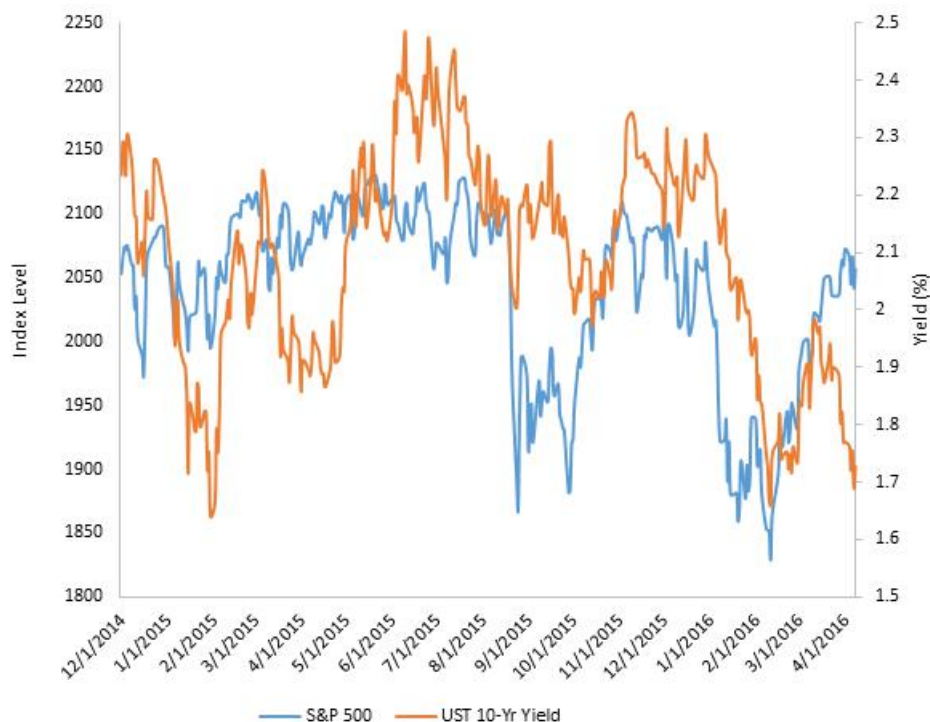


U.S. TREASURIES: THE SAFETY DANCE

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One of the more notable influences in the [U.S. Treasury market \(UST\)](#) over the last five years or so has been the flight-to-quality or [safe-haven](#) trade. In market parlance, it has been better known as the risk-on/risk-off trade. A variety of factors have created this environment in the past; most recently, we addressed this topic in our February blog post [U.S. 10-Year Treasury Yields: "Groundhog Day: The Sequel"](#). Specifically, we looked at the dynamic that was playing out between the [S&P 500 Index](#) and the [UST 10-Year yield](#). Indeed, throughout the first six weeks of the current calendar year, it was readily apparent that there was a tight [correlation](#) between falling U.S. equity prices and the rather visible drop in the 10-Year yield. In fact, this trend reached its peak on Feb. 11, when the S&P 500 had dropped nearly 250 points from its year-end high, while the UST 10-Year had witnessed a 65 [basis-point \(bps\)](#) plunge in yield during the same time frame. Following this safe-haven bid for Treasuries, the markets then reversed course, with the risk-on trade dominating. Once again, stocks and bonds experienced another tight correlation, but this time around, the trend was reversed, as the S&P 500 moved up off its aforementioned low while UST 10-Year yields began a renewed ascent. Interestingly, this relationship only lasted for about a month and was followed by an obvious disconnect. To provide perspective, up until March 11, the S&P 500 recouped almost 78% of its losses during the first six weeks of the year. At the same time, the UST 10-Year yield rose more than 30 bps and was just below the 2% threshold. As the graph below clearly illustrates, the correlation between stocks and Treasuries then began to break down. In other words, while stocks were continuing their upward move, the UST market also rallied, with the UST 10-Year yield falling back down to 1.69% last week. The natural question to ask is what type of catalyst could cause both the stock and bond markets to rally at the same time. Certainly, the [Federal Reserve \(Fed\)](#) interjected itself into the equation on two separate occasions during the month of March, and both instances were perceived as leaning toward the unexpectedly [dovish](#) side of the policy equation. The first instance was the [FOMC](#) meeting, which was followed by what some commentators have dubbed the "Yellen celebration," or the Fed chair's much ballyhooed public comments a couple of weeks ago. As a result, Fed [rate hike](#) expectations have noticeably dialed back. To be sure, the December [Fed Funds Futures](#) contract now barely prices in one rate increase for this year.

S&P 500 vs. UST 10-Year Yield



Source: Bloomberg as of 4/8/16.

Conclusion

So what lies ahead for the UST market, and should we expect to see the correlation with the S&P 500 returning any time soon? The first week of trading in April witnessed a bit of a return of the risk-off, or safety, trade. Most Treasury yields have now fallen close to the lows registered back in mid-February. As we have seen in just the last few months, this factor can have its ebbs and flows. That being said, the safety or risk-on/risk-off trade is likely to remain an integral part of the UST market landscape throughout the rest of the year.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Safe-haven : Characterized by being a potentially desirable focal point of investment flows during periods of increased volatility and market risk. Safe-haven is not synonymous with risk-free.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

10-year government bond yield : Yields on the 10 year government debt security.

Correlation : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

Basis point : 1/100th of 1 percent.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Dovish : Description used when stimulation of economic growth is the primary concern in setting monetary policy decisions.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Fed fund futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.