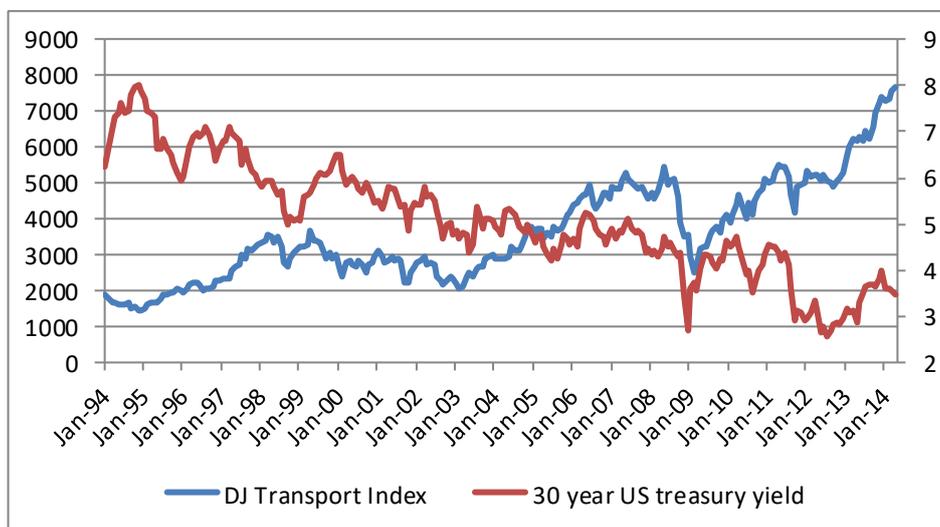


HOW LOW CAN YIELDS ON 30 YEAR TREASURIES GO?

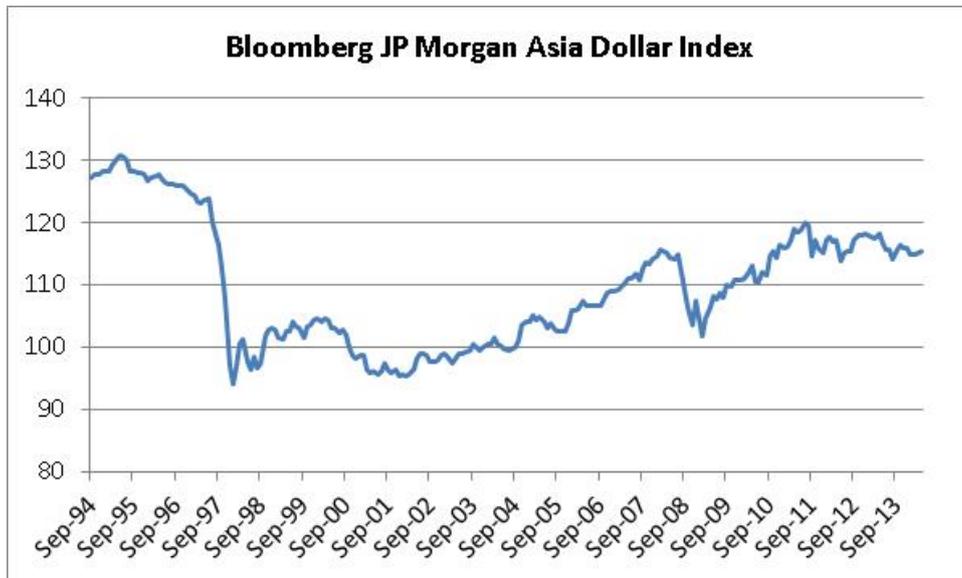


To my mind there are three possible reasons for the move in treasuries. Firstly, they are telegraphing problems in Asia. Secondly, they are signalling efforts by both Europe and Japan to weaken their currencies. Finally, they are moving due to a short squeeze caused by Fed ownership of treasuries and MBSs.

