CenterState
CORRESPONDENT DIVISION

Market Update

Economic News

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The latest episode of risk-off trading stemming from the growing concern of a virus spreading out of China is another example of an issue that is hard, if not impossible, to game-plan but nevertheless has considerable impact on Treasury yields. After the trade deal was completed, and many recent economic reports printed in fair-to-good territory, an investor would have been excused in thinking a fair amount of risk-on trading would ensue along with Treasury yields pushing to and/or above two-month support levels. That, however, has not been the case. With the virus now being identified in locations far beyond its origin of Wuhan, China, concerns about the spread of a lethal virus and its impact on growth have sent yields heading in the other direction, towards range resistance. This episode is another reason we think yields will have a hard time mounting any kind of material back-up. Along with the moderating growth and inflation picture (of which we discuss in more detail below), these one-off, flight-to-safety issues will likely continue to appear and work to keep yield back-ups limited. After a fairly active overnight session off better-than-expected PMIs in Germany, France, UK and the Eurozone, Treasury yields were initially higher but are back in the green (10yr 1.72%) as the US Treasury market continues to see bids off the virus concern.

While the primary focus of the market this week has been the potential spread of a deadly virus out of China, there were some economic releases this week that passed without much discussion but with some nagging concerns. Let's review some of them below.

- Existing home sales ended 2019 on a positive note, with the December reading topping expectations. Existing sales jumped 3.6% to 5.45 million but the months of supply reading plunged to an all-time low which speaks to the continuing squeeze in available inventory.
- While demographic conditions are turning favorable, with more millennials entering home-ownership age, short-term market dynamics are turning more challenging and that will limit housing affordability, capping the upside potential this year. Shrinking inventories will continue to push prices higher, and with wage growth slowing, and the decline in mortgage rates ebbing, the resale environment will see increasing headwinds, especially from first-time buyers which typically comprise over 30% of existing sales.
- The Conference Board's Leading Indicators Index is a compilation of metrics that tend to foretell economic direction, and it is particularly useful as a predictor of recessions. The index always falls well below zero prior to a recession and with yesterday's December print of –0.3% it marks five negative prints in the last seven months. The biggest positive contributor to the index was stock prices at 0.09%, while the biggest negative contributor was jobless claims at -0.23%. While the index is not flashing recession, the string of negative prints does speak to some slowing in economic momentum.

- A lesser known index, but one that also tries to assess future activity like the Leading Index, printed a slowing reading last month. The December Chicago Fed National Activity Index printed a –0.35 versus expectations of a 0.13 reading and the November reading was revised lower from 0.56 to 0.41. Fifty-six indicators deteriorated, two were unchanged and twenty-seven improved from November to December. A reading below 0 indicates below-trend growth in the national economy.

So, while the market and investors are fixated this week on the potential of the Wuhan virus to continue spreading and impacting global growth, some domestic indicators are presenting slowing indications. They could be merely one-month blips but they certainly warrant further attention.

Meanwhile, the message from next week's Fed meeting is likely to be one of continued optimism over the economy, especially with previous uncertainties like the trade deal and Brexit either done or approved, as the case may be. The virus issue, however, is a reminder that one-off, flight-to-safety concerns can arise suddenly and provide a bid to Treasuries even when the economic backdrop seems positive. The reaction this week to the virus is a sign that these one-off issues can and will work to keep a lid on Treasury yields for the foreseeable future.

TIPs Inflation Breakeven Rates Trending Lower Again

The start of the new year has stymied the fourth quarter increase in TIPs breakeven inflation rates as a combination of lower oil prices and dollar stability have turned both the 5-year (blue line) and 10-year (white line) breakeven rates lower in recent weeks. Both rates are well below the Fed's 2% target rate, and if the trend continues lower, it could force the Fed to resume rate cuts sooner than they would want to. In addition to the 9% drop in oil since the beginning of the year, the dollar has stabilized and moved higher after dipping 3% in the fourth quarter. Moving inflation above the 2% benchmark is a goal of the Fed, but right now TIPS breakeven rates are arguing they won't get there anytime soon.

Market Rates

Treasury Curve	Today	Chg Last wk.	LIBOR Rates	Today	Chg Last wk.	FF/Prime	Rate	Swap Rates	Rate
3 Month	1.55%	UNCH	1 Mo LIBOR	1.66%	-0.01%	FF Target Rate	1.50%-1.75%	3 Year	1.532%
6 Month	1.55%	-0.01%	3 Mo LIBOR	1.80%	-0.04%	Prime Rate	4.75%	5 Year	1.541%
2 Year	1.51%	-0.06%	6 Mo LIBOR	1.82%	-0.05%	IOER	1.55%	10 Year	1.665%
10 Year	1.72%	-0.13%	12 Mo LIBOR	1.92%	-0.03%	SOFR	1.54%		

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