Daiwa Securities

Daiwa's View

With release of ISM Services Index, yield uptrend seems to have played out

- Employment index suggests actual conditions weak, despite steady demand in service sector
- Uptrend in long-term yield has very likely stopped temporarily, without exceeding 4.5%

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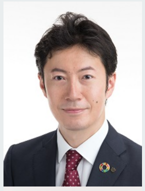

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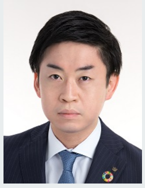

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Yesterday, the US long-term yield declined to 4.15% (down 6bp, d/d), landing at its lowest level in about one month. The main reason for this was an unexpected decline in the ISM Services Index, with the headline at 52.6 (forecast: 53.0; previous month: 53.4), Employment Index at 48 (51.4; 50.5), and Price Index at 58.6 (62.0; 64.0).

Currently, the market and the Fed are concentrating on working to ascertain whether the sharp recovery in employment and prices indicated in January statistics was noise or a change in trends. In that sense, the latest ISM Services Index can be said to have increased the possibility that the data in January, which included many disturbing factors, was noise. This is good news for the bond market.

Of course, it is the US jobs data that eventually determines the picture for the global market. The strong January jobs report (released last month) that substantially exceeded market forecasts, combined with noisy CPI readings that were announced later, has caused higher stock prices and yields. In order to ascertain whether the January jobs data was noise, we need to check JOLTS (due out tonight JST) and jobs reports for several months, including February's data to be released this weekend.

Furthermore, as shown by the fact that the New Orders Index (component of the ISM Services Index) was strong, we still need to be concerned about a resurgence of tight employment in the future due to the higher probability of a US economic growth scenario. We are also concerned about the casino-like market behavior that was pointed out by Warren Buffett in his shareholder letter. Therefore, we expect the long-term yield to remain directionless for the time being.

However, the latest ISM Services Index has no doubt resulted in the adoption of a wait-and-see stance by bond market participants who, since the release of the January jobs data, had begun to think of hedging towards a sub-scenario envisioning no landing, resulting in no rate cuts. Although the above-mentioned casino-like market behavior is a worrisome factor, it looks highly likely that the uptrend in the long-term yield since the release of the January jobs report has stopped temporarily, without exceeding 4.5%.

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