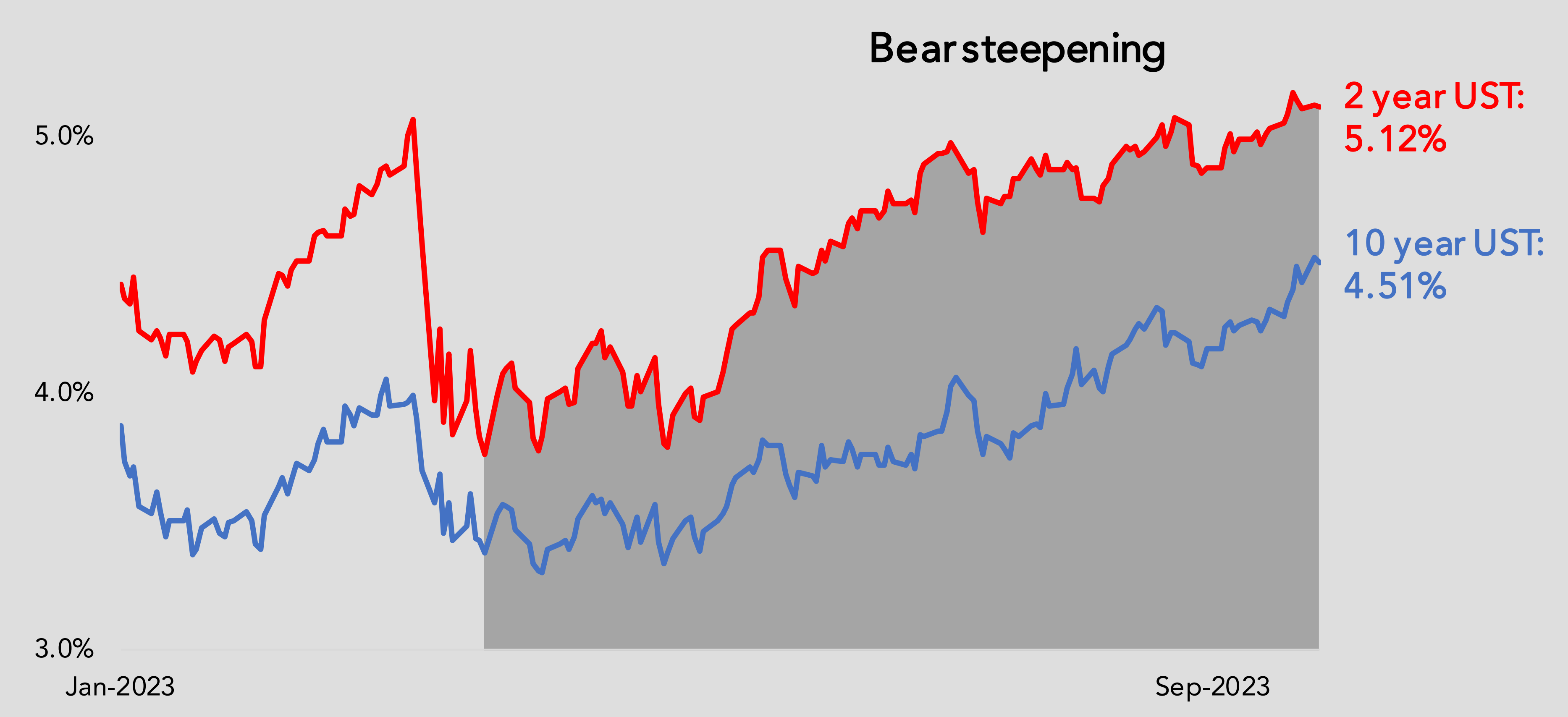
Capital Markets Strategy
Essential inSights for the C-Suite

