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Q4 2023 Rates Outlook

October 2023

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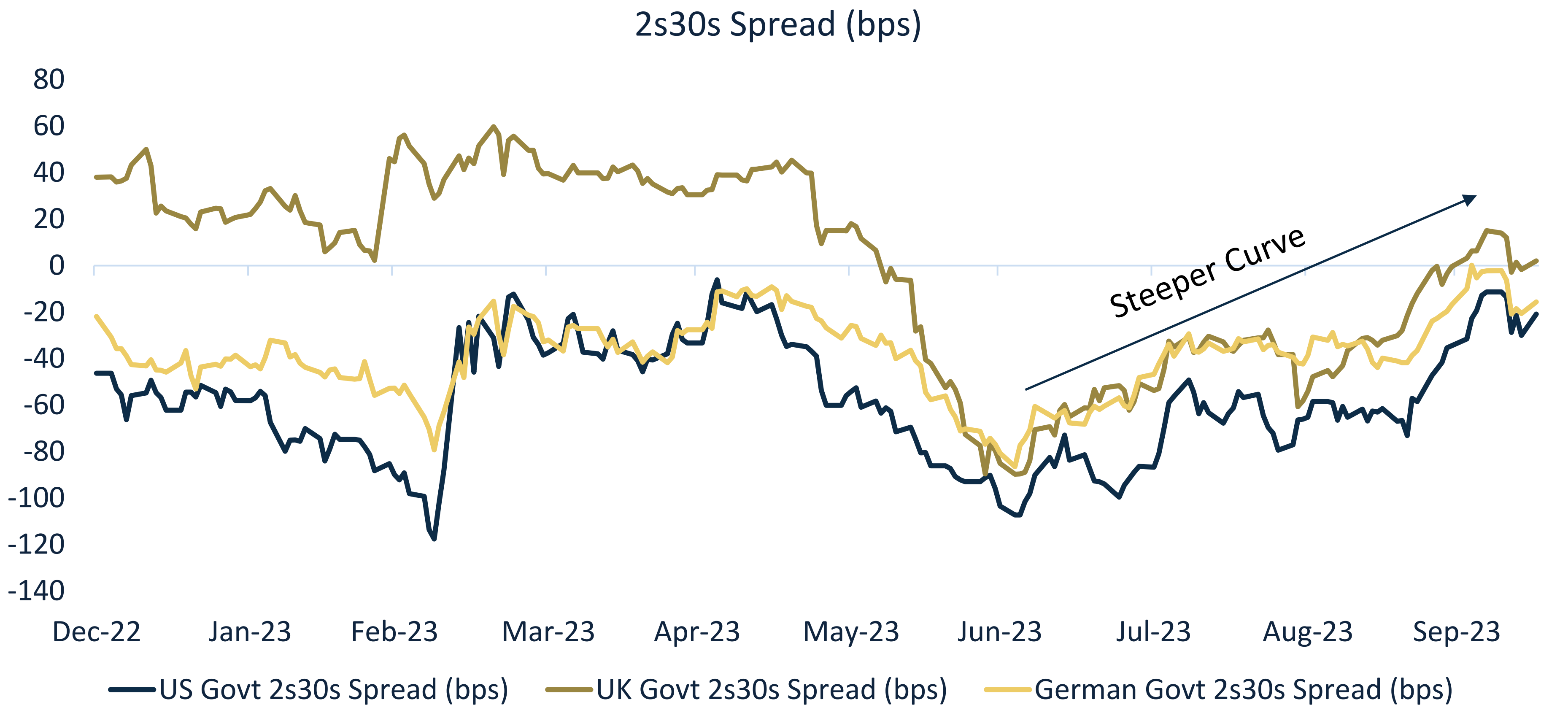
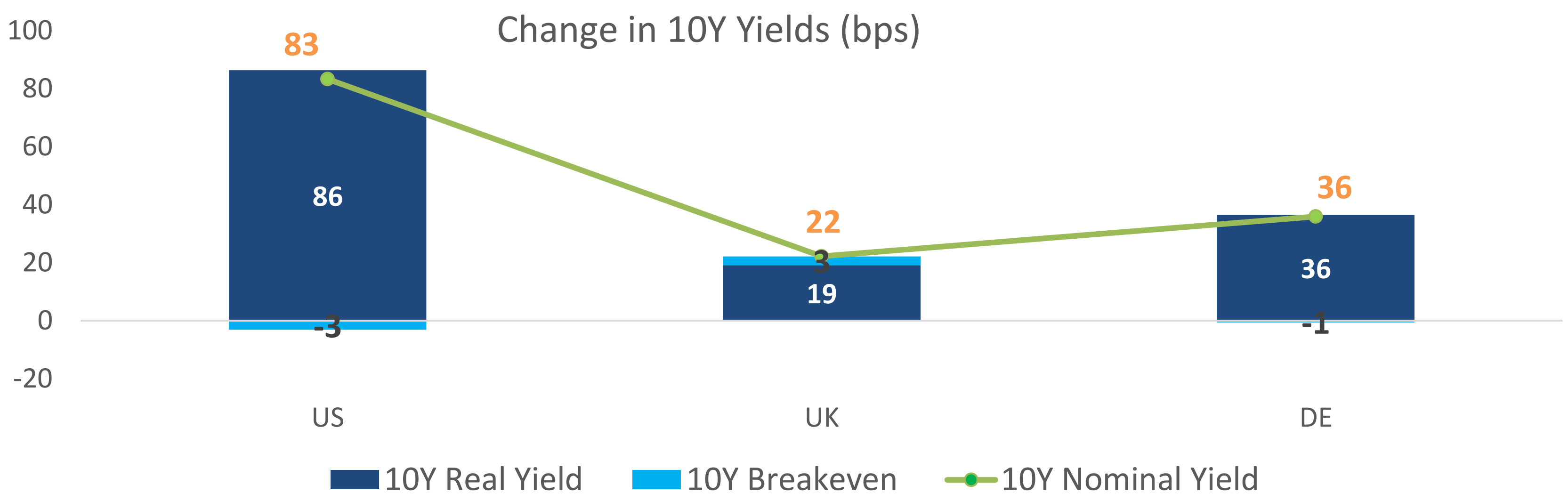
Q3 Characterized by Steeper Curves

