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Chart of the Day

This afternoon, the Fed is widely expected to raise rates by 50 bps for the first time in 22 years. Even with 10 year inflation break-evens above 2.8%, UST 10 year rates briefly breached 3% for the first time in 4 years (nearly doubling YTD from 1.51% on Dec 31) on expectations of accelerated Fed tightening . **According to the St. Louis Fed, 10 year UST yields have generally been higher than inflation for most of the last 20 years prior to March 2020**.

As the Fed drains liquidity, asset prices that have been fueled most by Fed-induced liquidity are the most vulnerable. For risk assets, a rising rate environment poses challenges, especially as **bond yields and sovereign debt** offer more competitive returns**.** Higher rates also exert downward pressure on P/E multiple expansion for **growth stocks** in particular. YTD, the **NASDAQ** is down nearly 20% and the **S&P 500** has declined 12%. **Tech-heavy regional stock markets** (Taiwan) globally have also come under pressure. High growth businesses and **low profit or loss-making start-ups** are particularly vulnerable.

The TINA (there is no alternative) trade is under pressure. **Commodity** currencies, companies and stocks are benefitting.

Returns on **IG & HY bonds** have been more deeply negative YTD than any year since the 1970s, as rising rates and spreads, as well as increased volatility, increase corporate borrowing costs. **Mortgage rates on new housing** purchases are now above 5% for the first time since 2011. Accelerated Fed tightening (and the unexpected war in Ukraine) has also precipitated more **US Dollar strength** in 2022 YTD (+8%) than most had anticipated, which in turn puts pressure on both **DM (Yen at 20 year lows, Euro also down sharply) and EM currency pairs (Hungary, Malaysia)**, multi-national **corporate earnings**, and the **USD liabilities** of non-US multi-nationals.

In our view, it will be much easier for the Fed to reduce inflation from 8-9% to 4-5% with its demand side tools directly impacting **interest rate sensitive sectors (durable goods, auto, housing)**, than it will be to reduce inflation from 4-5% down to 2-3% without precipitating a "hard landing," given the concurrent **supply side sources of inflation (COVID impact on supply chains, Ukraine on energy and food).**

After reaching a low of (-1.19%) in August, UST 10 year "real" yields have returned positive for the first time since March 2020, as they have been for much of the last 20 years

Source: (1) Bloomberg. Data as of May 4, 2022. WSJ. Barron's. FT. Freddie Mac. MUFG Rates Strategist (Goncalves).

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