the Plan

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Negative Interest Rates: Coming To a Bank Near You? By James B. Twining, CFP®

In recent months, several of the world's central banks have conducted a highly risky experiment with negative interest rates. For example, the Bank of Japan has a rate of minus 0.1%, the European Central Bank has a deposit rate of minus 0.4%, and Switzerland's bank rate is a minus 0.75%. German government bonds with maturities as long as seven years, and Japanese government bonds with maturities as long as ten years are now trading at negative yields.

"What!" you say? Do you mean to tell me that I won't ***receive*** interest, I will ***pay*** interest? Say it isn't so!"

Sadly, although "Shoeless Joe" Jackson was acquitted of throwing the 1919 World Series to the Cincinnati Reds, the Central Banks are guilty of taking money from savers and throwing it to the borrowers.

The traditional methods of curtailing debt and stimulating economies have failed. First came low interest rates, then zero interest rates, then quantitative easing (in all its iterations). Just as these gambits failed to gain traction, the negative interest rate experiment is also likely to be ineffective in my opinion. Ham-handed central bank intervention in otherwise free economies invariably leads to inefficient allocation of capital, distorted risk-reward motivations, and price instability of securities.

One obvious result of negative interest rates is that depositors may withdraw their money from bank accounts and bonds and stuff it under the mattress. However, we are not seeing runs on the banks in the countries in which negative rates are already the reality. It appears that depositors will pay a small price for the convenience and security of a bank account to store currency. I am sure there is a limit to the amount they will pay, however. At some point, if rates go too negative, depositors will withdraw their funds and store it in their vault at home or in a safety deposit box. The exception to this would be if we were to enter a deflationary environment in which currency would appreciate in real terms, perhaps even after a negative rate is assessed.

The other possible destination of the currency is equities, which will look better in comparison to cash and bonds that are encumbered with negative rates. In laymen's terms: You will be more likely to invest in stocks instead of cash and bonds if you know that cash and bonds will result in a guaranteed loss. This would drive up equity valuations, benefiting current owners of equities. That higher valuation would likely result in lower subsequent equity returns over the longer term, however.

In recent months, inflation expectations in the US have risen above the Fed target of 2%. For that reason I see a low probability of negative interest rates here in America over the short term. At least for this business cycle, it appears that the Fed's zero interest rate policy from 2008 through 2015 was sufficient to stimulate demand. As for the next recession, all bets are off. With each successive business cycle, the Fed's prescription has been ever stronger medicine. The next dose may well be negative interest rates.

These observations are not meant to be translated into a market forecast. (You know our philosophy better than that!) Future market prices and interest rates are not predictable. Period, end of story.

As always, our advice is to stay with your plan: A sensible, consistent equity exposure that is likely to continue to be beneficial over a long time frame; a common sense approach designed to control risk and maximize the likelihood that your goals will be achieved.

A Few Market Observations

James B. Twining, CFP®

This year, the US stock market has already seen the worst January in history, followed by a March that was so positive that we are now in the black in 2016. With all of this short term volatility, it is easy to lose sight of what has happened historically over very long time frames.

Over the past fifty years from 1966 through 2015, the annualized return has been 9.69%. Lest you think that those results were unusually good, consider that the previous fifty year period from 1916 through 1965 had a return of 10.36%, and the fifty years before that from 1871 through 2015 had a return of 9.05%.

However, over some long time periods, the results were less favorable. For example, in the fifteen year time period between 1966 and 1981, the market return was 5.89%, and after the very high inflation rate at the time, the real return was a negative 1.04%. In more recent memory we can point to the "lost decade" between 2000 and 2009, where even the nominal return was negative.

