The Day Ahead: Breaking Down Early Weakness. Is It Japan?

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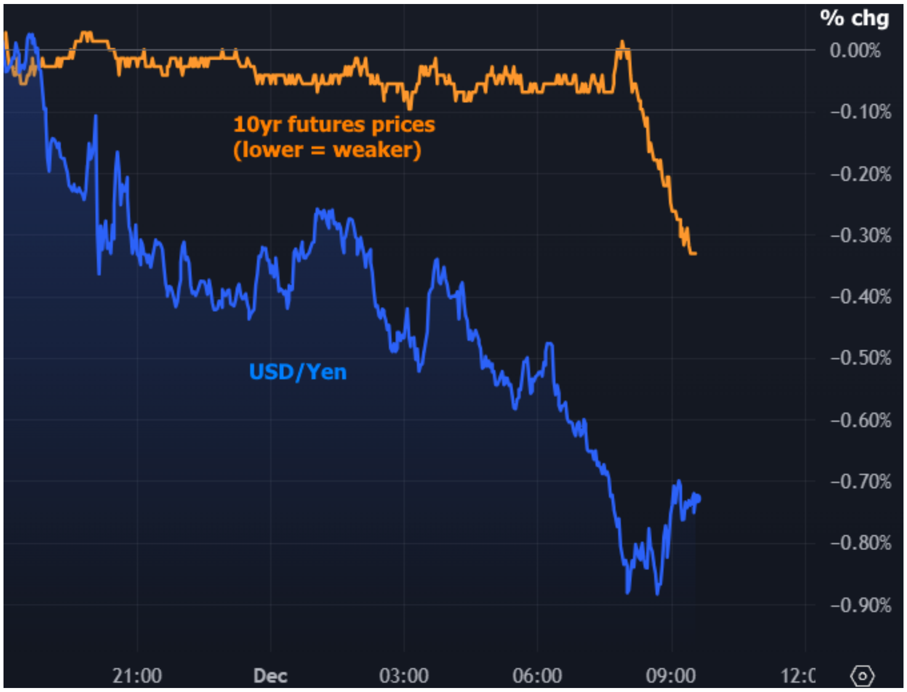
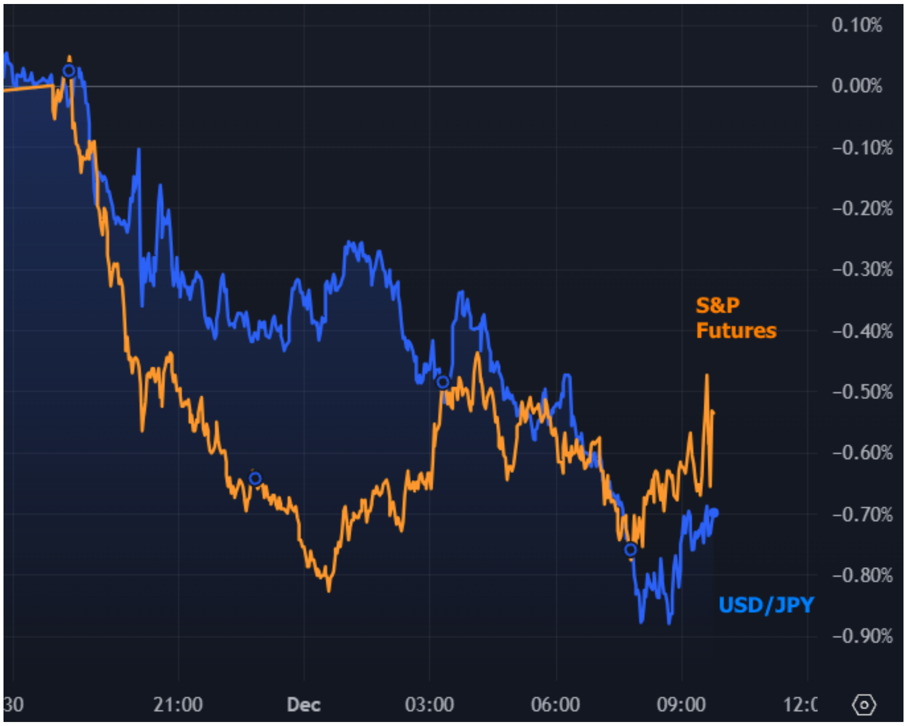
Bonds are sharply weaker to begin the new week and the new month. This is the first (and probably best) clue as to the nature of this morning's market movement. Thanksgiving weeks are prone to random volatility and today's selling basically erases the entirety of last week's movement. Then there's the Bank of Japan's comments on considering rate hikes at the next meeting. Past examples of policy shifts in Japan are burned into the memory of US markets as the source of several large, surprising reactions in bonds. Today's example is getting attention because there's nothing more obvious to blame. And while it could be having an impact for some traders, it's hard to confirm it's the main source of weakness this morning.

