How did we get here?

A chart package for MacroVoices listeners created by:

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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

Chart courtesy of Bloomberg

US 10-year future total return

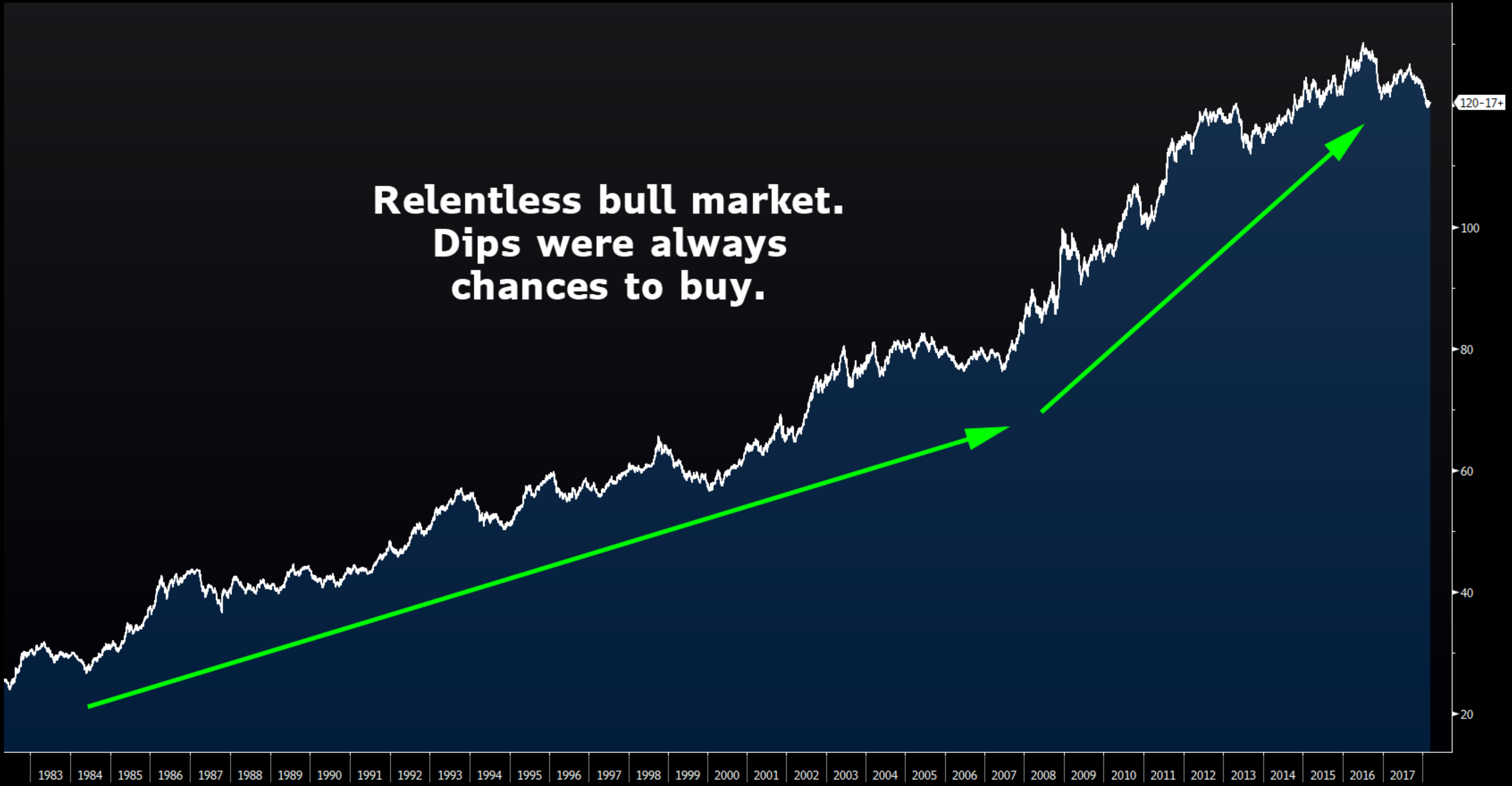

Chart courtesy of Bloomberg

But what caused it?

