TREASURY | PARTNERS

Corporate Cash Alert

Slowing and Steady Wins the Race?

June 14, 2019

Recession fears and trade concerns grip the markets while the Fed has pivoted to a more dovish stance. In response, short-term rates have plummeted and tipped the yield curve into inversion for the first time since the financial crisis. Are markets overreacting or consistent with the data? Read on for our current thoughts.

Richard Saperstein
Managing Director/Principal
+1 917-286-2777
rsaperstein@treasurypartners.com

Jerry Klein
Managing Director
+1 917-286-2790
jklein@treasurypartners.com

Daniel Beniak, CFA
Director
+1 917-286-2783
dbeniak@treasurypartners.com

treasurypartners.com

Timing is Everything

In our previous Corporate Cash Alert (***2019 Corporate Cash Outlook: It's Time to Extend***, 12/21/18), when we called for extending maturities, market conditions were markedly different from today:

- Short term rates were at or near post-crisis highs
- The Treasury yield curve was upward sloping
- Corporate credit spreads gapped wider (reminiscent to the last major move in December 2015). See the chart below.

1 -3 Year Investment Grade Corporate Credit Spreads

In Basis Points

Source: Bloomberg (Bloomberg Barclays US Corporate 1-3 Year Total Return Index)

Given these conditions, our view of a slowing but growing economy, and our expectations of a benign Fed, *we declared it an opportune time to extend maturities to capture attractive yields and spreads*. Specifically, we advised deploying portfolios out longer (e.g. 2-3 year maturities, if applicable), using barbell structures to bring durations and weighted-average maturities ("WAMs") near the maximum permitted.

However, all of these factors have now shifted:

- Absolute yields in all maturities 3 years and in have fallen
- The front-end of the Treasury curve is fully inverted

Maturity	Treasury Yield As of 12/31/18	Treasury Yield As of 6/10/19	YTD Change
3 Mo	2.38%	2.26%	**-0.12%**
6 Mo	2.53%	2.19%	**-0.34%**
1 Year	2.64%	2.04%	**-0.60%**
2 Year	2.63%	1.90%	**-0.73%**
3 Year	2.62%	1.87%	**-0.75%**

Source: Bloomberg

- 1-3 year Investment Grade ("IG") corporate spreads have retraced back down, undoing most of the Q4 spike

Obviously, the downward shift in rates and spreads vindicates our positive "it's time to extend" outlook during the Q4 market chaos. But what are we advocating in the current environment?

Much of the rate declines can be attributed to the Fed's dovish pivot, which caught many investors off guard due to how swiftly and suddenly Fed Chairman Powell walked back his hawkishness. In addition, the market has also digested the Fed's announcement its balance-sheet runoff will end prematurely in September.

These dovish leanings have been further amplified by trade war fears, the potential for headwinds from tariff-related supply-chain disruptions, and the fact that inflation still remains frustratingly subdued. Moreover, the relentless global low-rate environment (still featuring trillions in negative-yielding developed sovereign debt) makes US interest rates seem high by comparison.

As a result, the bond market has reacted by pricing in the equivalent of 2 full rate cuts before the end of 2019 and 3 cuts over the next year – clearly indicating a consensus that the economy is barreling towards recession.

