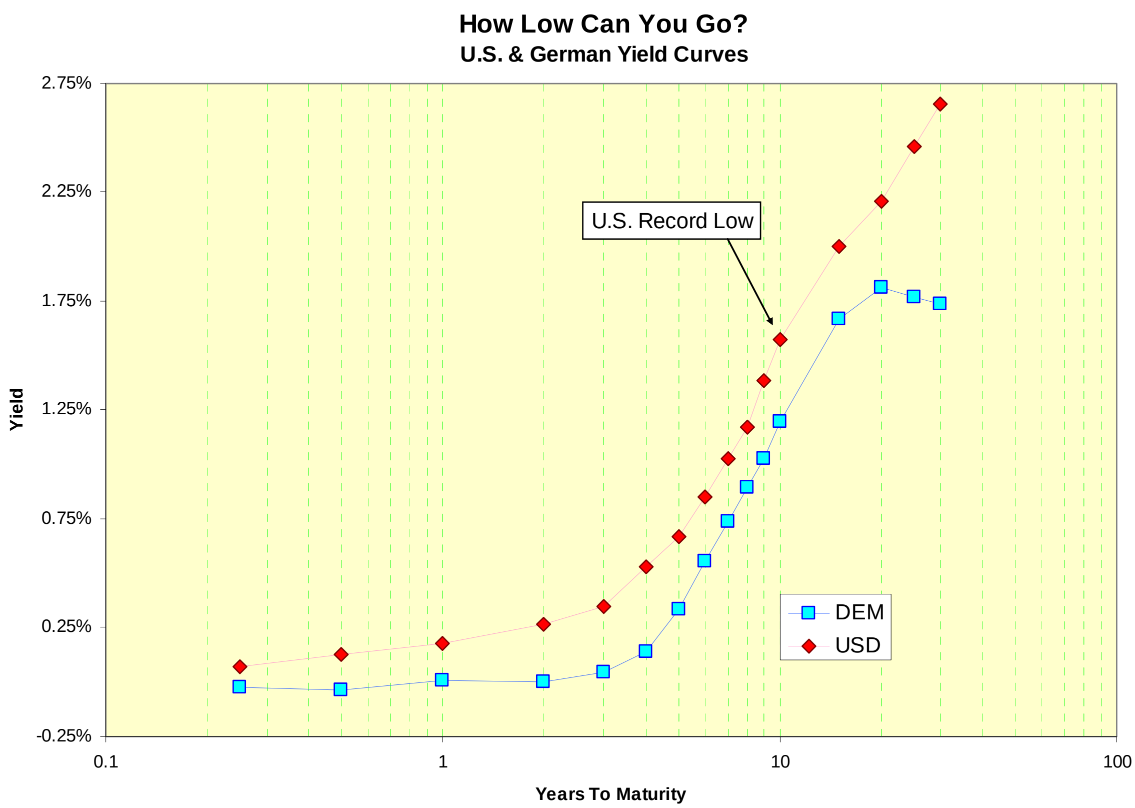
# Who Could Use Some Higher Rates?

Four Out Of Ten Sectors, For Starters

One of the reasons pharmaceuticals are so expensive to develop is the rigorous and almost obsessive-compulsive testing firms such as Merck (MRK) and Pfizer (PFE) have to do before getting FDA approval. Even then this procedure is subject to ongoing research studies that often find you might as well have taken the placebo.

It would be nice if central banks were held to similar standards. But they are not and therefore are allowed to persist in such snake-oil notions such as low interest rates stimulate economic activity or, at the very least, reward all manner of Wall Street fatsos so as to create an illusion of prosperity.

Well, here we are, four and one-half years into zero interest rate policy (ZIRP) and after two rounds of money-printing and enough twisting as to require some of those more heavily advertised pharmaceutical products, and these policies have been so successful U.S. record-low ten-year Treasury yields look Brobdingnagian in comparison to their German counterparts. The U.S. has negative real interest rates out to 2027; the U.K. out to 2062, and even little Denmark has negative nominal yields out to three years; how rotten is that?




## Industry Group Impact

If we look at the partial contribution of ten-year Treasury yields to U.S. industry groups, we see the net beta-weighted measure is negative: Lower yields are a positive for the market, all else held equal. However, that is deceptive as it masks a very pronounced sectoral skew. Industry groups with a negative partial contribution from higher yields are concentrated in the defensive sectors of healthcare, consumer staples and utilities (XLV, XLP and XLU sector ETFs). Lower yields will help these groups, but these sectors seldom provide strong market leadership.