Asian Currency Weakness



Looking at the Dow Jones Transport Index and US 30 year yields, we can see yields tend to move lower before equity markets. The period from 1996 to 1997 seems to match up most closely to current period. Both had a strong Transport Index as the US left recession, but suddenly yields began to fall even as the Transport Index hit new highs. In this case, the move in bond yields was reacting to trouble in Asia, and the deflationary consequences of the Asian Financial crisis.



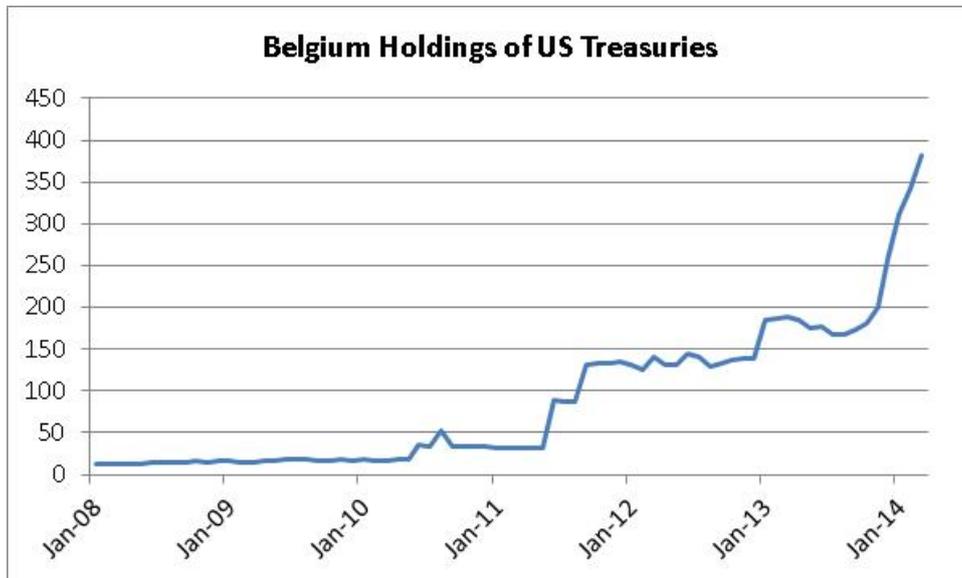
The Bloomberg JP Morgan Asia Dollar Index is shown above and shows that lower Asian currencies, tend to coincide with sharp drops in US yields. In both 1997 and 2008, a fall of 2% in yields occurred. With a recent peak in US 30 years at 4%, this would imply a fall of yields to 2%. Should the recent devaluation of the Chinese Yuan continue, then such a fall seems very likely to me.

**Potential Treasury Buying by the ECB and BOJ**

As the Federal Reserve has moved to taper its QE program, both the Bank of Japan and the ECB have signalled their willingness to ease policy further. As yields in the US are significantly higher than in either Europe or Japan, this could cause traders to seek a carry trade where they buy US Treasuries while selling Japanese and German bonds.



