THE OMNIVEST MARKET VIEW

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Time to Prepare for the Unlikely

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Most fixed income investors have not experienced what is likely in store for them over the next two years. It has been 55 years since the 10-year Treasury posted two consecutive years of negative total return. The last time was 1958 and 1959 when the total return was -2.10% and -2.65%. The only other time that the 10-year Treasury had a negative total return in two consecutive years was in 1955 and 1956.

Year-to-date, the 10-year Treasury has lost 7.62% with yields rising from 1.76% to 2.87% currently. Unless the economy begins to falter, it is quite likely that the poor 2013 results will be followed by an equally poor 2014. We think it is fair to say that most investors are ill prepared for two consecutive years of negative total returns.

	10-Year Treasury Yields		Total Return	S&P 500 Index Total Return
	12/31/1954	**12/31/1955**		
1955	2.51%	2.96%	-1.34%	31.56%
	12/31/1955	**12/31/1956**		
1956	2.96%	3.59%	-2.26%	6.56%
	12/31/1957	**12/31/1958**		
1958	3.21%	3.86%	-2.10%	58.00%
	12/31/1958	**12/31/1959**		
1959	3.86%	4.69%	-2.65%	43.46%
	12/31/2012	**YTD**		**YTD**
2013	1.76%	2.87%	-7.62%	17.55%

Source: *St. Louis Federal Reserve & Bloomberg*

Regardless of whether the Federal Reserve begins to taper or not, investors in the fixed income market need to understand that ultra-low interest rates can only result in pain when interest rates begin to normalize. In the table above, we illustrate previous periods when interest rates began to rise and the impact on total return for both fixed income and equity investors. And though history may not be a useful guide, it does present an interesting picture as to how stocks have performed in past rising rate environments.

The fact of the matter is that low interest rates always lead to negative total returns. If we look at a 12-month forward horizon for the 10-year Treasury note, yields would only have to rise to 3.29% to produce a negative total return, a level that is clearly a short distance away from where we are presently.

Hopefully investors in the fixed income market will get the opportunity to move out of low yielding securities, at a better price level, over the next several weeks. August employment data, an FOMC meeting, the Syria conflict, budget wrangling and debt ceiling debates are all events that can influence the fixed income market in the period immediately ahead. Of course, equity investors should remain mindful of increased volatility during this period as well.