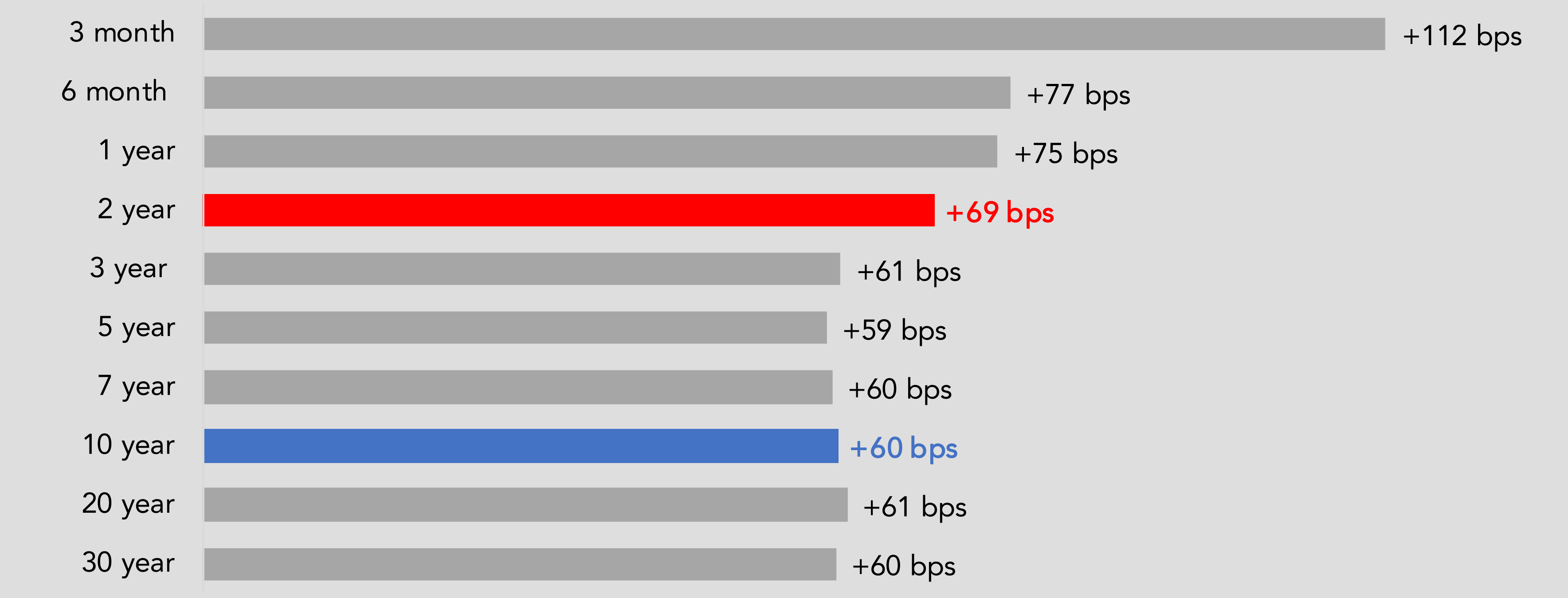
Policy Note

The bear market steepening in US rates since July, which is quite atypical this late in a Fed tightening cycle, has been reinvigorated as massive curve inversion positions unwind on the challenging combination of: (1) resilient US labor market data; (2) the Fed's hawkish pause; (3) ongoing Fed QT; and (4) resurgent UST supply. Two year UST yields, which more closely track Fed policy changes, have risen to their highest levels in 17 years (2006). 10 year UST yields have risen to 16 year highs (2007).

