HollisWealth®

"Staying Abreast of Changing Times"

Going Negative on Interest Rates – Hmm, Is there a reason?

Negative interest rates mean that depositors will have to pay for the bank to hold their money, really?

Yes, really!

While there are countries that have reached that point, Canada and the U S are not there, - yet. Will it come to negative interest rates in North America – we can only wait and see.

Many do not realize that negative interest returns are very similar to what we have had for the past several years; – low interest rates (though not negative) kept saving-returns in negative territory after the cost of inflation-and-taxation to the savers. When it comes to getting a return on capital, people don't think "after-tax and inflation," but there's always going to be these two evils and now in some countries savers pay the banks to hold their deposits.

The Bank of Japan recently tossed their hands into the air, -- "That's it, we are going to go negative on interest paid to depositors." Now in Japan depositors pay banks to hold their money and depositors receive no interest; - as in Switzerland, Denmark and Sweden. What's the backdrop to negative rates? Is it that they don't want to pay depositors for their money on deposit?

Read Bloomberg Quick Take on Negative Interest rates here:

http://www.bloombergview.com/quicktake/negative-interest-rates

The last several years of near-zero interest rates were to encourage people and businesses to spend and invest in order to stimulate the economy. Its true low interest rates can stimulate business activity – but is the outcome of low interest rates creating an economic long-term recovery? It appears not. The world has had low interest rates for some time and if that had worked for all countries why would countries move to negative interest rates?

It appears that world economies are sputtering along with slow growth, and most certainly not in overdrive even though low-rates. And now some countries are going to negative returns on bank deposits, hopefully to encourage savers to spend and businesses to spend and expand while buying new equipment and hiring more people.

Dixi Robertson, CFP®, FMA, CIM®
Portfolio Manager
Director, Private Client Group
HollisWealth, a division of Scotia Capital Inc.
Tel: 506-384-0770 / 1-888-384-0770
1351 Mountain Rd – Moncton, NB

Gary Robertson, CFP®
Financial Advisor
Director, Private Client Group
HollisWealth Advisory Services Inc.
Tel: 506-857-0757 / 1-800-263-0770
1351 Mountain Rd – Moncton, NB

It's a rule of thumb a healthy stock markets rests on three pillars: (1) earnings growth, (2) reasonable valuation, and (3) a supportive liquid investment environment. Right now we are one for three; -- valuations are fair. That's not enough to keep the markets going up steadily and that's why stocks have been struggling and perhaps one reason why they have been volatile since last summer.

In our opinion, the North American markets are now fairly valued and using forward-looking estimates, price of shares/to earnings (P/E ratios) are in the mid-teens, which is the middle of the historical range and appropriate for where interest rates and earnings are currently.

Valuations in many sectors are not the issue. We need growth in the economies which will likely provide liquidity.

So, let's look at negative rates again – if extremely low interest rates didn't do it will going-negative on rates make a big difference? Maybe but it begs an even bigger question; "What do investors do?"

Central banks around the world are developing a fondness for experimenting with a negative interest rate policy (NIRP) despite the unknown consequences and what appears now to be a chilling financial market.

The New Abnormal

Central Bank advocates of NIRP increasingly seem to portray it as a natural extension of conventional monetary policy. In a "normal" interest rate cycle, Central Banks cut interest rates to reduce nominal and real (inflation-adjusted) interest rates with the goal to ease the burden on debtors and lower interest rates to spur investments. The thought now is lower rates (even negative ones) are stimulating while higher rates are often restrictive. These negative rates could increase economic risk the lower rates go and the longer they stay low.

Although it is difficult to know if reducing interest rates to negative is delusional because this is such an unprecedented position, and it appears that NIRP has not been especially impactful in lifting growth or inflation (yet), or if it will be successful in lifting investor expectations for future growth and inflation. It does appear, however, that financial markets increasingly view these experimental moves as maybe inconsequently to financial and economic stability. This new abnormal interest rate policy has barely started and still under review and analysis.

What should investors do?

The world has shrunk so much due to superior transportation and technology, world wide competition and currency problems that an old approach is shining again. Professional "Active" Management might offer the greatest support, why?

A selection of properly selected active portfolio managers can provide a combination of different management skills, diversification of investment styles can lower risk, and management each with a different focus can help to increase returns.

At this time in history we need professional management to focus on putting money to work under changing conditions.

Society is in this discomfort zone when interest rate returns are low, and will remain low, and with a possibility they will go negative while economies are slowing all begs a question; "What is one of the main reasons investors lose their focus?"

While there are many reasons – it's a known fact that investors emotions rank right near the top. The example might be – "We certainly don't want a pilot flying our plane if he has a fear of flying," -- now would we? You and I may not be emotional about investing with some provisions in place (of course) such as a sound reasons to invest, sound management with focus, but other investors who are emotional well they can disrupt our portfolio (short term) if enough of them are panicking.

