# THE OMNIVEST MARKET VIEW

Investments

**Tom Sowanick**
Co-President
Chief Investment Officer
tom@omnivestgrp.com
Tel: +1 609 921 7939

**Eleni Athanatos**
eleni@omnivestgrp.com
Tel: +1 609 986 1001

## Bernanke's Testimony Unequivocally Dovish

**July 17, 2013**

Today Bernanke introduced financial conditions as another threshold for altering Quantitative Easing (QE). Implicitly, he's arguing that if employment conditions improve and inflation moves towards 2% but financial market conditions tighten, that QE may be maintained. Since May 21st (the day before Fed Chairman Ben Bernanke testified to Congress) long term Treasury yields have risen, credit spreads have widened and mortgage rates have increased. Taken together, financial conditions have tightened. By introducing the fact that financial conditions have tightened in the past six weeks suggests that tapering will not begin in September of this year.

Equity markets have recovered nearly all the lost ground that has occurred from May 21st to June 25th. In fact, on a closing basis, both the Dow and the S&P 500 Index have set new highs earlier this week. More importantly, volatility in the equity market has fallen sharply from its initial rise from May 21st to June 20th. Using the Volatility (VIX) Index as a measure of equity volatility, the initial spike during this period was a startling 53% increase (from 13.37% to 20.49%). The current level of volatility is 14.21%.

In the Fixed Income markets, the retracement has been quite slow and anemic and this is what is bothering Fed Chairman Ben Bernanke. Since May 21st, 10-year Treasury yields rose from a low of 1.93% to a high of 2.74% on July 5th and have since declined to 2.50% currently. Credit spreads are also wider with high yield corporate spreads 25 basis points (bps) wider than what prevailed on May 21st. Also, Investment grade spreads are 20 bps wider since May 21st.

Given that Bernanke has highlighted the tightening of financial conditions suggest to us that investors should look tactically to add to fixed income positions. More importantly, investors with a short term horizon should look to purchase longer term Treasury securities in anticipation of a decrease in bond market volatility. For example, 10-year yields currently at 2.5% could rally over the next several weeks to 2.2%.

Investors with a longer term outlook should look to the corporate bond market which has suffered from both rising yields and widening of spreads. In particular are the yields currently offered in the high yield bond market - still above 6.50%. By comparison, investment grade corporate bond market has an average yield of 3.35%.

In summary, Fed Chairman Ben Bernanke's dovish tone today should give investors comfort in knowing that tapering is further out the calendar than what was commonly thought a month ago. Thoughtful transparency by the Fed should also lead volatility lower which would favor owning risk assets.



OMNIVEST GROUP LLC