CETERA® INVESTMENT MANAGEMENT

COMMENTARY

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Treasury Yields Drop

Traditionally August is a quiet month for the financial markets as vacations and back-to-school preparations are at the forefront of most investors' minds. This month has been a different story in the bond market. A combination of macroeconomic factors including concerns about the global economy and increased trade war rhetoric has sent investors into safe haven bonds, pushing the yield on the 10-year U.S. Treasury note from 2.06% at the beginning of August to a near cycle low of 1.65%. We have also seen a flattening of the yield spread between the 2-year and 10-year Treasury. Historically when this spread has inverted, it has flashed a potential recession warning. While the reasons for lower bond yields are valid, we do not believe an impending economic disaster is on the horizon. Instead, we continue to expect assets to experience sharp swings in volatility as investors continue to take their cue from economic and market readings.

There are many reasons to explain August's sharp drop in bond yields. The global economy continues to see signs of a broad-based slowdown via weaker manufacturing surveys, slowing production data, and tepid inflation readings. Growing trade war rhetoric has exacerbated this slowing economic data. For example, President Trump recently announced a new ten percent tariff on $300 billion of Chinese imports, primarily consumer items like clothes, toys, and footwear. Past tariffs focused on industrial goods, so these consumer-goods-targeted tariffs will likely impact consumer spending, which has been a key driver of economic growth over the past few years. In a search for higher yields, negative bond yields in Germany, France, and Japan have sent investors into U.S. bonds, further pressuring Treasury yields (yield moves inversely to bond prices). Lastly, increasing global stock market volatility and rising geopolitical risks such as the unexpected election results in Argentina have led to a general eschewing of risk assets for safe haven investments such as U.S. Treasury bonds.

The sharp drop in yields is a concern, however, we do not believe it is a sign that global growth is collapsing. Yes, downside risks have increased with rising trade uncertainty and weaker manufacturing readings, but other parts of the economy are holding up well, such as services and employment growth. Lower yields also allow consumers to refinance mortgages or buy new homes with cheaper borrowing costs. Lower borrowing costs also allow more room for businesses to operate and consumers to spend. Furthermore, while trade war rhetoric has accelerated over the past month, we remain convinced that a resolution will be reached in short order as it has negatively impacted both the Chinese and U.S. economies and stock markets.

August has not turned out to be the quiet summer month that most investors had expected. Stock market volatility has jumped, and the bond market has reacted accordingly. As we have noted numerous times, we anticipated this jump in volatility. We are in the longest bull market and economic expansion in U.S. history. Volatility is typical in the later stages of a bull market. Market uncertainty is definitely increasing – the latest example is the New York Fed's Recession Indicator which now sits at its highest level since the Great Recession - it is prudent to mitigate portfolio risk. As a way to mitigate risk, we recommend rebalancing your portfolios to the long-term risk objectives, diversifying equity risk (with the inclusion of alternatives), and reducing credit risk within fixed income. Make sure you use this opportunity to talk to your financial advisor about any life changes that may impact your financial goals and objectives.

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