

How did we get here?

**A chart package for MacroVoices listeners created by:
Kevin Muir – Market Strategist for East West Investment Management and author of
the daily letter The MacroTourist**

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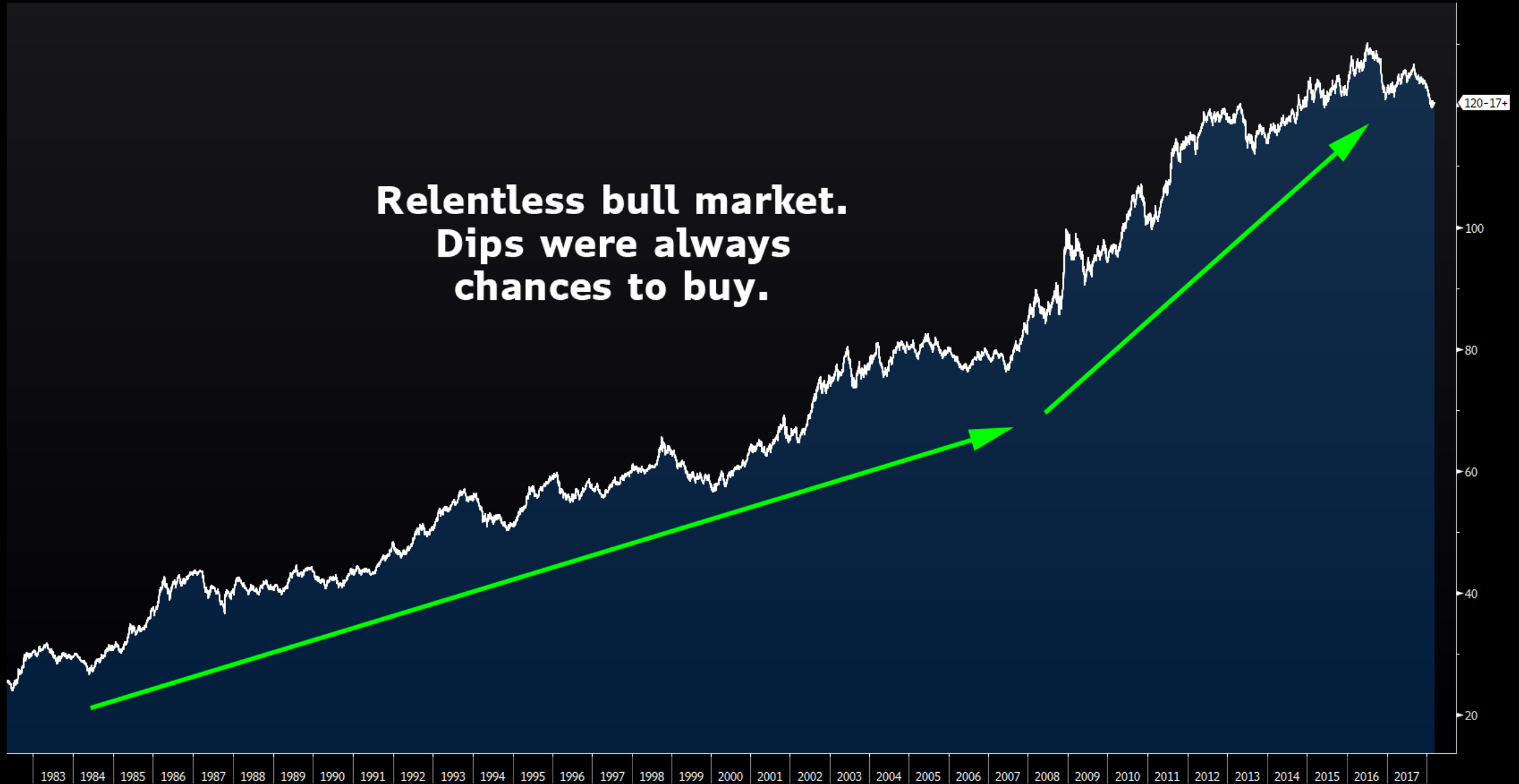
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**Over the last 35 years we have
experienced one of the greatest bull
markets of all time...**

