Macro Voices

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In the short term after a big run
US 10yr yields are near the important 3.00/3.05 area

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The same is true at the long end

On the monthly chart there are lots of levels around 3.15-3.25%

There's a neckline on an inverse head and shoulders, a 30yr trendline but most importantly is the 100 month SMA, which comes in at 3.2577% and has held us since 1985

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Big picture we believe Treasury yields need to move higher

Central bank policy has massively distorted yields

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The Fed believed QE lowered yields but they are wrong

If QE really lowered bond yields then during bouts of QE real yields would have fallen
Instead lower yields were driven by disinflation, Twist and since 2015 ECB/BOJ QE turbo charged by NIRP*

* despite higher CPI

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But those policies are only sustainable without inflation

Markit Composite: "Inflationary pressures meanwhile remain a key theme of the surveys, especially in manufacturing, reflecting increased raw material prices, notably for metals. The survey found average prices charged for goods and services are rising at one of the strongest rates seen since 2014. Furthermore, with factory costs showing the largest jump for seven years amid growing shortages of key inputs, inflationary pressures appear to be on the rise."

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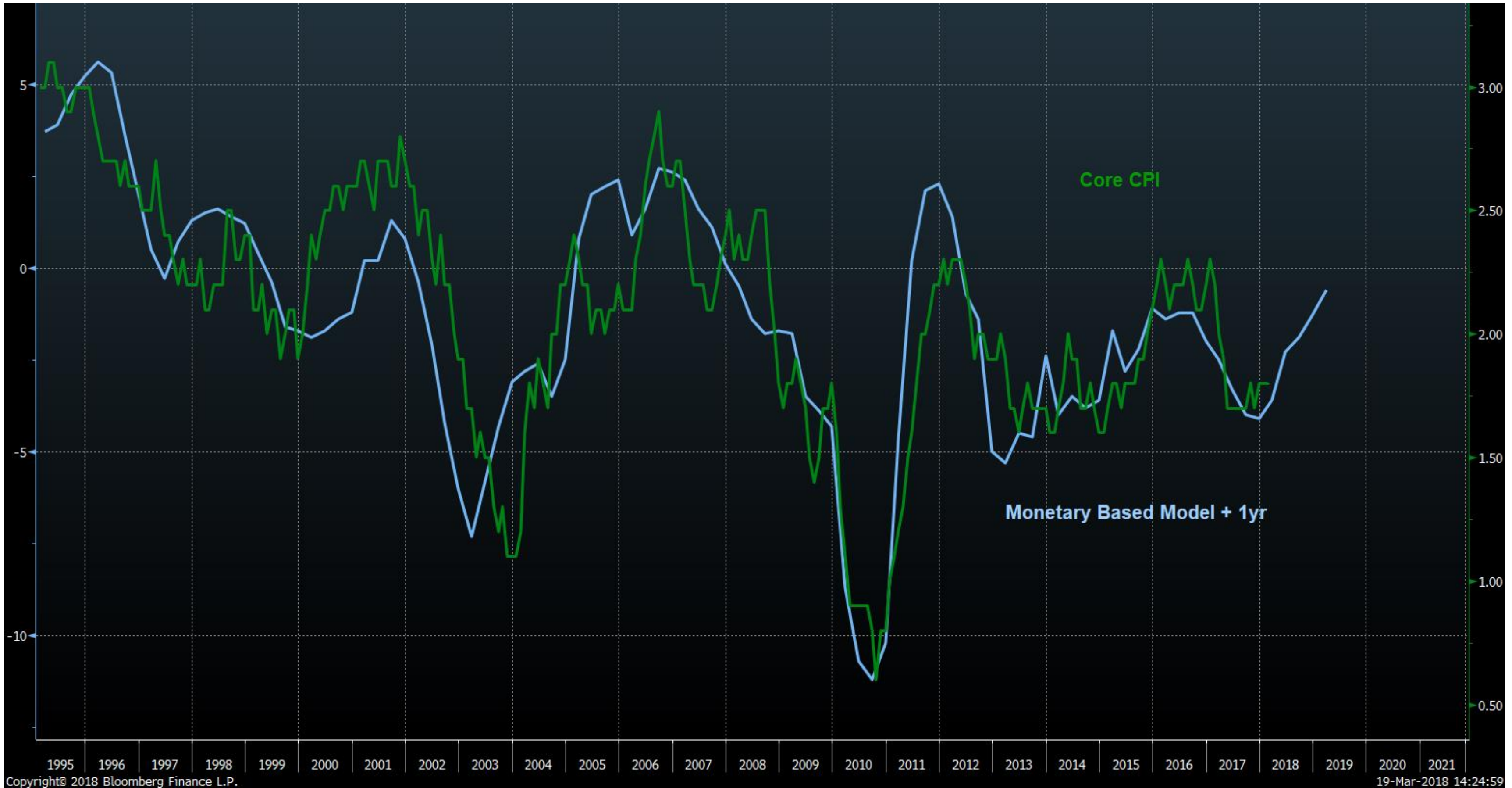
All of this will feed into core prices



