Sauberan & Co.

175 Walnut St. Suite 2, Lockport, NY 14094

Economic & Market Update

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I hope you and your family had an enjoyable holiday season! Following are a few thoughts on current market conditions.

As we finished 2019 with a strong rally, everyone is well aware that stocks are at all-time highs. Although the 10-year Treasury yield is often displayed along with the stock market indices, very little is shared about actual bond performance.

Since the Jan 2018 highs, following the "Tax Cuts and Jobs Act of 2017", the S&P 500 is up about 12% (with dividends) while the 2029 5.25% Treasury Bond has returned the exact same 12%. However, the Treasury Bond's interest income provided a more consistent return vs. volatility in stocks.

Actually, the 2029 5.25% Treasury Bond has been a superior investment since it was issued. It has taken the S&P 500 20 years to finally catch up. The S&P 500 had no gain and/or a negative gain for 2/3's of the 20 years. All of the gains in the stock market have come in the past 6 years! Meanwhile, long-term Treasury Bond investors have had significantly less volatility, positive gains and cashflow for the past 20 years. (see chart – "Bloomberg Barclays US Agg. Index" is frequently use as a stand-in for measuring the performance of the US bond market)

BNY Mellon recently surveyed 2,000 adults and, "only 8% could accurately define fixed income investment" which may explain why the Long-Term Treasury Market performance is rarely discussed?

More importantly, the bond market outperformance is the result of 2 issues, 1) in 1999 the stock market was significantly over valued, total market capitalization of publicly traded stocks reached 150% of GDP, highest since 1929 and 2) a slowing economy. To help stimulate growth the Fed Funds Rate has been at 1% or lower for 12 of the past 20 years with nominal growth averaging 4%. In the 80's the Fed Funds Rate was double digits and the US economy grew nominally above 9%. In the 90's the Fed Funds Rate was high single digits (6-8%) and the economy grew nominally above 6%.

The past several years, the bond/stock markets have been reacting to the same dynamic – slow or/no growth! More than 75% of the gains in the S&P 500 since 2014 have come from corporate share buybacks, over $7 trillion (yes, with a "t") – "Corporate America" doesn't see business investment opportunities so what's the alternative? Yields are falling (bond prices up) as growth slows back below 2% and is likely heading lower!

The current setup in the bond/stock markets is similar to 1999 whereas the stock market is once again trading at 153% of GDP and bonds will continue to outperform as the short-term boost from the "Tax Cuts and Jobs Act of 2017" fades!

Charles K. Sauberan, CFP®