

The Tonge Telegraph

June 2004

Measuring The Glass

Is the proverbial glass half full or half empty? After observing last year's overflow, I would argue that we have returned to the halfway mark. Some significant leakage occurred over the past couple of months. We can begin to see some balance between the excesses of last year and the prospects for this year and next.

Uncertainties abound in current assessments of our economy, our markets, and our politics. Markets notoriously do not like uncertainties. That is one of the reasons the markets have sold off over the last couple of months. Uncertain, however, does not mean bleak! The prospects for our economy are good, with growth for this year expected to be more than 4.5 percent, the best growth since the mid '80s. The markets will track and anticipate the economy as our election campaigns wend their way to November. The outcome of autumn's elections is uncertain, but there will be, at last, an outcome, and it is unlikely that the economy's progress or process will be unduly disrupted.

Much of the risk in the markets has now been drained off. Although nearly all sectors have been selling over the last month, some are beginning to reach levels where purchases may make sense. I have begun researching opportunities but will not commit cash reserves to the market until the selling pressure stops and some significant buying takes place. This could begin to happen next week . . . or not until the elections are over.

Meanwhile, I've had a number of conversations about bonds and bond portfolios recently. Bonds have gone through quite an adjustment in the last couple of months. Now that the Federal Reserve has stated that it will increase rates at a measured pace, it is abundantly clear that rates will go up. This near certainty has caused bond prices and yields to adjust, apparently to account for a prospective one-percentage-point increase in interest rates. We start, then, with Fed funds at one percent. Factoring in a one percent increase brings us to two percent. The top of this scale during reasonable economic conditions is 3 1/2 to 4 percent. These levels would normally take several years of significant growth and inflation pressure to attain.

With that analysis as foundation, I have recently created some laddered bond portfolios that start with a two percent bond in two years and go to a 5.5 percent bond in 10 years. The average yield for the portfolio is over four percent and there are some bonds with yields approaching six percent. Viewed in historical perspective, these are fair and reasonable yields. One rarely finds a laddered bond portfolio, made up of investment grade bonds, with an average yield above five percent. We may get there over the next couple of years, but it is unlikely we will go much higher. Perhaps, then, the glass is neither half full nor half empty. Perhaps, as Walter Cronkite used to say, it's just . . . the way it is.

As always, I look forward to your comments.