With the Fed (and Treasury Funding) Behind us…

The Treasury market got a boost on Wednesday morning as the Treasury Department published their issuance schedule. It was skewed more towards the front end, creating some relief in the bond market. The bond market was worried that they would continue to push supply at the long end, where the auctions have not been very strong of late. That concern was alleviated, at least for now.

My key takeaway (and I'm biased) was that they admitted that financial conditions have tightened and the rise in bond yields/real yields has done some of their work for them. Chairman Powell couldn't quantify the impact, but he seemed to re-affirm what we've been saying on that front.

He tried to say that hikes are still on the table, but clearly the market did not believe him at all. The market, based on futures contracts, is pricing in a 15% chance of a hike in December and nothing after that. I expect that to fade. They did have one hike priced into their last "dot plot," but he seemed to downplay that.

The Fed does not want to hike:

- Rate moves have done some of their work for them, so they don't have to hike.
- The long and variable lags are real, and something that they are watching. Another excuse not to hike.
- The economic data has not been that strong, so they don't need to hike, but recently the data has been a tad to the "strong" side.
- The Fed is well aware that if they hike, they have a greater risk of needing to cut. Another reason not to hike.

The Fed does not want to cut:

- For now, that is the easier message to deliver, but watch what happens if data slows (which is what I'm seeing and expecting). I'm not hearing a lot of great outlooks on earnings calls.

For now, the Fed Chair is correct that the ongoing Middle East conflict is not an issue for the economy, but:

- The risk of escalation remains high. Please tune in to our webinar on Thursday at 1pm ET led by Generals (Ret.) Deptula and Robeson (representing the Air Force and Marine Corps) along with Rachel Washburn moderating the conversation (registration link).
- I'm starting to hear some concerns about supply chains and disruptions for companies that rely heavily on Israel for talent or products. Something else to keep in mind as a potential problem as the battles go on.

Bottom Line

The Fed is out of the way. The supply issues are real, but it will take time to play out and the market has priced in too much risk.

I continue to like Treasuries and think that the 10-year can break below 4.55%, which it hit on October 11th.

That should be decent for risk assets, with two caveats:

- Escalation in the Middle East will be good for bonds, but bad for risk assets.
- Slowing data will be good for bonds and stocks, but dramatically slowing data will not translate into anything good for stocks.

I continue to like owning longer-dated call options on Treasuries as a hedge to geopolitical risk and a slowing economy (which might finally get picked up in the data).

Disclaimer