Article | 11 July 2024

Rates: How to play the US election drama

First, the important bit: we still like lower rates, steeper curves and wider eurozone spreads for 2024. But now for the US election drama! If Biden pulls out, Treasuries rally (yields fall). But if Trump wins, Treasuries sell off (yields rise), eventually. But, for unobvious and contrarian reasons

US President Joe Biden wears a Kansas City Chiefs helmet after the team's Super Bowl win

The half-time review

Our two big directional calls for 2024? We predicted lower yields and steeper curves. We've seen bouts of success through the first half of 2024 (and actually lots in December 2023, just after publication in November). We pivoted to a more bond-bearish stance early in 2024 as the US inflation data popped higher. We then switched back to a more bullish stance about a month ago, so we're back on the lower yields and steeper curve view for the rest of the year.

And our eurozone spreads call? We predicted tighter Italian spreads to Germany in early 2024 to morph to wider spreads later in the year. The actual tightening overshot our call to the downside, and our re-widening call was helped by the early French election. We maintain a re-widening risk as we journey through the second half of 2024, as fiscal issues dominate that bit more, and tend to hit the periphery more than the core.

Second-half prediction: Treasuries to rally hard if Biden pulls out

The biggest outcome of the recent CNN presidential debate was a chorus of calls for Biden to quit and let someone else run. So far, Biden has not budged. But what if he does? Then we think US Treasuries would rally. The logic here is a tad contrarian. Risk has been on since November 2023 and is arguably looking for an excuse to come off. An announcement that Biden would not run would seem to end uncertainty, but it would, in fact, create big doubts for risk-takers. A vacuum like this would be as good an excuse as any for risk to come off, and if that happens, US Treasuries are likely to rally, and yields will fall. That would be sustained by a lessor 'growth oomph discount' as the probability of a Trump victory is downsized. He might still win in the end, but that's for much later.

2 Second-half prediction: Treasuries to sell off if Trump wins the election

Our thinking here is twofold. First is the very basic market assumption that a Trump administration would be all about the here and now, with a keen focus on economic growth and instant equity market performance. In addition, tariffs as an offset to tax cuts add an inflationary aroma to this mix. This is a net negative for Treasuries. It can be a delayed reaction though. Second, if the Fed cuts in September, which is our view, and again in November, that should place downward pressure on Treasury yields. But we think this risks being a short-lived state as once the 10yr yield gets to below 4%, there is not huge relative value any more if the Fed funds rate is also projected to get to 4% (no curve). So, a Trump victory could kick-start a move that eventually gets the 10yr yield back up towards 5%, albeit not till 2025.

Author

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com