August 2019 – Spooky Boo Bills and Negative Danish Mortgage Rates

While it is never good to state a market is panicked, global bond markets and interest rates are certainly behaving that way. And that is what makes today's global financial markets so volatile and atypical. In the past, violent and rapid equity market selloffs have led to significant bond market rallies and lower interest rates. Today, the opposite is occurring. Global interest rates are hitting new lows causing fears of a global recession.

For example, frightened investors last week paid €100.37 for a German Treasury Bill (known as a "Bubill") that matures six months later at €100[1]. In other words, investors paid the German government 37 cents – or a negative 0.7% yield -- to hold their money for 190 days. In Denmark, homeowners can take out mortgages with negative yields. Yes, negative yields. For 10 years, Danish homeowners can have a mortgage with a fixed rate of negative 0.5%.[2] You are probably unfamiliar with the Danish mortgage market. We are not (note: In the 1998 financial crisis one of us flew to Copenhagen to meet with Danish bankers; after the 2008 U.S. housing crisis we advocated the U.S. adopting a Danish style mortgage market to replace Fannie Mae and Freddie Mac). It is the world's oldest and perhaps best mortgage market.

If you travel south from Copenhagen and head to Zurich or Geneva, the 2064 Swiss government bond yields negative -0.60%. Head over the Alps for some sumptuous Sacher Torte and a 100-year Austrian bond (OK, it matures in 2117) that yields a positive 0.60%.[3] In Japan, all government bonds that mature within the next 20 years have negative yields.

Interest Rates in the *Developed* World

