Fixed Income Market Insights

September 22, 2023

Key takeaways

Bond yields were higher this week, with GT2s up 14 basis points and GT10s higher by 21 basis points and 2s/10s less inverted by 7 basis points (-65), driven by more hawkish adjustments to the FOMC's interest rate Dot Plot and Summary of Economic Projections (SEP) post-Wednesday's rate hike 'pause' and lower initial jobless claims. On the data front, the University of Michigan Consumer Sentiment Index came in fractionally lower than expected at 67.7 in September, the lowest level in three months, driven by a marked deterioration in buying conditions for durable goods given the weight of higher interest rates, and elevated prices and slowing progress on the inflation front. Sales of existing homes during August again came in lower than expected to an annualized rate of 4.04 million homes, the lowest level in seven months and slightly higher than this January's pandemic era bottom (4.0 million/lowest since 2010), as higher mortgage rates, low supply, and near-record prices continue to weigh on activity. As expected, the FOMC left the federal funds rate unchanged at 5.50% on Wednesday afternoon with a unanimous vote of 12-0, the highest level since 2001 and the second meeting without a rate increase since January 2022.

Author

David Petrosinelli, CFA
Managing Director
Senior Trader
Insperex®

As the World Slows

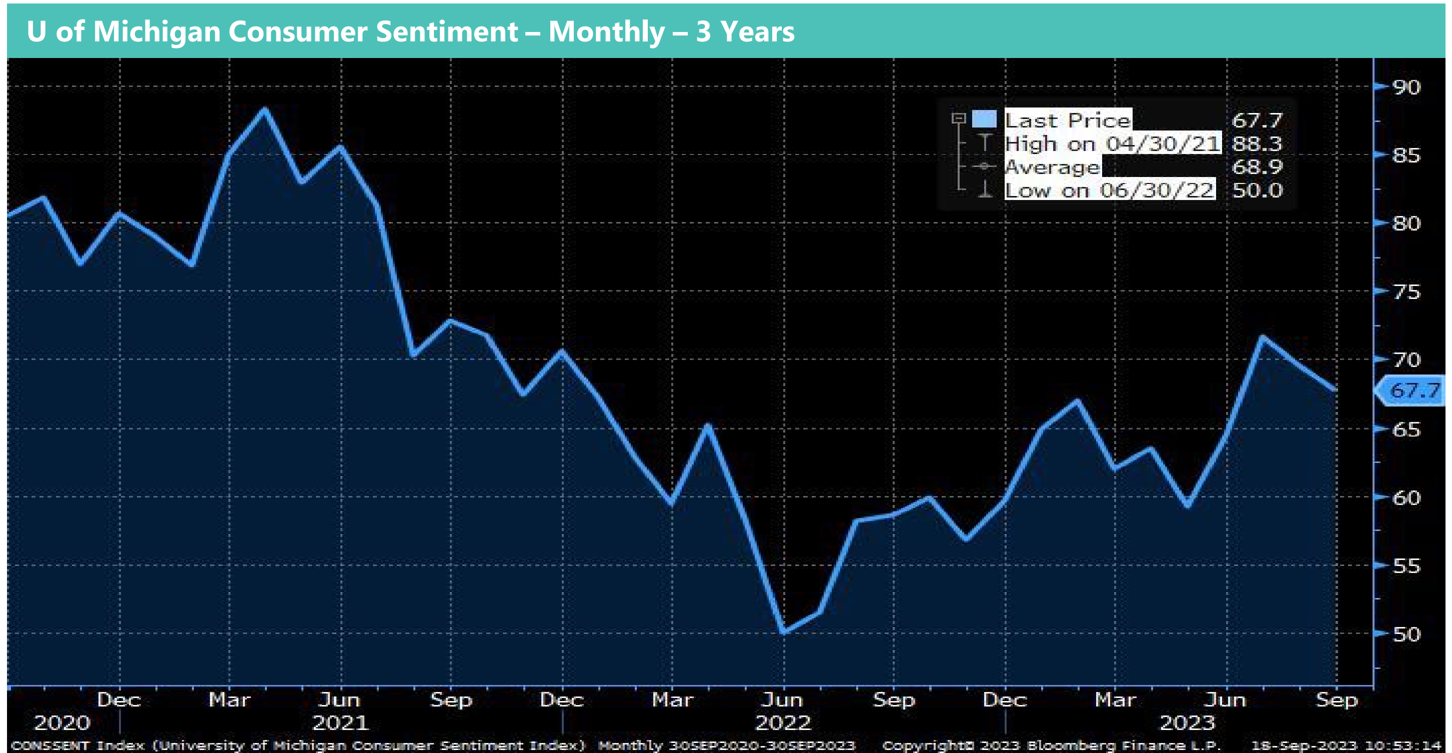
The global monetary policy response to runaway inflation across major economic regions after the darkest days of the pandemic appears poised to weigh more heavily on growth as we close in on 2024, according to a recent report by the Organization for Economic Co-operation and Development (OECD). Citing the growing influence of the cumulative effects of aggressive rate hikes, commonly referred to as the 'monetary policy lag,' stubbornly elevated core (less food & energy) inflation, and the newly minted headwind of rising energy prices around the globe, the OECD forecasts that global growth will slow to a lackluster 3% this year (versus 3.3% 2022) and decelerate further to 2.7% in 2024, which would mark the second weakest annual advance since the Great Financial Crisis (GFC). A deeper dive into regional and country-specific forecasts revealed that two G-20 nations, Germany and Argentina, are projected to have negative GDP growth for 2023 (-0.2% and -2.0%), with the United States and China forecasted to slow during 2024, from 2.2% and 5.1% this year to 1.3% and 4.6% respectively, along with some improvement in the Eurozone (0.6%/1.1% 2023/24).

