INTEREST RATES – THE RACE TO ZERO

Two years ago world economies were improving and the universal belief was that interest rates, especially in North America, would be going up after decades of declines. Not so - after the December 2018 stock market decline - mainly over the stalled US – China trade talks, the US Federal Reserve Board aggressively cut rates. The result was the widely followed benchmark – the 10 year US Treasury Bond, instead of rising to a much forecast 2.5% or 3% expected annual yield, in fact fell below 2% by the end of 2019.

The year ended with North American economies continuing their strength and, as trade issues abated, **growing signs that the rest of the world, especially Europe, would be joining in**. With interest rates at record lows and negative in many European countries, the consensus was that 2020 would be a year of stability, and with nary a recession in sight, there would be minimal need for Central Banks to intercede and do any more "rate cutting".

Two months and a week into the year no one could have forecast a more troubled picture. The spread of Covid-19 and the impacts on the economy spurred the US FED to make a surprise half-point cut in the bank rate. Canada followed suit a couple of days later. Rather than inject stability into equity markets and calm investors, the effect seems to be the opposite.

Last week saw daily large percentage swings both up and down in equity markets as pundits went to extremes in their extrapolation of the economic fallout. Cancelled cruises, conferences, sporting events, a severe cut-back in travel and consumer spending - what will be the long-term effect on economies?

The week ended with OPEC in disarray as Russia and Saudi Arabia fell out over oil output. **As I write, an all-out price war seems imminent and oil, already down by 30% for the year, could fall another 25%.** This cannot be good for Canada's troubled oil patch and the Alberta economy.

The uncertainty drove anxious investors en masse to the "safety" of government bonds. **The result was the week ending with the major US and Canadian bonds – 2, 5, and 10-year all yielding well under one percent**. Wow!! For someone who had an 18% mortgage back in the eighties, such low, low yields seem a stuff of fancy. Unless one believes Covid-19 and its fallout will last for years, locking one's money away for 10 years at 0.7% interest a year, does not seem to be a sound investment strategy.

As I wrote last week, the "**Unknown Unknowns**" have continued and for sure there will be a hit to economies everywhere. The fall in share prices seems to be telling us that and perhaps even a recession is very possible. How low can shares fall is the big question mark as we have no way to gauge the full economic impact. What seemed like bargains a week ago became bigger bargains this week.

The biggest issue driving it all, I think, is fear and my belief is that this will only abate when either this outbreak is contained or, as a number of experts predict, we accept coronavirus may well become an annual event much like the cold or flu. **Either way we will have certainty on the appropriate steps going forward** and sanity will return to stock markets and toilet paper to supermarket shelves.