Where are we now directionally for the US 10yr?

We called the way up – it made sense to us. But the move on the way down has been a tad tougher. The pop in MoM inflation and risk-on are complications for the rate cut story. So, bonds need a weak payrolls report, else they're vulnerable. Weakness would be a sub-150k headline and a meaningful move to(wards) a 4% unemployment rate, and extrapolation of more

The move from 3.8% to 4.3% on the US 10yr coincided with an unwind of rate cut discounts. First no March cut, then no May cut and then 50:50 for June. The key drivers were: 1) retracement from what was perceived as a festive overshoot to the downside, 2) pops in January inflation readings (0.4% month-on-month) and 3) a firm January payrolls report (353k). It really started with the latter, which is why Friday's payrolls report is key.

The subsequent move in the US 10yr from 4.3% to sub-4.1% (currently) was kicked off by a core PCE deflator number that was high (0.4%), but better than many feared (the whisper was 0.5%), and the prior month was revised down to 0.1%. Since then, most data has been weak, allowing 10's to do its persistent drift lower in yield.

However, 1) the Fed is not budging on the cut narrative (no urgency), 2) we remain in a risk-on mode (antithesis to a rate cut narrative) and 3) we really need to see the February readings for inflation come at 0.2%, yet the discount for core CPI is 0.3%. The latter was why we'd been reluctant to call for the recent move lower in market rates.

Yet, the pendulum has swung to a clear re-build of the discount for a June cut, now knocking on the door of a 70% probability. The re-build correlated with the 10yr yield slipping lower of late. The 80% to 90% probability area is one where the Fed would be expected to deliver what's discounted. Getting there likely has the 10yr back below 4%. But there has to be some payrolls cooling first, and the 200k market expectation is not a cooling.

The market is trading in a way that sets itself up for a much weaker payrolls number (say 100k). If we get it, then fine, we sail below 4% on the 10yr. But if we get the market discount number of 200k delivered, we really don't have the ammunition to go below 4%. Theoretically a 200k outcome is as expected and should leave little market reaction. But we'd argue it would more likely be a catalyst for yields to back up again (report details notwithstanding).

> Bonds need a weak payrolls outcome, else they're quite vulnerable. Weakness would be a sub-150k headline and a meaningful move to(wards) a 4% unemployment rate, and extrapolation of more to come...

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