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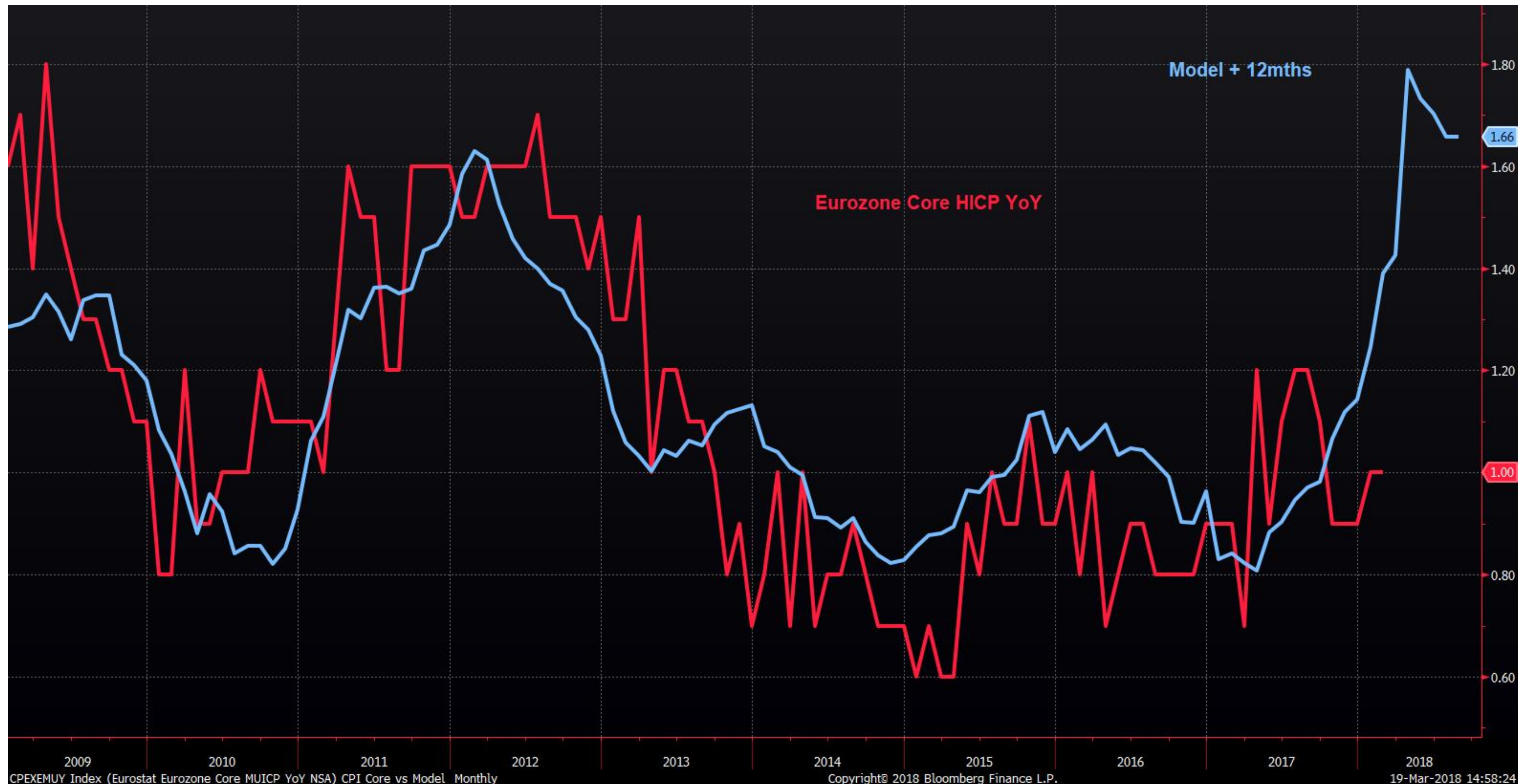
While in Europe our work suggests that core inflation will push materially higher in the next few months

