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Weekly Bond Commentary:

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Not the big meal the markets want

Last week served up a hearty helping of psychology mixed with a reappraisal of market dynamics and sprinkled with Federal Reserve comments to create a crunchy dish that left most with indigestion.

There is little surprise the Fed wants to continue raising its federal funds rate back to at least a neutral level. What seemed to catch the market off guard was Fed Chair Powell's comments in early October that policymakers viewed the fed funds rate as a long way from neutral and that it likely could rise past neutral on its path to normalization. Markets have consistently challenged the Fed on its plans, not believing it would move as far as it indicated.

In spite of continuing solid U.S. economic growth, especially in the labor markets, equity prices and Treasury yields fell last week. The prospect of slowing international growth—worsened by ongoing trade and tariff issues—and geopolitical uncertainty and instability in the U.K., Italy, Germany and Iran all conspired to weigh on confidence. Late in the week, two Fed members offered soothing comments that implied the central bank actually might be nearer to the end of the rate-hike process, and that the Fed takes into account international economic growth in its deliberations.

Treasury yields fell last week, as the 2-year yield fell from 2.92% to 2.81%, the 3-year yield fell from 2.99% to 2.86% and the 5-year yield fell from 3.04% to 2.90%.

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