Fixed Income Market Insights

March 9, 2023

Key takeaways

Bond yields were mixed this week, with GT2s up 4 basis points and GT10s lower by 15 basis points respectively and 2s/10s more inverted by 19 basis points (-102), driven strong services data and continued hawkish speak by Federal Reserve policymakers. On the data front, the ISM Services PMI index again came in stronger than expected during February, driven by another advance in new orders and resilient business activity metrics, indicative of still-robust demand for services given labor market strength and continued rotation away from goods in favor of services spending. The number of available jobs were again higher than expected at 10.84 million (10.55 million est.) in January, as durable labor shortages and robust demand continue to drive tight labor markets. Initial unemployment claims unexpectedly rose during the week ended March 4th to 211,000 (190,000 last), the first weekly jump in four weeks and highest read since the end of last December, interrupting a historic run driven by chronically tight labor market conditions that have dampened layoffs given persistent worker shortages.

We suggest

We continue to prefer playing rate defense given elevated inflationary expectations and ongoing FOMC rate hikes. We favor barbell strategies in securitized products, anchored by short, higher current cash flow assets and longer, high quality bonds.

Author

David Petrosinelli, CFA
Managing Director
Senior Trader

InspereX

Sublime Services

As economies around the world navigate an uneven period of Covid recovery and monetary policy adjustment, one of the bright spots across the globe has been the continued resilience in services. While this is not entirely surprising given the backdrop of lockdowns, goods over-consumption and supply chain bottlenecks of the recent past, the fact remains that services have been a beacon of light in otherwise uncertain environment of sagging residential and business fixed investment given the sharp rise in interest rates both in the United States and abroad. While this phenomenon is intuitive given the relatively low cost of services versus larger ticket, goods consumption, this trend is likely to continue for an artificially longer period of time given the massive amount of stimulus deployed by Federal and state government agencies, both in the form of direct payments and expanded benefits, and the accumulated excess savings on consumer balance sheets that resulted, estimated to be over $1 trillion. Of course, this is the quandary Federal Reserve policymakers find themselves in today.

Market Snapshot

	This week 3/9/23	Last week 3/2/23	Basis Points Change	Weekly % Change	YTD % Change
3-month USD Libor	5.12%	4.98%	14	2.81%	7.34%
SOFR	4.55%	4.55%	0	0.00%	5.81%
2-year US Treasury	4.94%	4.90%	4	0.82%	11.51%
5-year US Treasury	4.23%	4.33%	-10	-2.31%	5.49%
10-yr US Treasury	3.92%	4.07%	-15	-3.69%	1.03%
2s-10s UST Spread	-102.00	-83.00	-19.00	22.89%	85.45%
DJIA	32,586	32,962	-376.00	-1.14%	-1.69%
S&P 500	3,975	3,970	5.00	0.13%	3.52%
Spot Gold	1,834	1,842	-8.00	-0.43%	0.44%
WTI (Oil) Current Contract	76.41	78.03	-1.62	-2.08%	-4.80%
1-year Brokered CD	5.25%	5.10%	15	2.94%	14.13%
5-year Brokered CD	4.85%	4.60%	25	5.43%	21.25%
5-year Bullet US Agency	4.38%	4.44%	-6	-1.35%	7.35%
5-year/NC1yr Callable US Agcy	5.90%	5.80%	10	1.72%	9.26%
CDX IG Spread Index	76.24	75.25	0.99	1.32%	-7.05%
CDX High Yield Index Spread	101.45	101.61	-0.16	-0.16%	0.82%
15-yr UMBS	5.07%	5.09%	-2	-0.39%	8.80%
30-yr UMBS	5.56%	5.67%	-11	-1.94%	4.32%

Source: Bloomberg data as of 1:30pm ET 3/9/2023 and 2:45pm ET 3/2/2023

On the one hand, back to work disincentives have stunted employer efforts to increase payrolls to satisfy demand, pressuring wages and other compensation progressively higher to attract and retain these employees, adding to an already red-hot inflationary landscape. On the other hand, the cumulative effect of 450 basis points in monetary policy tightening has surely slowed demand in a growing number of economic sectors, with a deeper slowdown expected in the months to come as a series of additional FOMC rate hikes and a longer period of higher short term interest rates appear increasingly likely. Indeed, Federal Reserve Chairman Powell said as much during his semi-annual, congressional testimony this week, stating that the terminal rate, or peak Federal Funds level, is likely to be higher than what was estimated by policymakers in the Summary of Economic Projections (SEP) in December, citing reacceleration of inflation data, namely in core services (ex-housing), which have shown few signs of slowing into the new year. As we mentioned last week, the bond market has begrudgingly followed suit, with Federal Funds futures now indicating a terminal rate of 5.60% for the September contract, up 15 basis points since last Thursday, and higher by 76 basis points versus the end of last year. Additionally, the market has scaled back expectations for rate cuts priced around the end of 2023, with one, 25 basis point rate cut forecasted by January 2024, a reversal of the 50-75 basis points in easing implied at various times during the fourth quarter of 2022. While interest rate expectations are implicitly volatile during inflationary cycles, we believe that the union of resilient services demand, tight labor markets and steamy wage inflation will keep the pressure on the FOMC to continue raising rates, with the likelihood of meaningful, rate cuts by early 2024 fading fast. Stay tuned!

