Rising Treasury prices are worrisome: BMO Private Bank

By Editor Test *Wed, Nov 28, 2012*

The difference in yield between two-year and 10-year U.S. Treasury notes has been shrinking, BMO says. Recessions are associated with zero difference between the two.

A variety of sectors of the U.S. economy are growing, according to BMO Private Bank's December Outlook for Financial Markets Report.

According to the report:

- With net profit margins at 10.7%, corporate profits are at their highest levels since the early 1950s.
- Both 401(k) plans and home prices are rising, aiding consumer confidence.
- The S&P 500 has rallied more than 60% since the end of 2008.
- Thanks to low mortgage rates, home affordability has grown by about 25%.
- Retail sales are up nearly 5% year-over-year.

The "fiscal cliff"

As the January 2013 fiscal cliff looms, investors fret that the U.S. may lose its AAA credit rating from Fitch. The BMO Private Bank Report notes that 10-year Treasury prices have been on the rise, and difference in yield between two-year and 10-year notes has been shrinking. Recessions are associated with zero difference between the two.

Equity markets volatility

Average equity prices dipped about 5.5% in the third quarter of 2012 on fears of increased regulation and higher taxes. The financial and energy sectors were affected the most. The S&P 500 fell 3.3% percent in the three sessions immediately following the U.S. election.

Yield-oriented telecom companies dropped more than four percent in the days following the election. Nearly half of Europe's Stoxx 600 companies failed to beat analysts' profit expectations.

Chinese and American challenges

Income inequality in the U.S. and China is affecting the two countries' economic growth.

"Severe income inequality is not economically sustainable and consistent inequality impairs economic growth," said Jack Ablin of BMO Private Bank.

Outlook for next year

Rules and regulations aimed at domestic banks and energy companies will take effect. Financial stocks are now trading at a 19% discount, making them fairly priced when taking into account the prospect of new regulations. Energy stocks, trading at one per cent above their historical norm, are overpriced.