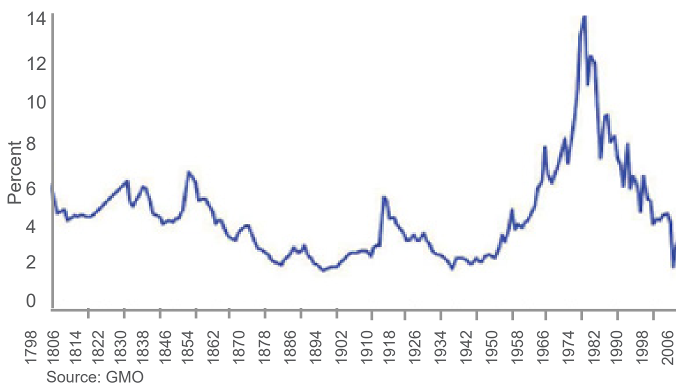
MitonOptimal

Weekly Comment | November 21, 2018

The big picture US Interest Rate debate

As we have been presenting and debating for over 20 years, the big picture discussion over US inflation / disinflation / deflation and then inflation again is clearly shown on any long-term chart of the US Bond Yield. The last time we had US 10 year interest rates at a cyclical low of around 2% was after the Second World War. A 30 year cycle of rising inflation from these low levels led to runaway inflation in the 1970's, eventually peaking at close to 14%.

10 year US Bond Yields from 1798

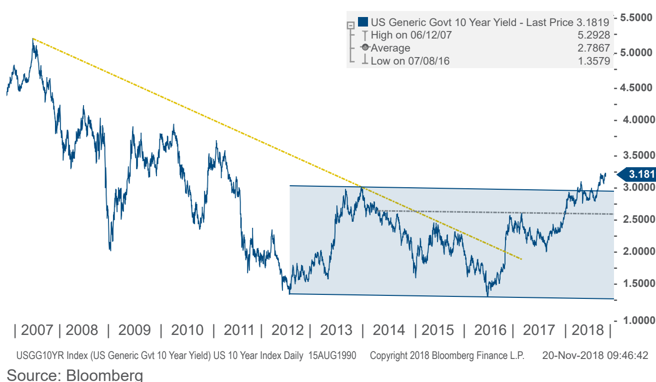


Source: GMO

This rising cycle started as a steady and gradual climb, reaching the more normal levels of 6-7% during the 1950's and 1960's.

This is the cycle we find ourselves in today. Comparisons with what happened in the great bond bull market of disinflation and ultimately deflation from the 1980's to the mid 2010's are meaningless and quite frankly pointless, unless looking at behavioural patterns. The long-term chart above shows some painful blow off phases in this rising interest rate environment in the late 1950's and then again in the mid 1960's.

10 year US Bond Yields, 2007 - 2018



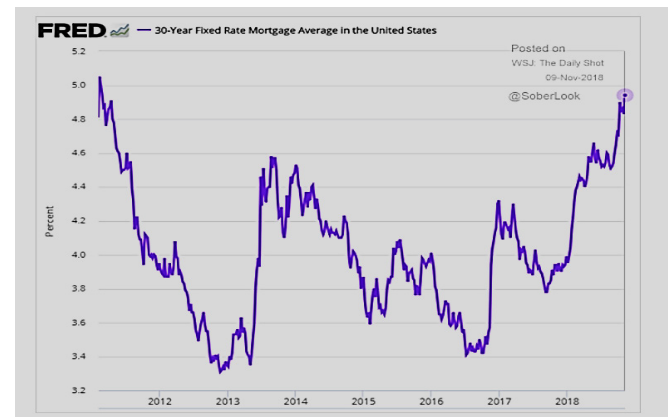
Source: Bloomberg

The gentle climb, and subsequent break of the current long-term bull market, in 10 year US interest rates has a very long way to go. Importantly, when these increases are gradual this is not disruptive for other asset classes but can become so, when volatility and painful blow offs occur. Which they will do.

As can be seen from the chart below, when 10 year interest rates rise, it's not just the Trump government that has higher interest costs. The chart shows 30 year mortgage rates in the US (which looks remarkably like the blue shaded area in the 10 year US Bond Yields, 2007 - 2018 chart) following the rising interest rate trend – which will have repercussions for the pricing of housing and other asset classes.

The executive summary is simple. In the longer term the only way to manage the vast swathes of global debt is by inflating it away. Not dissimilar to the WWII debt which was significant at the time. In the shorter term, gradual rising US interest rates that are well telegraphed is good for growth but will become unruly for markets in the blow off phases. Income investing must remain focused on floating / inflation protection and not locking into generational low long-term rates.

30 year Fixed Rate Mortgage average in the US



Source: Fred

SCOTT CAMPBELL
Group Managing Director and
Chief Investment Officer

www.mitonoptimal.com

This document has been issued by the MitonOptimal Group of companies. The content of this document is for information purposes only and does not constitute an offer or invitation to any person. The opinions contained in this document are subject to change and are not to be interpreted as investment advice. You should consult an adviser who will be able to provide appropriate advice that is based on your specific needs and circumstances. MitonOptimal's prior written consent must be obtained before the contents of this document are reproduced or communicated to any third party. The information and opinions contained herein have been compiled or arrived at from sources believed to be reliable and given in good faith, but no representation is made as to their accuracy, completeness or correctness. MitonOptimal's respective directors, officers, employees and associates may have an interest in the products, services or service providers occasionally referred to herein. The value of investments and the income from them may vary, and you may realise less than the sum invested. Past performance is not necessarily a guide to future performance and no guarantees are offered in respect of investment returns and/or capital invested. MitonOptimal Portfolio Management (CI) Limited (Registration No. 36763) and MitonOptimal Guernsey Limited (Registration No. 40985) are both registered in the Bailiwick of Guernsey and licensed and regulated by the Guernsey Financial Services Commission under the Protection of Investors (Bailiwick of Guernsey) Law 1987, as amended. MitonOptimal Portfolio Management (IOM) Limited is licensed and regulated by the Isle of Man Financial Services Authority (Registration No. 103941C). MitonOptimal UK Limited is registered in England and Wales (Company No. 09138865). Authorised and regulated by the Financial Conduct Authority. MitonOptimal South Africa (Pty) Ltd (Registration No. 2005/032750/07) & MitonOptimal Portfolio Management (Pty) Limited (Registration No. 2000/000717/07) are regulated in South Africa by the Financial Sector Conduct Authority (FSCA). MitonOptimal South Africa (Pty) Limited (FSP No. 28160) and MitonOptimal Portfolio Management (Pty) Limited (FSP No. 734) are authorised Financial Services Provider's (FSP's). MitonOptimal South Africa (Pty) Ltd and MitonOptimal Portfolio Management (Pty) Limited comply with all the requirements of the Financial Advisory and Intermediary Services (FAIS) Act (Act 37 of 2002). Full details on all companies within the MitonOptimal Group are available on our website (www.mitonoptimal.com).