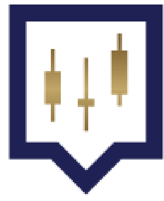

KPPFinancial

KPP INSIGHTS

Treasury bond auctions are where the U.S. government sells bonds to raise funds for its operations. They are routine but that doesn't make them unimportant. These auctions help determine the interest rates on U.S. government debt and are closely watched by investors. Understanding how these auctions work and the recent changes in market sentiment can provide valuable insights into the broader economic landscape.

The process itself starts with an announcement from the Treasury Department about the sale of a specific type and quantity of securities. There are three main types of marketable Treasury securities: bills (short-term), notes (medium-term), and Treasury Inflation-Protected Securities (TIPS). Bills are sold at a discount and pay face value at maturity, notes pay interest semiannually, and TIPS adjust their principal based on inflation.

Participants in these auctions can be primary dealers, financial institutions, or individual investors. They can submit either competitive or non-competitive bids. Competitive bids specify the yield the bidder is willing to accept, while non-competitive bids agree to accept the yield determined by the auction. The Treasury accepts non-competitive bids first and then fills competitive bids from the lowest yield up until the offering amount is met. All accepted bids are awarded at the highest yield accepted, known as the "stop-out yield."

Treasury auctions are important for several reasons. They help set the benchmark interest rates for the economy, influencing everything from mortgage rates to the cost of corporate borrowing. The auction results provide a snapshot of investor demand for U.S. government debt, reflecting broader economic sentiment.
A strong auction, where yields are lower than expected, indicates high demand and confidence in U.S. government securities. Conversely, a weak auction, where yields are

higher than expected, suggests lower demand and can signal concerns about fiscal policy or economic conditions. Primary dealers play a crucial role as they are required to participate in auctions and often absorb excess supply when demand from other investors is weak.

In December of last year, Treasury auctions faced challenges due to record levels of debt issuance and weak demand. The auction of long-term bonds, such as the 30-year bond, was particularly troublesome, with higher-than-expected yields and significant purchases by primary dealers, indicating tepid interest from other investors. This raised concerns about the government's ability to finance its debt without driving up borrowing costs, which could have broader economic implications.

By April, the sentiment had not improved significantly. Investors continued to demand higher interest rates to compensate for uncertainties, particularly regarding Federal Reserve policies and inflation. The Treasury's plan to issue over $10 trillion in bonds in the next 12 months (yes, I said trillion) further exacerbated these concerns, as it represented a substantial portion of the U.S. GDP. The fear of locking money in long-term bonds at potentially unfavorable rates kept investors wary, leading to higher yields and weaker auction results.

Recent developments in May and June have shown some shifts in sentiment. For instance, a poor auction on the five-year note in late May highlighted ongoing challenges, with the bid-to-cover ratio falling below the average, signaling weak demand. However, recent mixed economic data, such as falling housing starts and rising jobless claims, have added complexity to the market's outlook. As of June, investors are bracing for a significant $183 billion auction of Treasury notes. Yields have ticked up in anticipation, reflecting a cautious approach as market participants adjust their positions.

Treasury bond auctions are crucial for the functioning of financial markets and the broader economy. They not only help the government raise funds but also set benchmark interest rates that affect various aspects of economic activity. Over the past six months, market sentiment surrounding these auctions has shifted due to record debt issuance, inflation

concerns, and mixed economic signals. Going forward, as the US continues to issue record levels of debt, the dangers of a self-reinforcing debt spiral, where higher yields lead to higher yields, is a scenario that we will be closely watching and another reason that the Fed cannot keep rates higher indefinitely.

STOCK IDEAS

InterContinental Hotels Group (IHG) operates 946,000 rooms across 19 brands addressing the midscale through luxury segments, as of Dec. 31, 2023. Holiday Inn and Holiday Inn Express constitute the largest brand, while Hotel Indigo, Even, Hualuxe, Kimpton, and Voco are newer lifestyle brands experiencing strong demand. The company launched a midscale brand, Avid, in 2017 and closed on a 51% stake in Regent Hotels in 2018. It acquired Six Senses in 2019 and launched another midscale brand, Garner, in 2023. Managed and franchised represent 99% of total rooms. As of Dec. 31, 2023, the Americas represented 55% of total rooms, with Greater China accounting for 19% and Europe, Asia, the Middle East, and Africa making up 26%. InterContinental's current mid-single digit share of hotel industry rooms is set to increase as the company controls more than 10% of the rooms in the global hotel industry under-construction pipeline. InterContinental has a high exposure to recurring managed and franchised fees, which have high switching costs and generate strong ROICs. Forward P/E comes in around 20, which is reasonable considering its double-digit growth rates.

