

June 2021

Statistics Win Again — Where Do Rates Go from Here?

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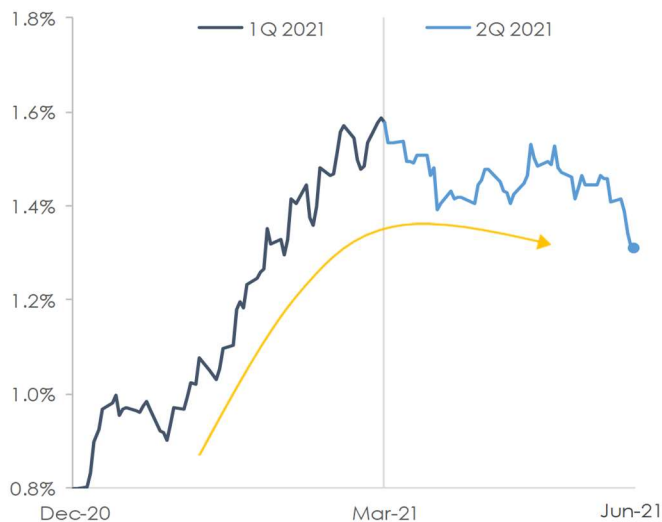
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The saying "this time is different" is a **dangerous mentality**. Yield curve steepening during 1Q21, and the recent trend reversal to yield curve flattening during 2Q21, is a good example. Figure 1 below shows the 10Y Treasury yield rose 0.82% during 1Q21. Long-duration bonds underperformed their short-duration peers by over 4% in 1Q21 as the 10-2 spread widened 0.78%. As 2Q21 started, market consensus called for the 10Y yield to rise above 2%. Investors were convinced the Biden administration's fiscal stimulus and infrastructure proposals, the Fed's dovish monetary policy, and supply chain issues would spur inflationary pressures and further steepen the yield curve. Long-duration bonds were viewed as vulnerable to rising rates and too risky.

Historical evidence pointed to yield curve flattening and favored extending duration. With the benefit of hindsight, it is easy to see statistics got it right and the market got it wrong. Below are some key statistical takeaways as of 3/31/2021:

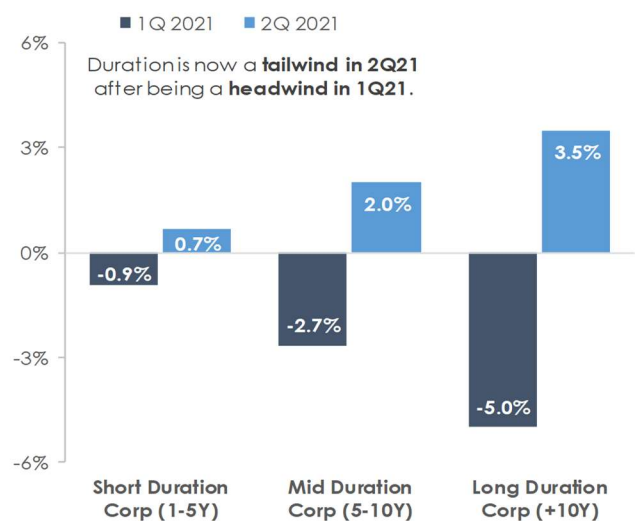
- The 10-2 spread's +2.3std steepening event over the prior 6 months. History shows the 10-2 spread tightened 100% of the time following each of the 13 prior +2std steepening events.
- Figure 28 analyzed performance by duration after the 10-2 spread historically steepened +1.5std. History shows long-duration corporate bonds outperformed over the next 12 months during 5 of the prior 6 times.
- Long-duration corporate bonds were trading -1.7std below their 200-day moving average. History shows long-duration corporate bonds generated double digit returns over the next 12 months during each of the 4 prior times.

FIGURE 1
10-2Y Treasury Yield Curve During 1Q21 & 2Q21



Source: MarketDesk Research, Federal Reserve

FIGURE 2
Total Return by Duration -- 1Q21 vs 2Q21



Source: MarketDesk Research

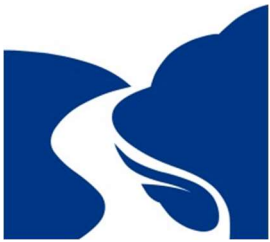
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