Debt, demographics and technological innovation resulted in a secular shift lower in inflation…

CPI Year over Year % Change

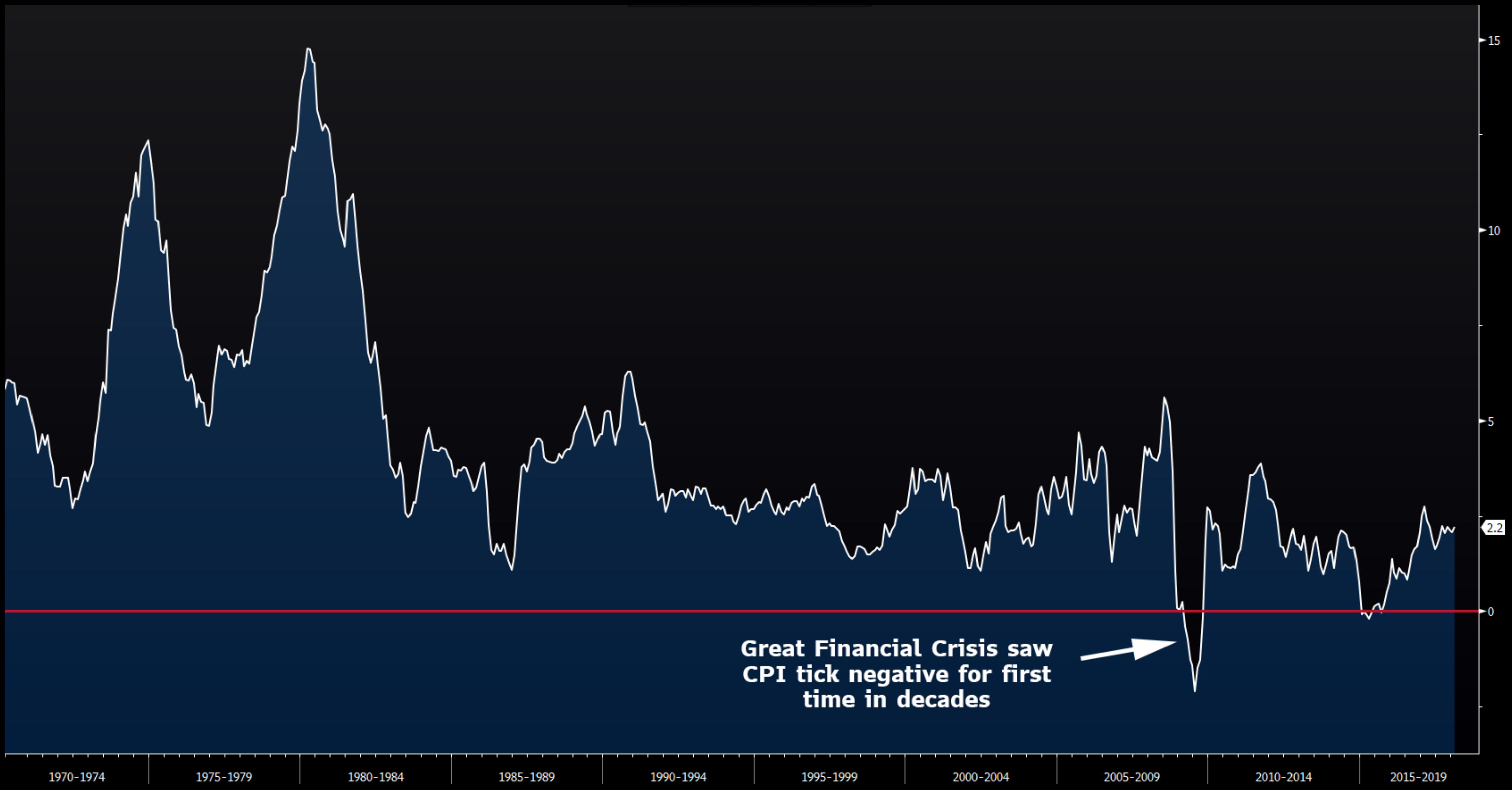

Chart courtesy of Bloomberg

These secular forces caused the velocity of money to collapse.