As of 8/14/2019

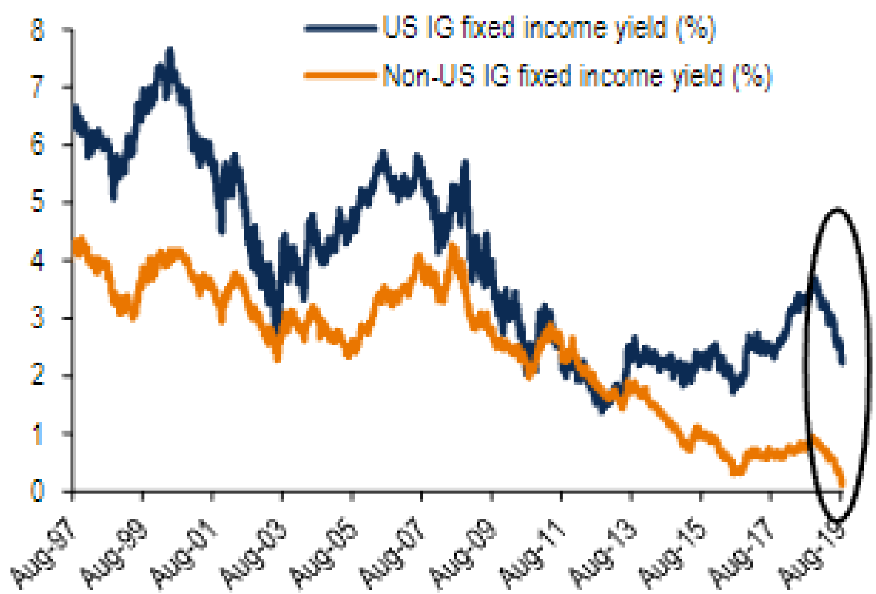
Country	Policy Rate	6-Month	1-Year	2-Year	3-Year	4-Year	5-Year	6-Year	7-Year	8-Year	9-Year	10-Year	15-Year	30-Year
Switzerland	-0.75	-1.16	-1.12	-1.12	-1.13	-1.12	-1.12	-1.10	-1.08	-1.08	-1.13	-1.03	-0.80	-0.52
Germany	-0.40	-0.75	-0.79	-0.88	-0.94	-0.92	-0.87	-0.87	-0.83	-0.78	-0.71	-0.65	-0.51	-0.18
Netherlands	-0.40	-0.81		-0.86	-0.89	-0.87	-0.81	-0.74	-0.70	-0.63	-0.58	-0.52	-0.40	-0.16
Sweden	-0.25	-0.50		-0.65		-0.71	-0.68	-0.61		-0.53	-0.44	-0.33	-0.17	
Denmark	-0.65	-0.75		-0.88	-0.90		-0.88	-0.83		-0.74		-0.60		
Finland	-0.40		-0.76	-0.81	-0.81	-0.78	-0.75	-0.65	-0.61	-0.51	-0.47	-0.38	-0.20	0.06
Japan	-0.10	-0.22	-0.23	-0.28	-0.28	-0.30	-0.31	-0.33	-0.34	-0.33	-0.28	-0.23	-0.05	0.19
Austria	-0.40		-0.71	-0.79	-0.79	-0.77	-0.71	-0.66	-0.57	-0.55	-0.49	-0.39	-0.13	0.19
France	-0.40	-0.71	-0.71	-0.78	-0.82	-0.81	-0.74	-0.67	-0.60	-0.52	-0.45	-0.37	-0.06	0.47
Belgium	-0.40	-0.80	-0.72	-0.78	-0.80	-0.74	-0.66	-0.61	-0.54	-0.46	-0.39	-0.32	-0.04	0.53
Ireland	-0.40		-0.64		-0.63	-0.61	-0.55	-0.42	-0.34		-0.20	-0.09	0.22	0.74
Spain	-0.40	-0.53	-0.50	-0.52	-0.51	-0.38	-0.31	-0.19	-0.09	-0.03	0.05	0.15	0.56	1.03
Portugal	-0.40	-0.55	-0.53	-0.60	-0.45	-0.33	-0.28	-0.13	-0.07	-0.02	0.10	0.18	0.52	1.04
Italy	-0.40	-0.21	-0.06	0.12	0.52	0.69	0.96	1.00	1.23	1.29	1.31	1.58	2.07	2.59
United Kingdom	0.75	0.73	0.55	0.47	0.36	0.36	0.35	0.31	0.34	0.38	0.36	0.46	0.76	1.07
Australia	1.00	1.04	0.88	0.72	0.67	0.67	0.67	0.73	0.79	0.85	0.92	0.94	1.18	1.55
New Zealand	1.00		1.73	0.80			0.86		0.98			1.10	1.28	
Canada	1.75	1.64	1.56	1.33	1.29	1.23	1.17		1.17			1.15		1.37
United States	**2.13**	**1.93**	**1.80**	**1.60**	**1.54**		**1.50**		**1.54**			**1.59**		**2.03**

