Two bond market stories provide contrarian insights

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Where the global bond market heads during 2024 is a key question for other asset classes as well.

That is especially true for US equities, which are atypically trending in tandem with the “govvies” (US Treasuries) due to the importance of interest rate psychology.

There were two very good, yet contrarian, insights on this in recent editions of the Financial Times.

First, an FT Weekend news story entitled “Fed revives investors’ hopes of end to quantitative tightening” (Report, January 6). That concerned the minutes of the Federal Reserve’s December 12/13 meeting and the mention of the Fed potentially reviewing its “quantitative tightening” programme. This was perceived by one observer as a “tailwind for the bond market”.

However, this is after the very accommodative inferences drawn from the December statement from the Federal Open Market Committee, from economic projections, and from the Fed chair Jay Powell’s press conference.

Those expecting the Fed to expand its balance sheet again at this point are equally likely to be “far out over the tips of their skis” as those anticipating a rapid series of rate cuts this year.

The article noted one informed observer saying: “The balance sheet remains bloated relative to GDP”.

This is the case, even if eliminating quantitative tightening would alleviate some pressure into larger debt offerings.

Those major auction increases were the topic of Tuesday’s FT headline article “Deluge of debt feeds fear of backlash in bond markets” (Report, January 9).

The piece especially noted the large government deficits with no plans to cut them into what is an election year in many countries.

That said, each of those factors are more likely tangential influences than the primary driver for bond markets and yield trends.

The lesson of the mid-1980s still stands. Brobdingnagian bond issuance of that era was roundly feared. Yet the sharp weakening of inflation meant those auctions were readily digested. That is due to an extended inflation fall leading to anticipation the “real yield” for those bonds was actually very attractive.

As such, whether recent inflation improvement continues will be the arbiter of the market decision.

In that regard, the key upcoming data will probably be more critical than either of those other factors for the bond market trend and its influence on other asset classes.

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