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Tarheel Advisors Newsletter

As the Yield Turns

Yes, it's that time of the year where Ryan writes a boring article about interest rates. I'll let you pause a moment and decide whether to continue to read or turn the page (joke's on you, more is on the back).

Great! You stayed around and clearly are a glutton for punishment, or maybe you're just tired of the 0% interest rate attached to your checking account. Well, if you're the second camp, I have some great news for you: cash has a positive rate of return again!

Nearly a decade ago the Federal Reserve dropped its target lending rate down to 0-0.25%. While this helped support the economy during the "Great Recession," it also effectively killed off any returns to be had in the short-term fixed income market.

Fast forward nine years to today, and after a couple of recent rate hikes cash has a return hovering around 1%. While it isn't the more exciting 3-4% we grew accustomed to in the early 2000s, at least it is a whole number.

What does this mean from a financial planning standpoint? First of all, you need to monitor and review where your cash is sitting again. The era of 0% rates lasted so long that most people stopped shopping around for better rates on their cash. This complacency could cost you moving forward.

Currently, short-term treasuries and investment grade corporate bonds are yielding around 1.1% These are the securities that money market funds invest in. So, you should be shopping for a similar rate of around 1% in your savings accounts.

The interest rate story gets a bit more complicated as you look further down the road. If you listen to media pundits, you might be hearing that interest rates are rising, but this has only been the case in short-term rates.

The 30 year treasury bond yield spiked upward to 3.2% shortly after the Trump election, but has since dropped as low as 2.7%. As you can see from the yield chart below, the differential between a 30 and 5 year treasury is less than 1%. So, for 25 years of interest rate risk you are only being rewarded with a 0.9% increase in annual return. In the fixed income world we call this a flat yield curve.

You're probably wondering why anyone cares about a flat yield curve. The good news is that since the recent increases have only impacted the short-term interest rates, the continued historically low rates on the long end of the curve are keeping mortgage rates down. Thus, home prices and mortgage financing remain amenable and companies can continue to finance their operations and spur growth at a reasonable borrowing rate.

Of course you know that sometimes bad news follows the good news. A flat yield curve is typically indicative of a stalled economy.

Instruments	3MO	6MO	9MO	1YR	2YR	3YR	5YR	10YR	20YR	30YR+
CDs										
Fixed Rate New-Issue Non-Callable	1.256	1.354	1.402	1.500	1.700	1.850	2.300	2.600	----	----
Fixed Rate New-Issue Callable	----	----	----	----	1.700	1.850	2.300	3.000	----	3.250
Stepped-Rate Coupon	----	----	----	----	----	----	2.599	2.042	----	----
BONDS										
U.S. Treasuries	1.029	1.174	1.244	1.352	1.486	1.620	1.988	2.365	2.706	2.913
U.S. Treasury Zeros	----	0.930	1.139	1.295	1.468	1.611	2.022	2.509	2.881	2.968
Government Agencies	1.019	1.246	1.294	1.453	1.656	1.851	2.639	3.099	3.464	3.708
Corporates (AAA)	----	1.119	1.155	1.372	1.548	1.581	----	2.924	3.495	4.247
Corporates (AA)	----	----	1.260	1.540	1.583	1.997	2.298	3.687	3.790	4.677
Corporates (A)	0.886	1.475	1.413	1.720	2.056	2.226	2.678	3.793	4.310	5.146
Municipals (AAA)	----	0.718	1.130	1.298	2.529	1.852	2.403	3.112	3.533	3.544
Municipals (AA)	----	1.813	1.347	1.564	2.949	3.215	3.479	3.696	4.642	4.687
Municipals (A)	0.535	1.813	1.347	2.946	2.949	3.465	3.479	3.938	4.865	5.008

Source: Charles Schwab 7/5/2017

2017 Market Update

S&P 500 **+9.34%**

DOW **+9.35%**

RUSS 2000 **+4.99%**

MSCI World **+12.82%**

BONDS **+2.27%**

GOLD **+7.9%**

Mortgage Rates

15-Year **3.09%**

30-Year **3.88%**

5/1 ARM **3.37%**

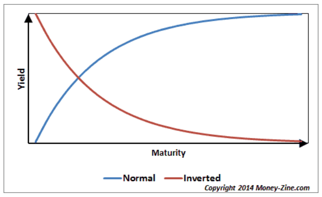
Did You Know?

