Polaris Greystone FINANCIAL GROUP, LLC

Polaris Greystone Educational Series

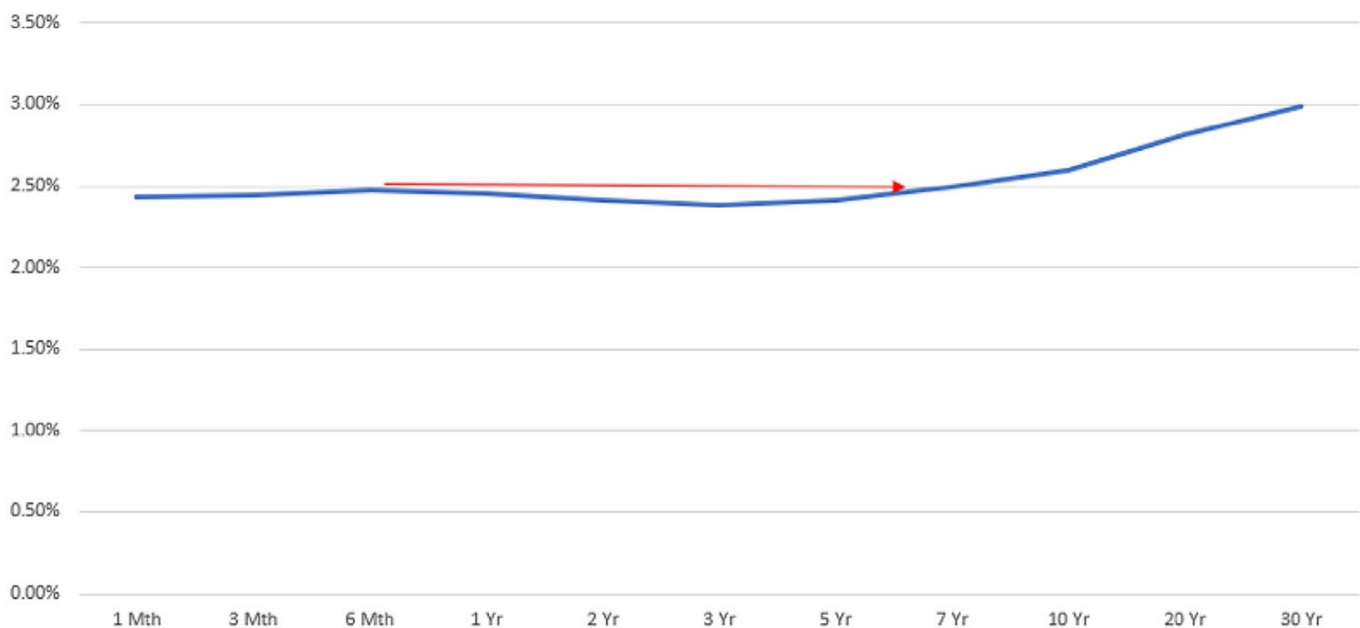
For more information or to schedule an introductory consultation contact us at: info@polarisgreystone.com I (800) 268-9046 I www.polarisgreystone.com

Flat Yield Curve

If you've read the news or turned on any financial television program, all anyone is talking about is our flat yield curve. Which raises several questions… What is a flat yield curve? Why does this normally happen? Is our current flat yield curve similar to historical flat yield curves? Will this impact my investments? Let's start with our first question.

What is a flat yield curve?

A flat yield curve is when a bond investor receives the same amount of yield (or income) investing in short-term bonds as they do by buying bonds with a longer maturity date. As you can see in the chart below, short-term treasuries are yielding approximately the same rate as a 7-year treasury, as of April 16, 2019. A six-month treasury is yielding 2.47%, barely below the 2.50% paid by owning a seven-year treasury. Bond investors get slightly more than ½% better yield to invest in the 30-year rather than the 1-month, a very thin historical spread.



Polaris Greystone Financial Group, LLC is a federally registered investment adviser. The information, statements and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Advisory services are only offered to clients or prospective clients where Polaris Greystone Financial Group, LLC and its representatives are properly licensed or exempt from licensure. No advice may be rendered by Polaris Greystone Financial Group, LLC unless a client service agreement is in place.

