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.
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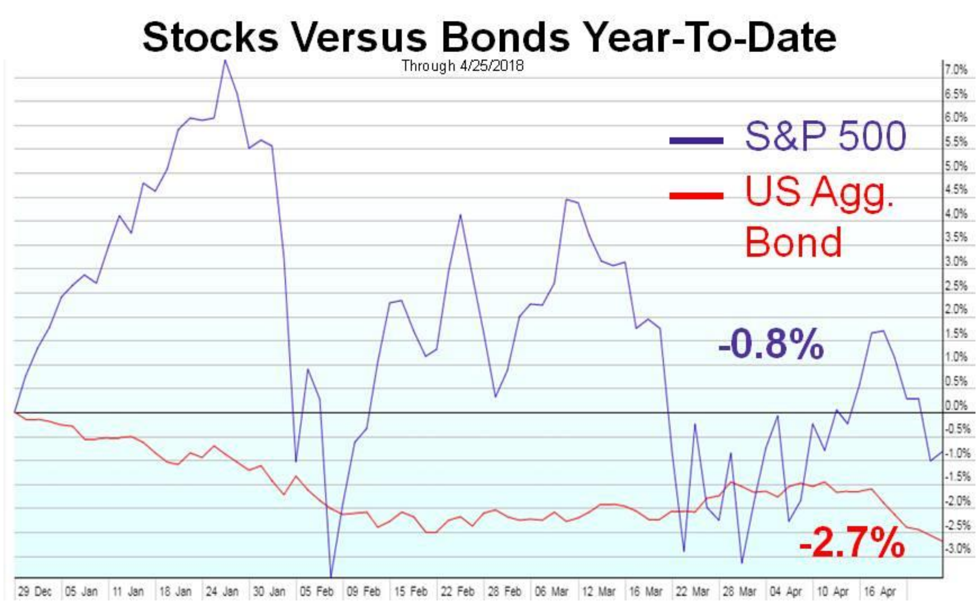
April 27, 2018

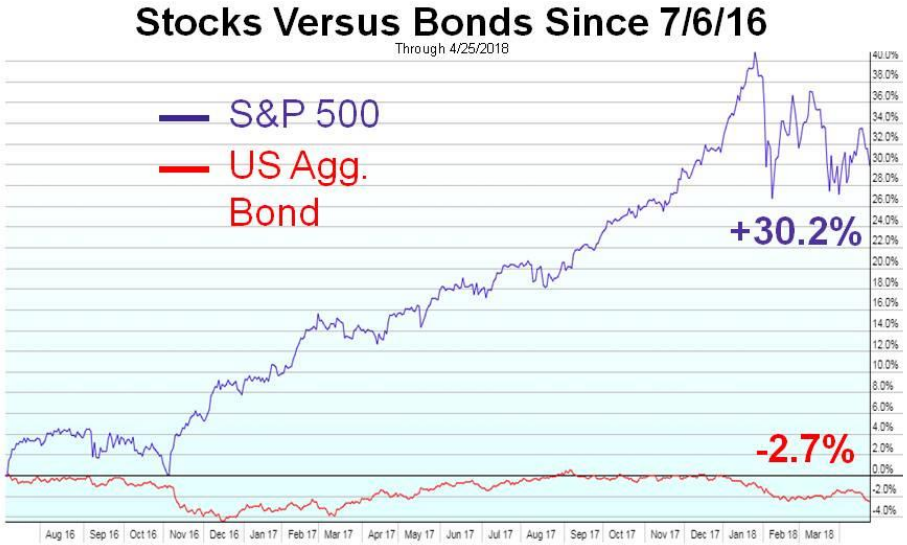
Sensitivity Training: Higher Interest Rates

Interest rates are rising. From the all-time low of 1.33% reached on July 6, 2016, the 10-year U.S. treasury rate reached 3.03% this week.

Rising rates are a negative for bond values. During the 23 year period from 1958 to 1981, the 10-year treasury rate rose from about 4.2% to 15.8%. The average annual real return from corporate bonds was -2%.

