9bps to 5.41%. That's about a 35% chance of a second hike.

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The rate for the December meeting had risen by 13.5bps to 5.375%, so not only has the market dropped the idea of rate cuts by year end, but higher rates are now priced in. The first full rate cut looks to be priced in for March of next year

The 2yr Treasury continued its rise in yield for the fourth week in a row, climbing another 15bps to close Friday at 4.895%. Monday's trading took the issue to 4.96% before closing at 4.935%. Yields have climbed back from the banking liquidity rally that took the issue to 3.56% in late March. The cycle high yield of 5.08% set on March 8 is in sight.

10yr Treasuries had been generally trading sideways for the past three weeks, trading between 3.67-3.85%, before selling off Thursday on the strong data. The issue got to 3.89% early Friday before bouncing to close at 3.84%, +10bps higher for the week. 3.85% looks like weak trend support, with 3.89% the recent high yield. 3.92% is a retracement level from the rally to 3.25% in April. 4.08% is the high yield from March, and then 4.335% is the cycle high yield from October. Resistance looks to be 3.79%, and then 3.66%.

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The 2s10s curve on Monday got back to that inverted -111bp level previously set on March 8, just before the banking issues grabbed the market's attention. Again, that's the most inverted the curve has been since 1981. With the Fed expected to continue raising rates until they break the back of inflation, the curve inversion will likely persist for some time longer.

Rates Vol rose a bit late in the week on the pop in rates but remains not far off the June lows. **Swaption Vol** rebounded a bit last week with short tenors and short locks performing best.

U.S. Equity markets finished the week higher with the S&P setting a 52week high: S&P +2.4%, Dow +2.0%, Nasdaq +2.2%. The VIX closed unchanged near 13.5 again last week, after trading as high as 14.7.

The **U.S. Treasury cash balance** rose to \$465bn on June 29, up \$99bn for the week, and \$442bn since June 1.

Looking Ahead

The Minutes from the June 14 FOMC meeting will be released this afternoon. This will be a big week for Employment data starting with the ADP release tomorrow. The market is expecting a drop to +225k jobs from 278k in May. Later tomorrow morning, the Job Openings report is expected to show a decline to just under 10mm. The June NonFarm Payroll report will be released Friday with the market expecting a slowing to 225k job gains, down from 339k in May. The Unemployment Rate is expected to tick down to 3.6%.

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Treasury will auction 4month TBills this morning, as well as 4wk and 8wk TBills tomorrow.

NY Fed President Williams will be speaking this afternoon and Dallas Fed President Logan will be speaking tomorrow.

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