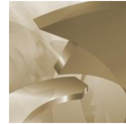

Economic and Market Insights
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U.S. Long-term Treasuries Near Record Lows – What It Tells Us About The World Economy Post-Brexit

Many were relieved last week to see the U.S. equity markets recover quickly from the impact of Britain's referendum to exit the European Union (EU). It almost seemed too easy. But now the bond market is telling us a different story than the stock market, signaling the "exit" might not be all that simple.

And we should listen.

While you may have been focusing on the stock market rebound, you would have also been well served to keep an eye on key U.S. Treasury bond yields. The U.S. 10-year and 30-year Treasuries are at historic lows and look to remain there for some time.

Why this sudden downward pressure on U.S. Treasury yields? The British decision on June 23 to depart the EU certainly had an unsettling influence on the world's financial markets and has likely put U.S. Federal Reserve policy on hold, pushing the timing of a second rate hike almost indefinitely into the future. The futures market signals this hike won't come until late 2017 or early 2018, while the majority of economists are more optimistic still thinking we might get one hike in by year-end.

And while the United States wrestles with the idea of raising rates, central banks around the world are now considering the other direction: more easing measures. Some countries are wondering where to go from here after already having ultralow or negative interest rates in place. The world is running out of monetary ammunition. As a result, some countries will move in and out of the economic spotlight as banking blunders come to light. This week, Italy is back on the front pages, stricken with sour loans throughout its banking system. As we worry about the EU effectively holding together, the markets wonder what country will be next to rock the confidence of financial asset investors.

As these eurozone tensions play out, the nations of the world are snapping up our, comparatively speaking, very attractive Treasury bond yields. The weighted average rate of all non-U.S. developed markets government debt (an 8.6-year average maturity) yields just 0.39%. Our comparable maturity Treasury bond yields 1.32%. As investors look for safe assets, ours are still cheap, keeping downward pressure on our interest rates.

And how low are our rates today? The 30-year Treasury yield is about 2.16%. This and other longer-end Treasury yields are now in general at historic lows. And Monday's intraday 10-year-yield low of 1.3770% takes out the old record low that was set back in July of 2012 during the Greek debt crisis.

What does this mean for you as an investor? Practically speaking, finding a safe haven for uninvested cash just got more difficult once again. Returns on the Lipper Government bond fund index for the first half of the year are a strong 4.10%. But most of these returns have been brought about by bond price appreciation. Going forward things won't be getting any easier as yields are now lower and the Fed rightfully has cold feet for raising short-term rates in a sluggish environment.

Mix in the stronger dollar against international currencies, which makes our exports more costly to sell abroad and reduces corporate profit, gold prices that are breaking through to short-term highs and continued concerns about expensive valuations for our own stock market, and our equity markets look less comforting as well. Throw in some worry about our own economy marked by the recent slowdown in hiring, geopolitical uncertainties, Goldman Sachs' recent call for a UK recession and a still-contracting economy in China, and it's tough to love the foreign stock markets as well.

Given that the Brexit issue could become contagious and that the U.S. market recovery is now seven years old since the Great Recession, we continue to expect lower asset returns for the foreseeable future. This has kept us a little more defensive, with an overweight recommendation to bonds, even with rates so brutally low. Oddly enough, they could still go lower as these global market forces shake out.

Takeaways:

- A global flight to safety is spilling over into U.S. Treasuries, which oddly enough remain cheap compared to other government bonds.
- These lower rates are reflective of a worldwide slowdown.
- The Brexit issues still have a long way to play out.
- Watch for contagion of Brexit issues to spread to other countries, while some international opportunities will actually present themselves along the way.
- Talk to your investment advisor and rebalance to your investment portfolio allocations if necessary.

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