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The Day Ahead: What Happens If Bonds Break This Ceiling? (Philosophical Discussion on Technicals)

This primer (and this one, and this one) will be useful for digesting the following, if you haven't read it before.

For those paying any sort of attention to trading levels in bond markets over the past few weeks, it's hard to miss the super narrow range between 2.825 and 2.885 in 10yr yields. That's been **perfectly** intact since June 27th, and was broken for the first time in today's overnight session.

In the chart above, there are plenty of **causes for concern** in terms of the technical implications of recent moves:

1. Mid-Bollinger (middle yellow line) is broken
2. 2.885% was broken overnight
3. short-term momentum hasn't been oversold enough (above upper blue line) to imply support

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 5.0	99.37	+0.02
MBS GNMA 5.0	99.93	+0.02
10 YR Treasury	3.9068	+0.0029
30 YR Treasury	4.1960	+0.0028

Pricing as of: 9/1 7:34PM EST

Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.43%	+0.02	0.00
15 Yr. Fixed	5.95%	0.00	0.00
30 Yr. FHA	5.82%	+0.02	0.00
30 Yr. Jumbo	6.62%	0.00	0.00
5/1 ARM	6.28%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85

4. longer-term momentum has plenty of room to run (empty space between current levels and oversold)

	Rate	Change	Points
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 8/30

But rather than serve as the **starting gun for an acceleration in selling**, the overnight break above 2.885 has been just like any other random bit of moderate weakness. In fact, even after breaking above 2.885% again in the opening hour, yields are back down into the 2.87's yet again.

So **what's the point** of following technical levels if "nothing happens" when important technical developments occur?

Several thoughts there:

First of all, no market approach will **ever** accurately predict the future. Take the highest probability approach of a simple "if/then" statement applied to data and bonds, for example. There have been times where we can say "if NFP comes in much higher/lower than expected, bonds should sell/rally accordingly." In fact, for a stretch of many years, such a statement was a given, but we've since seen it go out the window for various reasons.

In contrast, technical analysis is **far less reliable**. It always has been. To say that big things will happen if yields break over 2.885 is folly. To say recent movement suggests breaking above 2.885% is more important than any other random move higher is more in line with how technical analysis is implied.

So **why aren't we skyrocketing** higher after breaking 2.885%

Ahhhh! Now we come to the **wonderfully frustrating fudge factor** surrounding technical analysis. While we may be watching day to day market movements under a microscope, the market isn't always trading with a microscope. In my experience (which includes paying way too much attention to nitty gritty technical levels and observing how reality chooses to unfold), "important ceilings" oftentimes take the shape of a general zone of yields or prices. One day it might be 2.885. Another, it might be 2.889, and so on. It's only when we take a step back we see that bonds have been orbiting the high 2.8% range and the circumference of that orbit is less consequential than the central point of gravity.

And much like a planet that could theoretically escape its orbit around a central point of gravity, it would take **more than just a small change** in the circumference of its orbit to cause much concern.

This dovetails into **my final point:** technical breaks are rarely a major event in moment-to-moment trading. Granted, we can often see big buying or selling motivated by the break of intraday levels, but those levels are rarely the exact same ones everyone else is watching. For example, if we're all looking at 2.885, some accounts may have had selling triggers set at 2.87 (actually, probably true in the case of some selling yesterday afternoon). Other accounts may be waiting for something slightly higher than 2.885 to use **as a BUYING trigger** (yeah, that can happen too, and it may be happening this morning)!

Rather, we'd need to move above 2.885 with a certain combination of distance and time in order to consider the ceiling broken. There's always **a certain amount of magic** involved in determining that amount of distance and time, but markets know it when they see it, and you'll know it if they do. I know, you'd like me to give you some general ballpark though. In that case, I'd say we typically like to see a ceiling broken by more than 2bps (i.e. 2.905%+ for a technical of 2.885%), for that break to be intact by the 3pm CME close, and for it to remain intact throughout the following trading session.

With all of the above in mind, we can easily reconcile the absence of a massive selling spree this morning. The "**fun**" part about following financial markets, however, is that we can't easily rule out that it could always be right around the corner. That said, a big buying spree is always in the cards too--especially if everyone else is seeing a selling spree as being more likely.

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