SIMPLIFY

Macro Voices

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Simplify Asset Management

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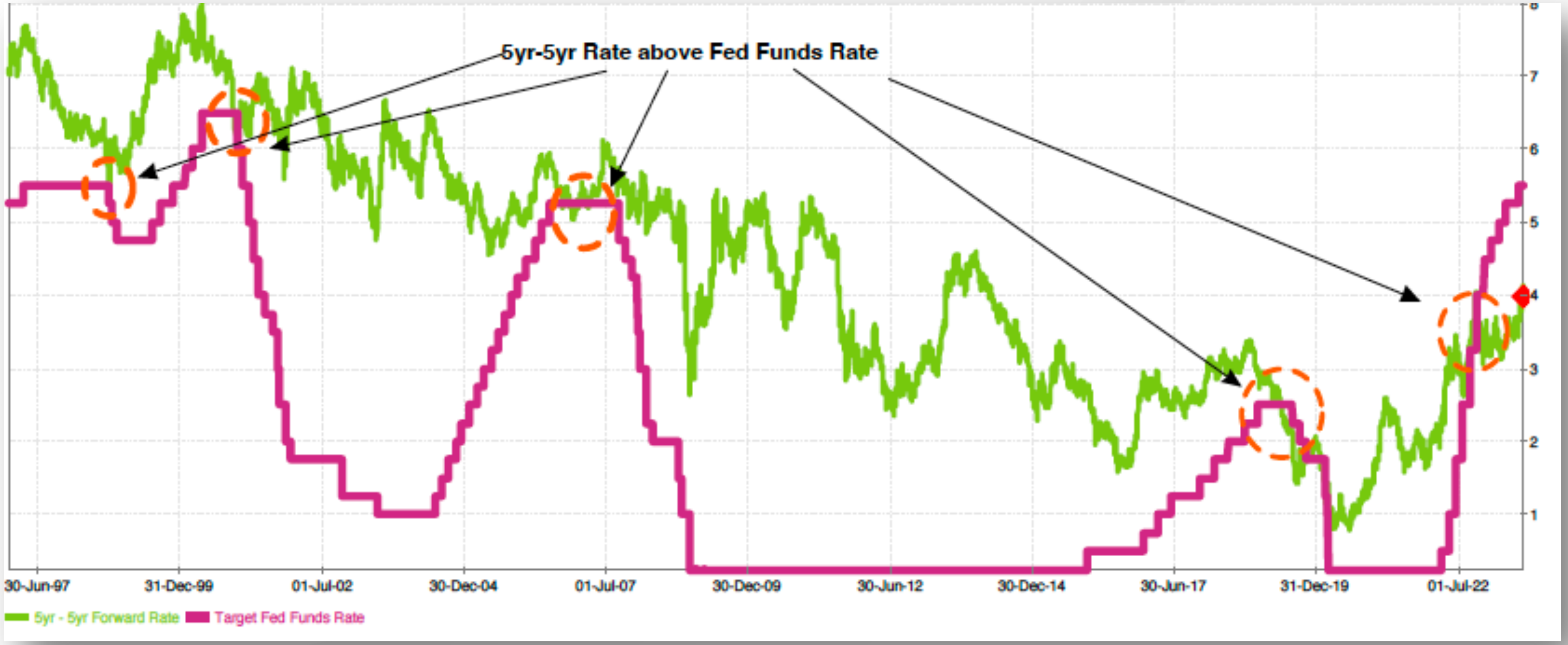
The FED's Master Plan

The FED recognized that there are only two ways out of a debt crisis – either default or inflate with the caveat that <u>inflation is simply a slow-motion default</u>.

