July 2016
Volume 8, Issue 3

Sandpiper Capital

Gleanings

1613 Laskin Rd., #200
Virginia Beach, VA 23451

757-962-4596
Fax 757-962-5038

www.sandpiper-capital.com

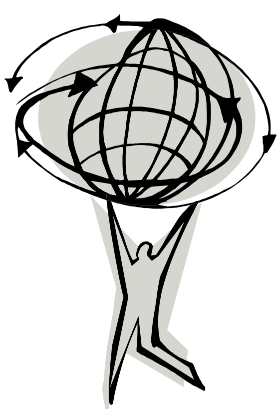
Lower and lower…

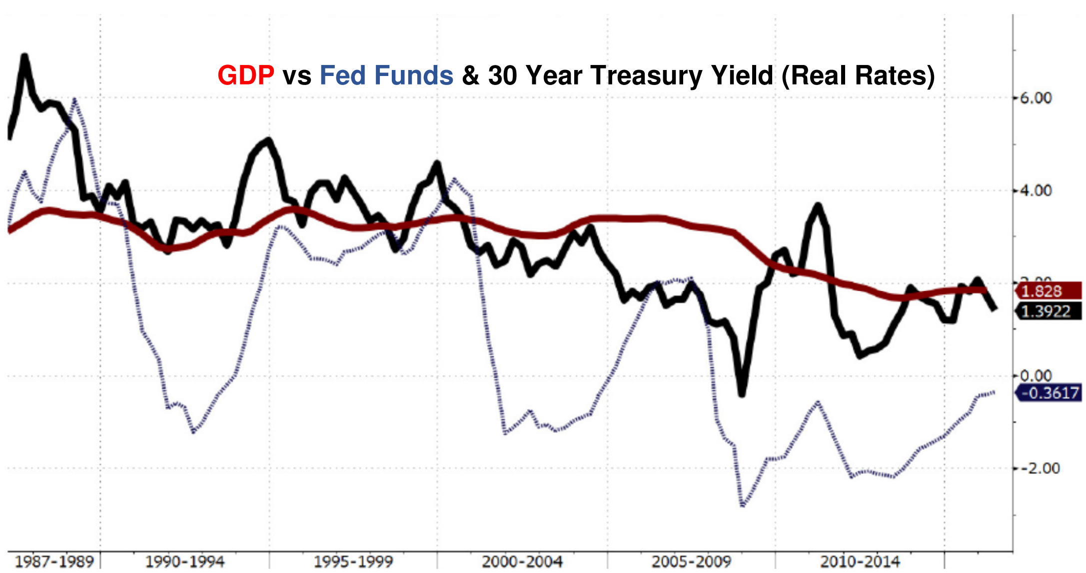
The market saw a fairly remarkable drop in rates last month on the news of the “Brexit” vote. Both short term as well as long term Treasury rates fell 30 basis points (.3%) in a day and then stayed down. The last time the rate on thirty year Treasuries was this low (2.25%) was 1956, a year which followed, not coincidently, the only *negative* inflation readings in the last half of the 20th century. Lower rates *can* help the economy by fueling growth of the financial markets and allowing companies and individuals to refinance existing debt, but lower rates are also a reflection of the expectation that the overall economy will not grow in the future as it has in the past. In the chart below, the real (inflation subtracted) rates for U.S. economic growth (GDP), the **thirty year Treasury** as well as the Federal Reserve’s policy rate are illustrated. The GDP line has been smoothed by averaging the trailing fifty quarters to reflect the long term trend. The trendline rate of growth has been halved over the last three decades from a real rate of 3.6% to the current 1.8%. Economic theory says this is from low population and productivity growth but no income growth for 90% of the population can’t be helping. The long real Treasury rate (in black) has varied around the GDP rate depending upon Federal Reserve policy at the time (blue dotted line). Having spent most of the last fifteen years negative, that is, the cost of short term funds in the Federal Reserve system being less than inflation, expectations are that easy policy will continue, keeping the thirty year rate below trendline GDP. Indeed, in the last two weeks, market expectations for Fed Funds have fallen to reflect a projected negative real rate for the *next three years*. It looks like low rates will be with us for a while.