Polaris Greystone FINANCIAL GROUP, LLC

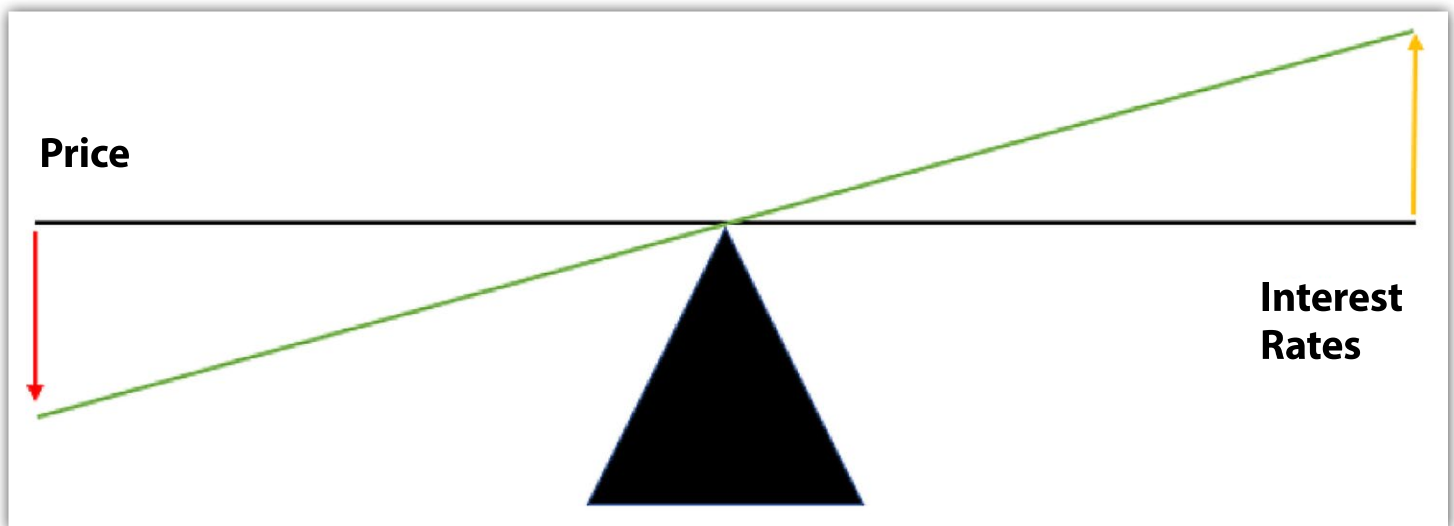
Polaris Greystone Educational Series

For more information or to schedule an introductory consultation contact us at: info@polarisgreystone.com I (800) 268-9046 I www.polarisgreystone.com

Why does this normally happen?

Most of the time the treasury yield curve flattens because investors see more risk in the short-term bonds than they do in the long-term bonds. Sometimes this is because investors think the economy is slowing, thus forcing the Federal reserve to lower rates to stimulate the economy. These investors will seek to lock in higher rates by selling their short-term bonds and buying long-term bonds (locking in a higher rate for a longer period of time).

Bonds have an inverted relationship between price and yield (as seen below). As short-term bond investors sell their bonds, it drives prices down and yield up (if there are more sellers than buyers, prices will drop). Conversely, they are using the proceeds from these sales to buy long-term bonds, driving prices up (more demand, higher prices) and yields down.



Is it the same this time?

The reason this is such a newsworthy story is that all recessions have been preceded by a flat or inverted yield curve. It takes months, sometimes years but it's happened every time. With this information we should get defensive, right? No. What the news hasn't told you is that we have had many flat or inverted yield curves without going into a recession. Let me repeat this… All recessions have been preceded by a flat or inverted yield curve, but not all flat (or inverted) yield curves have turned into recessions. We believe that we fall into the latter category. Let me explain why this flat yield curve is not a sign that a recession is looming.

The Great Recession brought with it a lot of monetary pain and suffering. It also created a whole new jargon to learn. Remember ZIRP? It stood for "Zero Interest Rate Policy." The Federal Reserve lowered rates to virtually 0% by December 2008 in an attempt to stimulate the economy and get us out of our recession. The Great Recession technically ended in June 2009, but the Fed didn't move rates above 0.50% until the beginning of 2017 because the economy was to frail.

Polaris Greystone Financial Group, LLC is a federally registered investment adviser. The information, statements and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Advisory services are only offered to clients or prospective clients where Polaris Greystone Financial Group, LLC and its representatives are properly licensed or exempt from licensure. No advice may be rendered by Polaris Greystone Financial Group, LLC unless a client service agreement is in place.

