Commentary

May 18, 2015

The Markets

The U.S. Treasury market is a bit like a lake in the midst of a drought. All the action – fish, frogs, crawdads, and such – that was once hidden in the depths has become a lot more visible as the water shallows.

For decades, traders and investors have turned to U.S. government debt – Treasury bills and bonds – because the market was so deep that hefty trades could be placed without triggering significant price changes, *Bloomberg* explained. That's one reason U.S. Treasuries have long been sought as a safe haven in tumultuous times.

Recently, however, the U.S. Treasury market has become more responsive to trades. The yield on 10-year Treasuries rose above 2.3 percent last Tuesday for the first time in months before closing lower on Friday. Some theorize yields are being pushed higher as investors try to stay ahead of Federal Reserve activity or changing inflation expectations, but others say the issue is liquidity.

Liquidity is the ease with which traders can buy and sell bonds. In a highly liquid market, bonds can be bought and sold easily. In a less liquid market, trading becomes more challenging. *Bloomberg* contends the U.S. Treasury has become less liquid because of financial regulations that were adopted after 2008 to reduce risk taking. The regulations have made bond dealers less willing to hold inventory and facilitate trades. Liquidity also was affected by the Fed, which bought lots of government bonds in its effort to stimulate the economy.

Bloomberg said, "How much depth has the market lost? A year ago, you could trade about $280 million of Treasuries without causing prices to move, according to JPMorgan Chase & Co. Now, it's $80 million."

Treasury market volatility had little affect on U.S. stock markets, which finished the week higher.

*US treasuries may be considered "safe haven investments but do carry some degree of risk including interest rate, credit and market risk.

Data as of 5/15/15	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	0.3%	3.1%	13.5%	16.9%	13.3%	6.2%
Dow Jones Global ex-U.S.	1.3	9.3	1.8	9.8	5.9	4.1
10-year Treasury Note (Yield Only)	2.1	NA	2.5	1.8	3.5	4.1
Gold (per ounce)	2.9	1.8	-6.0	-7.8	-0.3	11.3
Bloomberg Commodity Index	1.2	1.0	-22.4	-7.7	-3.4	-3.3
DJ Equity All REIT Total Return Index	0.7	0.6	13.3	12.3	13.7	8.4

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.

DEBT, DEBT, DEBT, DEBT… THE WORLD'S DEBT IS 286 PERCENT OF ITS GDP, according to *The Economist*. GDP stands for gross domestic product, which is the value of all goods and services produced in a country or region.

So, the world owes almost three times the value of what it produces. For the most part, governments have incurred the debt as they've tried to help their countries recover from the financial crisis and subsequent recession. A 2015 *McKinsey and Company* report explained it like this:

"Seven years after the bursting of a global credit bubble resulted in the worst financial crisis since the Great Depression, debt continues to grow. In fact, rather than reducing indebtedness, or deleveraging, all major economies today have higher levels of borrowing relative to GDP than they did in 2007. Global debt in these years has grown by $57 trillion, raising the ratio of debt to GDP by 17 percentage points. That poses new risks to financial stability and may undermine global economic growth."

McKinsey's findings show some types of debt grew more slowly from 2007-2014 as compared to 2000-2007. Increases in household debt and financial debt growth rates

(8.5 percent to 2.8 percent and 9.4 percent to 2.9 percent, respectively) slowed sharply.

Other types of debt grew faster. Corporate debt grew at a slightly faster pace during the period (5.7 percent to 5.9 percent), while government debt grew rapidly (5.8 percent to 9.3 percent). Higher government spending was welcomed in the depths of the recession when it served as a counter-balance to low spending in the private sector.

Now, however, government debt levels are becoming a concern. *McKinsey* reported government debt has risen to such high levels in six countries – Spain, Japan, Portugal, France, Italy, and the United Kingdom – that unusual measures may be needed to reduce debt.

The most obvious way to decrease debt is to trim annual spending – also known as reducing the fiscal deficit – but that could be counterproductive since it often inhibits economic growth, and encouraging growth was the point of taking on debt in the first place. *McKinsey* recommends alternatives such as "extensive asset sales, one-time taxes on wealth, and more efficient debt-restructuring."

Weekly Focus – Think About It

"Culture makes people understand each other better. And if they understand each other better in their soul, it is easier to overcome the economic and political barriers. But first they have to understand that their neighbour is, in the end, just like them, with the same problems, the same questions."

--Paulo Coelho, Brazilian novelist

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* Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.
*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.
* Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful.
* Past performance does not guarantee future results. Investing involves risk, including loss of principal.
* You cannot invest directly in an index.
* Consult your financial professional before making any investment decision.
* Stock investing involves risk including loss of principal.

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