FIXED INCOME: NO NEED TO BUY CANNED GOODS YET

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One can be forgiven if the last few days/weeks have felt like the end of the world could be near. Investors have been hit 24/7 about how "bad" things are, or could get, with what seemed like little, if any, rational or objective thoughts on what the underlying setting actually looks like, especially here in the U.S. Let's try to make some sense of it all, shall we?

- Yes, global/U.S. economic growth is more than likely going to slow this year, an expectation clearly underscored by the recent Purchasing Managers' Index (PMI) readings around the world.
- However, these PMI readings are not consistent with a pending recession. In fact, for the U.S., the recent ISM manufacturing reading is consistent with real GDP slowing from around the +3% threshold to somewhere around the +2.5% level. The 54.1 figure is right at the average it has been across periods of expansion

Now, let's talk about the U.S. jobs report—a solid showing across the board with no anomalies to speak of.

- First, the headline payroll number came in at +312,000, or 128,000 above the Bloomberg consensus. In addition, the prior two months' readings were revised upward by +58,000. Gains were widespread across sectors/industries.
- Average hourly earnings rose by a stronger than expected +0.4%, pushing the year-over-year rate to +3.2%. That means for four out of the five last months, wage gains have been at or above the +3% threshold. That's the best performance since 2009. Once again, gains were across the board.
- The jobless rate rose 0.2 percentage points to 3.9%, but do you know why? The civilian labor force exploded by +419,000, pushing the participation rate up 0.2 percentage points to 63.1%.
- It's been a roller-coaster ride in Federal Funds Futures-land. As recently as early November, two rate hikes for 2019 were priced in. Pre-jobs report, a rate cut actually showed up, but then disappeared post-report. As of this writing, futures point to no Federal Reserve (Fed) action this year.
- The Fed's focus will be on the "hard" data and financial conditions. If the hard data does confirm just a slowing in U.S. growth (as is expected by the policy makers), I would suspect the recent risk-off carnage could come to an end, providing the Fed with an opportunity to raise rates at least once in 2019 and keep balance sheet normalization ongoing.
- Fed Chair Jerome Powell's recent remarks seemed to underscore these points, and he's walking the tightrope by also acknowledging that policy makers are "listening carefully to market's risk concerns" —i.e., they are data dependent and can be flexible on both fronts.
- The U.S. Treasury (UST) 10-Year yield had fallen to the 2.55% mark to begin the new year, placing it right above the 61.8% three-/five-year Fibonacci retracement level of 2.5178 %. On November 8, the yield was 3.24%, an incredible drop of nearly 70 basis points in less than two months.

Conclusion

Barring a collapse in the hard data and an attendant risk-off environment (tighter financial conditions), the UST 10-Year yield seems to be pushing up against resistance to the downside, and has discounted a lot of "bad" news already.

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DEFINITIONS

Purchasing Managers' Index (PMI) : An indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A reading above 50 indicates an expansion of the manufacturing sector compared to the previous month; below 50 represents a contraction while 50 indicates no change.

ISM Purchasing Managers' Index : Represents the health of the manufacturing sector based on new orders, inventory levels, production, supplier deliveries and the employment environment. A PMI above 50 signifies expansion while below 50 signifies contraction.

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

Fed Fund Futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten 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.

Basis point : 1/100th of 1 percent.