Where will U.S. yields go from here?

We run down 2 scenarios: falling further or bouncing higher.

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As the ramifications of the coronavirus and its economic impact continue to unfold, determining where U.S. yields go from here is quite a challenge. Currently, our fixed-income duration committee sees two potential outcomes, one causing longer rates to fall quite a bit further and the other causing longer rates to bounce off their record lows of late. We'll call these possibilities Scenarios A and B, respectively.

Under Scenario A, rates falling further, widespread steps to contain an accelerating virus contagion will weaken U.S. and global growth, creating high recession risk and producing much more Fed easing. Under this scenario, the Fed could ease to zero and the 10-year Treasury yield could fall to around 0.50%.

Under Scenario B, rates bouncing, the contagion will prove less acute than feared, with clinical measures reducing the intensity and mortality risk of COVID-19 and/or containment measures proving to be less restrictive on economic activity. These developments would make recession risk rise less than feared with the Fed potentially easing just one more time. Such an outcome would sharply reduce downward pressure on longer yields and would allow longer Treasury rates to retrace higher. Add in potential fiscal stimulus, and long Treasury rates could rise quickly.

When our duration committee met on Wednesday, March 4, the members felt the more painful Scenario A was a tad more likely than Scenario B. That said, we opted not to move off the committee's current neutral duration position, mainly because uncertainty about the virus and responses to it are too high to speculate at this time and the market already seems to be a bit more priced for a Scenario A outcome. We continue to monitor the fight against the virus and its impact on the markets, and will keep you posted.

TAGS

INTEREST RATES | FIXED INCOME | VOLATILITY | MONETARY POLICY

DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Duration is a measure of a security's price sensitivity to changes in interest rates. Securities with longer durations are more sensitive to changes in interest rates than securities of shorter durations.

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