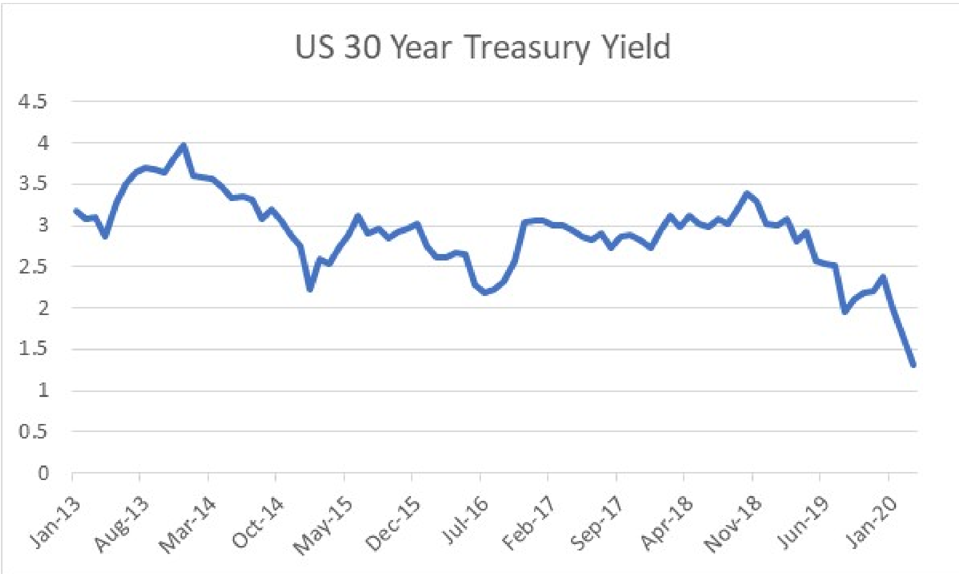
IS THE 30-YEAR TREASURY BULL MARKET OVER?

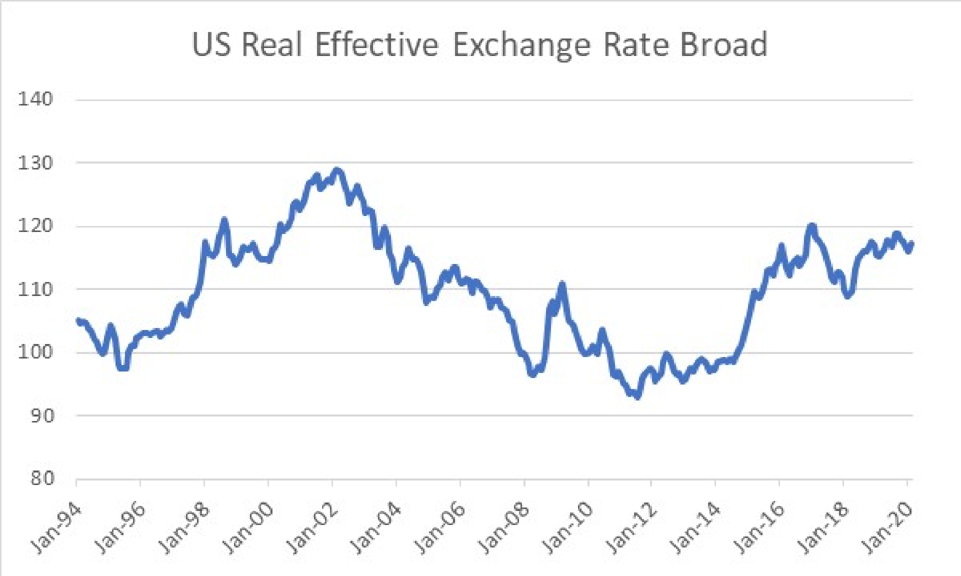
Russell Clark's
Market Views

"Today the dollar is strong and poised to weaken, which I see as inflationary. The risk reward in long dated treasuries to me is very poor."

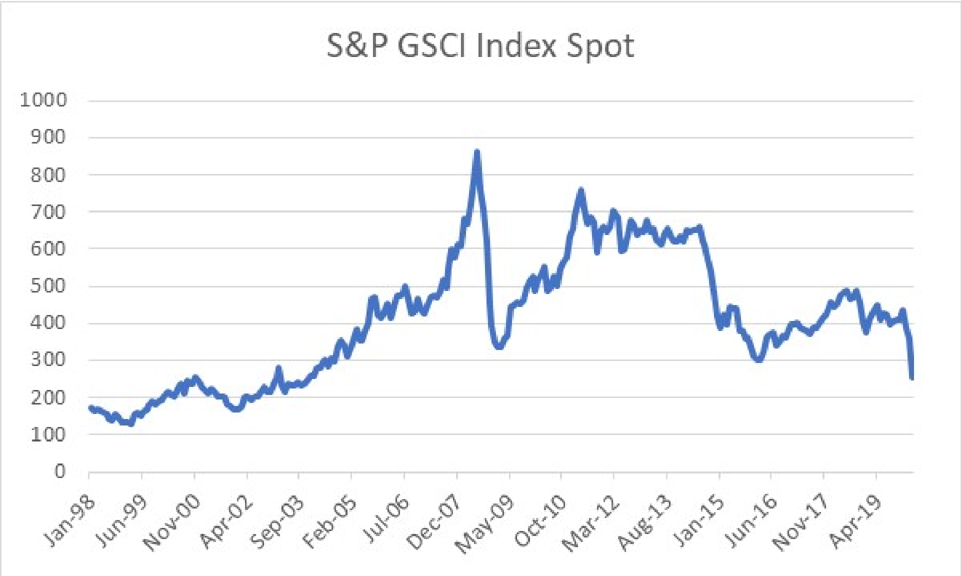
In 2014, I wrote a series of Market Views on the US 30-year treasury, including one that suggested a targeted yield on 30-year treasuries at below 2%. This has largely played out.