Polaris Greystone FINANCIAL GROUP, LLC

Polaris Greystone Educational Series

For more information or to schedule an introductory consultation contact us at: info@polarisgreystone.com I (800) 268-9046 I www.polarisgreystone.com

The Fed also bought $4.5 trillion (yes with a "T") is U.S. treasuries during this time. Another new jargon term, a little thing that we call "quantitative easing," or QE for short. We had three rounds of quantitative easing, beginning in 2008, with the last purchases made in October 2014. Remember what was explained above. The Fed bought $4.5 trillion in U.S. treasuries to drive prices up and yields down. This was another way they were able to artificially keep rates at 0%. The other impact that it had was it lowered the value of the dollar. The U.S. government was fine with this because it made our products cheaper abroad, allowing domestic companies to sell more of their goods and services. This further stimulated our economy.

2015 was the first time since the great recession that our economy was standing on its own two feet without having any direct government intervention. As you can see from the chart, we got off to a shaky start, almost slipping into a recession at the end of 2015. But then the economy found it's footing. As it strengthened, the Fed started raising rates not because we had inflation but because it was the first time in almost a decade that the economy was strong enough for them to reset one of the most important levers they have, Fed Fund Rates.

Source: tradingeconomics.com, U.S. Bureau of Economic Analysis

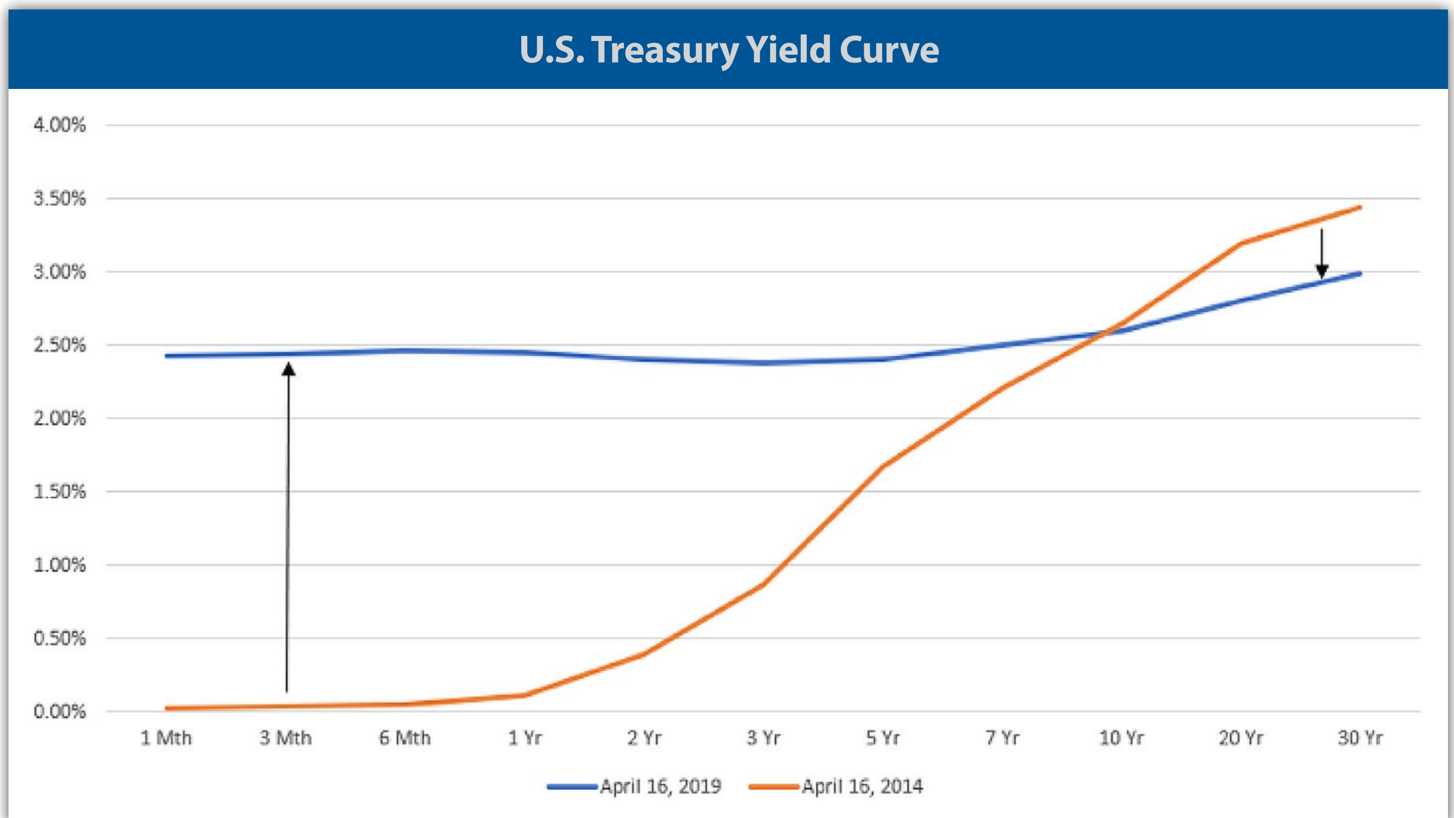
Polaris Greystone Financial Group, LLC is a federally registered investment adviser. The information, statements and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Advisory services are only offered to clients or prospective clients where Polaris Greystone Financial Group, LLC and its representatives are properly licensed or exempt from licensure. No advice may be rendered by Polaris Greystone Financial Group, LLC unless a client service agreement is in place.

