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The near-term bias on Treasury yields *may* be higher

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There's no doubt the factors behind recent risk asset volatility and lower U.S. Treasury yields—the U.S./China trade conflict, sharply falling oil prices and Fed Chair Jerome Powell's early October hawkishness—have all turned a bit more favorable. But our view is that nothing has been resolved with sufficient clarity, which suggests that while yields may rise off their latest lows, the increases aren't likely to be much. So Federated is maintaining a near-neutral recommendation on duration for its fixed-income portfolios, with a slight nod to be short, as we close out the year.

Among the reasons we think rates aren't likely to move up much: The Trump/Xi G-20 trade truce was better than no deal at all but left big issues unaddressed (intellectual property, forced tech transfer, state subsidies). The 90-day negotiating period seems likely to be punctuated with statements (or leaks) that cut in both favorable and unfavorable directions, making for a bumpy road ahead. Inflation risk is still biased higher long run, but the sharp drop in oil almost certainly will depress near-term headline inflation and restrain core indicators, likely pushing the appearance of cost-push inflation deeper into 2019. Regarding the Fed, Powell and Vice Chair Richard Clarida have intentionally signaled the Fed is not on a predetermined course to above neutral, walking back from Powell's more hawkish early October suggestions.

Other developments also driving our go-slow view on the likely rate direction: the U.S. economy appears to be mildly decelerating; China's economy is definitely slowing, with the risk of that slowdown emanating well beyond its borders; and the European economy has slowed and its markets face event risk with next week's Brexit plan vote in the U.K. Parliament. Wrap it all together, and it's hard to get too bearish on rates at this juncture.

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