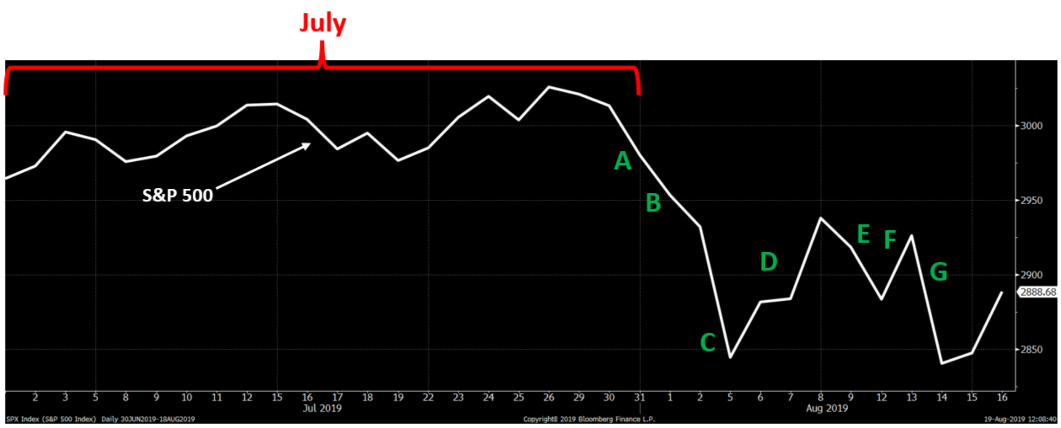
BCWM
PROVIDING PEACE OF MIND

Your Mattress or Negative Interest Rates

Up until the very last day, July was so boring. So accommodating. So mundane. Watching your investment account during July was like watching your neighbor's cousin's nephew's swim meet.

However, since the last day of July, the markets have been extremely NOT boring. Every day has brought unpredictable swings, most of them unpleasant. But then, as we have pointed out repeatedly, extreme market volatility almost always results in lower stock prices.

So what has happened since July 30th?



A. July 31: The Federal Reserve lowered the Fed Funds Rate for the first time since 2008. The stock market lost over 1% that day, which is ironic, because lower interest rates are supposed to be positive for businesses. But investors took the rate cut as a sign that the Fed is worried about potential slowing economic activity. So the positive became a negative. You just can't please some people.

B. Just one day later, President Trump intensified pressure on the global economy by announcing (via Twitter, of course) a 10% increase in tariffs on the remaining $300 billion of imports from China not currently subject to additional tariffs. For reference, the other $250 billion of imports have already been hit with 25% tariff *increases* over the past year and a half.

Fortunately, the weekend came along and investors were not allowed to panic for a couple of days . . .

Portfolio Management
Richard W. Boyer, CFP®, CFA
Laura Carley, CFP®, CFA
Cory Bloodgood, CFA

BCWM, LLC
14221 Metcalf Avenue
Suite 201
Overland Park, KS 66223

Phone: 913-685-2300
Email: info@bcwm.com

C. But China responded to the tariff announcement by allowing their currency (the yuan) to depreciate against the dollar. A cheaper yuan has the effect of making Chinese products cheaper (helping their economy) and U.S. products more expensive (hurting our economy). The United States labeled China a “currency manipulator” shortly after China devalued the yuan. If you weren’t previously convinced that this was a “trade war,” you should be by now.

D. August 6–8: The next couple days were fairly quiet on the trade war front and no news seemed to be good news.

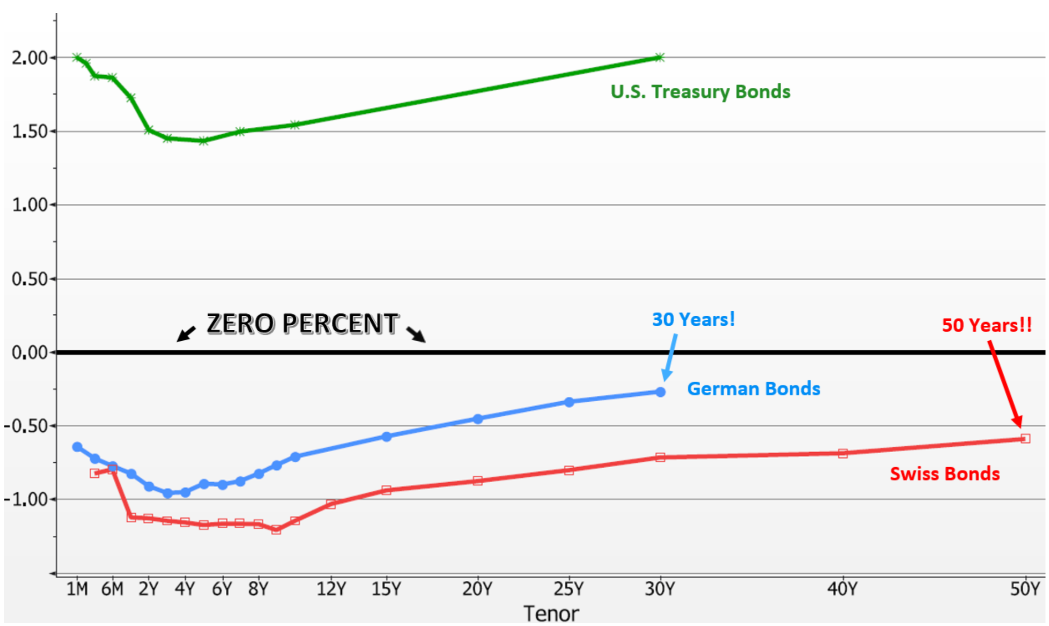
E. August 12: The Hong Kong protests flared up again. Protestors occupied the Hong Kong airport for two days, virtually shutting down all air transportation in and out of the area. Not only is this a thorn in China’s side, but Hong Kong is a significant global financial hub. If there is a serious crackdown from China, this would hurt the global economy, and fear of this was reflected in the stock market.