## Ten-Year Note Beta-Weighted Impact On S&P 1500

| | SPR Weight | TY Beta | Weighted Beta |
|---|---|---|---|
| Pharmaceuticals | 5.67% | 0.108 | 0.006 |
| Household Products | 2.15% | 0.166 | 0.004 |
| Integrated Telecommunications | 2.52% | 0.129 | 0.003 |
| Soft Drinks | 2.21% | 0.133 | 0.003 |
| Electric Utilities | 2.03% | 0.136 | 0.003 |
| Computer Hardware | 3.51% | 0.071 | 0.002 |
| Packaged Foods | 1.77% | 0.135 | 0.002 |
| Tobacco | 1.76% | 0.120 | 0.002 |
| Hypercenters & Superstores | 1.09% | 0.181 | 0.002 |
| Multiline Utilities | 1.49% | 0.113 | 0.002 |
| Restaurants | 1.55% | 0.094 | 0.001 |
| IT Consulting & Services | 2.25% | 0.049 | 0.001 |
| Biotech | 1.18% | 0.094 | 0.001 |
| Systems Software | 2.64% | 0.026 | 0.001 |
| Healthcare Equipment | 1.78% | 0.037 | 0.001 |
| Drug Retailers | 0.65% | 0.085 | 0.001 |
| General Merchandise Retailers | 0.43% | 0.121 | 0.001 |
| Gold | 0.24% | 0.216 | 0.001 |
| Managed Health | 1.09% | 0.039 | 0.000 |
| Healthcare Services | 0.69% | 0.053 | 0.000 |
| Healthcare Distributors | 0.43% | 0.060 | 0.000 |
| Food Retailers | 0.30% | 0.084 | 0.000 |
| Automotive Retailers | 0.29% | 0.062 | 0.000 |
| Industrial Gases | 0.43% | 0.040 | 0.000 |
| Food Distributors | 0.16% | 0.098 | 0.000 |
| Environmental Services | 0.32% | 0.035 | 0.000 |
| Gas Utilities | 0.32% | 0.029 | 0.000 |
| Insurance Brokers | 0.30% | 0.026 | 0.000 |
| Distillers & Vintners | 0.15% | 0.049 | 0.000 |
| Brewers | 0.06% | 0.096 | 0.000 |
| Healthcare Technology | 0.12% | 0.034 | 0.000 |
| Reinsurance | 0.09% | 0.034 | 0.000 |
| Water Utilities | 0.03% | 0.103 | 0.000 |
| Subtotal: | 39.69% | | -3.82% |

