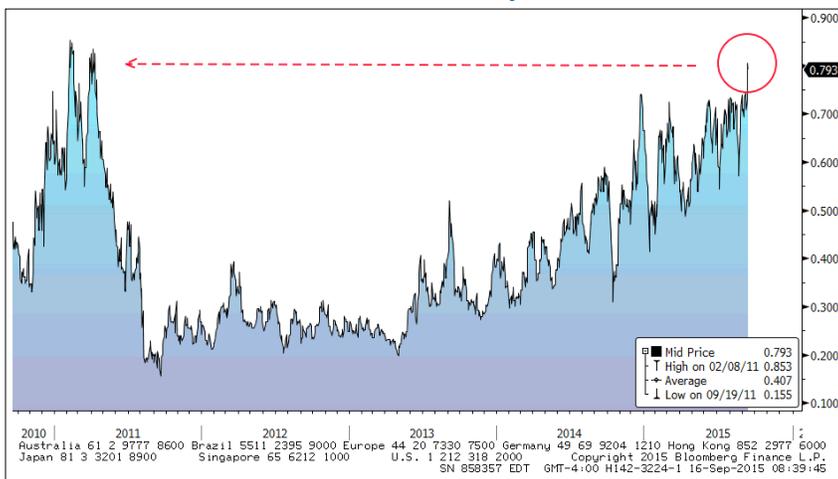


Thoughts Ahead of the Fed

- The 2yr T-Note now sits at 80bps, the highest level in nearly four and a half years. That yield has marched higher since mid-2013 and, moving in fits and starts, has roughly tripled since the low point that year. Most of this is clearly in anticipation of eventual Fed tightening which may be forthcoming in the next day or two. In this sense, we've already been in a rising rate environment since 2013.
- The futures market suggest 30% probability that the Fed will make a move tomorrow, and a 63% probability that they will do something before year-end.
- China continues to be a dangerous wildcard where much is in flux. They have seen a drop in foreign exchange reserves driven by weakening terms of trade, capital flight and withdrawal of previous capital flows. Among other things, this is causing them to sell bonds as the trend of their reserves position has suddenly... well, reversed. The fear is that they will spin into a cycle of falling investment and output, thereby weakening economies dependent on that country's demand or on prices set by its buying, and reversals of carry trades and shifts in exchange rates and that stress balance sheets. A recipe for global recession.
- Recessions typically occur every eight to ten years. The last one began at the end of 2007... we're late in the game.

Bottom line – if and when the Fed initiates a tightening cycle, it could be unprecedented in the way it plays out. It could be one and done. If a second move takes place, it could be months away. In any case, the entire process could be very short-lived. It's possible that we see a brief tightening phase leading to a flat, then inverted yield curve at something less than 2%. And at that point, we'd likely be on the cusp of another recession.

US Two-Year T-Note Yield: June 30 - Today



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