* Please welcome Austin Sellers, our Summer Intern!

Austin is a student-athlete at UNC, where he competes on the swim team. He is from Tampa, Florida, and is looking to gain some real world financial experience while completing his studies and training. Austin is currently pursuing an area of emphasis in Investment Management at the Kenan-Flagler Business School. Please welcome him and support him as he gives us his summer time to help us and our clients.

As the Yield Turns, Continued...

What is worse is that a flat yield curve can be a precursor to an inverted yield curve, where long-term borrowing rates are actually lower than short-term rates. This phenomenon is fairly rare, but it has been a strong harbinger of an imminent recession whenever it has appeared in the past.



The real challenge right now is figuring out where longer term interest rates head from here. While most think rates will increase from here, we are bucking conventional wisdom and think we will see the 30 year treasury hit 2% before we see it hit 4%. The Pandora's box of global 0% interest rates (and even negative in a few major countries) is wide open now. Despite many in the United States wanting the box closed, my feeling is that during the next stock market correction we will see long-term US interest rates hitting new lows. Nobody knows when the next correction will occur, but it certainly seems like we are overdue for at least a moderate pullback before year's end.

\- **Ryan Glover, CFP®**

Bitcoin: Hype or Hope?

Everybody wants to be the next one that benefits off a penny stock skyrocketing in value. Everyone wishes they could've predicted Bitcoin's rise from its humble beginnings in April 2010 of $0.003 to peaking at $3,000 on June 12th. Three years ago, Ryan wrote about the new fad in Bitcoin, which you can view here: http://www.tarheeladvisors.com/newsletters/July%202014.pdf. However, despite the glitz and glamour, Bitcoin has too many concerns to make it a serious investment.

In a short two day span from March 26-27, Bitcoin's price dropped an astounding 33% from $2,760 to $1,850. This wasn't a onetime occurrence, however, as Bitcoin reached an all-time high of $3,000 on June 12th and subsequently dropped to $2,316 just three days later (a 23% decrease). Bitcoin's volatility makes it more of a speculative asset than a currency, and should be regarded as such by those considering investing. Bitcoin will not be a safe asset until enough time has passed allowing it to stabilize its worth.

One of the greatest allures of Bitcoin is that it's not backed by a government, which allows its users to remain somewhat anonymous. If governments around the world declared Bitcoin to be a legal currency, Bitcoin exchanges would have to comply with anti-money-laundering regulations. Government involvement would reduce the prized invisibility which could lead to diminished appeal for Bitcoin resulting in plummeting value. The fad of being anonymous may not be permanent, and it is only a matter of time until laws are established to remove anonymity or ban the currency altogether.

Just because something has an upward trend in trading value doesn't mean it'll last forever, and it certainly doesn't mean you're ahead of the curve if you want to jump on the bandwagon now. People might understand a general concept of Bitcoin and cryptocurrency, but they might not understand the larger implications of how it's challenging monetary theory. On top of being mysterious, there isn't any reasonable way to invest in Bitcoin other than through risky no-name exchanges.

The risk associated with a Bitcoin investment is substantial and disproportionate when compared to the potential reward. Don't invest in something if you don't know what it is.

The three points previously stated about Bitcoin's price volatility, anonymity, and mysteriousness all are due to one encompassing principle: Bitcoin is not real. Bitcoin is an online currency which you cannot hold in your hand. Its value is based entirely on your trust in the algorithm, the exchange, and the willingness of the market to accept it. Dana Blakenhorn of Investor Place says, "Complain all you want about the ease with which the Federal Reserve creates dollars. You can create your own crypto-currency, today, using the PC in front of you, which becomes real as soon as someone is willing to create, or mine, and trade the resulting encryption keys." Bitcoin's value can fall as fast as it rises.

In my opinion, Bitcoin's drawbacks make it a logical comparison to your odds of profiting off gambling in Vegas. Would you trust risking your life savings at a casino? **-Austin Sellers**

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