CALAMOS® WEALTH MANAGEMENT

FROM THE INVESTMENT STRATEGY GROUP

J. Reed Murphy
Chief Investment Officer - Calamos Wealth Management

With Contributions by
Rob Young, CFA
Strategy & Analytics Specialist - Calamos Wealth Management

The Interest Rate Shakes

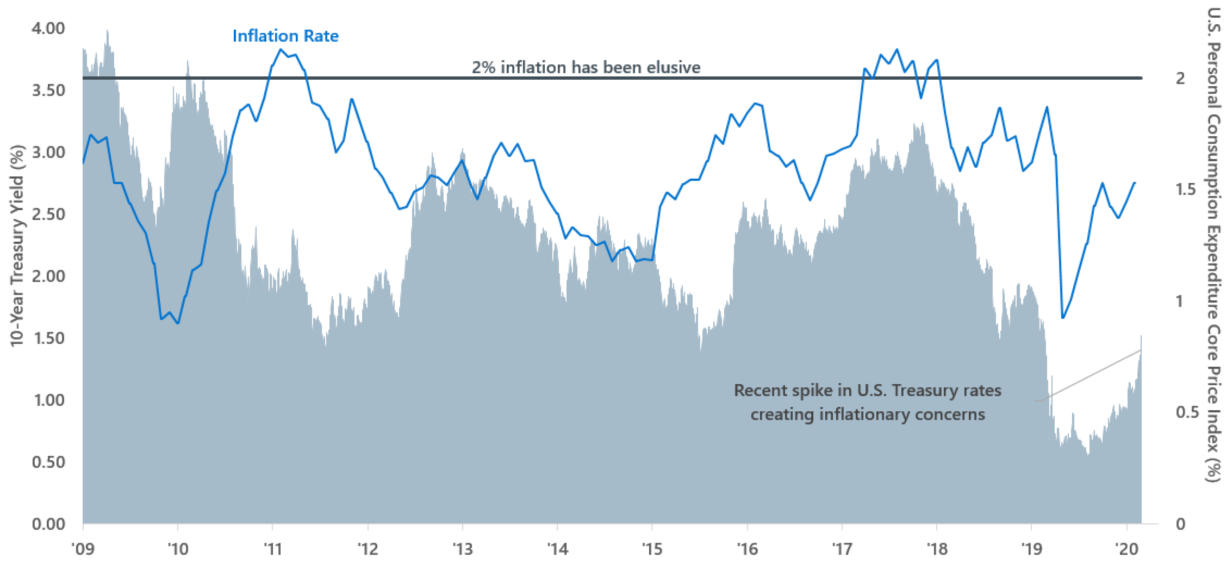
U.S. 10-year Treasury interest rates have increased over 50% since year-end creating a disruption on the bond market and contributing to a recent slide in equities. We evaluate the causes and implications of this increase, which provide insight to the rhetorical question – When is good news actually bad news?

The U.S. 10-year Treasury interest rate closed the month of February at 1.4% after hitting an intra-day high over 1.6% on February 25th. This rate represents an increase of over 50% since the year-end rate of 0.91%. Domestic equities (S&P 500) sympathetically declined approximately 4% over the past two weeks.

Why are interest rates rising?

Interest rates are rising based on the perception that inflation is set to increase. (inflation is a major determinant in longer-term interest rates.) These expectations are, in turn, a byproduct of an economy that continues to gain steam. So, isn't this good news? Yes, usually. However, the pace and rate of inflation is the actual concern. As the markets try to figure this out, we get the interest rate shakes – disruptions in bond and equity markets.

Exhibit: Interest Rate Shakes – Historically, Inflation Has Been Elusive . . .



Source: Bloomberg. Past performance may not be indicative of future results. Inflation in this chart is defined as the Personal Consumption Expenditure ("PCE"), which is a measure is the component statistic for consumption in gross domestic product (GDP) collected by the United States Bureau of Economic Analysis (BEA). It consists of the actual and imputed expenditures of households and includes data pertaining to durable and non-durable goods and services. It is essentially a measure of goods and services targeted towards individuals and consumed by individuals.

Why has this negatively impacted equities?

Commonly held wisdom suggests that rising inflation/interest rates hurt equities in the sense that equity valuations levels (i.e., Price to Earnings (P/E) ratios) should decline. However, this is somewhat exaggerated in that equity P/Es decline not just on higher interest rates, but also on elevated risks, such as Fed tightening (i.e., increase in Fed Funds rates) or economic weakness. Neither of those risks appear to be an imminent threat.

Regarding Fed tightening, the Federal Reserve is on record stating that they have entered a new era regarding inflation expectations. Historically, they have determined that inflation should be 2%, thereby starting to increase rates prior to those levels. The end result has been that inflation has rarely actually hit and held at the 2% level as seen in the provided exhibit. This also suggests that economic growth could have been stronger if the Fed let inflation climb higher. The new Fed policy entails an "average inflation" targeting at or above 2%. This means they will let inflation run longer and hotter before raising Fed Funds rates in an effort to curb inflation and slow the economy. The end result is a Fed induced economic slowdown is not an imminent threat.

Moreover, positive economic momentum continues. There is no shortage of:

1) Fiscal and Monetary Stimulus – global levels are historically unprecedented,

2) Global Re-openings - are broadening as vaccinations pick-up and Covid-19 cases roll-over,

3) Economic Momentum - continues to build steam globally,

4) Domestic Elevated Personal Savings Rates – are expected to rise even more, serving as dry powder for pent-up demand, and

5) Consumer Net Worth Levels - are at all-time highs.

These factors and others suggest we are early in a new economic expansion with lots of economic tailwinds.

Portfolio Implications

It is important to note that domestic corporate earnings (i.e., S&P 500) and prices generally peak at the end of expansions. As we appear to be at the beginning of a new economic expansion, this suggests a longer road ahead for equities. While a recent approximate 4% slide in domestic equities is unnerving, it should be considered in the context that the S&P 500 averages 3 to 4 declines per year of over 5%. Interest rates should continue to increase, but risk assets are still currently poised for more gains. Fixed income should continue to be considered for its overall lower risk anchor in portfolios. And, there are still some areas within fixed income that are relatively attractive.

Our investment team continues evaluate and will provide updates as newsworthy events unfold. In the meantime, please contact your CWM Advisor or any member of your CWM wealth advisory team for any additional guidance or answers to any questions you may have.

DEFINITIONS

U.S. 10-Year Treasury: A bond issued by U.S. government for borrowing money; it is widely accepted as a proxy for many other important financial matters, such as mortgage rates.

S&P 500: Widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 9.9 trillion indexed or benchmarked to the index, with indexed assets comprising approximately USD 3.4 trillion of this total. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

P/E Ratio: is the ratio for valuing a company that measures its current share price relative to its per-share earnings.

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Calamos Wealth Management
2020 Calamos Court
Naperville, IL 60563
888.857.7604
www.calamos.com/wm | cwm@calamos.com

6339_0321_CWM