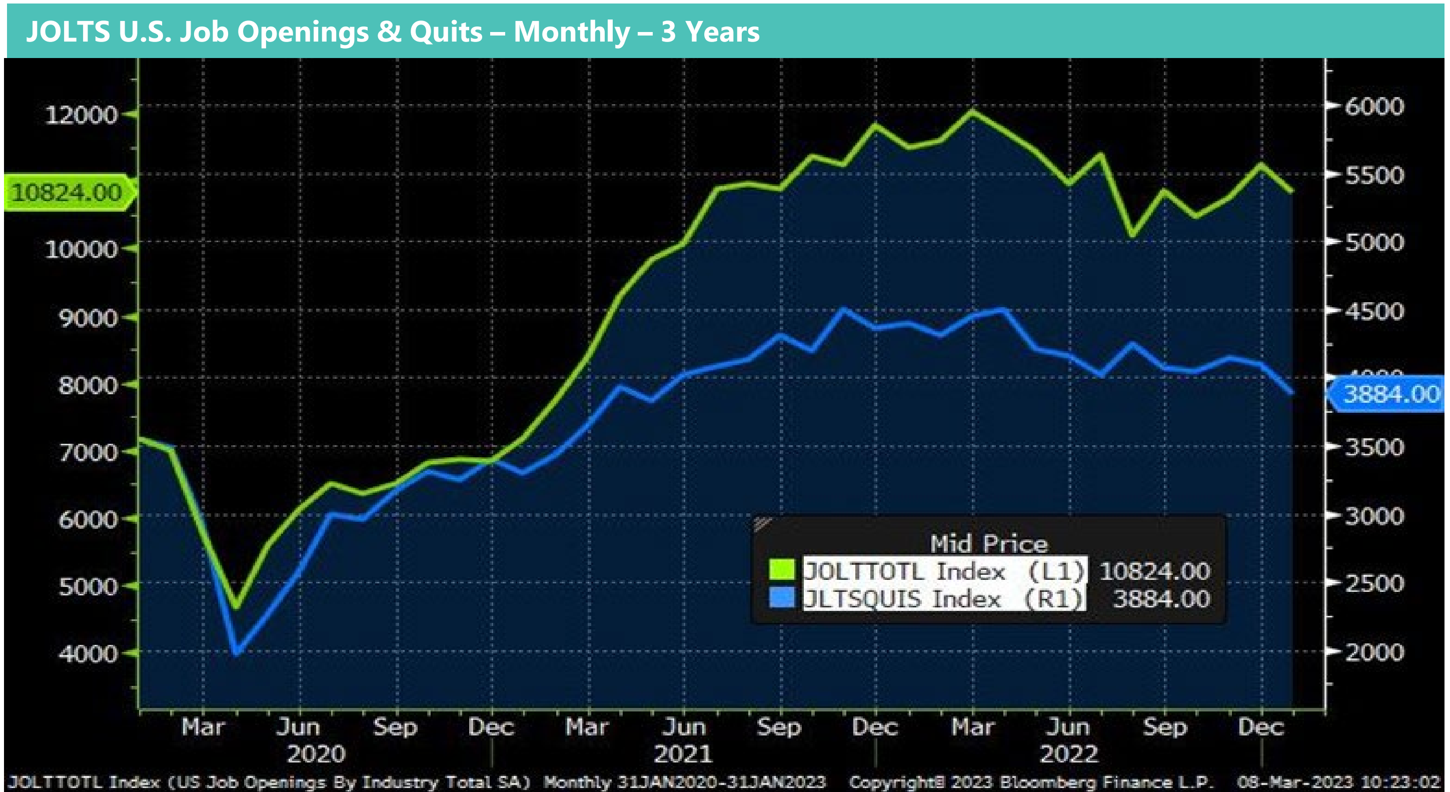
Still minimal news on the fiscal front as extended breaks and house hearings continue to dominate the congressional calendar. Among several legislative initiatives, negotiations regarding the debt ceiling will be front and center in the weeks to come. Away from legislation, the Supreme Court heard oral arguments on last Tuesday regarding the legality of the Biden Administration's student loan debt forgiveness plan, with the decision expected by June. Additionally, the Democratic-led Senate voted 50-46 last Wednesday to block the Labor Department's ESG/Sustainable investment rule adopted last November that aims to encourage retirement plans to weigh climate change and other environmental, social and governance issues in their investment decisions, which the Biden Administration has vowed to veto.