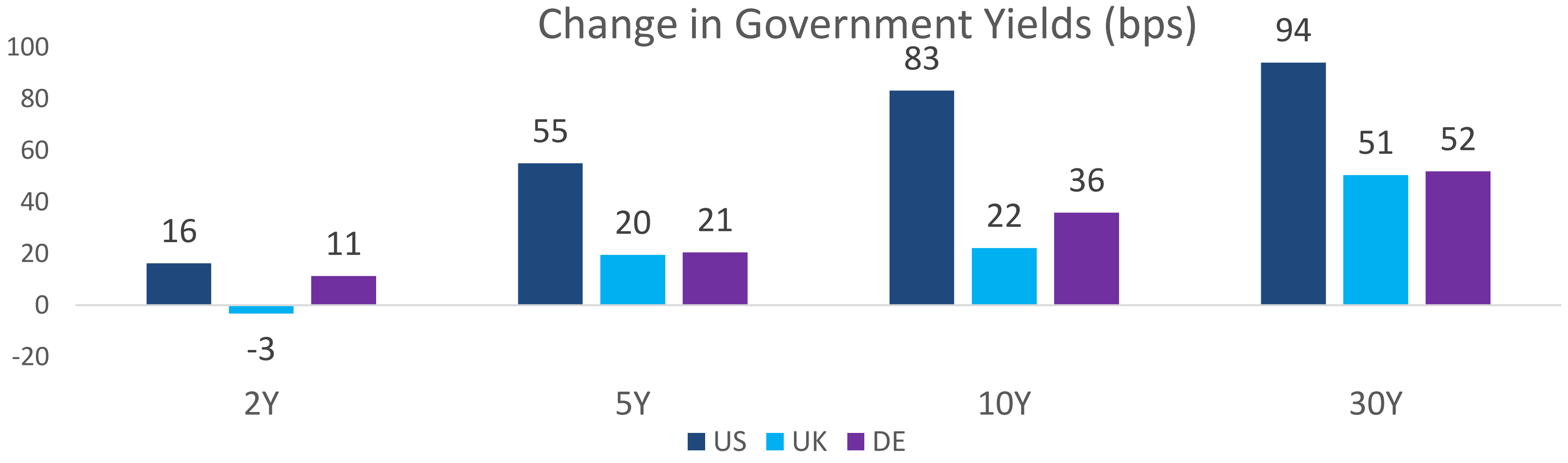


- Curves have increasingly traded with a steepening bias across US, UK and Germany