US 10-year Yield

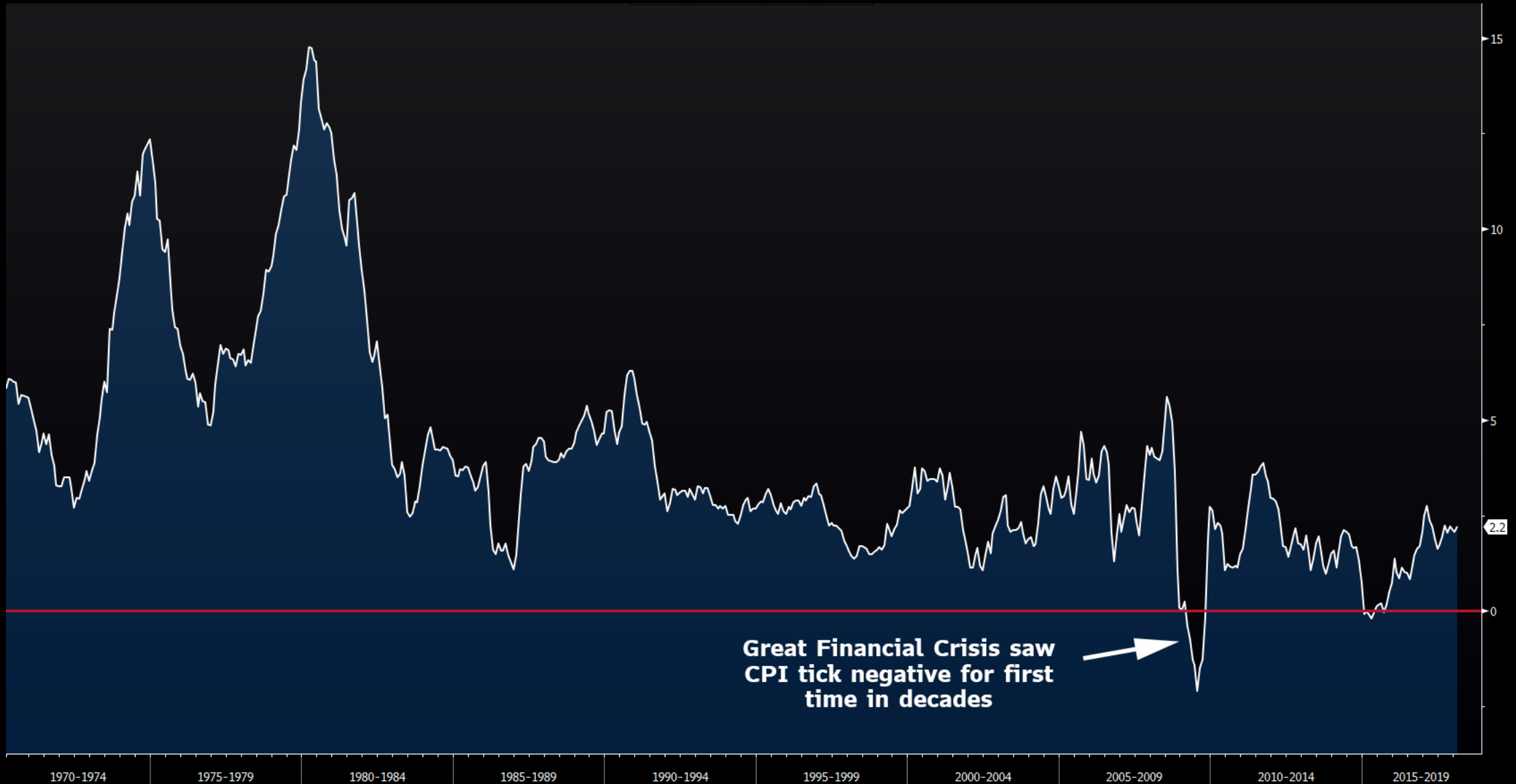


US 10-year future total return



But what caused it?
**Debt, demographics and
technological innovation resulted
in a secular shift lower in inflation...**

