Reflation Nation (Second of Two Parts)

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An astute Lead Left reader sent us the following note regarding last week's commentary:

"Besides the beneficial economic impact of pent-up consumerism, the Biden stimulus package, and vaccine distributions, you should also mention the healthy state of household savings," he wrote. "February's data [just released] showed family net worth's hit a record high of $130.2 trillion. That's up 10% from one year ago.

"Granted a lot of that is the stock market run-up," he went on. "And it doesn't reflect the challenge many unemployed people are having making ends meet with Covid still rampant across the country. But it adds fuel to the inflation fire some are concerned about."

Nuveen's Brian Nick noted the good shape of our family balance sheets. But he also pointed to the tame inflation numbers just in: core CPI actually slowed to an annual rate of 0.7% since December and 1.2% since September (vs 1.3% the year prior). A long way from the Fed's 2% target.

Analysts highlight indicators like the 5-year break-even rate – the five-year Treasury yield vs. the five-year TIPS (inflation adjusted) rate. It shows how investors are weighing what inflation will be over the next five years. As our *Chart of the Week* shows that rate has accelerated since the onset of Covid. From close to zero a year ago, it's 2.5% today, the highest since July 2008.

Meanwhile Treasury curve-ologists opine on when and by how much the curve will steepen. If medium growth expectations grow, the "belly of the curve" (between 3 and 7-year Treasuries) will likely steepen. All eyes were on this week's Fed meeting, sifting through tone and verbiage for clues on rate direction.

Retail loan funds recorded the ninth consecutive week of cash in-flows. The roughly plus-$7.5 billion so far this year, per S&P/Lipper, is evidence investors like loans more than last year. Their value doesn't diminish over time since the asset class is less sensitive to duration risk.

So much for long-term rates. But whither Libor? The short-end remains rooted near zero. But as one credit strategist reported to Bloomberg "You don't buy leveraged loans today because you expect the floating rate component to go up." That's unlikely anytime soon. "You buy it because the reflation theme hurts" high-yield bonds more than loans.

Now with bond yields at record lows, their comparison with loans is not favorable. For the 100 bps premium, why not be secured and top of the capital structure rather than unsecured and lower on the stack?

Smart money continues to reel in the years for rate hikes. The Fed is sticking to its message of lower for longer. Time will tell who is proven right. Institutional investors are finding loan managers are ok either way.