Rising rates can be a negative for stock values if they reach levels that inhibit economic growth, lower the price/earnings multiple and cause funds to flow from stocks to bonds. So what will it be, stocks or bonds? Below, we compare the performance of stocks and bonds using the S&P 500 Index for stocks and the U.S. Aggregate Bond Index (investment grade debt) for bonds:

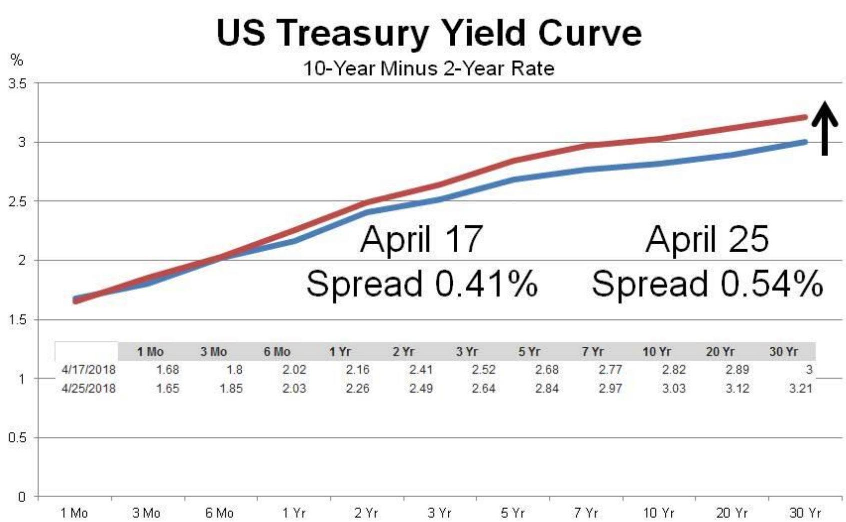




Today, rising rates are a bigger threat to bonds than stocks. The interest rate sensitivity of bonds is elevated (longer duration than historical average) and interest rates are rising from very low levels. Stocks are somewhat protected by strong earnings growth (20%+ this year) and a high earnings yield of greater than 6%.

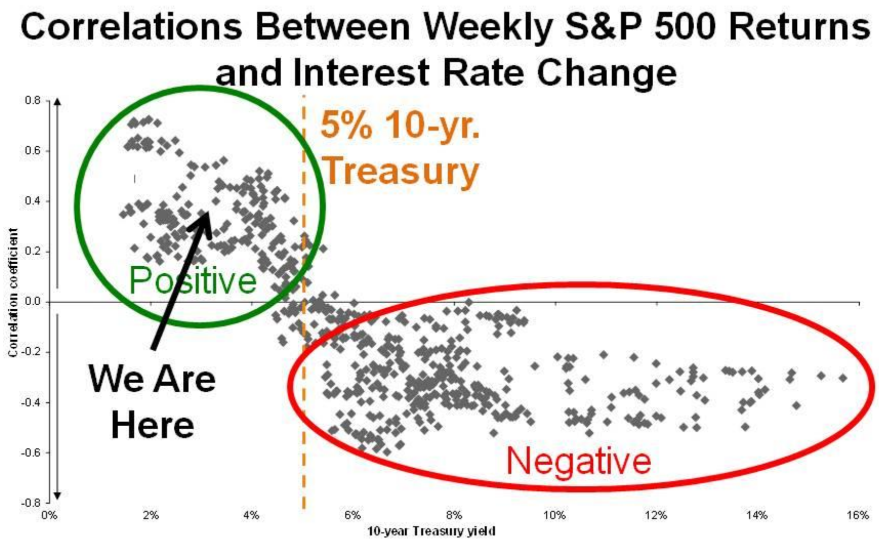
Investors have been worried about the flattening of the treasury yield curve and the potential for a yield curve inversion (2-year treasury rate greater than the 10-year rate). An inversion of the yield curve has been a reliable signal that the economy is approaching a recession. Investors have also been worried about rising interest rates.

Whoa! We can't have it both ways. Either the flattening yield curve is a negative or the rising rates are a negative, but usually not both. The rising 10-year rate is causing the yield curve to steepen. In the past week and a half, the spread between the 10-year and 2-year treasury rates increased by 32% from 0.41% to 0.54%.



At this time in market history, rising interest rates may actually be a positive. First, they are moving the yield curve further away from inversion. Second, rising long-term rates suggest a healthy, growing economy in the longer-term. Third, the absolute level of rates remains low and there is room for rates to rise before they suppress growth.

The chart below shows how rising rates are positively correlated with rising stock values as long as the 10-year treasury rate remains below 5%.



We address the subject of how high rates can go in a low-growth environment in our *Delta Insights* letters dated February 23, 2018 and March 2, 2018: “When Will Rising Interest Rates Be a Problem for Stocks?” and “Interest Rate Sensitivity.”

