



2019 Outlook: Conversations with Commerce Trust Fixed Income Transcript

Chris Schildz:

Welcome to Conversations with Commerce Trust. A podcast where various specialists discuss the latest research, insights and market news.

Good morning everybody, this is Chris Schildz with the Commerce Trust Company and we're going to discuss today some of the fixed income market activity as of late and into 2019 with Doug Koester, who is our Senior Vice President and Senior Portfolio Manager. Doug holds the chartered financial analyst designation. Doug, welcome this morning. How are you?

Doug Koester:

I'm fine Chris, thank you.

Chris Schildz:

The New Year is upon us and fixed income was certainly a volatile, if you will, like as some of the rest of the markets in 2018. Probably the easiest part to get started here would be have a look at interest rates. We had four hikes in 2018. What do we have to look forward to in 2019?

Doug Koester:

Yeah, we did have four fed funds rate increases in 2018 and that would make nine since they started raising rates in late 2015. So it's been three years now, but we think in 2019 they're going to be a little bit more slow and measured in their approach to rate increases. The economy isn't as strong as it was in 2018 and inflation is very much under control and so there won't be any strong impetus for them to raise rates too aggressively into 2019.

Chris Schildz:

Now a lot of people have bonds in their portfolios as a sort of an insurance policy. And yet, in 2018, we had the first negative annual returns since 2013. Is there more of that to come looking forward?

Doug Koester:

Yeah, the bond market was volatile as you mentioned and it did have a slightly negative return. The Barclay's Aggregate, the flagship benchmark was about flat for the year, but some of the other indices were slightly negative. That was because of less demand for fixed income products. And also that spreads were widening on a, basically a slower projected economic outlook going



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forward. But, you know, this year, we think that as things settle out and the economy is still pretty solid, we think that those spreads will come in again, those are credit spreads and you will have a pretty good year, basically earning your coupon on the fixed income sectors this year.

Chris Shildz:

Doug you touched on a key word there, flattening. We certainly have a flattening of the yield curve to take a look at this year. In fact, it even inverted for maybe a slight moment in time. Some people think that's a tapping of the brakes for a recession possibly around the corner. What does fixed income you have to say about that?

Doug Koester:

Well, a flattening yield curve has historically been a forecaster of potential recession. It doesn't happen every single time, but it also a flattening yield curve and even a negative yield curve is a consequence of the Fed raising short term rates. What they're trying to do is slow the economy and what happens is they raise short term rates and there's a tendency in the curve that the longer-term rates don't go up as much because of the potential of slowing the economy. So, we think that that's what we saw over the past year and it's normal. Going forward this year, we think the Fed's got, like I've mentioned before, that they're going to be less aggressive in their rate increases. And so I think we will, to the extent the economy continues to grow, we will continue to see a positive, slightly positively sloped yield curve. But of course it's still relatively flat by historical standards,

Chris Shildz:

Doug a lot of people who maybe don't follow the economy on a daily basis like do. you probably do focus in on benchmarks like the 10 year Treasury. Can you tell us anything going into 2019, what we might expect to see there?

Doug Koester:

Well, you alluded to this earlier. We did see the 10 year yield increase last year by about 40 to 45 basis points. That was due to a stronger economy and the Fed being a little bit more aggressive on their rate increases. This year in 2019, as I mentioned before, we don't think that the Fed is going to be all that aggressive and we think the economy is a little bit slower and again, inflation is under control, so there's not a lot of pressure on the 10 year rate to increase too much further than it has already.



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Chris Shildz:

Thank you Doug. That was Doug Koester from the Commerce Trust Company, Fixed Income Group. One of the key contributors to the 2019 Economic Outlook. Doug, thank you for working with us today.

Doug Koester:

Okay, and thank you Chris.

Chris Schildz:

Thank you for listening to this episode of Conversations with Commerce Trust. For more research, insights and market news, visit www.commerctrustcompany.com

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