The Emotional Stock Market vs. the Wise Old Bond Market

Last week, we discussed the coronavirus outbreak and implications it might have on markets going forward. I provided some statistics related to previous epidemics and the historical response to those by equity markets worldwide. That data is inconclusive at best. I ended the commentary by pointing out that this current medical crisis (like all worldwide events) does not matter to investors, until it matters. What I mean by that statement is that extraneous events don't necessarily impact asset prices just because they happened, or just because they are scary. Events only matter if they affect the supply and demand of goods and services.

It is these fundamental underpinnings of the world economy that drive interest rates and the all-important perceived opportunity for yield, relative to a risk-free rate of return. If demand is strong, businesses will perceive an opportunity to profit by investment in their products (supply) to meet that demand and generate earnings above and beyond what could be achieved by investing the same capital in things like government bonds. When demand becomes weak, businesses may feel the possibility of generating earnings is insufficient for the risk involved in putting money toward growing their business.

It is this ongoing analysis that is played out every day and is reflected in the bond markets in general, and the yield curve in particular. It is the bond market and the yield curve that tells us what investors think about prospects for growth over the next 1 year, 3 years, 5 years, 10 years and more. Think of the stock market as a loud and sometimes argumentative teenager. It is emotional and bounces around a lot while trying to find its way. Think of the bond market as a wise old man. It doesn't make as much noise or talk as much, but when it does speak it is worthy of attention.

Domestic and international stock markets (notably Chinese) have sold off precipitously during the past week as the coronavirus has continued to spread across the world, and global leaders have scrambled to quarantine large swaths of the Chinese and traveling population. It is now clear that the virus will infect significantly more people than the SARS virus did in 2003. Whether it is as deadly (on a relative basis) remains to be seen. Sectors with exposure to the Chinese economy, such as technology, have been hit especially hard. The energy sector, which is dependent upon Chinese demand has experienced the weakest start to a year in decades. The energy sector ETF (XLE) is down 16% in a month. Clearly, we are seeing at least the perception of demand being affected by this virus. But as stated above, stock markets bounce around a lot and perception can change overnight.

So, what says the wise, old bond market? Well, the bond market unfortunately looks like it agrees. The 10-Year Treasury Note has now dropped 40 basis points in just over two weeks. It is currently yielding 1.53%. That is a 20% move down and evidences real concern that global economic activity is going to be hurt going forward. In fact, we just saw the 90-Day and 10-Year Treasury Note invert. This means that an investor gets a better rate of return for loaning out his or her money for ninety days than for loaning it out for ten years. This is not normal and is not a good sign for economic growth going forward. This condition happened in 2018 and quickly resolved itself, which may happen again.

All things considered, I am not suggesting that we can't or won't find our way through this latest threat. Yesterday saw some buying in equity markets across the world and markets are up big today. Suffice to say, I am concerned that the bond market has rapidly forecast such weak demand in the face of good earnings here in the U.S. We are in the middle of earnings season and most companies are beating expectations. Bond markets often see things before everyone else does. That fact should give us pause going forward.

Last week's commentary can be found here.

G. Chadd Mason
CEO, The Cabana Group

IMPORTANT DISCLAIMERS

This material is prepared by Cabana LLC, dba Cabana Asset Management and/or its affiliates (together "Cabana") for informational purposes only and is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed reflect the judgement of the author, are as of the date of its publication and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by Cabana to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by Cabana, its officers, employees or agents.

This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. All investment strategies have the potential for profit or loss. All strategies have different degrees of risk. There is no guarantee that any specific investment or strategy will be suitable or profitable for a particular client. The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation. Investment involves risk including possible loss of principal.

Cabana LLC, dba Cabana Asset Management ("Cabana"), is an SEC registered investment adviser with offices in Fayetteville, AR and Plano, TX. The firm only transacts business in states where it is properly registered or is exempted from registration requirements. Registration as an investment adviser is not an endorsement of the firm by securities regulators and does not mean the adviser has achieved a specific level of skill or ability. Additional information regarding Cabana, including its fees, can be found in Cabana's Form ADV, Part 2. A copy of which is available upon request or online at www.adviserinfo.sec.gov/.

The Financial Advisor Magazine 2018 Top 50 Fastest-Growing Firms ranking is not indicative of Cabana's future performance and may not be representative of actual client experiences. Cabana did not pay a fee to participate in the ranking and survey and is not affiliated with Financial Advisor magazine. RIAs were ranked based on percentage growth in year-end 2017 AUM over year-end 2016 AUM with a minimum AUM of $250 million, assets per client, and growth in percentage assets per client. Visit www.fa-mag.com for more information regarding the ranking.

The Financial Advisor Magazine 2019 Top 50 Fastest-Growing Firms ranking is not indicative of Cabana's future performance and may not be representative of actual client experiences. Cabana did not pay a fee to participate in the ranking and survey and is not affiliated with Financial Advisor Magazine. Working with a highly-rated advisor also does not ensure that a client or prospective client will experience a higher level of performance. These ratings should not be viewed as an endorsement of the advisor by any client and do not represent any specific client's evaluation. RIAs were based on number of clients in 2018, percentage growth in total percentage assets under management from year end 2017 to 2018, and growth in percentage growth in assets per client during the same time period. Visit www.fa-mag.com for more information regarding the ranking.

Cabana claims compliance with the Global Investment Performance Standards (GIPS®). In addition to the firm's third-party verification, six of Cabana's core portfolios have been performance examined consistent with GIPS® standards. The Global Investment Performance Standards are a trademark of the CFA Institute. The CFA Institute has not been involved in the preparation or review of this report/advertisement. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS® standards. Verification does not ensure the accuracy of any specific composite presentation unless an independent performance examination has been conducted for a specific time period. Past performance is not indicative of future results. Due to various factors, including changing market conditions, the portfolios may no longer be reflective of current positions.

No client should assume that the future performance of any specific investment or strategy will be profitable or equal to past performance. All investment strategies have the potential for profit or loss. All strategies have different degrees of risk. There is no guarantee that any specific investment or strategy will be suitable or profitable for any investor. Asset allocation and diversification will not necessarily improve an investor's returns and cannot eliminate the risk of investment losses. While loss tolerance and targeted "drawdown" are identified on the front end for each portfolio, Cabana's algorithm does not take any one client's situation into account. It is the responsibility of the advisor to determine what is suitable for the client. An advisor should not simply rely on the name of any portfolio to determine what is suitable. Cabana manages assets on multiple custodial platforms. Performance results for specific investors may vary based upon differences in associated costs and asset availability.

CABANA