Asset Class Research

SHORT DURATION: WHY NOW?

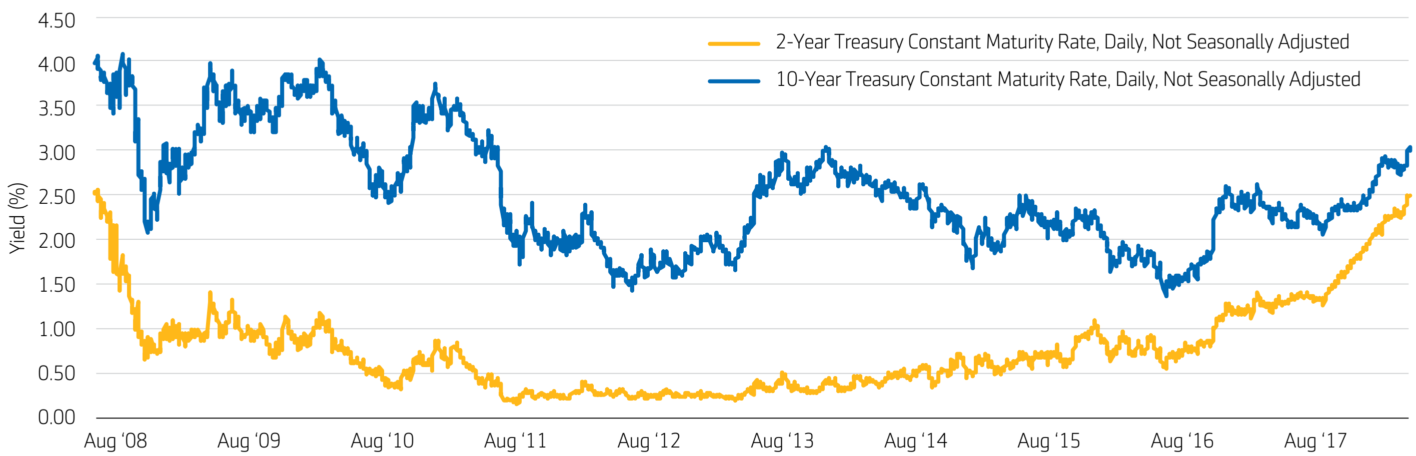
May 2018

Key takeaways:

- *Treasury rate curve flattening presents an opportunity within short duration.*
- *A short duration strategy can benefit from the pick-up in rates while not "locking in" investments for a long time horizon.*
- *Higher short duration rates may allow investors to dial back equity risk through a re-allocation to short duration fixed income.*

With the focus in recent weeks on the 10-year Treasury rate reaching 3%, investors may have lost sight of the continued steady increase in short-term rates, evidenced in the chart below by the 2-year Treasury constant maturity rate. As of April 26, 2018, the 2-year Treasury rate held at 2.49%, a level not seen consistently since August 2008.

2-year and 10-year constant maturity Treasury rates



Source: Board of Governors of the Federal Reserve System (US), retrieved from FRED, Federal Reserve Bank of St. Louis, 8/1/2008 – 4/26/2018.

The rate increase on the short end of the curve indicates the market is now pricing in expected future FOMC rate hikes, compressing the yield differential between 2-year and 10-year Treasury rates. This compression increases the relative attractiveness of investing at the short end of the curve.

Investors wanting to benefit from this curve flattening may want to consider an allocation to a short duration fixed income investment strategy. A short duration strategy positions investors to take advantage of the pick-up in rates while not "locking in" investments for a long time horizon. Additionally, short duration strategies that invest in a range of fixed income sectors, including investment grade corporate bonds, structured credit, and opportunistic allocations to high yield corporates and emerging markets, give investors exposures to relatively short, diversified credits that may have less downside risk than longer-dated paper.

Another investor base that may want to evaluate an allocation to short duration fixed income are investors that have turned to income-oriented equity strategies in recent years as an alternative income-generating investment. Today's rate environment may allow an investor to dial back equity risk through a re-allocation to short duration fixed income while not giving up as much income as in the past.

Learn more about the Aegon AM US Short Duration strategy.

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