GDP = Money * Velocity = Price * Quantity

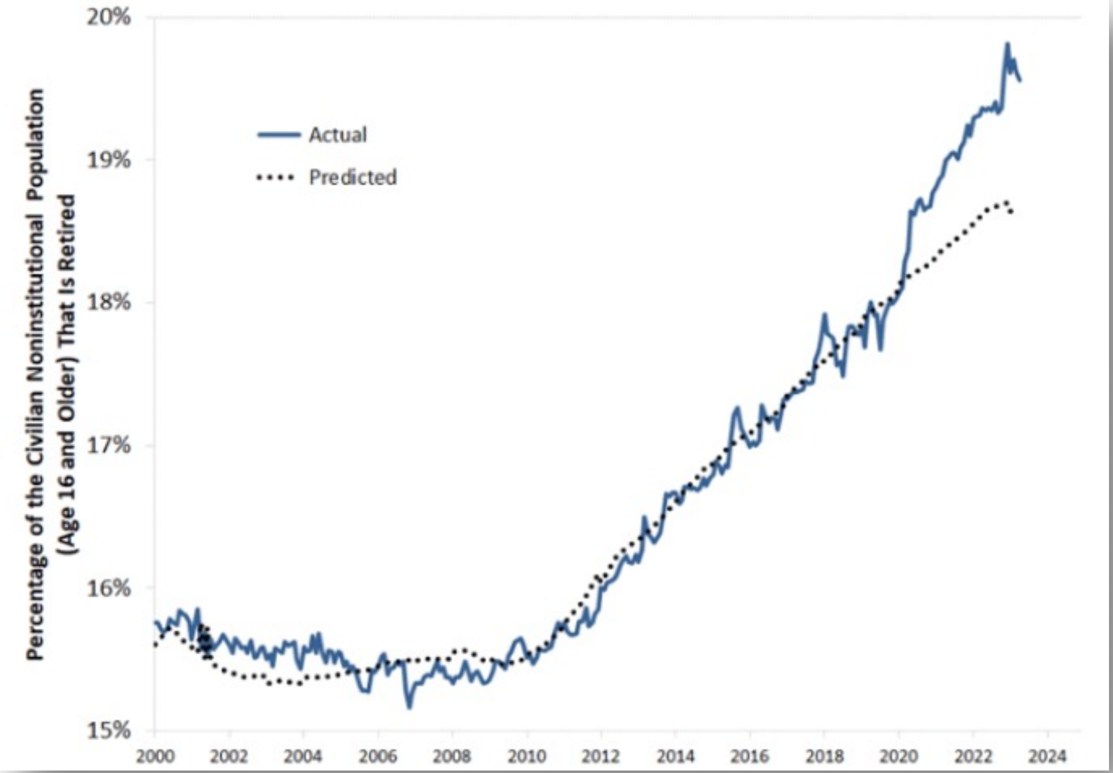
GDP = Workers * Hours * Productivity

Fed Funds Rate vs. 5-Year Forward 5-Year Rate



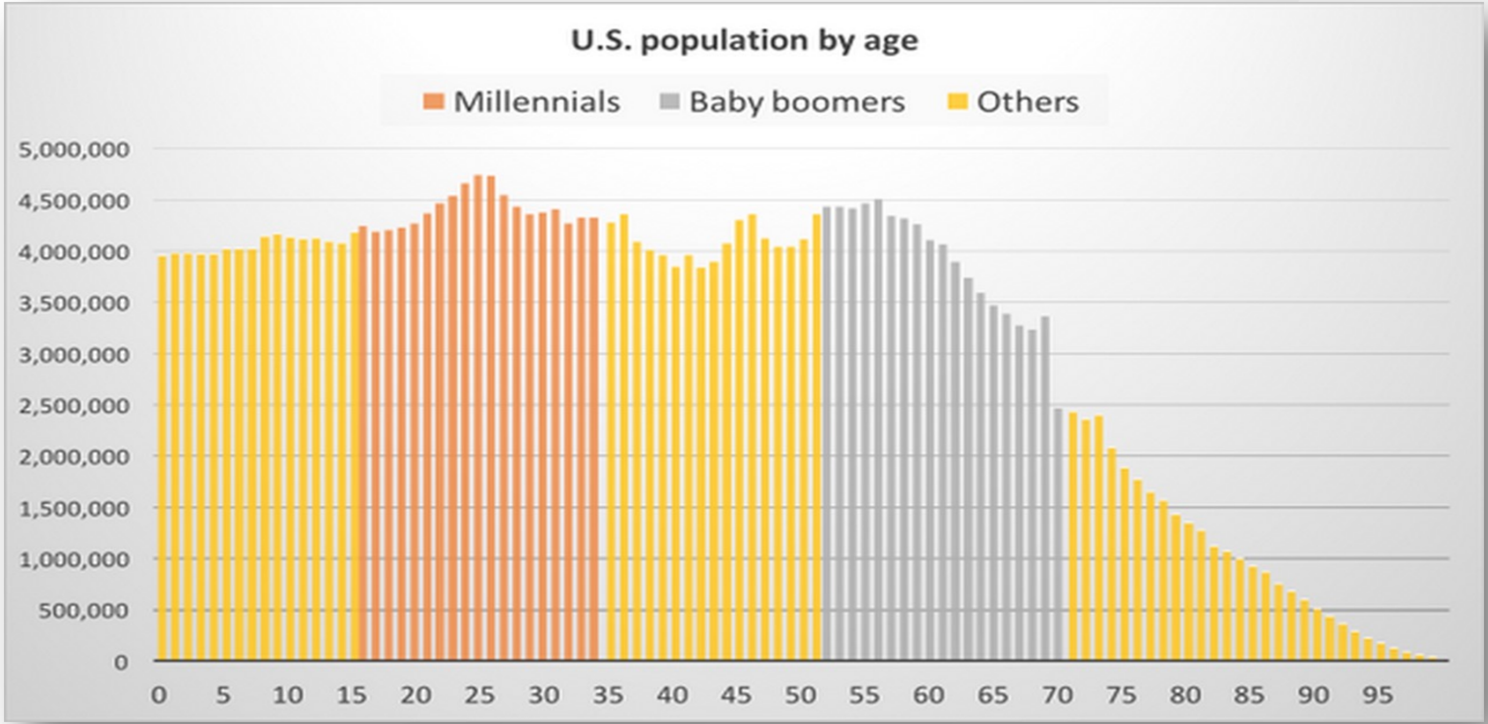
Source: Credit Suisse LOCUS

Actual Retirements vs. Predicted Trend



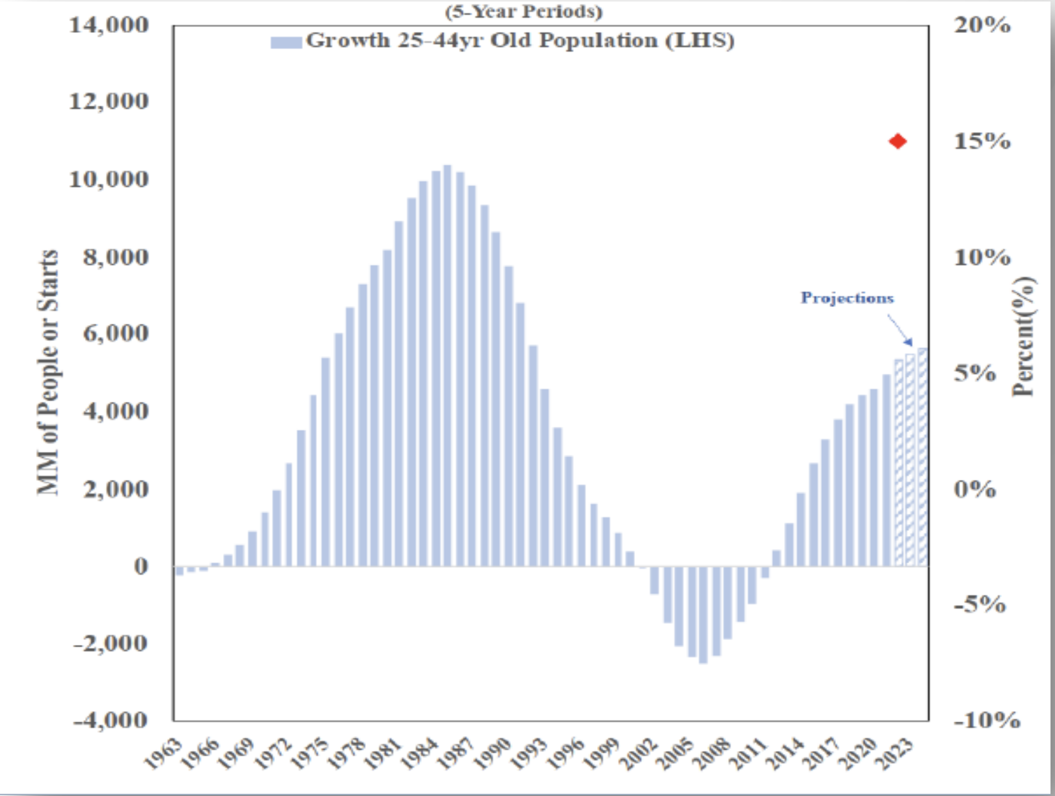
Source: Federal Reserve Bank of St. Louis

