U.S. Taxable Fixed Income Markets

Monday Morning Comments

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Overnight

Global equities are modestly higher overnight, as are U.S. futures. Core sovereigns are slightly lower, as are U.S. Treasuries. 10yrs are about 2 basis points worse at 3.97%.

Last week's data showed a resilient economy with moderating prices. Consumer Confidence rose to the highest since July 2021. Q2 GDP surprised to the upside, on the back of better than expected Personal Consumption. The preliminary read showed an increase of +2.4% vs an expectation of 1.8% and rising from 2.0% in Q1. It already sounds like some estimates for Q3 GDP are getting revised higher.

Durable Goods Orders for June also showed surprising strength, increasing by +4.7%. That was the highest read in 3 years.

The Labor market continues to defy the Fed as Weekly Jobless Claims dropped to the lowest since February and Continuing Claims dropped to the lowest since January.

Personal Income for June fell but Personal Spending exceeded expectations and rose +0.5%

The Inflation picture last week came in better than expected. The Q2 GDP Price Index dropped to 2.2% from 4.1% in Q1. Q2 Core PCE Price Index dropped to 3.8% from 4.9%. The Q2 Employment Cost Index dropped to 1.0% from 1.2%. The Fed's favorite indicator, the PCE Deflator, ticked up a tenth for the month of June to +0.2%, but the YoY headline dropped to 3.0% from 3.8% The Core PCE dropped a tenth to +0.2%, and the YoY Core dropped to 4.1% from 4.6%. The final read on the U of Michigan 1yr Inflation Survey for July held steady at 3.4%.

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I would think the Fed would be happy to see the trajectory of Prices, but they continue to point at the Core readings as a concern, and they still maintain their target for inflation is 2%.

At the **FOMC** meeting on Wednesday, the Fed hiked the Funds Rate +25bps to a new target of 5.25-5.50%, resuming their monetary tightening, as the market expected. The statement was little changed with the committee declining to give further guidance other than maintaining their data dependence. One interesting comment from Chair Powell when he noted the Fed staff is no longer forecasting a recession.

With the Core PCE dropping to 4.1% and Fed Funds rate now above 5.25%, the Fed has put rates solidly in restrictive territory. The economy and the Labor market in particular are showing continued strength, but the lagged effects of 525bps of Fed tightening and a significant amount of Quantitative Tightening, may yet slow things down. Given the Fed's stated goal of bringing Core inflation back to their 2% target, it's hard to imagine they would be done tightening, despite calls from the market. So, the big questions, is

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the Fed done hiking or how much further will they go? The next Fed meeting is seven weeks away on September 20 and they will see two more Payroll reports and two more CPI reports . The Jackson Hole conference is also coming up Aug 24-26.

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Rates

FedFunds Futures yields rose a bit over the course of last week. The market closed Friday pricing a 19% chance for another hike at the September meeting. The Terminal Rate also ticked up a couple basis points to 5.42% for the following meeting in November. The rate for the December meeting closed Friday at 5.375%. A bigger move was seen further out the curve as the rate for year end 2024 moved up 15bps for the week, to 4.18%.

Global Core Sovereign Rates generally rose last week with curves steepening a bit. In addition to the Fed meeting and data, there were other movers of the rates market. The ECB hiked 25bps Thursday morning to 4.25%, as expected. Then on Friday, the Bank of Japan kept rates unchanged, but unexpectedly said it would conduct its Yield Curve Control policy with more flexibility, allowing the 10yr JGB rate to fluctuate around its upper limit of 0.50% as a "reference", as opposed to a "rigid limit". The implication is that the yield could rise as high as 1%, to where the BOJ moved its purchase target. That news was leaked on Thursday on the back of Tokyo core CPI reaching 4%, a 41 year high. It doesn't sound like much, but global bonds sold off on the implication that the last remaining major Central Bank might be in the process of ending their easy money policies. The 10yr JGB ended Friday 11bps higher in yield to 0.54% and rose again overnight to 0.59%.

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Treasury rates rose a bit, as well.

2yrs closed the week +3.5bps at 4.875% after trading in a 14bp range and to a high yield of 4.95%. Front end rates continue to be under pressure from Fed policy, despite the better than expected inflation data. 2s had rallied after the CPI release on July 11 to a low yield near 4.60%, but have since retraced quite a bit. The cycle high yield was set on July 6 at 5.12%.

10yr Treasuries put in the largest move on the Treasury curve, rising +11.5bps to close at 3.95%, after putting in a 25bp range for the week. The high yield of the week was 4.04% on Friday. The bulk of the jump in rates took place Thursday off the surprisingly strong GDP report, and then the BOJ YCC news later in the afternoon. 10yr yields had generally been trending lower since hitting their cycle high at 4.33% way back in October, but the resilient economic data seems to have reduced the likelihood of a recession for many, sending 10yr rates back to the upper end of their range for the year. After that 4.04% level, the high yield from March and again in early July at 4.09% looks to be next support. Then the 4.33% cycle high yield. For resistance, 3.92% is a retracement level, then 3.79% is the midpoint of the macro range.

Since November, the **30yr Bond** has been trading in a narrowing range that is actually trending toward slightly higher rates. 4.08% is basically a double top in rates, reached early in July and again Friday before bouncing. Behind that looks to be 4.18%, 4.34%, and then the cycle high from October at 4.42%.

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The **2s10s curve** flattened early last week to a max of -106bps Monday, but reversed over the rest of the week, getting to -86bps early Friday before closing at +8.5bps less inverted at -93.2bps. The charts show a double bottom at -111bps from March and again early in July.

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Rates Vol jumped on Thursday's action but reversed a good bit of that Friday, and closed higher for the week, but still not far off five month lows.

Swaption Vol generally rose last week, modestly bouncing off some near term lows, though short maturities with short locks came off hard.

Looking ahead

Don't forget today is month end and then this will be another big week for data, and especially the Labor market, highlighted by the JOLTS Job Openings tomorrow, ADP Employment Wednesday, and of course the NonFarm Payroll report Friday. ADP is expected to show a gain of +183k jobs, but far fewer than the 497k in June.

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NFP is expected to come in fairly close to last month's increase of +209k, with the Unemployment Rate holding steady at 3.6%

No term Treasury supply this week, just TBills, but Treasury will announce their quarterly refunding plan on Wednesday.

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