



**BCWM**  
PROVIDING PEACE OF MIND



Portfolio Management

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# No Fear

The safest investment on the planet is (still) a U.S. Treasury bond. Today, if you purchase a 10-year Treasury bond, you will receive 4.2% interest every year and get your money back at the end of the 10 years.

Any other investment (stocks, corporate bonds, real estate, you name it) comes with at least some risk. The trade-off for taking that risk is the possibility of a higher return.

For example, if you buy a bond issued by a corporation, you're going to expect a higher yield than the 4.2% you'd get from the U.S. government. Why? Because there's always the chance the corporation won't pay you back (remember Enron?). The higher potential return is the carrot to get you to take the risk.

Safe — financially stable — corporations with strong balance sheets might only need to pay slightly more than Treasury bonds. Weaker — financially unstable — corporations (the ones that borrowed too much or whose business prospects have soured) must pay significantly more to attract investors.

Why does this matter?

Because, if you know where to look, the bond market tells a story. One of the most useful gauges we watch at BCWM is called the "credit spread."

The credit spread is simply the difference between what you can earn on a U.S. Treasury bond (4.2% today) and what you can earn on a corporate bond (about 5.2% today for relatively safe companies).

When investors grow anxious about the economy or corporate health, they demand higher yields from corporate bonds as compensation for risk. As investors become more fearful, the credit spread widens. When investors are relaxed and confident, they don't ask for much extra. The spread tightens.

Today, there is almost no fear.

In the graph below, you'll notice that corporate bonds usually pay only modestly more (about 1%–2%) than Treasury bonds. But every so often, fear takes over. Investors dump corporate bonds, prices collapse, and yields spike.

