Fixed Income Market Insights

May 18, 2023

Key takeaways

Bond yields were higher this week, with GT2s up 35 basis points and GT10s higher by 25 basis points and 2s/10s more inverted by 10 basis points (-61), as still elevated inflation expectations and resilient job market fueled speculation that the FOMC may not pause at the June 14th meeting. On the data front, the University of Michigan Consumer Sentiment Index came in much weaker than expected at 57.7 in May, the lowest level since last November, as durable inflation and the debt ceiling standoff weighed on consumer optimism despite tight labor markets, higher nominal wages and a five-decade low in unemployment. Sales of existing homes during April came in fractionally lower than expected to an annualized rate of 4.28 million homes, sustaining a rebound from this January's pandemic era low, but still well below pre-pandemic averages given rock bottom affordability via higher mortgage rates and elevated prices. Initial unemployment claims ticked down during the week ended May 13th to 245,000, the first decline in three weeks, consistent with some loosening of chronically tight labor market conditions despite still muted layoffs and persistent worker shortages.

We suggest

We continue to prefer playing rate defense given relatively low market rates, accelerating 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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Consumer's Last Stand?

While residential and business fixed investment have been the first casualties of the most aggressive monetary policy tightening in a generation, some signs of wary consumers have emerged that threaten to derail the economic resilience seen post the darkest days of the pandemic. Battered by durable inflation and higher interest rates, consumers have grown increasingly skittish regarding spending on bigger ticket, discretionary goods in favor of lower priced services. While headline retail sales continue to run ahead of pre-pandemic levels, this data is not adjusted for inflation and the picture changes when reducing these nominal sales receipts for higher prices, which revealed that sales volumes were flat in real (inflation-adjusted) terms during April. Notwithstanding last month's headline advance (+.4%), the first since January, the last ninety days have revealed that total retail sales are down 0.3%. Perhaps more telling, control-group sales, which exclude autos, building-material stores and gasoline stations and feed directly into GDP calculations, were up a mere +.1% over the same time period before adjusting lower for inflation.

Market Snapshot

	This week 5/18/23	Last week 5/11/23	Basis Points Change	Weekly % Change	YTD % Change
3-month USD Libor	5.37%	5.34%	3	0.56%	12.58%
SOFR	5.05%	5.05%	0	0.00%	17.44%
2-year US Treasury	4.25%	3.90%	35	8.97%	-4.06%
5-year US Treasury	3.68%	3.36%	32	9.52%	-8.23%
10-yr US Treasury	3.64%	3.39%	25	7.37%	-6.19%
2s-10s UST Spread	-61.00	-51.00	-10.00	19.61%	10.91%
DJIA	33,262	33,310	-48.00	-0.14%	0.35%
S&P 500	4,175	4,131	44.00	1.07%	8.72%
Spot Gold	1,978	2,021	-43.00	-2.13%	8.32%
WTI (Oil) Current Contract	71.68	70.87	0.81	1.14%	-10.69%
1-year Brokered CD	5.20%	5.10%	10	1.96%	13.04%
5-year Brokered CD	4.50%	4.50%	0	0.00%	12.50%
5-year Bullet US Agency	3.83%	3.50%	33	9.43%	-6.13%
5-year/NC1yr Callable US Agcy	5.20%	4.95%	25	5.05%	-3.70%
CDX IG Spread Index	80.45	80.92	-0.47	-0.58%	-1.91%
CDX High Yield Index Spread	100.16	100.12	0.04	0.04%	-0.46%
15-yr UMBS	4.79%	4.48%	31	6.92%	2.79%
30-yr UMBS	5.31%	5.00%	31	6.20%	-0.38%

