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VICTORIA
Capital Management, Inc.

# Market Musings

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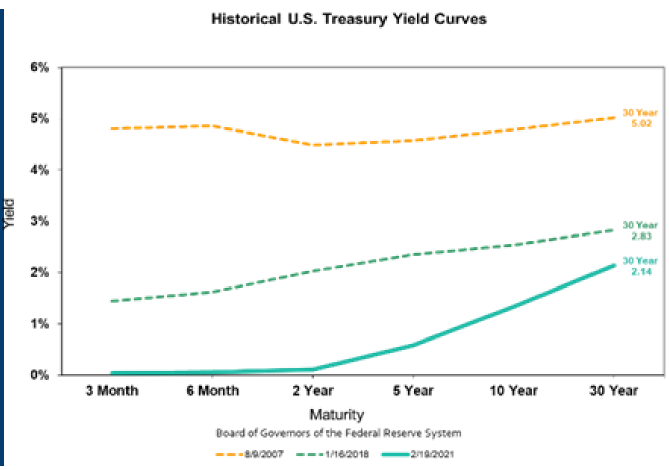
**The chart reflects the yield curve, a linear plot of the yields on U.S. treasury securities over different time periods. Note the relationships between the current yield curve and two previous yield curves when interest rates were substantially higher. The slope of the current yield curve reflects the Fed policy of maintaining low interest rates.**




## Taking Another Look at Bond Vigilantes

Bond Vigilantes: “A bond vigilante is a bond market investor who protests monetary or fiscal policies considered inflationary by selling bonds, thus increasing yields.” (source: Wikipedia)

Over the past couple of weeks, we have witnessed a sharp upturn in interest rates, albeit from record low levels. For example, the 10-year government bond yield at the low was 0.5% on March 9, 2020. From that low point, the rate has surged to a recent high of 1.46% last week. Fears of rising inflation are partly responsible for the move as the economy is experiencing a strong recovery. The Federal government’s desire to enact another round stimulus spending to the tune of $1.9 trillion provides the perfect scenario for bond vigilantes to take center stage.

Not so fast. Chairman of the Federal Reserve, Jerome Powell, is committed to maintaining low interest rates until 2022 at the earliest. Even then, there is no expectation that there will be anywhere near the experience of the Volcker years when interest rates were jumping by ½ to 1% every month as indicated by the rise in the Fed funds rate. Remember, the Fed has an infinite checkbook because they make money and, in a fiat currency system such as ours, there is no limit to how much money can be made available to help get a weak economy back on track. The bond vigilantes, to the extent that they still exist, have a formidable adversary when attempting to drive interest rates higher.

Rising interest rates are not necessarily a bad economic event. Remember that interest rates indicate the allocation of wealth between borrowers and lenders. While low rates benefit borrowers, they penalize savers. For example, money market rates, a safe investment, yielded 5% back in 2007. Since then, rates have fallen to near zero. If interest rates rise, there is a transfer of wealth back to the savers and an increase in costs to borrowers. Rising rates find their way into savers income that increases spending power and could prove more beneficial to the economy than falling rates.

***“The individual investor should act consistently as an investor and not as a speculator.”***

*- Ben Graham*

### *Market Commentary*

While the stock market got back on track in February with the S&P 500 gaining nearly 3%, the story for the month was the pop in interest rates that took the 10-year government bond yield up to 1.46%. The run up triggered a knee-jerk response among market observers responding with renewed expectations that inflation is right around the corner. For years, investors poured money into bonds of all maturities helping drive down rates. For those investors who expect to see historical rates of return on their bond investments, the outlook is grim. More likely, in a rising interest rate environment, they will see low, if not negative total returns. Bond investors are in for a rough ride.

278 executives surveyed in August 2020 anticipate reduced office space by an average of 30% when leases come up for renewal.

*(McKinsey Global Institute)*