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# The Week Ahead: Clock Ticks on New Era For Bonds, but Until Then...

- After 2012, low rates in US have followed Europe
- Even then, US rates have set their own limits
- Now we're bouncing along those limits again and 'consolidating'
- The next distinct move begins a new era for rates
- We're just waiting to see what direction it will go

There are simple and complex approaches to understanding bond market movement. **Let's take a simple approach** today and look at potential rate movements in the context of "the economy." There are those out there who say the economy isn't doing too terribly well. They also might call attention to the length of the expansion and point out that these things typically don't last much longer than this one has. They don't see any more meaningful growth without some fundamental change in terms of innovation or fiscal policy. They can easily conceive new all-time lows in US rates as soon as the writing in their minds makes it onto the proverbial wall.

Then there are those who feel that the current economic environment is **allowed to break the rules** regarding the things that should happen at this stage in an economic expansion. Their rationale is that the financial crisis and recovery has been so different from other examples that the logical next steps seen after past recoveries may well break the rules this time around. They don't think we're necessarily destined to see a decline in stock prices simply because the last two cycles rolled over right around the 7-year mark and because--as of now--so has this one.

One of these sides will end up being at least partially right in the sense that the economic outlook will either brighten or dim in the 2nd half of 2016. The Fed is generally saying that it will brighten enough for them to raise rates 2-3 times, depending on which Fed member you ask. Their contention is that rate hikes **won't hurt the economy**. Rather, they'd be a response to an economy that's strong enough to support them. If they're right, the "higher" crowd wins.

If, instead, the Fed can't quite keep to the plan of 2 or more hikes this year, **risks increase** that "lower" crowd is right about a big picture economic cycle shift.

At the moment, bond markets are absolutely telling us that there's a **stalemate** between these two fundamental ideals, and it's playing out in the

## MBS and Treasury

| | Price / Yield | Change |
|---|---|---|
| MBS UMBS 6.0 | 99.43 | -0.62 |
| 10 YR Treasury | 4.9860 | +0.0952 |
| 30 YR Treasury | 5.3557 | +0.0737 |

Pricing as of: 11/10 5:59PM 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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form of the consolidation that's dominated most of 2016 so far.




Not only is the timing of the consolidation no mistake (considering we're fast approaching a Fed meeting in June that would either need to see the Fed hike or strongly set the stage for a July hike if the "higher" crowd is to remain in this fight), but the levels of the consolidation are even more certainly not a mistake. Reason being: there is something **slightly magical** about the high 1.6 to low 1.7 range in 10yr yields when it comes to the long-term Treasury range.

Granted, we've seen lower yields in 2012 and briefly in 2013, but as I've said, that was a golden era of low rates, brought about by special circumstances that don't currently exist (domestic QE + Fed still talking about expanding accommodation + European crisis). Now that we have no more domestic QE as well as the Fed talking about continuing to remove accommodation, merely knocking on the door of that "golden era" range is quite an accomplishment. To be sure though, this is, for all intents and purposes, **the long-term floor** for domestic bond markets. Yields even chose to bounce here when their gravy train (European bonds) kept on truckin' to new all-time low yields.

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All that to say that a convincing break through the 1.7/1.6's would be a huge sign that the 'lower' crowd was emerging victorious. But until either side is able to lay its first claim to victory, the driving force will be more sideways than anything. On a final note, it's good to remember that there is much more room to run higher in yield versus lower in the context of the longer-term consolidation. What I mean by that is that the **path of least resistance** in the biggest of pictures is for yields to retreat to area in the white circle in the following chart. The fact that they haven't tells us just how skeptical markets are of the Fed's current rhetoric and/or the ability of the domestic and global economies to generate meaningful growth.




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