2 year and 10 year UST yields YTD

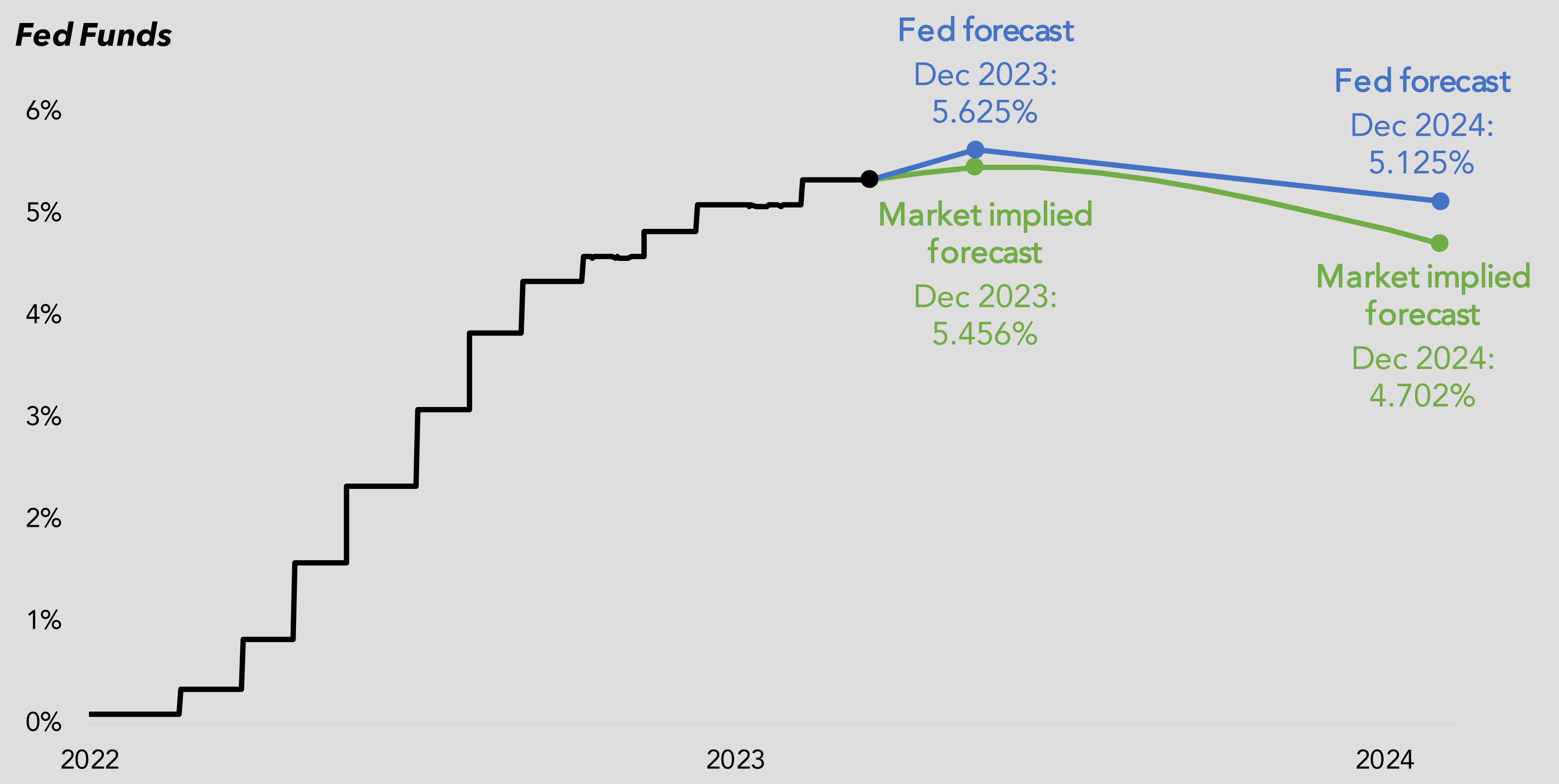


YTD change in US Treasuries



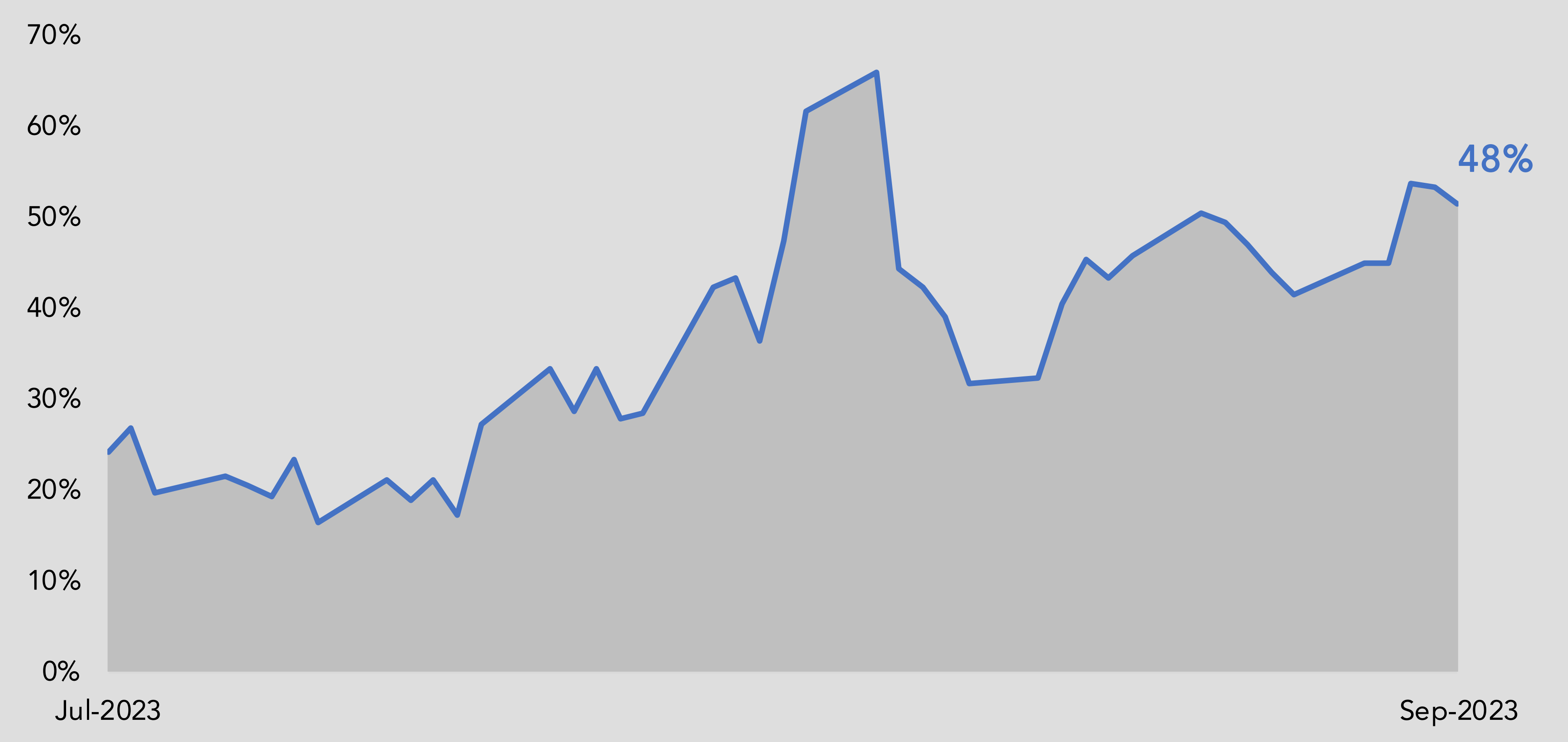
The Fed adopted a "hawkish pause" in their September meeting (their 2nd pause in the cycle), with the median estimate of the Fed's 19 forecasts indicating one additional rate hike in November or December, lifting Fed Funds to a cycle peak of 5.50-5.75%. The Fed also raised their future rate path forecasts meaningfully higher by reducing their projected 2024 rate cuts to 50 bps from 100 bps previously.

