Fixed Income Market Insights

April 6, 2023

Key takeaways

Bond yields were again lower this week, with GT2s down 29 basis points and GT10s lower by 26 basis points respectively and 2s/10s less inverted by 3 basis points (-54), driven by weaker jobs data and the first signs of softer services sector activity. On the data front, Headline PCE prices were up +.3% during February, as lower energy and durable goods prices, slower advances in food and other non-durables were again offset by brisk advances in housing and other services. The number of available jobs came in lower than expected at 9.93 million in February, the lowest level since May 2021 and suggestive of cooling demand in some industries, but still indicative of tight labor markets driven by durable labor shortages and robust demand. The ISM Services PMI index came in much weaker than expected at 51.2 during March, the lowest level in three months, as a steep drop in new orders, softer business activity and slower employment raised concerns that durable strength in services demand may be weaking given the weight of higher prices, elevated interest rates and tighter credit conditions.

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.

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JOLTS Subside and Yields Slide

It's been nearly a month since two-year U.S. Treasury note yields hit a cycle high of 5.07% on March 8th, the highest level since mid-June 2007, and all seemed orderly with Federal Funds Futures and the FOMC in sync regarding more rate hikes and the 'higher for longer' stance by policymakers. Indeed, while there is always an opposition party when it comes to more rate hikes at the end of any meaningful tightening cycle, the underlying economic data appeared to be congruent with the FOMC party line that inflation has come down, but not enough and the labor market remains historically tight, with lofty wage gains a real threat to mire the economy in a low growth, inflationary environment if not met with more rate hikes. Since then, markets have absorbed the shockingly rapid demise of Silicon Valley and Signature banks, mounting concerns of a meaningful credit contraction led by regional/community banks and, more recently, the start of what appears to be a long-awaited cooling in labor markets.

Market Snapshot

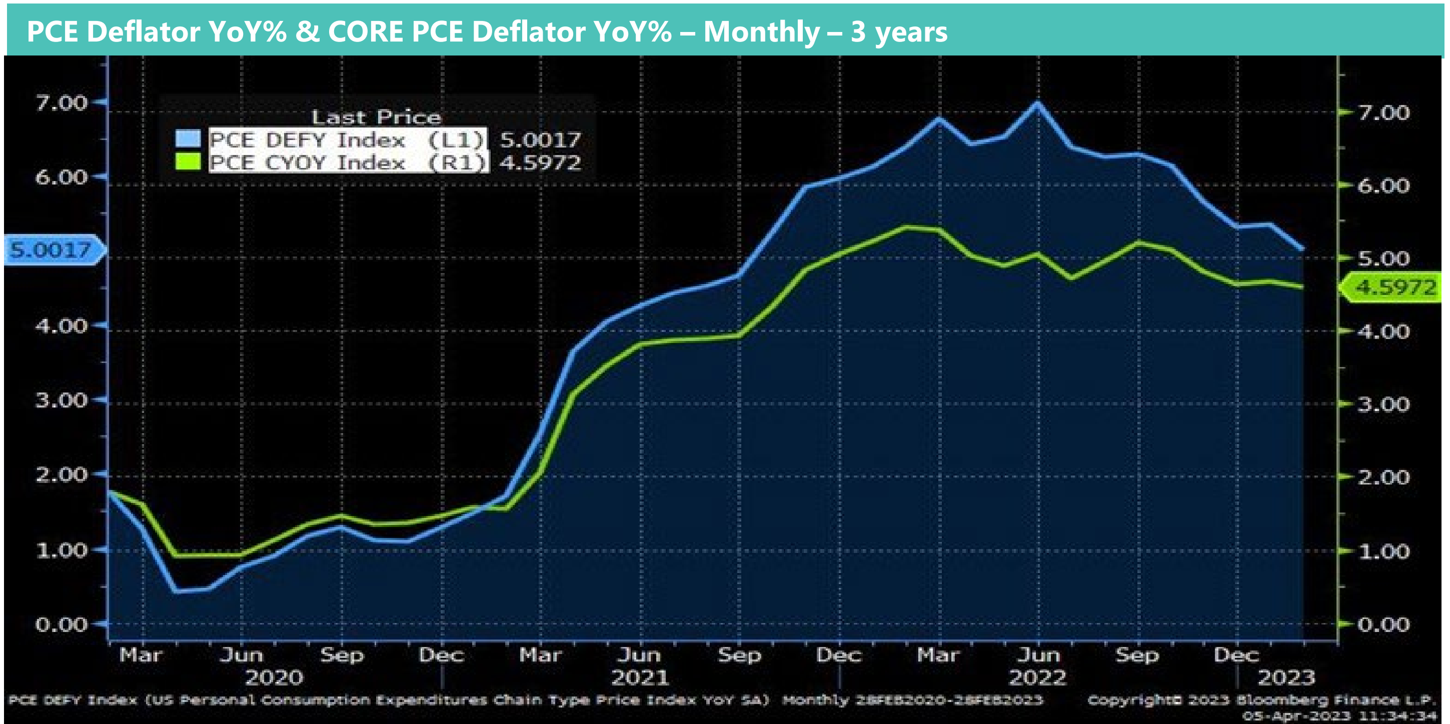
	This week 4/6/23	Last week 3/30/23	Basis Points Change	Weekly % Change	YTD % Change
3-month USD Libor	5.21%	5.18%	3	0.58%	9.22%
SOFR	4.81%	4.82%	-1	-0.21%	11.86%
2-year US Treasury	3.83%	4.12%	-29	-7.04%	-13.54%
5-year US Treasury	3.37%	3.69%	-32	-8.67%	-15.96%
10-yr US Treasury	3.29%	3.55%	-26	-7.32%	-15.21%
2s-10s UST Spread	-54.00	-57.00	3.00	-5.26%	-1.82%
DJIA	33,485	32,016	1,469.00	4.59%	1.02%
S&P 500	4,103	3,929	174.00	4.43%	6.85%
Spot Gold	2,026	2,015	11.00	0.55%	10.95%
WTI (Oil) Current Contract	80.58	69.38	11.20	16.14%	0.40%
1-year Brokered CD	4.80%	5.15%	-35	-6.80%	4.35%
5-year Brokered CD	4.40%	4.75%	-35	-7.37%	10.00%
5-year Bullet US Agency	3.54%	3.64%	-10	-2.75%	-13.24%
5-year/NC1yr Callable US Agcy	4.85%	5.00%	-15	-3.00%	-10.19%
CDX IG Spread Index	78.86	88.07	-9.21	-10.46%	-3.85%
CDX High Yield Index Spread	100.57	99.04	1.53	1.54%	-0.05%
15-yr UMBS	4.29%	4.33%	-4	-0.92%	-7.94%
30-yr UMBS	4.84%	4.89%	-5	-1.02%	-9.19%

