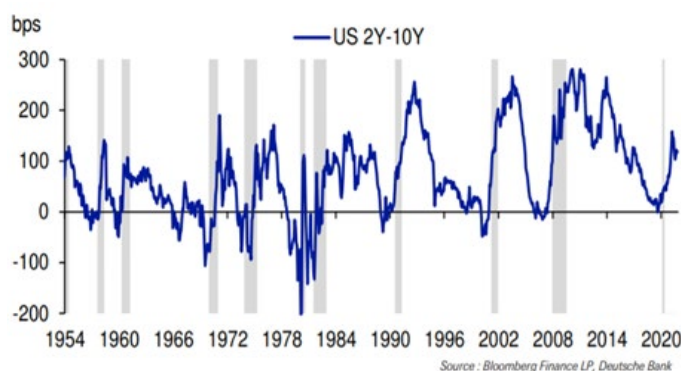


Fixed Income – Hitting the Curve

The yield curve is getting a lot of attention in the current environment of high inflation at both the consumer and producer levels. Short-term interest rates have historically tracked inflation expectations with the CPI and 3-month Treasury demonstrating high correlations. It is assumed that if inflation remains high, it will force short-term interest rates like the 2-year Treasury significantly higher than current levels. Given the fact that the 10-year Treasury bond is currently only about 50% of CPI (1.6% vs 3.5%), many are concerned that the 2-year Treasury yield could soon surpass the 10-year Treasury yield, causing an inverted yield curve. One of the more accurate predictors of recessions for more than 70 years is an inverted yield curve. The chart shows that the yield curve inverted in virtually all recessions and the spread between the 2/10's is about 115 basis points today, but worth watching as it narrows.



Technical – Investing for Generations

One of the greatest challenges for investors is determining what time frame they should use when evaluating investment trends for technical strength or weakness. Because reversion to the mean is considered a given over a long period of time, recent outperformance of certain asset classes may portend underperformance in the future. Take U.S. equities as an example -- the performance over the last 10 years has been at least double the average performance over 25, 50, or even 100 years, suggesting it is highly unlikely that they will continue their outperformance long-term. Commodities are at the opposite end of the spectrum, having underperformed during the prior 10 years at nearly 3 times the average over 25, 50, or 100 years. This data is factored into the GMO 7-year Asset Class Return forecast and why they believe most equities will have negative returns over the next 7 years.