U.S. Population by Age Cohort



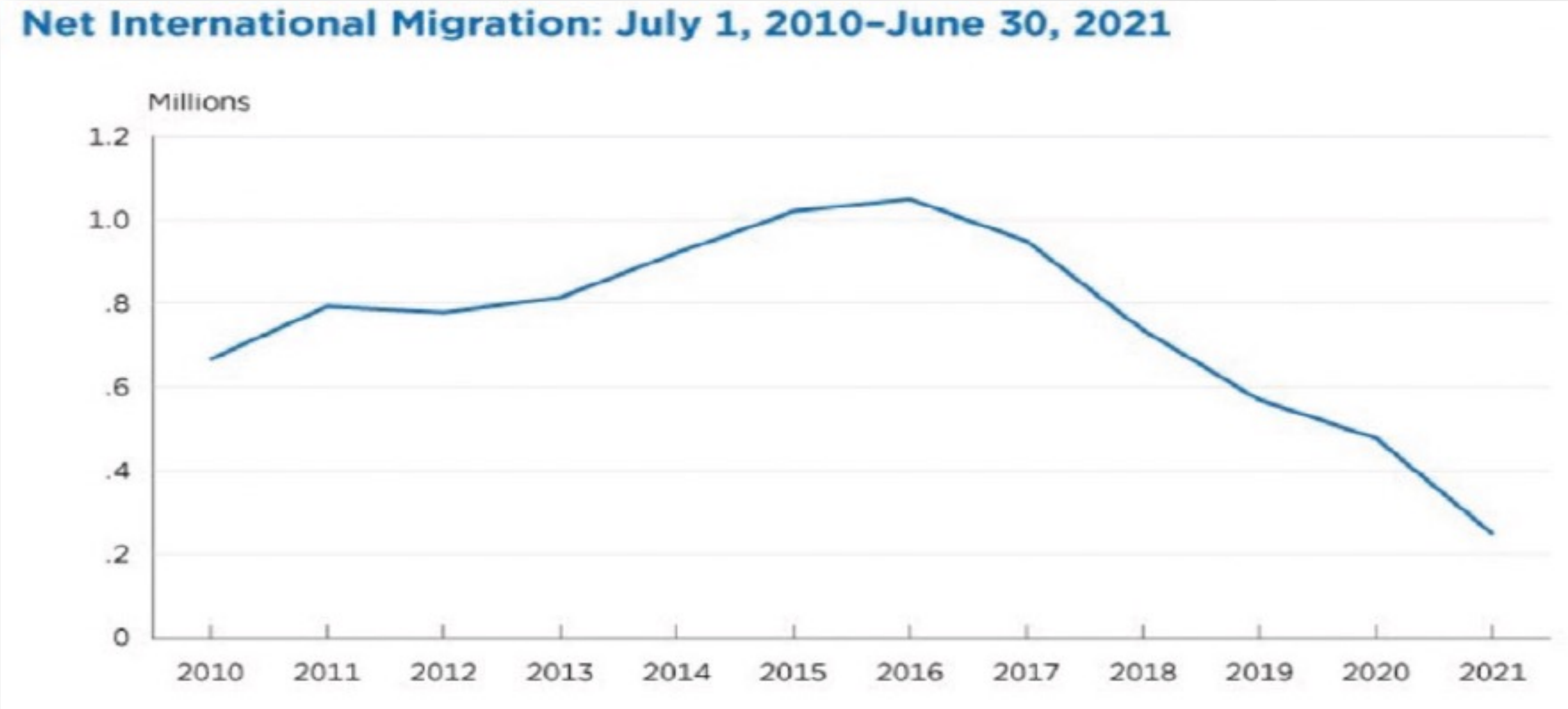
Source: Wall Street Journal

U.S. Population Growth in 25-44-Year-Old Population



Source: Wall Street Journal

Net International Migration



Source: U.S. Census Bureau, Vintage 2021 Population Estimates

The Three Risk Vectors

When making an investment decision in the bond market, there are only three risk vectors to consider:

1) Duration – When one receives their money back;
2) Credit – If one receives their money back;
3) Convexity – How one receives their money back.

When a bond matures is often used as a proxy for **Duration risk**, but more precisely it measures the bond's price sensitivity to interest rate changes.

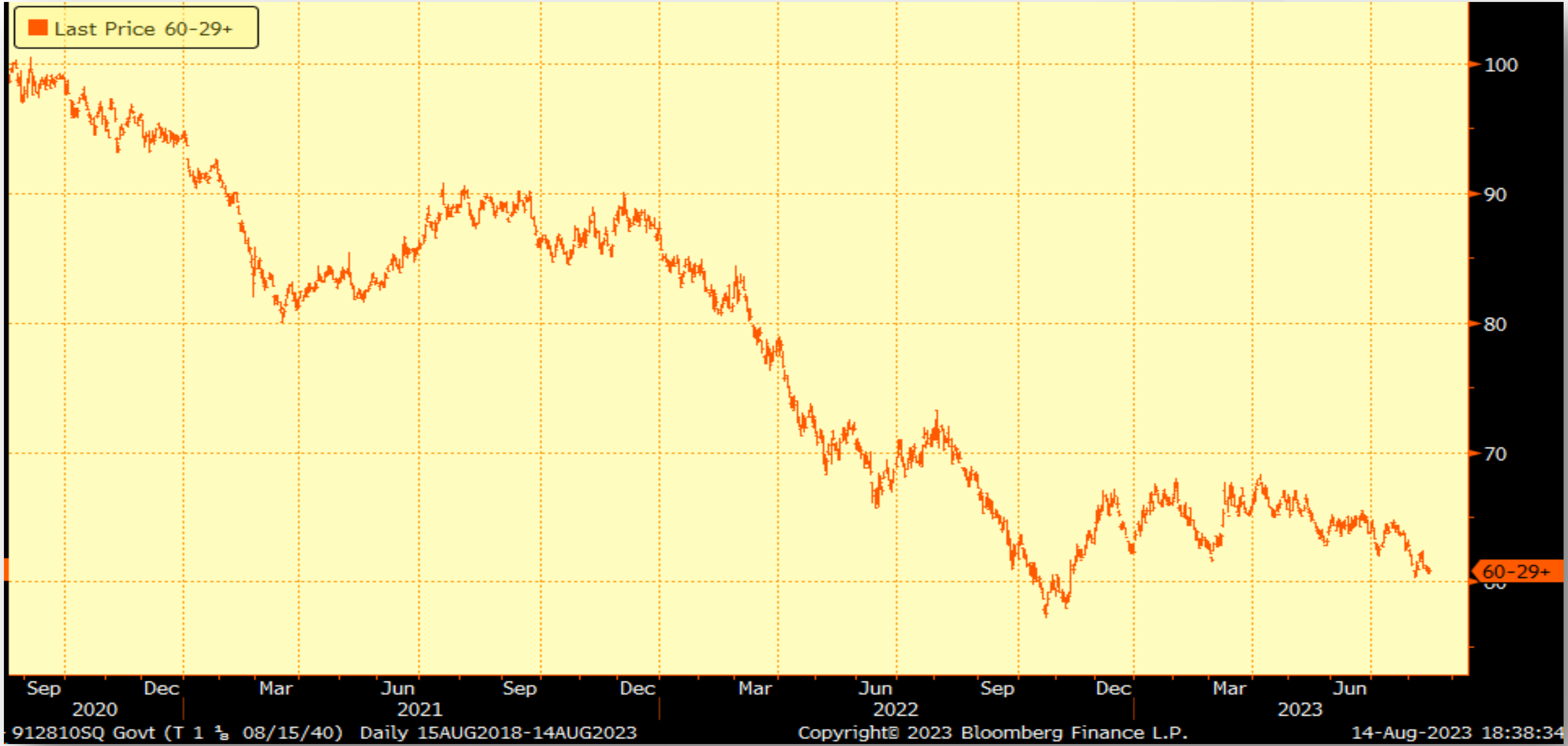
Credit risk is rather straight forward; it measures the chance of a default and the loss of one's investment.

Convexity risk is a bit tricky since it is mostly found embedded in callable bonds and can be challenging to measure; but the bottom line is that such bonds (mostly Mortgage and Municipal) <u>presently offer the best relative value</u>.