Source: Bloomberg, SECOR

Real yields have driven the increase in rates in Q3 2023

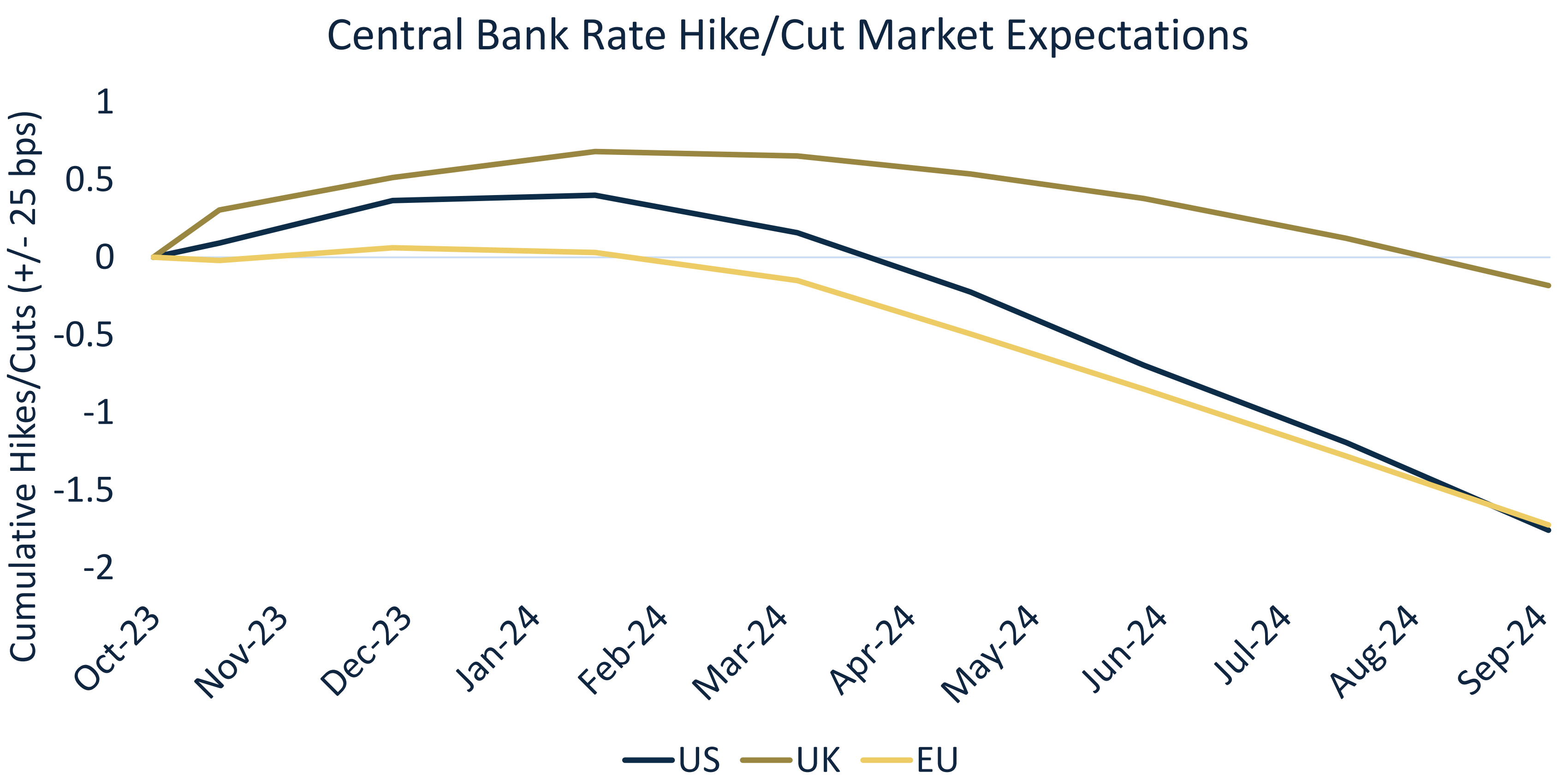




- Steepening was led by the long end and real yields

Data from 24 July 2023 – 16 October 2023. Source: Bloomberg, SECOR

Market Expectations of Central Bank Rates



- Markets are pricing in the end of hiking cycle along with cuts in 2024 for the US and EU
- UK Markets implying slight possibility of one more hike before hiking cycle ends

