

HOW LOW CAN THEY GO?



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Fears of inflation and higher interest rates have been discussed extensively in the media, but it does not appear that the bond market is paying attention. If the market anticipated inflation, one would expect that higher rates of interest on bond investments would be demanded. Contrary to this line of thought, the rate on 10-year government bonds has recently fallen to multi-generational lows.

Those with a bent toward conspiracy theory claim that the Federal Reserve is manipulating the system. Others simply observe that the United States is one of the safest places in a risky world, and that dynamic keeps rates low. Rather than approaching the question from a causative standpoint, considering interest rates from a technical view might give us a few insights into the future.

Historical studies have found that rates tend to move in 22- to 35-

year cycles, meaning that the transition from high rates to low rates historically takes 20 or 30 years, and the corresponding move from low to high rates typically covers a similar amount of time. Louise Yamada Technical Research Advisors constructed a study covering 200 years of long-term interest rates and found this to indeed be the case as seen in illustration #1. The current cycle began in 1981 with rates around 16% on the long-term U.S. Government bond. This cycle is now 30 years old and interest rates have slowly declined to 3% over the intervening years.

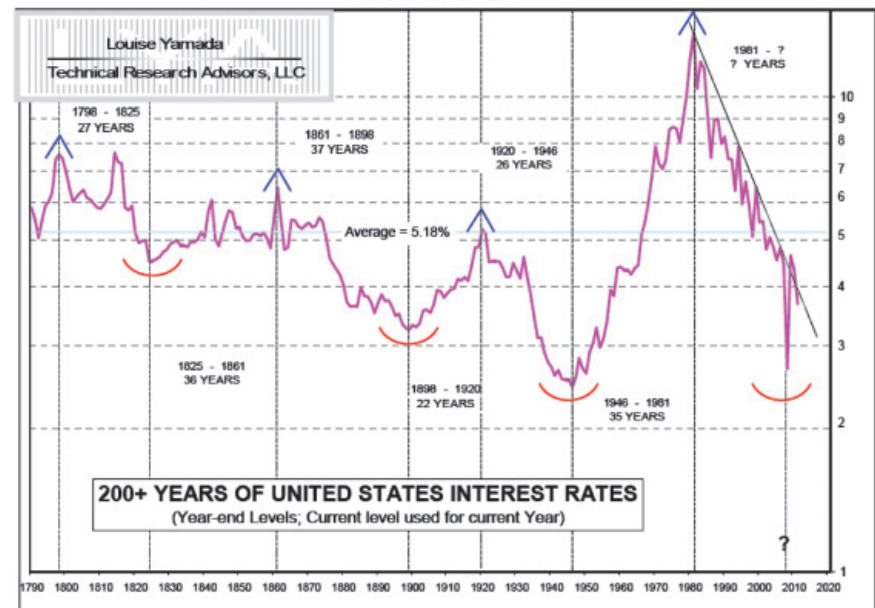
One of Yamada's more interesting observations is that the reversal

from a trend of higher rates to lower rates happens relatively quickly, as seen in 1861, 1920, and 1981 when rates peaked in one year and moved sharply lower the next. However, the transition from a low rate to a higher rate trend takes a number of years to form, which appears to coincide with our current environment. Indeed, as can be seen in illustration #2, 10-year bonds have been trading between 2% and 4% for nearly four years.

Whether these trends are rooted in generational cycles or the ebb and flow of the business cycle remains a topic of debate. Regardless, the last 70 years have certainly

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Illustration #1



Courtesy of Louise Yamada Technical Research Advisors, LLC

seen more significant rate changes than the prior 150 years. We believe that rates will indeed be higher 10 years from now, but the transition to

higher rates will take longer than many expect. Only time will tell whether we have seen the absolute lows in interest rates.

10-year Treasury Yields

Illustration #2



Source: *Facstet Research Systems*



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