The End of TINA?

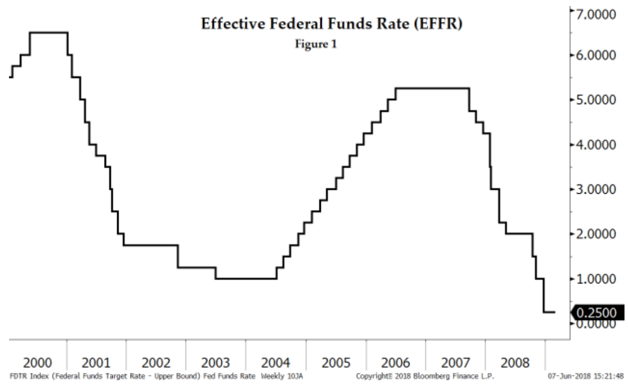
June 2018

By: Luke Nicholas, CFA
Portfolio Manager

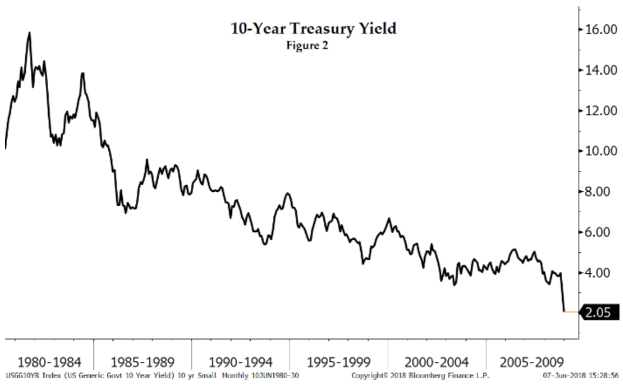
While the 1960s will always be remembered for free love and peace signs, the '80s for bad hair and the '90s for the rise of the personal computer – the 2010s may very well be remembered for something far different – record low interest rates. Low interest rates have impacted consumers and financial markets in a myriad of ways over the past decade. I will review some of those impacts, re-introduce the now famous acronym TINA and discuss whether this low interest rate era may finally be coming to an end.

Before discussing the implications of low interest rates, I want to explain how the low rate era began. Unfortunately, to do this we must go to a place that no one in my profession likes to revisit – the depths of the Great Recession in 2009.

As stalwart Wall Street firms were going bankrupt and the U.S. economy was in shambles, the Federal Reserve leapt into action in an attempt to pull the U.S. economy out of what became the worst recession since 1929. The Fed slashed the Fed Funds Rate to 0.25%, its lowest level in history (See Figure 1). Since countless financial instruments use the Fed Funds Rate as a base rate, a lower rate drives down interest rates across the economy. This makes the cost of borrowing cheaper and, in theory, stimulates economic growth.



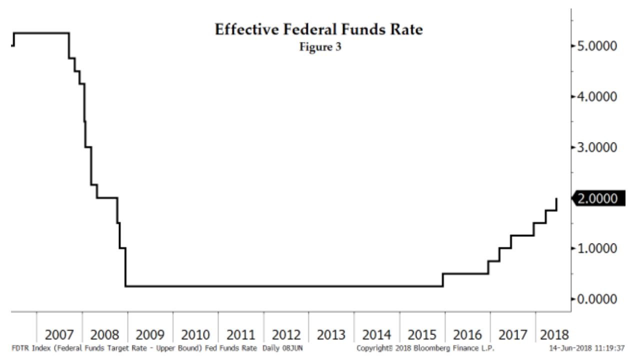
While the decision to cut rates did help to pull the economy from the depths of financial ruin, it also had rippling implications across financial markets. Since the Fed Funds Rate was at essentially zero, yields on investments across numerous asset classes, which are priced off the Fed Funds Rate, were suddenly yielding far less than they ever had. Investors accustomed to earning 5% or more on a Certificate of Deposit (CD) or short-term bond were left earning less than 1% on such investments. Even longer-term bonds, which come with more interest rate risk, were yielding next to nothing. The 10-year treasury yield, which had averaged close to 7% during the forty years prior to 2009, yielded just 2% (See Figure 2). Investors around the globe were left without any place to put their money that offered both relative safety and return potential.



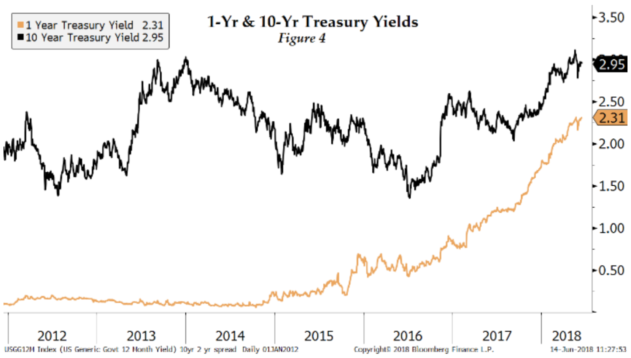
This is where TINA comes into play. TINA stands for "There is No Alternative." It speaks to the fact that for the last 8 years, because yields on short-term investments (CDs, short-term bonds, savings accounts) were effectively zero, investors had *no alternative* but to take on more risk in their portfolios if they hoped to achieve any sort of appreciable return.

This new reality forced the hand of even the most conservative investor to take more risk – whether that meant shifting from CDs to longer-term and/or lower quality bonds, or as was the case for many investors, moving more money into the stock market. We saw generations of "CD investors" disappear, as they were no longer able to meet their financial goals buying these safe investments. As more investors were forced into riskier investments, the stock market rallied. The S&P 500 has returned over 300% since the bottom in March of 2009, making the last nine years one of the strongest and longest bull markets in history.

Now, TINA may finally be coming to an end. The Fed has begun raising the Fed Funds Rate, as the economy has recovered, and it seems the stimulus of near-zero interest rates is no longer warranted (See Figure 3).



The increase in the Fed Funds Rate has flowed through to many other financial instruments. Short-term treasuries now yield over 2%, and 10-yr bonds are paying almost 3% (See Figure 4). Investors once again have options for positive returns without taking the risks associated with lower-quality bonds or stocks. This has numerous implications for investors and financial markets.



First, if you or someone you know has money sitting in a savings account earning close to nothing, know that there are now options to earn significantly more than the average savings account without taking much risk. After all, treasuries are backed by the U.S. government. Short-term treasuries are a great place to put cash if you plan on using it in the near-term, or if you are looking to have a liquid reserve to take advantage of potential market volatility. The team at Allegiant would be happy to discuss the options available to you.

Another significant impact will likely be on the stock market. As I mentioned before, because many investors had *no alternative* but to take on the risk of investing in the stock market, this led to one of the strongest, least volatile periods in stock market history. Now that the TINA era seems to have come to an end, we anticipate equity markets will have significantly more volatility than we have seen in recent years.

Some risk-averse investors may choose to return their money to the safe havens mentioned in the previous paragraph. Already in 2018, we have seen a return of much higher volatility in equity markets – and we believe higher interest rates are a significant contributor.

Beyond these two, the housing market will have to deal with higher mortgage rates and therefore is another area that stands to be significantly impacted by higher rates. But, it does not stop there. Interest rates have an incredibly large impact on just about every area of the economy – and how our economy and financial markets react without the support of near-zero interest rates is far from certain.

However economic events progress from here, the team at Allegiant will help guide you and your portfolio through any challenges that may come our way. As your Portfolio Manager and a member of our Investment Research team, I see that as my most important job over the next few years.

Please feel free to contact me directly at Luke@allegiantpa.com if you have any questions or concerns.