Fed Funds



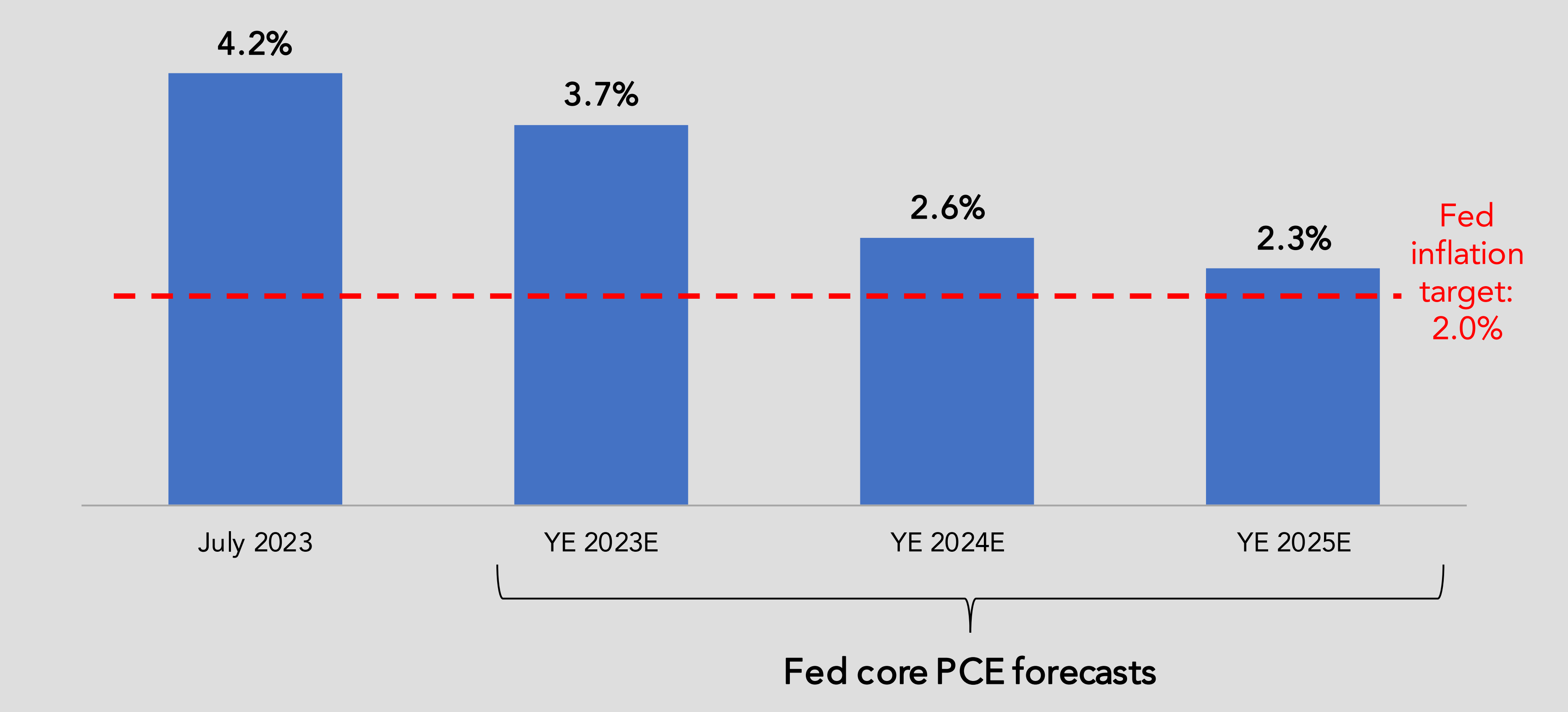
Since this historic tightening cycle began in March 2022, the Fed has consistently been more "hawkish" than market expectations. Today is no exception. Despite the Fed's forecasts and reinvigorated commitment to "higher for longer" at the September meeting, the market is only pricing a 48% probability of an additional rate hike by year end.

