

# FIXED INCOME: ALL THINGS MUST PASS

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Certainly, the lion's share of the post-election focus within the fixed income arena has been on the [U.S. Treasury \(UST\)](#) market, and rightfully so, considering the recent rate developments across the [maturity](#) spectrum. Somewhat lost in the headlines have been some of the changes that have occurred within the rest of the [G7 sovereign debt](#) universe.

Post-[Brexit](#), G7 sovereign debt yields were the "horse leading the cart" in terms of the direction for the Treasury market, but post-U.S. election, it's been the opposite. In other words, the rise in the [UST 10-Year yield](#) has helped push its G7 counterparts to higher readings as well. However, it should be noted that the overarching rising trend has not been a one-for-one relationship. To be sure, the 10-year rate increases abroad have not kept pace with what has been witnessed thus far in the U.S. To provide some perspective, as of this writing, the UST 10-Year yield has risen 45 [basis points \(bps\)](#) since election day; the remaining G7 increases have been as follows: Japan +7 bps, Germany +9 bps, UK +17 bps, France +24 bps, Canada +29 bps, Italy +37 bps.

## U.S. 10-Year vs. 10-Year [German Bund](#)

UST v German Bund

As a result, [spread](#) relationships, or relative value, have definitely shifted. With the German bund market essentially being viewed as "the Treasuries of the [eurozone](#)," this is where we will turn our attention. Since the "[taper tantrum](#)" in 2013, the 10-Year UST/bund spread has been on a rather visible upward trend. From the beginning of 2013 through the recent U.S. election, the spread moved from a low of +25 bps to as high as +190 bps. Post-election, this differential has risen by roughly 40 bps to break through the +200 bps threshold and now resides at its widest reading since 1989!

It is interesting to note that going into the final month or so of the campaign season, foreign purchases of Treasuries had revealed a discernible downward pattern. According to the most recent [Treasury International Capital \(TIC\)](#) data, foreign holdings of Treasuries through September had fallen by \$125.3 billion. Mainland China represented two-thirds of this total, or \$83.8 billion, dropping its UST holdings to their lowest level since 2012. Unfortunately, the TIC data operate with a one-month lag, so we won't be able to see the official foreign figures during this post-election surge in UST rates until the January 2017 report.

### Conclusion

Will this historically wide spread serve as an incentive for foreign buying of Treasuries? One could make the case that G7 sovereign rate differentials have moved in the UST market's favor. Another supporting factor comes from the technical side of the equation, as the [Relative Strength Index \(RSI\)](#), which measures whether the UST 10-Year is overbought or oversold, last week hit its highest oversold reading since 1990. That being said, the Treasury arena still seems to be in a phase of determining where the bottom lies, a process that seems to be causing global investors trepidation about jumping in too soon.

***Unless otherwise noted, data source is Bloomberg, as of 11/18/2016.***

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## **DEFINITIONS**

**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.

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

**G-7 Countries** : France, Germany, Italy, Japan, United States, United Kingdom, and Canada.

**Sovereign Debt** : Bonds issued by a national government in a foreign currency, in order to finance the issuing country's growth.

**Brexit** : an abbreviation of "British exit" that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Union.

**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.

**German bunds** : A debt security issued by Germany's federal government, which is the German equivalent of a U.S. Treasury bond.

**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.

**Eurozone (EZ)** : Consists of the following 18 countries that have adopted the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (source: European Central Bank, 2014).

**Taper tantrum** : a period in which global interest rates rose dramatically in 2013 as a response to a shift in monetary policy by the Federal Reserve.

**Treasury International Capital (TIC)** : Monthly statistics from the Treasury Dept. that details holdings and transactions in U.S. and foreign securities by domestic and international residents.

**Relative Strength Index (RSI)** : A technical analysis measure designed to track speed and price changes in an investment vehicle. It is used to identify potential overbought and/or oversold conditions.