Polaris Greystone
FINANCIAL GROUP, LLC

Polaris Greystone Educational Series

For more information or to schedule an introductory consultation contact us at: info@polarisgreystone.com I (800) 268-9046 I www.polarisgreystone.com

Over the last few years, the Fed has moved from a "ZIRP," zero interest rate policy, to trying to normalize monetary policy. As our economy has strengthened, they raised rates from 0% to 2.41%. The Fed has also been trying to sell the $4.5 trillion in U.S. Treasuries they own. To date, they have sold approximately $500 billion. These two actions have pushed short-term bond prices down (yields up), as seen on the graph below. Bond investors tried to preserve their yield by buying more bonds on the long end of the yield curve, thus pushing price up and yields down.



Another amazing phenomenon has occurred in recent years, which impacts U.S. Treasuries. As of the end of 2018, there was an estimated $6 trillion of negative yielding bonds. You read that correctly. Negative yield. For example, the five-year German Bund is currently yielding -0.36%. This means if you were a German citizen trying to buy your own sovereign debt you would lose almost 2% of your investment over that five-year time period. Think about it. You give me $100,000 of your money to invest in German Bunds and in five years I give you a little over $98,000 back. Are you in? Where do you our German investor is placing his money? That's correct, in U.S. Treasuries. This has also impacted our yield curve.

Polaris Greystone Financial Group, LLC is a federally registered investment adviser. The information, statements and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Advisory services are only offered to clients or prospective clients where Polaris Greystone Financial Group, LLC and its representatives are properly licensed or exempt from licensure. No advice may be rendered by Polaris Greystone Financial Group, LLC unless a client service agreement is in place.

Polaris Greystone FINANCIAL GROUP, LLC

Polaris Greystone Educational Series

For more information or to schedule an introductory consultation contact us at: info@polarisgreystone.com I (800) 268-9046 I www.polarisgreystone.com

Will this impact my investments?

The simple answer is "yes," it will have an impact on your investments but not in the way you might think. A flat yield curve can be a barometer of ailments or concerns about our economy. The U.S. economy grew by 3% in 2018. Over the last fifty years our economy has averaged a 2.7% growth rate, and only 2.3% since the end of the Great Recession. Our leading economic indicators have shown no sign of a looming recession.

Bond investors will be impacted, with most not understanding where or how to invest their money. Certain sectors of the S&P 500 will be impacted more than others. For example, banks will be impacted. They borrow money on the short end of the yield curve and then lend on the long end. The difference is what they make. The flatter the yield curve, the lower their margins. An investor will need to be careful navigating these challenging markets.

If you are interested in a free portfolio review or a comprehensive financial plan, please feel free to call us. We'd be happy to meet with you to see if we can add value to your circumstances.

As always, I welcome your questions and comments.

Sincerely,

Jeffrey J. Powell
Managing Partner & Chief Investment Officer

Polaris Greystone Financial Group, LLC is a federally registered investment adviser. The information, statements and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Advisory services are only offered to clients or prospective clients where Polaris Greystone Financial Group, LLC and its representatives are properly licensed or exempt from licensure. No advice may be rendered by Polaris Greystone Financial Group, LLC unless a client service agreement is in place.