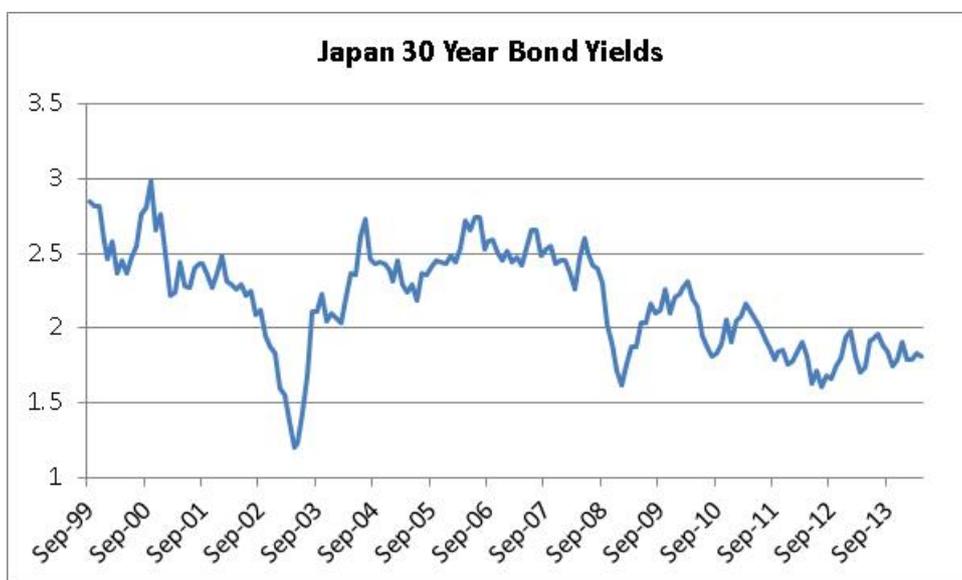
During 2008 and 2009 US treasuries traded in line with German 30 years. If they were to move to a similar level that would imply the US 30 year moving to 2.2%. From 2012 the spread of US treasuries to Japanese 30 years was 1%. That would imply a move to 2.6% at current yields.



Traders pre-empting any move by the ECB could be driving the huge increase in Belgium (home to Euroclear) holdings of treasuries.

### Short Squeeze

As noted in my last note, the Federal Reserve owns 50% of all long dated bonds. This creates the potential for a short squeeze. The Japanese bond market offers the best example for this as this is a market that has consistently attracted short interest which has then squeezed higher on market shocks.



In 2002, the Japanese banking system came under severe threat of going bust, which caused bond yields to move from 2.5% to 1% before selling off. The 2008 financial crisis caused a move from 2.5% to near 1.5%. Both moves pushed yields well beyond where they had traded in the recent past. This makes me think a similar thing could happen with US bonds, and then a move below the 2012 low of 2.5% is clearly possible.

## Conclusion

All three of the above situations are possible in my view. I also find it interesting that all three could occur at the same time. I think there is a good chance that we will see 30 year US treasuries yields move to below 2%.

## INFORMATION

Issue Date:	May 2014
Source:	Bloomberg, unless otherwise stated
Investor Relations:	Samantha Dunn
Email:	<a href="mailto:info@russellclarkim.com">info@russellclarkim.com</a>
Telephone:	+44 (0)20 7838 7580
Website:	<a href="http://www.russellclarkim.com">www.russellclarkim.com</a>

Business and registered address: Russell Clark Investment Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom. Registered in England and Wales - Company number: 04034280

## DISCLAIMER

This Market View has been prepared and issued by Russell Clark Investment Management Ltd (the "Firm") authorised and regulated by the Financial Conduct Authority. It has been approved as a financial promotion by the Firm and as such is intended **for professional clients and eligible counterparties only and is not intended for retail client use**. It is not intended for distribution to any country where such distribution or use would be contrary to local law or regulation.

This Market View is provided for information purposes only and should not be regarded as an offer to buy or sell any investments or related services that may be referenced herein. No guarantee is made as to the accuracy of the information provided which has been obtained from sources believed to be reliable. The view expressed in this Market View are the views of the portfolio manager at time of publication and may change over time. Nothing in this Market View constitutes investment, legal tax or other advice nor is it to be relied upon in making an investment decision. No recommendation is made positive or otherwise regarding individual securities mentioned herein. Past performance is not indicative of future performance. The price of investments can go up as well as down and can be affected by changes in the rates of exchange. The information contained in this document is strictly confidential and is intended only for the use of the person who has been provided the Market View by the Firm. No part of this Market View may be divulged to any person, distributed, resold and or reproduced without the prior written permission of the Firm.

Where "forward looking" information, including estimates, projections and subjective analysis and judgement are provided no representation as to the accuracy of such projections or estimates or that they may be realised. Certain assumptions used in formulating such "forward looking" information may differ materially from actual events or conditions.