THE OMNIVEST MARKET VIEW

Investments

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Bernanke - Needs to Taper Transparency

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Investors have become quite edgy in recent weeks following Fed Chairman Ben Bernanke's comment about tapering of asset purchases. Equities have sold off, Treasury yields have risen and spreads for corporate bonds have widened. Essentially, every asset class seems to have come under selling pressure. The Federal Reserve has clearly seen how quickly financial markets can re-price themselves from any hint of a change in monetary policy. Investors will be very keen to hear Bernanke speak on June 19th, following the Federal Open Market Committee (FOMC) meeting.

Certainly tapering will occur at some point, but it is unlikely to be realized in 2013. Bernanke will need to quiet the concerns in the market place that tapering of Quantitative Easing (QE) is right around the corner. If not, then more selling pressure across all asset classes should be expected.

The Bank of Japan (BoJ) is also contributing to investor uncertainty given the recent sharp increase in the value of the Japanese yen and subsequent decrease of the Japanese equity market. It appears that investors are willing to challenge the BoJ into taking action to arrest the appreciation of the yen and to temper the now 15% decline in the Tokyo Stock Price Index (TOPIX) since mid-May 2013. It's critical that the TOPIX finds stability soon given the emphasis that the government has placed on pushing investors out of Japanese Government Bonds (JGB's) and into the local equity market.

It is our view that investors will be well served by purchasing equities on dips and selling high quality fixed income assets such as Treasuries if and when these prices rise. Fixed income investors still need to be concerned about the Treasury curve steepening in a rising rate environment and the duration extension risk that still remains in the agency mortgage market.

High yield spreads have widened noticeably since mid-May without fundamental cause, creating an opportunity for risk tolerant investors. The fact that stock prices have gone down and interest rates across most market sectors have been rising suggests that indiscriminate selling pressure has taken place. Typically, market moves of this sort are short lived and are subject to sharp reversals. If the widening of spreads resulted in lower Treasury yields, we would have been very concerned. In other words the latest market correction has not been accompanied by a flight to safety.

Next Wednesday afternoon - June 19th, investors should expect Fed Chairman Ben Bernanke to present a more reasonable time frame to potentially begin a tapering process, and perhaps more color on the two boundaries that he has set for unemployment and inflation. A numerical target for the unemployment rate may need to include language that addresses the quality of job creation rather than just the quantity. If Bernanke's stance is strong (relative to the ongoing need for further QE), then this recent bout of market volatility may be put to rest.

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