Source: Bloomberg data as of 2:30pm ET 4/6/2023 and 2:00pm ET 3/30/2023

Regarding employment, this week's economic data revealed the first real signs of weaker job creation since emerging from the pandemic, with the JOLTS job opening data tipping under 10 million for the first time since May 2021 and ISM services data revealing a slowdown in employment growth, with the Chairman of the survey stating that "There has been a pullback in the rate of growth for the services sector, attributed mainly to a cooling off in the new orders growth rate, an employment environment that varies by industry and continued improvements in capacity and logistics." Indeed, Federal Reserve Chairman Powell has repeatedly stated that resilience in the services sector and the employment that results has been central to the FOMC's calculus regarding the need for more rate hikes and a sustained period of elevated front-end yields, with the implication that wage-price spiral risk outweighs the risk of overtightening. Along with this apparent softening in services and initial signs of labor market cooling, ISM services data also revealed a six-point slide in prices paid for inputs, the largest monthly decline since 2017 and lowest absolute level since July 2020. Taken together with the inventory component of the data, which revealed growth at the fastest pace in nearly two years and order backlogs that depleted at the fastest rate since May 2020, the seemingly impervious services sector appears to be slowing, reinforcing concerns of a more protracted downturn in consumer spending. Accordingly, the bond market response has been striking, with two-year U.S. Treasury note (2yUST) yields plummeting nearly 130 basis points (3.79% from 5.07% Mar. 8th), a more inverted 3month/10yr UST yield curve (-156 from -101 basis points Mar. 8th) and a Federal Funds futures yield curve in full inversion through the January 2024 contract, all strong indicators of the heightened risk of recession and rate cuts by the Federal Reserve as early as this Summer. In addition to the sheer magnitude of this drop in 2yUST yields over the last month, intraday moves have been supersized as well, with swings after the SVB/SBNY failures during mid-March the largest since 1982, with the attendant spike in the MOVE index, the bond market's measure of rate volatility, to the highest levels since the Great Financial Crisis during 2008. While rates markets appear to be in recession formation, the same cannot be said for the stock market and credit spreads for most sectors (ex. CMBS), with the three major equity indices actually higher over the last month, with the rate-sensitive NASDAQ leading the way (+3.40%), and Investment Grade Corporate and Asset-backed (ABS) spreads essentially unchanged over the same period. While it remains to be seen how long these conflicting signals across markets can last, suffice it to say that a full month of inflation, employment and sector-specific data lies ahead of the next FOMC meeting on May 3rd, setting the stage for another, pivotal rate decision and news conference by Chairman Powell. Should another month of softer employment and inflation data materialize, we expect to see broad market indicators (stocks, bonds and credit spreads) to begin flashing the same signal, which should be Red for Recession. Stay tuned!