I am not implying a forecast for the future, but simply pointing out that the rewards of long term investing come with declines, and these slumps can last for a long time. Just don't fall into the trap of believing that anyone knows when the next slump is coming, or how long it will last.

on a Personal note

Jamie and Jeanne

Bethany: pro surfer

On April 6, I turned the big 60, and my best friend Mark also turned 60 on April 9. Our wives got together and surprised us with a trip to the north shore of Kauai. We had a house at the mouth of the Wainiha river with a secluded beach just a short paddle across the river. I went surfing in Hanalei Bay (the same place where Bethany Hamilton got her arm munched off by a tiger shark) and I stepped on a sea urchin. The spines are hard to remove; they tend to break off when you pull them—so I'm just letting them rot in my foot. I show my foot upon request. (Not for the squeamish!)

We did all the usual Hawaii stuff - having fun in the water, sitting out in the sun, kayaking, etc. I can't count how many of Mark's mango margaritas I had, but I'm sure Jeanne had more. She drinks like a fish.

Dave and Bonnie

Thankfully, I have been able to slide under the radar and have not been harangued into coaching any sports this Spring. That has been a huge relief in that it has been crazy busy in the office and, try as I might, my omnipresence experiment has been an abysmal failure.

But...my daughter's favorite season is upon us and that is fast pitch softball season. I have been overwhelmingly excited to be able to just go and watch her play. It is truly the highlight of my day when I get to go set up the lawn chair and watch her go at it.

Her team is doing very well this year so far and are currently undefeated and usually outscore their opponents by at least 15 runs per game. Kristin has turned out to be a hitting machine and has even smacked a Grand Slam this season. Feel free to ask me about it :)

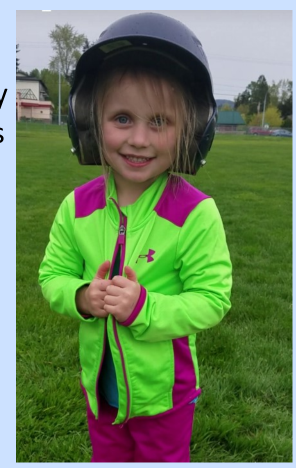
Devin and Stephanie

Springtime in the Wolf household is always a busy time of year. Between work, sports (kids playing, me coaching), and extra curricular activities (Estate Planning Counsel, mom's groups, school events, and teaching financial classes at Whatcom Community College) we also like trying to squeeze in as much fun as possible. In the spirit of focusing on experiences over things, for Christmas this year we gave Stella and Graedon skiing lessons. For 4 weekends in Jan/Feb we took them up to Mt. Baker where they learned the basics with help from mom, dad and a coach. I'm happy to report that there was less whining than anticipated and both kids have actually developed an affinity for the sport- which was the original goal (and how often does that really happen!?) To ensure Elodie did not miss out despite being too young for the lessons, she was gifted with a full mommy/daddy and Elodie date where we went swimming for hours then out for hot chocolate. The undivided attention was just what our almost "threenager" had been craving and we all had a wonderful afternoon.

This picture is from Valentine's day weekend at a family event in which our three Valentines opted to stand in line (correction: have MOM stand in line) for 45 minutes to have their faces painted. It's a continual joy to see their varied and hilarious personalities emerging.

Stella (6), Graedon (4), Elodie (3)

Nate and Lisa



We're at the point now where Finley is trying any sport that comes across her plate. The latest is Tee Ball, which amuses her for about 30 seconds before she realizes that most of the time she's just standing around waiting. A team comprised of a handful of 2-5 year olds sounds adorable, but it quickly devolves into crying, aimless wandering and flower picking. Occasionally, something resembling Tee Ball is also played.

Speaking of flowers, if you haven't had the chance or are new to the area, the Skagit Tulip festival is a sight to behold. During late March and April, acres and acres of multi-colored tulip fields spread out across the Skagit Valley and make for some amazing landscapes. If you haven't been, I encourage you to check it out (just go on a weekday; weekends get very busy).

Our own little flower, Annalise, thought that hiding in the rows of tulips was the best game in the world. She found one row that even matched her outfit, adding some much needed camouflage.