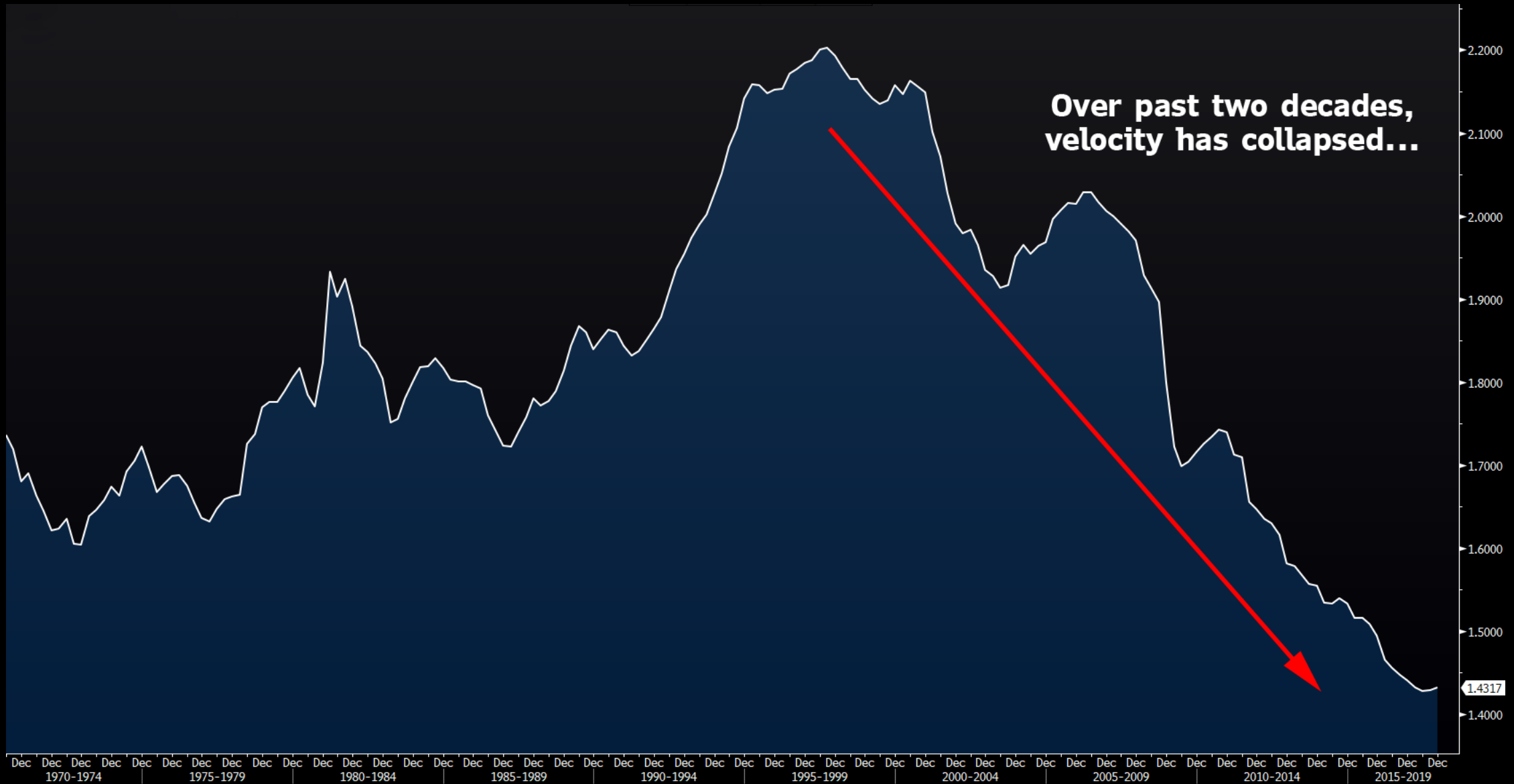
CPI Year over Year % Change



Great Financial Crisis saw
CPI tick negative for first
time in decades

**These secular forces caused the
velocity of money to collapse.**

US M2 Monetary Velocity



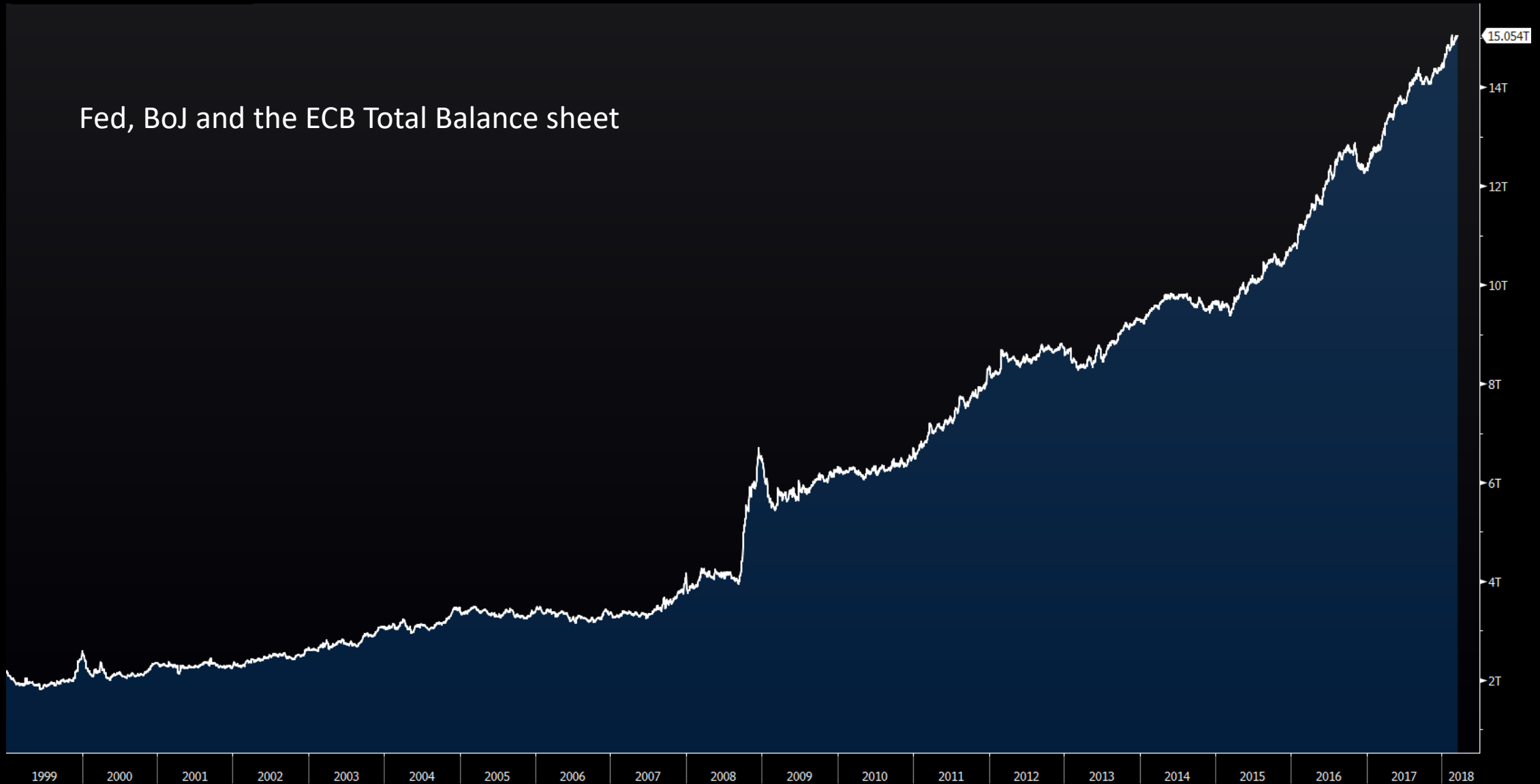
With the velocity of money plummeting, Central Banks were faced with two choices:

- 1. Let the general price level fall**
- 2. Increase the quantity of money**

We know how they chose...

