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The Day Ahead: Revisiting Longer Term Trends as We Wait For Next Move

- Bonds have maintained long-term consolidation trend almost all year
- We have yet to see a meaningful attempt to break out
- But such an attempt must come within next 2 months--probably sooner
- When it does, it's no guarantee of the eventual direction

The "triangle" or "pennant" is a fairly common buzzword in the realm of technical analysis (the study of market movement based solely on previous market movement, as opposed to fundamentals like economic data and headlines). I would **never** advocate relying solely on technical patterns as a framework to approach market movement, but like many, I agree that it's exceptionally useful to look for correlations between the technicals and the fundamentals.

The current environment lends itself quite well to this endeavor. For instance, we have the "triangle" of consolidating (aka "increasingly narrow trading range") rates in place for most of 2016. What **fundamentals** can we connect this to?

First thing's first: **we can no longer make a case** for oil and stock prices being a primary consideration, even though that seemed to be the case earlier in the year. There's just too much deviation recently. Check out German Bunds and US Treasuries marching to their own beat while stocks and oil move higher:

MBS & Treasury Market Data

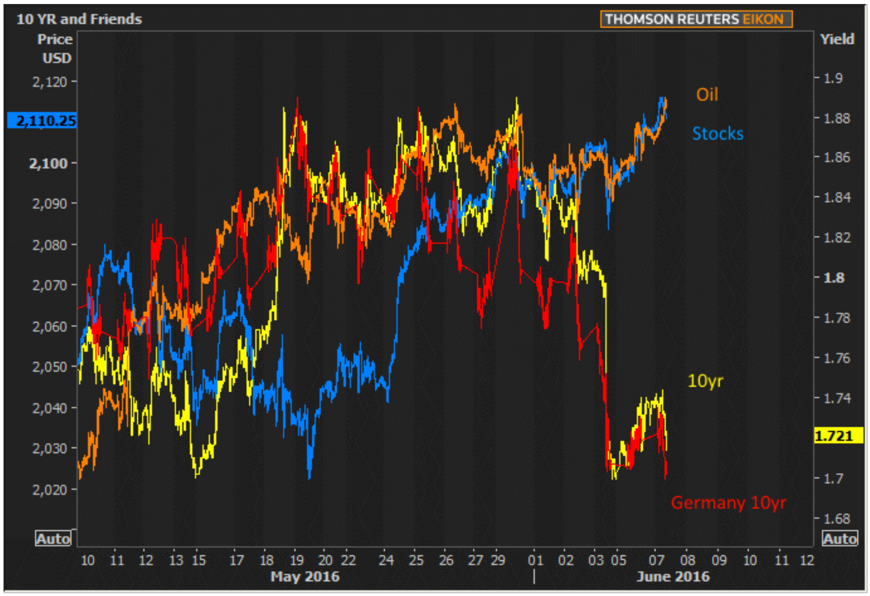
	Price / Yield	Change
MBS UMBS 6.0	100.61	+0.22
MBS GNMA 6.0	100.74	+0.21
10 YR Treasury	4.3150	+0.0332
30 YR Treasury	4.5088	+0.0231

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

Average Mortgage Rates

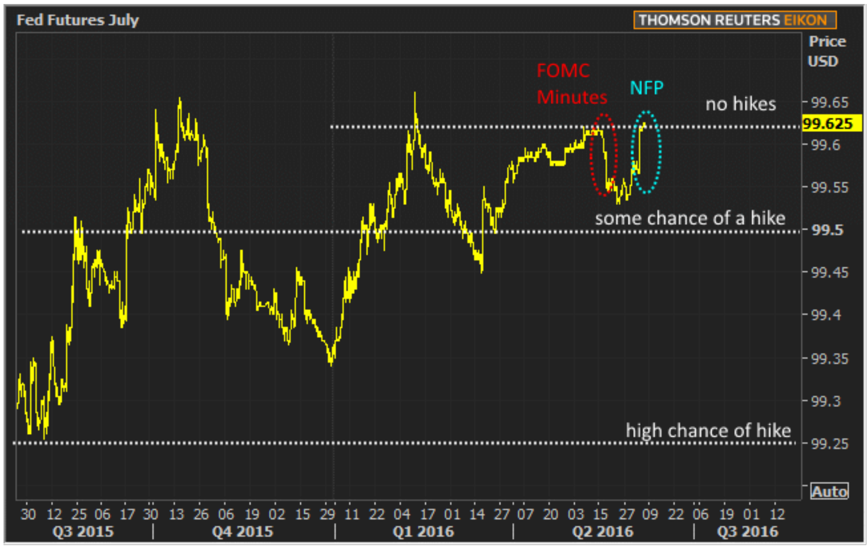
	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.03%	-0.05	0.00
15 Yr. Fixed	6.44%	-0.01	0.00
30 Yr. FHA	6.50%	-0.05	0.00
30 Yr. Jumbo	7.24%	-0.01	0.00
5/1 ARM	7.05%	-0.02	0.00
Freddie Mac			
30 Yr. Fixed	6.95%	+0.09	0.00
15 Yr. Fixed	6.25%	+0.09	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.03%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

