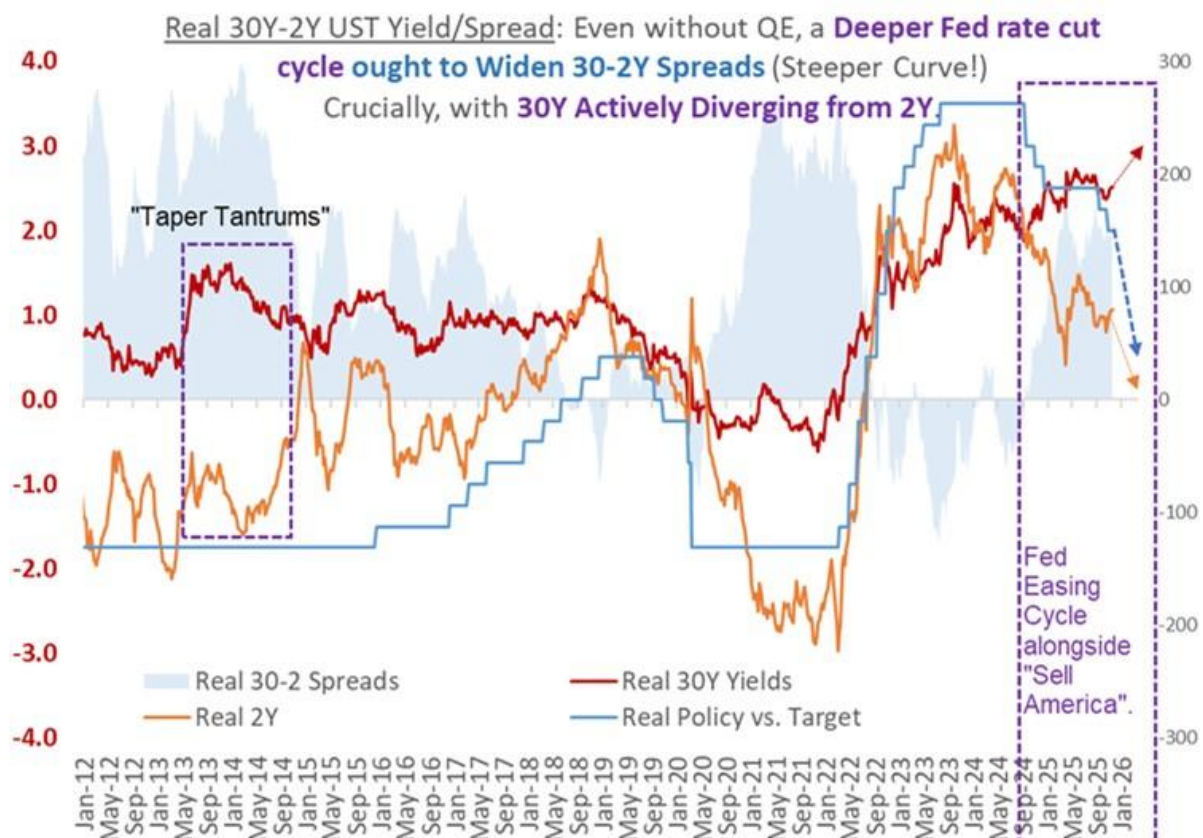


A Divergent Steepening

In a Nutshell:

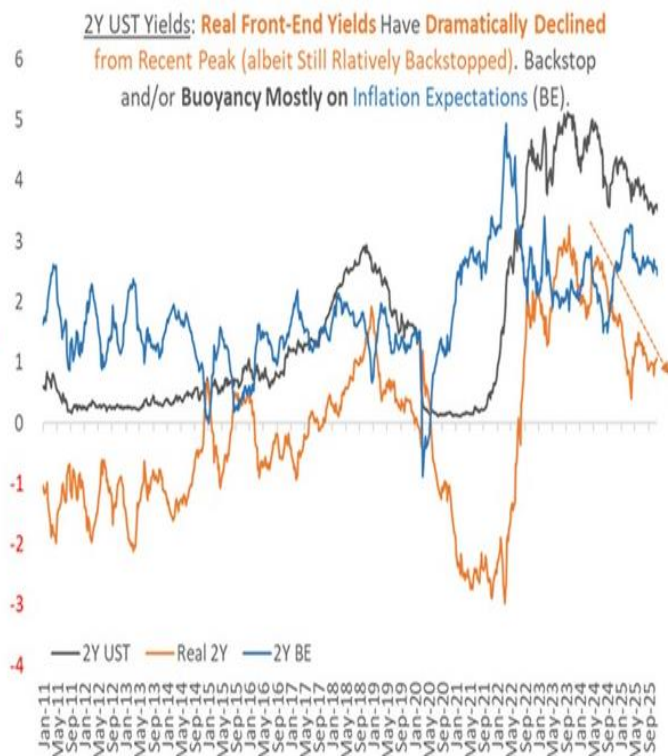
- **"Real" steepening**, with real 2Y yields falling while 30Y yields rise, reveals **key divergence** in drivers, risk profile and horizon/durability.
- **Drivers**: Distinction between **Fed cut driven bull steepening** and **"Sell America" driven long end sell-off (lift in yields)**.
- **Risk Profile**: The "risk on" profile of Fed cuts and risk re-pricing associated with "Sell America".
- **Horizon/Durability**: Crucially, the **Fed cut bull steepening is cyclical** while **upside risks in long-end yields** is a **structural** feature fraught geoeconomics.
- These factors could conspire to **accentuate the inherent UST curve volatility**.
- Nonetheless, this **real steepening is likely to persist**, predominantly driven by **front-end Fed cut dynamics initially** and **"Sell America" long-end pain thereafter**.
- In turn this could be a **more enduring driver of risk re-pricing** with **starker quality differentiation**.



"Alice: Would you tell me, please, which way I ought to go from here?"

Cheshire Cat: That depends a good deal on where you want to get to." – Alice in Wonderland

- The **active divergence in real yields**, between *falling front-end* and the *long-end buoyancy*, is **worth noting**.
- For one, because this dynamic involves **steepening from distinctly opposing forces**.
 - A *Fed cut cycle bull steepening** on the one hand, and;
 - “*Sell America*”^{***} on the other, which entails *bear steepening led by long-end sell off* (sharply higher long-end yields).
- Notably, these two opposing forces are **profoundly different in their risk profile** as well.
 - The *bull steepening Fed cut cycle* is typically **risk-positive**, inducing wider asset market rallies.
 - Whereas “*Sell America*” *long-end surge in yields*, while not necessarily ubiquitously “risk off”, is **likely to entail risk re-pricing** involving sharper differentiation.
- Moreover, the applicable **horizon for these two factors** is also **varies distinctly**, with one being *cyclical* and the other, *structural*.
 - *Bull steepening driven by Fed cuts* is *cyclical*.
 - Whereas the *long-end yield ascendancy* on “*Sell America*” is *structural*.
- If nothing else, the **divergent real steepening warns of inherent volatility embedded in the yield curve**.
- What’s more, the **triggers for volatility**, and **sensitivities to these triggers**, could **vary appreciably across the curve**.
- Notably *nominal front-end 2Y yields may be far more sensitive to inflation surprise* while the *long-end may suffer more from Fed politicization risks* (See Charts below).



- All said, our base case is for further **steepening in real 30Y-2Y curve** (widening 30-2Y spreads).
- *Initially* (over the next 2-3 quarters) this may be propelled predominantly by a **further pullback in (real) 2Y yields as a deeper(-than-expected) Fed cut cycle plays out.**
- But *beyond that* prone to endure/extend *as long-end yields lift in response to structural “Sell America” pressures.*
- What’s more, **real steepening could entrench amid dramatically increased competition for (and consequent squeeze in) long-term capital/funding.**
- Especially **due to “crowding out” from unprecedented funding demands** – as *unfettered ambitious AI “hyper-scalers”* collide with *an outburst of strategic geoeconomic capex commitments.*
- To be sure, the **rise in real, ultra long-end (30Y) yields** from “Sell America” is **unlikely to be unremitting or in a straight line.**
- But the bigger picture is that this **steepening from active divergence** is likely to entrench further.
- In turn, this **structural steepening alongside an uneven tightening in access to capital** is likely to **enduringly drive risk re-pricing, with more acute quality differentiation.**

* Bull steeping from Fed rate cut cycle owed to a much sharper drop in policy-sensitive front-end yields vis-à-vis the long-end.

** “Sell America” is shorthand for a sell-off in long-end USTs due to entrenched loss of faith in fiscal discipline/debt sustainability and attendant USD debasement risks, exacerbated by adverse feedback loops.

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