U.S. Treasury Yield Curve

Source: Investopedia

UST 1.125% 08/15/2040



Source: Bloomberg

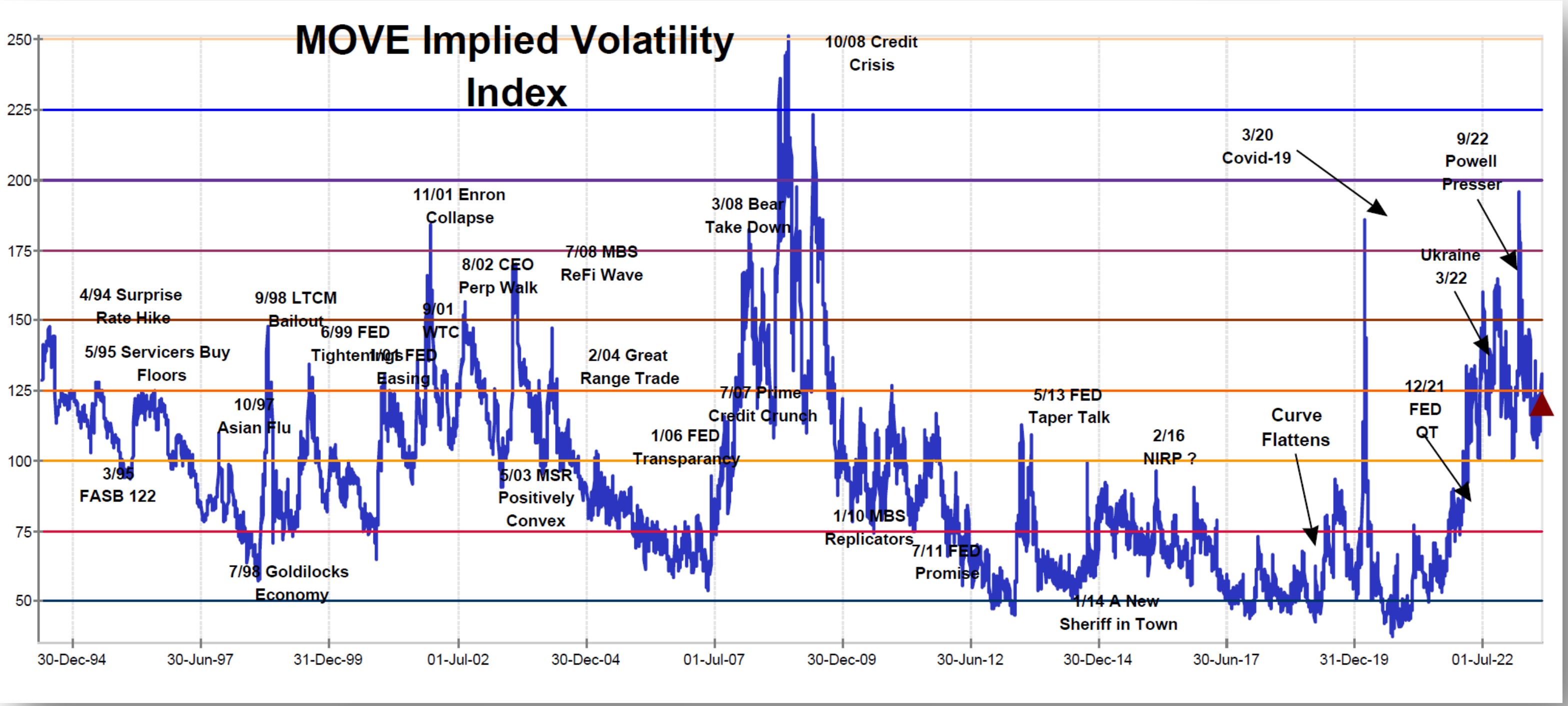
5-Year IG Credit Spread

Source: Credit Suisse LOCUS

High Yield (HY) Credit Spread

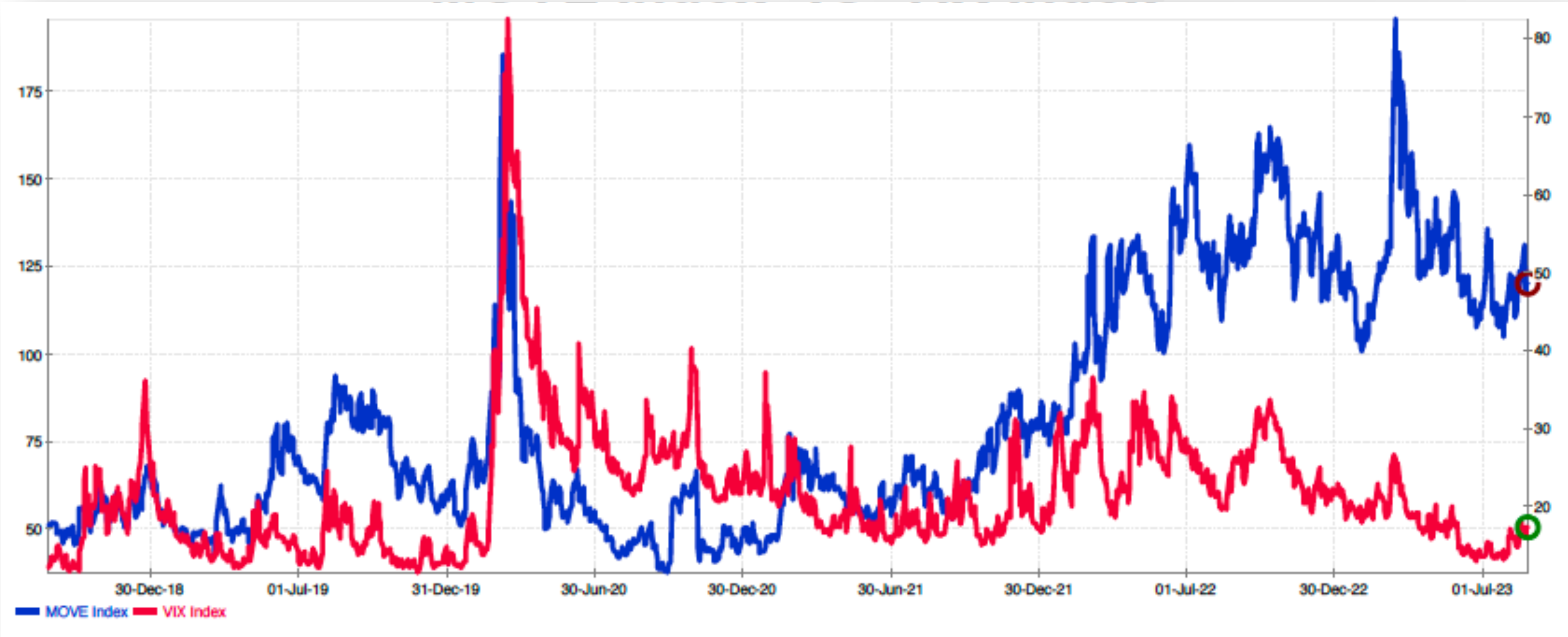
Source: Credit Suisse LOCUS

Move Implied Volatility Index



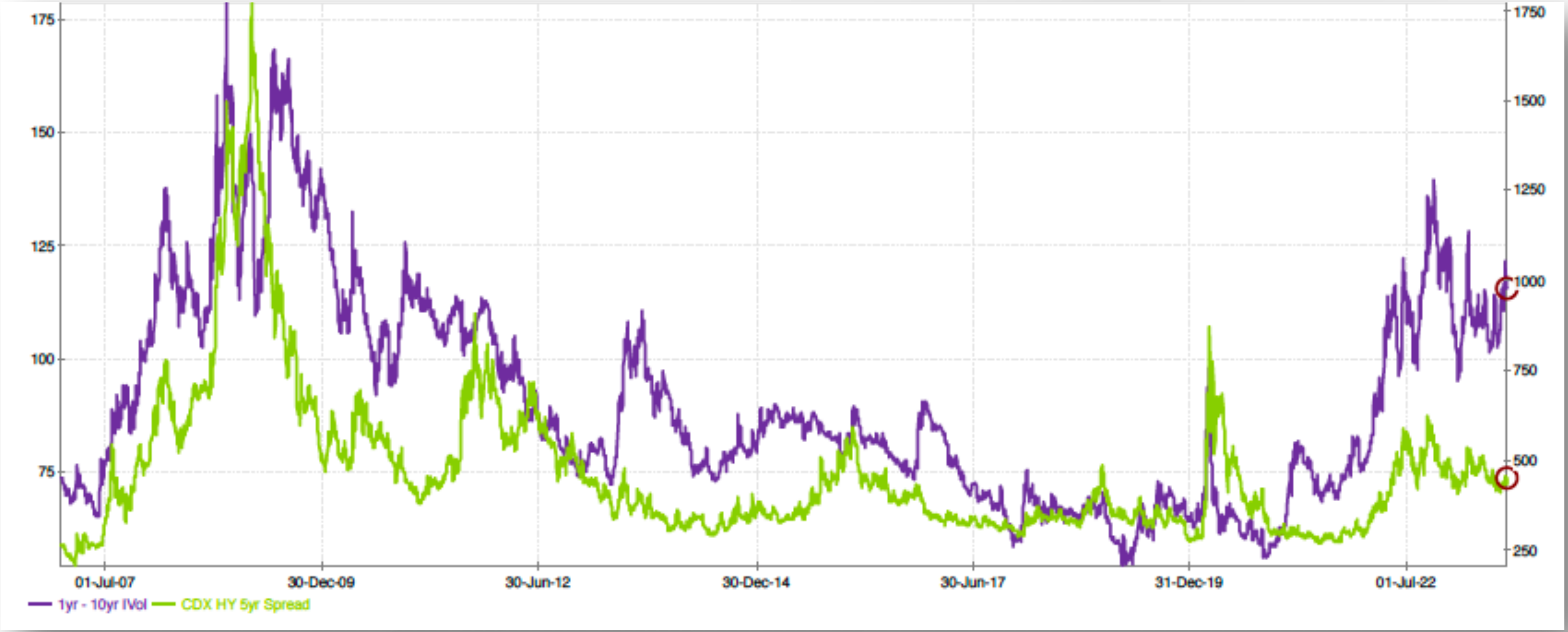
Source: MOVE

Move Index vs. VIX Index



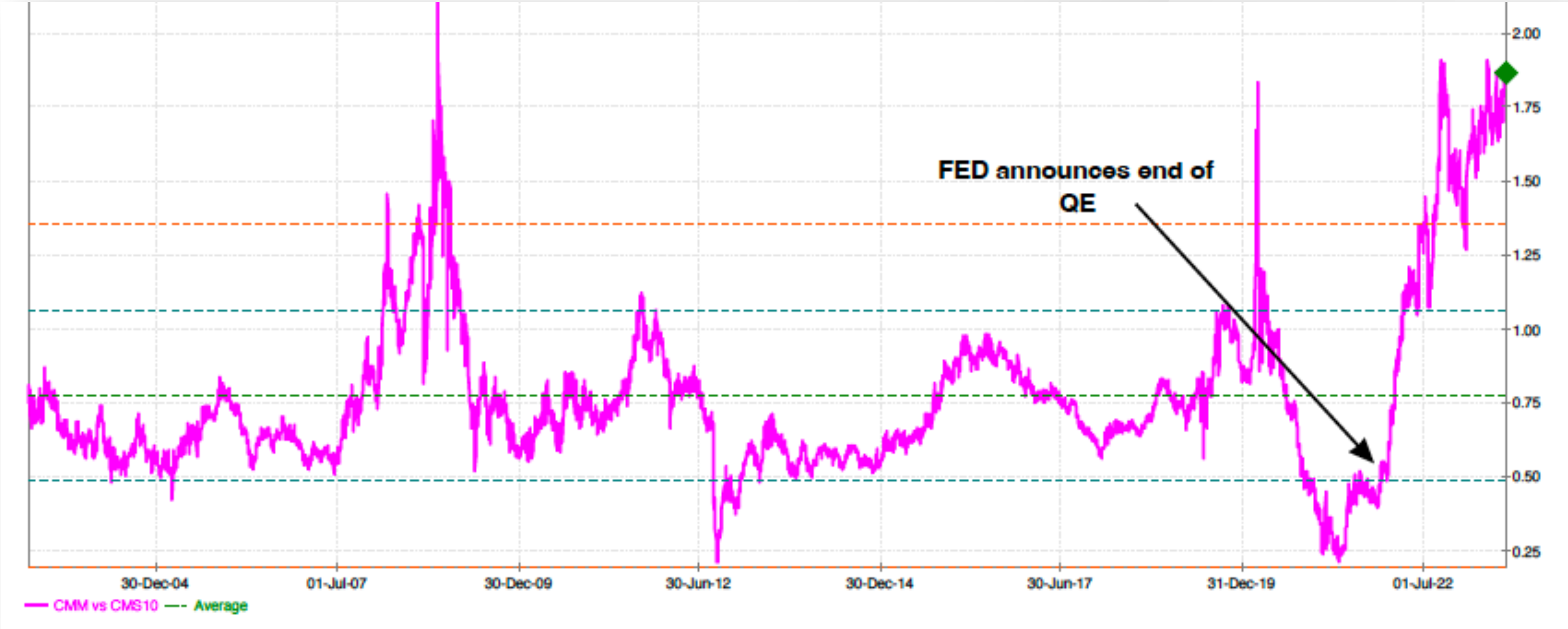
Source: MOVE

Interest Rate Volatility vs. HY Credit



Source: Credit Suisse LOCUS

MBS Rate vs. 10-Year Rate



