

Bonds Rally Despite Higher Q2 GDP

The Bureau of Economic Analysis (BEA) announced this morning that the U.S. economy grew at a +2.8% QoQ annualized rate in the second quarter, accelerating from +1.4% in the first. The primary contributors to growth were a restocking of business inventories and better-than-expected personal consumption. Auto sales fueled goods spending during the quarter which reaccelerated from a -2.3% negative pace to +2.5%, while spending on services slowed from +3.3% to +2.2%.

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Business investment improved in Q2 as equipment spending grew at the fastest pace in more than two years, while higher defense spending boosted the government contribution. Residential investment (housing) subtracted from growth for the first time in a year as rising mortgage rates sidelined potential buyers.

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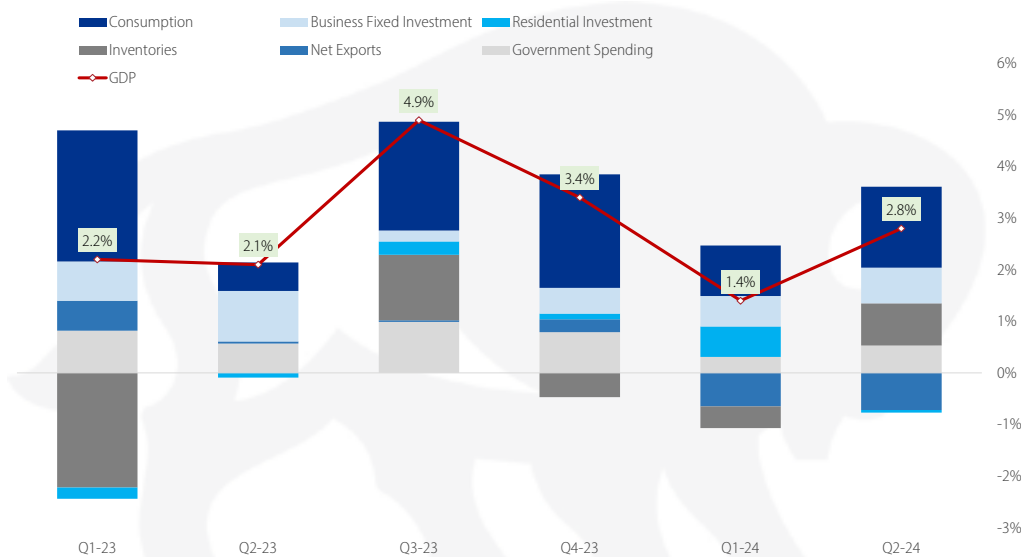
On the inflation side, all quarterly inflation measures slowed, *although not as much as expected*. Core PCE, which excludes food and energy, slipped from +3.7% in Q1 to +2.9% in Q2. PCE service inflation, excluding energy and housing, fell from +5.1% to +3.3%.

In response, bonds have rallied across the curve this morning (yields lower). The stronger-than-expected GDP report doesn't seem to justify lower yields, but market sentiment has clearly shifted. Investors expect rate cuts are on the horizon.

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Short Treasury yields also moved lower on Tuesday and then again on Wednesday, although economists were unclear on the cause. A case could be made that Wednesday's stock market collapse sparked a flight-to-quality into bonds.

Gross Domestic Product (Quarter-over-Quarter Annualized Percent Change)



Source: Bureau of Economic Analysis

Please see disclosure starting on page 2

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There was also a *Bloomberg* opinion piece on Wednesday morning in which former New York Fed President Bill Dudley argued that the Fed should cut rates *at next week's FOMC meeting*. Dudley has long been in the higher-for-longer camp but said recent weakness changed his mind. Dudley's opinion will not sway Fed members. There is virtually no chance of a July cut.

In other news from earlier this week, existing home sales (which make up between 85% and 90% of all sales) fell for the fourth straight month. The -5.4% drop brought June sales to their lowest annualized pace since December. In October 2020, annualized sales were well above 6.5 million units. Last month, it was 3.9 million. Typically, falling sales push prices lower, but *the median sales price for an existing home rose +4.1% year-over-year in June to a new high*. The available inventory of existing homes climbed to 4.1 months, the highest since May 2020, but remains below what would be considered normal.

It's ironic that the Fed is keeping rates elevated to slow inflation, but by doing so they continue to fuel price pressure in the housing sector, which is the primary contributor to consumer inflation.

Yesterday, the Commerce Department reported that sales of new homes fell -0.6% in June and -7.4% year-over-year. The available supply of new homes continues to increase as sales fall and supply gradually builds. The inventory of new homes (at the current sales pace) is now at 9.3 months, the highest since May 2020. In contrast to existing homes, the median price of a new home sold is now down -9.3% from the peak in 2022.

The futures market has now priced-in nearly three quarter point rate cuts for 2024. Given the surprisingly resilient Q2 GDP growth and the Fed's determined patience, this feels a little overdone.

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Market Indications as of 9:41 A.M. Central Time

DOW	Up 135 to 39,989 (HIGH: 41,198)
NASDAQ	Down -86 to 17,256 (HIGH: 18,647)
S&P 500	Down -8 to 5,419 (HIGH: 5,667)
1-Yr T-bill	current yield 4.82%; opening yield 4.84%
2-Yr T-note	current yield 4.40%; opening yield 4.42%
3-Yr T-note	current yield 4.21%; opening yield 4.25%
5-Yr T-note	current yield 4.10%; opening yield 4.15%
10-Yr T-note	current yield 4.21%; opening yield 4.27%
30-Yr T-bond	current yield 4.47%; opening yield 4.53%

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