U.S. TREASURIES: 'YELLEN' DOWN THE WELL

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04/06/2016

Usually, the Bureau of Labor Statistics' monthly Employment Situation Summary tends to be the highlight of the bond market news in the week of its release. However, the Federal Reserve (Fed) made sure *it* dominated the headlines this time around, as Fed chair Janet Yellen's speech at the Economic Club of New York on March 29 clearly underscored. As a result, the U.S. Treasury market (UST) appeared to have "used up all its gas" following Yellen's speech and barely responded to another relatively solid albeit unsurprising jobs report. The tenor of the Fed chair's speech was viewed by the UST market as being definitely on the dovish side. Positive responses were observed across the board, with yields falling all along the yield curve. In fact, that momentum continued right up to the release of the jobs report, but the market appeared to take a bit of a breather following the release of the employment data. Nevertheless, the "Yellen-led" gains remained basically intact. So, did the Fed chair really offer any groundbreaking news in terms of Fed policy? Obviously, based upon the reactions not just in the UST arena but also in other financial markets, the answer was an unequivocal yes. The main takeaway from Yellen's speech seemed to be that the bar had been raised for potential future rate hikes in terms of both timing and magnitude. In other words, the policy makers will be in no hurry to act and are awaiting further developments to see if another round of tightening is warranted. Was this really that groundbreaking? Not necessarily, especially given the language of the March FOMC policy statement. However, subsequent "Fed speak" led the markets to believe that the April FOMC meeting was still "live" and, given the right circumstances, could actually result in a rate hike. It would appear that, at a minimum, Yellen's goal was to squash the notion that a Fed Funds increase could occur later this month, and she continued to stress that the FOMC expects conditions will only merit "gradual increases" going forward, the exact same words used in the March policy statement and the opening of Yellen's speech. The Fed chair also continued to insist that future policy is data dependent, but it may be more precise to observe that decisions are contingent on improving financial conditions and global economic developments. Once again, these two latter considerations were prevalent in both forms of communication. In other words, domestic economic data is not the sole arbiter of U.S. monetary policy. **Conclusion** In our opinion, the Fed needs to be careful to not give the impression that financial markets are leading Fed policy decisions, as opposed to the other way around. This can have rather disruptive consequences, especially if the voting members begin to push back against market expectations. Since their most recent high points on March 11, both the UST two-year yield and ten-year yield have fallen 20 basis points (bps), as of this writing, while the five-year yield has witnessed an even larger decline of 25 bps. Against this backdrop, it is becoming increasingly apparent that the UST market is, once again, filtering out the Fed as an active consideration for the second quarter, and perhaps even further out on this year's calendar.

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

Dovish : Description used when stimulation of economic growth is the primary concern in setting monetary policy decisions.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

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

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

2-Year Treasury : a debt obligation of the U.S. government with an original maturity of two years.

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

Basis point : 1/100th of 1 percent.

5-Year Treasury : a debt obligation of the U.S. government with an original maturity of five years.