Rates of a Different Color

Janney Fixed Income Strategy & Research

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Investors may be more focused on the rally in equities than the selloff in treasuries until they look at the month's performance.

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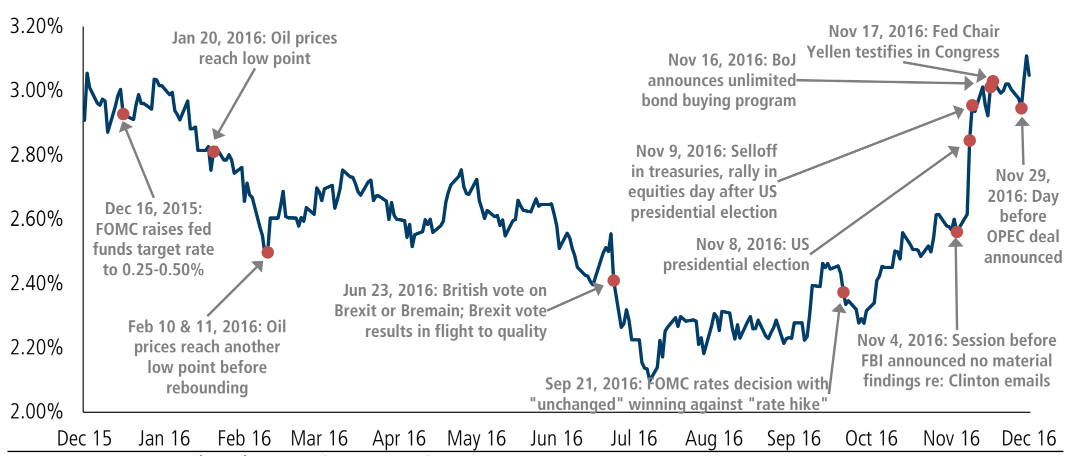
- Since the election, treasury rates have changed tune, and the selloff has spread into other parts of fixed income.
- Various factors have contributed to this selloff, and what happens next remains to be seen.
- For illustrative purposes, we have provided a list of securities across the fixed income spectrum to display the effects of the recent selloff in treasuries.

The rates market is different now than it was a month ago. In the few weeks leading up to the US presidential election on November 8, there was a flight to quality due to the uncertainty of the election outcome, particularly given the FBI announcement followed by the backpedaling a few days before the election. At the same time, the market anticipated a Clinton victory, so the surprise around a Trump victory first caused a selloff in the equities market in the overnight session, followed by a sharp rebound come November 9. At the same time that the equities market rallied, treasury rates rose on expectations that a Trump presidency meant reduced banking regulation, increased infrastructure stimulus, tax policy changes, a shift in the healthcare sector, and a potential for market optimism, whether or not it is warranted.

The 30-year Treasury Has Been Volatile; A Similar Move Can Be Seen with the 10-year



Source: Janney FISR; Bloomberg; Various Newswires

Beyond the election results, several other events over the past month have caused a selloff in rates. Most recently, the agreement reached by OPEC members and non-member Russia related to production cuts caused a rally in energy prices, a fall in the relative strength of the dollar, and a steepening of the yield curve. What's more, as we get insight into whom President-elect Trump picks for his cabinet, investors are speculating further about what that means for the new Administration's approach to the markets. For example, recent comments from Trump's Treasury secretary pick Mnuchin added to the selloff. Further, the market has priced in a December rate hike as a foregone conclusion, contributing to the sentiment that inflation and economic growth may be returning, hence the first hike by the FOMC since last December.

Apart from events happening domestically, the international markets are causing ripple effects into the US markets, as the European Central Bank, Bank of Japan, and other central banks potentially look to maintain monetary support. The Bank of Japan, for instance, announced an "experimental" bond-buying program, in which it will purchase an unlimited amount of securities at a fixed rate.

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Plans by international central banks may counteract Fed policies, though the possibility of expansionary fiscal policy remains the main driver of the selloff in rates currently.

