10 Reasons The 10-Year Treasury Rose 42 BPS Over The Last 7 Weeks

Matthew Cianci Oct. 29, 2017 5:19 AM ET

The 10-year yield bottomed for 2017 on September 8th.

Economic conditions are strong.

Investor anxiety has waned.

Improving inflation data continues.

To be clear: there are MANY factors why the 10-year treasury yield rises or falls on any given day. I believe the low point in the 10Y treasury yield in 2017 is far behind us. As I prefer to do with all my clients, I have 10 quick-hitting points, many accompanied by simple charts, that will help you understand why the 10Y yield is poised to break above its 2.60% ceiling. The black arrows on the charts show the data point for 9/8/2017.

Source: Image created by the author using data from FactSet

1. **Economic growth is accelerating.** Accelerating US real GDP and the cycle-highs in consumer confidence, PMI data, are all captured in Citi's economic surprise index. Strong growth prospects attract equity investors, not safe-haven assets.

Source: Image created by the author using data from FactSet

2. **Biggest beneficiaries of higher interest rates (Banks) are outperforming the bond proxies (Utilities).** The S&P Financial Sector Index is up over 14% relative to the S&P Utility index in the last 6 weeks.

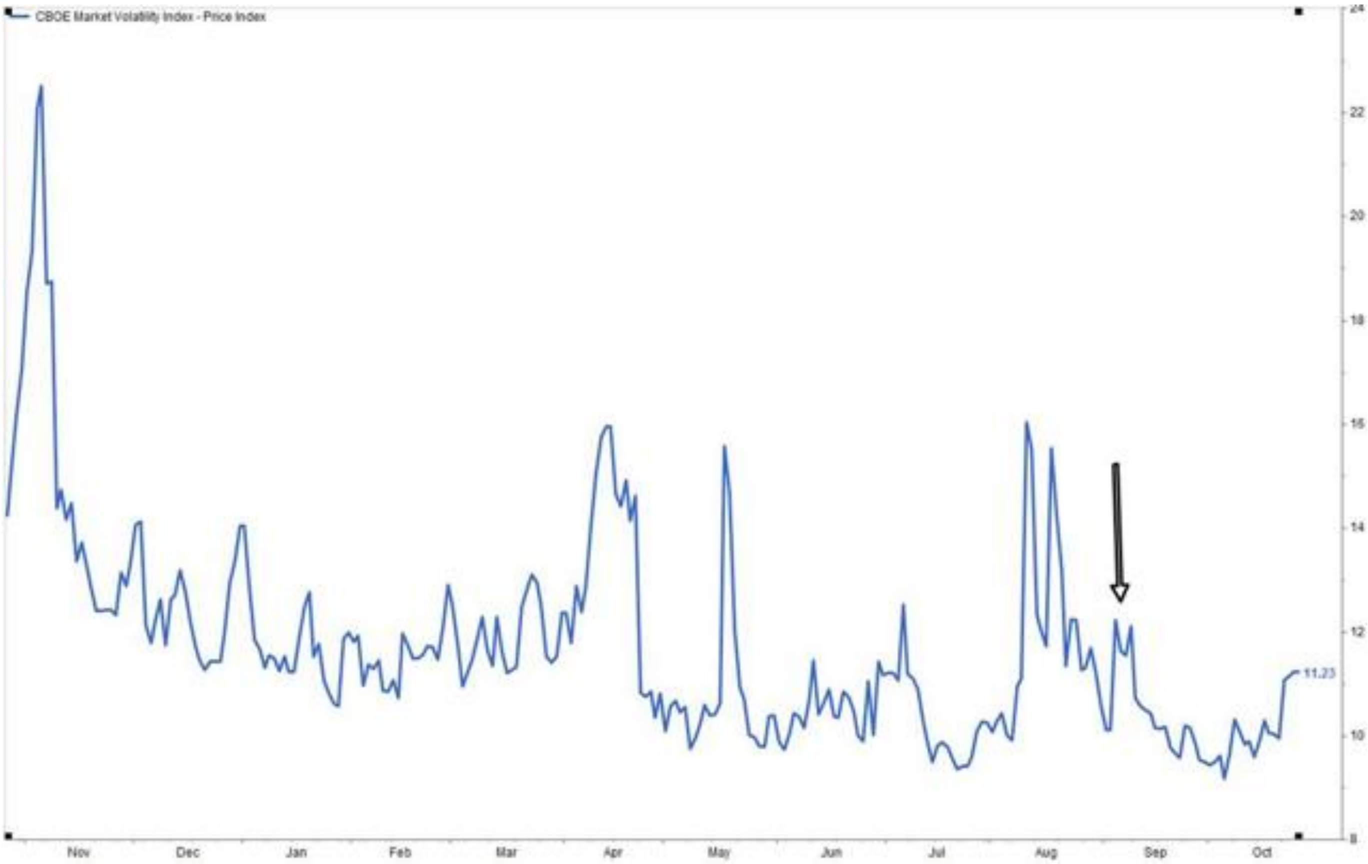
Source: Image created by the author using data from FactSet