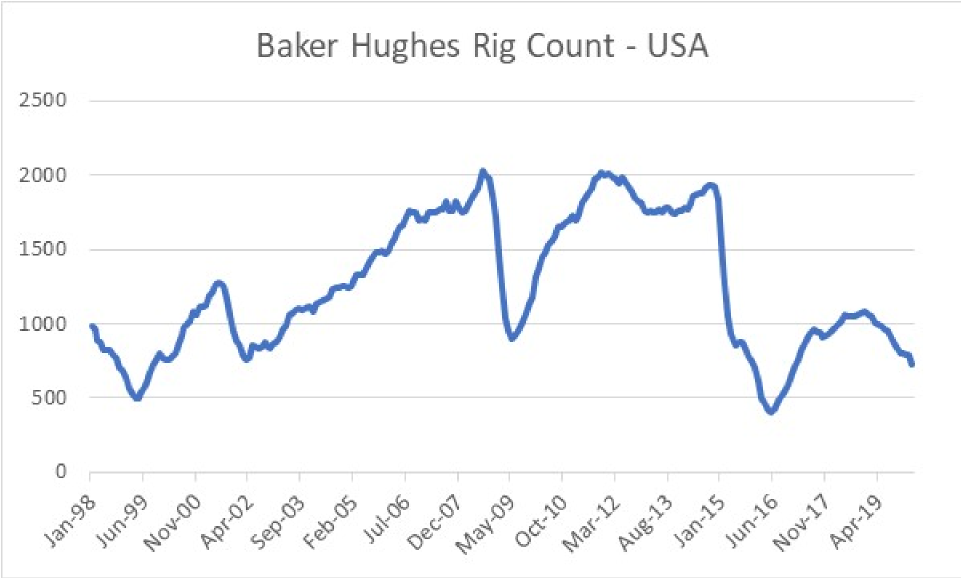
The main reasons for being bullish on treasuries at the time was that the macro environment was profoundly deflationary for the US. In 2014, the dollar was at its weakest point in many years, and poised to strengthen, which I saw as deflationary. Today the dollar is strong and poised to weaken, which I see as inflationary.



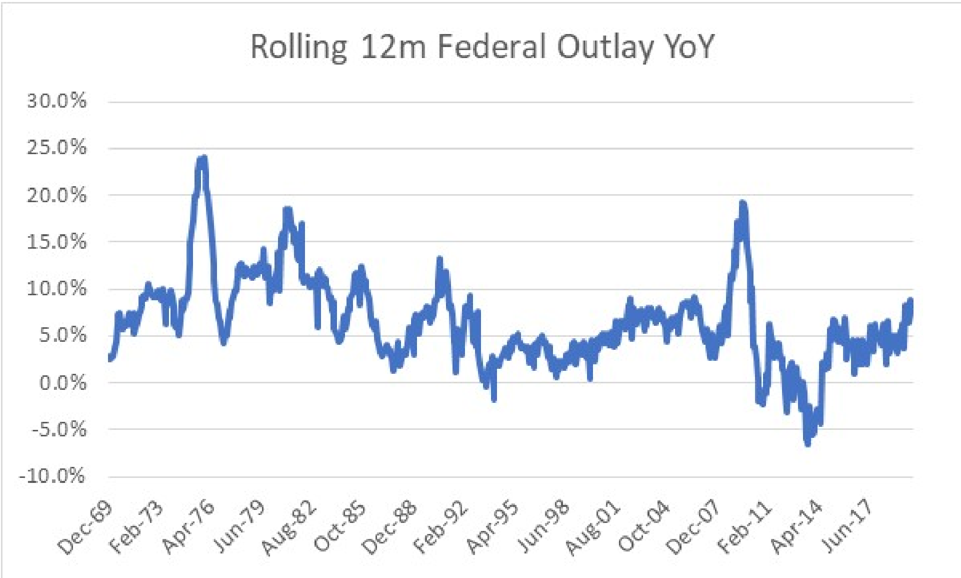
Also, in 2014, we were coming to the end of a decade long period of rising and high commodity prices as supply finally caught up to China's increasing demand for commodities. This has led to a sustained period of commodity weakness. Falling commodity prices are deflationary and tend to be good for bonds.



