

U.S. TREASURY YIELDS: THE NEXT GENERATION

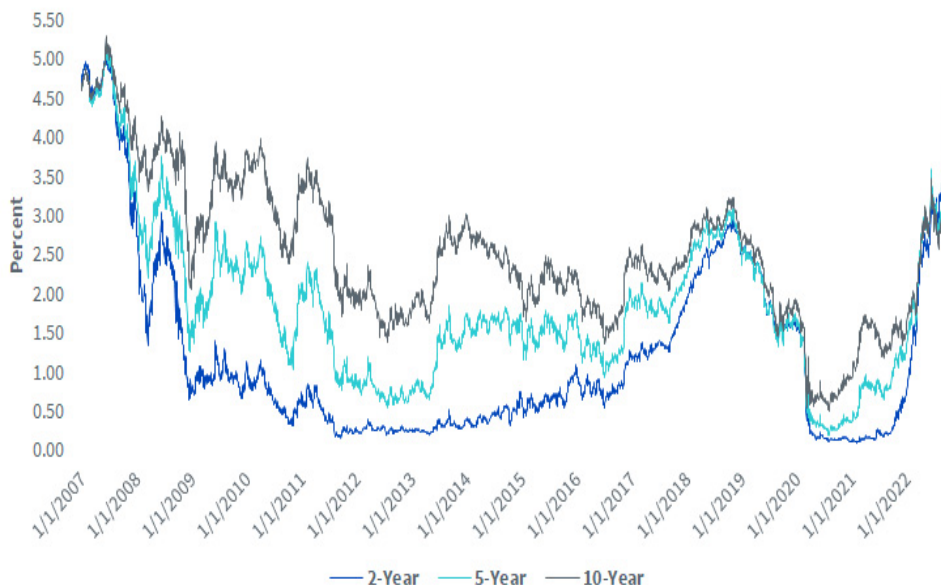
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Heading into October, the U.S. [bond market](#) was arguably already experiencing its worst year on record. Then, this month's sell-off kicked in, bringing [Treasury \(UST\) yields](#) to levels not seen since 2007–08.

Think about that for a minute (perhaps even longer)...we're talking about a period spanning roughly 15 years. In other words, there is a whole generation of investors who have never experienced UST yields at these elevated levels.

Let's break it down a little bit. As I've noted in prior blogs, there has basically been no place to hide in the [Treasury](#) market this year. The only exception has been [Treasury floating rate notes \(FRNS\)](#), but more on that later. The rise in [yields](#) has been across the [maturity](#) spectrum, with the closely followed 2-, 5- and 10-year notes all experiencing surging yields thus far in 2022.

U.S. Treasury Yields



Source: Bloomberg, as of 10/21/22. Past performance is not indicative of future results.

As of this writing, '4%' handles in terms of yield are now widespread along the fixed [co upon curve](#). As recently as early this year, those UST 2-, 5- and 10-year yields were trading from as low as 0.75% to about 1.65%. Unfortunately, the [Fed's](#) use of '[zero-interest rate policy](#),' or [ZIRP](#), following the [financial crisis](#), and again to offset the adverse effects of the COVID lockdown in 2020, created an environment where investors had become quite accustomed to historically low rates, going so far as to think this was the 'new normal.'

For us more 'seasoned' bond market veterans, this was always a conundrum of sorts. We remembered quite vividly where bond market yields resided before ZIRP, and always

wondered when the ‘good ole days’ would return. Well, here they are! I argue that the historically low yield levels that were being registered for the last 10 to 15 years were not normal, and that what investors are experiencing now is a better representation of where Treasury yields should probably be in the new era of [inflation](#) and the Fed’s attendant [monetary policy](#) response.

Conclusion

So, is there more to come? In other words, can UST yields continue rising from here? Let’s put the answer in the context of future Fed policy. Last week, [Fed Funds Futures](#) touched the 5% threshold as the [terminal rate](#) for the trading range by June of next year. If this level does come to fruition, we believe that Treasury yields will more than likely continue to rise, especially along the front end of the curve, as yields need to adjust to this potentially higher [Fed Funds Rate](#).

This is where UST FRNs come into play, as this vehicle is designed to ‘float’ higher with the Fed, due to the resetting mechanism being tied to the weekly UST 3-month [t-bill](#) auction. The [WisdomTree Floating Rate Treasury Fund \(USFR\)](#) is an investment option on this front.

Looking ahead, these higher Treasury yields, both currently and in 2023, are creating a scenario in [fixed income](#) that investors have not been presented with for a decade and a half. As a result, opportunity could be knocking on the door for bond investors in 2023.

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DEFINITIONS

Bond market: The bond market—often called the debt market, fixed-income market, or credit market—is the collective name given to all trades and issues of debt securities. Governments typically issue bonds in order to raise capital to pay down debts or fund infrastructural improvements.

Treasury yield: The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

Treasury security: A negotiable debt obligation issued by the U.S. government for a specific amount and maturity.

Floating Rate Treasury Note: a debt instrument issued by the U.S. government whose coupon payments are linked to the 13-week Treasury bill auction rate.

Yield: The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Maturity: The amount of time until a loan is repaid.

Coupon: The annual interest rate stated on a bond when it's issued. The coupon is typically paid semiannually. This is also referred to as the "coupon rate" or "coupon percent rate."

Curve: Refers to the yield curve. Positioning on the yield curve is important to investors, especially during non-parallel shifts.

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

Zero Interest Rate Policy (ZIRP): A monetary policy where by interest rates, such as Fed Funds, are kept close to, or at zero.

The Global Financial Crisis: Refers to the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009.

Inflation: Characterized by rising price levels.

Monetary policy: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Fed fund futures: A financial instrument that lets market participants determine the future value of the Federal Funds Rate.

Terminal rate: The peak spot where the benchmark interest rate – the federal funds rate – will come to rest before the central bank begins trimming it back.

Federal Funds Rate: The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

Treasury Bill: A treasury bill (T-Bill) is a short-term debt obligation backed by the U.S. government with a maturity of one month (four weeks), three months (13 weeks) or six months (26 weeks).

Fixed income: An investment security that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity.