Navigating the Current Interest Rate Environment

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Raymond James & Associates, Inc., member New York Stock Exchange/ SIPC
Navigating the Current Interest Rate Environment

- Navigational Beacons
- Rough Waters
- Smooth sailing
Navigational Beacons

Federal Reserve

Bond Market
The Fed’s three main functions are to:

• provide and maintain an effective and efficient payments system,

• supervise and regulate banking operations, and

• conduct the nation’s monetary policy
Monetary Policy 101

The Fed can use four tools to conduct monetary policy:

1) Discount Rate
2) Reserve Requirement
3) Interest on Reserves
3) Open Market Operations
Discount Rate

The **discount rate** is the interest rate Reserve Banks charge commercial banks for short-term loans.
Reserve Requirement

Reserve requirements are the portions of deposits that banks must hold in cash, either in their vaults or on deposit at a Reserve Bank.
Interest on Reserves

The newest and most frequently used tool given to the Fed by Congress after the Financial Crisis of 2007-2009.
Open Market Operations

Open market operations involves, the buying and selling of U.S. government securities.
$ policy =
M2 is a measure of the money supply that includes cash, checking deposits, and easily convertible near money. It is a broader measure of the money supply that M1, which just include cash and checking deposits. M2 is a closely watched as an indicator of money supply and future inflation, and as a target of central bank monetary policy.

Source: Bloomberg
Excess Bank Reserves

Excess reserves are capital reserves held by a bank or financial institution in excess of what is required by regulators, creditors or internal controls. For commercial banks, excess reserves are measured against standard reserve requirement amounts set by central banking authorities. These required reserve ratios set the minimum liquid deposits (such as cash) that must be in reserve at a bank; more is considered excess. Excess reserves may also be known as secondary reserves.

Source: Bloomberg
The Bond Market

The bond market is really several markets: the Treasury bond market, the corporate bond market and the municipal bond market to name three.
What Moves the Bond Market?

The bond market moves when expectations change about economic growth and inflation. Unlike stocks, whose future earnings are anyone's guess, bonds make fixed payments for a certain period of time. Investors decide how much to pay for a given bond (that is, for a stream of fixed payments of a certain length) based on how much they expect inflation to erode the value of those fixed payments.
# The Carillon Group of Raymond James

## Fed Forecast

### Economic Growth

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<tbody>
<tr>
<td>Real GDP (YoY%)</td>
<td>2.2</td>
<td>1.8</td>
<td>2.5</td>
<td>2.9</td>
<td>1.6</td>
<td>2.4</td>
<td>2.9</td>
<td>2.1</td>
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<td>Industrial Production (YoY%)</td>
<td>3.0</td>
<td>2.0</td>
<td>3.1</td>
<td>-1.0</td>
<td>-2.0</td>
<td>2.3</td>
<td>4.0</td>
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<tr>
<td>CPI (YoY%)</td>
<td>2.1</td>
<td>1.5</td>
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<tr>
<td>Unemployment (%)</td>
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<td>6.2</td>
<td>5.3</td>
<td>4.9</td>
<td>4.4</td>
<td>3.9</td>
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<td>Non Farm Payrolls (000s S.)</td>
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<td>2.7</td>
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<td>Average Hourly Earnings ($)</td>
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Source: Bloomberg
The Carillon Group of Raymond James

Private Economists Forecast
Economic Growth
# Fed Forecast

## Inflation

### Economic Forecasts

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Source: Bloomberg
# Private Economists

## Inflation

### Economic Activity

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<td>1.7</td>
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### Housing Market

| Housing Starts (000s SAA) | 1261  | 1250  | 1269  | 1273  |
| New Home Sales (000s S...) | 616   | 652   | 655   | 663   |
| Existing Home Sales (Mn... | 5.4   | 5.4   | 5.4   | 5.4   |
| Building Permits (000s S...) | 1310  | 1302  | 1352  | 1332  |

Source: Bloomberg
10 year Treasury Forecast vs Actual

10-Year Treasury Forecasts vs Actual

Sources: Philadelphia Fed, Raymond James, Bloomberg
Rough Waters
U.S. 10-year Treasury bond yields
1871–2019

Case for Higher Rates

Higher Inflation?
Case for Higher Rates

Higher Inflation?

