

Fisherman's Friends and Keep Hauling

You probably knew my brother Phil or Pippi to my family. I am flying to Miami for a small engagement party for Pip's oldest son. Alex beat the migration to Florida and moved to Miami a couple of years ago and within his first month of moving there he met Shelby, his now fiancé. Tonight, part of the Karmin family – but not all – will celebrate with the Reamer family. Pippi's spirit will be with us as will my dad's, who would have turned 96-years old in a few months.

Mom stayed in Evanston as we recently returned from a trip to Cornwall and Cotswold in the UK with Puppe (my sister), her husband and my wife. A great trip with many fond memories. One of the highlights was going to Port Isaac in Cornwall (see picture below), which is the home of the Fisherman's Friends – a folk music group made up of fishermen and locals who worked in Cornwall. Two movies were made about the group. One of their best-selling songs or sea shanties is called "Keep Hauling" with the lyrics "Hold your course and don't let go; Keep Hauling Boys."

With the recent 5% plus sell-off in the S&P 500 and a 15% sell off in semiconductor stocks,¹ "Hold your course" is our advice for longer-term stock investors.

For those with investment objectives based on income and preservation of capital, you should consider bonds with maturities of up to three years. Short-term interest rates yield 5% to 5.35% while 10-year Treasuries now yield 4.6%,² so it remains advantageous to buy shorter-term bonds.

To get a rate greater than the current 5.25% Federal Funds target, you must do one of two things: (1) take credit risk (buying high yield or junk bonds) or (2) sell bond volatility. Surprisingly, credit spreads, or the difference between highly regarded and "speculative" issuers, remain fairly tight and the risk / reward does not appeal to us. Conversely, implied volatility for bonds remains high and by selling that volatility through callable bonds, you can get a higher yield.

For example, you can buy a 3-year 6% bond issued by the Federal Home Loan Bank (the FHLB is a US government sponsored entity, but the bonds are not explicitly guaranteed by the government) while a comparable maturity US Treasury yields 4.8%. Your coupon or income is higher because you have sold an option to the FHLB that they can redeem your bond (at \$100) every quarter until the bond's maturity in three years. Simplistically, the FHLB is paying the investor roughly 1.2% each year (the 6% coupon on the bond minus the Treasury yield) for three years (if the bond is not redeemed early) for that option.



While the biggest risk is that the FHLB goes bankrupt, we are not worried about that. A more realistic risk is that the FHLB redeems the bond before the stated maturity in three years. The FHLB would do this if interest rates drop, and they can then refinance at a lower rate. Thus, you are then given your money back and you will have to reinvest at a lower rate than 6%, or even today's 5%. If you live in a state that has income taxes, you will be happy to know that the interest income from FHLB bonds is tax exempt.

Perhaps the biggest reason for the stock market sell off has been the recognition that the economy is strong, inflation remains stubborn, and the Federal Reserve is not lowering interest rates in the foreseeable future (compared to a market consensus of seven 25 basis point rate cuts at the outset of the year). In this instance, your FHLB bond should keep paying you 6% for perhaps the full three years. If you are uncomfortable with this type of investment opportunity and want a more conservative income alternative, you can buy Treasuries of up to two-year maturities at close to a 5% yield.

We are excited about the investment opportunities for income. Short-term interest rates are back at levels not seen in many years. Bonds now provide a viable alternative for income.

One other thing: As I re-read the letter and listened to the song (hopefully you will Google and listen to the song yourself), I heard Pip's voice. As he was going through chemo and suffering, Pip told me he was undergoing the treatments and fighting to show Alex and his two siblings that they should never give up. Or as the Fisherman's Friends would say, "Keep Hauling."

Sincerely,



Peter Karmin
Managing Member



Stuart Loren
Director

Citations and Disclosures

¹ Source: Bloomberg, from the March 7, 2024, high to the close on April 19, 2024, for the VanEck Semiconductor ETF (symbol SMH).

² Source: Bloomberg April 19, 2024.

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