Source: Bloomberg data as of 1:45pm ET 5/18/2023 and 5:00pm ET 5/11/2023

Accordingly, a growing chorus of retailers have been sounding the alarm about tapped out consumers and adjusting sales and earnings estimates lower for the balance of 2023. Indeed, consumers have been increasingly reliant upon tapping credit cards and excess savings to maintain what most consider resilient levels of consumption throughout the past 14 months of FOMC tightening. This, of course, has its limits and will likely result in a much more challenging economic environment during the second half of this year. For context and according to the Federal Reserve Bank of New York, household indebtedness continued to soar during the first quarter of 2023, with total debt hitting $17.1 trillion (+2.9 trillion pre-pandemic) and credit card debt up to $986 billion (all-time high). Taken together with the continued burn of pandemic-related excess savings, still-elevated inflation and slower job creation, the risk of a material pull-back in consumer spending continues to move higher, which may push the economy towards the most anticipated recession since the Great Financial Crisis. Stay tuned!

The debt ceiling public relations battle continues in earnest with little official progress post meetings with the President and congressional leadership. To recap, the House of Representatives narrowly passed (217-215) a bill two weeks ago that increased the debt ceiling by $1.5 trillion in exchange for a package of spending reductions. While the bill in current form continues to be publicly dismissed by Senate democrats and the President, its passage by the Republican-led House has triggered more, behind the scenes negotiation and presages more politically charged debate in the weeks ahead. Also, look for more hearings and debate regarding additional bank regulation in the wake of the SVB/SBNY/FRBK failures.

