LOM OFFSHORE FINANCIAL SERVICES

Monthly Global Market Commentary
February 5, 2018

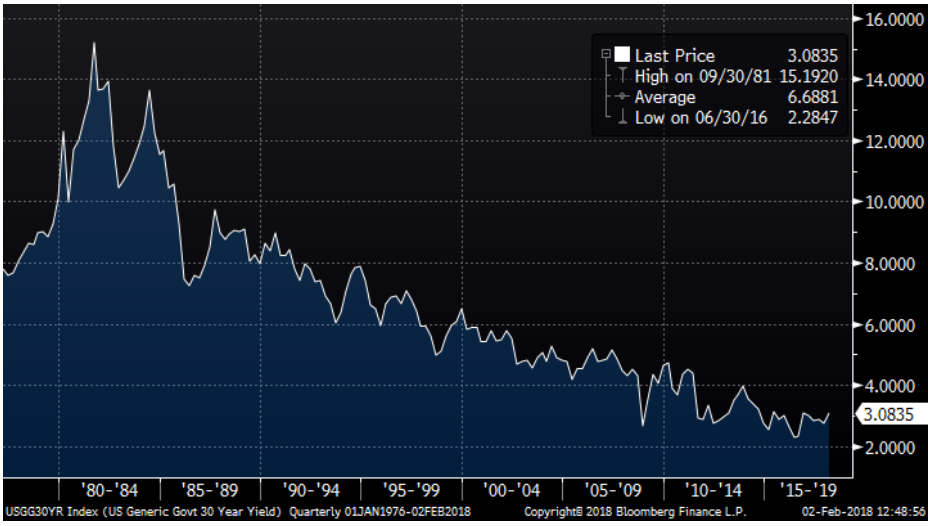
Rising Rates Scare Markets
By Peter Goodall

Global markets fell last week on news of rising interest rates. The S&P500 (SPX Index) fell 3.82% while the MSCI World Stock Index (MSDUWI Index) was down 3.44%. We saw continued selling on Monday.

United States

In his State of the Union speech last week, President Trump announced that "employment claims have hit a 45-year low" and that "black unemployment is at the lowest rate ever recorded." Both of these statements are true. The jobless rate stayed at 4.1% and hourly pay may have increased 0.2% month over month. Nonfarm payrolls, a Bureau of Labor Statistics metric tracking US employment, showed 200,000 jobs created in January, beating expectations of 180,000. We have also seen upward revisions of weaker December data (revisions are common as some data is late arriving) and we are in the middle of strong fourth quarter earnings reporting season. So why were the markets down last week?

The largest driver appears to be rising interest rates. The strong economy increases the likelihood that the Federal Reserve will continue to raise interest rates and higher bond yields could finally give investors an alternative to buying stocks. In the meantime, the Federal Reserve has a dual mandate of balancing unemployment and inflation, which they do by manipulating interest rates with monetary policy. With fiscal stimulus coming from Congress, the Fed presumably has more breathing room to normalize policy without crashing the market. The below chart shows 30 Year Treasury Rates (USGG30YR) over the last 40+ years. The yield on 30-year Treasury bills broke 3%. The historical average is 5%.



The recent uptick in rates is technically significant and may ultimately mark the end of an extraordinary era in US monetary policy (at least until the next crisis). As CFA Charterholders, we are taught to view interest rates as a combination of risk premiums:

Interest Rate = Risk Free Rate + Inflation + Maturity Risk + Default Risk + Liquidity Risk + Tax Premium

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The Federal Reserve rate is commonly viewed as a proxy for the risk-free rate. As the benchmark Federal Funds rate rises, it will affect other loans, like your car or mortgage. For corporations with revolving credit facilities, they will start seeing higher interest payments. This will likely offset some of the benefits from the Trump tax cuts.

For bonds, raising interest rates may also result in lower prices. Imagine you have a bond that pays $5 for every $100. If a new bond is issued paying $6 per $100, the price of the $5 bond will drop to make the buyer indifferent between the two. As a firm, we anticipated this change and repositioned part of our portfolio into floating rate notes which periodically adjust, protecting your securities against some of the risks associated with higher interest rates.

Cryptocurrencies

Bitcoin experienced its worst week in 3 years following several government crackdowns on the cryptocurrency exchanges. Notably, South Korea's Justice minister, Park San-Ki, was quoted saying there "are great concerns regarding virtual currencies and the justice ministry is basically preparing a bill to ban cryptocurrency trading through exchanges." Coinone and Bithumb, the nation's largest cryptocurrency exchanges, have been raided for alleged tax evasion. Authorities appear to be treating this as a bubble. They are concerned that the rise in use of cryptocurrencies, which are relatively popular in South Korea, will lead to a spike in crime. This has been met with some public backlash within South Korea.

While the $500M Coincheck heist is in recent memory, Bitcoin has experienced a number of hacks within the past few years. If you are interested in learning more about the history, there is a great article by Timothy Lee in ArsTechnica (https://arstechnica.com/tech-policy/2017/12/a-brief-history-of-bitcoin-hacks-and-frauds/).

Conclusion

At LOM, we invest for the long run. It is easy to get caught up in the panic but remember the recent drop in prices means that securities are on sale. Dollar-cost averaging, diversification and goal-oriented investing will help you outperform the average investor over the long run.

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Stock Market Performance

	2/5/18	W-o-W	M-o-M	Y-o-Y
DJIA	24,982	-5.5%	-1.2%	24.5%
S&P 500	2,714	-4.9%	-1.0%	18.1%
MSCI World	2,172	-2.8%	0.7%	20.3%
S&P/TSX	15,468	-3.9%	-5.4%	-0.1%
BSX	2,314	0.3%	6.3%	16.5%
FTSE100	7,335	-4.4%	-5.0%	2.0%
DAX	12,687	-4.8%	-4.7%	8.9%
CAC	5,286	-4.3%	-3.4%	9.5%
Nikkei	22,682	-4.0%	-4.4%	19.9%
Hang Seng	32,245	-2.2%	4.6%	39.4%
Shanghai	3,487	-1.0%	2.8%	11.1%

Key Rates and Prices

Currencies	2/5/18	Month ago	Year ago
EUR	$1.24	$1.20	$1.08
GBP	$1.40	$1.36	$1.25
JPY	¥109.82	¥113.05	¥112.61
CAD	$0.80	$0.81	$0.77
CHF	$1.07	$1.03	$1.01
AUD	$0.79	$0.79	$0.77
Fixed Income			
3M LIBOR	1.79	1.70	1.03
3M Treasury Bill	1.49	1.40	0.50
2Yr Treasury Note	2.09	1.96	1.20
10Yr Treasury Note	2.80	2.48	2.47
Fed Funds Rate	1.50	1.50	0.75
Commodities			
Gold/oz.	1,334.49	1,319.35	1,220.20
Silver/oz.	16.72	17.13	17.51
Copper/lb.	3.20	3.23	2.62
Oil	64.00	61.44	53.83

Global Economic Calendar (February 5th — February 9th)

Tue: International Trade (US)
Wed: EIA Petroleum Status (US), FOMC Minutes (US)
Thurs: Jobless Claims (US)
Fri: Baker-Hughes Rig Count(US)

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