MARKET COMMENTARY

Fig. 1: 10 Year Treasury Rate

Source: Bloomberg, Mill Creek.

For the past year, we have considered 3.5-4% as a good range for the 10-year Treasury yield. Now that the 10-year Treasury yield is back around 4%, we believe it is a good time to address just how high yields might go in the latter innings of this cycle.

Why did Treasury yields recently increase from 3.5% to 4%?

The move wasn't based on concerns about inflation — inflation expectations have remained generally unchanged this year. The answer is that economic growth has been more resilient than market participants expected. This led to real yields increasing by about 0.5%, driving 10-year Treasury yields up the same amount.

How much higher could yields go?

If market participants start to really embrace the "higher for longer" message from the Fed, a "normalized" term premium (the compensation that investors demand for holding long-term bonds) could result in a 10-year Treasury yield of 4.75%-5%. Of course, this assumes nothing (e.g. banks) in the economy breaks under the strain of higher rates before we reached that point and that inflation doesn't continue to subside. Fortunately, last Thursday's CPI release indicated that inflation continues to moderate, supporting an upper bound of about 4% on the 10-year Treasury yield for now.

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