F. August 13: Trump unexpectedly announced a delay on the 10% tariffs for some imports, and stocks rallied. The president said the tariffs would not be imposed until December, thus postponing saddling the U.S. consumer with higher prices until after the holiday shopping season. This statement was at odds with previous claims that tariffs on China would not hurt American consumers.

G. Stocks had their worst day of the year as the Dow Jones Industrial Average fell 800 points (2.9%). Why? Because the most reliable recession predictor finally sounded the alarm. The interest rate on the 10-year Treasury fell below the rate on the 2-year Treasury (also known as an inverted yield curve). The past seven times we saw this inverted yield curve, a recession followed. We also discussed this in March and December of 2018.

What’s happening this month in the world of bonds is hard to even understand. Interest rates all over the world are falling to levels that seem to defy logic. (But who ever said investors are logical?)

EVERY German bond . . . EVERY Swiss bond . . . EVERY Dutch bond . . . is trading at a price that guarantees a negative rate of return.



For the first time we can remember, it appears to actually be better to put your money in a mattress than invest it in some government bonds.

However, the reason investors buy bonds is to beat inflation by 1-2%. In 1981, interest rates were 16% but inflation was 14%.

If bonds have negative interest rates that means investors are expecting *deflation*. They are expecting prices to decline. Which is what happens in a slowing global economy.

And U.S. Treasury bonds, while still providing a positive rate of return, are heading toward zero in a hurry. In the first half of August, Treasury bond interest rates have plummeted.

In just two weeks, the U.S. 30-year Treasury bond interest rate declined from 2.52% to 1.98%.

In just two weeks, the U.S. 10-year Treasury bond interest rate declined from 2.01% to 1.53%. And ten months ago, it was around 3.33%.

We have gone on record (read virtually every Investment Commentary for the past several years) as saying we thought interest rates would decline. And even *we* didn't envision a decline as rapid as we are seeing this month.

Recently there were two mass shootings within a 24-hour period: one in El Paso, TX, and one in Dayton, OH. The frequency with which these tragic events continue to occur convinces us more and more that there will eventually be some sort of legislation regarding gun control.

As an investment company, we don't take stands on political and/or social issues. Passionate stances can lead to poor investment decisions.

But we still attempt to discern *what* is going to happen, whether we like it or not, whether it is good for the country or not. We still want to be able to predict, with some degree of accuracy, what type of legislation will make it through Congress and what won't.

And we can now see a day in the not-too-distant future when the generations of children who are in school or who have recently graduated become old enough to vote. These are young people who have lived through many years of "active shooter drills."

A couple of generations ago, elementary schools conducted "civil defense drills" because we believed Russia was capable of destroying whole cities in the United States. Turns out that was a rather slim likelihood.

Active shooters are for real. And although gun-control legislation may do little or nothing to stop unstable people from figuring out a way to hurt people in mass numbers, the attempt to dissuade them will still find its way through Congress.

We mention this because it has a lot to do with demographics and how we invest. We're always trying to assess trends. Some trends are very slow moving and take a long time to effect change. Some are a little quicker.

It's said that 10,000 people turn 65 years old every day. That figure may not be entirely accurate, but the point is that there are a LOT of people who are going to be needing more health care, go on cruises, live in assisted living centers, etc., etc.

These are the types of things, including potential gun control legislation that we think about when managing investment portfolios.

At BCWM, our defensive posture has helped us weather the August volatility rather well. We continue to have slightly lower equity allocations than usual and slightly higher fixed-income allocations. We don't think the decline in interest rates is over, although it may pause for a few months.

The "falling off a cliff" dive in interest rates this month has been rather spectacular. Investors may take a little while to digest that before rates begin the trek downward again.