Stephens
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The Week That Was

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The phrase "too much of a good thing" has been dated as far back as the late 15th century. Its meaning is supposed to convey that an excess of anything, even something that is essentially beneficial, can be harmful. However, the actual concept of moderation goes back much further than the 15th century and is most often attributed to an extrapolation of Aristotle's *Doctrine of the Mean*. In this work Aristotle extolled the merits of finding the mean, or middle ground, between excess and deficiency. And while Aristotle's work was focused on ethics, the framework tied to his logic is largely universally applicable.

As we approach the beginning of summer, the level of volatility in the market is showing no signs of abating. What is interesting is that we are seeing volatility across the investment spectrum. Ordinarily volatility would tend to be contained in one sector rather than the across-the-board phenomena that we have now. Moreover, the magnitude of the volatility has been impressive. The natural question arises around why there is so much volatility. The conclusion I have reached centers on the amount of monetary stimulus that has been injected into the markets.

The actual numbers tied to the stimulus that has been injected into the markets is staggering. According to a study by Bank of America, there have been 572 rate cuts around the globe; starting back in 2008 following the collapse of Lehman Brothers. This equates to roughly one rate cut per week (one every three trading days) over the last 7 years. Historically, this amount of stimulus is unprecedented—and it appears that we have deviated into an era where moderation no longer applies.

In the context of 572 rate cuts it becomes easy to understand why much of this week's activity and the corresponding volatility were driven by speculation around the first Federal Open Market Committee rate increase. Chairwoman Janet Yellen's speech on Friday was in line with the messaging that she has delivered throughout the first half of this year: it offered a balanced view of economic growth against a backdrop of mixed economic data. And while she indicated that a rate rise sometime this year would be "appropriate," she hedged her comments by stating that "we are not there yet" in regard to the Fed's targets tied to the employment data.

In looking at the actual data this week, its mixed tone followed the same pattern that we have seen all year. March U.S. consumer prices rose 0.20% (less than the expected 0.3% rise) but fell 0.10% on a year-over-year basis. On an annual basis consumer prices have not risen in 3 months. On the manufacturing front the headline number for March met expectations at 0.10% as auto production drove the growth while the strength of the dollar caused weakness in other segments of the report.

The mixed data drew the full spectrum of opinions from the FOMC regarding timing of an increase. Several members expressed the view that it is too soon to raise rates while others felt that a June increase is still not off the table. Orchestrating the first rate hike is proving to be incredibly difficult. Front and center are fears of inducing another taper-tantrum, similar to the one that occurred in 2013 when then-Chairman Ben Bernanke suggested that rate increases were likely. Surging yields would increase the costs of everything from mortgages to car loans and could potentially put the fragile economic recovery at risk.

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U.S. Treasuries continued their recent wave of rate volatility as the range (highs for the week vs. lows) on the long end of the curve came in just under 20 basis points. On an absolute basis (week-over-week) the middle of the yield curve saw the largest move as yields on 5-year rates rose by 10.5 basis points. Interestingly, even with the speculation tied to a shorter FOMC timeline, yields on the front of the curve were stable, with yields on 1-year Treasuries only increasing by 1 basis point.

The weakness in the middle-dated maturities resulted in the curve flattening. The spread between 2-year and 10-year Treasuries finished the week 1.5 basis points narrower, at 160. The largest move on the week occurred out the curve as the spread between 5-year and 30-year rates fell by 5 basis points. This week's flattening would seem to be at odds with a market that is expecting robust economic growth. In fact, the flattening coupled with the lack of movement on the front of the curve actually seems to indicate concern going forward about the economic picture.

Technically, even in spite of the intra-week swings in rates, the market continues to remain range-bound. The range on 10-year rates continues to adhere to the 2.00% to 2.30% zone that has governed the majority of the activity over the last 6 months. Yields are sitting at the higher end of their recent ranges and are attempting to unwind the overbought (on a yield basis) condition that was a result of the 40-plus basis point move off the April lows. Watch the 2.17% level on 10-year Treasuries: Breaching this level will indicate that the rate bulls have gained control of the market, which could result in a move toward 2.00%.

As we close the week, the market appears to be having a difficult time even entertaining the notion of a normalized monetary policy. The last four weeks have seen intra-week moves of 20 basis points or more as the uncertainty around monetary policy coupled with the lack of liquidity would appear to be fueling the large price swings. The historically unprecedented and frankly staggering amount of stimulus has completely skewed both risk and return, creating an environment that is ripe for massive volatility. Investors are quickly learning that the market is not normal and expectations around normalcy and averages need to be replaced with an understanding of extremes. Indeed, perhaps we have seen "too much a good thing" in the guise of the well-intentioned stimulus.