DELTA INVESTMENT MANAGEMENT

Delta Insights
a weekly commentary on investing

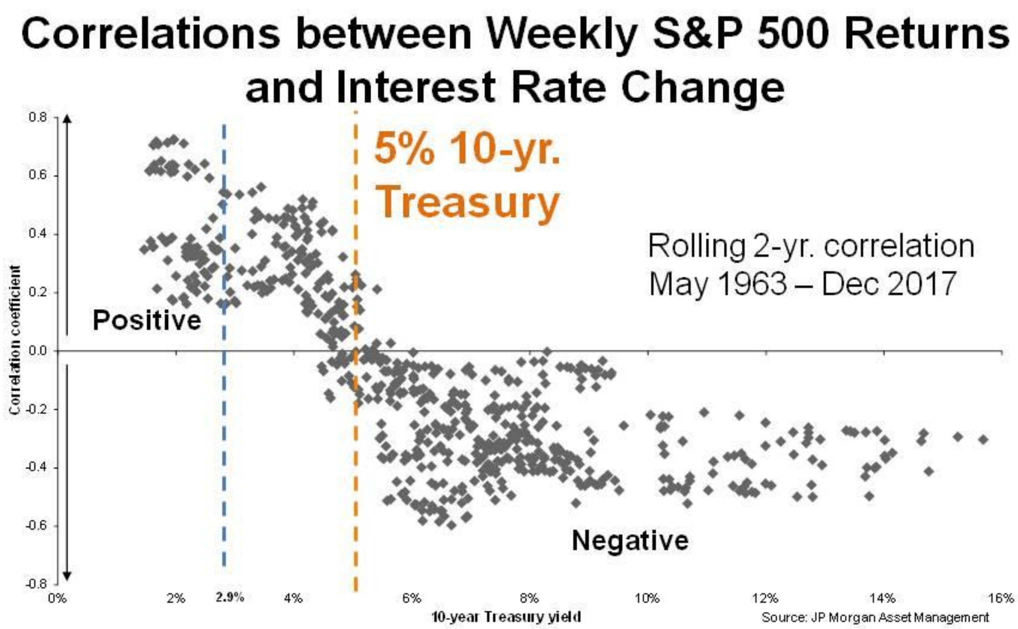
Delta Investment Management is a registered investment advisory firm headquartered in San Francisco.
Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new partner.
Delta manages portfolios at TD Ameritrade and Schwab.
Please contact Delta at info@deltaim.com or 415-249-6337 to learn more.

February 23, 2018

When Will Rising Interest Rates Be a Problem for Stocks?

Are rising interest rates negative for the stock market? The answer is yes and no. It depends on how high rates are while they are rising.

As long as the 10-year U.S. treasury rate is below 5%, rising interest rates have a positive correlation with a rising S&P 500. Said simply, rates go up and stocks go up. Above 5%, rising rates have a negative correlation with the direction of the S&P 500. Today, the 10-year treasury is about 2.9% -- shown with vertical blue dashed line on chart below.

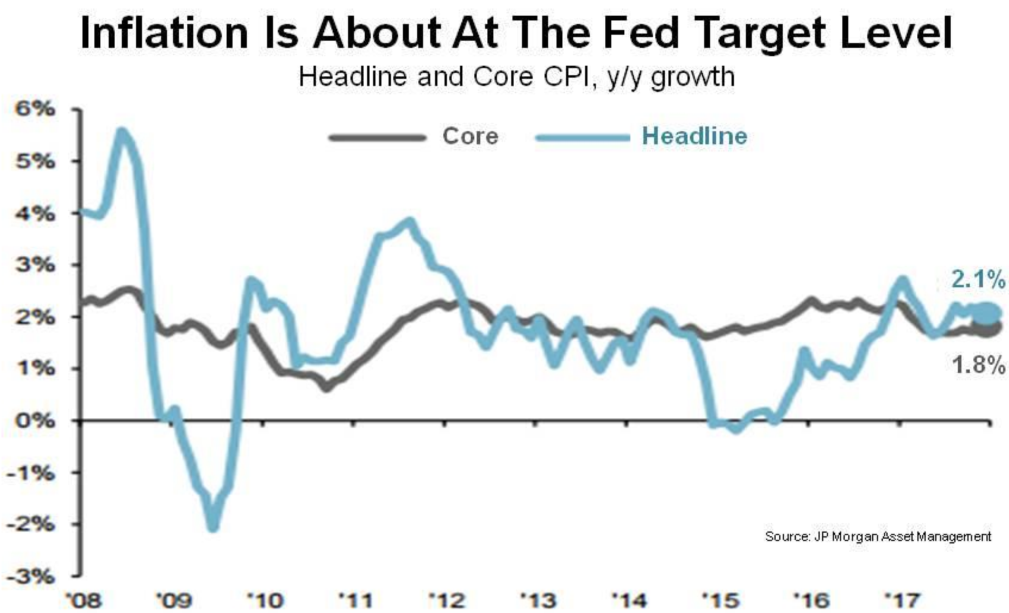


The Federal Reserve is implementing a multi-year interest rate increase plan as a way to manage inflation. Many bull markets have ended as a result of the Federal Reserve raising rates too much.

Inflation can be a byproduct of an overheating economy. As consumption accelerates, prices may rise. Inflation is a measure of rising prices.

