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Where do yields go from here?

Events in coming weeks may determine if yields have further to fall.

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That's the question on everyone's mind, including the fixed-income professionals here at Federated. A strong rally in May saw the 10-year Treasury yield plunge to near a 2-year low of 2.07% on a breakdown in U.S.-China trade negotiations, President Trump's wielding of new tariff threats against Mexico and, partly in response to trade policy uncertainty, signs the Federal Reserve may have a rate cut or two in its plans. The economic data also softened here and abroad. All of this, along with market technicals, suggests the bias on yields should be lower still.

But given the binary and sequential nature of uncertain event risks in coming weeks, we're maintaining a neutral stance for now as the factors that caused yields to break lower in May could just as quickly reverse. In particular, we are watching:

- This weekend's meeting between Treasury Secretary Mnuchin and the People's Bank of China chair. This could produce headlines on the trade front, good or bad. Then, Presidents Trump and Xi may meet at the G20 in late June. If this occurs and their meeting is characterized as constructive and talks resume, some retracement higher in yields is likely. If they do not meet or the meeting is confrontational, yields may fall further.

- Mexico and the U.S. are discussing what Mexico can do on the immigration front to forestall the layering in of escalating tariffs. Mexico seems apt to try and cooperate, but there is a lack of clarity on exactly what will address White House concerns. Meanwhile, Senate Republicans are suggesting they may act to restrain President Trump's use of tariffs for this purpose. Any resolution or intensification of this situation is apt to contribute to rates direction.
- Similarly, the Fed seems unlikely to ease at its June 19 meeting but probably will reiterate that it's poised to ease if necessary. Such an outcome would likely not move the bond market much as a rate cut and possibly two already are priced in. However, the potential for a mixed message—which will include new dots, new economic projections, the end-of-meeting statement and a Chair Powell press conference—may generate risk asset and rates volatility.

Finally, the interplay between a Fed willing to ease to extend a decelerating U.S. expansion and a Trump administration that views the expansion as part of its negotiating leverage with China offers the prospect of prolonged uncertainty. Additionally, a debt ceiling/budget debate looms, as does the 2020 election. This confluence of factors suggests a retracement in yields on incremental trade optimism could offer a better entry point to get long for a complicated second half of 2019.

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