

IS FIVE BECOMING THE NEW FOUR?

Kevin Flanagan — Head of Fixed Income Strategy
11/09/2022

Thanks to Powell & Co., the month of November has gotten off to an inauspicious start for the [money](#) and [bond markets](#). I recently blogged about [Fed Funds](#) and [Treasury yields](#) becoming a “four”gone conclusion , and now that these milestones have been met, you have to ask yourself the question: is five becoming the new four?

It all begins with where the [terminal rate](#) of the [Federal Funds target range](#) is going. At the September [FOMC](#) meeting, the [Fed’s](#) own median estimate placed the level at 4.6%. However, at the November FOMC meeting presser, Chairman Jerome Powell provided an update, stating that “incoming data suggests the September dots should be higher.” What, exactly, is higher? Well, if you look at the June 2023 [Fed Funds Futures](#) contract, the level was 5.14%, as of this writing. In other words, the market is pricing in a terminal Fed Funds target range of 5%–5.25%.

Fed Funds vs. Treasury Yields



Source: Bloomberg, as of 11/4/2022.

If this is where the Fed is headed in this [rate hike](#) cycle, where does that put the key [U.S. Treasury \(UST\)](#) 2-, 5- and 10-Year yields? Typically, these maturities will trade with a ‘[spread](#)’ or yield level over Fed Funds, especially during a [tightening](#) backdrop. This is exactly what investors have witnessed in this go-round as well (see graph), and there is nothing to make me to think this trend won’t continue until the Fed pivots to a ‘pause and cut’ monetary policy phase.

Based on Powell’s presser, the Fed is guiding the markets for a potential ‘higher for longer’ Fed Funds scenario, underscored by his comments that rate hikes still have “some ways to go” and it would be “premature to pause,” let alone to think of cutting.

So, let’s look to history for some possible guidance for UST yields. The last time the Fed took Fed Funds to 5% or higher was the 2004–2006 rate hike period. At that time, the peak readings for UST 2- and 5-Year yields reached 5.28% and 5.23%, respectively, while the 10-Year topped out at 5.29% in mid-2007.

Conclusion

The aforementioned UST yield levels are not meant to be an outright prediction. There is no doubt the Fed seems to be leaning toward a slower pace of rate hikes, but the terminal rate sure looks like it's going to be headed in the 5% direction. Against this backdrop, history suggests 5% yield handles could be forthcoming for short-term Treasuries, at a minimum, with intermediate maturities such as the 5-Year note not too far behind. At this point, I'm not ready to make that assumption for the UST 10-

Year yield (at least not yet), but it does appear as if some renewed elevation moving back into the 4.25%–4.5% trading range (if not a bit higher) is a reasonable scenario.

Stay tuned...things change quickly!

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

Related Blogs

+ [Fed Watch: Pivot 'Lite'?](#)

+ [U.S. Treasury Yields: The Next Generation](#)

+ [No Powell Pivot](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Kara Marciscano, Jianing Wu, Brian Manby and Scott Welch are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Money Market : a market for highly-liquid assets generally maturing in one year or less.

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.

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.

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.

Fed funds target range : the interest rate band the Federal Open Market Committee decides to implement for the federal funds rate.

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

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

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

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.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Spread : Typically refers to a difference between a measure of yield for one asset class and a measure of yield for either a different subset of that asset class or a different asset class entirely.

Fed tightening : Refers to the Federal Reserve enacting monetary policies that have the overall impact of reducing the availability of credit, which is widely thought to have the potential to slow economic growth.