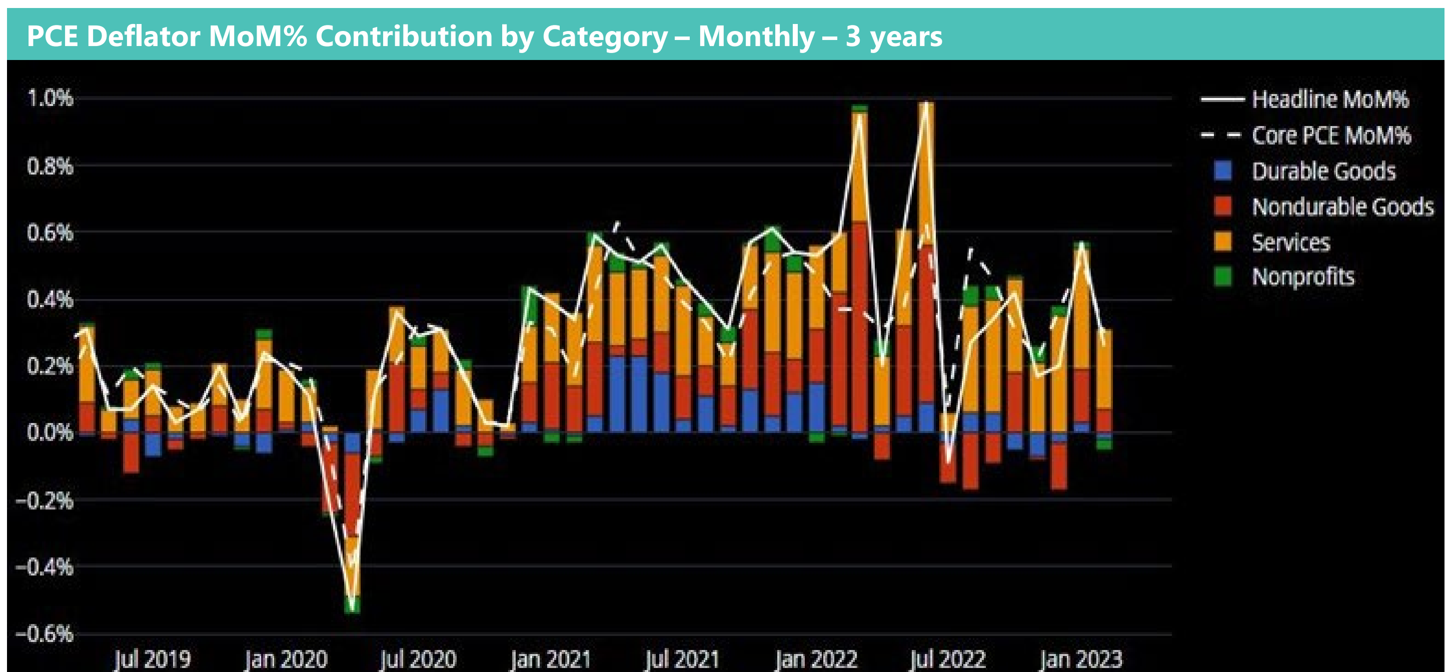
All quiet on the fiscal front again as extended breaks and additional House hearings continue to dominate the congressional calendar. Among several legislative objectives, negotiations regarding the debt ceiling are at the front of the line given the rapidly approaching date when the government could technically run out of money, with estimates ranging from July through September. Additionally, look for mounting calls for tighter bank regulation in the wake of the SVB/SBNY failures last week, with public hearings a near certainty.