Market Snapshot

	This Week 9/21/23	Last Week 9/14/23	Basis Points Change	Weekly % Change	YTD % Change
3-month USD Libor	5.66%	5.67%	-1	-0.18%	18.66%
SOFR	5.30%	5.30%	0	0.00%	23.26%
2-year US Treasury	5.15%	5.01%	14	2.79%	16.25%
5-year US Treasury	4.62%	4.42%	20	4.52%	15.21%
10-yr US Treasury	4.50%	4.29%	21	4.90%	15.98%
2s-10s UST Spread	-65.00	-72.00	7.00	-9.72%	18.18%
DJIA	34,070	34,907	-837	-2.40%	2.78%
S&P 500	4,330	4,505	-175	-3.88%	12.76%
Spot Gold	1,940	1,933	7	0.36%	6.24%
WTI (Oil) Current Contract	89.63	89.61	0.02	0.02%	11.67%
1-year Brokered CD	5.50%	5.45%	5	0.92%	19.57%
5-year Brokered CD	4.75%	4.65%	10	2.15%	18.75%
5-year Bullet US Agency	4.67%	4.49%	18	4.01%	14.46%
5-year/NC1yr Callable US Agcy.	5.90%	5.80%	10	1.72%	9.26%
CDX IG Spread Index	72.79	62.29	10.50	16.86%	-11.25%
CDX High Yield Index Spread	102.07	103.03	-0.96	-0.93%	1.44%
15-yr UMBS	5.70%	5.50%	20	3.64%	22.32%
30-yr UMBS	6.19%	5.91%	28	4.74%	16.14%

