CHART OF THE MONTH

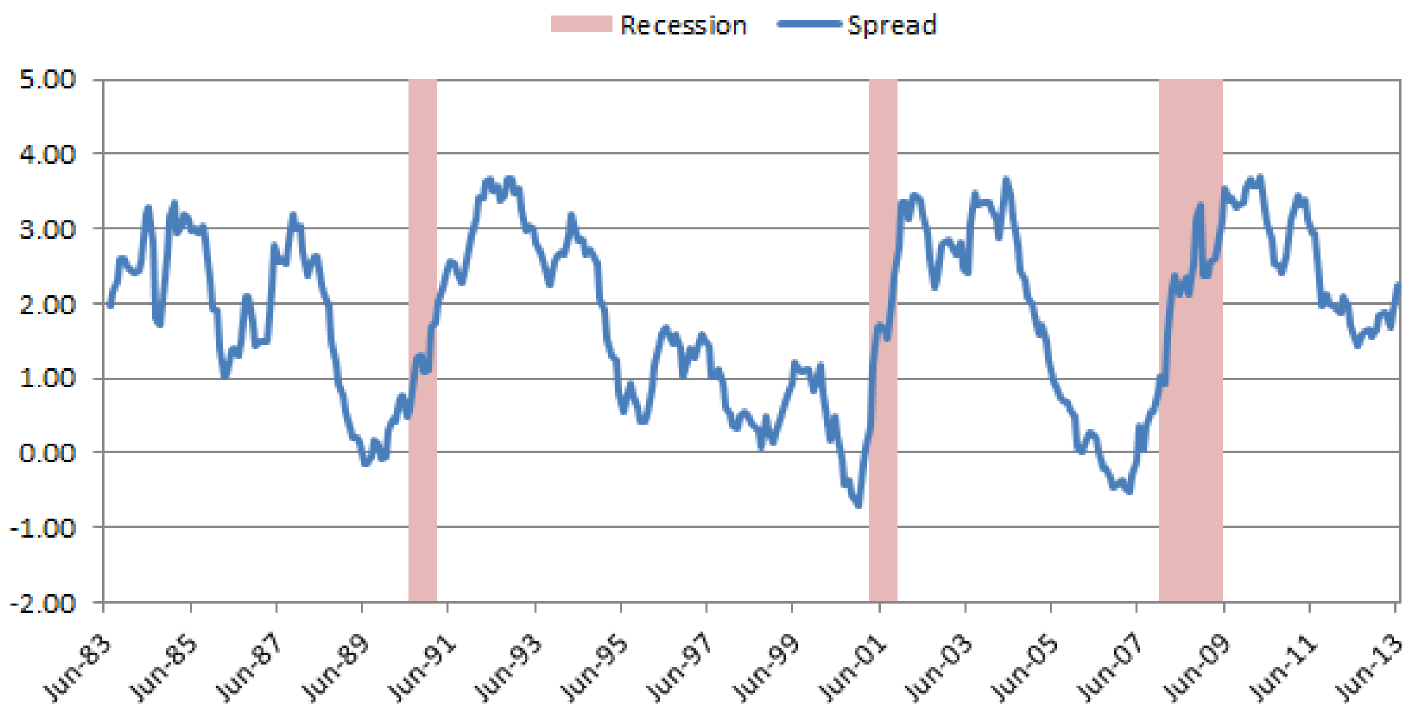
JULY 2013

The bond market sold off in May and June with the price of 10-year Treasury Notes falling roughly 10% in response to stronger-than-expected economic projections and concerns that the Federal Reserve's quantitative easing program would be unwound sooner than anticipated.

The 10-year Treasury spiked from 1.61% on May 1 to 2.72% on July 5, an increase of 1.11 percentage points and nearly 70 percent in just over two months. The yield has since settled at about 2.50%. Meanwhile, the yield on the 3-month Treasury is 0.20%. As shown in the chart below, the current spread between the two is 2.30%, which is fairly typical at this point in the economic cycle.

Of note, the spread between the 10-year note and 3-year bill has never exceeded four percentage points. With the Federal Reserve committed to keeping short-term rates in the range of 0-0.25% for an extended period, it seems improbable that the yield on the 10-year would rise above 4.00%. If anything, the recent jump in mortgage rates is likely to slow housing activity in the second half. A cooling economy would undoubtedly result in interest rates moving *lower* rather than higher.

Looking beyond the near term, we believe the greater risk to the economy is if and when the spread between the 10-year and 3-month turns negative. An inverted yield curve whereby short-term rates exceed long-term rates (as noted by the spread falling below 0.00% in the accompanying graph) has precipitated the past three recessions. The good news is that the yield curve remains positively sloped, which is a harbinger of continued, albeit subpar, growth over the foreseeable future.



111 West Ocean Boulevard, Suite 1350, Long Beach, California 90802
Tel: (562) 495-2350 ▲ Fax: (562) 495-2006
www.lederer-associates.com