Big Three Central Bank Balance Sheet

Fed, BoJ and the ECB Total Balance sheet

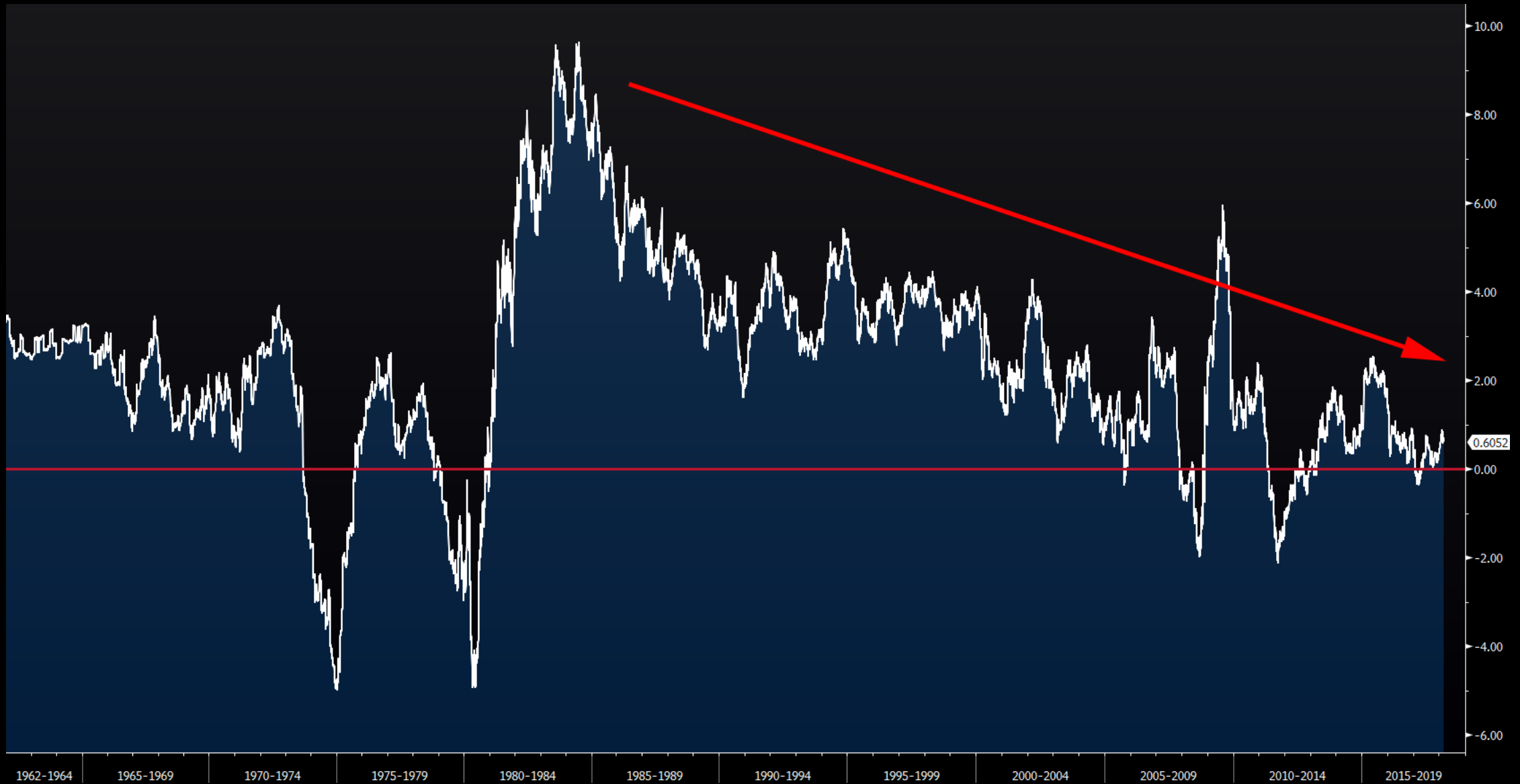


US Federal Debt as % of GDP



The financial repression continued as the governments and Central Banks tried to force feed more and more monetary stimulus into the global economy.

10-yr Real Yield (Treasury rate – CPI)

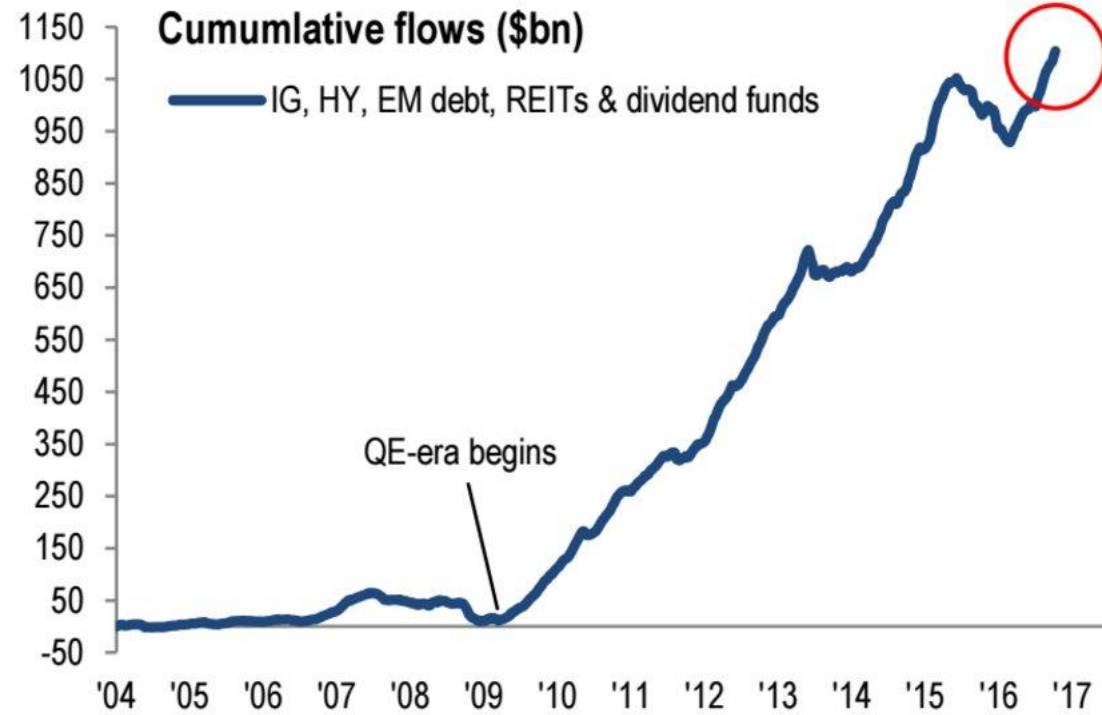


Although the initial response to extraordinary monetary stimulus was to worry about inflation, when it didn't appear, and instead resulted in lower rates as credit sat inert on bank balance sheets, investors embraced the idea that Central Banks were powerless to create inflation...