Source: Bloomberg

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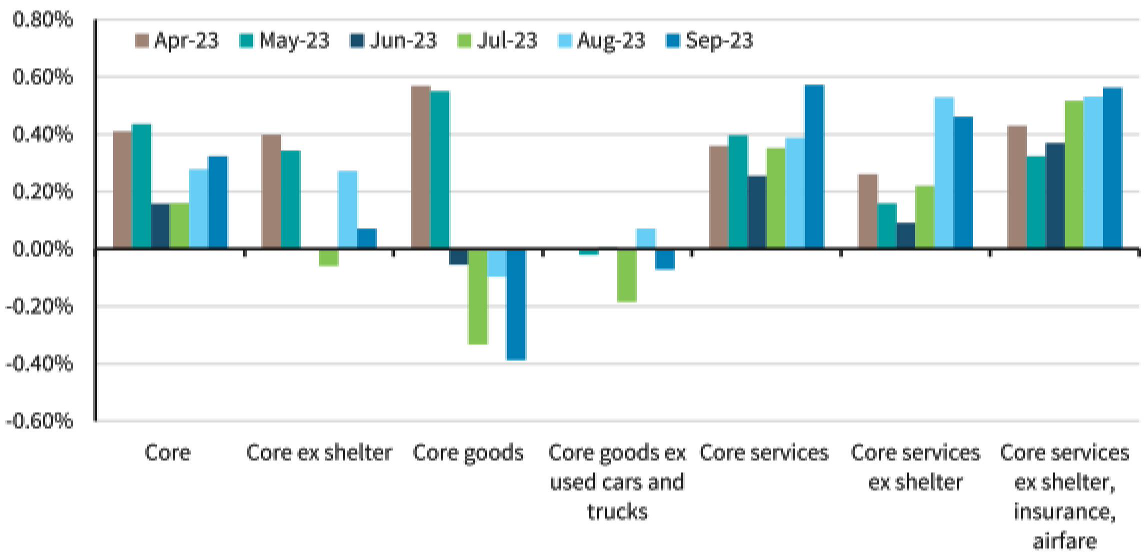
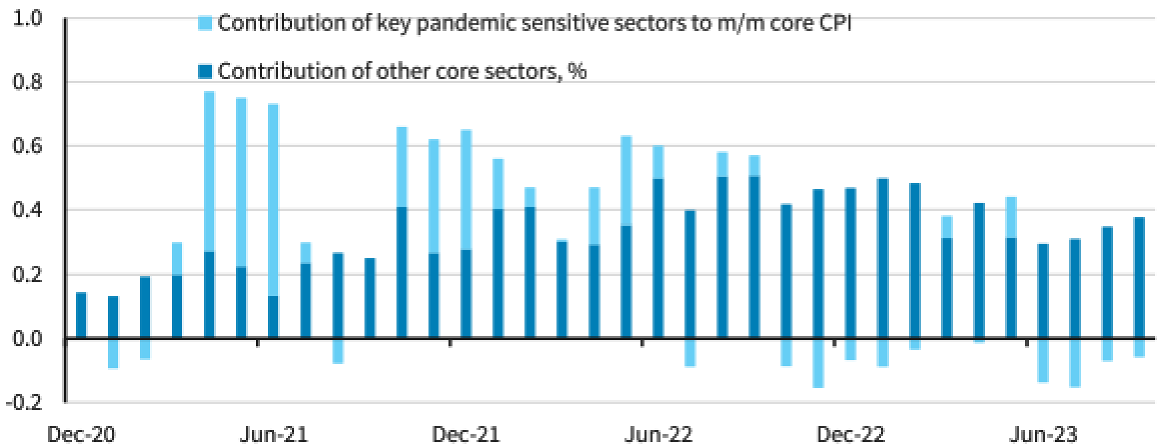
US Inflation





