U.S. TREASURIES: WHERE THE BANDS ARE

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The financial markets seem to be at an inflection point in trying to determine where the next visible move will be. Indeed, since this year's peak risk-off day on Feb. 11, the equity, credit and commodity markets have all experienced rather notable positive movement, but one has to wonder whether this improvement was merely a reversal from oversold conditions or a sign that a renewed forward trend has in fact begun. A key factor as we move ahead will be the U.S. economy. Economic growth here in the States has witnessed a definitive slowing over the last six months, highlighted by real gross domestic product (GDP) growing only 0.5% in Q1. We wrote in our April 20 blog post "U.S. Fixed Income: Skate to Where the Puck Is Going" how Q1 trends in recent years have tended to come in on the soft side, only to reverse course in subsequent quarters. Will the 2016 experience follow this trend? Perhaps; one of the more closely followed sets of data to help discern the state of the overall economy is the Bureau of Labor Statistics' monthly Employment Situation Report. The markets just received the April release last week; the tenor of the data was somewhat mixed and unfortunately did not serve as much of a beacon, or a key determinant from a June Federal Open Market Committee (FOMC) outlook. To provide perspective, job creation slowed to 160,000 per month, but wages—as measured by average hourly earnings—rose 0.2 percentage points to +2.5%, or at the high end of the band that has existed for the last few years and returning to levels not seen on a consistent basis since 2009. With the economy struggling to maintain the 2% growth pattern that has been in existence since the end of the great recession, and the unemployment rate at 5%, it is certainly up for discussion whether the pace of job growth can continue to be sustained at the rate of +229,000 per month that we saw in 2015. The question now is where Treasury yields are going, especially the 10-Year note. Since reaching a near-term peak of 1.98% on March 11, the U.S. Treasury (UST) 10-Year yield dropped down to 1.70% in immediate response to the April jobs headlines, or back down toward the bottom of the 1.65%–2.45% range that has been prevalent over the last 12 to 18 months.

Source: Bloomberg, as of 5/6/2016.

Looking at the UST 10-Year from a more technical perspective, we see that the yield has now gone through the Fibonacci line of 1.7575% yet again (a 23.6% retracement from the low of 1.53% that was hit on Feb. 11). As the accompanying graph reveals, this is not a new development thus far in 2016 and has not necessarily led to a sustained downward move, at least up to this point. In fact, in each instance over the last few months, this breach has actually resulted in the 10-Year yield resuming an upward pattern, albeit in a rather tight band, and failing to eclipse the 2.0135% threshold (the 50% retracement level). **Conclusion** The future for the UST 10-Year yield will certainly depend on whether growth here at home can snap back and will also take into consideration economic activity abroad. Part of the recent move to the downside appears to have been more safe-haven driven, as concerns about global growth remain. In addition, sovereign debt yields continue to be favorable for Treasuries. In the nearer term, the more likely scenario appears to be for the UST 10-Year yield to remain range-bound at the lower end of the relatively narrow band investors have seen since mid February.

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DEFINITIONS

Credit : A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Treasury yield : The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

U.S. 10 Year Treasury Note : A debt obligation issued by the United States government that matures in 10 years.

Fibonacci retracement : A technical analysis tool displaying percentage lines which look at support and resistance levels, potentially signaling short-term price/yield reversals. The concept of retracement suggests that after a period of market movement, prices/yields can retrace a portion of their prior pattern before returning to their original trend.

Safe-haven : Characterized by being a potentially desirable focal point of investment flows during periods of increased volatility and market risk. Safe-haven is not synonymous with risk-free.

Sovereign Debt : Bonds issued by a national government in a foreign currency, in order to finance the issuing country's growth.