US M2 Monetary Velocity

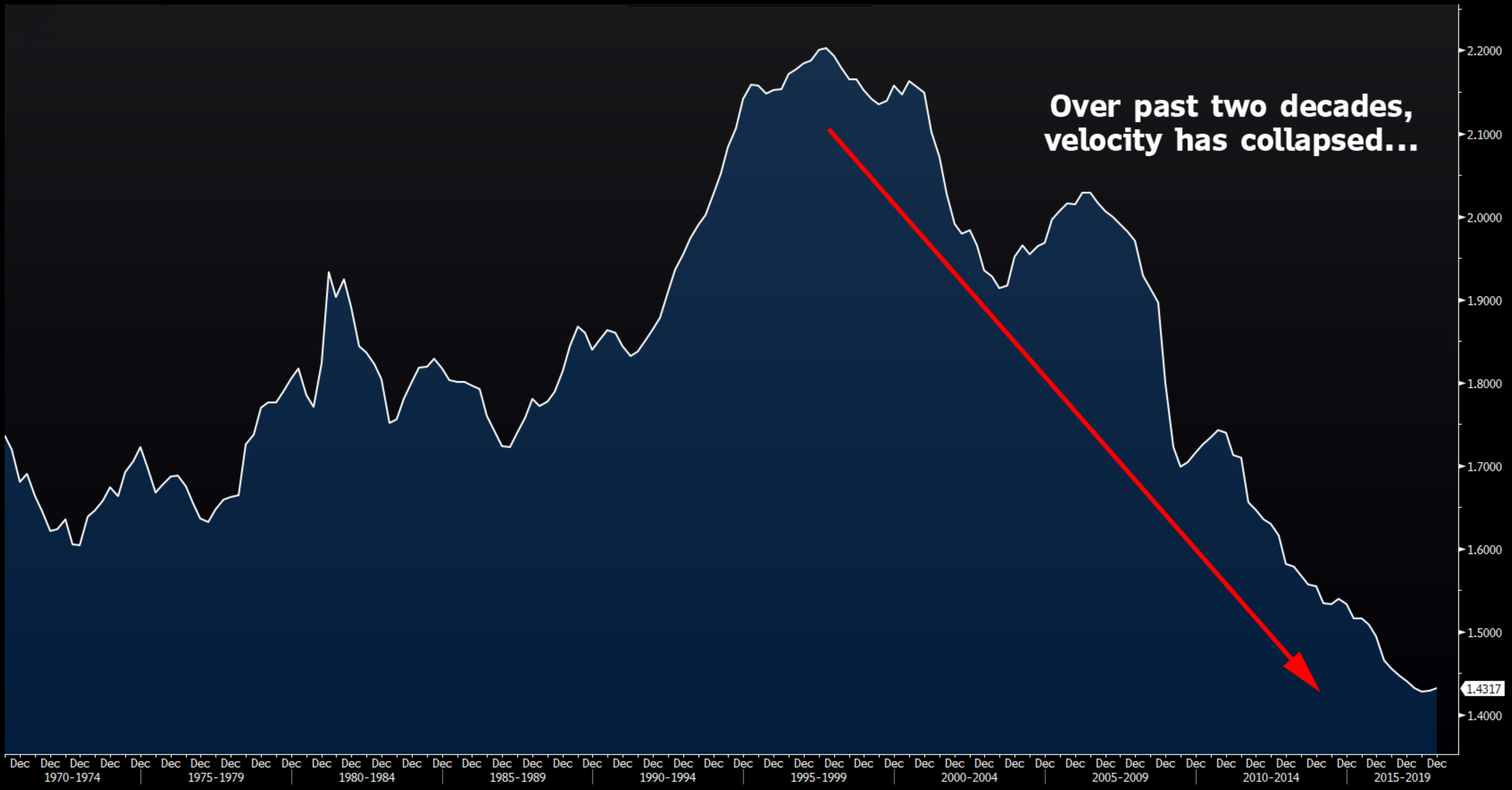

Chart courtesy of Bloomberg

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

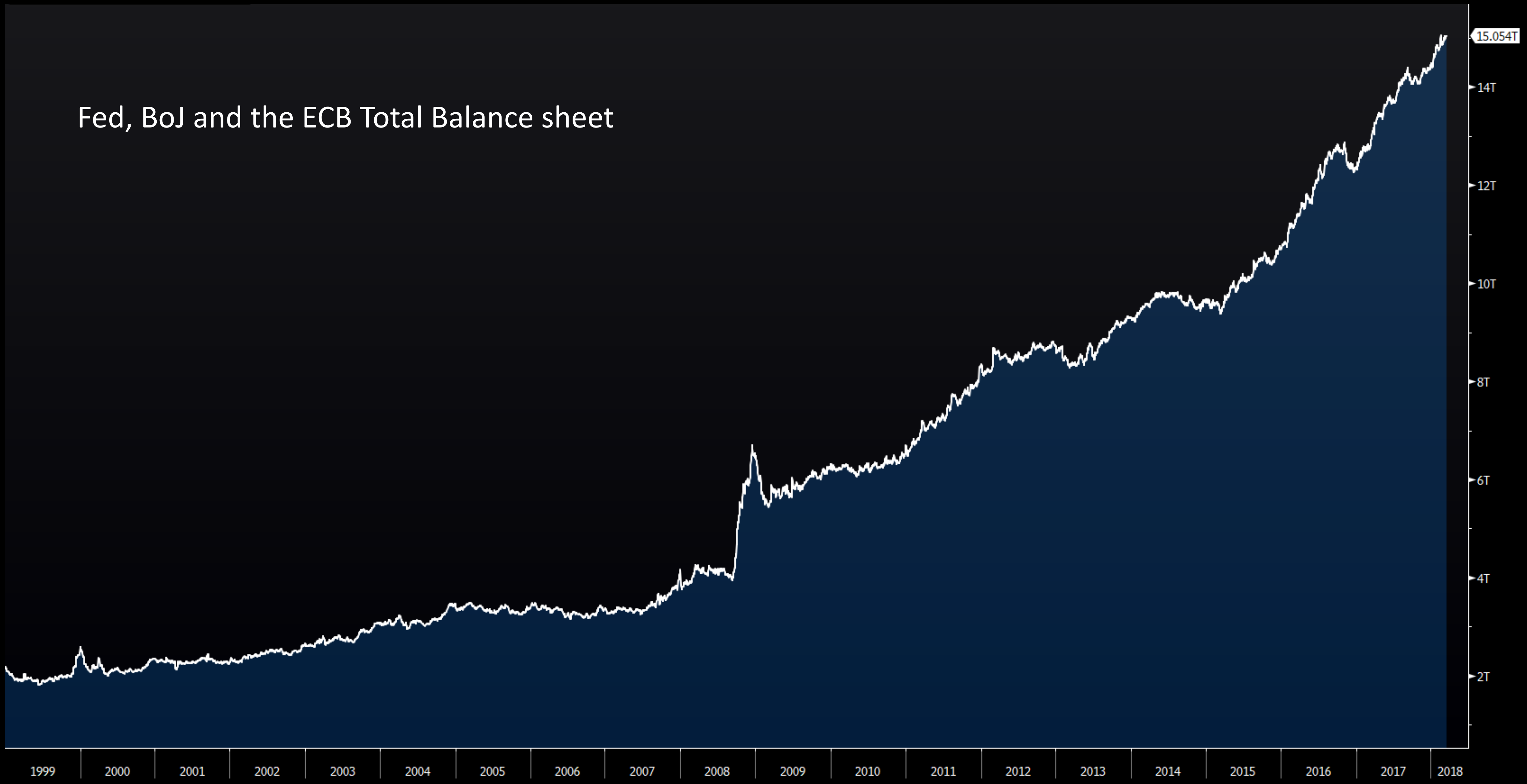

Chart courtesy of Bloomberg

US Federal Debt as % of GDP

Chart courtesy of Bloomberg

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

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10-yr Real Yield (Treasury rate – CPI)

