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## On the Bond Reversal

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We're reluctant to rush into calling a top in a **bond** market infected by such extreme bullishness, but today's reversal of the early rally touched off by the disappointing-looking gain to **May payrolls** could mark the beginning of a long-delayed return to reality. An explanation for the better than one-point pullback might be as simple as the fact that at a yield of 3.82% on the **10-year note**, bond holders may suddenly have become understandably anxious about the prospect of finding buyers at even higher prices, and instead saw a good opportunity to take profits. But beyond the purely technical machinations of players in such an overbought market, it could be that -- however reluctantly -- the marginal portfolio is finally coming to terms with the misguided set of expectations that have been driving prices to such heights.

Those expectations, of course, have revolved around the idea that an end to **the Fed's** policy normalization program is near due to signs of slowing growth. At first blush, today's employment report fit in that mold, showing an addition to payrolls of 78,000 last month, nearly 100,000 below expectations. Given the market's willingness to ignore a string of Fed officials clearly indicating that an end to the rate hiking cycle is not yet in sight -- but to seize on a greenhorn reserve bank president's comments Wednesday about "eighth innings" -- it was no surprise to see an early 20-tick surge on the weakish payroll news.

That early exuberance evaporated around mid-morning, however, when Fed governor **Edward Gramlich**, taking questions after a speech in **Washington**, told reporters "I don't know what inning we're in, period." He then added that to secure **price stability**, "we mean to keep at it." Contrary to the growing chorus suggesting that Fed action poses a threat to **growth**, Gramlich asserted that "other aspects of the economy don't suffer when we stabilize prices in this sense, and that's what we're going to do."

At the same time, a closer look at the jobs data started arousing some second thoughts about whether it was as soft as first appeared. For one thing, the **household survey**, which has had a closer correlation with economic performance than has the payroll data during this expansion, showed **total employment** up by 376,000 jobs. In addition, the **civilian labor force** expanded by 360,000, while the **unemployment rate** fell to 5.1%, down from 5.6% a year ago and lowest since the 2001-02 recession. None of these data points are indicative of an economy in a significant slowdown. It could be, as well, that a seasonal adjustment glitch explains at least part of the unimpressive looking payroll growth. Unadjusted payrolls grew by 707,000 on the month.

Meanwhile, it's a dubious proposition to think that the Fed is taking a single-minded focus on payrolls to the exclusion of other data at this point. With labor costs such an important component of the Fed's models, however flawed they may be, the report this week showing a 7.7% jump in **unit labor costs** in the fourth quarter of last year, and a 3.3% rise in this year's first quarter, assuredly did not go unnoticed at the central bank. **TM**