SOONER RATHER THAN LATER HAPPENED

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In my blog post last week, I discussed how the Treasury (UST) 10-Year yield could potentially breach the 1% threshold sooner rather than later. Well, it happened!

The December jobs report did come in softer than expected from a headline perspective, but it didn't change the bond market narrative. It should be noted that the unfortunate events at the Capitol building last week had no effect on the money and bond markets. The DC-related development that DID impact the bond market was the result of the Georgia run-offs. Here are some key takeaways:

Insights

- With the Democrat victories for the Georgia Senate seats, the 'Reflation Trade' came into full focus. The bond market's take is that the amount of potential fiscal stimulus/spending that could be forthcoming, as a result of the Democrats holding the presidency as well as the House and Senate, more than outweighs any potential negative economic consequences from higher taxes and renewed regulatory efforts.

- As far as the jobs report goes, total nonfarm payrolls fell by 140,000 versus a consensus forecast for a 50,000 increase. For what it's worth, weekly jobless claims held steady and the unemployment rate remained at 6.7%.

- This soft reading should not be all that surprising given the surge in COVID-19 and its attendant negative effects. The job declines were in the usual suspects, namely, leisure & hospitality.

- Interestingly, other December data points, e.g., manufacturing and service-related PMIs, remained solidly in expansion territory.

- The UST market is looking beyond the jobs numbers and focusing on the aforementioned fiscal stimulus/spending aspect. The 10-Yr yield moved above 1.10%, which is the one-year Fibonacci 50% retracement level. The next stop is 1.29%, and if that's breached, both the one- and five-year analyses then put a move toward 1.50% in play.

- Inflation expectations continue to rise with 10-Year breakeven spreads at 211 basis points, the highest since 2018.

- Other DC news that was somewhat swept under the table: first, the Federal Reserve appears to be in no hurry to change the pace or the composition (maturity breakdowns) of its Treasury purchases, and second, the FOMC minutes and some other Fedspeak last week talked about possible QE tapering later this year. We are keeping an eye on this.

Solutions

- Our 'Reflation Trade' theme has taken center stage in bond-land

- Against this backdrop, we would suggest fixed income investors consider:
  - The WisdomTree Interest Rate Hedged High Yield Bond Fund (HYZD) vs. bank loans
  - The WisdomTree Floating Rate Treasury Funds (USFR) vs. Treasury Inflation-Protected Security (TIPS)

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DEFINITIONS

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

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.

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.

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

Quantitative Easing (QE) : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

Treasury Inflation-Protected Securities (TIPS) : Bonds issued by the U.S. government. TIPS provide protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, you are paid the adjusted principal or original principal, whichever is greater.