Market implied probability of an additional rate hike by year end 2023



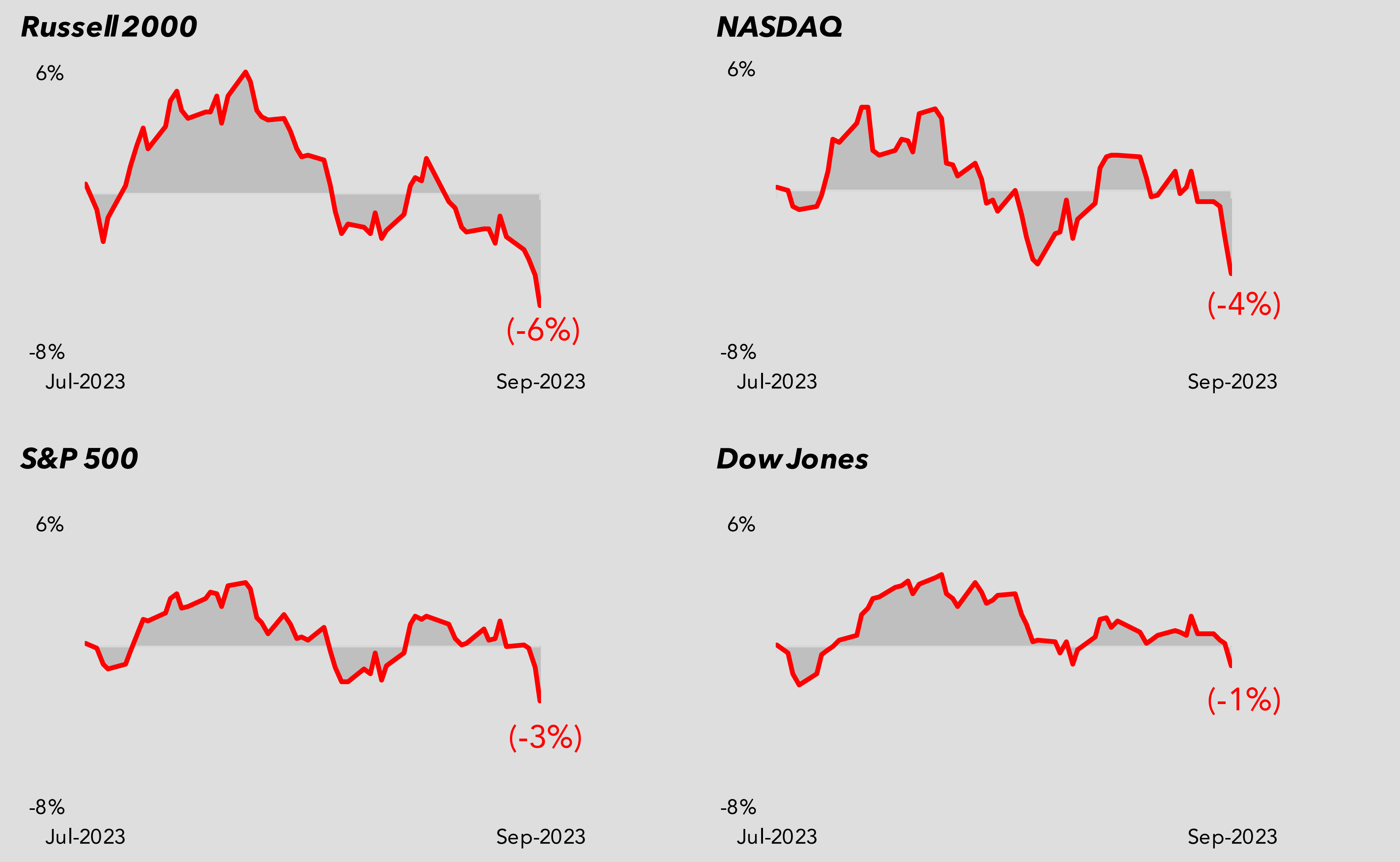
While economists and strategists debate the likelihood of a "soft" or "hard" landing for the US economy, the more important point may be that "we haven't landed yet". As noted by MUFG's George Goncalves, the meaningful development at the September FOMC meeting was their stated intention to maintain policy at restrictive levels until inflation recedes closer to their 2% target.

US core PCE, y/y



The prospect of higher US rates well into 2024 has put pressure on risk assets, with US equities on pace for their worst quarterly performance in more than a year. Should US 10 year UST yields rise above the 4.50% threshold for a sustained period, we would expect a broad range of global risk assets to come under greater pressure.

US equities YTD



Source: (1-9) Bloomberg. Data as of September 22, 2023.

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"Macro stability isn't everything, but without it, you have nothing."