"An Update on the Bond Market"

By Tommy Williams, CFP®

It's like déjà vu all over again!

This wasn't the first quarter, or even the first year, that bond markets have not performed in the way Wall Street strategists have expected. During 2014, bond yields were expected to rise. They did not. During 2015, bonds were predicted to finish the year yielding about 2.8 percent to 3.3 percent. On December 31, they were at about 2.3 percent.

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During the first quarter of 2016, despite persistent predictions yields would move higher after the Federal Reserve's rate hike, yields fell and bond values increased. Government bonds delivered the strongest returns gaining 3.7 percent for the quarter, according to *Bloomberg.*

There is an inverse relationship between interest rates and bond prices. When rates move higher, bond prices move lower, and the value of investors' holdings may fall.

The current bull market in bonds started in 1982. During January of that year, the 10-year U.S. Treasury yield was about 14.6 percent. Since then, rates on Treasuries have declined and investors have reaped the rewards of steadily rising bond values.

The Federal Reserve began tightening monetary policy in December 2015 by raising the fed funds rate. Late in the month, the rate on benchmark 10-year Treasury bonds reached about 2.3 percent. However, after central banks in Europe and Japan loosened their monetary policies, yields on Treasuries moved lower. By the end of the first quarter of 2016, they were at about 1.8 percent.

Overseas, the picture was a bit more complicated. An expert cited by *Bloomberg* explained, "Of the five countries that performed best – Germany, Belgium, Denmark, Japan, and the United Kingdom – the two-year debt of all but the United Kingdom has negative yields."

When bonds have negative yields, investors are paying to lend their money. Why would anyone do that? Some institutions with billions of dollars just need a safe place to "store" their money for now. In addition, *The Economist* reported there are three types of investors who buy bonds when yields are negative: 1) central banks and other entities that must own government bonds, 2) investors who expect to make money when a country's currency gains value, and 3) investors who would rather suffer a small loss in government bonds than risk a bigger loss investing in something else.

That something else might have been a stock market during the first month or so of the quarter. Globally, stocks underperformed bonds, returning 0.4 percent for the first quarter of 2016. However, the end-of-quarter return doesn't really tell the whole story. Fears of global recession, among other things, produced a wild ride for stock market investors during the first months of the year. Worldwide, stocks were down about 11.3 percent through mid-February, according to Barron's, and then gained 13.2 percent to end the quarter slightly higher, overall.

The United States delivered strong returns for the period. *Barron's* reported:

"Still, the United States fared a good deal better than other developed markets, with Europe down 2.4 percent, the United Kingdom off 2.3 percent, and Japan worse by 6.4 percent."

At the beginning of April, the *Bureau of Labor Statistics'* monthly jobs report showed more people were looking for jobs, increases in employment exceeded analysts' expectations, and average hourly earnings had moved higher. These were positive signs for the U.S. economy.

While you may be feeling a little blue about the bond markets, surely that tax refund you've probably received by now has your spirits lifted! If that doesn't work, perhaps you'll find comfort in the bond rally this past week.

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