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Market Musings

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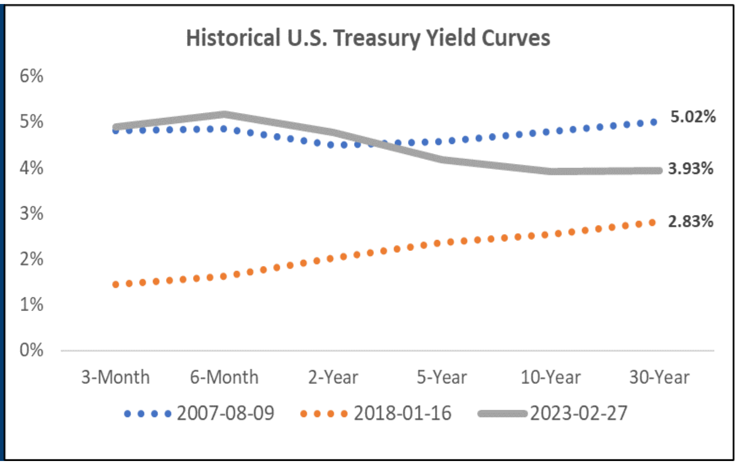
Yield curves are an important factor in analyzing Federal Reserve monetary policy. The current yield curve reflects a high interest rate Fed policy designed to slow inflation by impacting economic growth. Over the past year the Fed has increased short-term interest rates by a record amount to change the shape of the curve.

(data source: Federal Reserve of St. Louis)



The Yield Curve

One tool used by fixed income analysts is the yield curve. The curve illustrates in linear form the current yields of government securities from the shortest maturity to the longest maturity. These "curves" are given different names depending on the economic environment that exists at a point in time. An "upward sloping" yield curve exists during normal economic times when inflation is low and economic growth is about average. In other words, short-term yields are below long-term yields. An "inverted" yield curve exists when the yield on short-term securities exceeds the yield on long-term securities. These curves will change over business cycles depending on the Fed's efforts to impact growth and inflation. The economic significance of these curves is that the Federal Reserve uses interest rates to affect the economy and the level of inflation. By raising short-term interest rates that can be measured in movements of the yield curve, the inverted yield curve reflects Fed actions that are driving interest rates higher. Another important factor in using yield curve analysis is that comparisons with yield curves from prior business cycles can lead to developing conclusions about current and past interest rates.

After the financial crisis of 2008-2009, the Federal Reserve embarked on a low interest rate policy targeting short-term interest rates to near-zero. During the ensuing 9+ years, interest rates remained abnormally low contributing to increased borrowing and speculation. The impact of the pandemic compounded the problem as the Fed, after raising interest rates in 2018, abruptly reversed course and lowered interest rates. This policy favored borrowers over savers as interest rates on savings and equivalent short-term accounts remained low. In early 2022, the Federal Reserve rapidly increased interest rates taking the fed funds rate up to 4.5%, a level that is consistent with short-term interest rates prior to 2008. However, the long end of the yield curve remained below the levels existing back in 2007 suggesting that inflation expectations are lower than they were during that time. If the Fed maintains this change in the fed funds target, borrowers would be penalized, and savers would be rewarded, and economic activity would be impacted by this change.

"If there is something you really want to do, make your plan and do it. Otherwise, you'll just regret it forever."

Richard Rocco-Entrepreneur

Market Commentary

After experiencing a strong January, domestic equities took a breather and the S&P 500 fell 2%. Small and Mid-cap stocks lost a little over 1%. However, all market capitalizations are in the green so far this year. Foreign equities had mixed results with Developed Europe having positive returns led by the United Kingdom. Asia was mostly down with China leading the losses and Latin America was down on the back of political issues in Brazil.

Global bond markets fell on the back of continued inflation concerns and additional weak economic metrics. The 10-year Treasury yield rose to nearly 4%! The U.S. dollar remained neutral while commodities such as natural gas declined resulting in losses of nearly 40% so far this year.

Since 1945, February has been the S&P 500's second worst performing month in terms of average monthly returns (-0.18%). Bulls have tended to get back on track in March, though, as the average monthly return has been a gain of 1.13% with gains 64% of the time.

(*source: Bespoke Investment Group*)