WOULD FED TWEETS WORK BETTER?

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What a week last week was! From the Federal Reserve (Fed) to President Trump's tweet stating that more tariffs on China are potentially coming to Friday's jobs report, it was a bond market watcher's nirvana. Let's break it down and take it in backward chronological order:

- The July jobs report was right on target, and overall a "good" number. Total nonfarm payrolls rose +164,000 or basically the same figure as the consensus forecast. However, to be fair, the prior two months' tallies were revised downward by a combined 41,000. Nonetheless, the U.S. economy still produced +165,000 jobs per month through the first seven months of the year—not too shabby
- Interestingly, manufacturing payrolls rose another healthy +16,000 in July after a good performance the prior month. The June/July results sort of fly in the face of the recent softening in the purchasing managers' reports, which is something to keep an eye on
- The unemployment rate stayed at its 50-year low watermark of 3.7%
- On a final note, average hourly earnings rose at an annual rate of +3.2%, a 0.1 pp gain, and the first increase in five months
- There is no doubt that the President's tweet regarding China tariffs overtook any Fed-related headlines, as well as the July jobs report
- The potential for additional tariffs being levied on Sep. 1 elevated the "trade uncertainty quotient," and raised the specter of adverse economic consequences and additional rate cuts from the Fed
- Can you have a "hawkish" rate cut? That's what the money and bond markets thought after the Fed meeting
- Yes, they delivered on the widely expected one-quarter point move and kept the policy statement language leaning in the direction of another move later this year (September?), but Powell's statement that this decrease in Fed funds "isn't the start of a long series of rate cuts" took the air out of the market's expectations of two more cuts this year
- That all changed after the President's tweet, however, and Fed funds futures are back to two more rate cuts this year, at least as of this writing
- One thing to keep in mind is the Fed did end its quantitative tightening (QT) two months earlier than previously indicated. This could be akin to a rate cut itself but was largely glossed over
- OK, what about UST yields? After rising post-FOMC meeting, the two-year yield has since reversed course in a rather visible way, while the 10-year yield continued its post-meeting decline down to 2016 levels

- From a technical perspective, after the five-year Fibonacci retracement level of 1.7762%, the next stop on the train to the downside is the all-time low of 1.3180%.

Conclusion

Last week provided the perfect illustration of why fixed income investors should utilize the barbell approach. The market was faced with different scenarios in the span of 24-36 hours: a “hawkish” rate cut, a “tariff tweet” and, finally, a jobs report that suggests the U.S. economy is still moving in the right direction. These crosscurrents are probably not going away anytime soon, and they highlight the usefulness of the barbell approach.

Unless otherwise stated, data source is Bloomberg, as of August 2, 2019.

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DEFINITIONS

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

Rate Cut : A decision by a central bank to reduce its main interest rate, usually to influence rates charged by other financial institution.

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

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

Quantitative Tightening : Quantitative easing is a process whereby a central bank targets lowering longer-term interest rates by purchasing bonds and other securities to stimulate the economy. Quantitative tightening is the reverse process whereby securities are either sold or the proceeds of maturing securities are not reinvested with the goal of tightening economic conditions to prevent the economy from overheating.

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

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

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.

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.