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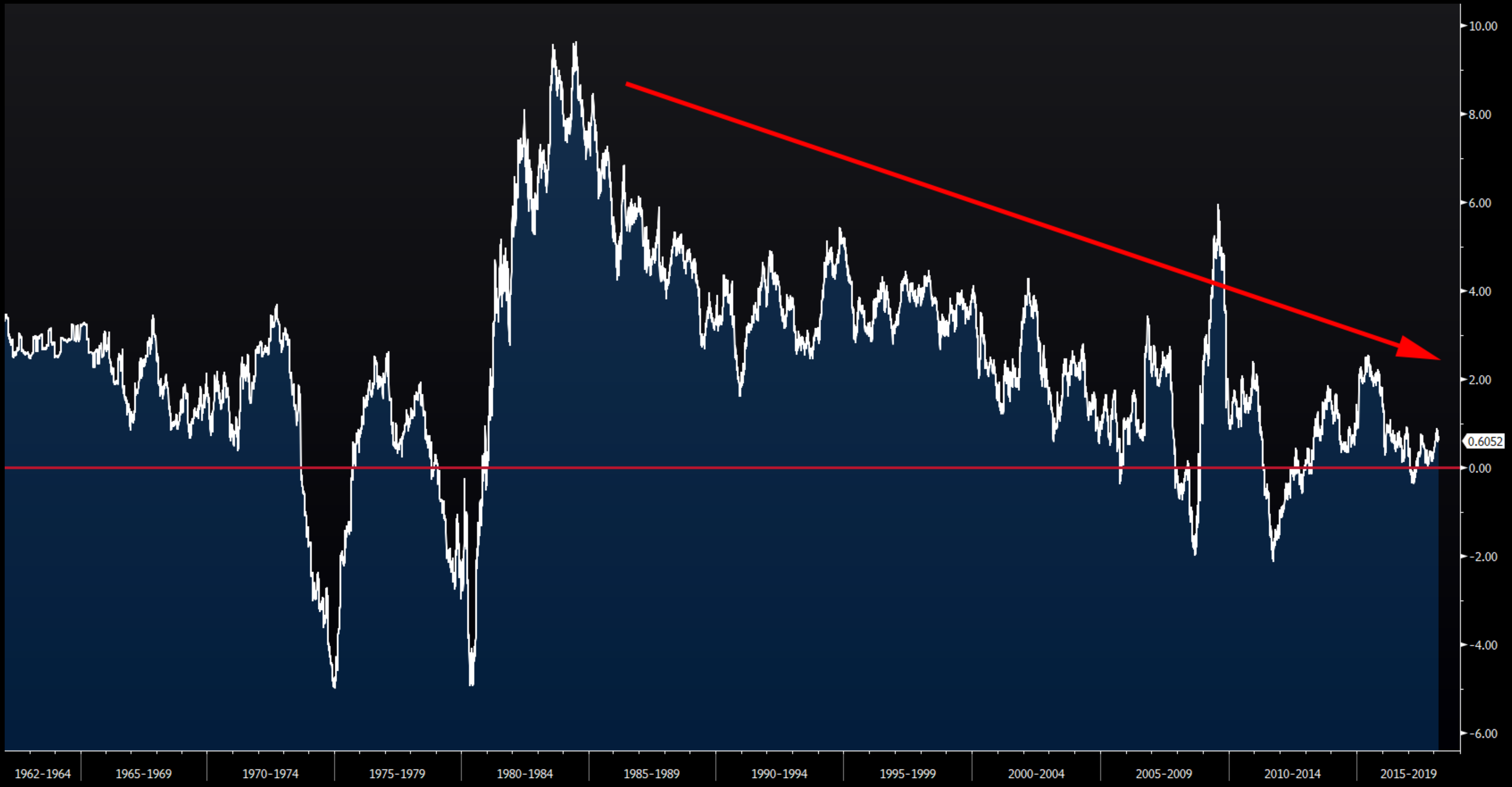

Chart courtesy of Bloomberg

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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.

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

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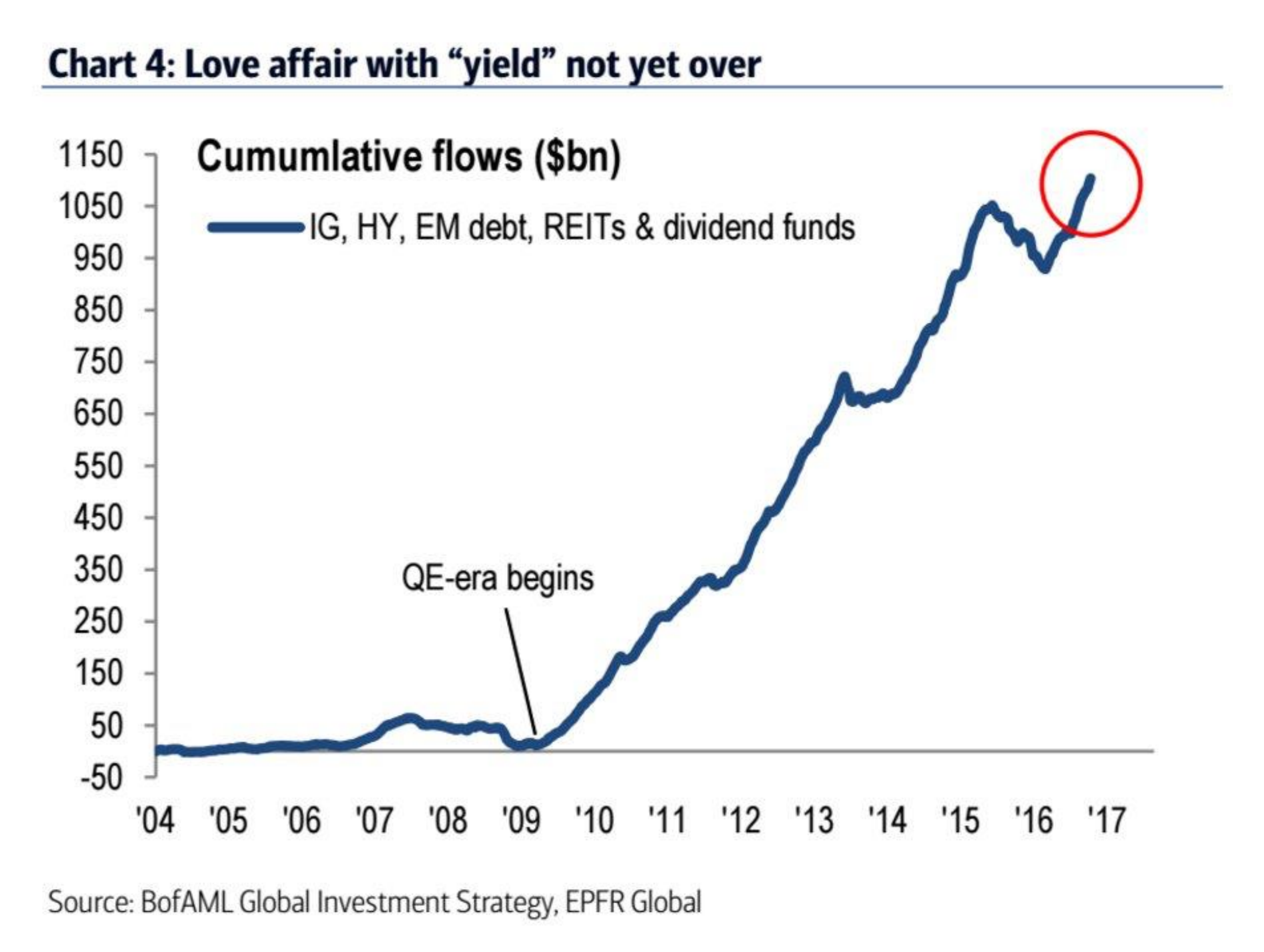

The love affair with bonds was made even worse by the popularization of risk parity strategies…

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

Chart courtesy of Bloomberg

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

Chart courtesy of Bloomberg

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

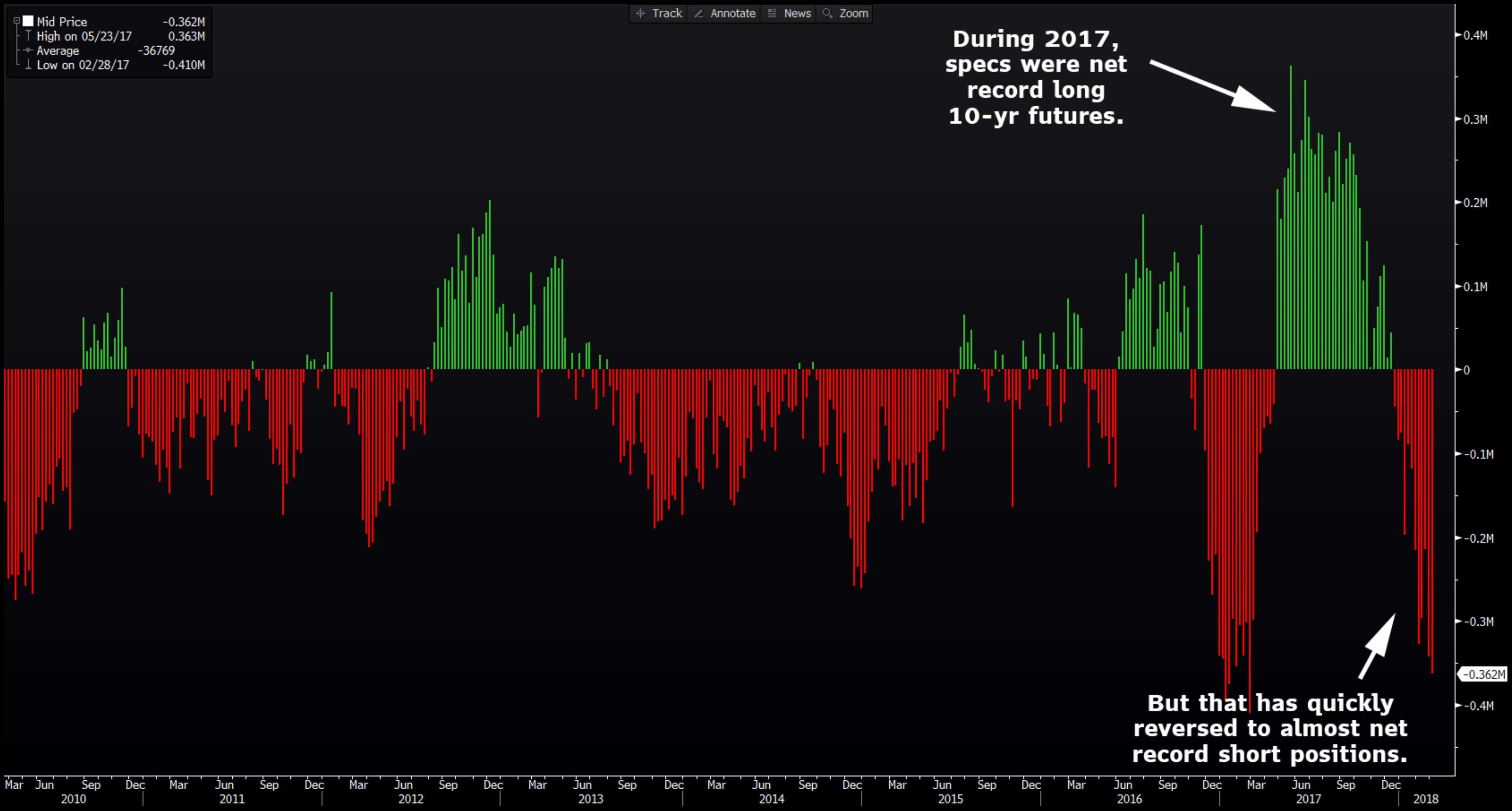

Chart courtesy of Bloomberg

3-mth EuroDollar Futures net spec position

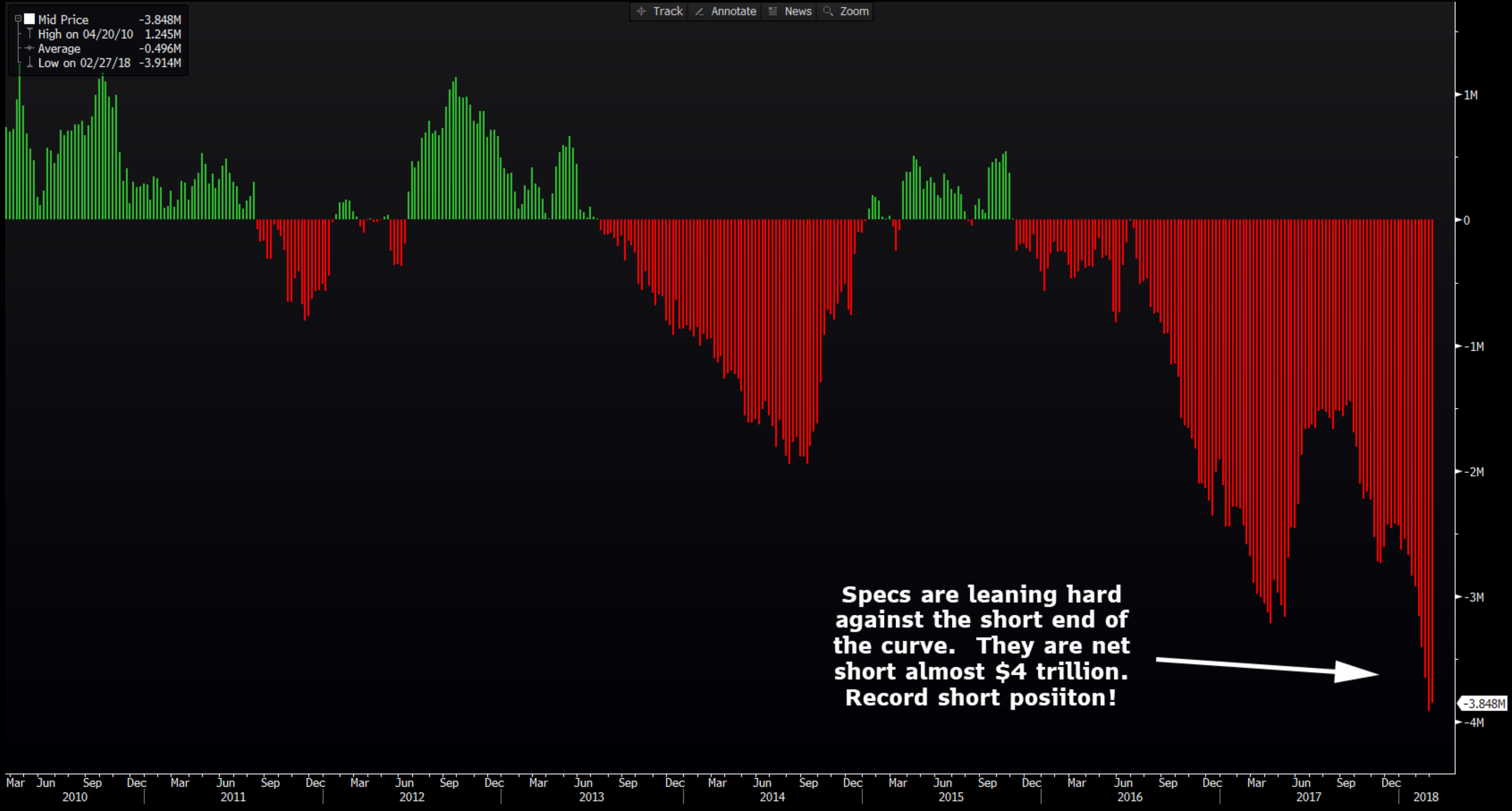

Chart courtesy of Bloomberg

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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