Our model is based off 2800 input prices i.e. price increases that are already in the system



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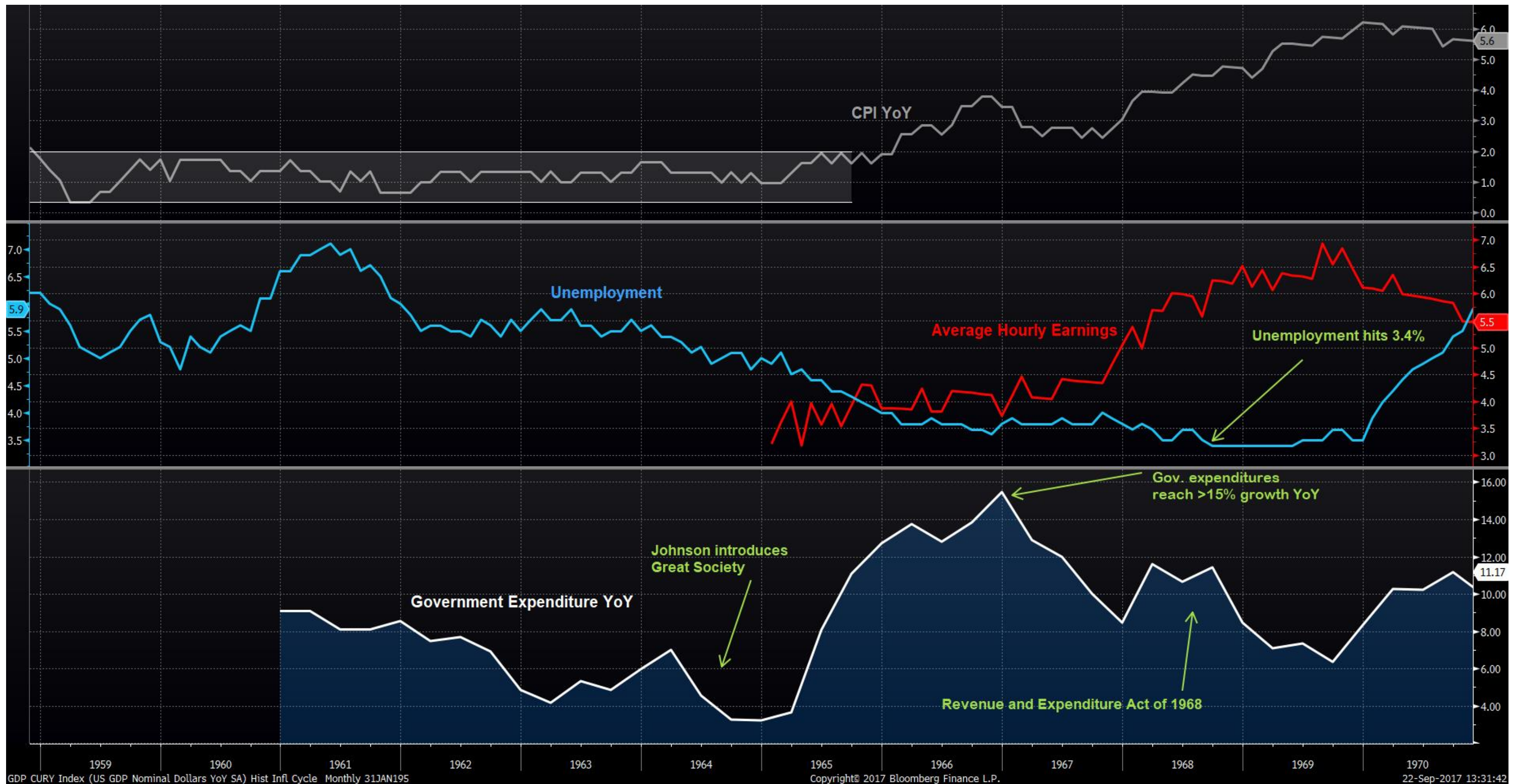
This is before Trump's plans kick in!

