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The Day Ahead: What's Next if Bonds Remain Under Pressure?

- Yesterday was a wake-up call, forcing us to think about defense vs offense
- Shorter term trends already under attack
- longer term trends aren't too far away from being under attack
- revisiting longer term trend boundary would be scary

Yesterday's FOMC Minutes and corresponding market movement served as a wake-up call for our sleepy, little, low rate range that has persisted for most of 2016. The "triangle" we've been tracking is suddenly at risk of being challenged. That's either a good thing or bad thing, depending on your point of view.

In the positive sense, reaching the top of the triangle and the 'oversold' levels in fast stochastics (the red/blue lines breaking the ceiling in the chart above) would provide a cue for the next bounce in the consolidative range. Of course, this assumes that the short-term consolidative range continues to hold. Naturally, **that range can't hold forever**, and unfortunately, there's a

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.61	+0.22
MBS GNMA 6.0	100.74	+0.21
10 YR Treasury	4.3150	+0.0332
30 YR Treasury	4.5088	+0.0231

Pricing as of: 7/8 5:51AM EST

Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.03%	-0.05	0.00
15 Yr. Fixed	6.44%	-0.01	0.00
30 Yr. FHA	6.50%	-0.05	0.00
30 Yr. Jumbo	7.24%	-0.01	0.00
5/1 ARM	7.05%	-0.02	0.00
Freddie Mac			
30 Yr. Fixed	6.95%	+0.09	0.00
15 Yr. Fixed	6.25%	+0.09	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.03%	+0.09	0.62
15 Yr. Fixed	6.56%	+0.09	0.54
30 Yr. FHA	6.90%	+0.11	0.95
30 Yr. Jumbo	7.11%	-0.01	0.50
5/1 ARM	6.38%	+0.11	0.54

Rates as of: 7/5

greater risk that it will be broken on the upside before we explore lower yields.

If such a break occurs, there are several places we can look for supportive ceilings, but I highlighted the two most important general options. The first option would be to bounce somewhere in the 2.0% range--a horizontal pivot zone that's seen its fair share of bounces at levels from 1.95-2.02. After that, we'd look to the longer-term bullish trend marked by the white dotted line. The actual level would depend on how long it took us to get there, but in any event, wouldn't be too much higher than 2% if it happens quickly.

I know **you might be thinking** something like this: "wait wait wait... Why are we suddenly so bearish on bonds and talking about these crazy high yield levels that I thought we'd never see again?!"

It's a fair reaction, but we've been **spoiled** by light volatility on the part of markets that have been fairly dismissive of the Fed. Now over the past 2 days we have a Fed that has loudly declared they're tired of being dismissed and markets need to show some respect. Not even 10 minutes ago, the following wire came out:

"LACKER: MKTS TOOK WRONG SIGNAL FROM FED IN MARCH AND APRIL"

Indeed, that's been the whole point of the Fed's rhetoric on Tuesday and Wednesday. History tells us that the repricing of Fed expectations can be a **quick and somewhat violent** process. I will frequently be reminding you not to be complacent about the risks simply because they seem to have come on suddenly and to be very much out of line with the reality that had been in force for the past 4 months. To be clear, I'm not saying we're necessarily destined to keep selling and to quickly hit these scary ceilings, but I am saying that we should be just as prepared for that eventuality as anything else.

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