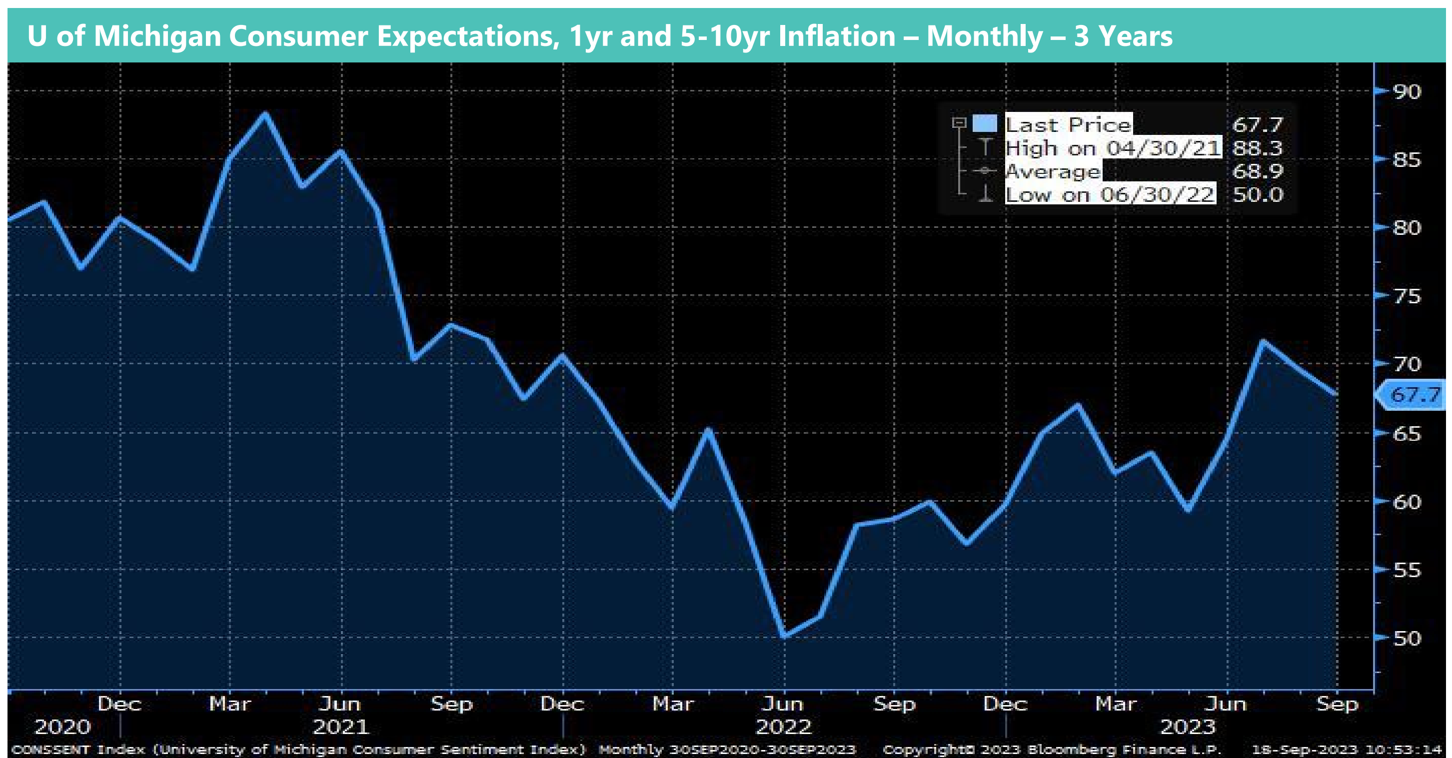
Source: Bloomberg data as of 5:00 pm ET 9/15/2023 and 9/21/2023