Change can be difficult and the adjustment process awkward. As investors, we are adjusting to a world of rising rates after enjoying a 35 year period of falling rates. Investors may increasingly question the use of bonds in their portfolios as a way to reduce risk. Bonds have delivered negative performance over the past 22 months. A better solution to risk management in a rising rate environment is the addition of agile equity strategies that are adaptable in their management of market exposure. The outperformance of stocks versus bonds for the past nearly two years is likely to continue as rates rise.

SPECIAL ANNOUNCEMENT FOR THE BOB WOODRUFF FOUNDATION & STAND UP FOR HEROES

Stand Up for Heroes (SUFH)— one of New York's most anticipated nights of hope, healing and laughter benefiting our nation's veterans, service members and their families— is slated to make its West Coast debut in San Francisco on Thursday, May 17 at The Masonic, featuring extraordinary live comedy performances by Bill Burr, Jeff Ross and special guests.

We would like to highlight the incredible work of our friends Bob & Lee Woodruff helping injured heroes. In 2006, Bob was seriously injured by a roadside bomb while covering the war in Iraq for ABC News. His miraculous recovery inspired his family to help injured heroes get access to the high level of support and resources they need. You can learn more about the Bob Woodruff Foundation at bobwoodrufffoundation.org

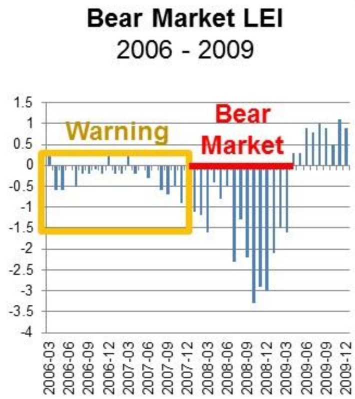
Tickets for **Stand Up for Heroes: Bay Area** just went on sale. We hope to see you there. Tickets are available at Ticketmaster.com

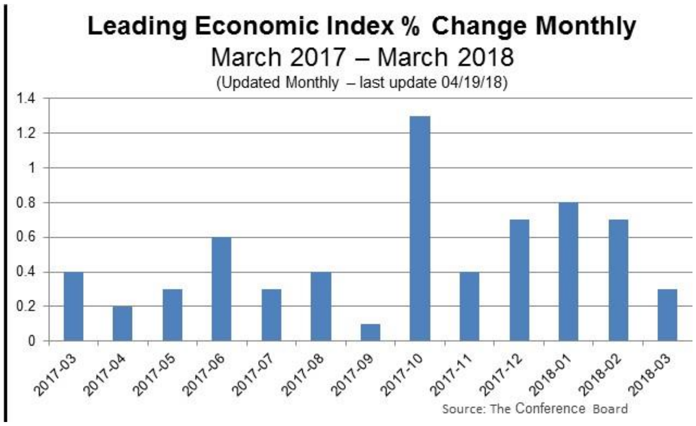
Give Us a Call Today

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.

"You should be happy. How many husbands even notice window treatments?"

Delta Stock Market Dashboard





MARKET SENTIMENT IS

BEARISH

THIS WEEK'S NUMBER IS

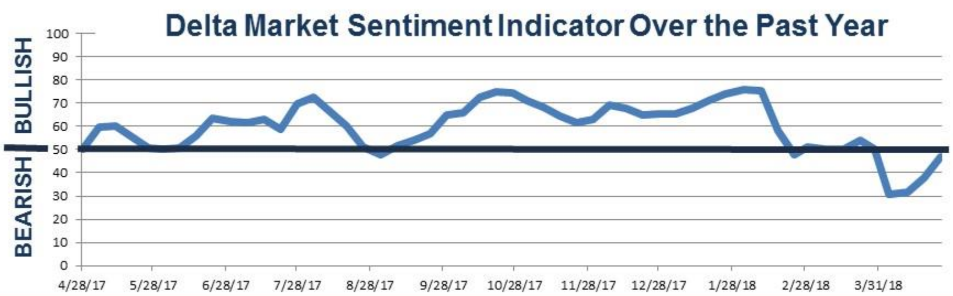
46.7

Our technical indicator decreased this week from 47.0 to 46.7

INDICATOR STATISTICS

Consecutive Bearish Weeks:	5
Cycle Inception Date:	3/29/2018
Range:	30.7 – 47.0
Mean:	38.8
Bullish Weeks YTD:	12
Bearish Weeks YTD:	5
*S&P 500	0.6%
*DJIA	0.5%
*NASDAQ	0.5%

** Percentage change during current cycle*



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