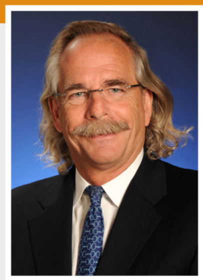
THE OMNIVEST MARKET VIEW



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Treasury Market Surprised Investors

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Investors who thought that they were buying US Treasury securities as a safe haven in advance of the Washington showdown and potential debt limit crisis have been unrewarded. In past crises Treasury yields have fallen on average by 40 basis points (bps) as measured by the 10-year Treasury note. Since the start of the crisis, 10-year yields are approximately 2 bps higher. This is clearly a rather surprising move by historical standards.

The lack of positive performance calls into question whether we have finally (and officially) entered into a rising interest rate cycle. If so, then investors looking for a return to lower yields in order to exit from underwater positions may want to consider having an exit strategy, even if interest rates are rising.

Investors are in the process of assessing how much interest rates will rise once the Fed starts tapering. While this assessment is difficult at best, investors should brace for 10-year yields to move closer to 4%, as opposed to recent highs closer to 3%, once the process begins in earnest.

In short, the notion that the Federal Reserve will hold the Fed Funds rate at or near 0% may prove false. The risk that the Federal Reserve begins to normalize the Fed Funds rate will change considerably once Fed Chairman Ben Bernanke leaves the Fed at the end of January 2014. This doesn't mean that the Fed will begin to raise rates in early 2014, but with change to the composition of the FOMC (Federal Open Market Committee) a new level of uncertainty will likely be priced into the market in the form of higher rates.

We also know that the zero interest rate policy (ZIRP) (subscribed to by several Central Banks) has significantly altered the valuation of financial assets, in particular sovereign debt that has benefited from the almost free cost of carry trades. We have seen the impact of the unwind of carry trades in emerging markets when the Federal Reserve first started to talk about tapering in May. The unwinding process will become even more pronounced once the tapering starts and investors begin to anticipate a shorter window to the rise of Fed fund rates.

Since investors are a collective of anticipators that take actions which drive markets, it is even more important to rely on price action rather than Central Bank statements. It is our belief that the lack of a Treasury rally over the past week is a very strong indicator to investors that we may have already seen the barn door close on lower interest rates.

Conversely, the resiliency of the equity market over the past week is sending a message that there is pent up demand to buy stocks on dips. The divergence in demand for stocks and bonds is becoming quite large and should continue to gain pace. We have seen large outflows from large bond mutual funds over the past several weeks and this too should gain more momentum in the weeks ahead.

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