ISM Services PMI – Monthly – 3 years

Source: Bloomberg as of 3/9/2023

The ISM Services PMI index again came in stronger than expected during February at 55.1 (est. 54.5/55.2 Jan.), driven by another advance in new orders and resilient business activity metrics, extending January's gains and indicative of still-robust demand for services given labor market strength and continued rotation away from goods in favor of services spending. A deeper dive into the survey revealed broad-based gains across industries (13 of 17 reporting growth), with new orders and employment up 2 and 4 points respectively (62.6/54), both the highest levels since the fourth quarter of 2021, and delivery times continued to fall (47.6/53.9 Sep.), the lowest level since mid-2009, all suggestive of resilient demand and improving supply chain logistics. Additionally, the data also revealed that prices paid by service providers fell for the fourth consecutive month in February (65.6 vs. 68.7 six-month average), the lowest level since January 2021, but remain historically high. Looking at the text of the report, the senior director of the survey stated that "Respondents indicated that they are mostly positive about business conditions," and that "Suppliers continue to improve their capacity and logistics, as evidenced by faster deliveries. The employment picture has improved for some industries, despite the tight labor market." All in all, a strong report suggesting that demand for services remains durable despite the cumulative effects of FOMC rate hikes and stubbornly high inflation, for now.

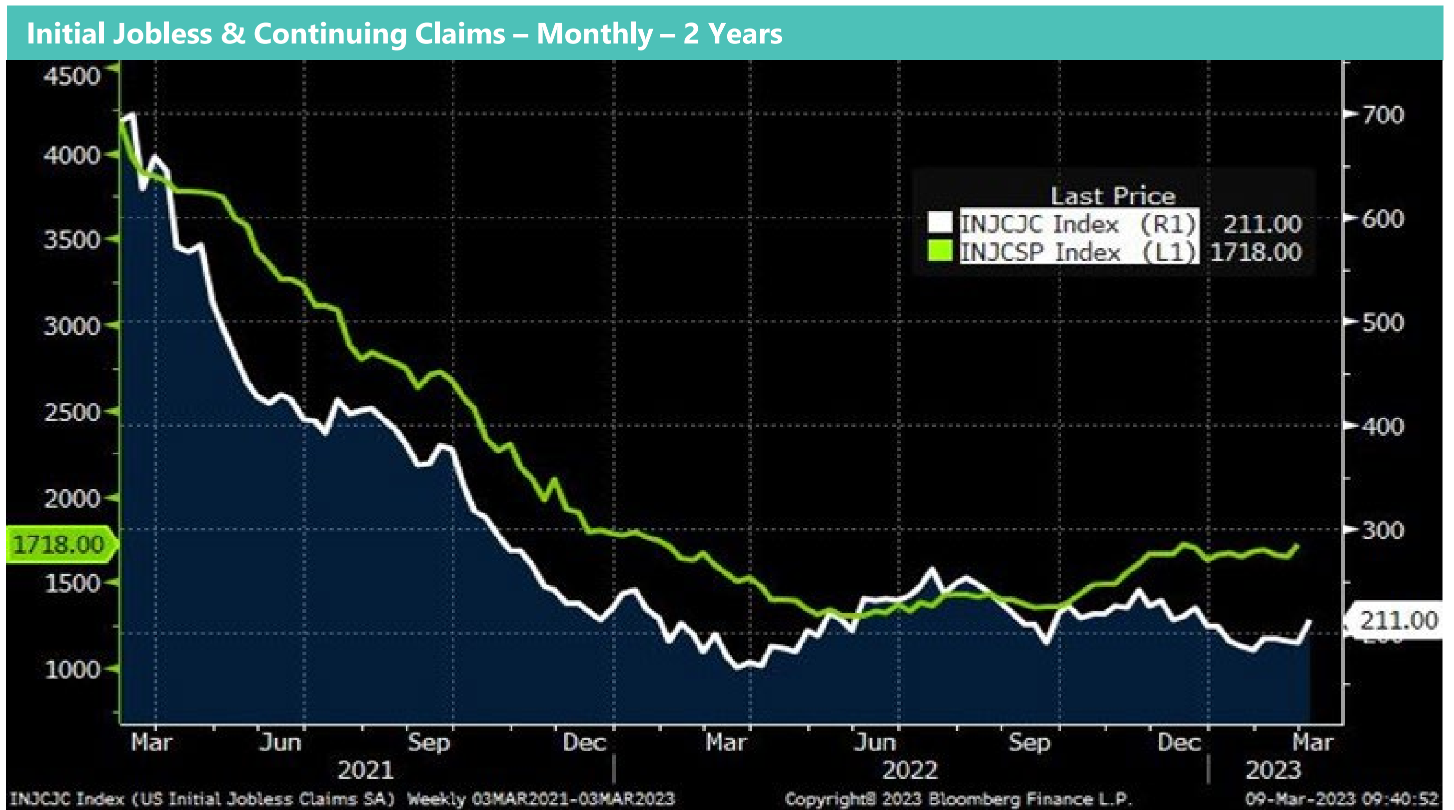
JOLTS U.S. Job Openings & Quits – Monthly – 3 Years



