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.*

March 2, 2018

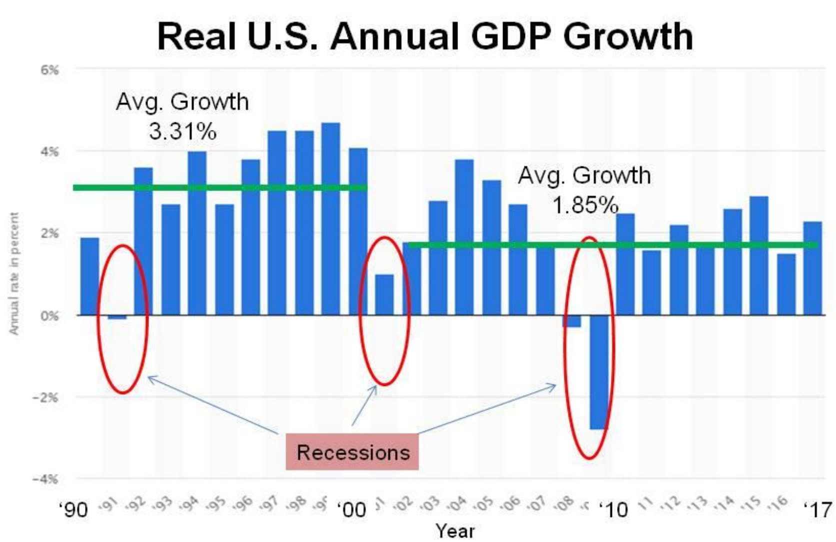
**Interest Rate Sensitivity**

The stock market has had a touchy relationship with bond yields in the past few weeks. On Friday of last week and Monday of this week, stocks rallied on a successful auction of $258 billion worth of treasury bonds which lowered the 10-year treasury yield. On Tuesday, the new Federal Reserve Chairman, Jerome Powell, spoke to Congress and said his economic projections strengthened since the December Federal Open Market Committee (FOMC) meeting. The market interpreted this remark as an indication the Fed may raise rates four (rather than three) times this year. Bond yields rose and stocks declined.

Because of the market's recent sensitivity to interest rate fluctuations, we once again examine the relationship between interest rates and stock prices.

**How High Can Rates Go in a Slow Growth Economy?**

Economic growth has slowed. From 1990 through 2000, average annual real GDP growth was 3.31%. From 2001 through 2017, average annual real GDP growth has been 1.85%. Growth has been a little more than half of what it was this Century versus the last decade of the Twentieth Century.



In-line with a slowdown in growth has been a decline in interest rates. From 1990 through 2000, the 10-year treasury rate was 6.3%. From 2001 through 2017, the 10-year treasury rate has averaged 3.2% per year. Much like the growth rate being half of what it was, interest rates have been roughly half of what they were.

This analysis suggests that in a low growth environment, economic growth and the stock market may stall-out at a lower level of interest rates than it has in the past. Long-time CNBC contributor, Art Cashin, says “once the 10-year yield hits 3% all hell could break loose.” He compares treasuries reaching a 3% yield to “touching the (electrified) third rail.”

Is Art right? It is a pressing question because the 10-year treasury is only about 0.1% away from Cashin’s third rail.

To determine the potential financial safety hazard presented by the 3% treasury yield level, we look at calendar year real GDP growth rates versus 10-year treasury rates in the last three bull market periods including 1995-2000, 2003-2007 and 2010-2017.

## 10-Yr. Treasury Rate and Real GDP Growth

| 10-yr. T Rate | | GDP Growth | | |
|---|---|---|---|---|
| 1995 | 5.58% | 1995 | 2.70% | Bull Market 1/1/95 – 12/31/00<br>CAGR 21.5%<br>Avg. 10-yr 5.66%, Avg. GDP 4.05% |
| 1996 | 6.43% | 1996 | 3.80% | |
| 1997 | 5.75% | 1997 | 4.50% | |
| 1998 | 4.65% | 1998 | 4.50% | |
| 1999 | 6.45% | 1999 | 4.70% | |
| 2000 | 5.12% | 2000 | 4.10% | |
| 2001 | 5.07% | 2001 | 1.00% | Bear Market, CAGR -17.28%, 1/1/01 – 12/31/02 |
| 2002 | 3.36% | 2002 | 1.80% | |
| 2003 | 3.77% | 2003 | 2.80% | Bull Market 1/1/03 – 12/31/07<br>CAGR 12.8%<br>Avg. 10-yr 4.16%, Avg. GDP 2.88% |
| 2004 | 3.94% | 2004 | 3.80% | |
| 2005 | 4.36% | 2005 | 3.30% | |
| 2006 | 4.71% | 2006 | 2.70% | |
| 2007 | 4.04% | 2007 | 1.80% | |
| 2008 | 2.25% | 2008 | -0.30% | Bear Market, CAGR -10.67%, 1/1/08 – 12/31/09 |
| 2009 | 3.85% | 2009 | -2.80% | |
| 2010 | 3.30% | 2010 | 2.50% | Bull Market 1/1/10 – 12/31/17<br>CAGR 13.9%<br>Avg. 10-yr 2.41%, Avg. GDP 2.16% |
| 2011 | 1.89% | 2011 | 1.60% | |
| 2012 | 1.78% | 2012 | 2.20% | |
| 2013 | 3.04% | 2013 | 1.70% | |
| 2014 | 2.17% | 2014 | 2.60% | |
| 2015 | 2.27% | 2015 | 2.90% | |
| 2016 | 2.45% | 2016 | 1.50% | |
| 2017 | 2.40% | 2017 | 2.30% | |