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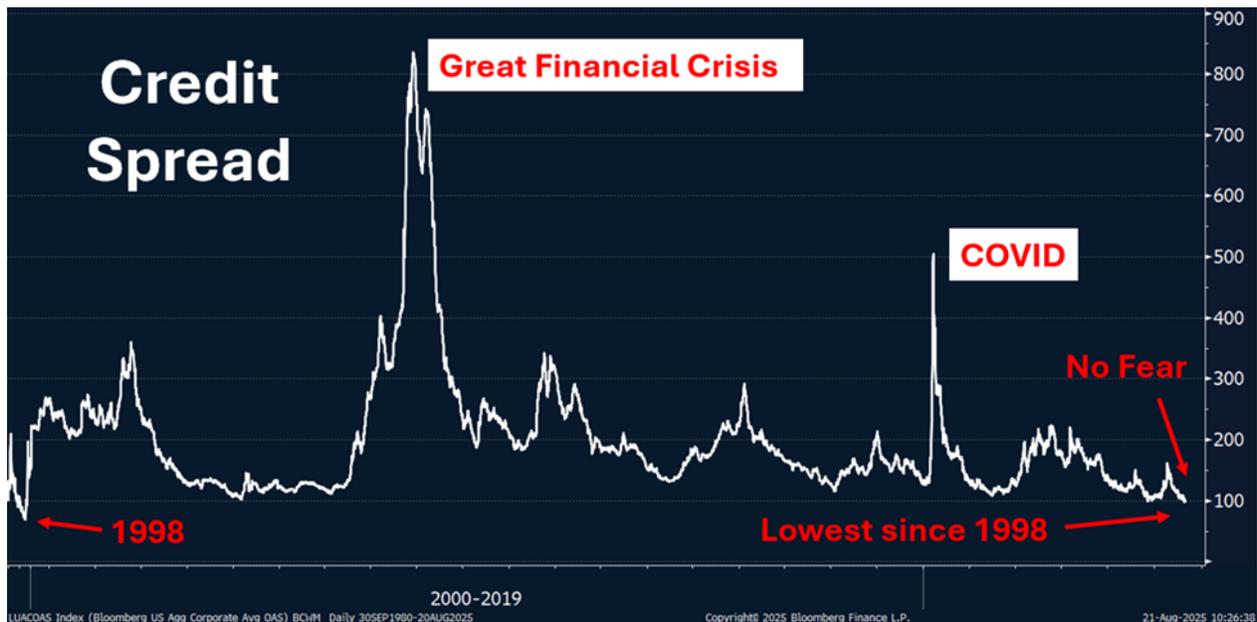
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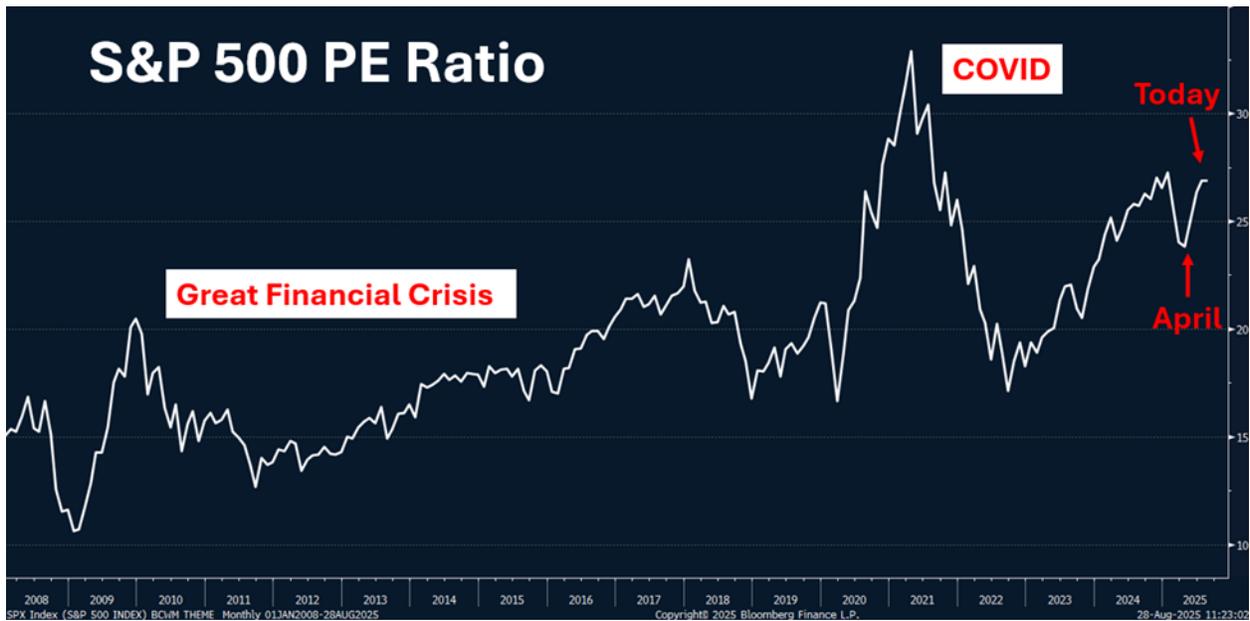
Ironically, those fearful moments (like during the Great Financial Crisis or COVID) when the spread is widest often turn out to be the best time to buy corporate bonds. And the opposite is true: when the spread is narrowest, investors are often the least worried . . . which historically has been the worst time to take extra risk.

Today, the credit spread is the tightest since 1998. Investors, in other words, are demanding very little extra compensation to own corporate bonds instead of Treasury bonds. The bond market is flashing a message of extreme confidence. That sounds reassuring, but history suggests that when investors are this relaxed, caution — not complacency — tends to be the wiser approach.

The complacency illustrated by the bond market can also be seen in the extreme confidence shown by stock-market investors. By many measures, stocks are anything but cheap. One metric we often highlight is the Price-to-Earnings (PE) ratio. This is the amount investors are willing to pay for a stock per dollar of that company’s earnings. When stock prices rise faster than earnings, the PE ratio climbs. And the higher it climbs, the less margin of safety investors are leaving themselves.

We pointed out in our [March Investment Commentary](#) that the market looked expensive. Then Donald Trump handed investors an unexpected “gift” with his sweeping tariffs announcement on “Liberation Day,” in early April. Stocks briefly collapsed, creating pockets of value that we were quick to scoop up. But those bargains didn’t last. As the chart below shows, the PE ratio has snapped right back to February levels. Many stocks (especially the AI-driven tech stocks) are once again trading at prices that can only be described as expensive.





To some extent, it's not surprising that investors have grown comfortable. The state of the economy seems just fine. But we find it worrisome that investors are ignoring potential storm clouds on the horizon.