Source: Barclays

- September CPI report, which came in a touch stronger than expected (m/m core CPI of 0.32% vs. the consensus of 0.26%)
- Non pandemic sensitive sector inflation is still inching up

Fed Speak

- **Logan**: "But the reasons for the tightening matter. If long-term interest rates remain elevated because of higher term premiums, there may be less need to raise the fed funds rate. However, to the extent that strength in the economy is behind the increase in long-term interest rates, the FOMC may need to do more."
- **Kashkari** "It's certainly possible that higher long-term yields may do some of the work for us in terms of bringing inflation back down, but if those higher long-term yields are higher because their expectations about what we're going to do has changed, then we might actually need to follow through on their expectations in order to maintain those yields."
- **Daly**: "If financial conditions, which have tightened considerably in the past 90 days, remain tight, the need for us to take further action is diminished. In contrast, if the deceleration of growth and inflation stalls, activity begins to re-accelerate, or financial conditions loosen too much, we can react to those data and raise rates further until we are confident that monetary policy is sufficiently restrictive to complete the job."
- **Waller** "The real side of the economy seems to be doing well. The nominal side is going in the direction we want. So we're in this position where we kind of watch and see what happens on rates…financial markets are tightening up and they are going to do some of the work for us."

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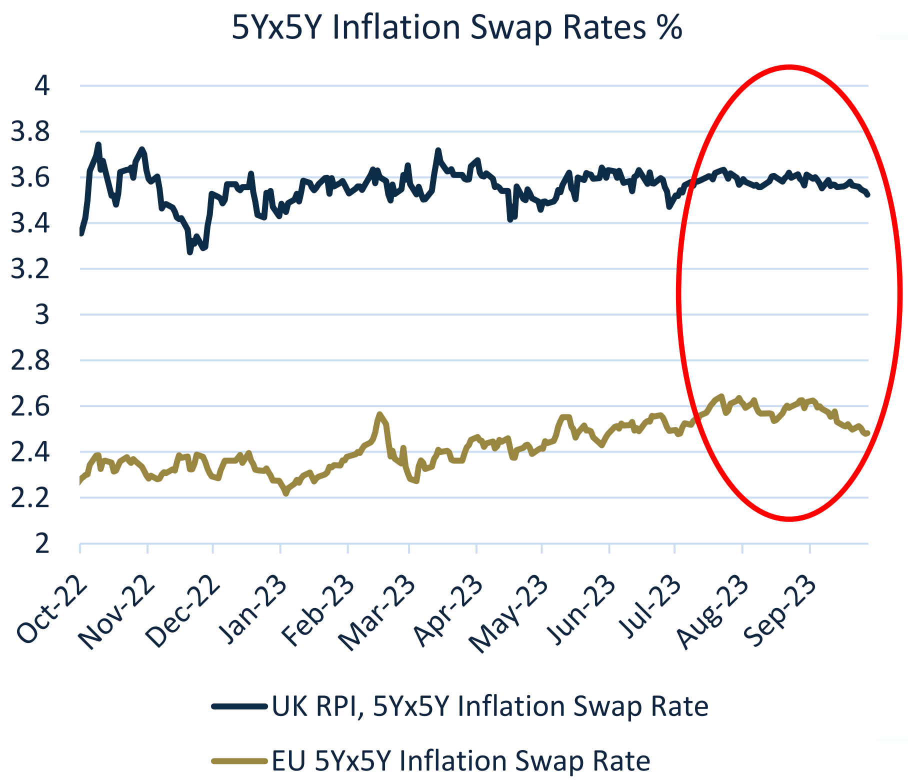
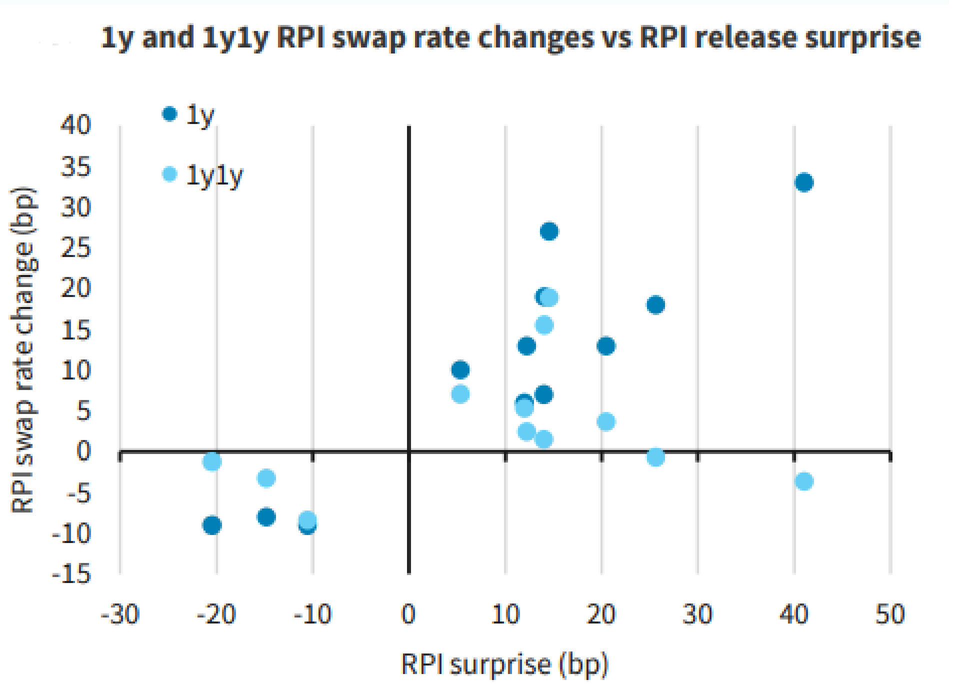
UK and European Inflation





