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The Day Ahead: If Yesterday was All Draghi, Does NFP Matter Today?

In yesterday's recap, I asserted that the crazy sell-off was 100% about Draghi and negative infinity percent about Yellen's congressional testimony.

What did Draghi do, exactly? It was actually surprisingly simple. He exposed and/or confirmed one of the fundamental market dynamics of the QE era. **Financial markets are addicted to QE!**

This is definitely **not a new concept.** After all, the punch bowl metaphor has been making the rounds for years with respect to the Fed , and to a lesser extent, the ECB. Even so, there is always some level of debate as to just how closely correlated market movement is with the proverbial punch bowl.

Long story short, we got a great opportunity to observe an ECB punch-bowl "de-spiking" in relative isolation. How can I say "isolation" if Yellen was talking to congress and if US bond markets got killed?

Simple...

1. EU bond markets got killed WAY WAY more than US bonds (in fact, US bond markets only had that token sell-off that we've seen so many times when they've been dragged around by Euro-drama)

2. EU stocks were destroyed more than US stocks.

3. Peripheral EU bond markets (the stuff that benefits most from ECB QE) experienced the full day's worth of selling in the first 15 minutes of the news! (That's a 25bp sell-off in Italian 10yr yields in 15 minutes. That's intense!).

4. 2yr yields (which more closely track Fed rate hike prospects) didn't budge! Seriously, they didn't even rise a full basis point. By contrast, 10yr yields were up over 11bps. This is probably the biggest clue that Yellen didn't matter.

Failing all that, we could just look at German Bunds (one of the tamer performances in the EU today) versus US 10's, with chart scaling based on the past few days (meaning we'll line up the highs and lows in Treasuries and Bunds from earlier this week) and then see how Thursday looks.

It looks like this:

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.40	-0.15
MBS GNMA 6.0	100.78	+0.04
10 YR Treasury	4.4223	+0.0454
30 YR Treasury	4.5610	+0.0549

Pricing as of: 5/17 5:59PM EST

Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.09%	+0.07	0.00
15 Yr. Fixed	6.56%	+0.03	0.00
30 Yr. FHA	6.62%	+0.07	0.00
30 Yr. Jumbo	7.35%	+0.04	0.00
5/1 ARM	7.30%	+0.06	0.00
Freddie Mac			
30 Yr. Fixed	7.02%	-0.42	0.00
15 Yr. Fixed	6.28%	-0.48	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.08%	-0.10	0.63
15 Yr. Fixed	6.61%	+0.01	0.65
30 Yr. FHA	6.89%	-0.03	0.94
30 Yr. Jumbo	7.22%	-0.09	0.58
5/1 ARM	6.56%	-0.04	0.66

Rates as of: 5/17

Moving on now... If Yellen didn't matter yesterday, does NFP matter today?

You bet! Yellen and NFP are **two entirely different** representatives of US market fortunetelling. Unless Yellen specifically addresses a concrete plan for the pace of rate hikes, all we really care about from her is whether or not the Fed is hiking at the next meeting. They are indeed hiking (barring an unforeseen catastrophe) and so Yellen was of no use to us yesterday, nor can she be of much use to us until we start getting into the 2ND rate hike debate (yeah, that's coming up quickly).

NFP, on the other hand, is **infinitely qualified** to comment on the 2nd rate hike. NFP is all about the longer term shape of the economy. That's why it moves markets. NFP is very likely NO LONGER all about determining whether or not the Fed will hike in December. So we're not talking about the same sort of shock-value seen in yesterday's Draghi Drama--at least not unless NFP utterly and completely tanks (sub 100k and an increase in unemployment combined with stable or rising labor force participation). If we don't see such a tail event (hat tip to MBS Live cornerstone S.K.), then NFP doesn't have a bearing on short term Fed decisions. Thus, it is just like a regular old NFP. That means it can move markets a lot or a little. But in either case, keep in mind that markets just moved a whole heck of a lot yesterday. In such cases, the following day can have a mind of its own due to whatever havoc was wreaked upon the structure of trading positions

This **could look like either of the following scenarios:**

1. Traders who were left holding bonds they wanted to sell yesterday who are now merely waiting for a corrective overnight bounce or weak NFP headline to bump prices a bit (higher prices = better selling opportunity

2. Traders who are interested in buying the proverbial dip, but who were waiting to see if an NFP beat could bring prices just a bit lower before they get back onboard (lower prices = better entry point for buyers).

Sorry if that seems like an equivocal "markets could go higher or lower" statement, but that's the way it works. If there was any sort of market consensus on which way things would go, it would already have been traded back to neutrality. Market participants aren't going to let you or me (or even other market participants) see those cards until they're being played.

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