The President has his tax cuts and now a massive budget.

All of that before, there's any discussion of infrastructure or the J-Curve effect of a weak dollar!

In the 60's poorly timing fiscal spending kicked off a cycle of inflation

The most halcyon period of stable inflation was thrown off balance by fiscal spending
Back then unemployment was 5% now it's closer to 4% and inflation doubled in 18 months



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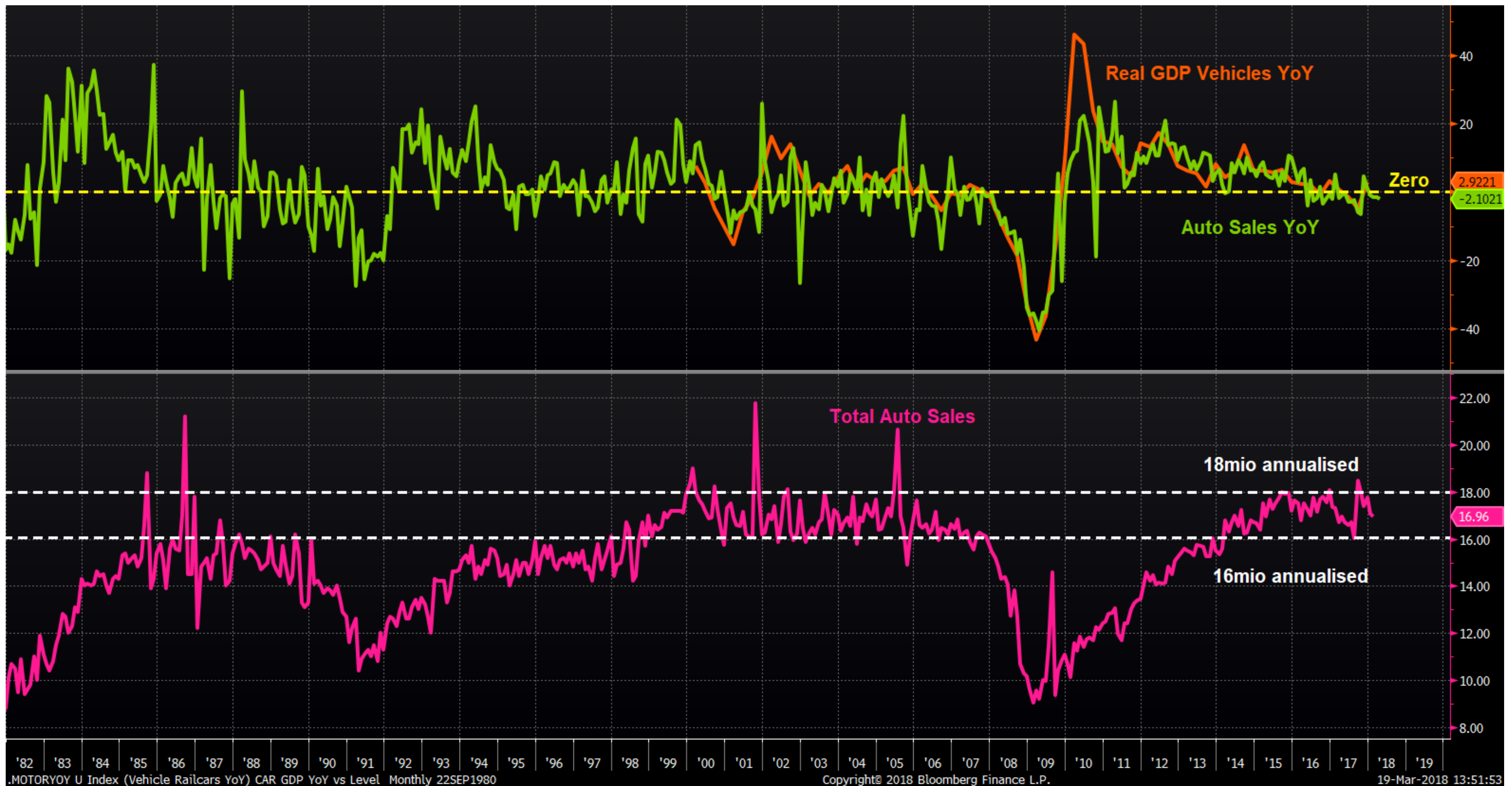
But the move to higher yields won't be linear
There are consequences!