**After the Great Financial Crisis,
investors abandoned risky assets
and loaded up on bonds... at all
time record low interest rate levels.**

When bond yields shrank to minuscule levels, investors ventured out the risk curve, but still chasing yield.

Chart 4: Love affair with “yield” not yet over



Source: BofAML Global Investment Strategy, EPFR Global

**The love affair with bonds was
made even worse by the
popularization of risk parity
strategies...**

S&P 500 vs. 10-yr Treasury Future Correlation



Fixed income investors are making a large bet that regardless of the monetary stimulus, Central Banks are powerless to create inflation.

**Bill Fleckenstein – “Central Banks
will continue printing until the
bond market takes away the
keys...”**

But sentiment changed when Trump was elected...

Suddenly, investors worried that fiscal spending combined with pro-business policies would cause the economy to grow and inflation to take off.

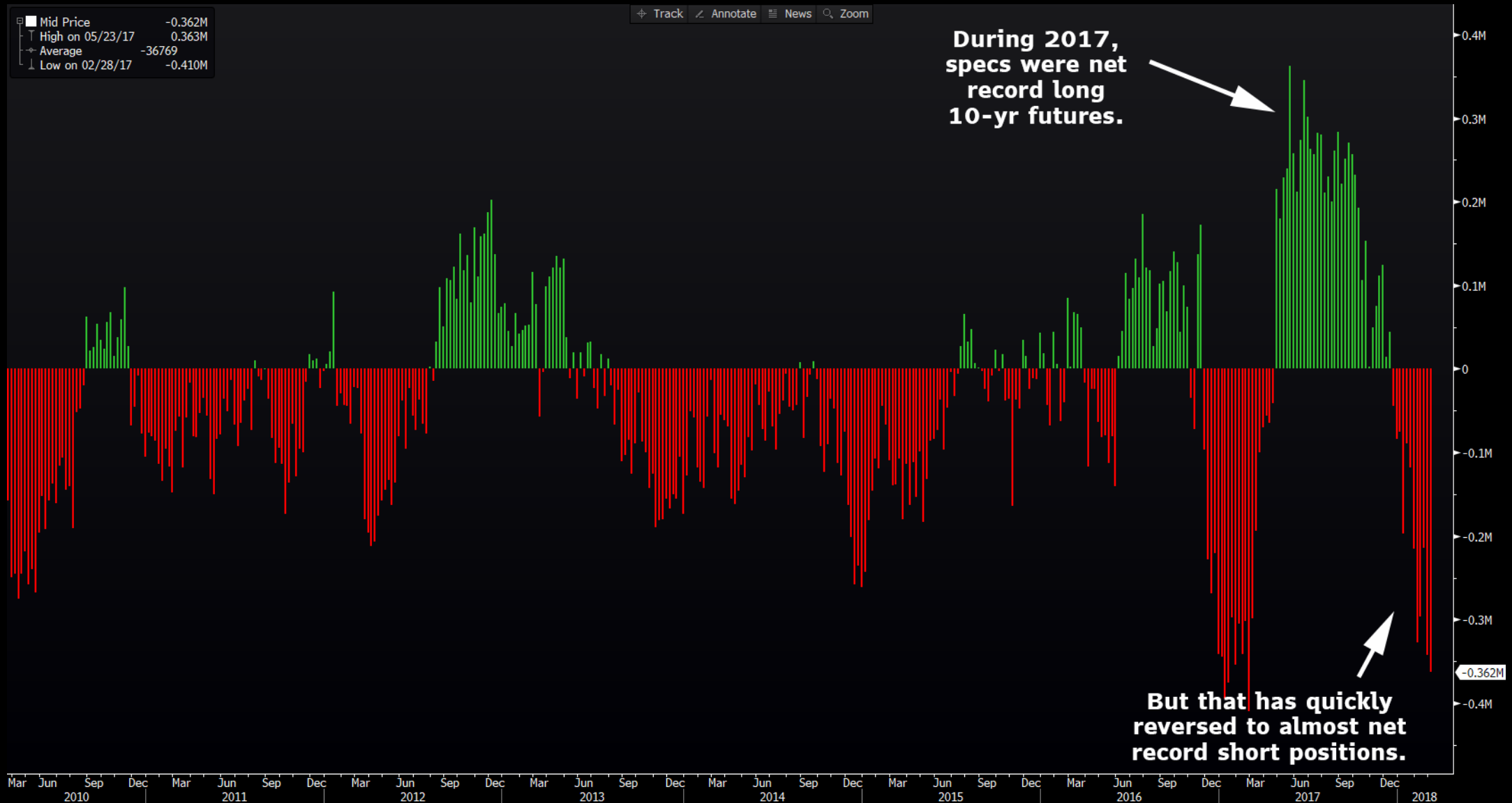
10-yr Breakeven inflation rate



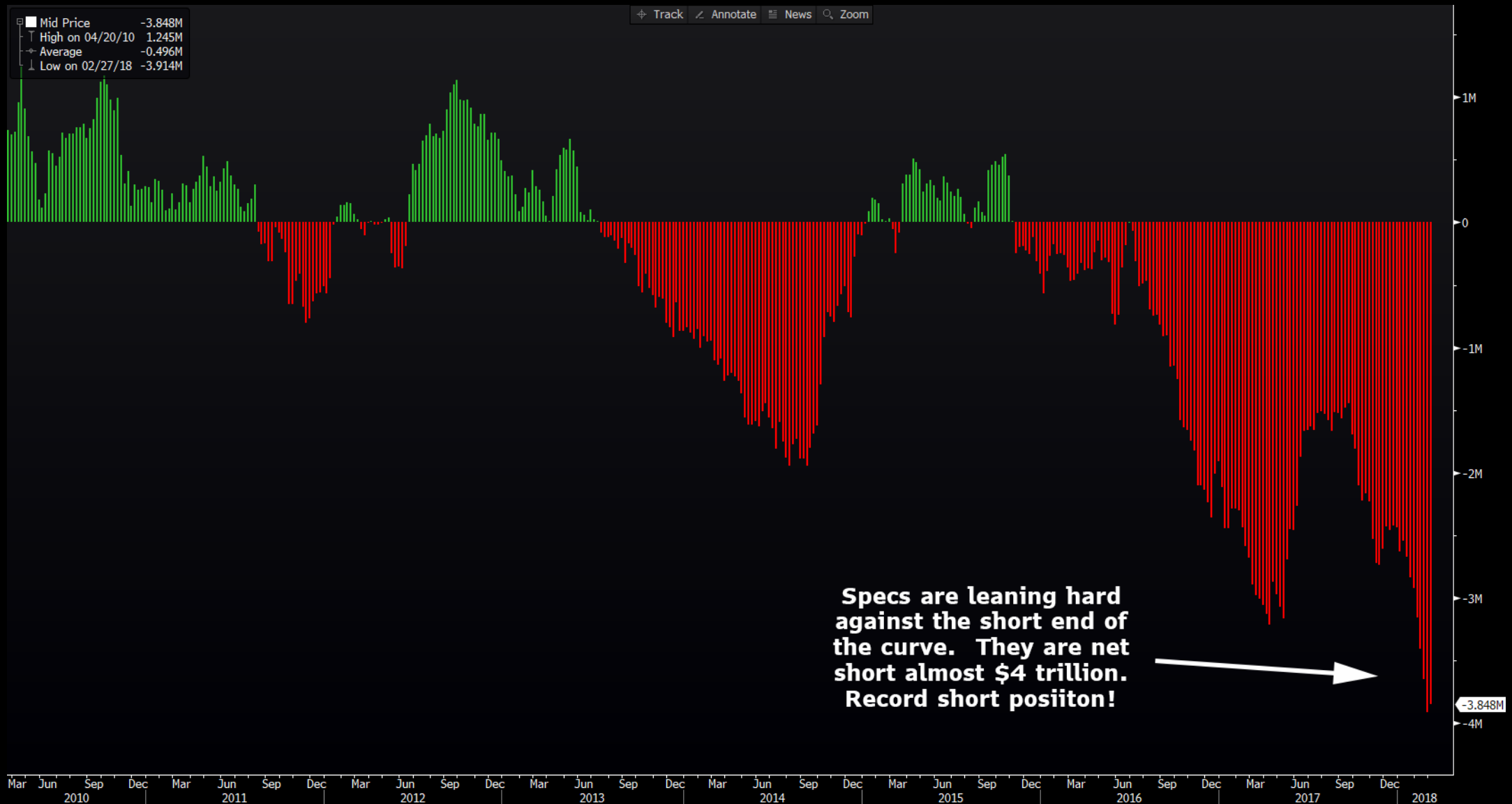
Investors have become extremely optimistic about U.S. growth – especially after the passing of the Trump tax cuts.

Suddenly, they are worried about the Fed raising rates too quickly, so they are aggressively hedging their interest rate risk.