- Longer term inflation expectations leveling out
- Front end inflation may see a boost if we get inflation surprises

Source: SECOR, Bloomberg, Citi, Barclays

Trade Bet Performance: USD 2s10s Curve Steepener

- Currently +6.25% return since beginning of 2023 when trade was recommended
  - Last meeting in July 2023, the return was -0.36%
- Trade benefitted in March 2023 during "banking crisis" and during long end real yield increase in Q3 2023
- Spread currently at -59 bps vs -118 bps – no longer as attractive but carry low to neutral
- Now a balance of supply and repricing of neutral vs increased demand from as yields are 10Y highs
- If we run into a recession we could see further steepening as central banks cut short term rates

Source: Citi Velocity, SECOR Analytics

Rates Summary Page

Factors	Comments	Historical Range
Valuations and Fundamentals	▪ Potentially higher volatility in the long end due to greater uncertainty with the supply-demand imbalances in the bond market ▪ We are nearing the end of the hiking cycle should reduce volatility the short-term although many tail risks remain ▪ There is a question around the aggressiveness of the rate cuts being priced	 Bearish Neutral Bullish
Technicals	▪ We are seeing increase in supply but may be offset eventually as investors find bond yields attractive ▪ Lesser opportunity in 2s10s and 5s30s steepening but may persist, especially if trade offers positive carry in the long end	 Bearish Neutral Bullish
Macro Impact	▪ Inflation may have peaked but still a big risk. Markets still watching economic data prints to determine policy path which should be supportive of volatility in the near term	 Bearish Neutral Bullish
Overall	▪ 9-to-12 month view vs Fwds	 Bearish Neutral Bullish

● Current Quarter

X Last Quarter

Scenario-Based Outlook: Neutral Duration

- Key take aways
  - Rates should eventually stabilize over the next 1 to 2 years as inflation normalizes and monetary policy pivots
  - There are risks around data prints as the central banks are more data driven
  - Overall, we are neutral vs the forward rates

As of 13 Oct 2023	30yr EUR Swap	30yr GBP Swap	30yr USD Swap
Spot Rates	3.01%	4.19%	4.08%
Probabilities			
Tail risks: Recession shock, geo-political environment deteriorates	10%	10%	10%
Policy mistake, Inflationary surprises, Earnings below expectations	40%	40%	40%
Base Case: Soft Landing	40%	40%	40%
Positive earnings + falling inflation and improved productivity	10%	10%	10%
Probability Weighted Rate	3.06%	4.23%	4.11%
Implied 1yr Forward Rate	2.94%	4.11%	3.98%
Difference vs Forward	0.12%	0.12%	0.13%

Source: SECOR, FTSE

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