Market Spotlight | Fixed Income

Fixed Income in a Low Rate Environment

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Low Rates Likely to Persist

A surge in global bond yields is contributing to the rotation into riskier assets. As little as a week ago, however, bond investors and traders were once again dealing with volatility across the maturity spectrum. Yields plummeted in the wake of Brexit and the fall continued through last week. Generally, when yields fall (bond prices rise), it is a sign of risk aversion as investors pile into the safety of government backed securities. This time around, stock prices rallied simultaneous with bonds. This is an interesting divergence and one that warrants our full attention. Additionally, spillover investing from other countries is part of the low yield continuation.

Looking ahead, we expect yields to remain near historical lows well into 2017 and no longer anticipate the entire yield curve will move higher based on the outlook for inflation and economic growth. Moreover, we don't anticipate or believe the Federal Reserve will consider rates hikes in 2016, though they will surely talk about it as a matter of routine discussion during each Fed meeting.

The global flight to quality, monetary policy and potentially insolvent banking systems around the globe has led to historically low interest rates. We are confident that this theme will continue for several quarters. This flight to quality has collapsed the yield curve, which is another indicator that U.S. economic growth will likely remain sluggish into 2017. Looking at our portfolio allocations, we believe bonds are fully-to-over-valued. Our tactical portfolios, as such, will hold a relatively low 25% exposure to bonds. Corporate bonds and preferred stocks issued by financially strong companies, if held to maturity, appear more fairly valued relative to other fixed income assets and we remain focused on the short to intermediate duration as opposed to longer maturities.

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