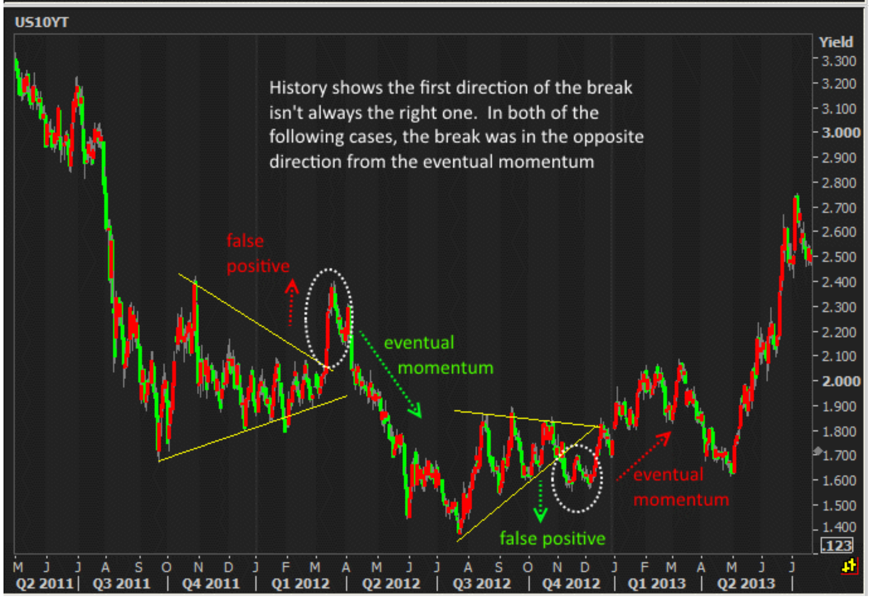


So what is the consolidation all about if not the potential long term "top" in stock prices? If you're thinking about the Fed rate hike outlook, you're right! When in doubt, we **always come back** to the simple stuff like major central bank policy. After all, it essentially determines the cost of money!

The following chart is July Fed Funds Futures. The higher the line, the lower traders see the Fed Funds Rate by the end of July. Essentially, a level of 99.5 would mean traders are betting on a Fed Funds rate of 0.5% after the July Fed meeting (Fed Funds Futures work like this: 100 minus the price = the rate that traders are betting on). Because the Fed is setting rates in quarter point ranges, a 99.625 price equates to 'unchanged' rates (due to the 0.25-.5 range averaging out to 0.375, and 100-0.385 = 99.625). Long story short, last week's NFP got us back to **"very little chance" of a hike in July.**



You might have noticed something else about the chart above. It, too, seems to be moving in that triangular, consolidative pattern we've been following in Treasuries. And of course that's right in line with today's thesis about the bigger picture market movement being chalked up to the Fed policy outlook. The following chart shows that, although rates technically have room to continue moving inside the triangle through the July Fed meeting, past examples show that they tend to break these triangles **before** running out of room. Two of the most prominent examples from 2011 and 2013 show that the direction of the first break isn't always the prevailing direction after a few weeks or months.



It should be noted though, in both of the historical examples, the classical reading on each of the triangles suggested the eventual momentum. In other words, in 2011, a flat triangle following a downtrend suggested a continued downtrend. In 2012, the ascending triangle suggested a move higher in rates. In both cases, **that's what we got,** even though there were head fakes that made us doubt it at first.

Things don't always work out "as expected" when it comes to financial markets, but if they did, the current triangle's classic implication probably leans more toward lower rates. That's both **exciting and scary** considering we're on the doorstep of all-time lows.

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