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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **October 18, 2023**

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Last week's S&P 500 Index: +0.5%

Treasury yields

Key takeaways

- There are a number of reasons why the 10-year yield has moved up steeply since the first quarter of 2022.
- Perhaps most importantly, the large amount of U.S. government debt the Treasury department is set to issue to fund spending has weighed on prices.

Anyone who has tried to finance the purchase of a home or car knows that interest rates are a lot higher than they were 18 months ago. Over that time, the yield on the 10-year Treasury note moved from 2.8% to the current 4.7%. So, borrowing and spending is more expensive these days, just as the Federal Reserve (Fed) has intended as it moved its federal funds target rate from near zero to the current 5.25% to 5.50% range in an effort to slow the economy and cool inflation.

There are a number of reasons why the 10-year yield has moved up steeply since the first quarter of 2022. As the Fed moved interest rates higher starting in March 2022, the economy performed better, and market participants slowly came to grips with the theme that inflation would likely be higher for longer than many had anticipated. Higher growth along with higher inflation tended to push Treasury yields up, at least initially and especially from very low levels.

More recently, near-term inflation expectations have ticked up, according to recent surveys. Also, the large amount of U.S. government debt the Treasury department is set to issue in the coming months and beyond to fund spending has weighed on prices as investors have required higher yields as bond supply increases noticeably.

The Treasury department issues most governmental debt with a relatively short maturity. The average maturity of U.S. debt was 67 months in June of this year, according to the Treasury's Office of Debt Management. Former Treasury Secretary Yellen, when asked in a 2021 Congressional hearing if the Treasury had any plans to lengthen maturities, said that there were "no current plans to do that." She made that statement even though interest rates across the curve were at or near historical lows at the time. Our current Fed Chair also hasn't indicated that maturities might lengthen.

Now, of course, with interest rates far higher and the sale of new debt necessary to fund increased spending levels, the cost to carry government debt is set to jump from $745 billion in 2024 to $1.4 trillion in 2033, according to the CBO (Congressional Budget Office). However, the U.S. Congress has been through periods when rising deficits coincided with rising yields, and those instances led to some degree of belt-tightening. We expect that to be the case this time around.

Rates may have some room to move higher, but we believe most of the upward push in yields is behind us, if our expected recession is around the corner. We believe today investors are being offered an opportunity to lock in yields that are higher than they have seen in decades. If volatility is the concern, short-term fixed income may be a better way to go. But remember, if short-term rates fall, an investor wouldn't be locked at the higher rates we see today. We favor extending portfolio maturity by taking advantage of higher longer-term yields.

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