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We Have to Talk about Rates Again

Greg Cater Sr & Greg Cater Jr

Whether you are a long time client, a colleague, or just someone who's been stuck in a room with us for more than 5 minutes, it is safe to assume you have heard one of us say the following: "Increasing US Government debt causes interest rates to fall." We hammer on the idea a lot. This isn't our first note on the topic, and it won't be our last, but hang with us, this is important.

Last April we posted a note titled *Government Debt, Deficits, and Interest Rates.* If you need a refresher, you can find it in the *Notes* tab of caterwealthmanagement.com, but here's the reason it matters today:

10-Year-Treasury April 2019:	**2.59%**
10-Year Treasury Feb 2020:	**1.56%**

We are down over 1% in rates from April '19 to Feb '20. That's a 38% drop in less than a year! So how about the debt? Richard Rubin, in a Wall Street Journal article dated Jan. 28, 2020 wrote:

> "The government will spend $1 trillion more than it collects in 2020 and deficits will exceed that amount every year for the foreseeable future. As a share of gross domestic product, the deficit will be at least 4.30% every year through 2030."

We are in an election year; promises will be made and promises will be broken. Ronald Reagan promised to balance the Federal budget and reduce the Federal debt if elected. During his 8 years in office the Federal debt tripled. President Trump, when asked by Bob Woodward in an April 2nd 2016 Washington Post interview how long it would take him to pay off the "$19 trillion in debt" he said:

> "Well, I would say over a period of eight years."

And Reagan and Trump are republican fiscal conservatives! What do you think will happen if a liberal democratic socialist wins? If trillion-dollar annual deficits are projected for the next 10 years under a conservative president and higher government debt = lower interest rates, a democratic liberal socialist could cause us to lower our interest rate forecast further.

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Understanding and predicting the direction of interest rates is one of the most important factors in a successful income investment strategy. It is impossible to know if a given yield is attractive without some understanding of how that equity's cashflows will be valued in the future. Remember, (all else equal), falling interest rates make current income assets increase in value, and rising rates do the opposite.

We hit our 2.0% target for the 30-Year-Treasury-Bond again today. 1.0% for the 10 year may prove to be too high.