# STRATEGY NOTE:
## CROSS-ASSET STRATEGY

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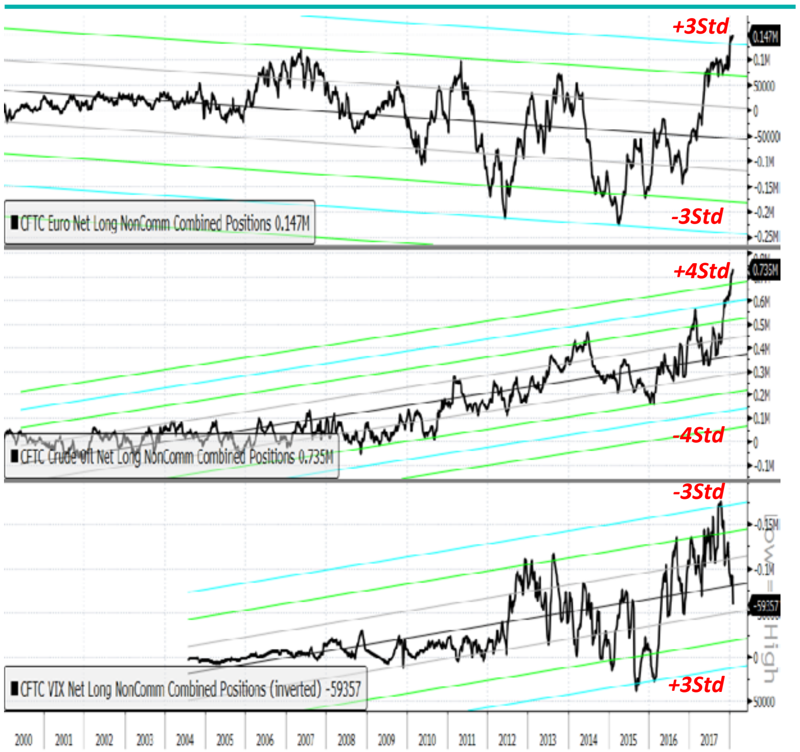
## THE RISE OF THE TERM-PREMIUM


*Source: BBG , Nedbank CIB Research*

- *"History has not dealt kindly with the aftermath of protracted periods of low risk premiums"* - Alan Greenspan at the 2005 Jackson Hole Economic Policy Symposium.
- We believe the statement above speaks to the build-up to the 2008/09 financial crisis, when the US term-premium (which was at record lows at the time) reflected a distortion in the world's risk-free rate (ie US interest rates). Note that the term premium is not the same thing as inflationary pressures; it is rather the risk premium an investor should receive over and above his/her growth and inflation expectations.
- Thirteen years later, and the US term-premium is again at record low levels, again reflecting a distortion in the term/risk premium in financial markets. This time it is as a consequence of the extraordinary central bank (CB) policies.
- We believe that as CBs scale back their QE programmes, and as US inflationary pressures rise and the US treasury increases supply, that it will result in higher bond yields and a higher term-premium. These forces increase the risk of a significant correction in financial markets (seeing as risk was being mispriced).

## RECORD RISK-ON BETS




*Source: BBG, Nedbank CIB Research*

- Since the start of 2016 (post the G20 statement on financial stability at the Shanghai meeting, aka The Shanghai Accord) the markets have placed huge 'risk-on bets', as reflected in the panels alongside: 3-stdev long Euro, 4-stdev long Brent, and 3-stdev long VIX.
- We believe a reversal of the US yield curve (30-10) would be the leading indicator for clients to look out for. For more on levels please see here.
- As mentioned above, the return of the term-premium is likely to lead to a reversal of these risk-on trades. The equity market has already reacted. In our opinion, it is now only a matter of time before it spills over into the other asset classes.
- Implications for SA assets are as follow: As volatility rises the risk-adjusted carry trade should come under pressure, and foreign flows should turn negative. This would obviously be negative for SA bonds as well as the rand.





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