

## Rates

# Plotting a Path to the Terminal Rate

### Treasury issuance remains at record levels across the yield curve.

With the Fed easing cycle now underway, the market's focus has shifted to where the terminal rate will likely fall and how quickly we will get there. Over the medium-term, the evolution of the employment landscape will likely drive this path forward, although we anticipate detours along the way caused by economic data and macro surprises.

## Sector Commentary

- Resilient data on employment, consumer spending, and above target inflation have moderated Fed easing expectations, causing volatility in Treasury yields and the shape of the yield curve.
- After the Fed delivered its first rate cut this cycle with a 50 basis point ease in September and 25 basis points in November, subsequent strong economic data led the market to revise its expected terminal rate from 2.875 percent to 3.45 percent, more in line with our base case of 3.25–3.5 percent.
- Treasury issuance remains at record levels across the yield curve, and investment funds continue to be the largest buyers in the primary Treasury auctions. Primary dealer bidding also remains significant.
- The impact of higher issuance has led to a greater need to finance Treasury positions. With dealer balance sheets already constrained, intermediation of repo trades is challenging and has pushed financing rates higher.

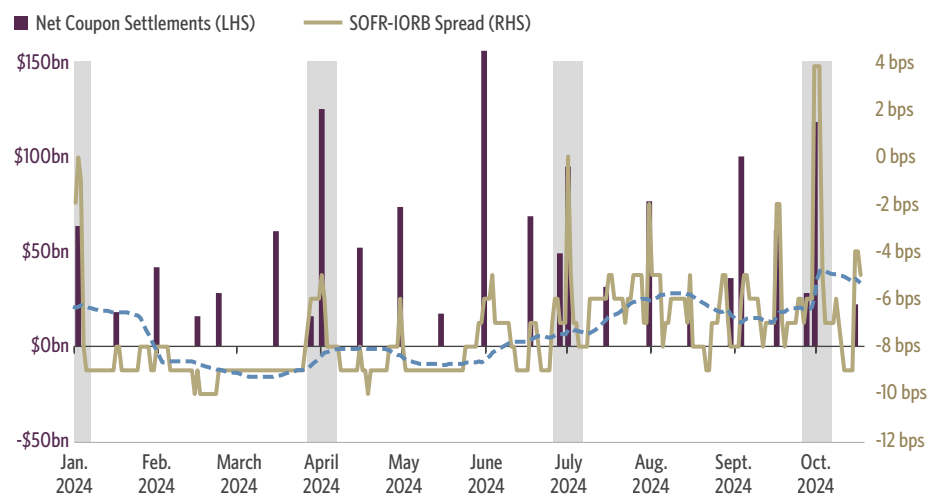
## Investment Themes

- Regulatory requirements are pressuring dealers to reduce their capital intensive businesses, such as Treasury securities financing, creating funding pressures on recent heavy settlement and statement dates—a situation likely to occur again around year end.
- Longer term, changes to Basel III and a deregulation push from the new administration could alleviate some of this pain. Post-election, banking stocks rallied materially on those prospects.
- Potential funding pressures could lead to opportunities in other market segments, such as foreign exchange, where investors can create short-dated synthetic dollar-denominated foreign bonds and earn incremental risk-adjusted yield over comparable U.S. money market instruments.
- We expect the yield steepening curve trend to continue. We also think the macro environment favors owning inflation protection, and that TIPS can continue to do well relative to nominal Treasuries.

By Kris Dorr and Tad Nygren

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### Funding Pressures Could Lead to Opportunities Around Year End



Source: Guggenheim Investments, Bloomberg. Data as of 10.17.2024. Gray shaded areas represent periods of funding spikes.

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