

REAL INTEREST RATES EDGE BACK INTO POSITIVE TERRITORY

Market Perspectives

August 7, 2013

- ▶ Real interest rates, as measured by the difference between the 10-year Treasury bond less the Consumer Price Index (CPI), have returned to a slightly positive level over the past quarter.
- ▶ Federal Reserve action to support economic growth and employment had contributed to driving real interest rates into negative territory for much of the last two years. As would be expected, real interest rates are typically positive. Since 1965 real interest rates have averaged 2.47%, well above the current level.
- ▶ As the economy strengthens and unemployment declines, we expect real interest rates to continue to rise as the Fed begins to taper its Quantitative Easing (QE) efforts.
- ▶ Positive real interest rates help fixed income investors and participants in stable value funds maintain the purchasing power of existing assets as the return earned on these assets should outstrip the rate of inflation.
- ▶ The return of positive real rates has been an outgrowth of the significant increase in the 10-year Treasury yield that is up over 90 basis points from May. The primary driver of the rise in yield has been the indication from Fed Chairman Bernanke that the Fed may start dampening its bond-buying program sooner rather than later with the intention of ceasing completely by mid-2014.



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Real Rate*, 1965 to present



Source: Bloomberg

*10-year treasury minus CPI yoy

It will be interesting to see if Treasury yields stay elevated, or retrench once the market further evaluates the likelihood of continued improved economic growth. The 10-year Treasury yield as of August 1, 2013 reached 2.74%, which is the high for the year.

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