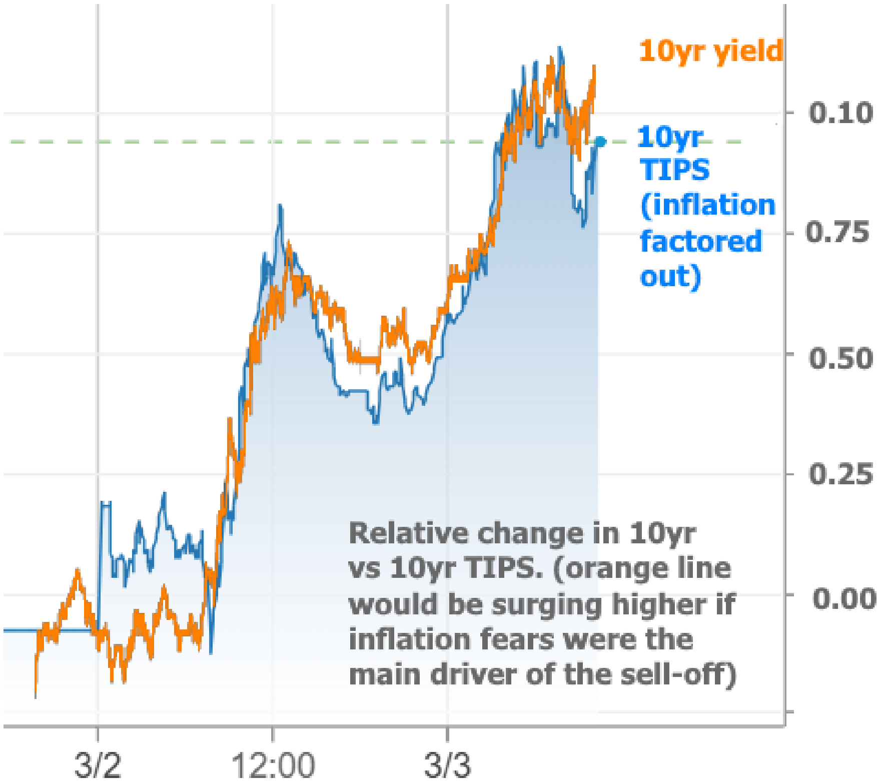
The Day Ahead: Heavy Overnight Selling But Inflation Narrative Remains in Doubt

Bonds sold off again overnight with 10yr yields now challenging the 4.10% technical level in early trading. MBS are down another 3/8ths, roughly. And there's stronger correlation with higher oil prices and rising bond yields. So in light of our contrarian take yesterday, are we now forced to acquiesce to the "higher inflation/higher rates" narrative? Not entirely. While there's no doubt that a certain contingent of smaller traders are drawing that conclusion, and while there's better evidence for it in some of today's charts, there remains a problematic reality in an even simpler chart. There's a tradeable security that measures market-based inflation expectations and it has shown almost no uptick in the past 2 days.



Smart analysts are calling out this oddity. Unfortunately, it doesn't do anything to help us explain the scope of the sell-off, but we strongly suspect Treasury issuance implications are a factor as they relate to military spending. Lastly, if we look at shorter-term TIPS, we can see slightly more inflation concern, but not enough to say "this is the main reason bonds are selling." That has us thinking about things like issuance implications from increased military spending.

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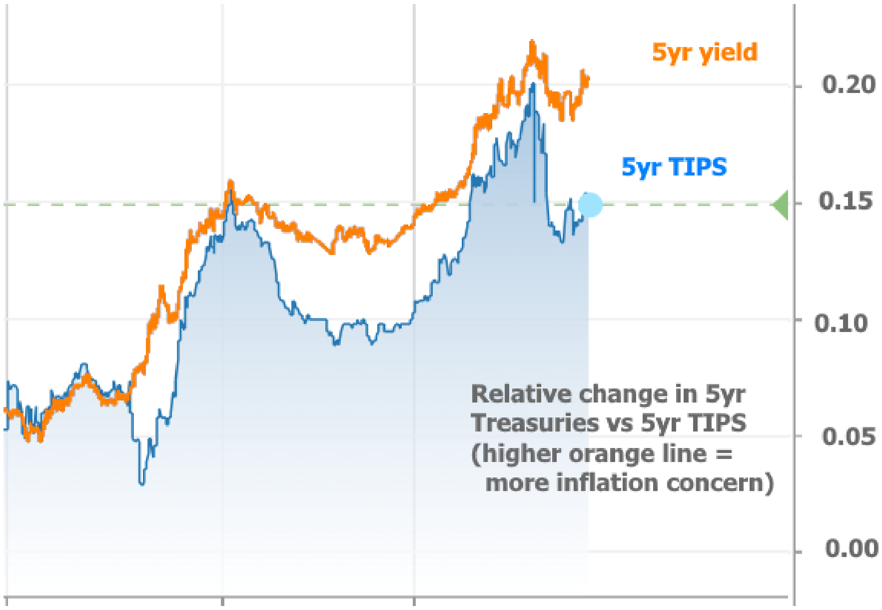

Here are the charts showing how yesterday's correlations have reversed course today for stocks/bonds and oil/bonds.

Last but not least, this chart shows today's much more noticeable uptick in the implied Fed Funds Rate for the June meeting. In other words, rate cut odds evaporated more quickly today (although they have bounced back a bit since 6:30am ET).