Concept courtesy of @CharlieBilello https://www.biancoresearch.com

As shown in the table above, a number of countries have nothing but negative yields or rates.[4] The U.S. is truly an outlier in that bonds in our country offer a positive rate of return.

The move in the U.S. Treasury market the last few weeks has also been quite remarkable. Since August 1st, the yield on the U.S. 10-Year Treasury has dropped more than 50 basis points to 1.54%, the 30-Year Treasury yield has dropped from 2.6% to 1.99% (its lowest yield ever) and the 2-Year Treasury yield has dropped from 1.88% to 1.51%.[5] For a brief time, the yield on the 2-Year Treasury exceeded that of the 10-Year Treasury, causing the spread between the two yields to invert. The below figure shows the discrepancy between US and non-US investment grade fixed income yields:[6]

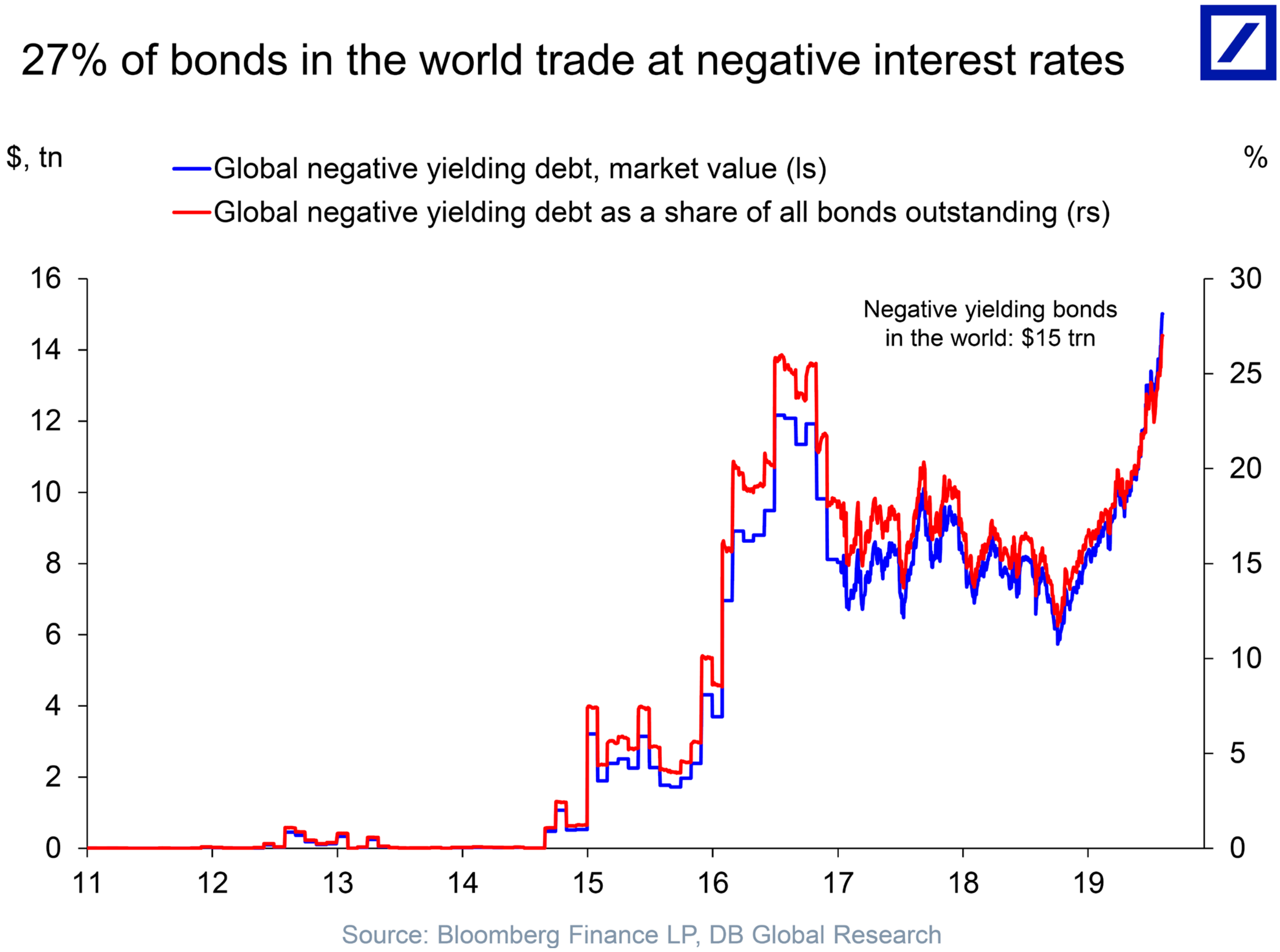
Figure 2: Non-USD IG fixed income yields approaching zero



Note: Based on index eligible debt in the Global Broad Market Index (GBMI). As of August 15, 2019.
Source: ICE Data Indices, LLC, BofA Merrill Lynch Global Research