Market Returns Annually and Ten Years Ending 06/30/2016

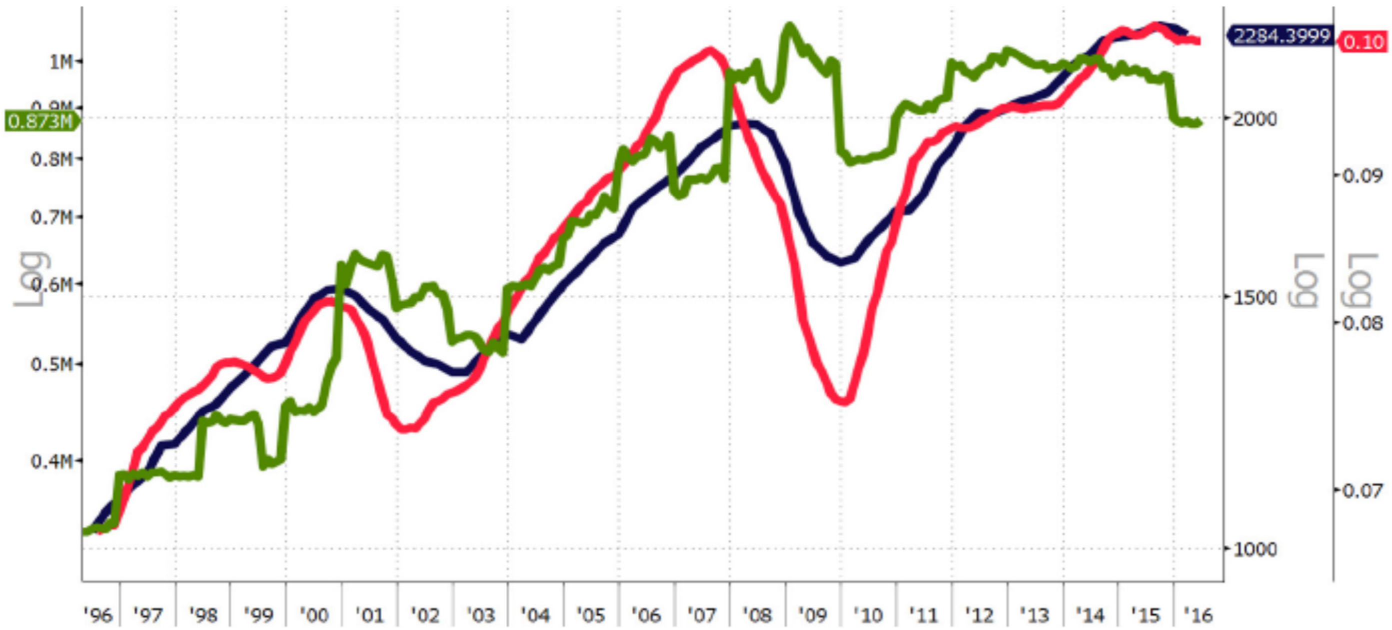
Index	2014	2015	10 Yrs	YTD
S&P 500	13.7	1.4	**7.4%**	**3.8%**
ML 1-5 yr Gov’t/Corp	1.5	1.1	**3.5%**	**2.6%**
EAFE (Dev Fgn Mkts)	-4.9	-.8	**1.6%**	**-4.4%**
Emerging Markets	-2.1	-14.6	**3.9%**	**6.5%**

“The last time the rate on thirty year Treasuries was this low (2.25%) was 1956, which followed, not coincidently, the only negative inflation readings in the last half of the 20th century.”

