WEALTH MANAGEMENT GROUP

LEO A. PITRE, MBA, CFP®, CEP® • WILLIAM S. BORDELON, JR.

Pitre Wealth Management Group
Weekly Market Commentary
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The Markets

If it looks like a bond, and it acts like a bond...oh...that's the problem. Government bonds aren't acting the way investors expect.

Last week, 10-year U.S. Treasuries – which, typically, are thought to be safe and stable investments – suffered the biggest one-week sell off since June 2013, according to *The Wall Street Journal*. Treasuries finished the week yielding 2.4 percent, a gain of 0.3 percent. In the world of stodgy, backed-by-the-full-faith-and-credit-of-the-U.S.-government-bonds, that's a big change.

The performance of U.S. bonds paired with that of German government bonds. *BloombergBusiness* reported 10-year Bunds delivered their worst weekly performance since 1998. On Friday, the German benchmark bond settled at 0.8 percent after rising to almost 1 percent on Thursday. In late April, the yield on Bunds was at an all-time low of 0.049 percent.

So, what's going on? Why are bond values fluctuating so much? *Barron's* said the problem is a lack of liquidity in fixed-income markets:

> "The global financial system is awash in liquidity, created by central banks as they have driven short-term interest rates to zero (or even below) and expanded their balance sheets by the equivalent of trillions of dollars. And so the world is swimming in cheap money. At the same time, liquidity is said to be at a low ebb in the financial markets, especially for bonds... As a result, transactions that once didn't cause prices to budge now send them lurching from trade to trade... And the advice from central bankers on both sides of the Atlantic about this new volatility? Get used to it."

One reason for the lack of liquidity is the relative scarcity of market makers, reported *Barron's*. In the past, banks made markets – buying and selling for their own accounts – which created liquidity, but new regulations have curtailed those activities.

Looking beyond bond market illiquidity, there was economic good news in the United States: employment numbers improved. However, investors worried that could push the Federal Reserve toward a rate increase sooner rather than later, and U.S. stock markets finished flat to lower for the week.

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Data as of 6/5/15	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-0.7%	1.7%	7.9%	17.6%	14.8%	5.7%
Dow Jones Global ex-U.S.	-1.7	4.5	-4.5	10.4	6.3	3.4
10-year Treasury Note (Yield Only)	2.4	NA	2.6	1.6	3.2	4.0
Gold (per ounce)	-2.3	-2.9	-7.0	-10.7	-0.8	10.5
Bloomberg Commodity Index	-0.7	-3.9	-24.8	-7.7	-3.9	-4.3
DJ Equity All REIT Total Return Index	-2.1	-3.8	5.0	12.2	14.9	7.5

S&P 500, Dow Jones Global ex-US, Gold, Bloomberg Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT Total Return Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.
Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.
Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable.

WHEN A GOVERNMENT HAS A LOT OF DEBT, IS IT BETTER TO implement an austerity plan and pay the debt down? Or, take advantage of low interest rates and invest in the country?

Since the financial crisis, countries around the world have racked up a lot of debt through stimulus programs, financial bailouts, and other monetary and fiscal rescue efforts. *When Should Public Debt Be Reduced?*, a new paper published by the International Monetary Fund (IMF), reported advanced economies currently have some of the highest debt ratios of the past 40 years.

So, should they be paying off their debts? It all depends on how much 'fiscal space' your country has, according to the IMF. *The Economist* explained it like this:

> "This concept [fiscal space] refers to the distance between a government's debt-to-Gross Domestic Product ratio and an "upper limit", calculated by Moody's, a ratings agency, beyond which action would have to be taken to avoid default. Based on this measure, countries can be grouped into categories depending on how far their debt is from their upper threshold… It is a decent measure of how vulnerable a government's finances are to a shock."

The IMF report concluded countries already at the upper limit – like Japan, Italy, Greece, and Cyprus – are out of luck. They must take action to reduce debt levels. However, for countries that have fiscal space, there may be merit to the idea of "simply living with (relatively) high debt and allowing debt ratios to decline organically through output growth."

In other words, if the country's economy grows faster than its debt, the debt will become a smaller percentage of GDP, resolving the debt issue gradually over time. Given enough time and economic growth, the problem could resolve itself.

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The IMF cautioned these conclusions do not constitute policy advice. The paper was intended to fuel debate about the proper course of action for rich, but indebted, countries.

Weekly Focus – Think About It

"You have brains in your head. You have feet in your shoes. You can steer yourself in any direction you choose. You're on your own, and you know what you know. And you are the guy who'll decide where to go."

--Dr. Seuss, American writer and cartoonist

Best regards,

Leo A. Pitre, MBA, CFP®, CEP®

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

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*Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.
* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. You cannot invest directly in this index.
* The Standard & Poor's 500 (S&P 500) is an unmanaged index. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.
* The Dow Jones Global ex-U.S. Index covers approximately 95% of the market capitalization of the 45 developed and emerging countries included in the Index.
* The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.

* Gold represents the afternoon gold price as reported by the London Bullion Market Association. The gold price is set twice daily by the London Gold Fixing Company at 10:30 and 15:00 and is expressed in U.S. dollars per fine troy ounce.
* The Bloomberg Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
* The DJ Equity All REIT Total Return Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.
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* Consult your financial professional before making any investment decision.
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