Source: Bloomberg as of 3/9/2023

The number of available jobs were again higher than expected at 10.84 million (10.55 million est.) in January, a reduction of nearly 400,000 jobs from a upwardly revised December (11.23 vs. 11.01), as durable labor shortages and robust demand continue to drive tight labor markets. By industry, job openings decreased in construction (-240,000), leisure & hospitality (-194,000) and financial activities (-151,000), with increases in professional/business services (+95,000), trade/transport (+51,000) and non-durables manufacturing (+50,000), as employers continue to report difficulty attracting and retaining enough workers to keep up with persistently strong demand for goods and services. To be sure, the labor participation rate remains over 1% lower than its 2019, pre-pandemic peak as higher retirement rates, skill mismatches and mixed participation have dampened employer efforts to add new workers. Additionally, the quits rate, which measures voluntary job separations per month as a percent of total employment, was fractionally lower to 2.5% (3.9 million jobs; 2.3% Dec. 2019), just shy of last March's all-time high (3%), as compensation increases, recruiting incentives and the sheer magnitude of job vacancies continue to drive higher employee turnover. Further evidence of job market snugness can be seen in the layoffs and discharge rate, which ticked up to 1.1% during January (record low .9% December 2021) and the 1.92x ratio of jobs available to each unemployed worker (cycle high 1.99x March 2022; 1.15 Dec. 2019), the second highest level since July 2022 (1.95x) and indicative of very tight labor markets. To be sure, chronic labor shortages have forced companies to increase compensation to attract and retain workers, with marginal relief expected during the first half of 2023. While selected labor market imbalances should recede some given FOMC rate hikes and moderating demand, we believe the JOLTS data will remain high as the pandemic and elevated, state-level direct economic assistance drove structural changes to the labor force that have slowed the return to pre-pandemic levels of labor participation. All in all, open positions and the job openings rate (6.5%; 7.4% peak in March 2022) remain historically high and will hasten more rate hikes during the first half of this year as durable labor supply/demand imbalances will likely support solid wage growth and broad-based pricing pressures in the months to come.

Initial Jobless & Continuing Claims – Monthly – 2 Years



Source: Bloomberg as of 3/9/2023

Initial unemployment claims unexpectedly rose during the week ended March 4th to 211,000 (190,000 last), the first weekly jump in four weeks and highest read since the end of last December, interrupting a historic run driven by chronically tight labor market conditions that have dampened layoffs given persistent worker shortages. While weather and one-time effects of New York City school worker holiday filings likely inflated last week's data, this series is likely to trend higher over the next few months as the recent uptick in layoff announcements may presage a broader economic slowdown, triggering more layoffs and slower hiring. The four-week moving average of initial claims, which smooths out outsized observations in the data, rose for the first time in ten weeks, coming in at 197,000 (versus 230,250 on Dec 3rd), though still muted as job vacancies continue to be plentiful. That said, some initial signs of cooling appear to be brewing given the recent rise in continuing unemployment claims, which increased to 1.718 million (1.498 million on Nov 4th) and include people who have already received unemployment benefits for a week, but still historically muted as employers push to absorb the nearly 11 million open positions estimated by this week's JOLTS survey. While total employment has finally exceeded pre-pandemic levels (2+ million jobs), labor participation continues to lag as expanded government assistance, elevated retirements and skill mismatches have stymied employer efforts to attract and retain workers. All in all, the job market remains tight and the claims data portend a slow path to restore better balance between the supply of and demand for labor, which is supportive of the current FOMC party line of 'higher for longer' regarding short term interest rates.