U of Michigan Consumer Sentiment – Monthly – 3 Years



Source: Bloomberg as of 9/21/2023

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

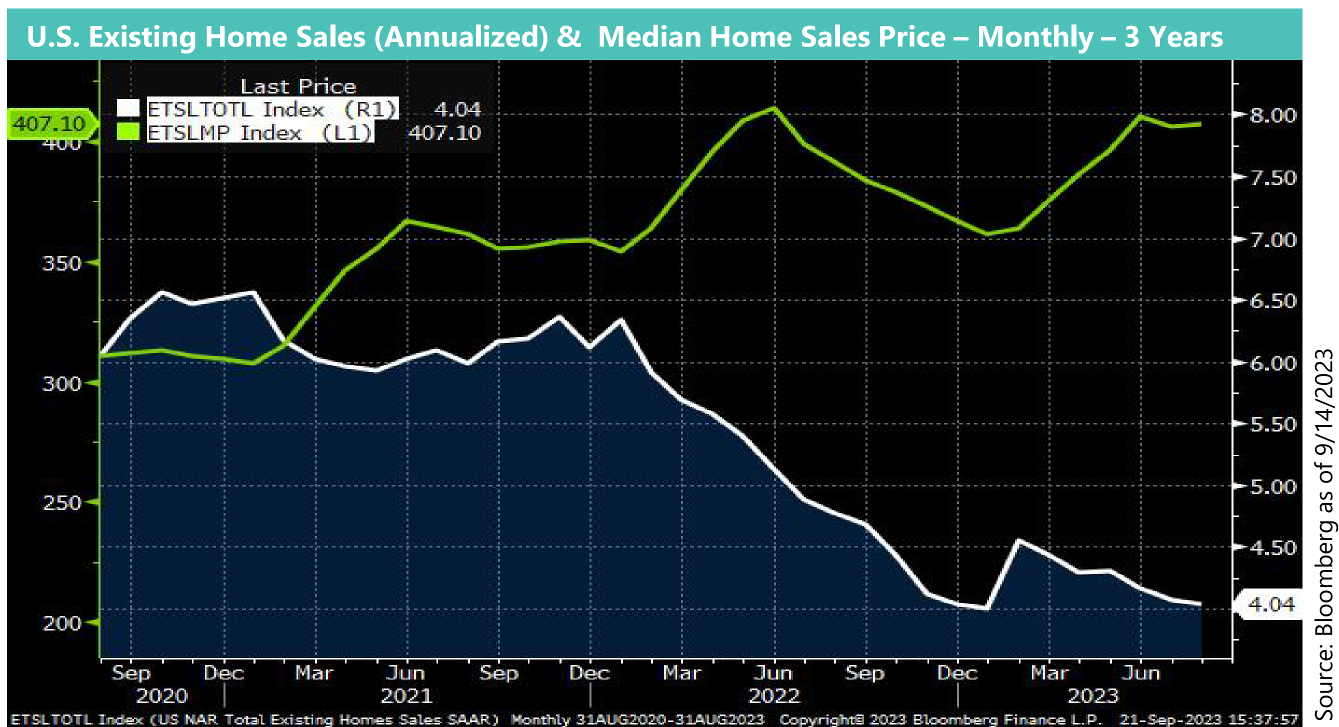


Source: Bloomberg as of 9/21/2023

We suggest

We continue to prefer playing defense given elevated inflationary expectations and the likelihood of elevated short-term interest rates in the quarters to come. We favor barbell strategies in securitized products, anchored by short, higher current cash flow assets and longer, high quality bonds.

The University of Michigan Consumer Sentiment Index came in fractionally lower than expected at 67.7 in September (69.0 est.; 69.5 Aug.), the lowest level in three months, driven by a marked deterioration in buying conditions for durable goods given the weight of higher interest rates, and elevated prices and slowing progress on the inflation front. Indeed, nearly 39% of consumers attributed their negative views regarding personal finances to inflation (37% Aug.; 36% in Jan.), just shy of the all-time high during the 2008 financial crisis (49%). A mere 21% expect their incomes to rise more than inflation, an improvement over last June's 13% cycle low, but still historically low. Additionally, a mere 31% of consumers expect good economic times over the next year (July 2022 cycle low: 13%) as higher interest costs, still-elevated inflation, and dissatisfaction with government's economic policies (44% cited poor jobs) continue to weigh on consumer optimism regarding their near-term financial health. A deeper dive into the survey revealed mixed results for both components of headline sentiment, with current conditions leading the headline index lower with a six-point decline to 69.8 (75.7 Aug.; 68.4 Jan), the lowest level in three months, and expectations fractionally higher to 66.3 (65.5 Aug.; 62.7 Jan), the second highest level since December 2021, but still well below pre-pandemic levels. On the price front, year-ahead inflationary expectations unexpectedly dropped to 3.1%, the lowest level since March 2021 (3.5% Aug.; 2.6% 2019 average; cycle high 5.4% March 2022), and longer-term expectations also drifted lower to 2.7% (3.0% Aug.; 2.4% 2019 average; cycle high 3.1% May 2023), both historically elevated and well above of the FOMC's target of 2%. Looking at the text of the report, the director of the survey stated that, "Throughout the survey, consumers have taken note of the stalling slowdown in inflation. Buying conditions for durables, which have been particularly volatile over the past year, tumbled nearly 11% from last month to June 2023 levels, with consumers citing both high prices and interest rates," and that ultimately "Consumers expect the slowdown in overall inflation to resume." All in all, the usual suspects of elevated inflation, high interest rates, and dissatisfaction regarding government policies continue to dampen consumer optimism, headwinds that threaten to slow consumption as the cumulative effects of FOMC policy tightening filter through the economy.



