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ALERT: What's With The Paradoxical Reaction to Italy?

With so much volatility in US bond markets recently, it's been easy to simply focus the market movement itself, as opposed to considering the **root causes** of the movement. In that sense, the market has been like a patient with a traumatic outward injury, and markets have been like ER doctors dealing with the trauma.

Now it's time to consider the underlying disease that might be causing the symptoms. We know the most traumatic injury occurred in the wake of the US election, but is that the patient's **only problem? No.** There's also Europe to consider, and this actually accounts for a good amount of weakness last week (because of increased certainty over the ECB's plans to announce some sort of tapering on Thursday).

Part and parcel of the European situation was the **Italian referendum** this past weekend (good story on it HERE). It received plenty of attention (some would argue "undue") as another expression of populist sentiment--similar to Trump's victory in the US. The problem (which is rapidly becoming clear in hindsight) is that most investors thought the outcome of the referendum would be a tradeable event, whereas it was the market's response to an already-known outcome that has been the big story.

That's a bit confusing, so I'll try to break it down.

Bottom line: heading into this weekend, the rejection of the Italian referendum was **much more likely** than the average market participant realized. For those in the know, the uncertainty wasn't about the referendum result, but rather, the market response.

The initial market response was **as expected:** ostensible populism won. European uncertainty increased. So bond markets rallied. 10yr yields were as low as 2.34% just before the start of the European session as a result.

But things **changed on a dime** when European traders sat down for the day. The safety and caution built into trading levels following NFP on Friday were quickly erased. For German Bunds (a benchmark for the overall European bond market), we can see the "caution rally" just barely erased. Italian bonds had built in even more caution, and they began well before Friday's NFP (notice the spike lower in the orange line on Dec 2 in the chart).

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
Freddie Mac			
30YR Fixed	7.18%	+0.97	0.00
15YR Fixed	6.57%	+1.10	0.00
Mortgage Bankers Assoc.			
30YR Fixed	7.30%	+0.18	0.75
15YR Fixed	6.76%	+0.33	0.98
30YR FHA	7.02%	+0.24	1.07
30YR Jumbo	7.20%	+0.05	0.48
7/6 SOFR	6.29%	+0.19	1.00

Rates as of: 11/10

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Think of this like **"bracing for impact,"** and then getting back to business when you realize the impact wasn't all that scary. Markets were prepared for more chaos following the referendum. When traders saw no chaos, they quickly moved back into previous positions.

Unfortunately for us, the "previous position" was "10yr yields holding above the important 2.42% pivot point.



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