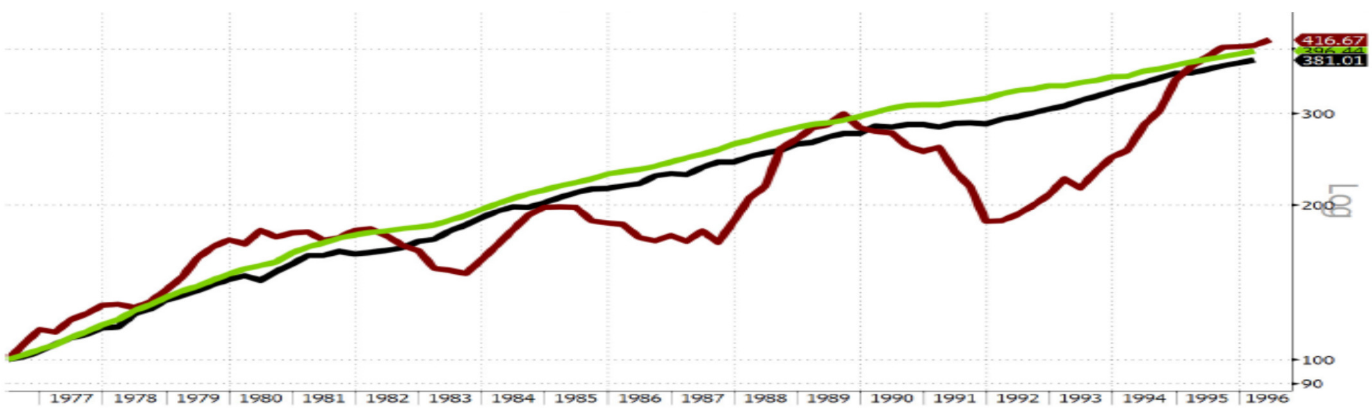


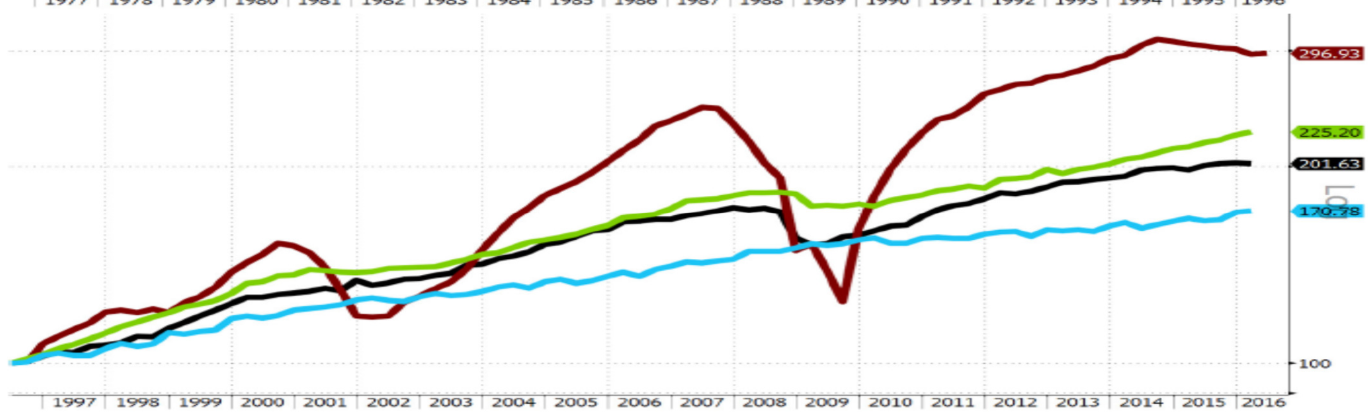


Economic growth is linked by economists to the growth of productivity (output per worker). The experience of the last twenty years has seen the combination of global competition, low interest rates and technological improvements combine to make capital investments especially profitable. (Witness the green line - sales per employee for the S&P 500). The result has been great for the stock market even as the broad economy has seen a sharply reduced rate of growth. S&P earnings per share as a proportion of sales per share, while dropping precipitously during the last two recessions, have increased from under 7% to 10%, lifting profits by 50%. That lift does appear to have run its course, however, with capital spending and sales per employee flat or down over the last two years.



Historically long run growth in wages, profits and **retail sales** have been about equal, (with profits more cyclical). The twenty years ending in June of 1996 (the chart immediately below) saw all three up in nominal terms by a factor of four. The most recent twenty year period saw profits triple but retail sales only double because wages only doubled. Average wages which are skewed higher by high earners were up by 125%. Median wages which are those wages where half are higher and half are lower, were up by only 71%, pulling retail sales (and GDP) down.





Tom Lukic