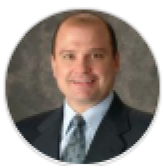
JUN 7, 2017 @ 12:03 PM 542

Beyond The News Noise, The Bond Market Reflects Current Investing Realities



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In *A Tale of Two Cities*, Charles Dickens famously writes, "It was the best of times, it was the worst of times." Today, depending on where you get your news, you might agree with either perspective. While some channels and websites report chaos, collusion, corruption, and ineptitude, others report a picture of leadership, reopened factories, promises kept, and American strength rebuilt. Wherever the truth resides, Wall Street seems to have come to its own conclusions and many stock-market investors believe we are seeing the best of times.

CHICAGO, IL - JULY 30: (Photo by Scott Olson/Getty Images)

Several U.S. stock-market indices are flirting with all-time highs. In fact, multiple stock markets around the world, notably in developed Europe and emerging markets, are outperforming the high-flying U.S. market thus far in 2017. For many casual market observers, this global stock rally may seem surprising. But for investors who are focusing on the news rather than the catchy headlines, there is a story of economic strength inside the numbers.

Our domestic economy continues to move forward albeit at a modest rate. The consumer remains strong and is finally benefiting from some wage growth. We also see low levels of personal debt, low unemployment, low oil prices, and surprisingly low interest rates. All of these factors are typically bullish for the overall U.S. stock market. European growth rates are finally perking up, and perhaps most importantly, corporate earnings around the globe are strengthening. When we look at this economic news, it is easier to see why the stock market continues to climb, and why a sudden and dramatic end to this historic bull market is unlikely.

As with any market, you'll see warning signs; but I am fairly sure substantive cautionary notes are not what is blaring on the cable news headlines. For example, one indicator of concern that hasn’t gotten all that much attention is the recent decline in U.S. interest rates. Last summer, the 10-year U.S. Treasury Note fell to around the 1.40% range. Gradually, as the economy showed some improvement, rates climbed to about 1.80% a week before Election Day. Subsequently, with Wall Street's exuberance regarding the "Trump Agenda," the 10-year Note soared to 2.60%, signaling the bond market's expectation of a more rapidly growing economy. However, in the past month we have seen the 10-year Note slump below 2.20%. This rapid drop may be signaling that the bond market is no longer expecting robust growth.

Given that the economic data is strong, it seems the bond market's reaction may be due more to the lack of legislative movement and the dimming hopes for comprehensive tax reform passing a divided Republican party and a Democrat party staunchly in opposition. With an infrastructure spending bill also seeming less likely, the bond market may be telling us that the President's full tax and infrastructure plan's passing Congress is unlikely.

Why listen to the bond market? To many seasoned Wall Street pros, the bond market is considered the "smart money." And this is for good reason. Perhaps surprisingly, the bond market is actually bigger than the stock market. Many long-term investors (such as pension funds, insurance companies, and retirees) have their financial futures tied to the bond market. Looking back in time, we don't see the type of crashes associated with bond markets that we see with stocks. Bonds tend to trade more in line with actual realities, and while they will also correct and decline from time to time, they tend to be a good forecaster of economic activity. With the 10-year Treasury Note in the middle of its post-election trading range, the bond market may be looking at the uncertainty in Washington and contemplating which cable channels have the real news and which have the fake news.