The Week Ahead

The data calendar picks up over the next week, headlined by Non-Farm Payrolls, CPI, PPI and the NFIB Small Business Optimism index. Looking ahead, markets remain focused on inflation, employment data and more signs of slowing economic activity. On the new issue front, ABS volumes surged during the first full week of March with 11 deals totaling $7.29 billion priced through the 8th and $48.6 billion year to date ($48.6 billion over same period last year; $276.7 billion for 2022) and IG corporate issuance was again heavy with $35.5 billion in deals priced through the 8th and $346.3 billion year to date ($317.6 billion over same period last year; $1.26 trillion for 2022). While new issue supply slowed last year given FOMC rate hikes and higher volatility, market conditions have improved significantly since the start of 2023 and the new deal landscape remains favorable for a wider breadth of ABS and corporate issuers as investor demand remains robust.

Friday 3/10
Non-Farm Payrolls

Monday 3/13
No Data Scheduled

Tuesday 3/14
CPI; NFIB Small Business Optimism

Wednesday 3/15
PPI; Retail Sales

Thursday 3/16
Weekly Jobless Claims; Housing Starts

About the author

David Petrosinelli, CFA
Managing Director
Senior Trader

As a fixed income trader with more than 25 years of experience, David Petrosinelli brings deep knowledge and unique perspectives to InspereX's clients. His background includes sales and trading of mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities, collateralized loan obligations, and collateralized mortgage obligations. Before joining InspereX (formerly known as Incapital) in 2020, he served as a Managing Director at Brean Capital and previously held various positions with Piper Sandler Companies and Shay Asset Management. David closely monitors underlying trends within the bond markets and how those markets are shaped by both American policymakers and the global macro economy. He earned a bachelor's degree in accounting and finance from Northeastern University and an MBA in economics and finance from Loyola University Chicago. He is a CFA Charterholder and holds FINRA Series 7 and 63 licenses. He is based in New York City.

This message was prepared by InspereX LLC as of 3/9/2023 at approximately 1:30pm ET for informational and educational purposes only. The author of this material is a Managing Director and Senior Trader for InspereX and is not a Research Analyst. Any opinions expressed herein may differ from opinions expressed by other departments of InspereX. The information and data contained herein is subject to change without notice. Additionally, the content of this material was obtained from sources believed to be reliable, but InspereX does not warrant the accuracy or completeness of any information contained herein and provides no assurance that this information is, in fact, accurate. The information contained herein is for illustrative purposes only and may not represent specific securities available at any given time.

InspereX LLC ("InspereX") and its affiliates explicitly disclaim any responsibility for product suitability or suitability determinations related to individual investors. This information should not be regarded by recipients as a substitute for the exercise of their own independent judgment and the information provided herein is not an offer, solicitation, or a recommendation to buy, sell or hold any security or investment strategy. This material should not be considered, construed, or followed as investment advice, an investment recommendation or research material. InspereX does not provide financial planning, legal, or tax advice. Past performance is not indicative of future results.

This material may include discussions of securities or financial products in which InspereX may have positions, long or short, held proprietarily or in trust. InspereX may execute transactions that may not be consistent with any discussion or conclusion contained herein. InspereX may also have received compensation for performing investment banking services or be (or previously been) engaged in soliciting or performing other services for the issuer(s) of the securities discussed herein. Further, InspereX may have received compensation as a manager or co-manager in a public offering for the issuer(s) mentioned herein.

Investing involves the risk of loss. Investments discussed here may not be suitable for all investors. You should not purchase an investment product until you have read the specific offering documentation and understand the specific investment terms and risks of such investment. The information contained herein does not constitute an offer to sell or a solicitation of an offer to buy securities. Investment products described herein may not be offered for sale in any state or jurisdiction in which such an offer, solicitation or sale would be unlawful or prohibited by the specific offering documentation.

All bonds and fixed income products are subject to a number of risks, including the possibility of issuer default, credit risk, market risk, and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. This effect is usually more pronounced for longer-term securities. Lower-quality fixed-income securities generally offer higher yields, but also carry more risk of default or price changes due to potential changes in the credit quality of the issuer. Adverse conditions may affect the issuer's ability to pay interest and principal on these securities and, as a result, they may have a higher probability of default.

©2023 InspereX℠. All rights reserved. Securities offered through InspereX LLC, Member FINRA/SIPC. InspereX and insperex.com are trademarks of InspereX Holdings LLC.

InspereX