

# Global macroeconomic update

## Key themes

- Fixed income markets are in the process of pivoting back towards trading off fundamentals
- Completion of the September Federal Open Market Committee (FOMC) meeting and an apparently large program working its way through the market in the weeks prior has allowed the curve to begin recalibrating higher
- We expect 5-year yields to continue to move higher as the market prices in both a more robust economic outlook as well as a more hawkish Fed



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## Uncorked

In our last piece from July – [Detached](#) – we spoke about how fixed income markets had been mostly trading away from fundamentals as well as the four or so key themes driving markets. We noted at the time: “Taking a slightly longer-term view we continue to see rates resetting higher later this year as the market gets back to fundamentals; tactically in the shorter-term these drivers [positioning, risk management, concerns over a Fed policy error and the Delta variant] are likely to not completely disappear and could keep rates rangebound for a while.”

We believe we are now very close to or at that inflection point where fundamentals – data, expectations and risk sentiment are once again beginning to primarily drive fixed income markets. September’s FOMC meeting was generally expected to be hawkish, particularly the Fed’s dot plot - is a quarterly chart summarizing the outlook for the federal funds rate for each of the FOMC’s members. The median of all the dots represents the forecasted rate for each of the next three years, as well as the long term. The September meeting was more hawkish than median expectations with an even 9-9 split of voting members on the first 25bp hike coming in 2022 (up from 7 in June) while the 175bp worth of cumulative hikes through the end of 2024 was more than most market participants were anticipating.

And while we expected the 5 years to 30 years curve to flatten ex-post - or at least not steepen as much as it has (chart 1), 2 years and 5 years are (finally) behaving more like they should and starting to recalibrate with expectations of a more aggressive Fed. We think 2s and 5s have more to go in the short-term, particularly 5s, as the market continues to recalibrate not only upside growth and inflation expectations heading into the fall, but also an incrementally more hawkish Fed at its December meeting followed by a more hawkish voting rotation in 2022, Boston Fed President Rosengren’s abrupt retirement notwithstanding.

**Chart 1 | UST 5 years to 30 years spread**  
(Daily, bps, 3/31/21 - 9/28/2021)



Sources: Bloomberg; Mackenzie Investments



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Investments

We are also picking up interesting soundings from market sources that a large corporate pension program (or programs) was working its way through the market in the weeks prior to September's FOMC meeting; the quick summary being strong equity and fixed income markets were putting some pension funds in an overfunded (!) position, triggering an automatic requirement to de-risk which somewhat synthetically kept rates lower than they should have between late August through mid-September, particularly at the long end of the curve. Beyond the anecdotal evidence, a deeper dive into "investment funds" record purchases (as a percentage of total) for September's 10-, 20- and 30-year Treasury auctions seems to corroborate the notion of significant appetite for paper, likely via inflows as opposed to position squaring. This also harks back to the "flows versus fundamentals" discussion in our last piece and particularly our second rationale for longer rates looking somewhat artificially low: "risk management." We understand the program is now effectively done, and, in the process, the proverbial cork appears to have been taken out of the fixed income bottle. With the program wrapping up coincidentally a day or two before September's FOMC meeting it has allowed for a quicker (flow based to start) repricing in the long-end despite a relatively hawkish Fed while fundamentals are helping the front-end to recalibrate. We believe that soon fundamentals will be dictating the majority of the long-end's path.

### Chart 2 | Rolling 22-day DXY & UST 10 yr real yield correlation

(Daily, March 2020 - present)



Sources: Bloomberg; Mackenzie Investments

Besides being long Chinese government bonds, our favourite trades within the fixed income sovereign space are short 2 years and 5 years, particularly in the US. The broad USD call remains challenging with the DXY Index (admittedly EUR-heavy) correlation falling off versus real yields which has been a decent barometer of USD direction this year (chart 2). With equities stalling out a bit, it is possible we are rotating back towards a more classic "risk on / risk off" USD environment where the dollar takes its cues from equity markets and global risk appetite as opposed to real rates. With a lot of US fiscal work to get done in the next month and associated event risk, we believe it is difficult seeing the USD materially selling off; accordingly, we have a slight bias towards a choppy USD in the weeks ahead but have stronger conviction in the short UST ideas above and remain both tactically and structurally short duration in US, CAD and EUR sovereigns versus benchmark across most of our portfolios.

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