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November 1, 2021

Macro Alert

Yield Curve Flattening Carries a Warning About Looming Rate Hike Cycle

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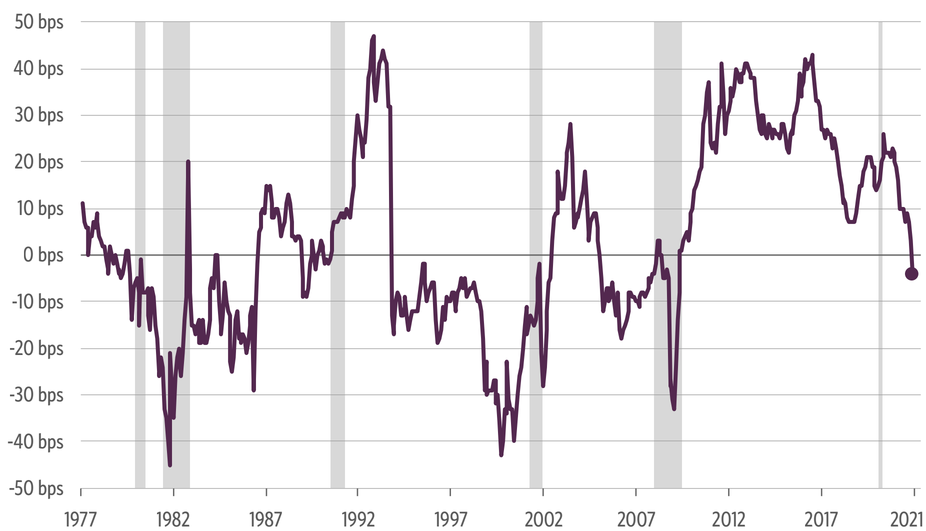
The long end of the U.S. Treasury curve has inverted, with 30-year yields falling below 20-year yields for the first time since 2009. The flattening yield curve could be an indicator that the Federal Reserve (Fed) will raise rates to a degree that could threaten another recession in a few years.

The Long End of the Treasury Curve Has Inverted For the First Time Since 2009
20-Year/30-Year Treasury Yield Curve



Source: Guggenheim Investments, Federal Reserve, Haver Analytics. Monthly average data as of 10.29.2021. Dot indicates latest datapoint.

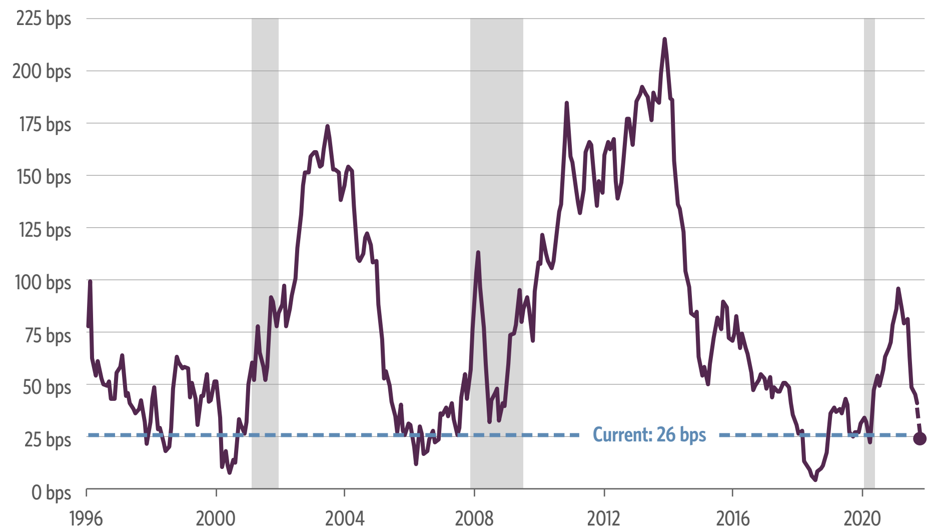
An inversion of the long end of the curve is counterintuitive given the Fed's looming tapering announcement, but the flat forward curve—measured by the three-year forward 3-month/10-year swap curve—indicates that the market is likely looking ahead to the economic impact of the hiking cycle to follow. We expect the Federal

Open Market Committee to announce the tapering of quantitative easing at its Nov. 3 meeting, with purchases likely to end in mid-June 2022. We have also moved forward our expectation that fed funds rate hikes will begin in the fourth quarter of 2022. A rapidly tightening labor market and a persistent overshoot of the inflation target may justify raising the fed funds target to a terminal range of 2.00–2.25 percent.

History shows that an inverted 20s/30s curve on its own does not necessarily predict a recession, but the flat forward curve has been a stronger indicator. The three-year forward 3-month/10-year swap curve stands at just 26 basis points, and based on data from the last three business cycles, that level has historically preceded recessions by an average of 28 months.

A Flat Forward Curve Has Foreshadowed Future Business Cycle Risks

3-Year Forward 3-Month/10-Year Swap Curve



Source: Guggenheim Investments, Bloomberg. Monthly average data as of 10.29.2021. Dot indicates latest datapoint. Past performance does not guarantee future results.