Rates

Positioning for the Next Phase of Fed Policy

Economic data are finally starting to align with the Fed's targets.

In the upcoming months, the Fed will likely enter an easing cycle as inflation comes down and the labor market softens. Meanwhile, the Congressional Budget Office (CBO) is projecting an increase in fiscal deficits by $400 billion to $1.9 trillion in 2024, which will lead to an uptick in Treasury issuance. The confluence of lower short-term rates and additional reliance on coupon Treasurys to fund the deficit will likely cause the yield curve to steepen, as we expected.

Sector Commentary

- Economic data continue to be generally robust. However, employment and inflation have begun to moderate, opening the door for the Fed to ease policy if the trend continues, as we expect in September.
- Changing market expectations around the depth of the easing cycle have led to an uptick in volatility, which we expect to continue.
- When the Fed begins to cut interest rates, money market fund investors will likely extend duration, which would support Treasury market demand.
- As Treasury issuance continues to remain high for the foreseeable future to fund fiscal deficits, we expect investment funds to continue to be the largest buyers in primary Treasury auctions.

Investment Themes

- The projected increase in the 2024 fiscal deficit should result in increased Treasury coupon issuance needs in future quarterly refunding announcements.
- Our macro view continues to support a steeper yield curve in the medium term. However, the carry in steepening trades remains punitive, and we continue to look for ways to position portfolios for steepening exposure while minimizing the negative carry.
- Elevated real yields in the short end of the Treasury curve and breakeven rates that are generally inside of 2.25 percent continue to make shorter maturity Treasury Inflation-Protected Securities (TIPS) look attractive while enabling investors to position for on-going inflation, albeit at a slowing pace.

By Kris Dorr and Tad Nygren

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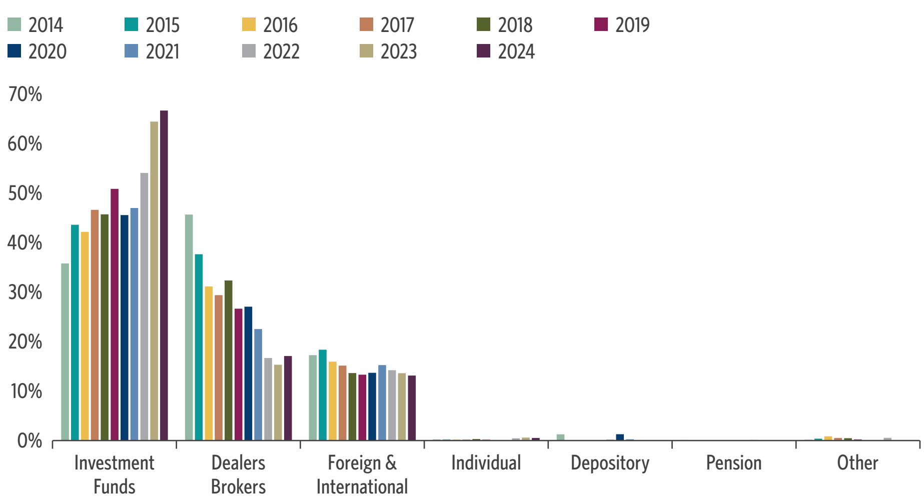
Investment Funds Should Remain the Largest Buyers in Primary Treasury Auctions



Source: Guggenheim Investments, Bloomberg. Data as of 6.30.2024.

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