The 1995-2000 was a very strong bullish period. From January 1, 1995 through December 31, 2000, the S&P 500 had a compounded annual growth rate (CAGR) of 21.5%. Average GDP growth was 4.05% annually. The average 10-year treasury yield was 5.66%. The stock market showed spectacular growth with 10-year yields at about 140% of average GDP growth.

The bull market running from January 1, 2003 through December 31, 2007 had a CAGR of 12.78%. Like the late 1990s bull market, the ratio of 10-year treasury rate to GDP growth was about 140% (average 10-year 4.16%, average GDP growth 2.88%).

In the current bull market beginning January 1, 2010, the average 10-year yield has been 2.41% and the average real GDP growth has been 2.16%. The ratio of 10-year yield to GDP growth is at 112%. This year, GDP growth is expected to be 3%. The 10-year treasury rate so far is roughly 2.9%. The ratio is 97%. Relative to prior bull markets, it appears that interest rates are low and not a threat to further market advances.

If we apply the 140% interest rate to growth ratio on a 3% GDP growth this year, the 10-year treasury rate has room to rise to about 4.2% before we would expect to worry about "all hell breaking loose."

The bull market that ended in 2007 essentially ended very close to the time when the 10-year treasury rate reached a zenith of 5.26% on June 12, 2007. The 10-year interest rate fluctuates day to day. It is quite possible that the 10-year treasury rate moves significantly above the 4.2% average annual rate before this bull market ends.

There is a relationship between economic growth and interest rates. Currently growth is strong and rates are relatively low. As long as both of these conditions persist, the third rail is further away than Cashin might have us believe.

**Interesting Warren Buffett viewpoint from the Berkshire Hathaway 2017 annual report, Letter to Shareholders:**

"It is a terrible mistake for investors with long-term horizons – among them, pension funds, college endowments and savings-minded individuals – to measure their investment "risk" by their portfolio's ratio of bonds to stocks. Often, high-grade bonds in an investment portfolio increase its risk."

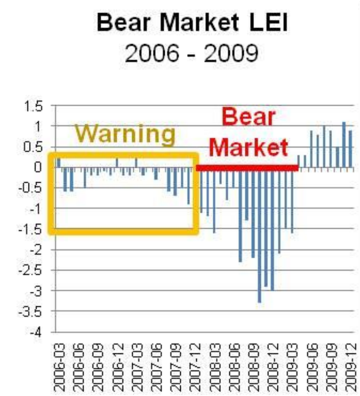
**Give Us a Call Today**

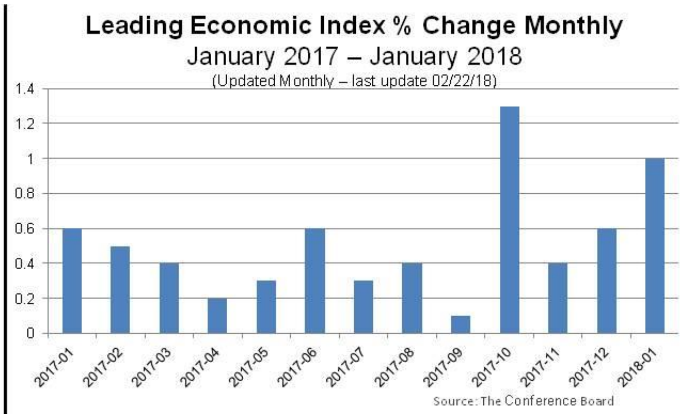
We invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com if you have questions about how we can assist you in managing your investment accounts.


*"Oh, come on!"*

---

# Delta Stock Market Dashboard




MARKET SENTIMENT IS

## BULLISH

THIS WEEK'S NUMBER IS

## 50.1

Our technical indicator decreased this week from 51.4 to 50.1

**INDICATOR STATISTICS**

| | |
|---|---|
| Consecutive Bullish Weeks: | 68 |
| Cycle Inception Date: | 11/15/2016 |
| Range: | 47.9 – 75.7 |
| Mean: | 62.9 |
| Bullish Weeks YTD: | 9 |
| Bearish Weeks YTD: | 0 |
| *S&P 500 | 24.2% |
| *DJIA | 32.5% |
| *NASDAQ | 36.4% |

** Percentage change during current cycle*


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