The Federal Reserve attempts to manage inflation (Fed target rate of inflation is 2% year-over-year) through interest rates. By raising interest rates, the Fed can slow economic activity. Borrowing (e.g., for a home or any other purpose) becomes more expensive. Saving and earning interest becomes more attractive. Consumption moderates relieving upward pressure on prices (inflation).

The chart below shows headline and core inflation (Consumer Price Index – CPI). At 2.1% and 1.8%, respectively, inflation is very close to the Fed target rate. No deflation and not too much inflation.



In classic economics, low unemployment, rising wages and rising demand are drivers of inflation. Deflationary counterbalances to traditional inflation drivers are technology driven "disruption" and globalization. In an increasingly flat and technical world, we may be experiencing deflationary pressure from these two forces more than ever. It is possible that technology and globalization are strong enough forces to hold back inflation even in a "tight" economic environment. The Federal Reserve may not have to push rates too high to keep inflation at its target level.

The Fed Funds rate is currently about 1.4%. The Fed says it plans to raise the Fed Funds rate to about 2.7% in 2019. The current spread between the Fed Funds rate and the 10-year treasury rate is about 1.5%. If we assume the spread remains constant going forward, the 2019 10-year treasury rate using the Federal Reserve's projection of the Fed Funds rate is 4.2%. Based on market relationships dating back 55 years to 1963, interest rates rising should not be a major threat to the bull trend this year.

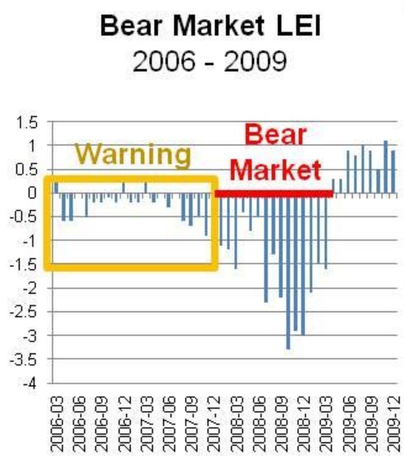
The 17 consecutive month of positive Leading Economic Index (LEI) percent change month over month was reported this week at plus 1% for January. The LEI continues to signal growth through the first half of 2018.

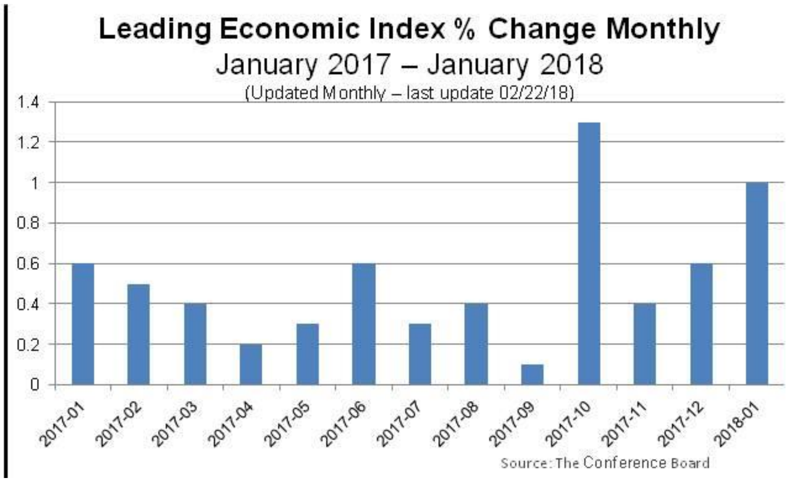
Give Us a Call Today

We invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com if you have questions about how we can assist you in managing your investment accounts.

"Scotch and toilet water?"

Delta Stock Market Dashboard





MARKET SENTIMENT IS

BULLISH

THIS WEEK'S NUMBER IS

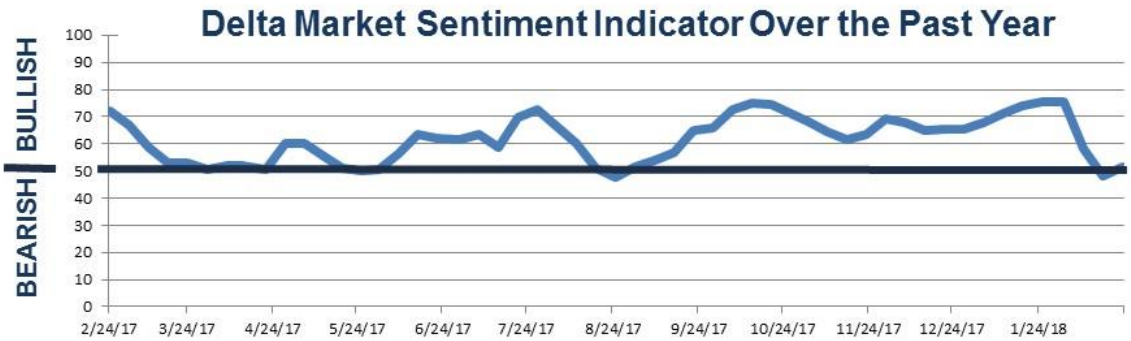
51.4

Our technical indicator increased this week from 48.0 to 51.4

INDICATOR STATISTICS

Consecutive Bullish Weeks:	67
Cycle Inception Date:	11/15/2016
Range:	47.9 – 75.7
Mean:	63.1
Bullish Weeks YTD:	8
Bearish Weeks YTD:	0
*S&P 500	23.8%
*DJIA	32.3%
*NASDAQ	35.6%

** Percentage change during current cycle*



(Delta MSI is published every week in ***Barron's***)

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