

WHERE IS THE TREASURY 10-YEAR YIELD HEADED?

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One week after the January [FOMC](#) meeting, the money and bond markets are still “buzzing.” Without a doubt, Chair Powell & Co. put on a “[hawkish](#)” show for investors, and one question that I keep getting asked is, “where do you think the Treasury (UST) 10-Year yield is headed?”

Obviously, the lion’s share of the focus has been placed on the number of potential [rate hikes](#) and where the [Fed Funds](#) target range could be by year-end. However, the level of Fed Funds traditionally has more impact on the front end of the [yield curve](#), whereas maturities such as the UST 10-Year are less directly impacted by the “cost” for overnight money.

| Federal Reserve Holdings of Treasuries, MBS & Federal Agency Securities (Millions of dollars—details may not add due to rounding) | | | |
|--|------------|------------|------------|
| | 1/1/2020 | 1/26/2022 | Change |
| Total Holdings | \$3,740.00 | \$8,379.40 | \$4,639.40 |
| U.S. Treasuries | \$2,328.90 | \$5,716.20 | \$3,387.30 |
| 1 Year or Less | 465.80 | 1,139.70 | 673.90 |
| Over 1 Year to 5 Years | 901.00 | 2,197.60 | 1,296.60 |
| Over 5 Years | 962.10 | 2,378.80 | 1,416.70 |
| Mortgage-Backed Securities (MBS) | \$1,408.70 | \$2,660.80 | \$1,252.10 |
| Federal Agency Securities (MBS) | \$2.3 | \$2.3 | \$0.0 |

Source: Federal Reserve, as of 1/27/22

This is where the [Fed's balance sheet](#)—specifically their holdings of Treasuries, MBS and federal agency securities—can come into play. As I noted in my [post-FOMC blog piece](#) last week, it is this aspect of future Fed policy that also bears watching and carries the potential to have a more explicit effect on the UST 10-Year yield. At his FOMC presser, Powell stated the policymakers will be “talking about balance sheet runoff over the next few meetings.” If you look at the FOMC schedule, that could potentially put the June 15 meeting in play for the announcement and/or starting point for [quantitative tightening \(QT\)](#) to commence.

So, let’s look at the Fed’s aforementioned holdings of Treasuries, in particular, to put things in perspective. As the table reveals, total holdings more than doubled to roughly \$8.4 trillion as a result of the COVID-19-related QE program, with Treasuries making up nearly 75% of the overall increase. Within the UST component, 42% of the Fed’s buying occurred in maturities that are five years or greater. Against this backdrop, it is reasonable to assume that this sector of the UST curve, which includes the 10-Year maturity, will see a visible [drawdown](#) once the Fed begins this part of its exit strategy. In addition, the federal government will be “losing” a rather noteworthy buyer at the same time trillion-dollar deficits need to be financed.

Back to the question at hand. Looking at things from a technical analysis perspective, the UST 10-Year yield has already broken through its Fibonacci 50% retracement level of 1.79%. The next “stops on this train” are 2.13% and then 2.56%. In my opinion, a “reasonable case” scenario seems to be pointing toward the UST 10-Year yield heading into a potential

2.25%–2.5% trading range later this year, especially if [inflation](#) remains elevated and the economy continues to maintain a relatively “healthy” growth trajectory.

Conclusion

Interestingly, a “camp” of investors believes the rise in rates has already occurred. I think the Fed will have something more to say about that going forward, and while the march toward higher yields has begun, we may still be in the early innings. In fact, the Fed seems poised to be the catalyst for higher rates not just for this year but for 2023 as well.

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DEFINITIONS

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

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

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

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

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

Quantitative Tightening : Quantitative easing is a process whereby a central bank targets lowering longer-term interest rates by purchasing bonds and other securities to stimulate the economy. Quantitative tightening is the reverse process whereby securities are either sold or the proceeds of maturing securities are not reinvested with the goal of tightening economic conditions to prevent the economy from overheating.

Drawdowns : Periods of sustained negative trends of return.

Inflation : Characterized by rising price levels.