Traders watching to see if that's the air beginning to leak from bond bubble

[Patti Domm](http://www.cnbc.com/patti-domm/) | [@pattidomm](http://twitter.com/pattidomm)

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With bond yields snapping back to June highs, traders are beginning to take notice and worry the markets are at a turning point where those rising yields could pressure stocks.

Stocks sank Tuesday as oil prices fell. Treasury yields rose to three-month highs after [comments from major investors at the CNBC/*Institutional Investor*'s Delivering Alpha conference](http://www.cnbc.com/2016/09/13/bond-yields-spike-as-delivering-alpha-investors-voice-negative-views.html) and a weak 30-year auction. LMM's Bill Miller said he's shorting the 10-year, and Elliott Management's Paul Singer said the long end of the bond market was a bubble and Treasurys and other developed market bonds are not safe havens.

"I think rates are no longer going down," said Lindsey Group chief market analyst Peter Boockvar.

"Yesterday's weak 10-year [auction] was followed by the weak 30-year. A weak bond auction followed by a fragile state in the market is enough to trigger it. The market is handing investors the highest yields in three months and people aren't biting," said Boockvar.

The [S&P 500](http://data.cnbc.com/quotes/.SPX) fell 32 points to 2,127, while the Dow slumped 258 points to 18,066. The [10-year Treasury](http://data.cnbc.com/quotes/US10Y) note briefly touched 1.75 percent before falling back to 1.72 percent in late trading, while the [30-year bond](http://data.cnbc.com/quotes/US30Y) yield rose to 2.47 percent.

"All you needed to see [Monday] was the 10-year yield did not fall. That was another tell on the state of bonds. [Fed Gov. Lael] Brainard was dovish and the 10-year yield didn't fall, and the 2-year didn't fall either," said Boockvar.

Boockvar said a key to the markets will be whether the [Japanese 10-year](http://data.cnbc.com/quotes/JP10Y-JP) sovereign returns to positive yields, now that [10-year German bund yields](http://data.cnbc.com/quotes/DE10Y-DE) have turned positive. "The 10-year could turn positive for the first time in many, many months. That's what I'm going to be watching for. Japan is the epicenter of all this [quantitative easing]," he said. U.S. yields have fallen to stunningly low levels and traded in a tight range all summer as buyers found them attractive compared to negative and low yielding sovereigns from elsewhere.

Strategists said the move in the bond market was also more related to the European Central Bank than the Fed. [ECB President Mario Draghi did not reveal](http://www.cnbc.com/2016/09/08/draghi-just-fueled-speculation-the-ecb-is-pressuring-governments-to-splash-the-cash.html) further easing plans last week, as was expected. Strategists stress that higher yields do not mean the Fed is going to hike rates next week, but that bond markets have instead bucked up against central bank easing and negative yields. The Fed is widely expected to raise interest rates in December.

"Today, we're just seeing a continuation of the post-Draghi bludgeoning," said Ward McCarthy, chief financial economist at Jefferies. "My take on it is it's post-Draghi redux. There's anxiety that the day will come when QE ends. That's why you had such a correlation between stocks and bonds. The reaction would be very different if it really was Fed anxiety."

Justin Lederer, rate strategist at Cantor Fitzgerald, said the Treasury market also hit some key technical levels that pushed the selling harder. "There's a lot going on today. You started the day with just a continuation of [European government bonds] going down. Now we have the bond and equity trade. You couple everything together and I wouldn't put one thing behind today," he said.

He said the 30-year auction, which fared poorly, was also a factor. "To see this type of move, it's definitely something supply-related going on," he said. "Then you have a lot of people talking about the Fed, talking about rates. … We're at a crossroads here."

Strategists say the markets had been too complacent, and the recent volatility around global rates is not unexpected. There's also been a crowded long stocks and bonds trade that some say is about to unwind once the Fed starts to tighten policy.

So for stock traders, a jolt in the bond market could bring a shock to stocks. Fund managers in [Bank of America Merrill Lynch's September survey](http://www.cnbc.com/2016/09/13/bond-shock-and-pricey-stocks-worry-money-managers.html) said Treasurys would be the biggest driver of stocks in the next six months, followed by the dollar.

"This started late last week, and had more downside correlation this week," said Scott Redler, partner with T3Live.com. "I would say technically we broke below the summer range which was 2,148 to 2,163 [on the S&P 500]. We broke below that on Friday, then on Monday we reversed, came back up, retested it and then sellers came back. We're now developing a new level below that. The longer we stay below that, the more vulnerable the market is to lower prices," he said.

"We have 2,119 to trade against. If that were to break, we could see 2,080 next week, but for tomorrow I think there's going to be a little bounce back," said Redler.

On the calendar for Wednesday are mortgage applications at 7 a.m. EDT and import prices at 8:30 a.m. EDT.

Traders will be watching U.S. oil and gasoline inventory data at 10:30 a.m. EDT Wednesday to see if it confirms the smaller-than-expected build of 1.4 million barrels reported by the American Petroleum Institute Tuesday afternoon. Last week, government data showed a near record 14.5 million barrel drawdown of U.S. inventories, as Hermine and other storms kept foreign tankers from reaching U.S. refiners.

[Oil prices fell hard](http://www.cnbc.com/2016/09/12/oil-prices-fall-on-profit-taking-eyes-on-china-data.html) Tuesday after the International Energy Agency said it sees a drop in oil demand growth and rising supplies that will keep markets oversupplied at least through the first half of 2017. OPEC also released a bearish outlook with forecasts of a larger surplus next year, due to new fields in non-OPEC countries and more resilience in the U.S. shale industry. West Texas Intermediate futures fell 3 percent to $44.90 per barrel.

"I think last week was a clearly a bullish surprise, but I think the market has already reversed a lot of that," said Michael Dragosits, senior commodities strategist at TD Securities. "Expectations are for over 4 million barrels this week."

Dragosits said the oil market will focus on the Fed meeting next week, before it turns its attention to the OPEC meeting in Algeria later in the month. "There's not too much going on. A few data points in the U.S. here and there. The Fed speakers are in the blackout right now. The market's waiting for next week. Will they or won't they? Our view is they won't." Dragosits said if the stock market keeps selling off and yields rise, that could pressure the dollar.

"That would be a negative for crude. We'd tend to be quite choppy," he said.