SkyView Investment Advisors:

What About Long-Term Interest Rates?

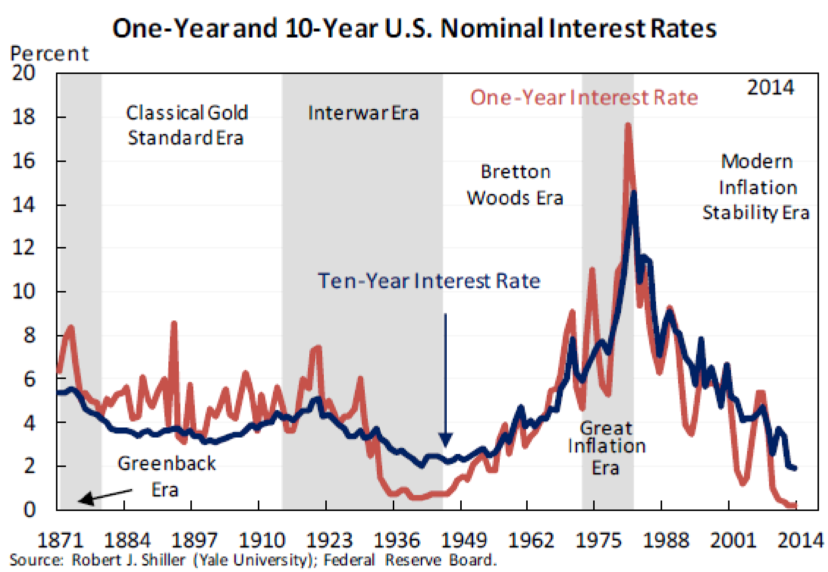
September 5, 2015

Inside This Issue

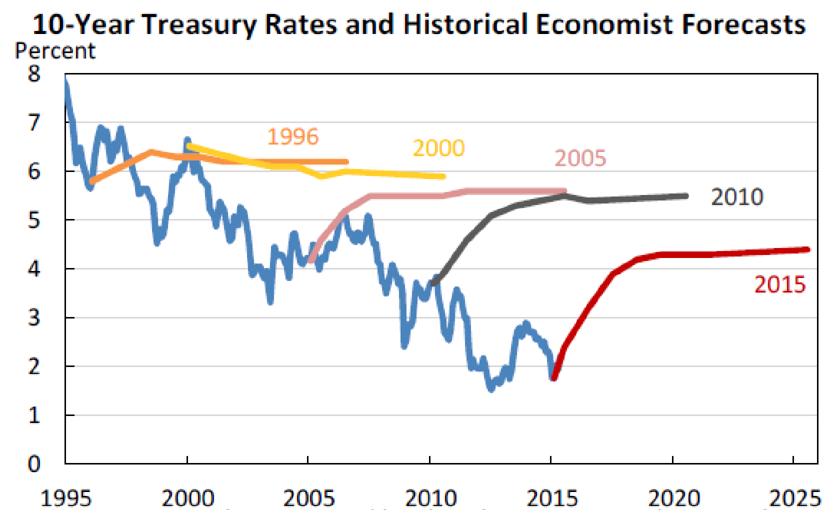
History

The President's Council of Economic Advisers (C.E.A.) recently published a study, "Long-Term Interest Rates: A Survey," which examined the extended decline in long-term U.S. interest rates. We thought it of importance to review its conclusions, particularly in light of the changing global economic forces. Those forces could begin to reverse the extended trend of declining long-term U.S. interest rates.

The next graph from the C.E.A. survey gives perspective of short and long-term interest rates since 1871. Clearly, our current period shows the historic lows of interest rates – both short and long. This provides important perspective for investors when determining their current asset allocations. Interestingly, the stability of long rates in the early years of this graph reflects the influence of the classical gold standard era.



The survey suggests, in our opinion, that the decline in long-term interest rates came as a surprise to most economic forecasters. The next graph appears to support that conclusion by comparing their forecasts at different periods with the actual 10 Year Treasury rates. In fact, most forecasters tended to err on the side of mean reversion. Most long-run forecasts came within a range of 4.4-6%. In comparison, nominal ten year rates, according to the survey, ranged from below 2% to a high reaching nearly 8%.



