Rates, Bonds, Inflation.

The near term direction of rates and bonds are not dependent on whether or not the Fed actually hikes rates in Q3 2015 or Q1 2016. They are dependent on when the market thinks the Fed will hikes rates in Q3 2015 or Q1 2016. It is clear from the ruminations of central bankers that they themselves don’t know when they will hike rates; so much is dependent on data. Each piece of data exerts a pull on the Fed, some towards raising rates and some towards delaying the day.

1. The US economy is stronger than the Fed or the market thinks. Especially relative to the new lower long term potential mean.
2. The labour market is healthier than consensus.
3. Economic nationalism will favor economies with a deep consumer base, intellectual property generation and manufacturing capability. NAIRU will, however, be lower.
4. Inflation may surprise on the upside. Inflation could arrive sooner than expected as slack in the economy is underestimated.
5. The US treasury’s funding requirements may be lower than expected on the back of stronger tax revenues.
6. The substitution of funding type from fixed coupon to floating creates a relative shortage of fixed coupon.
7. War may change the funding requirements for Treasury. Currently, however, military spending is expected to continue to decline.

Point 1 above allows one to trade around cyclical assets as the market misjudges the cycle by misjudging growth relative to long term mean. Cyclical slowdowns are pauses which can be misinterpreted as fails creating buy opportunities. Cyclical lows are misjudged as fails when in fact they are inflexion points. Trading should be buying and selling earlier than the consensus cycle.

Point 2, 3 and 4 may introduce volatility to the treasury market and duration assets. Point 5 and 6 could imply a relative oversupply of corporate duration relative to sovereigns translating into spread widening.

Points 5 and 6 in isolation of 2, 3 and 4 suggest buying the dips of longer dated treasuries. Unless 7 takes hold.