Rates

More Volatility Ahead

Fed interest rate policy will likely cause the yield curve to steepen further.

The third quarter ushered in significant Treasury market repricing and volatility brought on by changes in projected Fed policy for the remainder of this year and into next. While the projected terminal rate remained unchanged at the Fed's last Summary of Economic Projections, the Fed is increasingly uncertain as to the need for any future rate hikes. The Fed will likely continue to rely on forward guidance to attempt the delicate dance of bringing inflation back to target, keeping long run inflation expectations anchored, while trying to engineer a soft landing. This balancing act will likely mean more talk and less action, depending on data and markets.

The magnitude of prior hikes and the Fed talk of a potentially prolonged timespan of higher rates have pushed up nominal and real yields to levels not seen since 2007 as the market required more term premium for purchasing Treasury securities. The selloff also brought into focus debt financing costs and the impact of quantitative tightening amid future increases of Treasury supply to finance fiscal spending. Excluding the extraordinary level of fiscal stimulus during the pandemic, budget deficits have been on an upward trajectory since 2016, pushing U.S. Treasury debt held by the public to $25.7 trillion, nearly 100 percent of nominal gross domestic product (GDP).

Looking forward, we continue to believe that the next major move in the yield curve will be an additional steepening, and we continue to position our portfolios accordingly. As Treasury issuance needs increase in 2024, we believe much of the Treasury bill issuance seen since the resolution of the debt ceiling will be termed out along the coupon curve, adding to steepening pressure. Finally, with the significant increase in real yields, particularly at the front end of the curve, short maturity TIPS look relatively attractive.

By Kris Dorr and Tad Nygren

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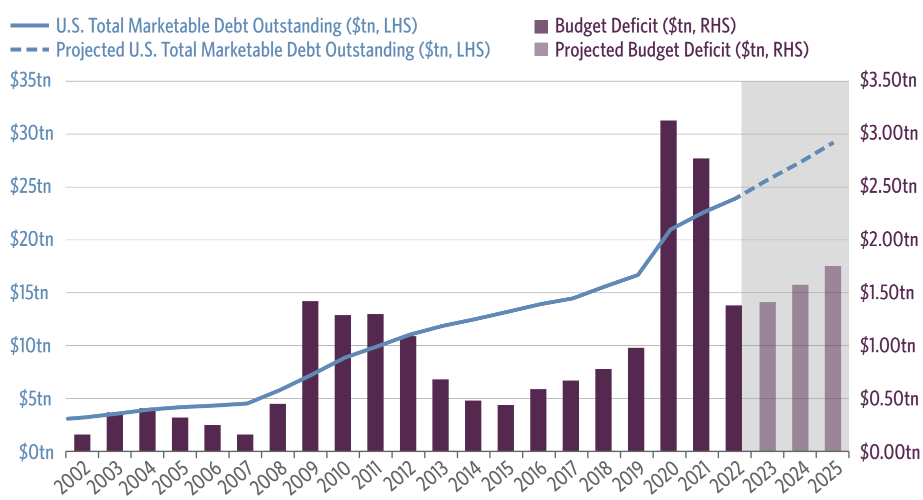
U.S. Debt Will Near $30tn by 2025



Source: Guggenheim Investments, Bloomberg. Data as of 9.30.2023.

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