

CURRENTS: The Bond Market & Interest Rates

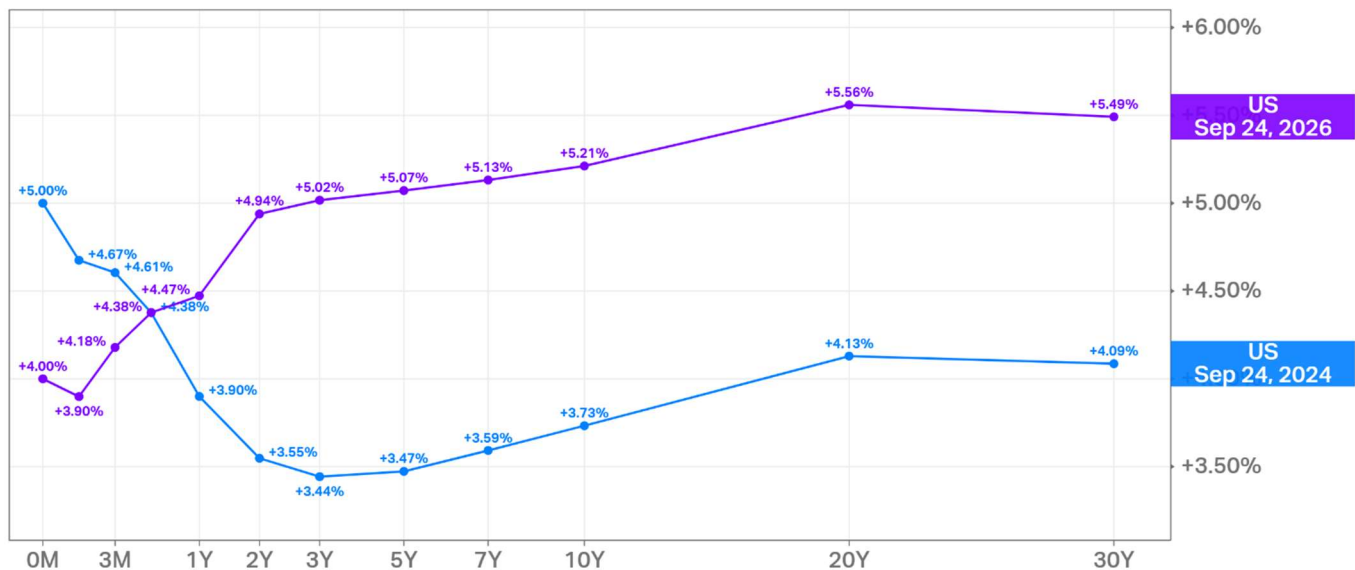
They dominate the headlines in the financial news media and understandably so. Intermediate to longer term rates are near their highest levels since 2007. The Federal Reserve recently raised the overnight lending rate for the first time in 3 years.

Two years ago, the Federal Open Market Committee (FOMC or The Fed) kicked off their most recent easing cycle by cutting the benchmark interest rate for overnight lending. As a quick aside, the Fed Funds rate is what banks charge each other for overnight lending. It is also closely tied to the rate the Federal Reserve pays to banks who hold excess reserves with the Fed.

The Fed cut from September 2024 through late 2025, paused, and has now reversed course. The most recent hike was largely driven by inflationary trends above the Fed's target.

The yield curve plots interest rates from very short to very long maturities. Comparing today's yield curve with the yield curve of two years ago; back when the Fed started cutting interest rates.

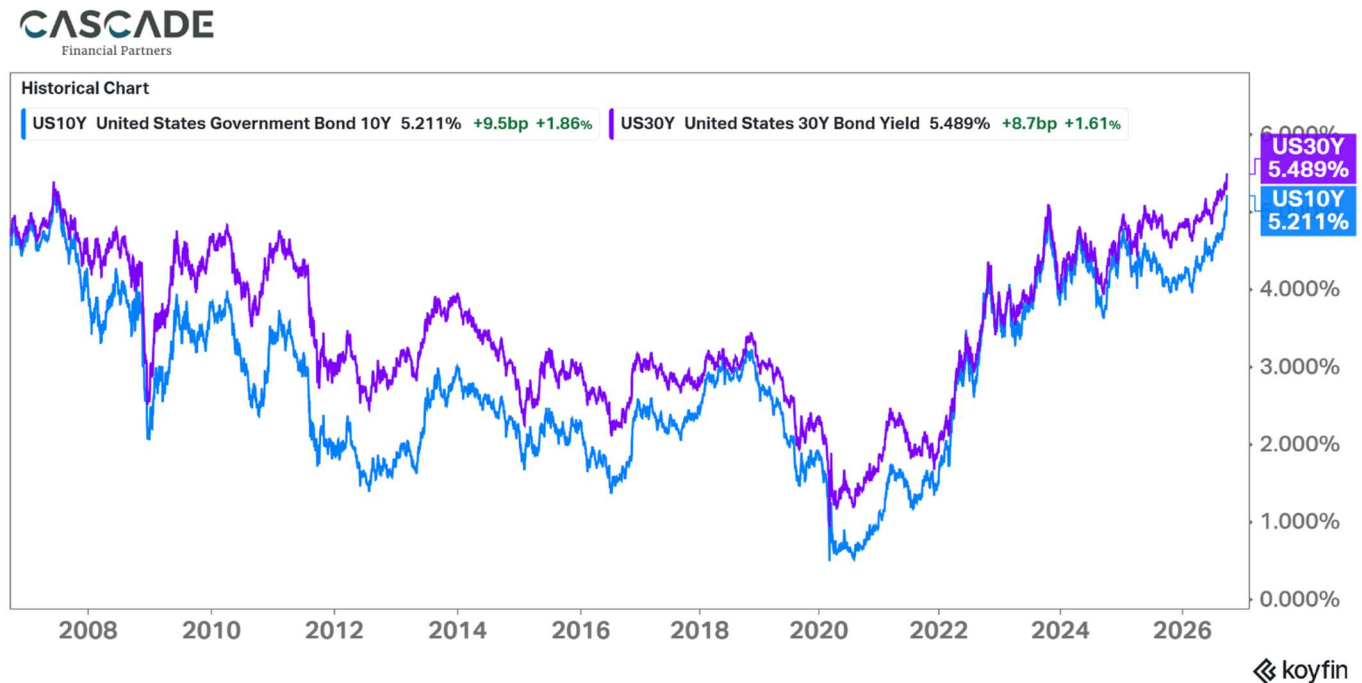
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As you can see by the purple line, very short term rates are still lower today than they were 2 years ago. As a result, we are paid less in money market funds and banks pay less in savings accounts than they did 2 years ago. However, intermediate to longer term rates (and mortgage rates) are higher today than they were two years ago. As such, investors earn more today by owning intermediate to longer term bonds than they did two years ago.

