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The Day Ahead: Quest Begins For Treasuries to Fill The Gap

We started to talk about **"the gap"** in yesterday's closing commentary and unless bond market momentum manages to stay far weaker than anyone expects, we'll be talking about "the gap" again very soon. Well, technically, we'll be talking about it right now, but you know what I mean.

Simply put, "the gap" refers to a gap in the trading range between 2 days of trading. If today's **lowest** intraday yields are **higher** than yesterday's highest intraday yields, that's a gap (it can work in the other direction of course, but that's not the kind of gap we're dealing with at the moment). The more visible the gap, the bigger a deal it tends to be for traders.

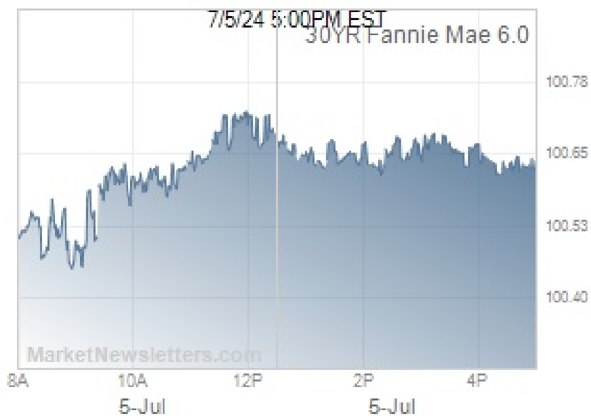
Here's the current gap:

So **what do traders do with gaps?** The prevailing wisdom suggests that gaps are inflection points that often serve as a cue to reset and re-trade the trades that created the gap in the first place. In other words, if yields were to fall back to the 2.155-2.17 range, traders would be concerned that other traders would begin selling bonds more aggressively again.

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	4.2818	-0.0784
30 YR Treasury	4.4857	-0.0440

Pricing as of: 7/5 5:59PM 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

But of course, when it comes to financial markets, if a certain pattern always played out the same way, the fabric of space time would ultimately disintegrate and the **universe would implode**. Things just don't work that way. So indeed, there are instances of gaps being filled where rates subsequently break through the gap and head in the other direction.

As I'm very fond of saying, with respect to significant technical levels, the technical level itself (be it a "gap" range or simple pivot point) **doesn't** hold any promise of serving as a ceiling or a floor. Rather, if a particular technical level has suggested its own importance by consistently acting as a ceiling or floor (or as a gap!), our takeaway from a market-watching standpoint is to pay more attention to what happens next when yields (or prices, or whatever we're tracking) hit, cross, bounce, or orbit that significant technical level or zone. Long sentence, but an important one.

Bottom line, we're **likely due a showdown** with the gap (at least we'd hope we make it back there). I would go so far as to say that gaps tend to have a special sort of gravity that all but guarantees they'll be revisited. It's the next move after that that deserves the most attention. If bonds bounce without breaking through, it would have big, negative implications for longer term trends. If they break through resoundingly, the next major showdown would be with 10yr yields that start with a "1" instead of a "2."

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