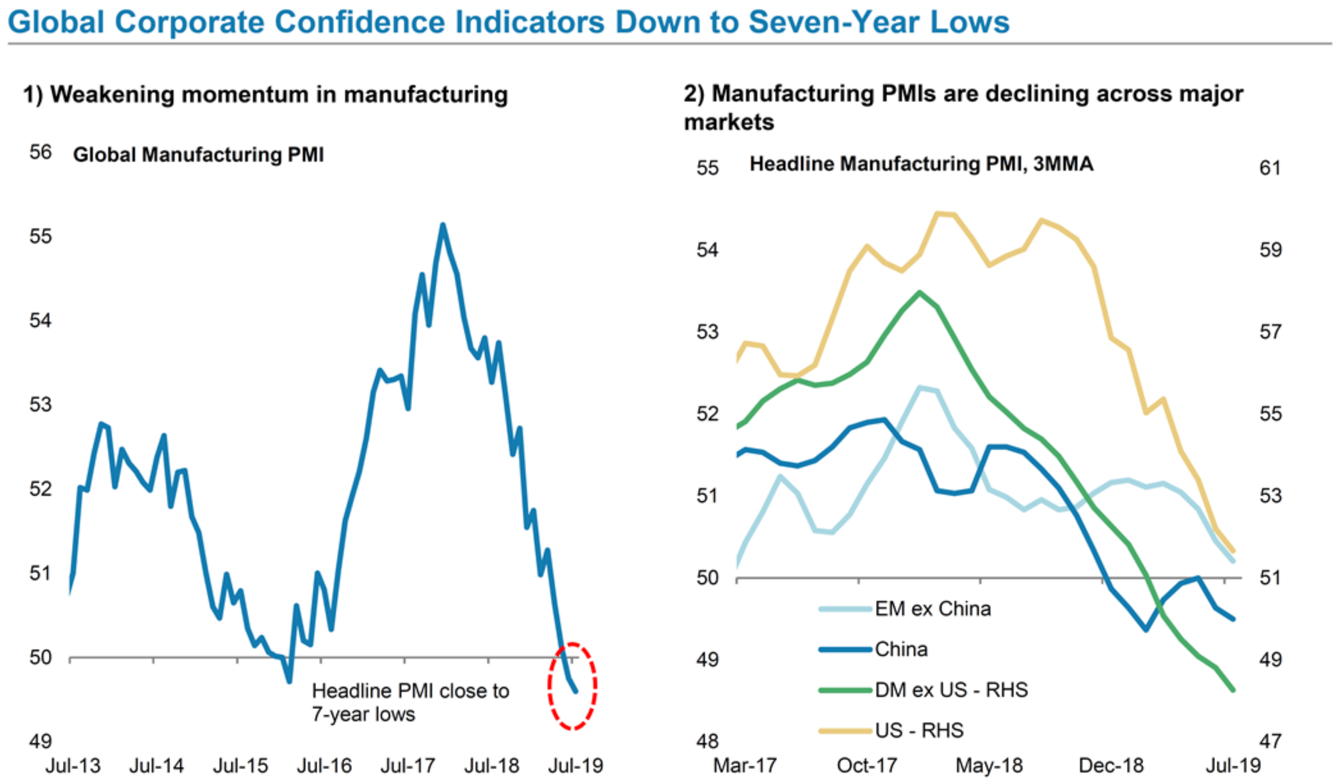
Declining U.S. bond yields reflect massive foreign demand for owning safe assets with a positive yield, muted economic growth expectations and technical flows where insurance companies and mortgage servicers are forced to buy more bonds at ever lower yields to hedge their liabilities. These technical flows along with muted liquidity are exacerbating the move lower in interest rates.

As depicted in the below chart, close to 27% of all global bonds (worth more than $16 trillion) trade at negative interest rates.[7] If you exclude the U.S. bond market, the proportion of negative yielding debt is even more extreme, with 45% of investment grade bonds trading at a negative interest rate.[8] In other words, those investors are guaranteed to lose money if the bonds are held to maturity. This is great if you are a borrower, but not so terrific for savers (such as most of our clients) who may depend on income to supplement their living expenses or fund their retirements.



This is ultimately why we believe investors will continue to buy stocks. Investors have no choice. Bonds at these levels are anything but risk-free, as any change in inflation or growth expectations could result in a significant downward move in the underlying prices of bonds (sending yields higher). As income-oriented investors seek meaningful yield, we believe many will turn to the stock market. At 1.99%, the S&P 500 currently yields more than the 10-Year U.S. Treasury and offers growth exposure (even though growth expectations have declined over the last year).[9] Many individual securities offer far higher yields and trade at reasonable valuations. In fact, the market as a whole is not terribly expensive, with the S&P 500 trading at 15.6x next year's expected earnings.[10] And when compared to current interest rate levels, there is even an argument that stocks are undervalued. Future cash flows that stocks will generate should be worth more to investors today if discounted back at 1.5% (the current 10-Year Treasury yield) vs. a rate of 4% (the 10-Year Treasury yield prior to the Financial Crisis), yet the market's valuation (based on a forward price to earnings ratio) is almost the same as 10+ years ago.