U of Michigan Consumer Sentiment – Monthly – 3 Years

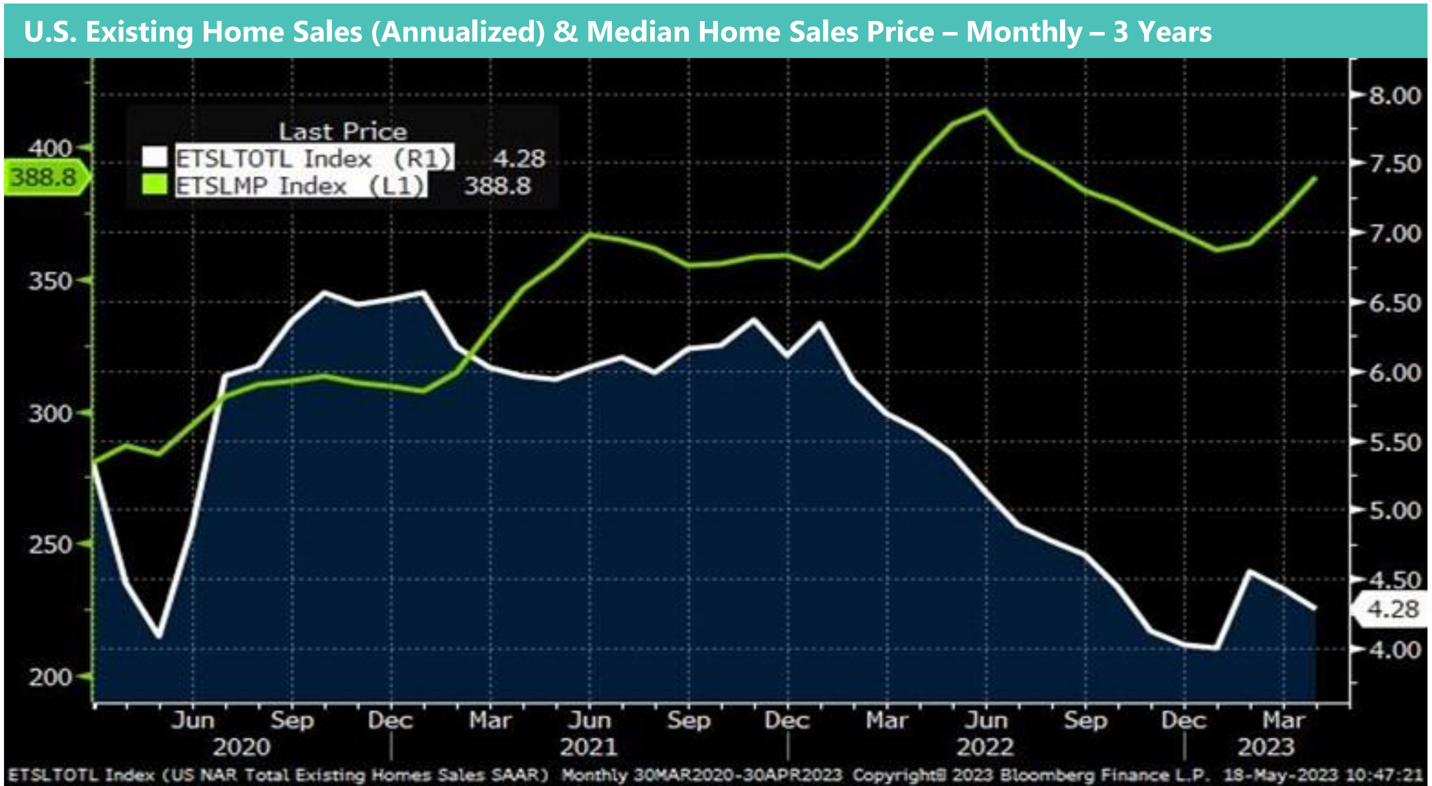
Source: Bloomberg as of 5/18/2023

U of Michigan Consumer Expectations, 1yr and 5-10yr Inflation– Monthly – 3 Years

Source: Bloomberg as of 5/18/2023

The University of Michigan Consumer Sentiment Index came in much weaker than expected at 57.7 in May (63.0 est.; 63.5 Apr.), the lowest level since last November, as durable inflation and the debt ceiling standoff weighed on consumer optimism despite tight labor markets, higher nominal wages and a five-decade low in unemployment. Indeed, over 42% of consumers attributed their negative views regarding personal finances to inflation (40% Apr.; 42% in Sept.), just shy of the all-time high during the 2008 financial crisis (49%), and a mere 16% expect their incomes to rise more than inflation, a marginal improvement over last June's 13% cycle low. Additionally, a mere 19% of consumers expect good economic times over the next year (July 2022 cycle low: 13%) as higher interest rates, inflation and surging disapproval of the government's economic policies (51%; highest since last July) continue to dampen consumer optimism regarding their near-term financial well-being. A deeper dive into the survey revealed that both components of headline sentiment were lower, with current conditions down to 64.5 (68.2 Apr.; 65.6 Oct. 2022) and expectations plunged to 53.4 (60.5 Apr.; 56.2 Oct. 2022), the lowest level since last July. On the price front, longer-term inflationary expectations rose to 3.2%, the highest level since 2011, and remain historically high over the near (1yr. 4.5%; cycle high 5.4% Mar. 2022) and longer terms (5+ yrs. 3.2%; New Cycle High), both well above of the FOMC's target of 2%. Looking at the text of the report, the director of the survey stated that "While current incoming macroeconomic data show no sign of recession, consumers' worries about the economy escalated in May alongside the proliferation of negative news about the economy, including the debt crisis standoff," and that "the rise in long-run inflation expectations did not reflect the growing influence of inflationary psychology or increased risk of a wage-price spiral." All in all, inflation, higher interest rates and withering confidence regarding government policies continue to dampen consumer optimism, conditions that threaten to weaken consumption during the second half of this year when the cumulative effects of 500 basis points of FOMC rate hikes take full effect.

U.S. Existing Home Sales (Annualized) & Median Home Sales Price – Monthly – 3 Years