3. **Odds of successful tax reform are increasing.** The House passed a budget resolution on Thursday, moving closer to passing tax reform. If tax reform is passed, this will put upward pressure on economic growth (good for stocks over bonds), and also increase the deficit (increased treasury issuance).

4. **The Street still believes long-term rates are headed lower.** I could not pull up a chart on net positioning for the 10Y treasury, but if the Street is net long the 30Y treasury, it is likely long the 10Y as well. Since September 8, those long the treasury future contracts have been covering their losses. If we break through the 2.60% support yield, I'd expect the Street to throw in the towel and go net-short.

Source: Image created by the author using data from FactSet

5. **Volatility is low.** Low volatility does not mean short the market, buy puts, or go to cash. The Volatility Index (VIX) measures front-month option volatility, and is best used as a signal of the current environment - not the future environment. Low volatility suggests things are good in equity land, and bond bulls can take their foot off the gas.



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6. **Geopolitical risks are abating.** We seem to have forgetting about Kim Jong-un. The last time North Korea launched a missile was six weeks ago (9/16/17). Without nuclear war on the back of investors' minds, there is less demand for safe-haven assets.

7. **China's expected sale of the dollar bond.** Although China does not have the same credit rating as the US, the fact that the world's second largest economy is issuing a sovereign bond in the currency of the world's largest economy means there will be competition for treasuries. Higher supply will lead to higher yields. Also note the date of the article.

8. **Low credit spreads.** Bloomberg Barclays US Credit Index securities that are B-rated (my proxy for high yield) currently have spreads at 3.45% above treasuries. Compared to the 1Y average of 4.02% suggests that equity

conditions are strong and investors are preferring credit over treasuries.