C.H. Robinson (CHRW) is a top-tier non-asset-based third-party logistics provider with a significant focus on domestic freight brokerage (about 61% of net revenue), which reflects mostly truck brokerage but also rail intermodal. Additionally, the firm operates a large air and ocean forwarding division (27%), which has grown organically and via tuck-in acquisitions over the years. The remainder of revenue consists of the European truck-brokerage division, transportation management services, and a legacy produce-sourcing operation. Robinson's non-asset-based operating model has generated average returns on capital near 20% over the past

five years—well above returns generated by most traditional asset-intensive carriers. CHRW stock price has been knocked down over the last few years due to declining growth rates. However, this decline is expected to reverse back to growth this year. The stock has rebounded nicely off its setback in April. This is a good logistical company to have on your watchlist.

PORTFOLIO MANAGEMENT

Cryptocurrency has been gaining a lot of attention, and investors want to know how it fits into their portfolio, and if it has staying power. This topic is complex, but there are several factors we can consider.

Firstly, the underlying technology of cryptocurrencies, blockchain, offers significant benefits. It provides a decentralized, secure, and transparent way to record transactions, which can be applied to various industries beyond finance, such as supply chain management, healthcare, and real estate. This technological innovation is likely to endure and evolve, supporting the longevity of cryptocurrencies.

Secondly, institutional adoption of cryptocurrencies has been increasing. Major financial institutions, corporations, and even governments are exploring or have already integrated cryptocurrencies into their operations. For instance, companies like Tesla and Square have invested in Bitcoin, while countries like El Salvador have adopted Bitcoin as legal tender. Such endorsements provide legitimacy and signal long-term viability.

Furthermore, regulatory frameworks are gradually developing to accommodate and oversee the cryptocurrency market. While regulations can introduce new challenges, they also help to stabilize the market, protect investors, and reduce the risk of fraud and illicit activities. A more regulated environment can encourage broader acceptance and integration into the global financial system.

However, cryptocurrencies face significant challenges. Their value is highly volatile, and they are subject to market speculation. Regulatory crackdowns in some regions,

technological vulnerabilities, and environmental concerns related to energy-intensive mining processes also pose risks.

In summary, while cryptocurrencies are likely to face ongoing challenges, the technological innovations, increasing institutional adoption, and evolving regulatory landscapes suggest that they have the potential to remain a significant part of the financial ecosystem. Whether they will achieve widespread mainstream adoption is still uncertain, but their foundational technology and growing integration into the economy indicate that they are more than just a passing trend.

CONSUMER WATCH

In today's economic climate, many prospective homebuyers are grappling with the question of whether to rent or buy. With mortgage rates on the rise and home prices still elevated, the cost of homeownership has become a significant barrier for many Americans. But how does the price of buying a home with a mortgage really compare to the cost of renting?

Recent studies suggest that in most major U.S. cities, renting is currently the more affordable option. A report by Redfin found that buying a home is cheaper than renting in only 4 out of the 50 largest metros: Detroit, Philadelphia, Cleveland, and Houston. In all other major cities, renting wins out in terms of affordability.

Nationally, the average home costs 25% more to own than to rent. The gap between owning and renting is at its widest in over 15 years, with homeowners paying an additional $1,176 per month compared to the typical rent payment. A new analysis by CBRE reveals that buying a house in the U.S. is 38% more expensive than renting, with the average monthly mortgage payment of $2,997 being 38% higher than the average monthly rent of $2,165.

The primary culprits behind this trend are rising mortgage rates and a persistent housing shortage across the country. Mortgage rates have surged from around 3% to over 7% in recent years, significantly increasing the cost of homeownership. Additionally, a lack of new

housing construction has driven up home prices, making it even harder for buyers to afford a home.

The affordability gap is most pronounced in high-cost cities like San Jose, California, where the typical home costs 165% more to own than to rent. The median monthly mortgage payment in San Jose is over $11,000, compared to just $4,200 in median rent.

However, it's important to note that there are exceptions to this trend. A Today's Homeowner study found that in 46 out of 97 major cities, long-term renting is cheaper than homeownership over a 30-year period. But in general, the data suggests that for most Americans, renting is currently more affordable than buying a home with a mortgage.

Of course, the decision to rent or buy is not solely based on cost. Factors such as lifestyle preferences, job stability, and long-term financial goals should also be considered. Homeownership offers the potential for equity growth and tax benefits, while renting provides more flexibility and lower maintenance costs.

Ultimately, the choice between renting and buying comes down to your unique circumstances and priorities. If affordability is your primary concern, renting may be the more prudent option in today's housing market. But if you're willing to stretch your budget and commit to a long-term investment, homeownership can still be a viable path to building wealth and stability.