Tax Cut Fueled Growth?
Case for Higher Rates

Higher Inflation?
Tax Cut Fueled Growth?
Scaling Back of Quantitative Easing?
Case for Higher Rates

Higher Inflation?
Tax Cut Fueled Growth?
Scaling Back of Quantitative Easing?
Fed Rate Hikes?
Case for Higher Rates

Higher Inflation?

Tax Cut Fueled Growth?

Scaling Back of Quantitative Easing?

Fed Rate Hikes?

Tariffs?
Case for Higher Rates

Higher Inflation?

Tax Cut Fueled Growth?

Scaling Back of Quantitative Easing?

Fed Rate Hikes?

Tariffs?

War?
Wholesale price inflation in the U.S.
1750–2018

The Case for Lower Rates

Demographics
The Vanishing Worker

Who will fill the jobs?
Working-age population *
2015=100

Source: United Nations Population Division *Aged 15-64
The Case for Lower Rates

Demographics
The Dollar
US Trade Weighted Dollar

The trade-weighted US dollar index, also known as the broad index, is a measure of the value of the United States dollar relative to other world currencies. It is a trade weighted index that improves on the older U.S. Dollar Index by using more currencies and the updating the weights yearly (rather than never). The base index value is 100 in Jan 1997.

Source: Bloomberg
The Case for Lower Rates

Demographics
The Dollar
World Monetary Policy
4G Central Bank Total Assets

G4 Central Bank Total Assets
Converted To Dollars ($billions)

$Billions
6/29/2018 19,998
7/31/2018 19,883
8/31/2018 19,651
9/28/2018 19,684
10/31/2018 19,394
11/30/2018 19,421
12/31/2018 19,878
1/31/2019 19,970
2/28/2019 19,676
3/31/2019 19,441
4/30/2019 19,417
5/31/2019 19,522
6/30/2019 19,696

Source: Bloomberg LP, Raymond James
The Case for Lower Rates

Demographics
The Dollar
World Monetary Policy
Competing Sovereign Debt
### Foreign Sovereign Rates

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<tr>
<th>World Bond Markets</th>
<th>2-Year</th>
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<tr>
<td>United States</td>
<td>1.464</td>
<td>1.348</td>
<td>1.473</td>
<td>1.953</td>
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<td>Canada</td>
<td>1.334</td>
<td>1.166</td>
<td>1.141</td>
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<tr>
<td>France</td>
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<td>-0.754</td>
<td>-0.396</td>
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<td>Germany</td>
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<td>Greece</td>
<td>-</td>
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<td>Ireland</td>
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<td>-0.525</td>
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<td>Italy</td>
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<td>Japan</td>
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<td>-0.347</td>
<td>-0.284</td>
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<td>Netherlands</td>
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<td>-0.832</td>
<td>-0.556</td>
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<td>Spain</td>
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<td>-0.360</td>
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<td>0.992</td>
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<td>Sweden</td>
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<td>United Kingdom</td>
<td>0.334</td>
<td>0.274</td>
<td>0.406</td>
<td>0.916</td>
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</table>

* as of 09/03/2019

Source: Bloomberg LP, Raymond James
The Case for Lower Rates

Demographics
The Dollar
World Monetary Policy
Competing Sovereign Debt
Geopolitical Uncertainty
Zero Interest Rate Policy
Why Own Bonds?
Know Your Risks
Credit Risk
Interest Rate Risk
Reinvestment Risk
Stay Disciplined
Have a plan
Stay Informed
Get a buy-in
Conclusion
The information contained in this presentation does not purport to be a complete description of the securities, markets, or developments referred to in this material. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Investing involves risk and you may incur a profit or loss regardless of strategy selected. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results. Future investment performance cannot be guaranteed, investment yields will fluctuate with market conditions. Prior to making an investment decision, please consult with your financial advisor about your individual situation.
Bond prices and yields are subject to change based upon market conditions and availability. If bonds are sold prior to maturity, you may receive more or less than your initial investment. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.
Credit Risk: The possibility that a bond issuer will fail to repay interest and principal in a timely manner. Also called default risk.
Interest Rate Risk: The possibility that a bond issuer will fail to repay interest and principal in a timely manner. Also called default risk.
Reinvestment Risk: The probability that an investor will be unable to reinvest cash flows (e.g., coupon payments) at a rate comparable to the current investment's rate of return.