IS A 4% TREASURY 10-YEAR YIELD POSSIBLE?

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With the Fed ramping up its rate hikes, investors are wondering where this will all end. Certainly, Powell & Co. have been moving the goalposts in that regard, with their latest dot plot revealing a median terminal Federal Funds Rate target of 3.80% in 2023, a full percentage point from what was estimated in March. This has become a moving target, which makes projecting where the U.S. Treasury (UST) 10-Year yield may end up a challenging endeavor.

While the overarching trend thus far in 2022 has been for the UST 10-Year yield to move to the upside, recent trading action has underscored the volatile nature of the bond market. After approaching 3.20% in early May, the 10-Year quickly reversed course and fell nearly 50 basis points (bps) toward the end of the month, to just above 2.70%. Then, last week investors witnessed a renewed surge northward, as the yield was knocking on the door of 3.50%.

U.S. 10-Year Fibonacci Chart

Source: Bloomberg, as of 6/17/22.

Naturally, the question remains whether a top has been reached. However, after looking at technical analysis, the rise in the UST 10-Year yield may not be over just yet. According to the closely followed Fibonacci retracement levels, this most recent move to the upside broke through the longer-term level of roughly 3.41%. As the enclosed graph reveals, there is now nothing between this aforementioned reading and the next retracement level of 4.14%.

Now, I'm not projecting that the 10-Year is about to break through the 4% barrier at this time. But the lack of any support levels before this threshold does create quite the conundrum. As we've discussed in some prior blog posts, watching developments from a real yield perspective could help determine where the nominal UST 10-Year yield could go as well. Thus far, it has worked quite well. During the current run-up of close to 3.50%, the 10-Year Treasury Inflation-Protected Securities (TIPS) yield surged by 75 bps, or nearly identical to the increase for the UST 10-Year. In fact, after being in the negative column as recently as late April, the 10-Year TIPS yield rose to as high as 0.83% before settling in at 0.64% as of this writing. Interestingly, this yield is still about 50 bps below the peak registered in 2018 during the last Fed rate hike cycle.

Conclusion

Barring a collapse in the economic data or a stock market meltdown, investors may look to the technicals and real yields for guidance on where that elusive top will be for the UST 10-Year yield. In my opinion, another test and potential overshoot of the 3.50% level seems distinctly possible.

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DEFINITIONS

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

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Federal Funds (Fed Funds) : Excess reserves that commercial banks and other financial institutions deposit at regional Federal Reserve banks

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

Basis point : 1/100th of 1 percent.

Fibonacci retracement : A technical analysis tool displaying percentage lines which look at support and resistance levels, potentially signaling short-term price/yield reversals. The concept of retracement suggests that after a period of market movement, prices/yields can retrace a portion of their prior pattern before returning to their original trend.

TIPS : Treasury Inflation Protected Securities.