Truist Advisory Services, Inc.

Fixed income perspective from the Investment Advisory Group

We expect rates to head higher, so keep duration short

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What happened

10-year U.S. Treasury yields have bounced higher in recent days, up to 1.34% today. Friday's strong jobs report extended the sharp sell-off in U.S. Treasuries, pulling yields further up from their five-month low. The ongoing economic reopening efforts, strong labor market gains, exceptional growth and inflation, and further vaccination progress are the sort of positive developments that typically fuel upward yield momentum. Instead U.S. yields have remained persistently low due to:

- The Federal Reserve's (Fed) ongoing **quantitative easing**
- Rising **Delta variant** uncertainty
- **Peak growth** concerns
- **Ultra-low** foreign yields
- **Seasonal factors** in U.S. fixed income markets

Our take

Since May, a confluence of factors has dragged U.S. Treasury yields lower. Many of these downward forces should ease during the second half of 2021, which we believe will allow low yields to move somewhat higher. Accordingly, we reiterate our stance that below-benchmark duration remains prudent within fixed income portfolios.

Quantitative easing – Lest we forget: the Fed is still buying $80 billion in U.S. Treasury debt and $40 billion in agency mortgage-backed securities (MBS) every month. By definition, these purchases are mandatory and insensitive to yield levels. They equate to an enormous source of demand and a major yield suppressant. However, we believe the Fed will taper its asset purchases in late 2021 or early 2022. As the Fed reduces its supportive role in these markets, the diminished aggregate demand should encourage higher yields.

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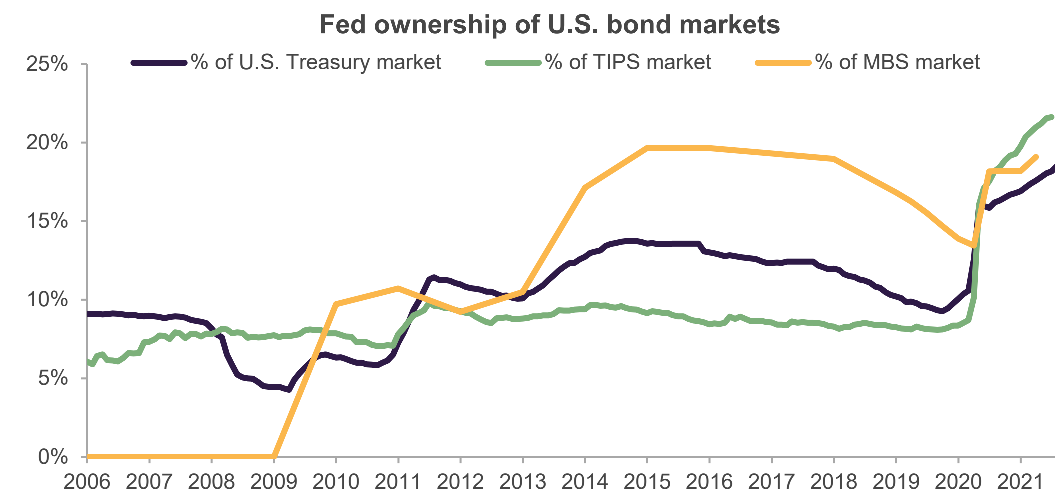
• Are not FDIC or any other government agency insured
• Are not bank guaranteed
• May lose value

The Fed owns an unprecedented proportion of U.S. fixed income markets as a result of its post-pandemic quantitative easing.



