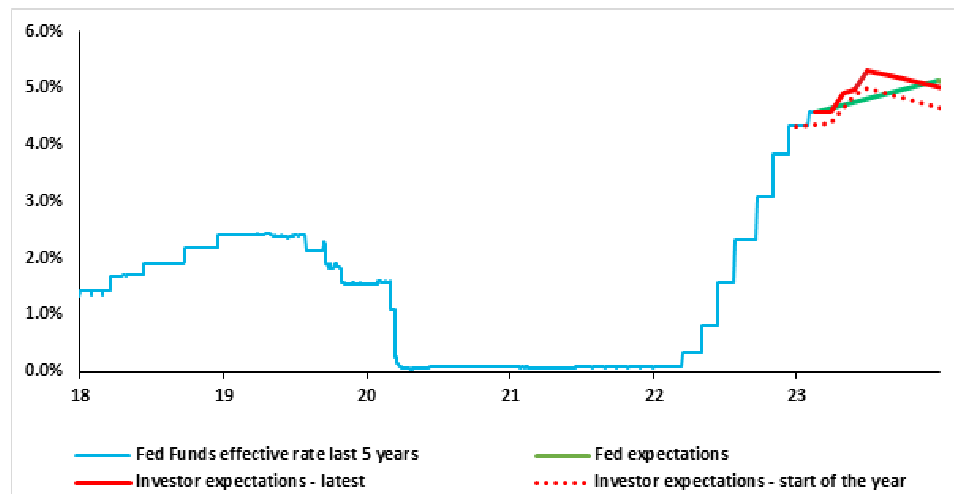
Global Matters Weekly

20 February 2023

Insights from rate markets

by Richard Stutley, CFA, Portfolio Manager

This is the first chart[1] I look at each day: expectations for future US interest rates. I include the view of the technocrats at the Federal Reserve Bureau (Fed), updated quarterly, plus that of investors, inferred from live Treasury prices:



One only has to look at last year to understand why US interest rates or 'the risk-free rate'* (*I prefer the phrase 'lowest risk investment' because US Treasuries are not without risk, a view shared by the ratings agencies) matters: the more investors can earn on dollar cash, the less they are willing to pay for all other investments.

As can be seen from the chart, there has been a meaningful shift in investors' interest rate expectations so far this year, with investors gravitating towards the Fed's view from December (they are set to update their forecasts next month). As a result, interest rate expectations for the end of 2023 are up by 30 basis points and Treasuries are looking more attractive.

Both sides agree that interest rates are going to peak fairly soon and then come down, implying that monetary policy is in restrictive territory at current levels of around 5%. Longer term, 5% nominal interest rates do look high when aligned to a ~2% inflation target, implying a real yield on cash of 3%. This would take serious impetus out of a US economy which can only grow at around 2%[2] if history is anything to go by: why take a chance on a business in a low-growth economy when you can earn a higher real yield on cash?

If this view is proven to be correct, it will have been a moderate tightening cycle by historical standards: using the past ~25 years as a guide, US inflation topping 9% should require materially higher interest rates than 5% to arrest[3]. This leads to uncomfortable comparisons with the 1970s when the initial hiking cycle was eventually proven to have been too timid. On the other hand, the amount of tightening we've seen (i.e. where interest rates are today compared to where they started) looks more on par with this same history, suggesting policymakers have in fact made decisive moves.

At the start of the year, investors were predicting an imminent pivot by the Fed. Without trying to be too precise – overconfidence in forecasts is a pitfall in our view – we felt imbalances could take longer to work out, as was the case post the financial crisis, which will ever be remembered for its 'looser for longer' monetary policy. Add to that the fact that inflation is the enemy of any investment that pays a fixed amount in nominal terms, and it's clear we should be patient and wait for yields to price in this risk. Yields remain below their peaks from last year, but with inflation slowing, they are starting to look attractive.

Sources:

1 FEDL01 Index, YCGT0025 Index and DOTS <GO>, provided by Bloomberg Finance L.P

2 GDP CYOY Index, provided by Bloomberg Finance L.P. Average since 2000

3 FEDL01 Index and CPI YOY Index, provided by Bloomberg Finance L.P. Data since 1996

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise

Belvest 研富

20 February 2023

For more information, please contact your adviser or alternatively contact:

Belvest Investment Services Limited
研富投資服務有限公司
9th Floor, Centre Mark II
305-313 Queen's Road Central
Sheung Wan, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
belvest@bis.hk
www.bis.hk

Important notes

This communication is issued by Belvest Investment Services Limited and/or Belvest related companies (collectively, and individually Belvest) solely to its clients, qualified prospective clients or institutional and professional investors. Unless stated otherwise, any opinions or views expressed in this communication do not represent those of Belvest. Opinions or views of any Belvest company expressed in this communication may differ from those of other departments or companies within Belvest, including any opinions or views expressed in any research issued by Belvest. Belvest may deal as Distributor or Agent, or have interests, in any financial product referred to in this email. Belvest has policies designed to negate conflicts of interest. Unless otherwise stated, this e-mail is solely for information purposes.

This message may contain confidential information. Any use, dissemination, distribution or reproduction of this information outside the original recipients of this message is strictly prohibited. If you receive this message by mistake, please notify the sender by reply email immediately.

Unless specifically stated, neither the information nor any opinion contained herein constitutes as an advertisement, an invitation, a solicitation, a recommendation or advise to buy or sell any products, services, securities, futures, options, other financial instruments or provide any investment advice or service by Belvest.

No representation or warranty is given as to the accuracy, likelihood of achievement or reasonableness of any figures, forecasts, prospects or return (if any) contained in the message. Such figures, forecasts, prospects or returns are by their nature subject to significant uncertainties and contingencies. The assumptions and parameters used by Belvest are not the only ones that might reasonably have been selected and therefor Belvest does not guarantee the sequence, accuracy, completeness or timeliness of the information provided herein. None of Belvest, its group members or any of their employees or directors shall be held liable, in any way, for any claims, mistakes, errors or otherwise arising out of or in connection with the content of this e-mail.

This e-mail and any accompanying attachments are not encrypted and cannot be guaranteed to be secure, complete or error-free as electronic communications may be intercepted, corrupted, lost, destroyed, delayed or incomplete, and/or may contain viruses. Belvest therefore does not accept any liability for any interception, corruption, loss, destruction, incompleteness, viruses, errors, omissions or delays in relation to this electronic communication. If verification is required please request a hard-copy version. Electronic communication carried within the Belvest system may be monitored.

Belvest 研富