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The Day Ahead: Low Rate Narrative Entering Tricky Territory

We're getting into some **tricky territory** with respect to market behavior and predicting the future. 2016 has been fairly unidimensional so far. Bonds rally, stocks lose ground, and even when stocks try to gain back ground, bonds still hold theirs (thanks to things like foreign central bank accommodation and the general global economic malaise).

That combination of accommodation and malaise is the sort of stuff that's helped German 10yr yields do as well as they have in the following chart (red line):



As you can see, and as we discussed yesterday, US 10yr yields have been caught in a bit of tug-of-war between positive and negative cues. Clearly, bonds benefited earlier in the year from panic in oil and stocks. To whatever extent oil and stocks can stage a recovery here, bond rally prospects will be **limited, at best**. In that scenario, weakness would be the baseline.

But what about the so-called 'narrative?' I'm talking about the **bigger picture, economically bearish point of view** that takes into consideration the following:

- The maturity of the economic cycle colliding with the discontinuation of Fed accommodation
- Currency wars (competitive devaluation among major foreign banks in order to bolster economies via exports)
- Structural debt-servicing burden (i.e. it's easier for governments to pay back debt at lower rates)

MBS and Treasury

	Price / Yield	Change
MBS UMBS 6.0	99.02	-0.41
10 YR Treasury	5.0427	+0.0567
30 YR Treasury	5.3801	+0.0244

Pricing as of: 11/12 9:42AM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30YR Fixed	7.30%	+0.12	0.00
15YR Fixed	6.92%	+0.09	0.00
30YR FHA	6.89%	+0.07	0.00
30YR Jumbo	7.40%	+0.03	0.00
7/6 SOFR	6.80%	+0.31	0.00
30YR VA	6.90%	+0.07	0.00

Rates as of: 11/10

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- The uneven economic recovery (i.e. the bottom half of society isn't in the same sort of historical position that it may have been in the past to spend money and help elevate the broader economy)
- The possibility that low oil prices will be more persistent than economic models currently predict, thus keeping inflation persistently lower (because oil is key ingredient in the cost of so many goods and services--either directly or indirectly).
- The absence of the next great exponential driver of growth. (Last one was "the internet" in the 90's and 2000's, potentially with some help from the housing bubble).
- The eerie realization that rampant central bank stimulus may have crippled the efficiency and resilience of financial markets in such a way that they cannot truly recover, and that a large percentage of the apparent gains in recent years has merely been borrowed from monetary policy, and that said gains will have to be given back at some point.

Yes, there's that. Whether or not it's accurate remains to be seen, but it's certainly **a romantic ideal** for a fan of low interest rates: "the world is going to hell in a handbasket. Long live low rates!" Or something like that.

But here's where it gets tricky. For the sake of the argument, let's assume the narrative holds enough water that the general trend in rates will continue to be "flat-to-lower." The current issue is that markets **simply can't** go one direction indefinitely. If everyone is on one side of the trade then no one is making money. In other words, there will be corrections along the way, even if the narrative continues.

That's why things are tricky at times like this, because they lead to a questioning of the narrative. This doesn't have to be tricky from a strategy standpoint though. Simply assume the narrative is defeated or at imminent risk of being defeated when charts start looking like they are now, but secretly hope this is merely a lost battle (as opposed to the war). The part about assuming we're screwed is important though. There are only a few historical examples of bounces like this getting right back on track with lower rates. Most of the time, days like Tuesday were **fairly big turning points**. Sometimes that's meant only a month or so of pain. Other times, it's been considerably worse.



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The rest of the week's data will probably only make fine-tuning adjustments to the bigger picture. Yesterday's ISM data simply cannot be SOLELY credited with such a move. The fact that it happened anyway tells us that **trading goals are bigger than the data**. That doesn't mean data won't matter, or that we shouldn't observe the reaction in markets. It's just my way of saying don't be surprised if weak data fails to help us or if stronger data doesn't have as punchy of an effect as yesterday's ISM.

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