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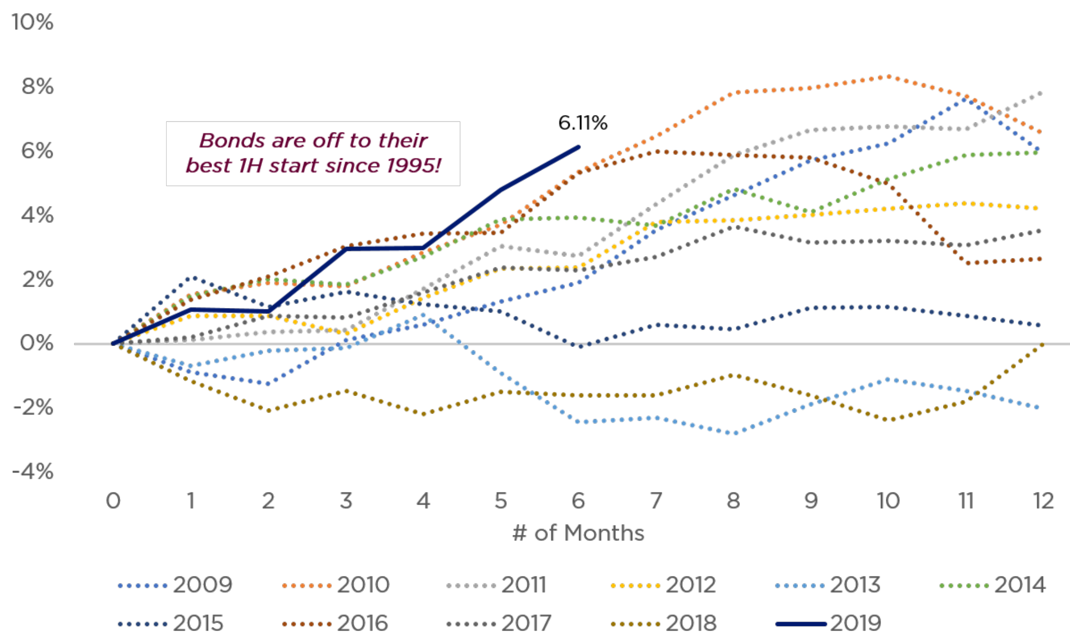
# BOND iQ
## Intra Quarter Update

## Raise Your Hand if You Predicted Double Digit Bond Returns Last Summer

What a difference a year makes. Looking back to last summer, most of our conversations revolved around the fear of rising interest rates. This time last year, the 10-year Treasury yielded over 3.0%, and markets were predicting the Fed would continue to raise interest rates into the foreseeable future. Fast forward to today, and the 10-year Treasury yields just 1.56% - a cool 168 basis points below its November 2018 peak – helping to push trailing twelve month returns on the Bloomberg Barclays AGG into double digit territory. Just as quickly as bond yields made an about face, so too has investor sentiment. Fear of rising rates has evolved into fear of missing out on the rally. So, the current question investors seem to be grappling with is, **"Now that bonds have rallied so much, where do we go from here?"** .




While it's always challenging to predict the direction of interest rates, we do believe that economic fundamentals justify a new, lower range for interest rates. Most notably, tariffs on Chinese imports have led to slowing manufacturing activity and souring business sentiment. To make matters worse, the next round of tariffs set to take effect on September 1st turns decisively toward consumer goods like cell phones, footwear, apparel and toys. As the breadth of the trade war spreads, so will the economic impact. While we don't believe that the Fed is in the midst of a prolonged easing cycle just yet, the market is well justified in pricing two or three additional rate cuts by the end of this year. In this type of environment, we believe that there is additional downside for longer term rates. In the event the economic picture continues to darken, it's not unreasonable to think that rates could end up back at (or even below!) 0.0%. At the other extreme, should the Trump Administration make an abrupt compromise on its negotiations with China, the top end of the Fed Funds target range should keep longer term rates contained at around 2.25%. In order for longer term rates to rise much above that level, investors must assume that the Fed makes another abrupt pivot back to tightening monetary policy once again – an unlikely move considering persistently low inflation and negative global term premiums. While investors should not hold their breath expecting an encore presentation of double-digit bond returns, fear of higher rates and negative returns is not warranted either.

Most importantly, however, we believe it's crucial that investors keep in mind the role that fixed income plays within diversified portfolios – to provide stability and protection especially during periods of economic and market stress. As the economic cycle ages, and trade pressure intensifies, we believe that our "Quality Yield" approach will continue to offer the stability and consistency that our clients have come to expect.

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