PCE Deflator YoY% & CORE PCE Deflator YoY% – Monthly – 3 years



Source: Bloomberg as of 4/6/2023

PCE Deflator MoM% Contribution by Category – Monthly – 3 years



Source: Bloomberg as of 4/6/2023

Headline PCE prices were up +.3% during February (+.3% est./.6% Jan.), as lower energy and durable goods prices, slower advances in food and other non-durables were again offset by brisk advances in housing and other services. Notably, February's more tepid advance dampened concerns that January's reacceleration in goods prices would be more durable, with goods prices up +.2% and services higher by +.3% during the month, and +3.6% and +5.7% on a year-over-year basis, with services accelerating for the sixth time in seven months on an annual basis. In total, headline PCE prices were up 5.0% during the past year, the smallest annual advance since September 2021, but a stubbornly slow descent from last June's 7% cycle high, which was the largest annual increase since December 1981. This closely followed inflation gauge, known as the 'PCE Deflator,' has moved sharply higher since the first quarter of 2021 as higher food and energy prices, elevated rents and chronic labor and materials shortages have slowed production alongside of still robust demand, pushing prices progressively higher. The Core PCE Deflator (excluding food and energy) also slowed during February, up +.3% for the month and higher by 4.6% over the past year, a small deceleration versus September's annual increase (5.2%) and evidence that broad-based inflation remains stubbornly high and demonstrably sticky. Indeed, Core PCE price index advances have been slow to moderate, running 4.4%, 4.1% and 4.4% (Feb-Dec) on a three-month annualized basis, data that supports the persistent narrative by FOMC policymakers that more work needs to be done before the cessation of this cycle's inflation fight. All in all, services inflation remains resilient and continues to offset progress on the goods front, a condition supportive of the current 'higher for longer' short term interest rate stance by Powell and Company.

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

Source: Bloomberg as of 4/6/2023

The number of available jobs came in lower than expected at 9.93 million (10.50 million est.) in February, the lowest level since May 2021 and suggestive of cooling demand in some industries, but still indicative of tight labor markets driven by durable labor shortages and robust demand. By industry, job openings decreased in professional/business services (-278,000), trade/transport (-210,000) healthcare (-150,000) and leisure/hospitality (-87,000), with increases in construction (+129,000) and financial activities (+25,000), as employers continue to report difficulty attracting and retaining enough workers to keep up with 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 stymied 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 higher to 2.6% (4.0 million jobs; 2.3% Dec. 2019), just shy of last March's all-time high (3%), as compensation increases, recruiting incentives and the magnitude of job vacancies continue to drive elevated employee turnover. Further evidence of job market snugness can be seen in the layoffs and discharge rate, which ticked down to 1.0% during February (record low .9% December 2021) and the 1.67x ratio of jobs available to each unemployed worker (cycle high 1.99x March 2022; 1.15 Dec. 2019), a pull-back from January (1.9x) and the lowest since November 2021 (1.95x), but still indicative of tight labor markets. Indeed, durable labor shortages have forced companies to raise 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. Notwithstanding a cumulative decline of nearly 1.3 million job vacancies since the start of 2023, open positions and the job openings rate (6.0%; 7.4% peak in March 2022) remain historically high and will likely support solid wage growth in the months to come as labor supply/demand imbalances endure.

Source: Bloomberg as of 4/6/2023

The ISM Services PMI index came in much weaker than expected at 51.2 during March (est. 54.4/55.1 Feb.), the lowest level in three months, as a steep drop in new orders, softer business activity and slower employment raised concerns that durable strength in services demand may be weaking given the weight of higher prices, elevated interest rates and tighter credit conditions. A deeper dive into the survey revealed broad-based gains across industries (13 of 17 reporting growth), with new orders down 10 points (52.2/62.6 Feb.), the second lowest level since May 2020, employment lower by 3 points (51.3/54.0 Feb.), and delivery times continued to decline (45.8/53.9 Sep.), the lowest level since mid-2009, indicative of improved supply chain logistics. Additionally, the data also revealed that prices paid by service providers fell for the fifth consecutive month in March (59.5 vs. 69.8 six-month average), the lowest level since September 2020 and more in-line with historical averages. Looking at the text of the report, the Chairman of the survey stated that "There has been a pullback in the rate of growth for the services sector, attributed mainly to a cooling off in the new orders growth rate, an employment environment that varies by industry and continued improvements in capacity and logistics." All in all, a demonstrably weaker report suggesting that demand for services may be starting to cool given the cumulative effects of FOMC rate hikes, stubbornly high inflation and tightening credit conditions.

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 picked up this week, with 6 deals totaling $5.6 billion priced through the 5th and $71.3 billion year to date ($80.2 billion over same period last year; $276.7 billion for 2022) and IG corporate issuance was muted given the holiday-shortened week with $9.1 billion priced as of the 5th and $403.9 billion year to date ($485.7 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 generally improved for much of 2023 and the new deal landscape remains favorable for a wider breadth of ABS and corporate issuers as investor demand remains robust, with the caveat that additional fallout from the SVB/SBNY failures will trigger issuance furloughs like observed over the past month.

Friday 4/7
Non-Farm Payrolls

Monday 4/10
Wholesale Trade

Tuesday 4/11
NFIB Small Business Optimism

Wednesday 4/12
CPI; FOMC Meeting Minutes (March)

Thursday 4/13
PPI; Weekly Jobless Claims

About the author

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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.

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