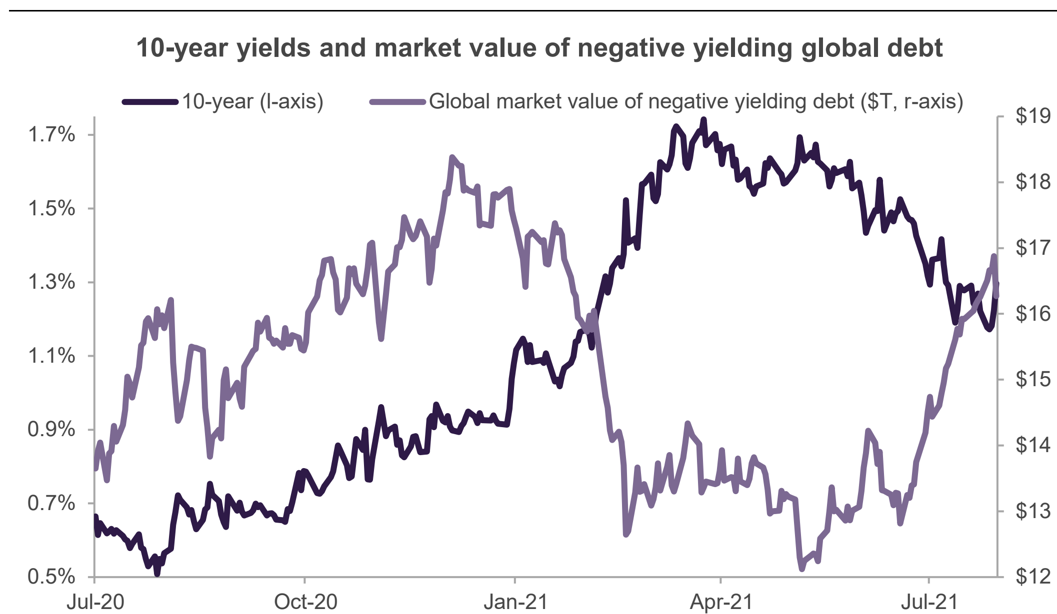
Data source: Truist IAG, Bloomberg

Delta variant – The rise of the COVID-19 Delta variant is an unsettling development, particularly as a new school year approaches and companies try to increase on-site workers. Concerns have grown over the variant's ability to disrupt the progress made—not just in the U.S., but globally. Yet, empirical evidence suggests vaccinated individuals are well-protected from the worst health outcomes. That is welcome news given America's higher vaccination rates relative to many foreign peers, particularly for the most vulnerable (those over age 65). Additionally, the economic impact from Delta's rise appears limited thus far in the U.S. While regional hotspots are likely to continue, the health and economic threats appear manageable compared to 2020 thanks to the vaccines as well as better treatment drugs and therapeutics. As vaccination and natural immunity rates rise, Delta fears should fade and reduce demand for safe haven assets.

Peak growth – There is a big difference between peak economic growth and weak growth. We believe the yield curve's flat trajectory is expressing an overly pessimistic outlook for the strength and scope of the U.S. recovery. Although the impressive gross domestic product (GDP) and inflation data will almost certainly descend from its lofty heights, a strong recovery should persist, and inflation may prove more durable than many expect. Additionally, rising rents, upward wage pressure, and ongoing supply bottlenecks suggest elevated inflation readings will not vanish overnight. Friday's jobs report provided a reminder that the recovery roars on, and the labor market still has plenty of room to heal. Therefore, intermediate and long U.S. yields are too low, even after last week's move higher.

Ultra-low foreign yields – In May, the amount of negative-yielding global debt fell to $12.1 trillion, its lowest level in 11 months at the time. That total has grown 35% since then as our international developed markets peers contained the pandemic to widely varying degrees. As international yields fall, demand spikes for the relatively attractive yields available in the U.S. The decline in U.S. yields since May has been closely synchronized with the expansion in global debt offering negative yields. As Europe and Asia make headway in their respective pandemic battles, their economies more fully reopen, and global quantitative easing slows, international yields should rise. U.S. yields are likely to move higher in concert.

The recent decline in 10-year U.S. Treasury yields has mirrored the sharp rise in negative-yielding global debt outstanding.



Data source: Truist IAG, Bloomberg

Seasonal factors – In July and August, U.S. Treasury yields often fall as trading activity declines amid summer vacation season. In 2021, U.S. Treasury debt issuance also slowed dramatically around quarter end and the July 4th holiday creating a supply-demand imbalance. Furthermore, the U.S. Treasury department recently completed a massive rundown of its Treasury General Account (TGA), the bank account it uses to pay for governmental activities. The TGA swelled as the cash proceeds from the government's post-pandemic debt issuance flowed in. However, the government did not spend all of the $1 trillion it raised. By reducing the TGA, a huge amount of cash in search of liquid investment vehicles was injected into the system. Each of these factors has put downward pressure on yields over the past few months. Going forward, these seasonal disruptions should fade, while liquidity and trading volumes rise. Lastly, new U.S. Treasury debt issuance appears robust through November.

Bottom line

The current low U.S. Treasury yields are misaligned with economic realities. We see exceptionally strong trends on virtually all economic fronts—growth, inflation, and hiring, to name a few. While U.S. economic data have peaked, we expect sturdy readings to last well beyond the next couple months. Powerful central bank accommodation, Delta variant concerns, ultra-low international yields and seasonal factors have each played a role in suppressing U.S. yields. However, these forces should ease as we progress through the rest of the year and provide some upward yield lift. These expectations inform our preference to maintain a below-benchmark duration profile in fixed income portfolios.

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