SN VALUATION

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Interest Rates Rise as QE Ending Near

FI portfolios will see a drop in their NAV over the next period as the Treasury yields rise, with noise of QE ending surrounding the market. A couple months ago, yields were at historic lows, meaning investors were purchasing the FI securities above par, which brought down the coupon yield. However, as the benchmark rates set by the central banking bodies rise, the coupon payments are fixed for the FI securities, which means the price of the bonds will have to fall to accommodate the higher benchmark rates.

Investors of high yield bonds were enjoying interest rates in their teens, but that was because the price of the bonds were appreciating. However, if bond prices fall, that means there will be principal amortization, possibly below par. This means, the total return, or principal movement plus coupon income, will be below the weighted average coupon rate. So high yield investors could anticipate returns below 7%.

Where will investors reinvest their capital from the sale of their FI securities? REITS, dividend stocks, commodities, gold?

We think real estate related stocks have some steam left in its' rally. We favor dividend stocks which are selling below intrinsic value. In our SNV Value Focus Fund, we have been stacking up investments in dividend stocks and they have been performing nicely. Yet, the majority of equities are selling at premium to our target price, which makes us hesitant to reinvest large amounts into the broad equity market.

Another good investment play is to buy the ETFs which trade at an inverse to the high yield market, so when rates rise, the ETF moves in a positive corollary to the interest rate movement, as opposed to the bond prices, which is at an inverse.