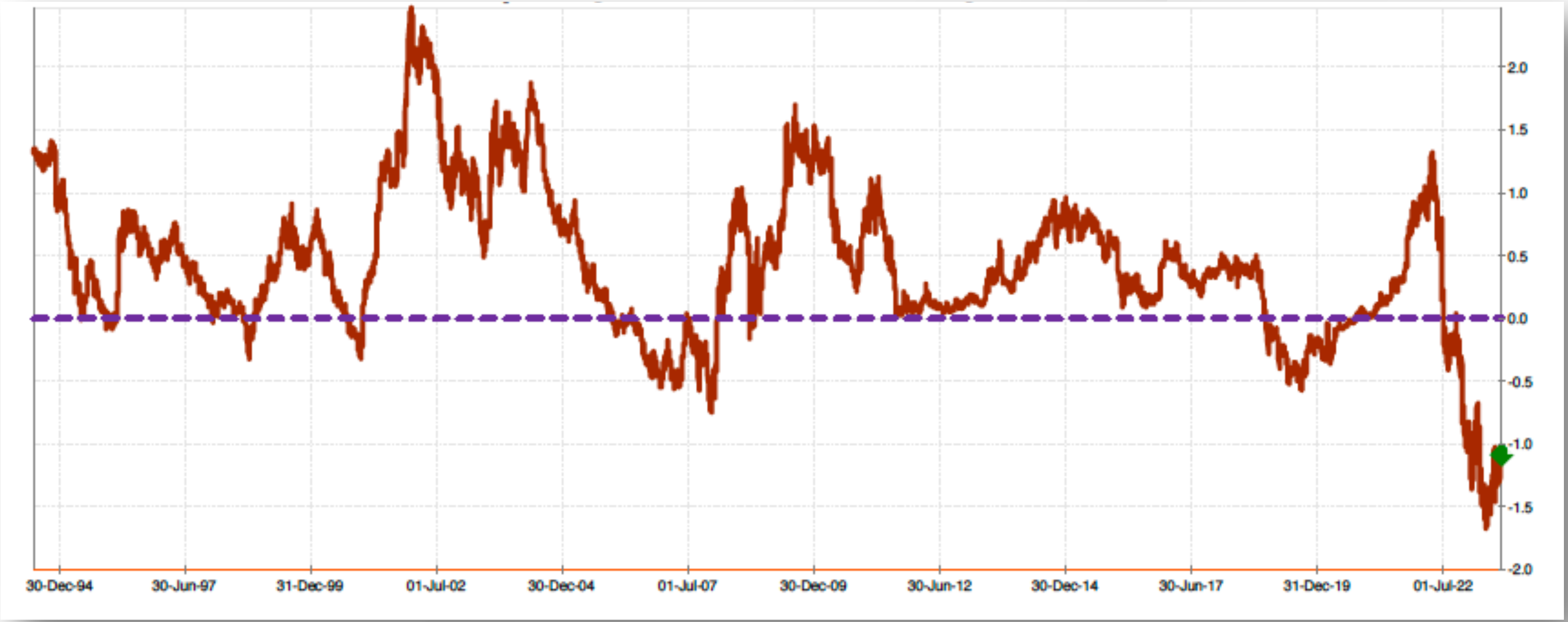
Source: Credit Suisse LOCUS

What Is a Forward Rate?

As detailed in "Dangerous Curves" – February 15, 2022: "Forwards are NOT a prediction, rather they are the simple mathematical discounting of the Spot Curve to produce an "arbitrage-free" price, no more, no less."

In a nutshell, if Grandma can buy a one-year CD at 2% or a two-year CD at 3%, she would only buy the one-year CD if she thought she could buy another one-year CD next year at 4% or higher. We would call this 4% rate the one-year rate one year forward (or the break-even rate).