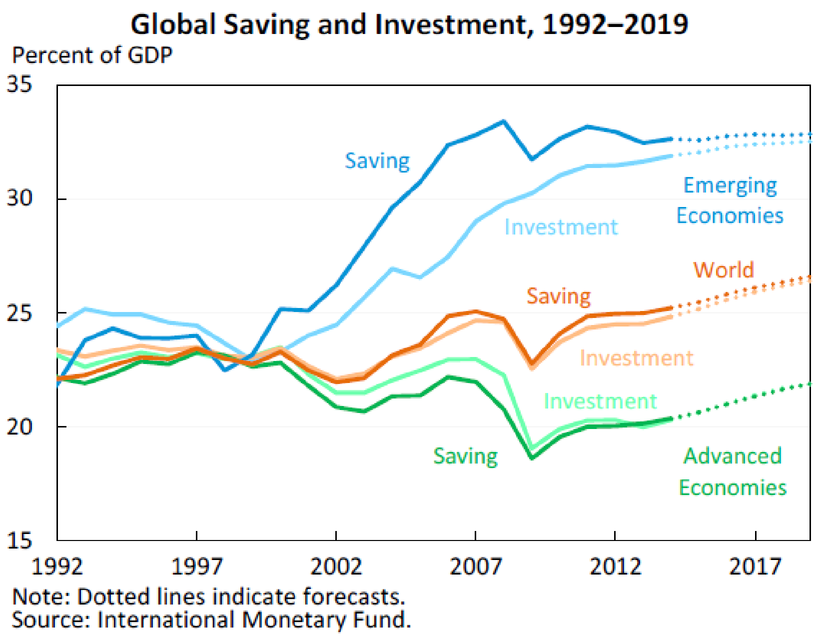
Note: Forecasts are those reported by Blue Chip Economic Indicators released in March of the given calendar year, the median of over 50 private-sector economists. Source: Blue Chip Economic Indicators, Aspen Publishers.

And the Future for Long-Term Rates

If the longer-lived factors continue to influence the decline in long-term rates, then an increase in the Fed funds rate will likely lead to a flattening of the yield curve.

The report lists factors that will likely prove transitory to keeping long-term rates lower than historic equilibrium levels. At the same-time, it lists factors that will likely prove longer-lived. If the longer-lived factors continue to influence the decline in long-term rates, then an increase in the Fed funds rate will likely lead to a flattening of the yield curve.

However, what if one of the longer-lived factors changes direction? Then we might see higher long-term interest rates and an upward move in the yield curve. One long-lived factor cited by the survey, the global savings glut, may come under pressure. The next graph pictures global savings and investment, and illustrates the important influence of the emerging economies.



Long-Term Rates and Oil Prices

We believe the question will be whether recent changes in the global economy will change this recent period of extended lower long-term U.S. interest rates. More specifically, lower oil prices could prove a burden for the Arab OPEC countries as well as Russia. While the Saudis produce oil at some of the lowest costs of any producer, that production must support the kingdom's social spending. The current price of oil remains substantially below levels required to fund that spending. If oil prices do not recover to around $100 per barrel in the next year or two, it will be interesting to see whether the Saudis and other Arab OPEC members will be able to maintain their peg to the dollar. Overall, if oil prices remain low for an extended period, the flow of dollars from the Arab OPEC countries will likely reverse itself. If that reversal occurs, the possible outcome would be higher long-term U.S. interest rates.

If oil prices do not recover to around $100 per barrel in the next year or two, it will be interesting to see whether the Saudis and other Arab OPEC members will be able to maintain peg to the dollar.

Long-Term Rates and China

If the concerns over a slowing Chinese economy prove correct, then it may also be forced to reduce its substantial reserves.

And then there is China. China accounts for roughly one-third of global reserves. If the concerns over a slowing Chinese economy prove correct, then it may also be forced to reduce its substantial reserves. Such a change would also likely put upward pressure on U.S. long-term interest rates. In both cases we cited, much can occur to offset such changes, but it is important for investors to be aware of these potential influences and the impact on their portfolios.

Long-Term Rates and Changing Foreign Holdings

In light of these changing possibilities, a January, 2012 study from the Federal reserve, titled "Foreign Holdings of U.S Treasuries and U.S. Treasury Yields," provides some perspective. In its summary, it states, "By our estimates, if foreign official inflows into U.S. Treasuries were to decrease in a given month by $100 billion, 5-year treasury rates would rise by about 40-60 basis points in the short-run." At the same time, the study suggests "the long-run effect is about 20 basis points."

Long-Term Rate Changes and Portfolio Asset Mix

As important, investors may need to closely examine the asset mix of their portfolios in light of these changes. Most investors remain very alert to what the Fed telegraphs on short rates. At the same time, investors may be less sensitive to the potential influences on long-term U.S. interest rates from changes in the global economy.

DISCLOSURE AND IMPORTANT INFORMATION

This report is for information purposes only, and is not intended as a recommendation with respect to the purchase or sale of any fund. Although third party data has been obtained from and is based on sources SkyView reasonably believes to be reliable, SkyView does not guarantee the accuracy of the information, which may be incomplete or condensed.

The opinions expressed are as of the date written and may change as subsequent conditions vary. This paper is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this paper is at the sole discretion of the reader.

Sources:

"Long Term Interest Rates: A Survey." Whitehouse.gov. Accessed September 4, 2015.

https://www.whitehouse.gov/sites/default/files/docs/interest_rate_report_final_v2.pdf.

"FOREIGN HOLDINGS OF U.S. TREASURIES AND U.S. TREASURY YIELDS." Federalreserve.gov. Accessed September 4, 2015. http://www.federalreserve.gov/pubs/ifdp/2012/1041/ifdp1041.pdf.

"Employment Situation Summary." U.S. Bureau of Labor Statistics. Accessed September 4, 2015.

http://www.bls.gov/news.release/empsit.nr0.htm.