The Day Ahead: Time For One of Those "Path of Least Resistance" Headlines

Bonds are selling off for no obvious reasons for however many days in a row it's been (at least 2 unless you count last Thursday). Episodes like this result in bond analysts dusting off phrases like "the path of least resistance"--typically only ever seen with selling pressure. This path arguably began in early December after the jobs report failed to push 10yr yields sustainably below 4.17. One could even say it began with the jobs report in early October that singlehandedly obviated any urgency on the part of the Fed to address some sort of troubling slide in the labor market. At the very least, the most recent leg of weakness can be thought of as the path of least resistance in light of last week's Fed announcement/dots/press conference.

The act of pushing the rate cut outlook farther into the future and/or of declaring a higher neutral rate is consistent with "steepening" of the yield curve. That's a fancy word that means 10yr yields are moving higher relative to 2yr yields, or that 2yr yields are falling faster than 10yr yields.

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Bottom line, there was a chance that a floundering labor market would accelerate the rate cut outlook, sticky inflation be damned. October's release of NFP meant that the focus could shift back toward sticky inflation, and subsequent inflation reports confirm there's no reason to rush additional hikes. Combine that with some unknown risk that fiscal changes continue to juice the economy and we're right back to the "higher for longer" mentality that dominated the discourse last year.

Don't lose hope though. Things can change, but it will take a noticeable shift in the inflation data, or another troubling swoon in labor metrics. Either way, the path of least resistance can't really change until we actually get those reports in the first 2 weeks of January, and even then, it would take a few months in succession to really make a case for a shift. There's also some hope from the outright level of yields, which began to bring out value buyers the last time 10yr Treasuries moved into the upper 4% range.

(NOTE: MBS Live is on holiday half-day protocol today. That means this morning's commentary is also the closing commentary unless something really crazy necessitates additional coverage. Updates/alerts will only go out in the event of extreme movement. As always, MBS Live members can set up multiple automated alerts (here) if you're actually making intraday lock decisions today.)