How the Recent Selloff Affects Your Portfolio

Without going into too much of the math behind bond prices, we note that for as much as investors may have benefited over the past month from the rally in the equities market, they likely have experienced erosion in their fixed income portfolios. (For the "why," please see our series on Interest Rates, including the note, "Effects of Interest Rates on Bonds.") Although not all areas of the fixed income market demonstrated the full movement seen in treasuries, the selloff in rates and the steepening of the yield curve were felt to some degree across asset classes.

Note that main drivers of bond prices are interest rate risk and credit risk. In some cases, the improvement in an individual issuer's credit quality—whether it be actual performance metrics improving or speculative improvements based on the change in Administration—offset headwinds caused by the rise in interest rates. In most instances, however, issuers' credit risk did not reduce enough to compensate for the volatile swing in rates.

For illustrative purposes, we have included below a list of fairly liquidity securities across the fixed income spectrum to demonstrate the change in bond prices from the start of November to today. One could deduce that a similar move would appear in his/her portfolio.

Change in Price of Various Liquid Fixed Income Securities

Asset Class	Security Description	Tenor	Price			Yield		
			Dec 1	Nov 1	Chg	Dec 1	Nov 1	Chg
Treasury	US Treasury 0.750% Oct-2018	2 years	99.3	99.8	(1%)	1.15%	0.83%	+32bps
Treasury	US Treasury 1.250% Oct-2021	5 years	97.2	99.8	(3%)	1.93%	1.29%	+63bps
Treasury	US Treasury 1.500% Aug-2026	10 years	92.3	97.1	(5%)	2.47%	1.83%	+64bps
Treasury	US Treasury 2.250% Aug-2046	30 years	84.1	93.2	(10%)	3.13%	2.58%	+55bps
Corp: IG	Apple Inc 2.450% Aug-2026	10 years	93.4	97.8	(4%)	3.23%	2.70%	+54bps
Corp: IG	JPMorgan Chase & Co 4.850% Feb-2044	27 years	109.0	116.3	(6%)	4.26%	3.85%	+41bps
Corp: IG	CVS Health Corp 5.125% Jul-2045	29 years	109.0	116.1	(6%)	4.55%	4.14%	+40bps
Corp: HY	HCA Inc 5.250% Jun-2026	10 years	99.4	104.1	(5%)	5.33%	4.69%	+65bps
Corp: HY	CenturyLink Inc 7.650% Mar-2042	25 years	84.7	86.6	(2%)	9.16%	8.94%	+22bps
Preferred	Wells Fargo & Co 6.000% (WFC.V)	Perpetual	24.7	26.0	(5%)	6.08%	5.10%	+97bps
Munis	Phila Water & WW Rev 5.000% Oct-2026	10 years	115.3	124.3	(7%)	3.14%	2.24%	+90bps
Munis	Met Transport Auth 3.125% Nov-2035	19 years	87.1	98.2	(11%)	4.10%	3.24%	+86bps
Agencies	Fannie Mae 1.875% Sep-2026	10 years	91.9	97.7	(6%)	2.83%	2.14%	+69bps
Agencies	Fannie Mae 5.625% Jul-2037	21 years	133.3	143.6	(7%)	3.35%	2.80%	+56bps
MBS	Ginnie Mae 3.000%	N/A	100.9	104.1	(3%)	2.85%	2.35%	+50bps

Source: Janney FISR; Bloomberg; using last price shown with decimals over fractions; note that some high yield corporate sectors, for example, showed price improvement due to their correlation with equities and economic cyclicality

Our Recommendation

The near-term rates environment is uncertain. Key milestones before year-end, including the Italian referendum vote, the European Central Bank's December 8 meeting, and the December 14 FOMC rate decision, among other items, are likely to affect the direction and degree of movements across the yield curve. Nonetheless, it is too early to tell the true effect the new Administration's policies will have on rates, and there exists the possibility that treasuries are oversold at this point. We, therefore, suggest investors do not hit the "panic" button, but rather employ the various tools to create a defensive portfolio, as outlined in our recent note, "Preparing for Changes in Interest Rates." Year-end is usually a good time for investors to review with their financial advisor their current portfolio strategy, so the recent volatility may just be another topic to consider when having the portfolio strategy meeting.

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