STONEBRIDGE Capital Advisors

The Stonebridge Market Commentary

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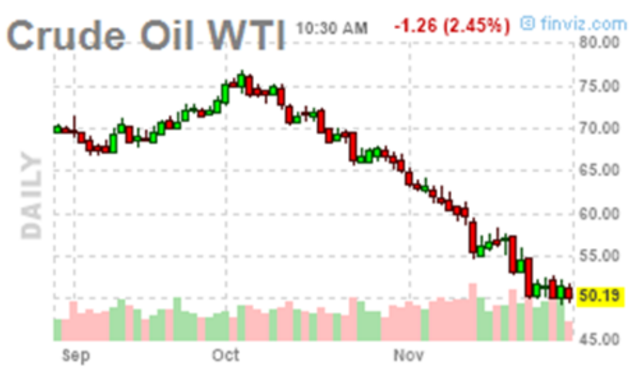
Equity Market Commentary

November was another wild month, just like October and for that matter, February. A pretty good rally in the last week of the month saved us in a way. Last month I opined that the correction that began in October would likely take months to recover. The action on November bears this out. After losing 6.94% in October, we managed to claw about half of the drop back during the last week of the month. That last week saw the S&P jump 4.85% leaving November in the black by 1.79%. We are still crisscrossing the positive line for the year and have regained the positive by 3.24% year to date.

We had a number of cross currents to deal with since October. Oil which had a major rally going, slumped from $75 to $50. Part of this was political and part of it was inventory coupled with a slow global macro setting. We also had a drop in rates, partially due to safety concerns over stock market volatility. Having hit 3.25% on the 10 year treasury, rates dropped back to nearly 3%.

The S&P 500 may have created a double bottom; We will know in a few weeks. With the economy still doing rather well and consumer confidence high, we can look forward to a solid holiday spending season. Thanksgiving weekend started off well so maybe a "Santa Claus" rally is in the offing. Then we can get on to worrying about 2019. At least there no elections. The good news is that the Presidential election in 2020 is under way.



Fixed Income Market Commentary

Fixed income vehicles largely rallied from the beginning of the month of November to the end, leading to lower yields nearly across the board with high-yield corporate bonds being the exception as credit spreads widened with the choppy equity markets. 10-year Treasuries hit a high yield of 3.24% early in the month before settling back around 3%. Earlier in the year 7 and 10-year maturities flirted with inversion, but during the last month it was the shorter end that showed the most flattening. In fact, on Friday morning, the last trading day of the month, both the 3 and 5-year bonds briefly traded at yields less than a basis point away from each other.

We continue to expect modestly higher interest rates in the new year particularly on the shorter end of the curve as the Fed continues to lessen its accommodative monetary policy and continue with additional rate increases. With that expectation, a fixed income investor may wonder if it makes any sense to hold off putting cash to work until higher rates have arrived. The answer: under a perfect scenario it may, but under most, the cost of waiting in foregone income is too high to justify it. Consider the following example.

Let us assume an investor could buy a 5-year bond trading at a yield of 2.85% today. The investor also expects interest rates to be higher six months from now. Because of his rising rate expectation, he chooses to put the investment on hold until he can lock in 3.10% (25 basis points higher than current rates) for the same amount of time. While he is waiting, his cash is earning 0.50% in his money market account.

Now, fast-forward six months, rates have risen 25 basis points just as expected and 5-year bonds are now available at 3.10%. It turns out, waiting to lock in 3.10% 6 months down the road, even accounting for income earned from the money market holding period doesn't surpass the immediate investment at 2.85% on a cumulative income earned basis over the 5-year term. In fact, rates would need to rise to nearly 3.15% and no later than 6 months afterwards to earn even a slightly higher amount of cumulative income. And let us not forget, yields could rise less or not at all during that time period. After all real 5-year Treasury yields are only higher by about 20 basis points over the last six months.

When we are in a rising interest rate environment it can be tempting to think of holding back cash for future reinvestment. We just need to remember, there is a cost to waiting. If the market forces us to wait too long, there may be no way to recoup it. Fortunately, most investors structure fixed income portfolios using individual bonds either in a ladder or barbell strategy with bonds maturing at staggered points in the future rather than at one single time, so this is less of an issue. By using those structures there should always be some portion of the portfolio's principal coming due and available for reinvestment at more attractive rates in the future.

Sources
Data sourced through Bloomberg
Charts provided by finviz.com