Sales of existing homes during August again came in lower than expected to an annualized rate of 4.04 million homes (4.10 est.), the lowest level in seven months and slightly higher that this January's pandemic era bottom (4.0 million/lowest since 2010), as higher mortgage rates, low supply, and near record prices continue to weigh on activity. On the supply front, there were 1.10 million previously owned homes for sale last month (970k Mar.), more than 14% lower YoY(1.28 million) and the lowest August inventory level in data back to 1999. Notwithstanding last year's increase in supply from January 2022's cycle low (850,000), housing stocks are historically low (1.92 million peak in 2019) as higher mortgage rates and elevated prices have impeded mobility. The magnitude of this tighter supply is also apparent in the months of supply and days on the market metrics for August, which came in at 3.3 months (record low 1.8 months) and 20 days (record low 14 days) respectively, both low by historical standards. As a result, home prices have maintained nearly all of the outsized pandemic era gains with median selling prices coming in at $407,100 last month ($405,700 July), just over 1.5% lower than last June's all-time high of $413,800, with data showing that rock-bottom supply has led to homes receiving multiple offers, with over 30% selling above asking price. The report stated that existing home prices are up 46% since August 2019, effectively locking out many first-time home buyers and discouraging turnover given mortgage rates. Looking at the text of the report, the survey's chief economist stated that, "Supply needs to essentially double to moderate home price gains," and that, "Mortgage rate changes will have a big impact over the short run, while job gains will have a steady, positive impact over the long run." Just as sky-high home prices and higher mortgage rates have diminished affordability, another negative has been the surge in national median rents, which came in at $2,052 during August, up $14 from July (+0.7%) and off a mere $2 from August 2022's all-time high of $2,054. While resilient prices and high mortgage rates will likely dampen home sales further, we expect demand for housing to remain robust and prices to remain elevated given chronically low inventories and the likelihood of mortgage rate relief next year as the cumulative effects FOMC monetary policy more fully infuse into the economy.

FOMC Rate Decision & Statement Analysis

As expected, the FOMC left the federal funds rate unchanged at 5.50% on Wednesday afternoon with a unanimous vote of 12-0, the highest level since 2001 and the second meeting without a rate increase since January 2022. As has been customary, Chairman Powell reiterated the Committee's resolve to reduce inflation and advanced more hawkish than expected revisions to their interest rate Dot Plot and Summary of Economic Projections (SEP). Regarding the Dot Plot, which outlines rate projections by 18 FOMC members, the median interest rate forecast for 2023 was left unchanged from June, and unexpectedly increased for 2024 and 2025 via a reduction of rate cut estimates, rendering 50 and 125 basis point rate cuts respectively. Said differently, the FOMC left the terminal Federal Funds rate unchanged at 5.60% during 2023, with both 2024 and 2025 rate forecasts raised 50 basis points compared to June's projections. Additionally, the SEP data revealed that Core PCE inflation was edged lower for 2023, coming in at 3.7% (versus 3.9% in June), and left unchanged in 2024 at 2.5%, both above the 2% target. Accordingly, the SEP for 2023 Real GDP growth was raised to 2.1% from 1.0% from June, with 2024 and 2025 little changed at 1.5 and 1.8% respectively, largely indicative of FOMC expectations for below trend growth through 2025. In addition to the pause, the other big takeaway was the removal of 50 basis points in rate cuts next year (50bps versus 100bps June), rendering a median federal funds rate projection of 3.90% for 2024. As has been customary, the Chairman reiterated that inflation remains too high and labor markets are still tight, stating that "We need policy to be restrictive so that we can get inflation down to target, and we are going to need that to remain the case for some time," and that "SEP sees a majority believe it's more likely than not that we will raise rates one more time this year." For context, 12 of the 19 members advanced SEP projections for one more, 25-basis-point hike over the last two meetings in 2023, while the remaining seven forecasted none. While Powell again delivered the Committee's party line on inflation and growth – that they understand the hardship and believe that a 'soft landing' is possible – the Chairman conceded during the Q&A session that a soft landing is not his 'base case,' particularly given the reduction of 50 basis points in rate cuts during 2024, which amplifies the 'higher for longer' message from the FOMC and the need to slow growth until a sustainable path towards a 2% inflation rate is achieved. Indeed, the mounting headwinds of credit contraction, soaring consumer debt, cumulative effects of past rate hikes, and resumption of student loan payments next month have increased the risk of a larger contraction in consumption and investment as we approach 2024. While the Chairman stated several times that the process to get inflation sustainably down to 2% has a 'long way to go,' we believe that will more likely take the form of leaving short-term interest rates 'higher for longer,' versus more monetary policy tightening.