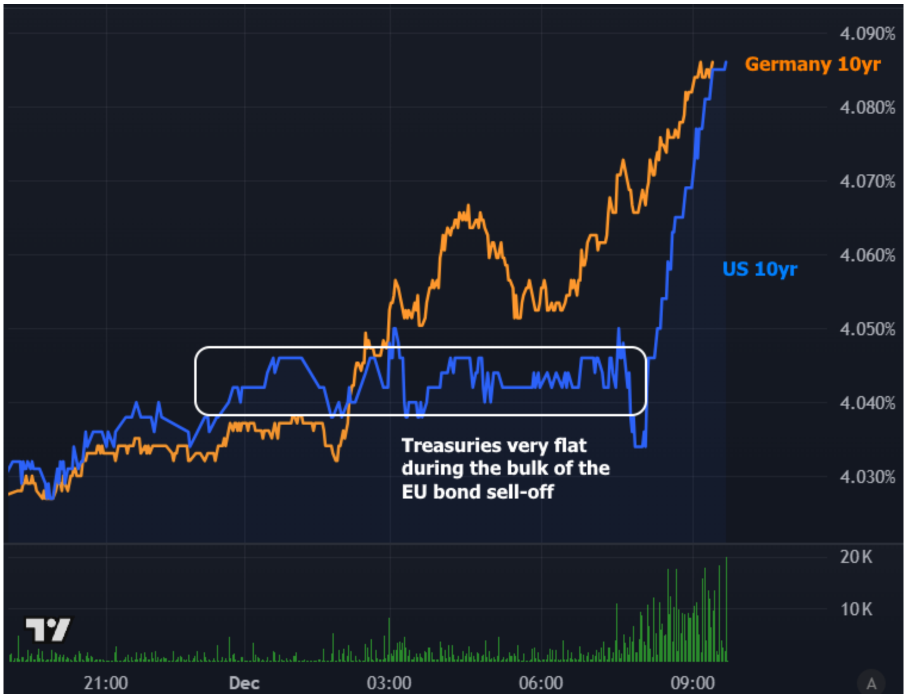
If US bonds were obviously destined for pain over Japan, we would have expected stronger correlation with dollar/yen (USD/JPY) in the overnight session, but the selling didn't really start until domestic hours.



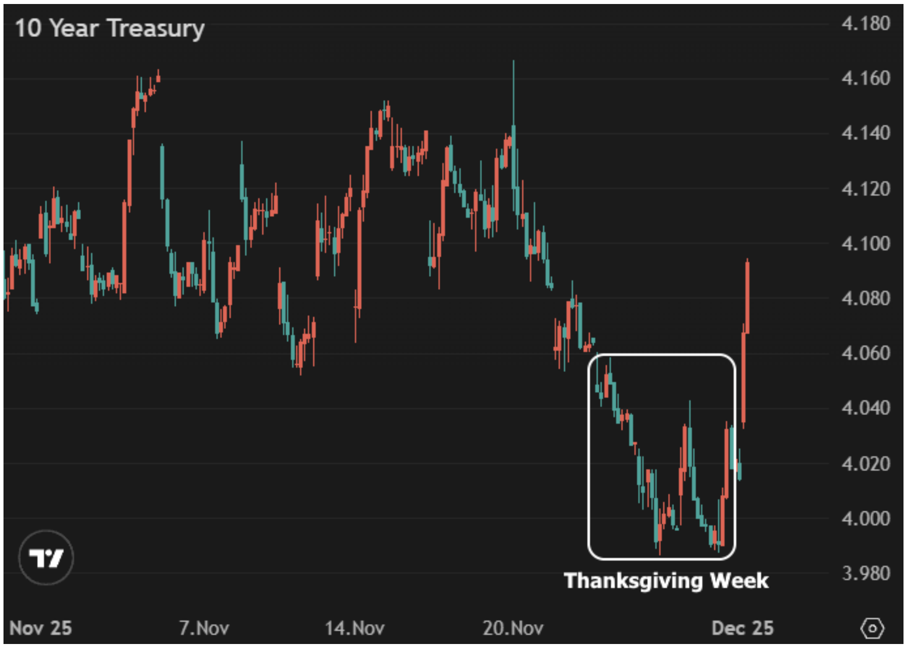
Contrast that to S&P futures, which had no problem moving with the Yen sell-off.



There's been some suggestion that the Japanese influence was more of a domino effect that first played out in other bond markets. But here too, overseas markets were moving while Treasuries were flat.



None of this is to say that the Japan news isn't having an impact. The simple fact that everyone's talking about it ensures that at least some accounts are trading it. Perhaps this helps explain why the timing lines up with US traders waking up and reading the news. Nonetheless, our favorite explanation is to take the entirety of last week's volatility and throw it out. In so doing, today's levels seem right in line with the pre-Thanksgiving range.


10 Year Treasury
4.180
4.160
4.140
4.120
4.100
4.080
4.060
4.040
4.020
4.000
3.980
Thanksgiving Week
Nov 25
7.Nov
14.Nov
20.Nov
Dec 25