In fact, investors are paid more today to own intermediate to longer term bonds than they have been in almost 20 years. Here is a chart reflecting interest rates for 10-year treasuries (blue) and 30-year treasuries (purple) over the last 20 years.



Rates could certainly move higher, which would put further pressure on bond prices since rates and bond prices move in opposite directions. However, we would expect declines in high-quality, intermediate-term bonds to be considerably smaller than in stocks if rates move meaningfully higher from here.

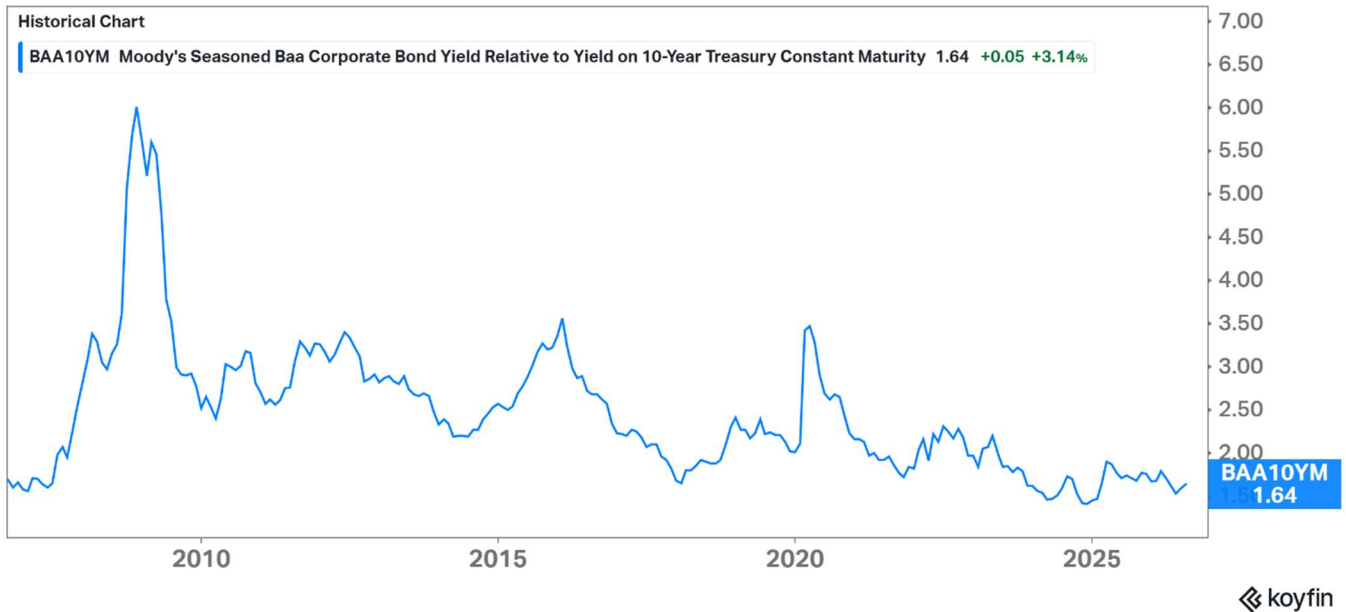
At the 2013 Berkshire annual meeting, Warren Buffett said “interest rates are to asset prices, you know, sort of like gravity is to the apple. And when there are very low interest rates, there’s a very small gravitational pull on asset prices.”¹

When rates rise, the pull on stocks prices gets stronger, so the extra return investors need to justify stock risk goes up. This is not a prediction that the stock market is about to fall off a cliff, but after strong returns from stocks, many portfolios have drifted above their stock targets. This may be a good time to take profits from stocks that are above targets and rebalance to high quality bonds that are below target allocations.

Credit worthiness and risk is another important consideration when investing in bonds. When a bond carries more credit risk, investors demand higher rates and yields than they do for bonds with less credit risk or higher credit quality.

¹ [Warren Buffett: Interest Rates Power Everything In The Economic Universe - The Acquirer's Multiple®](#)

Currently, “credit spreads”, which is the extra yield over a comparable Treasury is narrow. Take a look at the Moody’s Baa corporate bond yield relative to the yield on U.S. 10-year treasuries over the last 20-years.



Investors are being paid well to own high-quality bonds with some duration, and poorly to take extra credit risk. That combination is why Cascade’s bond (safety) allocations generally lean toward treasuries and high credit quality. We have been consistently positioned this way since we began reducing our allocations to money market funds about a year ago.

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