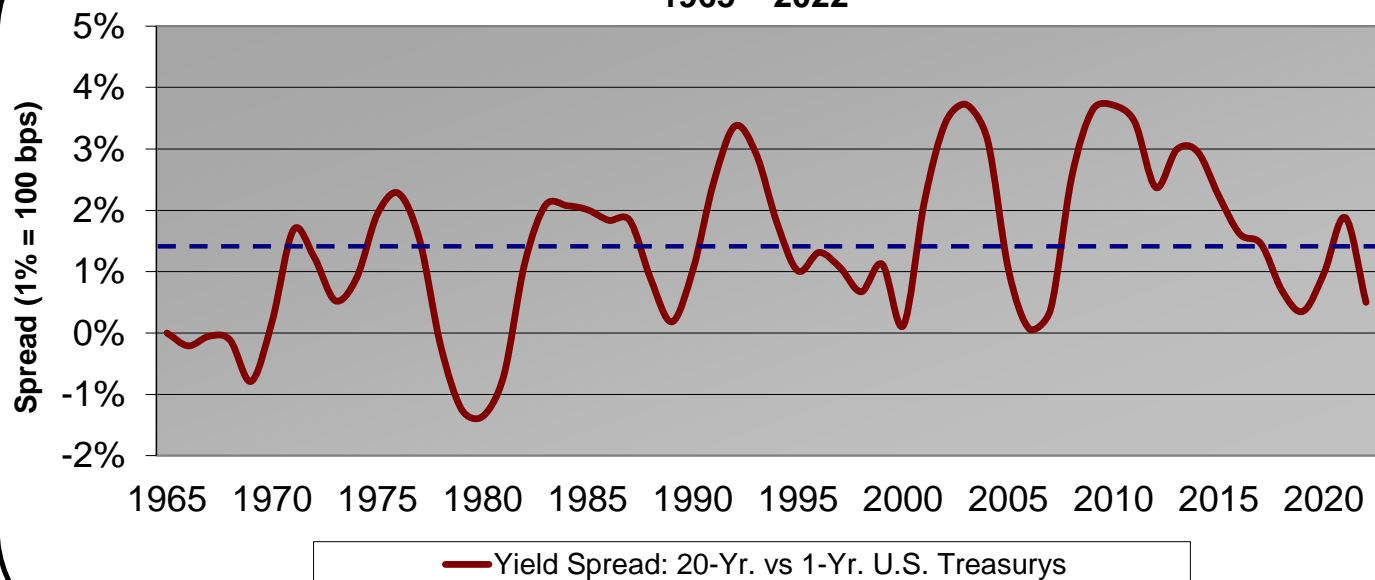


TREASURY YIELD CURVE AVERAGES 1.37% (137 BASIS POINTS) 1965 – 2022



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SPREAD	FREQUENCY	PERCENTAGE
> 3%	7	12%
2% to 3%	12	21%
0% to 2%	31	53%
-1% to 0%	6	10%
< -1%	2	3%

THE YIELD CURVE, THE FED, & P/Es

Changes in short-term interest rates by the Fed, on their own, have minimal impact on stock market P/Es...unless the Fed is unsuccessful in controlling inflation or preventing deflation. Increases in short-term rates are intended to contain the inflation rate, the driver of P/Es and long-term interest rates, at levels of price stability. Decreases in short-term rates, often to stimulate the economy, must be done in a way that does not cause inflation or foster inflation expectations. The implication of an average yield curve spread of approximately 100 basis points (1%) is that the interest rate that relates to inflation expectations, the long-term rate, is likely to stay relatively low. When the spread exceeds 1%, the implication is a risk of potentially higher inflation and lower P/Es. Spreads below 1% imply tighter monetary policy and efforts to control inflation risks (yet this also creates the risk of deflationary conditions and lower P/Es).

Why? Short-term interest rates should be only slightly above inflation. If inflation is restored to the Fed's goal near 2%, then short-term Treasurys should yield slightly over 2%. Add 1% for the long-term spread and that implies bond yields just over 3%. Even using the market's assessment of future inflation (currently around 2.2%), the resulting long-term rate would be less than 4%. Further, based upon Crestmont's "P/E Pinnacle" analysis, P/Es should stay in the low to mid 20's—except during periods of market disruption—yet this is dependent upon the inflation rate returning to low levels reflecting price stability.

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