Is There a Bond Bull Fight in the Post Trump/Pre-Yellen Arena?

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With the exception of an increase in consumer spending in liquor sales due to the "despair of Clinton supporters," the pundits predicted Trump-Ageddon.

The experts were wrong again; instead, stock markets soared and bond prices crashed, the latter suffering a ferocious and mind-boggling $1.29 trillion sell-off. The uncertainty generated by the election has brought about a lot of changes in Wall Street's outlook.

For a few hours on election night, investors looked for safety, and government bonds rallied. That response was very short-lived and reversed course in a big way. Government bond prices then fell sharply, and yields increased to levels not seen since early January. More volatility means strategists will make tactical changes to their portfolios in anticipation of 2017. As a result, bond and target-date funds are among the strategies gathering the largest inflows, along with international funds. "A really disproportionate flow has gone into fixed income," explains Robert Johnson, the director of economic analysis at Morningstar. Yet, one of the biggest areas of uncertainty and change right now isn't in stocks at all — it's in bonds.

You may be wondering why it seems that while the markets in general have reacted positively since Trump's Election, some elements of your actively managed portfolio at Assetmark may have gone down slightly. Specifically, the area of fixed income and bond allocations have come under particular pressures. I have noticed this trend and have put in quite a bit of time to not just investigate, but to determine if we should make any adjustments to your portfolio.

Just in the last month, the high yield bond market (JNK) is down 4%. Our position in the actively managed *Clark Capital Fixed Income Total Return* (FITR) strategy is down only 1.44%. However, the FITR strategy is still up 10.82% YTD , while it's benchmark (JNK) is up only about 5%.

Even though I considered moving the money to another safe harbor position, or cash, it's worth remembering that FITR is a tactical bond portfolio that can move to either treasuries or cash. ***So, the strategy is designed to navigate all markets***. For me, as your advisor, to move out of that strategy into another would be a duplication of the work that Clark Capital already is doing.

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Their long term track record has NEVER suggested that we get out at the top, or in at the bottom. Rather, for 11 years, they have gotten out near tops, and gotten in near bottoms. Additionally, I have to remind myself that a 2% move down in the strategy is WELL WITHIN the range of expectations. If this type of temporary market move is too much for you as a client, then investing in general in the stock market may not be the right strategy in the first place. I do not believe this is the case.

Bond investors appear focused on the likelihood of big tax cuts and spending increases that may spur inflation and hurt fixed-income investments.

But just as we learned on election night, we have to be careful about drawing long-term conclusions too quickly. The market could easily tell us something differently next week, next month or next year.

Here's what income and bond investors need to know about the next few months:

- **Another interest-rate hike is preordained.** Federal Reserve Chairwoman Janet Yellen, in prepared testimony to be delivered at a hearing on Capitol Hill, reiterated that an increase in short-term interest rates "*could well become appropriate relatively soon*" but offered no new signals about what the central bank will do at its meeting next month. Officials decided to hold off on raising rates at their last meeting after judging that there was "somewhat more room" for the labor market to improve than officials had anticipated at the beginning of the year.
- High yield corporate bonds generally trade in sync with the stock market (without the same volatility). But that's not always true at the industry level. High yield corporate bond shares fell while stocks in their underlying companies rallied. Most analysts believe this divergence can be blamed almost entirely to the rise in underlying Treasury rates. Surprisingly, the environment is looking pretty good for investors looking to buy bonds right now.
- According to the CME's FedWatch forecasting tool , there is a 91% chance of a rate hike in December to a range of 0.50% to 0.75%. That's not surprising, seeing as the Federal Reserve has talked a lot about rate increases in calendar 2016, but thus far we haven't seen a single one. The expectation that the Fed will eventually follow through on its hawkish talk — coupled with criticism from Republicans about the current rate picture — makes it very difficult to imagine we will see the December meeting come and go without another increase to benchmark rates. December will mark the one-year anniversary of the what has been called the Federal Reserve's beginning of "liftoff" in interest rates, and we will probably see the sequel to last year's rate hike in a few weeks.
- **However, that hike has been priced in.** Of course, it's important to note that bond markets have already responded in kind after rates exploded in the past week or so. After trading briefly under 1.8% on Election Day, yields on the 10-year Treasury hit 2.3% recently — the highest level since January — on expectations of a higher interest-rate environment.
- Some investors have been waiting for the Federal Open Market Committee meeting to buy into bonds, but have probably missed the boat. Case in point: The popular iShares 20+ Year Treasury bond ETF has sank about 6% in the past week as higher rates have weighed on the value of bonds and bond funds. That move is a clear sign that markets have already adjusted in a big way.

While this brief memo about the recent movements in the bond markets may be somewhat technical for your taste, I try to distill it into its simplest parts. Investing, and not

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trading, requires a good deal of discipline and patience. Our portfolios are being guided by a collective brain trust of the best and brightest financial minds in the world. Although they "guess" right most of the time, they do not do so all of the time. I suggest that we remain patient and allow the natural flow of the markets, and the appropriate reallocations by our strategists, to play itself out. Should my conviction in this strategy change in the near future, you will see the necessary adjustments that I will make behind-the-scenes.

As always, please do not hesitate to contact me or our staff if there's anything we can do to support you. We look forward to our conversations over the course of the next few months and years.

Thank you for your trust and support,

Ron

Ronald Papa is the founder and senior advisor at Legacy Advisors Wealth Management, where he focuses on helping people understand the practical and technical aspects of retirement income planning. Legacy Advisors Wealth Mgmt. is an independent registered investment advisory firm providing unique, unbiased insight into the most critical financial, legal and tax issues facing pre-and post-retirees. Legacy Advisors was founded in 1996 and is located in Norwell, MA.

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