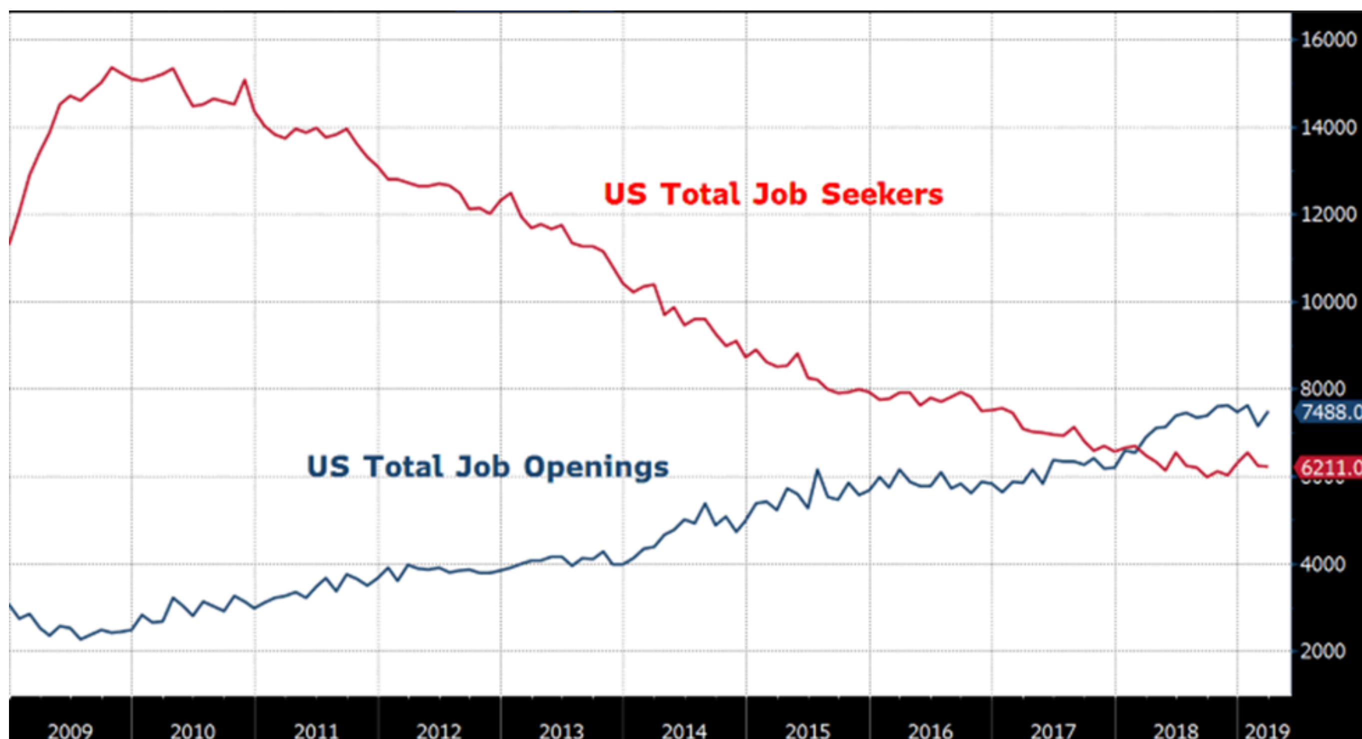
We Disagree

The fact is that we really haven't seen any unexpected deterioration in economic fundamentals:

- Unemployment remains at cycle lows, the 3 month moving average of payroll growth is still healthy, and the number of job openings continues to outstrip the number of unemployed workers

US Total Job Seekers vs. Job Openings

In Thousands



Source: Bloomberg

- While corporate earnings growth has no chance of matching 2018's tax cut-aided 20%+ YoY increase, an unspectacular but still-positive 2-3% YoY gain remains the market consensus following the conclusion of Q1 earnings season.
- ISMs and consumer sentiment readings have moderated considerably off their 2018 highs but are still signaling expansionary activity
    - There's no sign of trade war-induced problems for now, although the situation bears close monitoring
- Although inflation remains low and stable, most measures of headline and core inflation are printing at or near the Fed's 2% target – i.e. nowhere near a deflationary level
- The global macroeconomic picture is clearly deteriorating (particularly in Europe), but there's no compelling reason to believe the malaise will spread to the US economy

In short, slowing growth doesn't mean the US expansion is over. Obviously a lower growth rate provides less "runway" to weather the inevitable headwinds that emerge over time (e.g. additional China tariffs). But unless and until the negative effects begin to demonstrably outweigh the positive news in the economic data, there's no reason to assume a worst-case outlook.

Treasury Partners View

Our previous portfolio recommendations require some modifications to account for the lower rates and inverted curve.

We believe the worst-case scenario already priced into the market is overdone, reflecting a forecast that's appropriate for an impending recession rather than the much-more likely probability of a continuing expansion (albeit at a slower pace than prior years). Rather than 3 rate cuts over the next year, our base case is the Fed may cut once in July/September (and potentially remains neutral), unless presented with clear and convincing evidence we're headed into a recession..

Our advice is different for those clients who followed our call to extend in December vs. those who didn't or have new liquidity to deploy:

- For those portfolios with weighted average maturities ("WAMs") at or near their limits, focus on reinvesting to maintain the portfolio's current average life, as the best opportunity for extending maturities has passed for this portion of the cycle.
- For clients who didn't extend or who have significant new money to invest, we're creating laddered maturities
    - With an inverted curve and spreads near a trough, it's not the time to radically extend WAMs or durations: maintain flexibility to extend in the future if opportunities arise.
    - But importantly, we're not stacking the liquidity portion of the portfolio in the event our outlook grows negative; as we stated earlier, slower growth means less "runway" to deal with emerging headwinds.

Patience is key at this juncture – the bond market strikes us as unduly pessimistic. We're keeping our eyes on credit spreads, Fed policy and global developments before making any further strategy shifts.

Disclosure

Treasury Partners is a team of investment professionals registered with HighTower Securities, LLC, member FINRA and SIPC, and with HighTower Advisors, LLC, a registered investment advisor with the SEC. Securities are offered through HighTower Securities, LLC; advisory services are offered through HighTower Advisors, LLC.

This is not an offer to buy or sell securities. No investment process is free of risk, and there is no guarantee that the investment process or the investment opportunities referenced herein will be profitable. Investors may lose all of their investments. Past performance is not indicative of current or future performance and is not a guarantee. The investment opportunities referenced herein may not be suitable for all investors.

Treasury Partners has obtained all data and other information referenced herein from sources believed to be reliable. Treasury Partners and HighTower shall not in any way be liable for claims, and make no expressed or implied representations or warranties as to the accuracy or completeness of the data and other information, or for statements or errors contained in or omissions from the obtained data and information referenced herein.

The data and information are provided as of the date referenced. Such data and information are subject to change without notice.

This document was created for informational purposes only; the opinions expressed are solely those of Treasury Partners, and do not represent those of HighTower Advisors, LLC, or any of its affiliates.