The key for the stock market's performance will be whether growth materializes or contracts. Unfortunately, much of the growth story depends on whether global policy makers, including Presidents Trump and Xi (of China) pursue sound economic policies. Investors are concerned that global trade policy uncertainty (in other words, tariffs on Chinese goods) is causing a slowdown in business investment and manufacturing (see below chart, PMI figures below 50 signal a contraction).[11]



We just hope that global leaders don't wait to create a more certain business environment until it is too late and the data shows a recession has already begun. As hope is never the greatest basis for making an investment decision, we are not surprised by the recent spurts of volatility and rush into the perceived safety of bonds. Until a trade deal is concluded and/or economic growth indicators pick up, we expect continued volatility and negligible returns for stocks. While we are comfortable with our core positions and think there are individual securities trading at attractive prices, now is likely not the time to take on extra portfolio risk. We don't expect a major market correction or recession, but we do think that trading will remain choppy until the global economic picture improves.

Please let us know if you would like to discuss any of the ideas reviewed in this letter and how they may impact your portfolio. Thank you for your continued support.

Sincerely,

Peter Karmin
Managing Member

Stuart Loren
Director

Citations and Disclosures

[1] Bloomberg (Aug. 15, 2019)
[2] https://fortune.com/2019/08/13/negative-mortgages-rates-denmark-investors
[3] Bloomberg (Aug. 15, 2019)
[4] Bianco Research (Aug. 14, 2019).
[5] Bloomberg (Aug. 15, 2019).
[6] Bloomberg Opinion, John Authers, *Points of Return* (Aug. 19, 2019).
[7] Deutsche Bank Research (Aug. 2019).
[8] Deutsche Bank Research (Aug. 2019).
[9] Bloomberg (Aug. 15, 2019).
[10] Bloomberg (Aug. 15, 2019).
[11] Morgan Stanley Research (August 13, 2019)

Investing involves risks, including the possible loss of principal and fluctuation of value. Past performance is no guarantee of future results.

This letter is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of the date noted above and may change as subsequent conditions vary. The information and opinions contained in this letter are derived from proprietary and nonproprietary sources deemed by Karmin Capital to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by Karmin Capital, its principals, employees, agents or affiliates, or by Fort Sheridan Advisors LLC, its principals, employees, agents or affiliates. This post may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will materialize. Reliance upon information in this post is at the sole discretion of the reader.

Please consult with your Karmin Capital financial advisor to ensure that any contemplated transaction in any securities mentioned in this letter align with your overall investment goals, objectives and tolerance for risk. In addition, please note that Fort Sheridan Advisors LLC, through its wealth management division, Karmin Capital, including its principals, employees, agents, affiliates and advisory clients, may have positions in one or more of the securities discussed in this communication. Please note that Karmin Capital, including its principals, employees, agents, affiliates and advisory clients may take positions or effect transactions contrary to the views expressed in this communication based upon individual or firm circumstances. Any decision to effect transactions in the securities discussed within this communication should be balanced against the potential conflict of interest that Karmin Capital has by virtue of its investment in one or more of these securities.

The S&P 500® Index is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. You may not invest directly in an index.

Additional information about Fort Sheridan Advisors LLC is available in its current disclosure documents, Form ADV and Form ADV Part 2A Brochure, both which are available without charge by contacting Fort Sheridan toll-free at 866-559-9700. You may also request copies by email at info@fortllc.com, or access the documents online via the SEC's Investment Adviser Public Disclosure (IAPD) database at www.adviserinfo.sec.gov, using CRD# 151139 or SEC# 801-70517.

Karmin Capital neither provides investment banking services nor engages in principal or agency cross transactions. Karmin Capital is the wealth management division of Fort Sheridan Advisors LLC. All securities transactions are effected through Western International Securities, Inc. and Fidelity Brokerage Services LLC. Fort Sheridan Advisors LLC is not an affiliate of Western International Securities, Inc. or Fidelity Brokerage Services LLC.