Invest in the Spread: It's All About the Shape of the Curve.

With rates expected to continue to move upward at the longer end of the yield curve, while shorter rates remain low, compliments of the Fed, the key question is whether now is the time to invest in longer assets, or simply remain in cash.

The height of the yield curve is, of course, an important consideration when looking at the relative attractiveness of any asset opportunity, in terms of coupon and associated yield on a loan or bond. However, it is the shape of the yield curve which determines the spread associated with that asset, and ultimately the value which that asset brings to the institution. Understanding the likely cost of funding the asset over its life, and knowing that this cost will fluctuate with the shape of the curve provides useful parameters for decision making.

For example, booking a 30 year fixed rate loan at a rate of 3.25% may be of concern given current historically low rates, yet when comparing the likely cost of funding that asset over the coming 5-7 years, the "likely spread" (i.e. incorporating a most likely rate forecast) and "spread to worst" (i.e. incorporating a least attractive rate forecast) may meet performance goals. Calculating these spreads over the life of the asset, given a view of how the height and shape of the curve could shift, is a relevant and useful way of forecasting how an asset acquired today will continue to contribute tomorrow, regardless of how high or low rates might go.

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