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The Day Ahead: Stock/Bond Divergence: Is Someone Lying?

- <insert something about "Brexit" and "Uncertainty" here>
- <insert a few random bullet points about stuff that doesn't matter here>

Woops! I gave away the formula for 99% of any market analysis over the past week, but I have some space to fill, so on we go! Yes, the post-Brexit trade really is that big of a deal, and yes, there really is a metric tonne of uncertainty surrounding the topic. **The problem** we're dealing with is "the long-term maybes vs the short term realities."

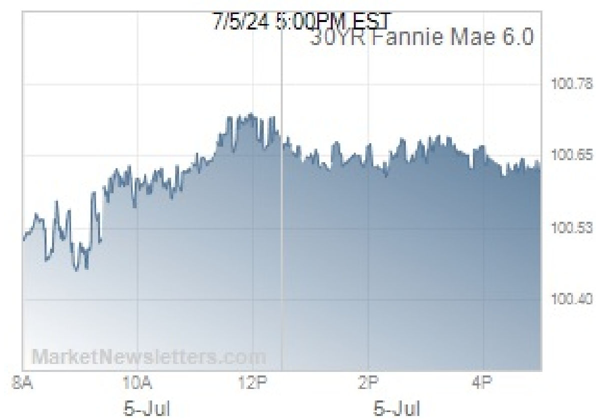
As it turns out, the short term realities **aren't that scary.** When I began reading up on Brexit from folks that knew a lot more about it than I did, I definitely got the sense that the short term realities were never destined to be that serious. One of the main reasons for this is the drawn-out political process that must take place before anything really changes in terms of the UK's legislative and financial relationship with the rest of the EU.

It seems like stock markets **didn't really understand** this at first, and are only slowly coming to terms with the possibility that Brexit doesn't bring about the immediate end of the world. British stocks actually express the best understanding of this, as they're already generally back in line with pre-Brexit levels. In other words, investors are increasingly seeing Brexit as "not so bad after all" for the UK, but still potentially bad for the rest of the EU. This can be seen in the discrepancy between UK and EU stocks in the following chart (US stocks are splitting the difference)

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	4.2939	+0.0121
30 YR Treasury	4.4881	+0.0024

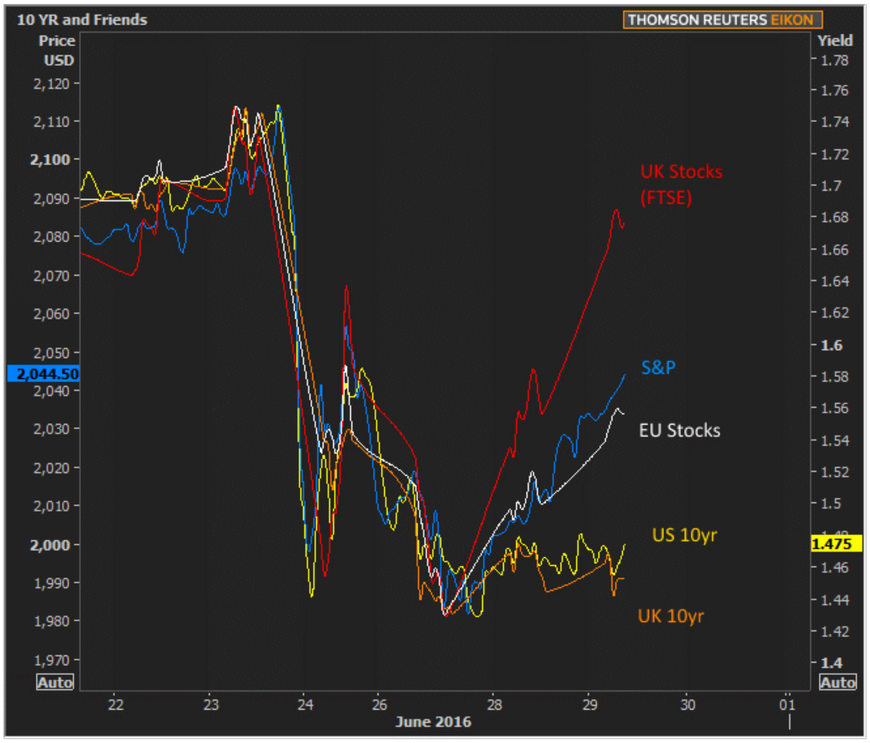
Pricing as of: 7/8 3:55AM EST



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



And then there are the bond yields... still pretty low! **What's up with that?**

Bond yields are staying low for **several reasons** and several more possible reasons.

- long term, bonds are accounting for the increased odds of more countries leaving the EU
- The bounce back in stocks is largely due to CASH getting put back to work after being pulled out pre-Brexit (thus, not much of an implied strain on bonds)
- It's the day before quarter-end, thus requiring bond traders to hold a certain mix of bonds and dissuading any significant selling pressure
- Even if Brexit isn't an immediate threat to global economic stability, it definitely creates long-term uncertainty. Bonds benefit from that.
- Even if Brexit is altogether meaningless for almost everyone, it's meaningful enough for the Fed to have said it probably won't hike rates any time soon

The problem, or rather, **the risk I see** here is that bonds have made a move based on things that operate on longer-term timelines and that are rooted in uncertainty. While I continue to believe that global growth and rates are in the process of asymptotically approaching 0-1%, I'm not sure what will keep US rates near all-time lows in the short term, unless investors simply decide "it's time" to start accepting the global realities as opposed to continuing to be duped by perpetually optimistic forward guidance from the Fed (i.e. the stuff they say about where they think rates will go).

We're near all-time lows just as much because Yellen said (effectively) that "low rates could be the new normal" as anything else. **Case in point:** bonds hit 1.51 on the day she said that, and today we're at 1.47. With this in mind, perhaps the fact that stocks are bouncing back while bonds stay low doesn't necessarily mean one side of the trade is lying. After all, super low rates have historically been good for both stocks and bonds. I'm not sure what else stocks have to instill confidence about moving back toward all-time highs unless it's all-time low rates.

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