Asset Allocation

Capital allocation (a target percentage range for stocks, bonds and cash) is the foundation for navigating the murky waters of uncertain investment outcomes and is a pillar of risk management. As investment managers, we focus daily on the allocation goals of our clients. The asset allocation for an individual or family works best when it reflects a synthesis of reasoned opinion and emotional insight. Understanding how we feel as investors about volatility and safety is as important as cash flow needs and growth expectations. When uncertainty is elevated, as we believe it is today, it can be useful to re-visit our assumptions about capital allocation and investment objectives. The goals are engagement, reflection and consideration of some of the following factors that we believe are impacting the investment markets today:

- The Federal Reserve: The rate that is directly controlled by the Fed is the Federal Funds Rate or the rate at which banks can lend to each other over-night. It is expressed as a range and in July of this year, the Fed cut rates for the first time in a decade to a range of 2-2.25%. We expect to see another quarter point decrease in September. After the July cut, the Fed expressed an opinion that interest rates might be steady until 2021. That does not seem to be the case now.
- The inverted yield curve: When short-term rates exceed medium or long-term rates, it is called an inverted yield curve. Today, a one month US Treasury yields 1.9%. The five year Treasury bond yields 1.46% and the ten year yields 1.57%. Inverted yield curves are unusual, and the last four times the curve inverted, we had a recession within 6-24 months.
- Negative interest rates: About $15 trillion in global government and corporate debt pays an interest rate to buyers of <0%. This is an unprecedented event and the impacts are not well understood. Historically, low interest rates reflect an expectation for slow economic growth.
- Tariffs.
- September has historically been the worst month for stocks.
- The TINA theory: “there is no alternative,” meaning interest rates are so low that stocks are the only alternative that provide liquidity.
- The S&P 500 dividend yield now exceeds the 10 year US Treasury bond yield.
- Political unrest again in Italy and Greece as well as October 31 Brexit deadline.
- We are in the early stages of what could be a very divisive election cycle in the US. Political extremes and policy differences are likely to add to a general feeling of uncertainty until the election is decided and perhaps beyond that date.
- There is substantial debt issued by developing countries that is denominated in US currency. This will make it difficult for these countries if there is a significant economic slowdown.
- Projections for global economic growth are positive at 2.6%, but those projections have been declining.

The above list is one possible starting point for thinking about capital allocation in an uncertain world. Please let us know if you would like to review any aspect of your current investment strategy.

Dale Slater

The Hanson Slater Power Group
Baird
925 4th Avenue, Suite 3600
Seattle, WA 98104
206 664-8888

Baird – Nationally recognized as a great place to work since 2004.