Weekly Market Summary

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US Treasuries Finally Give-In & Break Major Levels!! Surely Not the Levels I had in Mind Though!!

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Ten days back, the US Federal Reserve met under Chairman Jerome Powell and unanimously agreed to raise the benchmark lending rate a quarter-point whilst also forecasting a steeper path of hikes in 2019 and 2020, citing an improving economic outlook. "*The economic outlook has strengthened in recent months… and will require further gradual adjustments in the stance of monetary policy*," the policy-setting Federal Open Market Committee said in its statement. "*The job market remains strong, the economy continues to expand, and inflation appears to be moving toward the FOMC's 2% longer running goal*," Chair Powell added at his ensuing press conference.

With US 10-year yields hovering around the 2.90% level, Chinese officials recommending slowing or halting purchases of American debt, bond veteran & legend Bill Gross claiming a bear market in US bonds has already began, and ballooning US budget deficits over the coming years necessitating the US government to sell the most debt in eight years in 2018 (JP Morgan estimates net issuance at $ 1.3 trillion this year, more than double the 2017's tally), it was just a matter of time – at least to my mind - for that benchmark US rate to break the psychologically important 3.00%, and head soon after towards 3.50% (before 2018 year-end).

Instead, and to my great surprise, all we could get was a 20 bps move lower in yields, that accelerated once the all-critical 2.80% support got taken out (US 10-year yields settled yesterday at 2.735%)! So what exactly triggered this surprising bond surge, and where do we go from here?!

A slew of factors seem to have fuelled this latest rally:

1) Stock markets - both in the US & globally – have witnessed sharp volatility and sell-offs in past weeks, with Dennis Gartman calling the peak in equities (Dennis is a popular commodities and equities pundit & editor and publisher of the closely watched Gartman Letter).
2) The Federal Reserve Bank of Atlanta downgraded its first-quarter growth estimate after retail sales missed estimates.
3) Regular inflammatory tweets from the White House on how badly the US is getting treated by its trade partners. Trade tensions also stirred anew as German Chancellor Angela Merkel said she is unsure if Europe can win exemptions from American tariffs.
4) Surprisingly strong US bond auctions this week offered a supportive backdrop (usual herd mentality trading that leads to buying the highs and selling the lows!).

More importantly, it is hard to deny the déjà vu feeling in the US$14.7 trillion Treasuries market, as traders look back to 2014 and 2017, when yields peaked in early months and later defied market consensus - trading and settling lower as both years drew to an end (in fact, 2017's high in 10-year yields was witnessed on March 14th - almost exactly a year ago!). "*We are increasingly comfortable with the notion that the 2018 peak of 10- and 30-year yields might have already been established*," BMO Capital Markets strategists Ian Lyngen and Aaron Kohli wrote in a report.

For those caught off-guard by the extent of the bond rally (pick me!), the shift is "*still not alarming but definitely worth watching current rates if equities can't find their way home,*" Jim Vogel, a strategist at FTN Financial Capital Markets, wrote in a note earlier this week. "*As various tech and social media stories continue to get pummelled on a regular basis, however, trading lower on yields is gaining ground.*" What is more, positioning in Treasuries – as suggested by recent figures showing that hedge funds and other large speculators had a net short position in 10-year Treasury futures that was the close to the most extreme in a year – signals that the latest break of major technical levels and moving averages might have been the main cause for the recent shift in momentum and market shakeout, with traders rushing to cover "*wrong*" bets to protect from further losses!

A lot of very smart investors have looked very dumb in recent years by predicting a bear market in bonds (pick me again!☺). Of course, bonds have had their ups and downs, but nothing that can really be called a full-on, nasty, 1970s-style selloff. And whilst they may still turn out to be right, it appears that it won't probably happen anytime soon. That said, more strategists are expressing concern about the ability of the U.S. to fund the twin budget and current-account deficits; that was also a major concern in the early 2000s, but then the financial crisis came and those worries subsided as the Federal Reserve took control of markets. With the Fed now backing away, those worries will shortly resurface, and market players – as well as our valuable clients - would certainly be better-off adapting to the notion that a combination of improving growth prospects and larger US deficits will sooner or later require higher yields, a weaker dollar, or both to attract foreign investors and domestic interest!

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