Spot 1-Year Rate vs. Forward 1-year Rate



Source: Credit Suisse LOCUS

10-Year Rate vs. 3-Year Forward 10-Year Rate

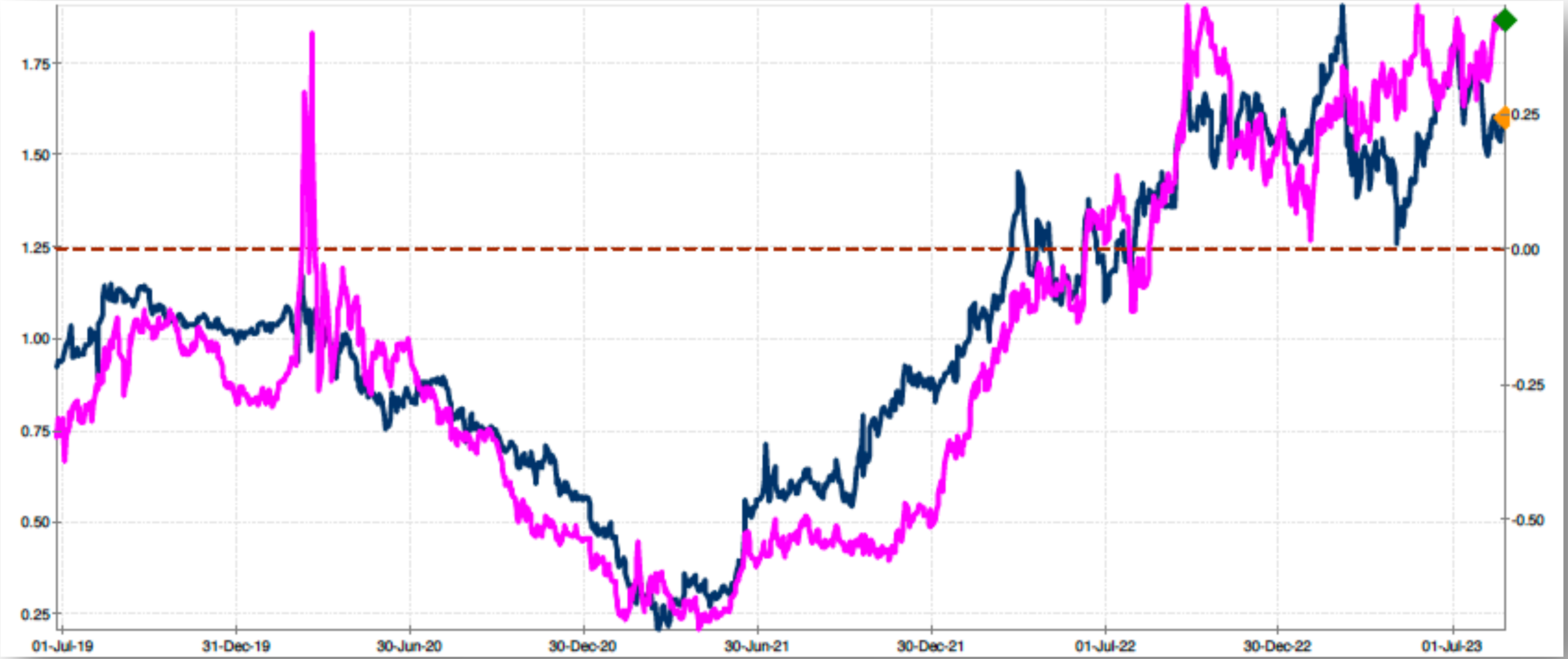
Source: Credit Suisse LOCUS

Implications of a Steeper Yield Curve

	~Current Curve	HB Twisted Curve			
	Rate	Rate	Change		
Fed Funds	5.00%	2.00%	-3.00%		
1m	5.25%	2.25%	-3.00%		
3m	5.25%	2.25%	-3.00%		
1yr	5.10%	2.25%	-2.85%		
2yr	4.50%	2.50%	-2.00%		
3yr	4.00%	2.75%	-1.25%		
5yr	3.75%	3.00%	-0.75%		
7yr	3.60%	3.25%	-0.35%		
10r	3.50%	3.50%	0.00%		
20yr	3.50%	3.60%	0.10%		
25r	3.40%	3.55%	0.15%		
30yr	3.30%	3.50%	0.20%		
40yr	3.10%	3.50%	0.40%		
3yr - 10yr Rate	3.31%	3.85%	0.54%		
5yr - 20yr Rate	3.27%	3.75%	0.48%		
3y - 10yr Call Option	Px = 6.01	PX = 4.06	-1.95	K = 3.50%	Ivol = 100
5yr - 20yr Call Option	Px = 10.32	Px = 7.37	-2.98	K = 3.50%	Ivol = 80

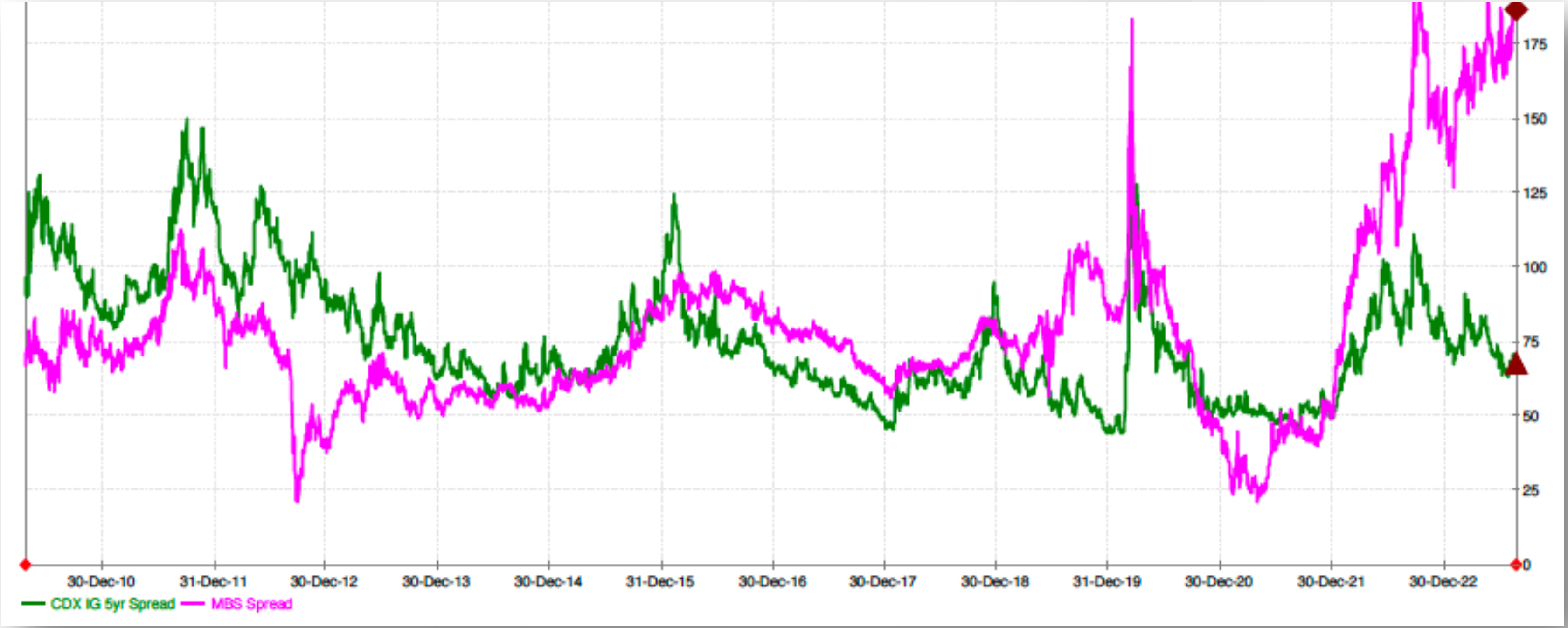
Source: Bloomberg

MBS Spread vs. Yield Curve



Source: Credit Suisse LOCUS

MBS Spread vs. IG Credit Spread



Source: Credit Suisse LOCUS

MBS Index vs. Newly Issued MBS

MBS Index:

Price ~ **85.5**

Coupon ~ **3.0%**

Distribution ~ **3.5%**

Effective Duration **7.5**

Yield to Maturity ~ **4.85%** (+60bp UST)

Newly Issued MBS:

Price ~ **98**

Coupon ~ **5.5%**

Distribution ~ **5.6%**

Effective Duration ~ **4.2**

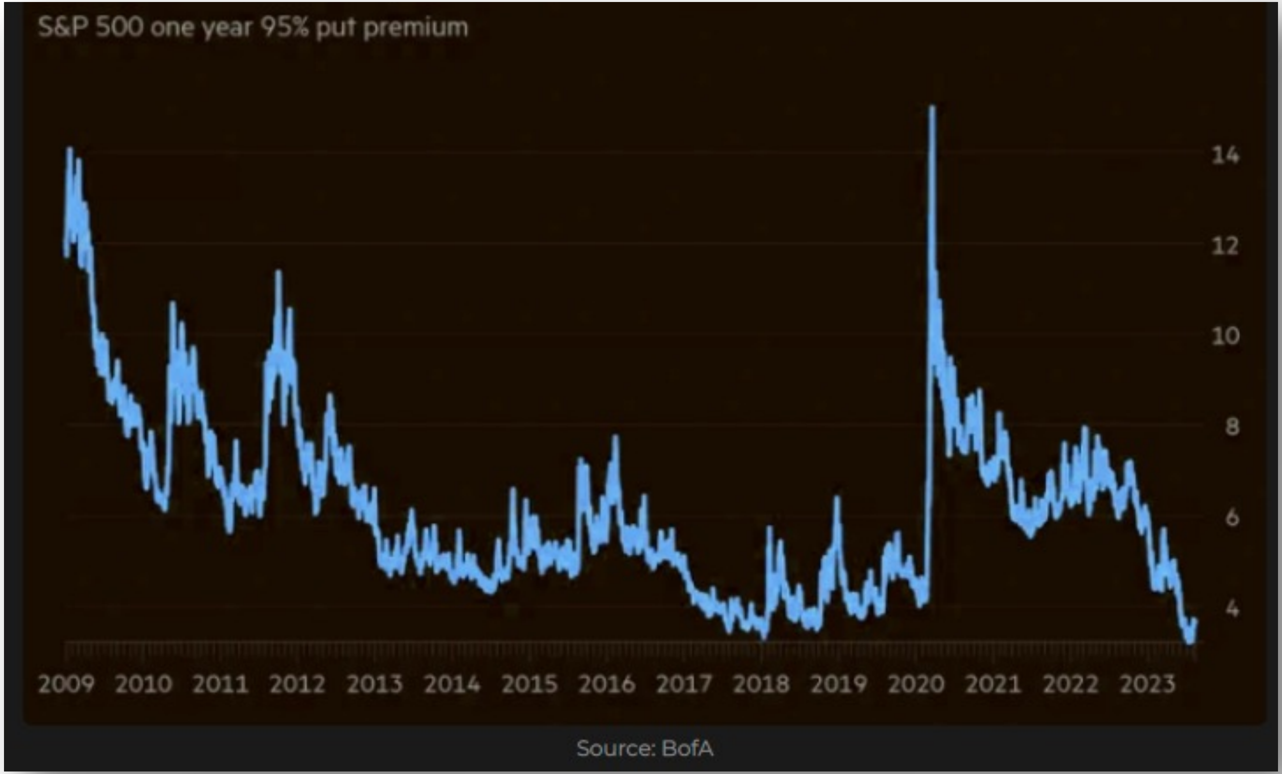
Yield to Maturity ~ **5.85%** (+160bp UST)

