Bell Institutional

November 2023

# ECONOMIC OUTLOOK

U.S. Treasury bonds are considered the world's safest asset. Sometimes, these bonds are referred to as "risk free." This means that owners of U.S. government bonds have the highest probability of receiving timely interest payments and the full return of the bond's principal face value at maturity date.

By now, most investors have come to learn the term "risk free" is misleading, because it does not apply to other investment perils beyond the payment of interest and principal. As of the end of October this year, the price of the long-term U.S. Treasury index is down -45% from July 2020. That is an annualized loss of -17%.

Rising interest rates erode the value of fixed-income securities, and U.S. Treasury bonds are no exception to this type of risk. Some of the more common themes triggering rising interest rates are higher Fed Fund rates and elevated inflation. Some of the more subtle but perhaps nearly as influential causes are changes in term premium risks, reduced foreign buying, Fed quantitative tightening and market reactions to increased deficit spending by the federal government (and the increased bond issuance supporting that spending). Years ago, "bond vigilantes" was the term used to explain market response to these types of conditions.

Specifically, interest expense on U.S. government debt has gone from $500 billion per year to $900 billion in the last 30 months. Total taxes collected by the federal government last year were $5 trillion. Interest expense is now nearly 20% of revenues. By comparison, the defense budget for last year was $782 billion. The bond market, in part, is signaling that federal debt, deficits and interest expenses are a growing concern.

Interest rates are the highest they have been in nearly 20 years. Our bond strategies have avoided the significant declines represented by long Treasury bonds mentioned above, in large part due to the structure of the portfolio. There is no way to know how high rates will go, but it is time to make some adjustments to portfolio positioning by slowly moving toward slightly longer maturities. It may seem counterintuitive to do this when short rates are so attractive, but it helps manage another risk known as "reinvestment risk." If too much of a portfolio matures near the same time, there is a chance that large portions will be reinvested in an unfavorable environment. Spreading maturities along a maturity spectrum helps control this risk and provides a more consistent return profile. As a Bell Bank Wealth Management client, this essential activity occurs within the boundaries of the investment objective for your account.

As always, thank you for your business and confidence in Bell!

Greg Sweeney, CFA®

SVP/Chief Investment Officer

**Tenure:** 1992

**Investment Experience:** 38 years

**Education:** Bachelor's degree in business, University of North Dakota; Chartered Financial Analyst designation

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