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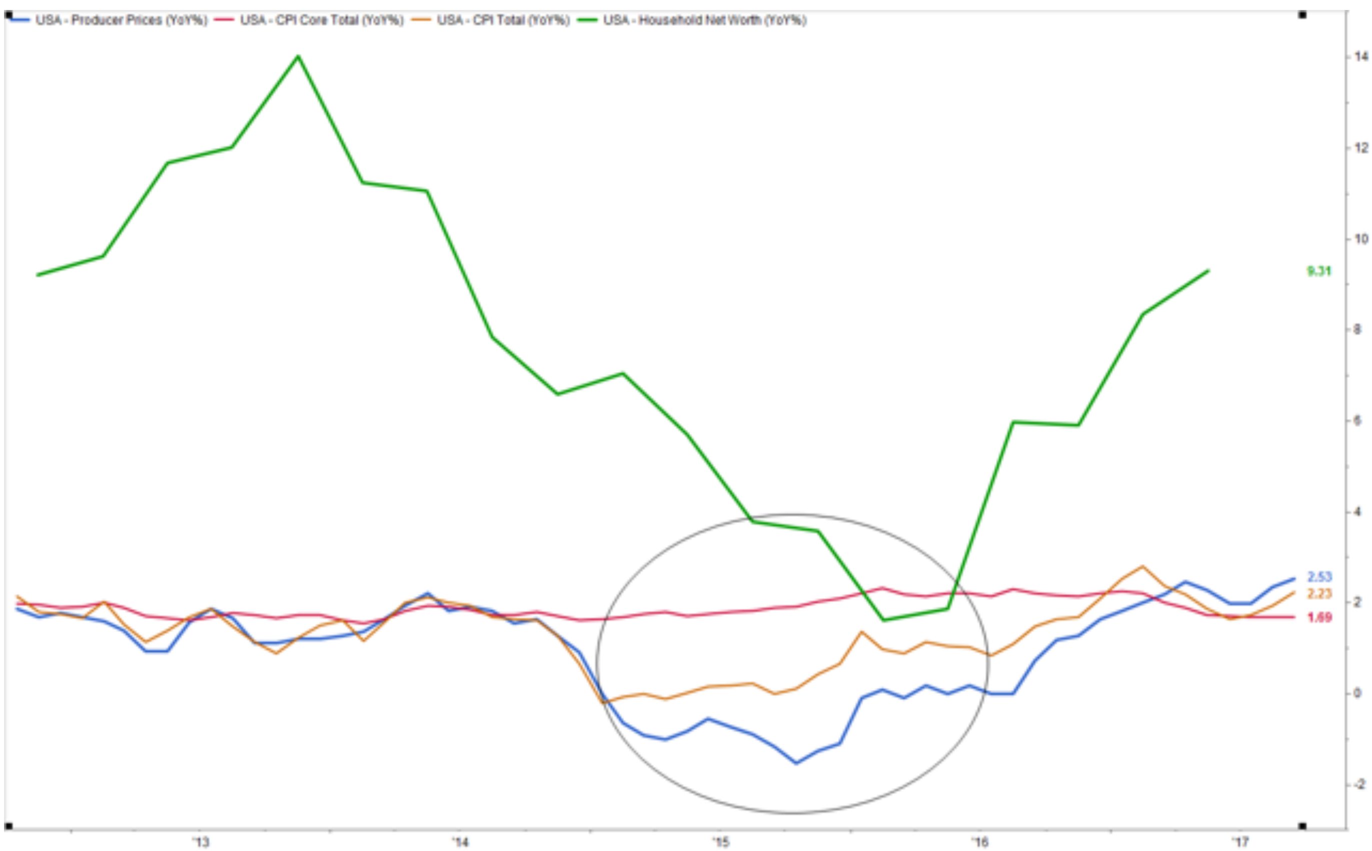
9. **Central bank tightening... globally.** The Fed is about to set forth on balance sheet run-off and the ECB just announced today that they will be tapering in 2018 (decreasing purchases from 60B to 30B euros per month). Hence, some of the largest sources of demand for long-term government bonds are beginning to step away.

10. **Global reflation supportive of higher yields over the short to intermediate term.** Rather than point to an inflection point in the beginning of September, I chose to circle the slowdown in inflation and growth in the US late 2015 to early 2016. The inflection point here is not as sharp given inflation comes in monthly data points, but there is a strong trend emerging. Producer prices tend to lead consumer prices (CPI) given

that PPI includes unfinished goods and CPI focuses on finished goods and services. I include the accelerating chart of household net worth to show the strength of the US consumer. A strong consumer suggests the economy can absorb higher prices on goods and services for the time being. This is also being confirmed by Japan, a country many would consider to be a bellwether for global growth and inflation. Here are more charts on how Japan is beginning to show signs of life on the back of increased growth, inflation and eventually higher interest rates.



Source: Image created by the author using data from FactSet

Owners of long-term bonds beware. I would pare back exposure to long-term treasury ETFs like the iShares 7-10 Year Treasury Bond ETF (IEF), iShares 20+ Year Treasury Bond ETF (TLT), Vanguard Long-Term Bond ETF (BLV), iShares Core U.S. Bond Market ETF (AGG). They hold high durations (interest rate risk) and you have likely already begun to see a small deterioration in price over the last few weeks. Nevertheless, I see a trend emerging and trends accelerate. I would reduce interest rate exposure and therefore any high duration position.

Disclosure: I/we have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

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