THE BOND MARKET HAS BECOME NON-LABOR INTENSIVE

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10/07/2020

Jobs Day last Friday was the final such report before the election. However, given the headlines surrounding President Trump and the First Lady's COVID-19 diagnoses and the ongoing specter of a potential fiscal stimulus package, this month's employment data has flown a bit under the radar and had little, if any, immediate impact on the bond market. That being said, labor market improvement continued, albeit at a more moderate pace than the last few months. Here are the key takeaways:

1. Despite the "headline miss" for payrolls, the overall report was relatively solid
2. Total nonfarm payrolls (NFP) rose 661,000, visibly lower than the +859,000 consensus estimate, but the prior two months were revised upward by 145,000. Put those two numbers together and the gain (+806,000) is a lot closer to consensus
3. Also, temporary census workers got removed in September, *but perhaps more important was the fact that private payrolls rose 877,000, with job gains widespread across sectors/industries*. Uneven school openings around the country appear to have pushed state and local government education employment down by 280,000
4. The jobless rate fell 0.5 pp to 7.9%, as the number of unemployed declined by 970,000—the peak was 14.7% in April
5. Obviously, the pace of job gains has slowed, and further improvement would certainly be helped by another round of fiscal stimulus no doubt—a point the Fed continues to emphasize. NFP has now recouped about 52% of the Mar/Apr job losses
6. Remember the good old days when Fed Funds Futures would respond to the jobs report? Well, not anymore… With the Fed on autopilot, Fed Funds Futures show no rate hikes all the way through 2023

Fixed Income Insights

After showing little response to the jobs data, the U.S. Treasury (UST) 10-year yield started off this week on an ascending trajectory, with the UST 2s/10s spread widening. Was it a case of revisiting the employment data? Not really. There seems to be a growing sentiment that longer-duration instruments may be vulnerable to a backup in yield in the weeks ahead.

Our base case does look for the UST 10-year yield to rise back over 1% and the yield curve to steepen. In the meantime, any uncertainty over the election results, like we saw in Bush vs. Gore in 2000, could create a risk-off period that could actually push UST 10-year yields lower until a final outcome is known. However, "bond market timing" is not a strategy we would pursue.

Unless otherwise stated, all data sourced is Bloomberg, as of October 5, 2020.

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DEFINITIONS

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

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

Duration : A measure of a bond’s sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

Risk-on/risk-off : refers to changes in investment activity in response to perceived risk. During periods when risk is perceived as low, investors tend to engage in higher-risk investments. When risk is perceived as high, investors tend to gravitate toward lower-risk investments.