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The Day Ahead: Selling Obviously Overdone, And That's a Problem

If you didn't catch it, and want to get caught up with yesterday's big move, this tweet has several links that should bring you thoroughly up to speed: https://twitter.com/MG_MBS/status/1047627670987526145

Moving on to today, I have a saying that I've only dusted off a few times over the past 10 years. I was thinking about using it today:

> "The biggest risk to this analysis is how obvious it is."

This is analogous to a scene in any given movie where someone says "this feels like a trap" or "it's quiet... almost too quiet." In market terms, it has to do with the fact that widespread agreement on what SHOULD happen next often results in the opposite thing happening. After all, if every trader made the same trade, **none of them** would make money. So it can behoove the savvy trader to take a contrarian position to that of the masses.

What's the **obvious** conclusion this time? That's a good question. I think the gut reaction for most market watchers is that the rate spike is **obviously** overdone and that we're **obviously** due a reprieve. Based on my little saying above, that would actually be a bad thing because opportunistic traders would further push a selling agenda as they did the last time we saw a remotely similar breakout.

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

	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

I don't bring up May 15th to make a prediction about the next few days. Predictions are for suckers. I bring up May 15th as a reminder that markets can easily do the opposite of whatever it is we thought they should/would do. It's entirely natural to think of a move like yesterday's as **"too much, too soon"** and assume it's destined for a quick bounce.

I do hope we see such a bounce, but it **would be a mistake** to feel entitled to it. If you've been tuned in over the past 24 hours, you're probably tired of being directed back to this old blog post from April, but it's super relevant to the current situation. Back then, it felt like "too much, too soon" to see 10yr yields surge up to 3%, but when we looked at the economic stats compared to the last time rates were at 3%, it not only made sense to be there again, but 3% actually looked a bit low by comparison.

This time around, we could easily expand the same list as follows:

CORE CPI INFLATION

2013/14: 1.6-2.0

April 2018: 2.1

October 2018: averaging 2.3% over past 2 months. Average hourly earnings at post-crisis highs

AVERAGE (6-quarter) GDP READING

2013/14:: 1.5-2.4

April 2018: 2.6 (could be higher on Friday)

October 2018: 2.88% today, and possibly over 3% by the time Q3 GDP is finalized

STOCK PRICES

2013/14:: S&P closed out 2013 around 1850

April 2018: 2634 at yesterday's close

October 2018: 2925 at yesterday's close

FED POLICY STANCE

2013/14:: Tapering announced, but reinvestments remained and rates were pinned at 0-.25

April 2018: Reinvestments being tapered (more to come). Fed target: 1.5-1.75% and more hikes foreseen

October 2018: Fed rate is now 2.125% and an even faster pace of hikes is foreseen

OTHER CENTRAL BANKS

2013/14:: Europe had not even begun its big QE plan yet

April 2018: Europe's big QE plan slated for tapering after Sept 2018. Other central banks talking about tightening.

October 2018: European tapering plan finalized and discussion has moved to timing of first rate hike (sound familiar?)

FISCAL POLICY STANCE (ISSUANCE OUTLOOK)

2013/14:: cruise control. No major developments after Fiscal Cliff (resolved Jan 2013, well before rate spike)

April 2018: Tax bill creates huge Treasury issuance needs (selling more bonds to cover revenue loss). This is certainly priced-in to current rates, but not completely. It's also a moving target until we see what the increase in revenues looks like from any uptick in economic activity/profits/earnings/etc.

October 2018: Revenues definitely aren't paying for the tax bill. Repatriation has far undershot forecasts. More Treasury issuance is implied.

Add to this list all of the other anecdotes like the highest ISM readings in 14 years or the highest consumer confidence in 18 years, and being "only" 20bps higher than we were in April 2018 makes more logical sense.

All of the above having been said, I DO think there's a lot of fear built in to current levels, and I think that same caveat applied in April. In other words, we could say that 3% rates in April weren't necessarily a reflection of where economic data actually was at the time, but rather, where it COULD go. Same story now as the recently amazing numbers increase the risk of inflation and growth to such an extent that the Fed could be hiking too slowly. **Fortunately**, I think some portion of the strength in the current numbers represents a sugar high from the tax changes as well as an urgency to move business decisions forward due to trade-related uncertainty.

Nonetheless, the economic data matters much more than we're accustomed to. **If you glean nothing else** from this commentary, glean that. This is the first time in the past 10 years that we've been in a stable cycle of rate changes from the Fed. Such cycles greatly increase the importance of econ data because confirmed shifts in the data will result in much more predictable policy changes from the Fed. When rates were pinned at zero, no one really knew what it would take for the lift-off to begin.

Bottom line: tomorrow's NFP--especially the wage growth component--is critical. It was a critical ingredient in last month's weakness as well. If the year-over-year reading breaks over 3.0%, today's rates **might look generous** by comparison. On the other hand, if earnings disappoint, the corrective bounce could undo a significant amount of yesterday's damage.

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