Bills Asset Management

BAM MARKET NOTE

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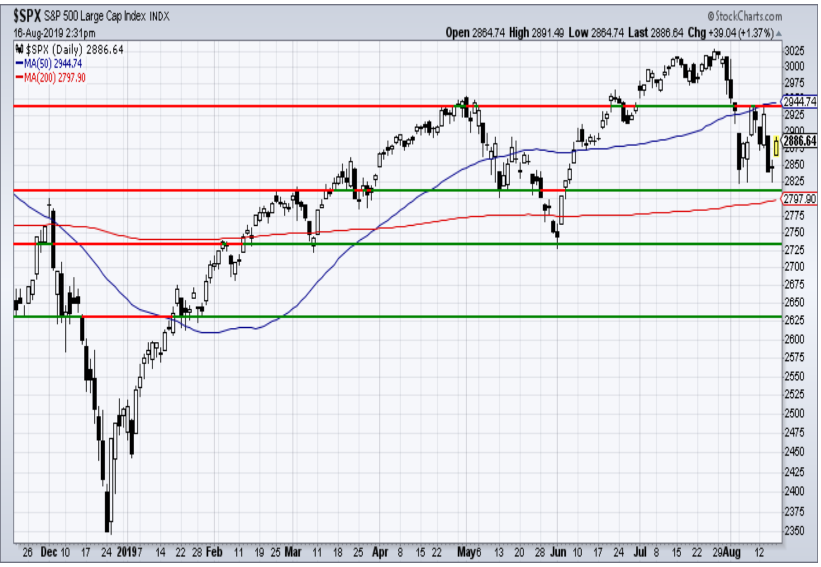

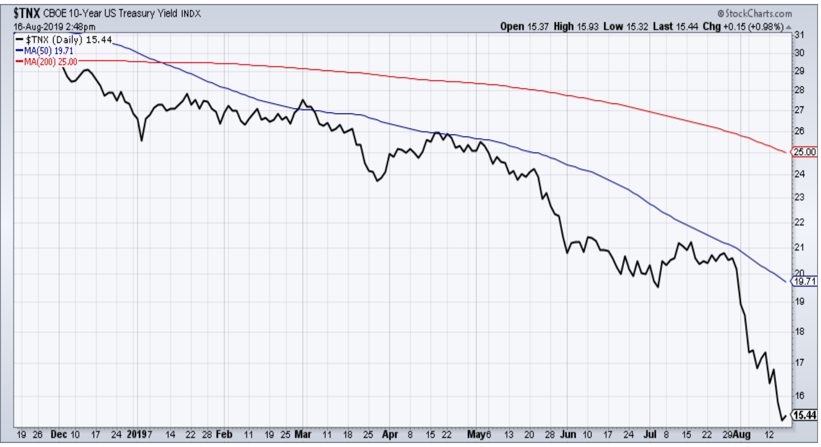

It has been another topsy-turvy week with the major indices falling precipitously on Wednesday before gaining its footing yesterday and today. Despite Wednesday and if the gains hold throughout today, the week will finish down only 1%. It has been a lot of excitement for a relatively minor move. To this point, the S&P fell a total of 6% from its highs and looks to finish today only 5% from those levels. Some technical damage has been done, so it would not be surprising for the S&P to remain in the trading range bound by 2940 to the upside and 2800 to the downside. Until one of those levels is broken, the market is trendless and daily movements are noise. It should be noted that the bottom of the range coincides with the 200 day moving average. Accordingly, the lower range holds extra significance and any break to the downside is likely to produce outsized losses that would create chatter of a revisit to the December 2018 lows.

Treasury yields plummeted this week. As you can see, there has been a steady decline since November of last year. However, the pace quickened a couple of weeks ago. Since August 1st, the widely watched 10 year treasury yield has fallen from 2.02% to 1.54% - a 2 week decline of 24%! Something in the market has changed but may only be apparent in hindsight. In any event, the decline shows a flight to safety on behalf of stock investors. Another reason for the decline is the search for yield – any yield. With developed market bond yields trading at 0% or even negative yields, foreign investors are surely buying treasuries and driving yields down.

Our Point

It has been another crazy week at the corner of Wall and Broad. Wednesday's climactic loss was precipitated by news of interest rate inversion. Interest rate inversion is simply when short-term treasury bonds are yielding more than longer term treasuries. In the current case, the 10 year treasury yield dipped below the 2 year treasury yield. The panic that ensued led to the watershed decline on Wednesday. The rate inversion happens when investors believe that near-term risk is higher than long-term risk. Rate inversions are widely touted to predict recessions. In fact, rate inversions have predicted 7 of the last 4 recessions! So while a rate inversion CAN predict a recession, its presence is not foolproof and there are a number of occasions when a rate inversion led to nothing more than short-term weakness. It is something to watch and be aware of but certainly not something to base your investing strategy on. Should the rate inversion persist, it will put more pressure on the Fed to lower rates in September (if not before). Despite the fireworks and the talking heads on the financial networks, the sky is not falling. In fact, the major indices remain a good week or two from regaining their old highs. We are not predicting a quick return to the highs but do think we will be range bound for a few weeks before the market decides where it wants to go next. Headlines will continue to drive the market which makes it a difficult market to manage. Defensive sectors have held up well as real estate and utilities have logged gains during the market decline. Since July 26, our utilities holding is up 1% while the S&P has fallen almost 5%. Our bond holdings have also outperformed. We made no changes to our portfolios and will wait for the market to move out of the trading range before making any significant changes. With the Titans opening up their home preseason on Saturday, I would love to say Fall is in the air but the heat and humidity of August prevents me from doing so. It looks to be a sticky weekend – enjoy!

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