Source: Bloomberg

SPX Put Options Cheapen as the Interest Rates Rise

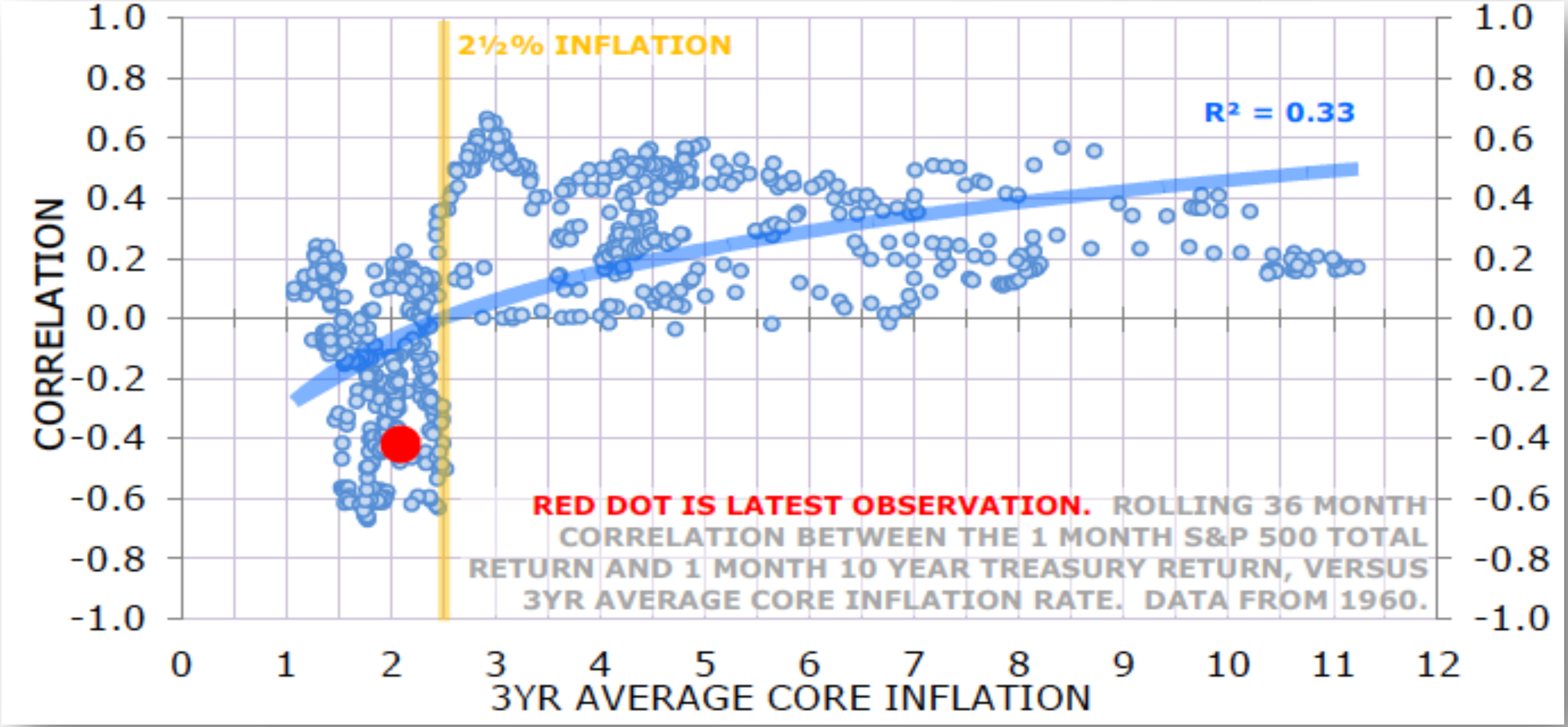
Source: Bloomberg

S&P 500 Hedges Cheapest Since at Least 2008



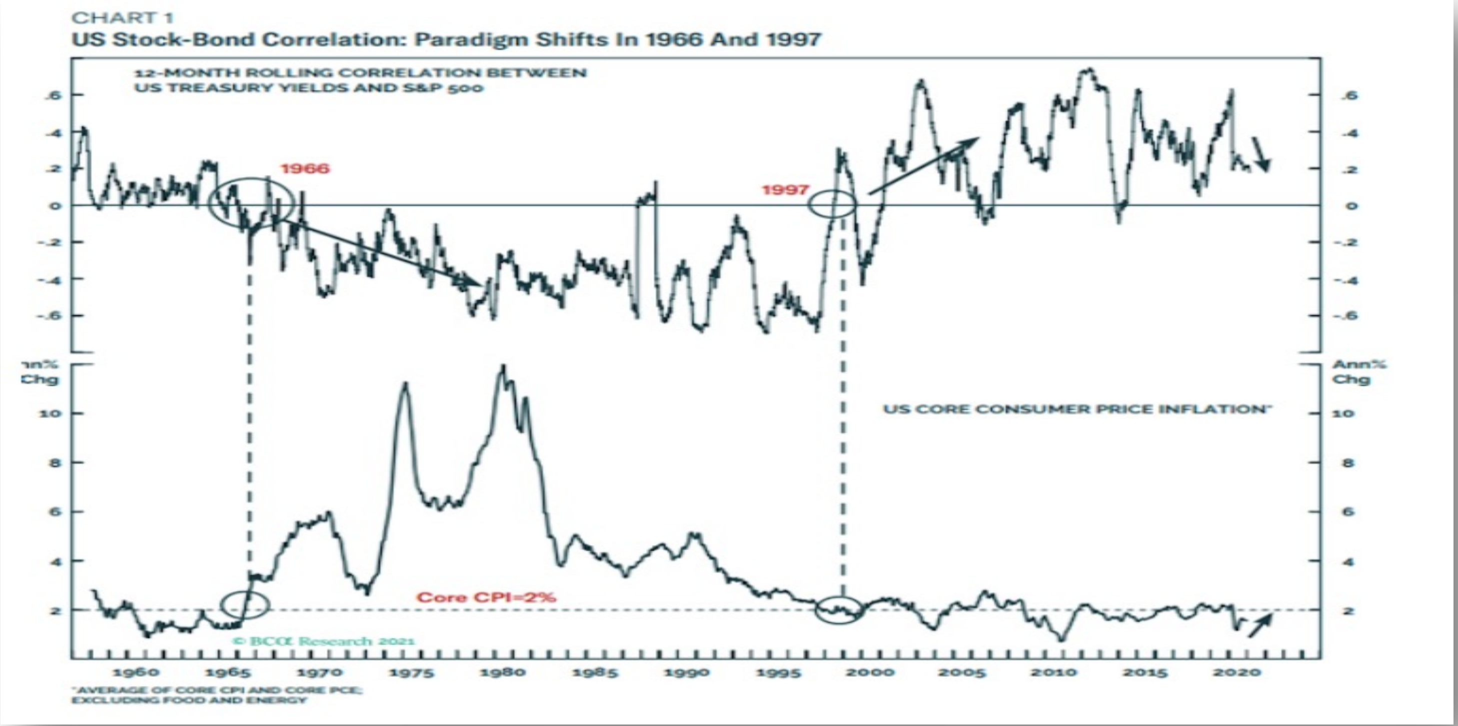
Source: Bank of America

U.S. Equity vs. Bond Correlation and Core Inflation



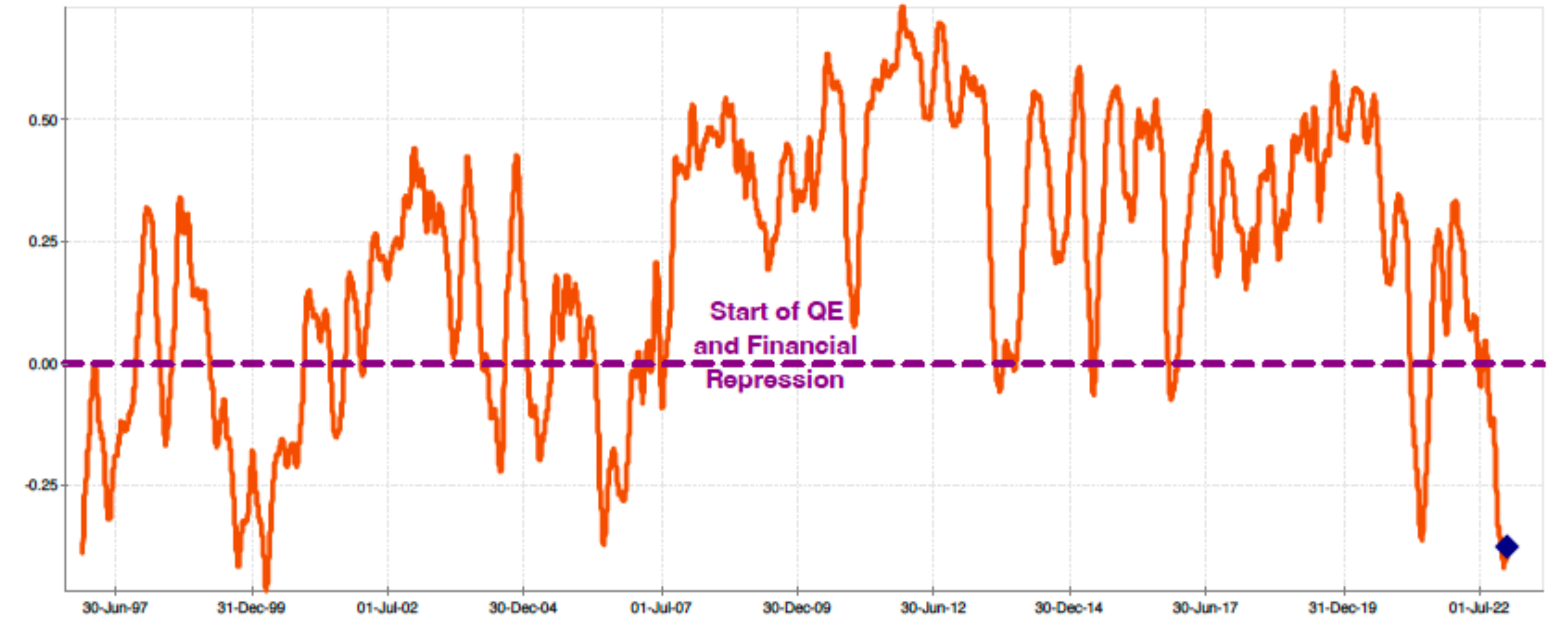
Source: S&P, Bloomberg-Barclays, GFD, BLS; Minack Advisors

U.S. Stock vs. Bond



Source: Bank of America

Correlation of SPX and 10-Year Yield



Source: Credit Suisse LOCUS

Public Policy Benefits of a Steeper Yield Curve

- A steeper Yield Curve supports the plumbing of our financial system.
- Higher long-term interest rates improve the health of our pension and insurance systems.
- Higher long-term rates make private long-term health care policies more affordable and thus reduce the reliance upon Medicare.
- It is a public policy benefit for corporate borrowers to enhance retirement income via higher interest rates, and thus reduce the need for Government assistance.
- Yield Curve Control conceals market information and encourages Moral Hazard, to the detriment of both policy makers and investors.

Sizing Is More Important Than Entry Level

Contact Information

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simplify.us

"I'm looking for a hedge against my hedge funds."

THANK YOU!

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HELPING ADVISORS BUILD BETTER PORTFOLIOS