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In this week's recap: Tighter money policy; Market drops.

Weekly Economic Update

Presented by Ed Papier, May 9, 2022

THE WEEK ON WALL STREET

With the Fed in focus, the markets experienced wide price swings over the course of last week, as technology companies led the market lower.

The Dow Jones Industrial Average slipped 0.24%, while the Standard & Poor's 500 declined 0.21%. The Nasdaq Composite index dropped 1.54% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, fell 1.99%. [1,2,3]

A WILD WEEK

After successive daily gains to begin the week, stocks staged a powerful relief rally in response to Wednesday's Federal Open Market Committee (FOMC) announcement, aided by Fed Chair Powell's comment that a 75-basis point hike was not under active consideration.

Stocks, however, dropped the following day as investors reassessed the implications of a tighter monetary policy. Also on Thursday, the yield on the 10-year Treasury Note closed above three percent. News that worker productivity fell 7.5% and labor costs rose 11.6% in the first quarter fanned inflation fears and added to investor unease. Despite a better-than-expected employment report, stocks closed out the week with another day of losses amid volatile trading. [4]

FED RAISES RATES

The May 2022 FOMC meeting resulted in an increase of 50 basis points in the federal funds rate, the largest rate increase since 2000. In a post-meeting press conference, Fed Chair Powell said additional 50 basis point hikes are likely, acknowledging that inflation was much too high and sending assurances that he was committed to price stability.

The Fed also announced that it would begin reducing its $9 trillion balance sheet by $95 billion a month, a step the markets had been anticipating. [5]

THE WEEK AHEAD: KEY ECONOMIC DATA

Wednesday: Consumer Price Index (CPI).
Thursday: Producer Price Index (PPI). Jobless Claims.
Friday: Consumer Sentiment.

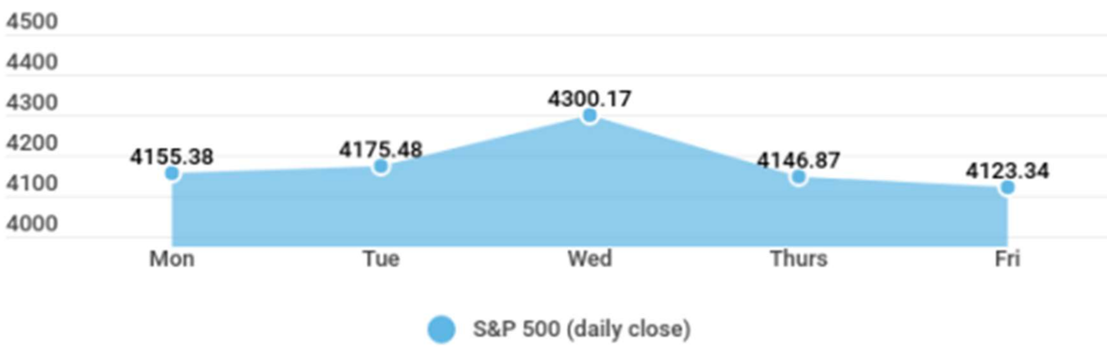
QUOTE OF THE WEEK

"Those who can make you believe absurdities

can make you commit atrocities"

Voltaire

Market Index	Close	Week	Y-T-D
DJIA	32,899.37	-0.24%	-9.46%
NASDAQ	12,144.66	-1.54%	-22.37%
MSCI-EAFE	1,993.23	-1.99%	-14.68%
S&P 500	4,123.34	-0.21%	-13.49%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.12%	+0.23%	+1.60%

Sources: The Wall Street Journal, May 6, 2022; Treasury.gov, May 6, 2022
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, April 29, to Friday, May 6, close. Weekly performance for the MSCI-EAFE is measured from Friday, April 29, open to Thursday, May 5, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Investors contemplating the purchase of a bond mutual fund or bond exchange traded fund (ETF) want to know how to figure out the potential yield on their purchase. Investors may simply look at whichever yield is at the top of the page when they browse through their investment management company's offering. However, determining the yield is a little trickier than it may seem at first.

There are two primary ways of determining yields: the distribution yield and the SEC yield. It's helpful to know how to each type of yield is calculated so that you can use both of them to get a better sense of how much you'll truly earn.

