U.S. TREASURIES: JUST ANOTHER ROLL OF THE DICE?

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While the May jobs report was certainly softer than expected from a headline perspective, I don't think it will prevent the Federal Reserve (Fed) from raising the Fed Funds target range at its next policy meeting on June 14. The overall tenor of the May employment data, while not living up to consensus forecasts in some respects, still revealed a labor force setting that the Fed will no doubt view as skewing to the "tight" side.

The headline-grabbing nonfarm payroll figure was the area of the release that most visibly failed to live up to market expectations. Indeed, total payrolls rose by +138,000, against a consensus forecast of +182,000. Also, the prior two months' tallies were revised downward by a combined -66,000. The question is whether this is a sign of weakness or rather a symptom of where the unemployment level is.

On that note, the unemployment rate actually fell by 0.1 percentage points, to 4.3%, the lowest reading since 2001. Even though this latest drop was due to a decline of -429,000 in the civilian labor force, it's still a historically low rate. Given this low level of joblessness, it is probably unrealistic to expect sustained payroll gains of between +180,000 and/or more than +200,000 at this point.

Inflation measures are certainly on the Fed's radar as well. The year over year gain for average hourly earnings held steady at +2.5%, staying in the recent range, but still down from this year's high of +2.8% in February. Once again, considering where the jobless rate is at this point, it would seem reasonable to expect some pickup in wage pressures in the months ahead if job growth holds in the area of at least +100,000 to +150,000.

So, how does the Q2 economic setting look as we enter the final month of the quarter? According to most economists, Q2 real GDP is expected to post a visible rebound from the disappointing +1.2% mark of Q1. The Atlanta Fed's GDPNow gauge (the hot new indicator that markets are watching) has Q2 growth pegged at +4.0%. The aforementioned point is key for the FOMC's decision-making process at its June meeting and why I think another hike is forthcoming. In other words, the disappointment of Q1 could very well prove to be the "transitory" development the voting members thought it was. For the record, the market is certainly expecting a rate hike next week. Fed Funds Futures implied probability had a June rate hike at 90.6% before the jobs report, and after a knee-jerk drop following the headline figures, it actually rose to 92.7% as of this writing. A third 2017 rate hike is still not fully priced in, but that's where the Fed's balance sheet normalization plan enters the conversation.

Conclusion

The U.S. Treasury (UST) 10-Year note rallied in response to the jobs data, with the yield falling to levels not seen since right after Election Day. From a technical perspective, there are two key takeaways: the one-year Fibonacci retracement level to watch for is 2.1346, while the five-year trend analysis has the level to watch at 2.1848. On the downside in terms of yield, both the one-year and five-year trend analysis has the next level at essentially 1.98%. This is certainly a conversation that market participants were not engaging in as recently as a few weeks ago, let alone to begin 2017.

Unless otherwise noted, data source is Bloomberg, as of 6/2/2017.

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DEFINITIONS

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

Fed funds target range : the interest rate band the Federal Open Market Committee decides to implement for the federal funds rate.

Inflation : Characterized by rising price levels.

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

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.

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.

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.