| | SPR Weight | TY Beta | Weighted Beta |
|---|---|---|---|
| Other Diversified Financial Services | 2.04% | 0.226 | 0.005 |
| Oil & Gas Equipment | 1.81% | 0.147 | 0.003 |
| Oil & Gas Exploration | 2.12% | 0.106 | 0.002 |
| Diversified Banks | 1.57% | 0.125 | 0.002 |
| Regional Banks | 1.30% | 0.144 | 0.002 |
| Life & Health Insurers | 0.83% | 0.209 | 0.002 |
| Asset Management & Custodial Banks | 1.10% | 0.154 | 0.002 |
| Construction & Farm Machinery | 1.14% | 0.143 | 0.002 |
| Industrial Conglomerates | 2.33% | 0.056 | 0.001 |
| Industrial Machinery | 1.24% | 0.101 | 0.001 |
| Investment Banking & Brokerage | 0.72% | 0.172 | 0.001 |
| Diversified Chemicals | 0.85% | 0.112 | 0.001 |
| Movies & Entertainment | 1.31% | 0.071 | 0.001 |
| Steel | 0.34% | 0.212 | 0.001 |
| Electrical Components & Equipment | 0.68% | 0.094 | 0.001 |
| Consumer Finance | 0.72% | 0.083 | 0.001 |
| Multiline Insurers | 0.35% | 0.154 | 0.001 |
| Diversified Metals & Mining | 0.32% | 0.164 | 0.001 |
| Coal & Cons. Fuels | 0.20% | 0.245 | 0.000 |
| Application Software | 0.86% | 0.052 | 0.000 |
| Hotels | 0.30% | 0.143 | 0.000 |
| Automobile Manufacturers | 0.33% | 0.125 | 0.000 |
| Oil & Gas Drilling | 0.27% | 0.141 | 0.000 |
| Construction & Engineering | 0.26% | 0.140 | 0.000 |
| Oil & Gas Refining | 0.30% | 0.119 | 0.000 |
| Apparel & Accessories | 0.47% | 0.071 | 0.000 |
| Electronic Equipment & Instruments | 0.23% | 0.135 | 0.000 |
| Specialized REITs | 0.90% | 0.034 | 0.000 |
| Broadcast & Cable TV | 0.25% | 0.112 | 0.000 |
| Railroads | 0.81% | 0.035 | 0.000 |
| Computer Storage & Peripherals | 0.64% | 0.041 | 0.000 |
| Specialized Finance | 0.37% | 0.070 | 0.000 |
| Auto Parts & Equipment | 0.26% | 0.091 | 0.000 |
| Electronic Comp | 0.25% | 0.097 | 0.000 |
| Semiconductor Equipment | 0.34% | 0.068 | 0.000 |
| Office REITs | 0.32% | 0.067 | 0.000 |
| Paper Products | 0.20% | 0.101 | 0.000 |
| Aluminum | 0.08% | 0.229 | 0.000 |
| Department Stores | 0.33% | 0.054 | 0.000 |
| Building Products | 0.11% | 0.164 | 0.000 |
| Casinos & Gaming | 0.15% | 0.114 | 0.000 |
| Industrial REITs | 0.11% | 0.148 | 0.000 |
| Homebuilding | 0.14% | 0.105 | 0.000 |
| Technology Distributors | 0.14% | 0.097 | 0.000 |
| HR & Employment Services | 0.10% | 0.134 | 0.000 |
| Electrical Equipment Manufacturing | 0.12% | 0.096 | 0.000 |
| Trading Companies | 0.28% | 0.043 | 0.000 |
| Real Estate Services | 0.06% | 0.199 | 0.000 |
| Advertising | 0.15% | 0.073 | 0.000 |
| Office Services & Supplies | 0.10% | 0.108 | 0.000 |
| Office Electronics | 0.10% | 0.084 | 0.000 |
| Motorcycle Manufacturers | 0.07% | 0.123 | 0.000 |
| Diversified REITs | 0.16% | 0.051 | 0.000 |
| Multisector Holdings | 0.04% | 0.222 | 0.000 |
| Construction Materials | 0.08% | 0.095 | 0.000 |
| Home Furnishings | 0.06% | 0.118 | 0.000 |
| Agricultural Products | 0.19% | 0.036 | 0.000 |
| Tires & Rubber | 0.03% | 0.246 | 0.000 |
| Publishing & Printing | 0.19% | 0.033 | 0.000 |
| Healthcare Facilities | 0.12% | 0.048 | 0.000 |
| Household Appliances | 0.04% | 0.120 | 0.000 |
| Trucking | 0.12% | 0.042 | 0.000 |
| Consumer Electronics | 0.02% | 0.201 | 0.000 |
| Specialized Consumer Services | 0.11% | 0.041 | 0.000 |
| Commercial Printers | 0.03% | 0.122 | 0.000 |
| Forest Products | 0.01% | 0.193 | 0.000 |
| Leisure Facilities | 0.02% | 0.122 | 0.000 |
| Housewares & Specialty Stores | 0.07% | 0.029 | 0.000 |
| Commodity Chemicals | 0.02% | 0.096 | 0.000 |
| Real Estate Development | 0.00% | 0.180 | 0.000 |
| Heavy Electrical | 0.00% | 0.111 | 0.000 |
| Subtotal: | 31.73% | | 3.61% |
| Total: | 71.42% | | -0.21% |

Now take a look at what is on the right-hand side of the table. These industry groups are concentrated in the basic materials, industrials, financial and energy sectors. Those are groups capable of providing market leadership. If the Federal Reserve has been trying to create inflation as a way to repudiate the federal debt, it might have boosted the energy and basic materials sectors (XLE and XLB). Of if lower interest rates boosted financials (XLF) via the carry mechanism, they would have done so by now.

What we have seen instead is a massive macroeconomic drag as free money has been diverted into low-productivity transfer payments.  The policy has failed and as one who predicted it would for this reason, I can say it failed predictably.  A drug that worked like this would be taken off the market and its maker would know every class-action cockroach in the country.  Maybe central banks could use similar discipline against their nostrums.