The distribution yield—also known as the trailing 12-month yield or TTM—is calculated by comparing a fund's distributions in the previous 12 months to the fund's net asset value (NAV) at the end of that 12-month period.

Not every fund, analyst, or website calculates the distribution yield in quite the same way. Some will take the most recent dividend distribution and multiply that by 12 to average out the years' worth of dividends.

Averaging out the 12-month yield based on the most recent dividend is much easier than digging up every dividend and calculating the exact figure. It can quickly give you an idea of the yield, but it's often a rough—and inaccurate—estimate of the annual return.

The first and most obvious issue is the often-inaccurate assumption that the income over the last 30 days multiplied by 12 equals the 12-month return. In many instances, this is a reasonably close approximation of the actual 12-month return. At other times, however, the calculated average income and the actual income may be quite different.

The second assumption is that the current NAV represents the average NAV over the past 12 months. While bond funds are less volatile than stocks, there will be an element of volatility and price movement with any investment—even bond funds, particularly in rising or falling interest rate environments.

The third assumption issue that may compromise the distribution yield calculation's accuracy is that the simplified version doesn't account for the various lengths of the months. If you calculate the return at the end of February, you're using a 28-day distribution period. If you calculate it in July, you're using a 31-day period. This difference can skew your result, though it may not be the most consequential of the inaccuracies.

To address the issue of various distribution yield calculations, the SEC yield was created by the Securities and Exchange Commission as a market-wide standard. Companies must use this calculation when reporting yield information to the SEC.

The actual SEC yield formula is a bit complicated, but in simplified terms, the SEC yield is calculated by dividing the previous 30 days' worth of income by the best share price on the last day of the period. The SEC yield isn't perfect, but it has one clear advantage of other yield calculations—it is standardized and allows investors to compare apples to apples.

The full calculation accounts for small details such as management fees, expenses, waivers, and reimbursements of the fund. It also assumes each bond in the fund will be held until maturity and that all income is reinvested. However, depending on the type of fund, those assumptions may not be accurate. For example, actively managed funds are more likely to trade bonds, while passively managed funds are more likely to hold them to maturity.

While it's important to understand the differences, an investor may find it advantageous to consider both yield calculations. You should be able to find both calculations on the fund website or a fund screening website. By considering both, you may give yourself a more complete view of the fund.

Neither the distribution yield nor the SEC yield can tell you what income your bond fund will produce from the time you buy it until you sell. Bond funds are subject to risks, including interest rate risk and credit risk.

In general, the distribution yield can be used as an estimate of how the fund will affect your portfolio in the long term. The SEC yield, on the other hand, gives you more recent, targeted data—which could help you get a better sense of the short-term performance and regular income of the fund. By using both measurements in conjunction, investors may be able to buy funds that are likely to offer steady income and long-term stability.

What is a good SEC yield? Yields constantly fluctuate, and they are highly dependent on the broader market being traded. A good SEC yield today might not be a good SEC yield in two months. A good SEC yield for a Treasury note might not be a good SEC yield for a REIT. To get a sense of what to expect from your investments, look at an index that tracks your target market.

For example, you can get a sense of the average yield across the entire bond market by looking up the SEC yield for the Bloomberg Barclays U.S. Aggregate Bond Index. You can also use the SEC yield of an ETF that tracks the index. If an individual bond has a higher yield than the index, it may be considered a "good" yield, but you must consider the risks that come with higher yields.

What is the dividend yield? A dividend yield is the same as a distribution yield. The different name simply stems from the fact that mutual fund income is typically referred to as a "distribution," while stock income is called a "dividend." To calculate dividend yield, just add up the annual dividend total in dollars, and divide it by the share price. [6]

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Know someone who could use information like this?
Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

CITATIONS:

1. The Wall Street Journal, May 6, 2022
2. The Wall Street Journal, May 6, 2022
3. The Wall Street Journal, May 6, 2022
4. CNBC, May 5, 2022
5. CNBC, May 4, 2022
6. thebalance.com/distribution=yield-vs-sec-yield-which-should-you-use-416978