FIXED INCOME'S RESPONSE TO RISING RATES

Ask the PORTFOLIO MANAGER

How has fixed income been affected by the Fed raising rates?

Transcript of a video recorded on November 30, 2017.

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Matt Freund, Co-CIO, Head of Fixed Income Strategies, Senior Co-Portfolio Manager, discusses the common misperception that yields all along the curve have a similar reaction when the Fed raises rates. He explains that since the Fed has begun tightening, the long end of the curve has remained well behaved, and the team expects this to continue.

It's a common misperception that when the Fed raises short term interest rates, yields all along the curve react in the same manner and that's just not true. It's really like a unicorn, we talk about them but they don't really exist. So, most of the time, the yield curve is twisting and turning in different and often unpredictable ways. Now we think that occurs for a couple of reasons. The first is what impacts the front end of the curve—so think out to two or three years—is very different than the long end of the curve—out from 10 to 30 years. So the front end of the curve is really impacted by Fed policy—short term overnight interest rates. It really dominates the front end.

So when the Fed is raising rates you will see two- and three-year Treasuries' rates go up as well. So rates go up, prices fall. At the same time, though, the longer end of the curve is really dominated by the outlook for first inflation and second long term growth expectations—GDP growth. And right now, despite the fact the Fed is raising interest rates, inflation is notable by its absence and long term GDP growth is really where it's been for the last several years. In fact, it's very similar to where we were back in 2014. So until we see inflation become a problem or growth really achieve its escape velocity—where it's a self-sustaining acceleration, we think the back end of the curve will be surprisingly well behaved.

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Video recorded 11/30/2017.

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