INCOME RESEARCH + MANAGEMENT

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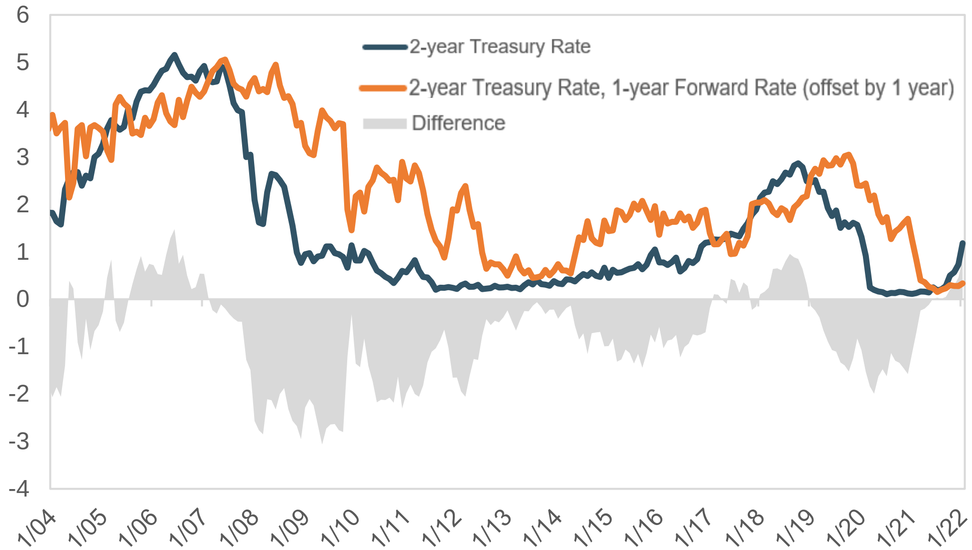
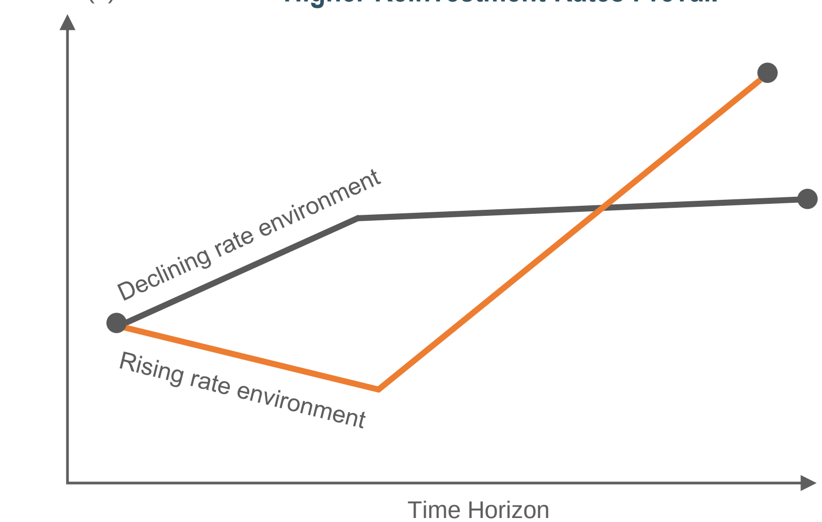
Rising Rates – Keep Calm and Carry On

Rates Are Rising Fast, But They Are Hard to Predict



After Initial Drop In Value, Higher Reinvestment Rates Prevail



- **Treasury rates are on the rise.** Yields on both short- and longer-term Treasuries have been on the rise since the end of last year and have recently surged on hawkish rhetoric from the Federal Reserve (Fed). At January's FOMC meeting, Fed Chairman Jerome Powell said he expects a series of rate hikes this year, with reduced pandemic support from the central bank, to quell rising inflation. Year-to-date, the 2-, 10-, and 30-year yields have climbed 55bps from 0.77% to 1.32%, 32bps from 1.63% to 1.95%, and 23bps from 2.02% to 2.25%, respectively.
- **Rates are notoriously hard to predict.** Following the FOMC's comments at its January meeting, the market is currently pricing in five rate hikes in 2022, up from three in December. Historically the market has struggled to predict rates accurately and consistently. Over the last 20 years, the 2-year Treasury rate, 1-year Forward predicted the actual rate within 25bps and 50bps only 15% and 30% of the time, respectively. We believe positioning for rates is less likely to add long-term value and instead remain duration neutral across our strategies.
- **As the Fed prepares to raise rates, keep calm.** Some investors may reconsider their fixed income allocations given that fixed income portfolio values may initially fall as rates rise. However, investors can benefit from higher reinvestment rates, especially those with time horizons longer than their durations, as the coupon income can offset the negative price return over the long term (see chart on the right above).

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