Rates Spark: Tech jitters

The DeepSeek story was in the news last week, but the market reaction was left to Monday. Nothing to suggest at this juncture that there is follow-through to come, although the notion of overvalued tech stocks is not a tough one to sell. For Treasuries, we're back at c.4.5% in the 10yr, and still looking down. Not a whole lot of room for materially lower yields though, with 10yr SOFR at 4.05%; just 25bp over the funds strip bottom at 3.8% (an effective floor for longer tenor rates)

Delayed reaction to a story that was doing the rounds last week

The latest dip lower in market rates stems from a risk-off episode involving the reassessment around the perceived AI lead of US companies amid a new viable contestant out of China – as (tech-)stocks retreated, bonds and rates rallied. At the front end, two Fed cuts are now fully priced again for the year. In the eurozone, the belly of the curve rallied with the 5y point of the swap curve falling more than 5bp.

So far we're on a one-day move post the tech re-assessment. But US Treasuries can show a meaningful reaction lower in yields from here should this turn into a multi-week reaction to the downside for stocks, or at least a 10% fall in broad indices. As it is, the 10y Treasury at 4.5% is what we'd call a relatively neutral valuation. It coincides with 10y SOFR at around 4%. The forward market discount for the trough in the funds rate is now in the 3.75% area. That would need to dip much deeper to inspire rationale for further large falls in the 10y yield from here.

We'd been tactically bullish in the past week looking for a reaction lower in US yields in any case, partly on core inflation optimism, and benchmark revisions to payrolls data likely coming next week. Monday's move pushes in that direction. Significant dips below 4.5% on the 10y will need more than a one-day dip in tech stocks. Note that we remain structurally bearish for Treasuries through 2025, meaning that we'd need something more seismic to shift that longer term view.

We also saw Bunds outperforming versus swaps while other eurozone govies lagged. Bunds put their role as risk hedge on display, which confirms our view that the cheapening trend of Bunds versus swaps might have gone far enough – at least away from the long end. While the front end is also anchored in money markets the very long end can still remain more exposed to structural tightening factors and fiscal concerns.

Tuesday's events and market view

It is getting busier on the data side with the US releasing durable goods orders and the Conference Board's consumer confidence index. The European Central Bank will release its latest bank lending survey.

In primary markets the main focus in eurozone government bonds is on Austria's dual tranche deal – a new 10y benchmark and a tap of the 45y green bond. In terms of auction supply the focus is on shorter-dated supply. Germany is selling a new 2y Schatz while Italy is also launching a new 2y BTP alongside linker taps. The Netherlands are tapping a 5y DSL.

In the UK a new 11y Gilt linker will be sold. Following the new 2y and 5y notes on Monday the US Treasury will sell new 7y notes and new 2y FRNs on Tuesday.

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