John Maynard Keynes stated; "The right method of investing is to put money into enterprises and into management in which one thoroughly believes." Do you know that describes Professional Active Management (with a focus and non-emotional)?

An investor might say, "That's my problem, I read the paper, I watch TV, I become a little shaken and I lose my focus." Losing focus is easy, really easy; -- it's getting it back that's the hard part.

We believe in this time, -- in this special time in our history there will be tremendous opportunities – but it will take a lot of skill to manage – and focus by experts may be needed.

We have to place our confidence with those people who are professionals, those people who were born to manage investments, with those people who love that industry, those professionals with a team of experienced long-term employees, those employees who are trained to study the daily ups-and-downs in the world market, those connected to their computers daily, and those tied at the hip to what's happening in this world. Whatever those professional managers specialty are – that is what we want to hire for our clients.

Besides focus, an active managed portfolio, having skilled employees, all with interest rates around the globe starting to go negative, and together with sloppy-markets, and emotional investors – what else could possibly stare us all in the face?

This next word should blow your mind – it's very likely the most overused transmission of ideas in the world today! It's the two-way process of reaching mutual understanding, in which participants not only exchange information, news, ideas and feelings (emotions) but also create and share meaning. What is that word? Do you have it, does our office have it, can we get more, do we want more of it? Truth is – we all have too darn much!

Communication!

It's not because we don't have enough communication in this world that hurts us – as we have all we need and more, it's because we have too much and we all have system overload. A breakdown in communication is not always because there is no discussion on ideas – the breakdown can be due to system overburden. If a professional active manager were an emotional manager I doubt we would be too excited with his returns. Think! Two professional managers both watching interest rates, world news, world happenings, and the stock market dipping – one's buying with both hands and the other selling into a panic. So it's not just communication and possibly overload but also how we deal with what we know.

The world is smaller now and investors over the past few years gained by being out of the oil economy, while investing outside of Canada and into countries with a stronger currency, and into countries with stronger markets. There's a hint; "Nor can we be stagnant."

If, by example, we have professional active managers managing a U S Fund and the U S was going through a period of stagflation --- that management team (or teams) would work towards growing and protecting money during stagflation, but what if the country is turning a corner into a growth economy will the active manager know and prepare for the next period?

What happens when a country such as Japan drops their interest rates to a negative – they lower the return to the saver to negative, the value of their currency drops, the cost of their exports decreases the cost to other countries, the cost of their imports increase.

And as we have stated above people might start to spend money. This is all done with the hopes that their economy starts inflation. Will the managers investing in that country be investing for deflation or impending inflation? Does "Nor can we be stagnant," have meaning?

What would we expect other countries to do if this negative interest rates (NIRP) were to start to spread? Of course, everyone starts to lower their interest rates to lower the value of their currency – and then guess what – inflation could start to work its' way around the globe, well maybe.

Monetary policies have an important influence on inflation. When the Central Bank fund rates are reduced (hopefully) the resulting stronger demand for goods and services will push wages and other costs higher, reflecting the greater demand for workers and materials that are necessary for production.

Should you invest to get ahead of inflation? We're back to focus again, aren't we?

Maybe, -- it depends upon where money is being placed, what will country's monetary policy bring upon them – we already know that if we stick to just one large (property mass) country with a small population and tied to energy resources it can be disruptive to returns; – diversification, focus, skill, study, active, and communication are required.

Are You Diversified Properly?

Well that's a question for one of our next releases. Today it's enough to stockpile a treasure of sound ideas on active management for the next period that we will all have to travel through. To realize the value that all the electronics have gifted us today – with all the knowledge that come across our TV and on our computers today, and the gift of all the people in the world (doctors, nurses, mechanics, trades people, clerks, cooks and business people) who are working for us all today that these all add up to our futures.

We are living in this era, to be serving our clients and having a world of knowledge at or fingertips -- so that we can share. Low and very low or negative interest rates are opening other doors – doors that governments will have to deal with for their purpose just as you and I will have to deal with to – with portfolios to serve your needs into the future.

We believe we have access to those who can help, and the focus to do so.

But the question today was, "***Going Negative on Interest Rates – Hmm, Is there a reason?"*** The answer is simple! Governments are doing it to stimulate their economies, to try to get growth again into their countries. What is the reason it is happening that an investor can point too? Maybe it's a time for investors to witness a big change, a different direction, -- a new experience. We have to look ahead and plan.

Just as we have seen incredible new sophisticated means of travel, entertainment, and technology so we walk along a new path of currencies; twisting and winding down a new road.

Thank you for your support and for your confidence and your thoughts – we believe we are facing change again – and professional active management is needed perhaps more than ever.

Call us if you need anything, we have a great staff ready to serve. We look forward to speaking with you and reviewing your portfolios.

Disclaimer