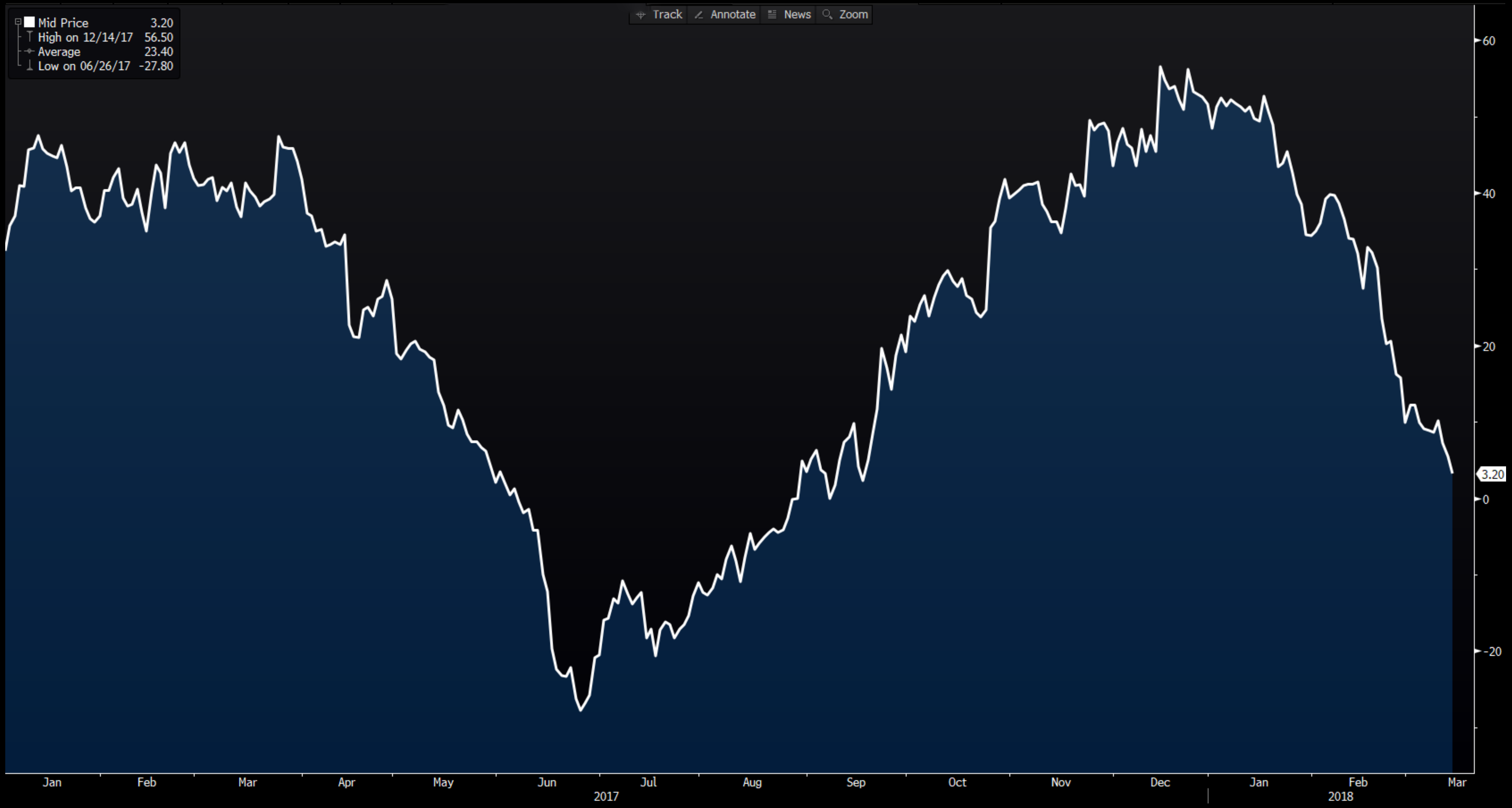

Chart courtesy of Bloomberg

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

Chart courtesy of Bloomberg

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."