Comparing September and July statements, the changes were minor and made to reflect the pause and to acknowledge the resilience of the economy and loosening of excess demand for labor:

"Recent indicators suggest that economic activity has been expanding at a solid pace,"
replaced July's
"Recent indicators suggest that economic activity has been expanding at a moderate pace"

"Job gains have slowed in recent months but remain strong, and the unemployment rate has remained low."
replaced July's
"Job gains have been robust in recent months, and the unemployment rate has remained low."

All in all, Chairman Powell delivered what many perceived to be a mixed message, where the 'pause' was accompanied by more hawkish SEP updates: the paring of rate cuts in 2024 (50bps versus 100bps June), reduction of unemployment rate projections through 2025, and higher Real GDP estimates through 2024. Judging by federal funds futures levels post-meeting, which revealed a peak terminal rate of 5.45% by December and 75 basis points of rate cuts by the end of 2024, the market remains skeptical. Stay tuned!

Date	Target	BN Survey	Survey vs Actual	Direction	Change	Discount	Vote
09/20/23	5.25%-5.50%	5.25%-5.50%	Expected	None	None	5.50%	12-0
07/26/23	5.25%-5.50%	5.25%-5.50%	Expected	Tightening	0.25%	5.50%	11-0
06/14/23	5.00%-5.25%	5.00%-5.25%	Expected	None	None	5.25%	11-0
05/03/23	5.00%-5.25%	5.00%-5.25%	Expected	Tightening	0.25%	5.25%	11-0
03/22/23	4.75%-5.00%	4.75%-5.00%	Expected	Tightening	0.25%	5.00%	11-0
02/01/23	4.50%-4.75%	4.50%-4.75%	Expected	Tightening	0.25%	4.75%	12-0
12/14/22	4.25%-4.50%	4.25%-4.50%	Expected	Tightening	0.50%	4.50%	12-0
11/02/22	3.75%-4.00%	3.75%-4.00%	Expected	Tightening	0.75%	4.00%	12-0
09/21/22	3.00%-3.25%	3.00%-3.25%	Expected	Tightening	0.75%	3.25%	12-0

Source: The Federal Reserve and Bloomberg as of 9/21/2023

The Week Ahead

The data calendar lightens up over the coming week, headlined by Consumer Confidence, Durable Goods Orders, and S&P CoreLogic U.S. HPI. Looking ahead, markets remain focused on inflation, employment data, and more indications of slower economic activity. On the new issue front, ABS slowed from last week's red-hot pace with 12 deals totaling $6.53 billion priced through the 21st and $221.7 billion year to date ($220.2 billion over same period last year; $276.7 billion for 2022). Investment-grade corporate issuance also cooled with $16.1 billion priced through the 21st and $963.5 billion year to date ($1.1 trillion over same period last year; $1.26 trillion for 2022). While new issue supply has generally slowed this year given FOMC rate hikes, market conditions have normalized since the first-quarter bank failures, and the new deal landscape remains favorable for a wide array of securitized products and corporate issuers as investor demand remains strong.

Friday 9/22

S&P U.S. Manufacturing & Services PMI

Monday 9/25

Dallas Fed Manufacturing; Philadelphia Fed Non-Manufacturing

Tuesday 9/26

Consumer Confidence; New Home Sales; S&P CoreLogic U.S. HPI

Wednesday 9/27

Durable Goods Orders

Thursday 9/28

Weekly Jobless Claims

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.

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