Market Alert

Food for Thought: Post-Election Bond Market Move

Like the "Brexit" vote earlier this year, the election of Donald Trump surprised pollsters and financial markets alike. Bond prices have weakened noticeably since November 8th with the 10yr Treasury Note yield popping up 40bps from 1.85% pre-election to 2.25% ten days later. As always, a market move like this cuts both ways. It will provide a welcome opportunity to add earning asset yield onto the balance sheet... good news indeed, but it will also cause most current holdings to see a deterioration in value.

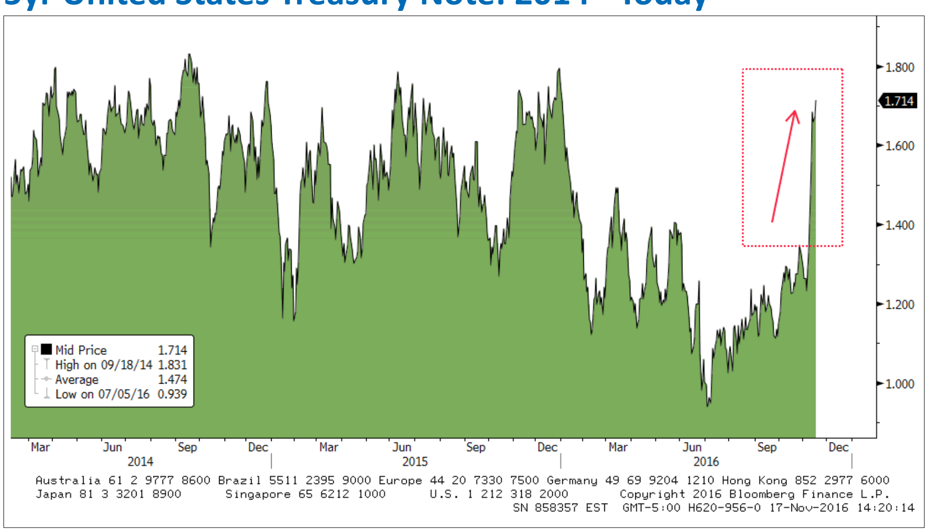
All primary bond market sectors were affected by the selloff with perhaps the greatest impact being felt in municipal bonds. This is because of uncertainty about the form and magnitude of any tax rate changes or reforms to the code generally. We will have more to say about the potential impact on municipals in a separate piece, but in general, investment officers and portfolio managers can expect to see a drop in the value of all portfolio holdings for their November month-end pricing.

A good way to gauge the impact of the market move is to look back to the experience of 2013, the year of the so-called "Taper Tantrum" when bond yields jumped sharply over a period of eight months subsequent to the Fed's announced policy shift away from QE asset purchases.

For comparative purposes we should look at the behavior of the 5yr point on the curve since the average bank portfolio in our database has an average-life of between four and five years. In 2013, the 5yr Treasury yield rose from .65% at the beginning of May to 1.75% at year-end. That, of course, was over an eight-month period. So far, we've seen nothing like that since the election. It's instructive, however, to look specifically at the month of June 2013, during which the 5yr yield jumped from .65% to 1.00%, or 35bps, very close to what we've seen since election day.

The average portfolio on our database during June of 2013 saw unrealized gains of 1.59% replaced by unrealized losses of -.15%. Something similar to that degree of change can be expected for the month of November 2016. Of course every bank's portfolio is different in terms of size, sector allocation, and numerous other characteristics. Differences in price impact will vary accordingly. If managed prudently in terms of security selection, cash flow integrity, average life volatility and interest rate risk exposures, this move offers an excellent opportunity to fight margin compression and boost earnings by reloading with bonds at higher yields than have been available in some time.

5yr United States Treasury Note: 2014 - Today



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