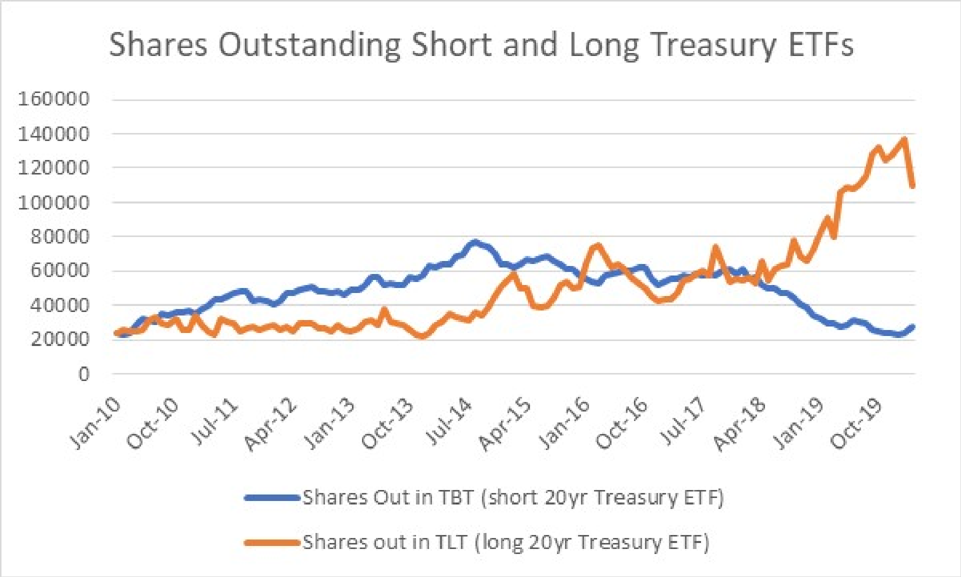
The collapse in commodity prices, and particularly energy, has been driven by the substantial increase in drilling in the USA, and consequently the increase in oil and gas production. Rig counts in the US have now fallen to a 20 year low, suggesting that commodity price risk is now to the upside rather than the downside.



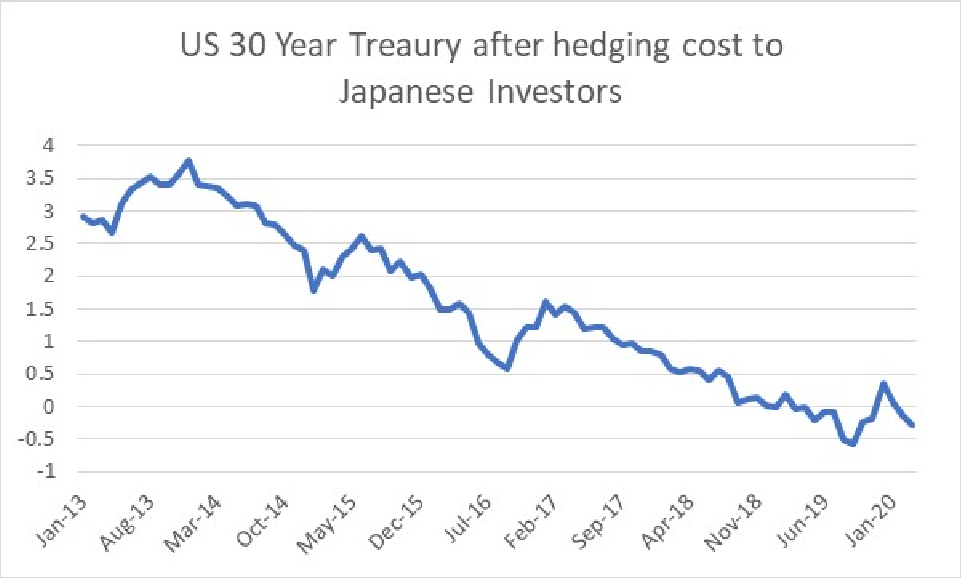
Also in early 2014, the US was running a conservative fiscal policy with the biggest contraction in 12 month rolling expenditure ever. This was a deflationary policy and good for bonds. In the US the outlook is for a huge increase in federal spending over the next 12 months.



In 2014, investors were generally positioned bearishly in long dated treasuries, with shares outstanding in bearish treasury ETFs much higher than those in bullish treasury ETFs. Today that position is completely reversed.



Finally, in 2014, Japanese investors could still get a high yield on 30-year treasuries after hedging. These days, the after hedging cost of buying treasuries is negative.



Central banks have made it clear that they would like to keep yields low, but there is also the possibility that they may wish to see the yield curve steepen to the benefit of banks. This would see long dated treasuries sell off. The risk reward in long dated treasuries to me is very poor.

INFORMATION

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