10-yr Treasury future net spec position

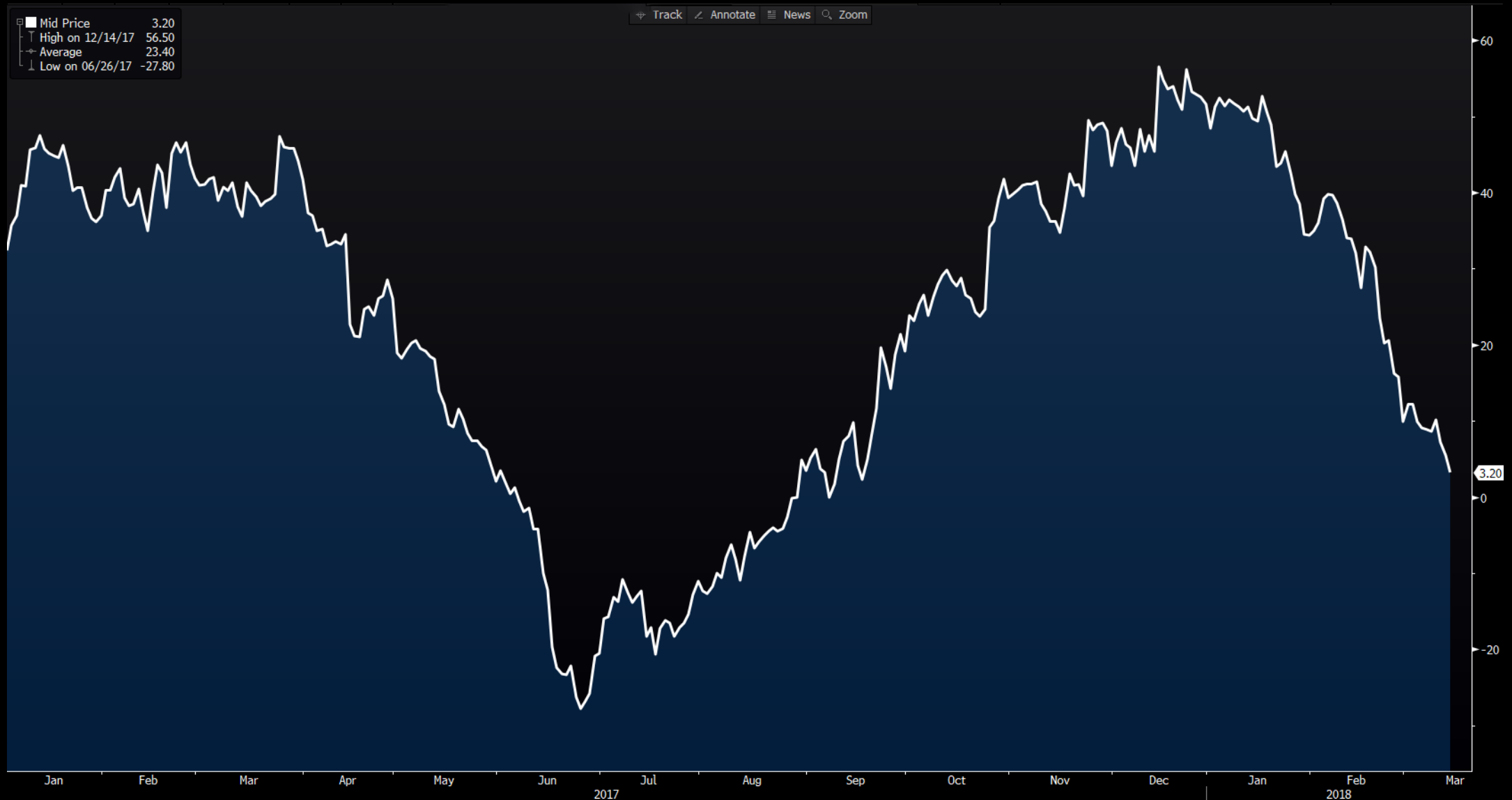


3-mth EuroDollar Futures net spec position



After years of downplaying the risks of higher rates, investors are panicking and desperately pitching their fixed income securities.

CitiBank Eco Surprise Index – Major Economies



**The true bond bear market will
come when Central Banks are not
able to raise rates due to debt
burdens...**

The recent backup in yields has been the result of increased economic optimism, but it has been accompanied by higher short rates, thus flattening the yield curve.

US 2-10 yr Treasury Yield Spread



Currently the Federal Reserve is still chasing the curve higher. But there will reach a time when they actively push back against higher rates, even though inflation is heading higher. That will be when the bond bear market will begin in earnest.

Larry Kudlow – “Growth is not inflationary. Just let it rip, for heaven’s sake.”