Rates

When Doves Cry

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The next 50 basis-point move in the Treasury yield curve is likely to be a steepening.

The doves cried louder in the second quarter. The December 2020 fed funds futures contract traded at an implied yield of 1.89 percent at the end of March, but ended June at an implied yield of 1.32 percent, adding the expectation of at least four rate cuts over the next 18 months. The FOMC also ended the second quarter with a decidedly more dovish outlook, with members lowering their 2019 median target projection for the fed funds rate in 2020. The Fed then proceeded to lower the target range by 25 basis points in July despite a string of solid economic data in the weeks leading up to the meeting. The fed funds futures market is currently pricing in 60 basis points of additional rate cuts for 2019 following July's ease, and more by the end of 2020 (see chart, top right).

The U.S. Treasury yield curve bull steepened in the second quarter and yields declined by 30–50 basis points across the curve. The long-end of the Bloomberg U.S. Treasury index (maturities of 20 years and beyond) clipped the best performance with a year-to-date total return of 11.0 percent, the best first half since 2016 (see chart, bottom right).

We have begun to position portfolios to outperform in a steeper yield curve environment, as we believe the next 50-basis-point move will bring a steepening to the yield curve. If the Fed eases aggressively or, conversely, delivers fewer rate cuts than anticipated, the Treasury yield curve should still steepen: either front-end rates will fall faster than the long end or the long end will sell off more than the front end. The rally in the Treasury market has also led to a large increase in callable redemptions, and the resulting increase in supply has been met with tighter spread levels on new issue bonds. We continue to focus on longer lockout callable debt and fixed-rate bullet Agency bonds.

Market Is Pricing in Sharp Cuts for 2019 and 2020

Cuts Priced in by Calendar Year in Basis Points

Source: Guggenheim Investments, Bloomberg. Data as of 8.15.2019.

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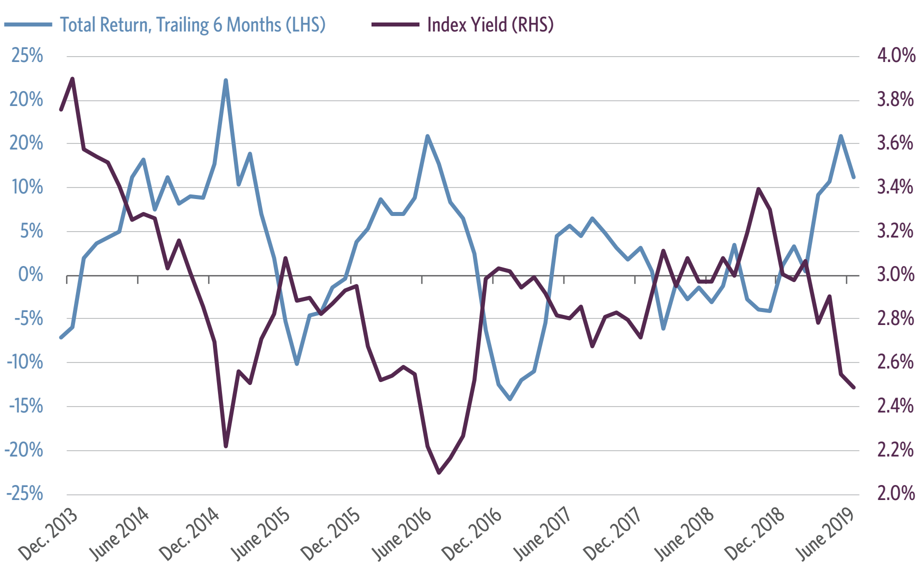
Strong First-Half Performance at the Long End of the Curve

Bloomberg Barclays Treasury Index, 20+ Year Maturities



Source: Guggenheim Investments, Bloomberg. Data as of 6.30.2019.

The long end of the Bloomberg U.S. Treasury index (maturities of 20 years and beyond) clipped the best performance with a year-to-date total return of 11.0 percent, the best first half since 2016. This performance may be difficult to repeat in the second half because yields at the long end would have to decline from about 2.5 percent to 2.0 percent by year-end to return another 11 percent.