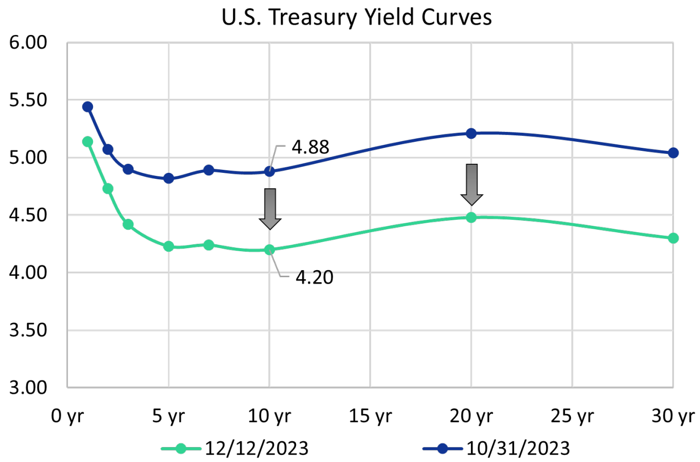
Markets Get Ahead of the Fed

With inflation and wage growth continuing to trend lower, markets have been bidding up bond prices (prices up, yields lower) in anticipation of next year's rate cuts. That stated, some have argued that the bond market has overestimated how quickly the Fed will cut rates.

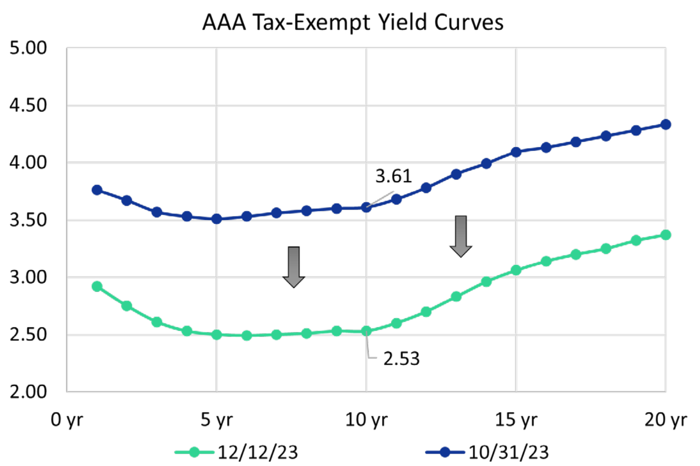
Bond and Stock Markets

US treasury yields have rallied considerably over the past six weeks, as evidenced by the 10-year benchmark treasury closing at 4.20% on December 12, versus a 4.88% on October 31. The below chart provides the corresponding treasury par yield curve rates from 1 to 30 years during this period.



Source: U.S. Department of the Treasury

Tax-exempt municipal borrowers finally have something to cheer with rates following US treasuries lower after experiencing generally increasing rates for most of the summer and autumn. The following chart provides Municipal Market Data (MMD) AAA yield curve rates out to 20 years. Notice how the 10-year yield has moved lower by over 1.00% during this six-week period.



Source: REFINITIV MMD yields for a AAA rated General Obligation (5.00% coupon)

With a resilient labor market and robust consumer spending, economists have generally been sanguine about recession risks in 2024 and as such, equities have rallied in tandem with US treasuries. Between October 31 and December 12, the S&P 500 has gained 10.7%, which puts the index to the highest level since January 2022.

Inflation Measures

On Tuesday of this week, the November consumer-price index (CPI) was released and the data showed inflation largely unchanged from the previous month. The all-items CPI showed a seasonally adjusted monthly increase of 0.1%, and an increase of 3.1% over the past 12 months. The all-items index less food and energy (core CPI), rose 0.1% on a month-over-month basis and on an annual basis gained 4.0%, as it did for the 12 months ending in October. At a six-month annualized rate, core CPI was at 2.9% in November. The index for shelter was the largest factor in the increases in both CPI and core CPI.

Labor Market

The November jobs report from the Department of Labor was released on December 8 and it estimated that nonfarm payrolls increased by 199,000, which was slightly more than economists expected. November's total included approximately 30,000 motor vehicle and parts workers returning from the UAW strike.

Hourly wages for November grew by 4.0% over the past 12 months, down from the previous month's 4.1% increase. Another month of slowly moderating job gains and wage growth, which is good news for those hoping the economy will achieve a soft landing. Additionally, the unemployment rate moved lower by 0.2% month-over-month to 3.7%.

The Fed

The Federal Open Market Committee (FOMC) meeting concluded on December 13, and as expected there was no change to the overnight rate, leaving it at 5.25%-5.50%. What was unexpected was dovish comments by Fed Chair Jerome Powell and in response markets surged to end the trading session. The 10-year benchmark US treasury saw its yield drop 0.16% to 4.04%, and the S&P 500 tacked on 1.37%. Investors in interest rate futures now have a 70% probability of at least 0.50% in rate cuts by the May 1, 2024 FOMC meeting, up from 25% the prior day.

PMA is dedicated to staying up to date on market trends and will be ready to guide you through a dynamic and evolving market. If you have any questions about the municipal bond market in general or your specific bond issue, please feel free to contact a PMA advisor below.

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