BLOG POST
Analyst Corner
Part 2
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Fixed Income: Taking its Cue

It is normally presumed that the bond market takes its cues for trading from the Federal Reserve but that relationship, like the yield curve, seems to have inverted recently. Analyzing the July FOMC minutes and listening to Chairman Powell in Jackson Hole suggests the Fed is taking their cue from the bond market today. At the prior meeting Fed governors had difficulty expressing why they were cutting rates noting that the downside risks to the economy had diminished since their June meeting. More attention seemed to be given to not disappointing the markets than anything else. Powell stated, “Shifts in the anticipated path of policy. . . help explain why the outlook. . . remains largely favorable.” Translation: the bond market is setting Fed policy. Pricing on inflation-protected bonds (TIPS) suggests inflation will average 1.6% for 30-years, an aggressive assumption.

Technical: No One “Call”ing

The Put-to-Call ratio provides a glimpse into the psyche of traders and what they expect the immediate future to hold. Traders buying puts are concerned about a fall in the equity markets while buyers of calls are expressing the belief that stock prices will rise. Because traders are generally bullish about stocks, the long-term average for the ratio is .7, meaning there are more buyers of calls. When the ratio moves above .7 it is a signal that traders are becoming more bearish about the markets. Through the end of July the Put/Call ratio averaged just below .6 for 2019, suggesting broad bullishness about future stock prices. Since August, however, the ratio has risen dramatically, almost touching 1.0, a level it has only touched 3 times in the past 10 years. The current level of .88 suggests there is still plenty of fear among equity traders.