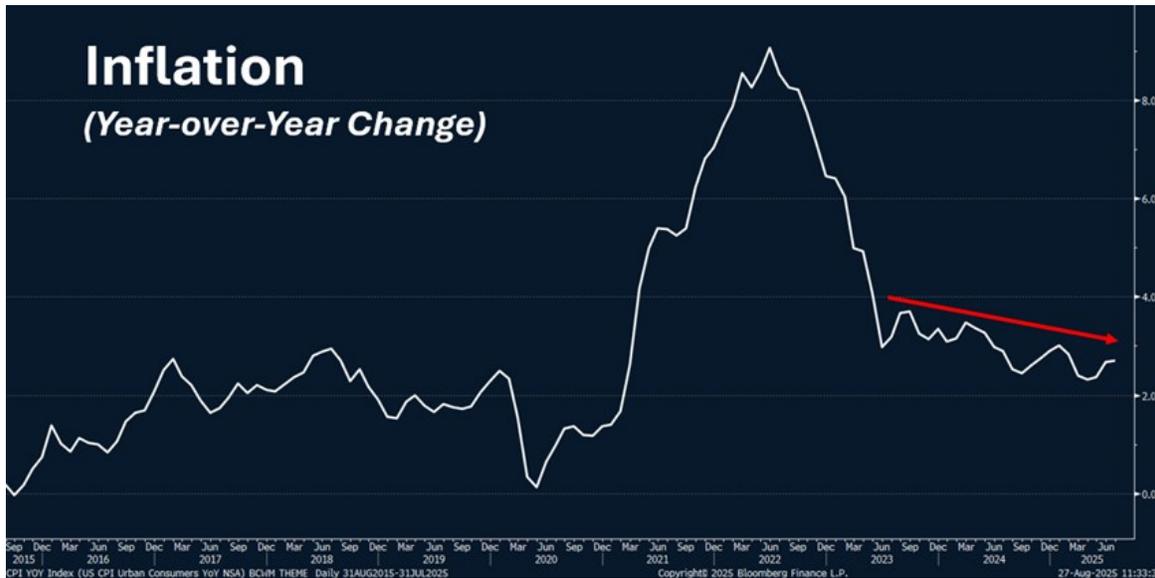
The job market has been remarkably strong yet has been weakening for several years.



If that trend continues, it could signal slower growth or even a recession. That wouldn't be good news for stocks. It also gives the Federal Reserve more incentive to **cut interest rates** to help stimulate economic growth and stave off a downturn.



In addition, we have seen very slow progress on lowering inflation over the last two years, and there is concern that the full effects of tariffs are yet to be felt. History suggests that when American companies are forced to pay more for foreign goods, they pass those costs on to consumers in the form of higher prices. The Fed is keenly aware of this risk and, right or wrong, regularly cites tariffs as a reason to **keep interest rates higher** for longer.



With the slowly deteriorating jobs market and inflation that refuses to fade, the decision whether to cut interest rates or keep them higher for longer is becoming increasingly consequential. *(This comes at a time when headlines about the Fed are getting almost as much airtime as the Kelce-Swift engagement.)*

These uncertainties make it hard to justify current stock valuations. Much depends on how the economy ultimately digests tariffs . . . and we'll need a few more quarters of data before that becomes clear.

One recent data point that does shine a positive light on tariffs came from the Congressional Budget Office (CBO). Last week the CBO updated its deficit forecast, showing that tariff revenue is expected to meaningfully offset the costs of the Big Beautiful Bill. And, remarkably, the tariffs may *reduce* deficits (instead of slightly increasing them, as previously projected). This would be welcome news if it plays out, but it's far from a sure thing.

We aren't structuring portfolios around Washington's projections. We think it's prudent to reduce risk across all our portfolios while the market trades at expensive, borderline euphoric, levels.

We've shifted our mix of bonds to be more heavily weighted towards Treasury bonds because corporate bonds don't compensate us very well for taking the additional risk.

And we have pared back our equity exposure as well, predominantly in growth-oriented tech stocks. We are trimming positions where valuations have become stretched and redeploying capital into areas where the risk/reward balance is more favorable. In short, we are taking gains off the table while other investors seem comfortable paying top dollar.

This is a healthy time to have *some* fear.

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