Source: Bloomberg as of 5/18/2023

Sales of existing homes during April came in fractionally lower than expected to an annualized rate of 4.28 million homes (4.30 est.), sustaining a rebound from this January's pandemic era low (4.0 million/lowest since 2010), but still well below pre-pandemic averages given rock bottom affordability via higher mortgage rates and elevated prices. On the supply front, there were 1.04 million previously owned homes for sale last month (980,000 Mar.), sustaining a reversal of the upward trend for much of last year and only fractionally higher than April 2022 inventory levels (1.03 million). Notwithstanding last year's increase in supply from January 2022's cycle low (850,000), housing inventories are still historically low (1.92 million peak in 2019) as higher mortgage rates and elevated prices have discouraged mobility. The magnitude of this tighter supply is revealed in the months of supply and days on the market metrics for April, which came in at 2.9 months (record low 1.8 months) and 22 days (record low 14 days) respectively, both still historically low. As a consequence, existing home prices have risen sharply and maintained most of these pandemic era gains with median selling prices coming in at $388,000 last month ($375,400 Mar.), a decline from June's all-time high of $413,800 and down -1.7% during the last year, the largest year-over-year decline since 2012, but still historically high. Looking at the text of the report, the survey's Chief Economist stated that "Home sales are bouncing back and forth but remain above recent cyclical lows," and that "The combination of job gains, limited inventory and fluctuating mortgage rates over the last several months have created an environment of push-pull housing demand." Indeed, while rising home prices and higher mortgage rates have dampened affordability, another negative effect has been the run up in national median rents, which came in at $1,967 during April, unchanged from March and off just $86 from August 2022's all-time high of $2,053, and up +.29% over the last twelve months, the smallest yearly change in 37 months. While elevated prices and higher mortgage rates will likely soften home sales further, we expect demand for housing to remain strong and prices to remain elevated in the near term given historically low inventories and higher likelihood of mortgage rate relief as the cumulative effects of FOMC take hold later this year.

Initial Jobless & Continuing Claims – Monthly – 2 Years

Source: Bloomberg as of 5/18/2023

Initial unemployment claims ticked down during the week ended May 13th to 245,000 (264,000 last), the first decline in three weeks, consistent with some loosening of chronically tight labor market conditions despite still muted layoffs and persistent worker shortages. Notwithstanding this year's run of historically light initial claims, this series is likely to trend up over the next few months as the recent uptick in layoff announcements may portend a broader economic slowdown, sparking more layoffs and slower hiring. The four-week moving average of initial claims, which smooths out outsized observations in the data, remains near year-to-date highs, coming in at 244,250 (versus 209,300 on Dec 30th), though still near pre-pandemic levels 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 was little changed at 1.799 million (1.645 million on Dec 30th) and include people who have already received unemployment benefits for a week, just shy of 2023 highs but still near pre-pandemic averages as employers push to absorb the 9.6 million open positions estimated by the latest JOLTS survey. While total employment has exceeded pre-pandemic levels since August 2022, labor participation continues to lag as expanded government assistance, elevated retirements and skill mismatches have dampened employer efforts to attract and retain workers. All in all, the job market remains tight and the claims data still imply a relatively slow path to restore better balance between the supply of and demand for labor, which will likely encourage policymakers to reiterate their 'higher for longer' posture regarding short term interest rates.

The Week Ahead

The data calendar slows considerably over the next week, headlined by S&P Services and Manufacturing PMI, FOMC Meeting Minutes and Initial Jobless Claims. Looking ahead, markets remain focused on inflation, employment data and more signs of softer economic activity. On the new issue front, ABS volumes were again heavy during the third week of May, with 15 deals totaling $10.9 billion priced through the 17th and $111 billion year to date ($123.7 billion over same period last year; $276.7 billion for 2022) and IG corporate issuance surged with $57.1 billion priced as of the 17th and $582.8 billion year to date ($656.7 billion over same period last year; $1.26 trillion for 2022). While new issue supply slowed during the second half of last year given FOMC rate hikes and elevated volatility, market conditions have generally improved for much of 2023 and the new deal landscape remains favorable for a wider array of ABS and corporate issuers as investor demand remains deep.

Friday 5/19

No Data

Monday 5/22

No Data

Tuesday 5/23

S&P Services/Manufacturing PMI; New Home Sales

Wednesday 5/24

MBA Mortgage Applications; FOMC Meeting Minutes

Thursday 5/25

GDP (1st Quarter/Second Look); 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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