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Using the Forward Curve: Break-even Analysis

The Forward Curve is a quantitative tool that can help portfolio managers view hypothetical scenarios based on current market conditions. By using today's market rates, our Forward Curve mathematically interpolates where breakeven rates would be six months and one year from now based on the shape of the current curve. The forward curve does not predict future rates, but can be useful in helping an investor draw his or her own conclusions about future rates.

An example using the Forward Curve for break-even analysis:

Let's look at a 2-year investment horizon. By finding the 2-yr column on the table, we see the current rate is 4.42%. Would we be better off buying a 1-yr today and another 1-yr one year from now? Let's go to the 1-yr column. Today we can get a 1-year at 4.98%. One year from now we would need 3.83% on our second 1-yr to equal a two year investment today at 4.42%. The curve implies that the 1-yr will decrease 1.15% over the next year so that a 3.83% will be a reality on a second 1-year piece. If you expect the one year rate to be less than 3.83% one year from now, then you would be better off investing in a 2-year today. If you expect the 1-year rate to be above 3.83% a year from now, you should take the consecutive 1-yr pieces.

