

U.S. Treasury Yields: The Next Generation

Published October 26, 2022

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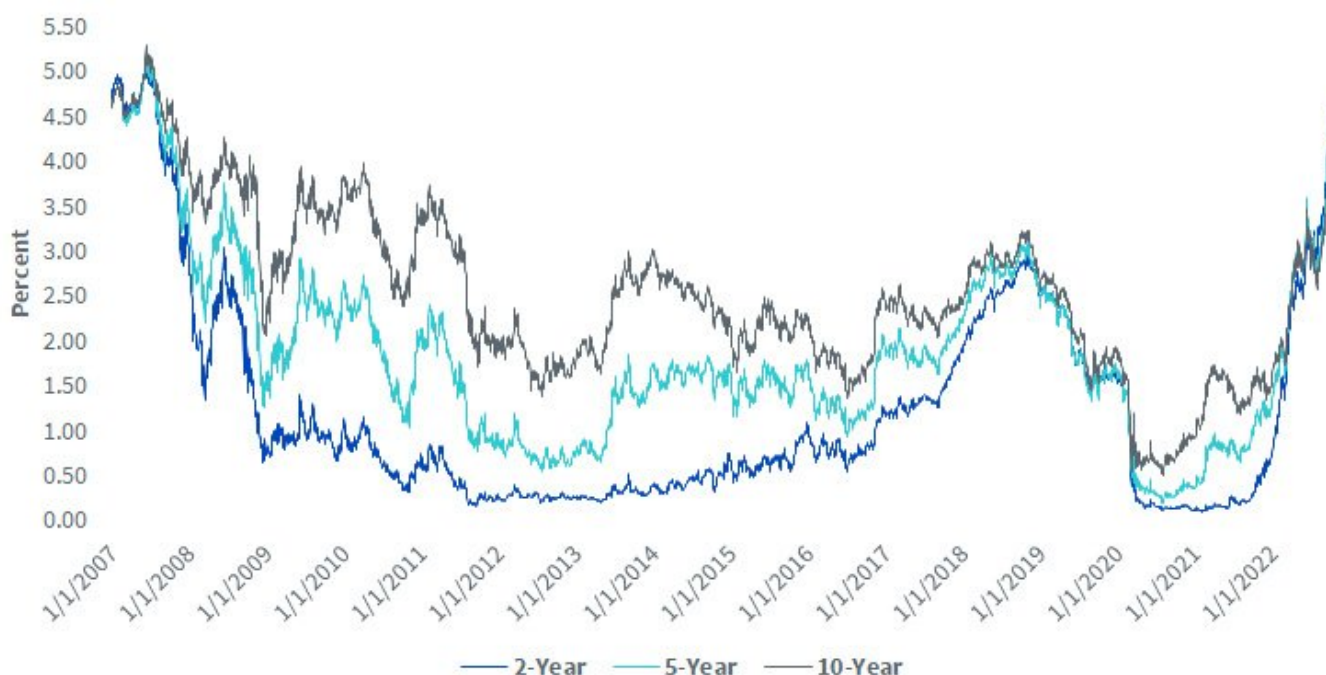
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Heading into October, the U.S. bond market was arguably already experiencing its worst year on record. Then, this month's sell-off kicked in, bringing Treasury (UST) yields to levels not seen since 2007–08.

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 coupon 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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