



The Arizona Loan Baron

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The Week Ahead: Bonds Brace for Fed; History Suggests Not Getting Too Excited

The week's key event is undoubtedly Wednesday's FOMC Announcement, but should markets be getting worked up over the possibility of a change? Of course we can be nearly 100% certain that a "change," in this case, would **NOT** amount to an actual rate hike, but instead would simply be a change in the verbiage that alludes to the eventual hike.

In trying to divine what form such a change might take, we have several solid clues. The last FOMC announcement placed some blame on the global economic outlook as a barrier to hiking rates. Fed speakers subsequently said that the US economy justified a hike, but that they were waiting to make sure the overseas outlook wasn't deteriorating (because a weaker global economy would create further headwinds for inflation and domestic growth). The **takeaway** was that any marked improvement overseas would pave the way for an easier Fed hike.

Since then, we've seen generally stable data overseas. We've also seen steady improvements in one the main bellwethers for "overseas economies" as China's Shanghai composite continues trudging back from last August's lows. It's not much in the grand scheme of things, but enough to suggest the **cleansing process** from mid-2015 highs has run its course.



If the Fed is true to its word (i.e. if overseas data really is the hang up), then we should see some mention of that fact in this week's announcement. Putting that together with the previous announcement, the **conclusion** would be that a December rate hike is more likely.

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.55	-0.25
MBS GNMA 6.0	101.31	-0.18
10 YR Treasury	4.3701	-0.0068
30 YR Treasury	4.5131	+0.0070

Pricing as of: 5/17 1:27AM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.02%	+0.03	0.00
15 Yr. Fixed	6.53%	+0.03	0.00
30 Yr. FHA	6.55%	+0.03	0.00
30 Yr. Jumbo	7.31%	+0.01	0.00
5/1 ARM	7.24%	+0.04	0.00

Freddie Mac

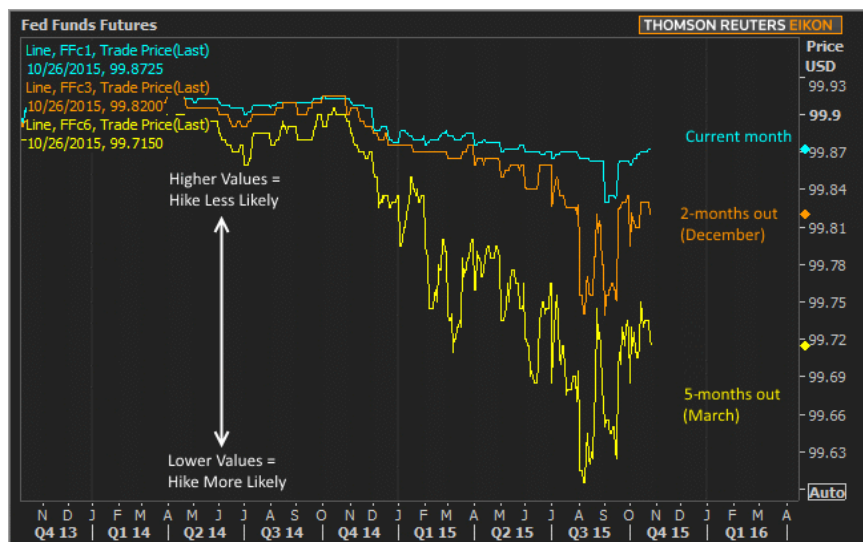
30 Yr. Fixed	7.02%	-0.42	0.00
15 Yr. Fixed	6.28%	-0.48	0.00

Mortgage Bankers Assoc.

30 Yr. Fixed	7.08%	-0.10	0.63
15 Yr. Fixed	6.61%	+0.01	0.65
30 Yr. FHA	6.89%	-0.03	0.94
30 Yr. Jumbo	7.22%	-0.09	0.58
5/1 ARM	6.56%	-0.04	0.66

Rates as of: 5/16

Even then, it's unclear whether market participants would actually take the leap of faith when it comes to believing that that was the final hurdle. For instance, what happens if November's **DOMESTIC** data is increasingly negative? History shows the best odds for a Fed rate hike are always at least a few months out, and this has been going on for nearly a full year. The following chart shows Fed Funds Futures for the impending Fed meeting as well as those 3 and 6 months out. In the current case, that's October, December, and March, respectively.



As you can see, A Fed rate hike has only ever been a legitimate concern when it comes to the intermediate future, but never the immediate future. The only arguable exception was the September meeting, which you can see in the dip in the Teal line in the chart. This October meeting is definitely not an exception as the implied probability of a hike doesn't exceed 50% until the March meeting. October itself only has a 6% probability, which seems **comically high** given the last jobs report. But perhaps those 6% are considering the fact that the Fed said it's not about the domestic data, and that the overseas developments have been positive enough to pull the trigger. (**They'd still be wrong** though, considering the overseas positivity is partially a factor of foreign central bank easing measures, which basically accomplishes similar goals to a domestic rate hike).

As for the rest of the week from a NON-Fed perspective, the data is moderately important as we'll get Durable Goods on Tuesday and the first look at Q3 GDP on Thursday. Friday brings wage data in 2 different flavors at 8:30am and also marks 'month-end.' October's month-end is slightly more interesting than most as money managers have more funds to allocate due to the the 10/15 extended tax deadline. Much of the deposited cash isn't able to be invested right on 10/15, and thus trickles in by the end of the month. This often leads to a marked trend into the end of October, followed by a **reversal** in November. In other words, if bonds continue their recent trend of weakness this week, that would actually be a **more positive** signal, long term. The 2.135 technical level looks like an ideal place to make a stand, if a stand is to be made. Conversely, a convincing break above 2.135 would be a negative technical cue that suggests a more defensive stance from a lock/float perspective.



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