In the real economy autos has already come off the boil
What happens if rates really spike?

Auto sales are plateauing as they have in other cycles hence contribution to GDP ≈ zero



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Another problem area is housing which has been hit by higher rates

The reality is that mortgage demand has slowed since mortgage rates started to rise

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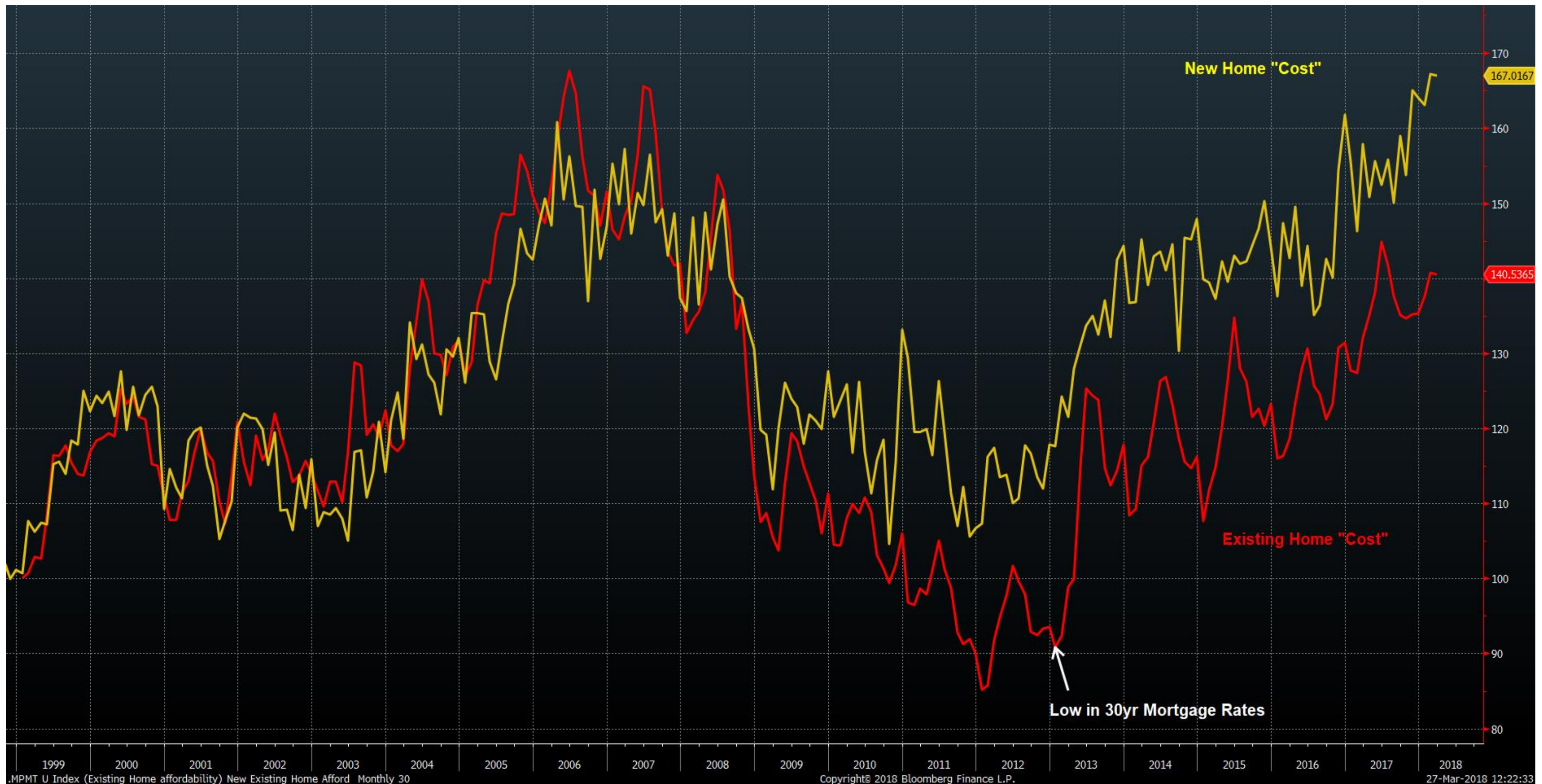
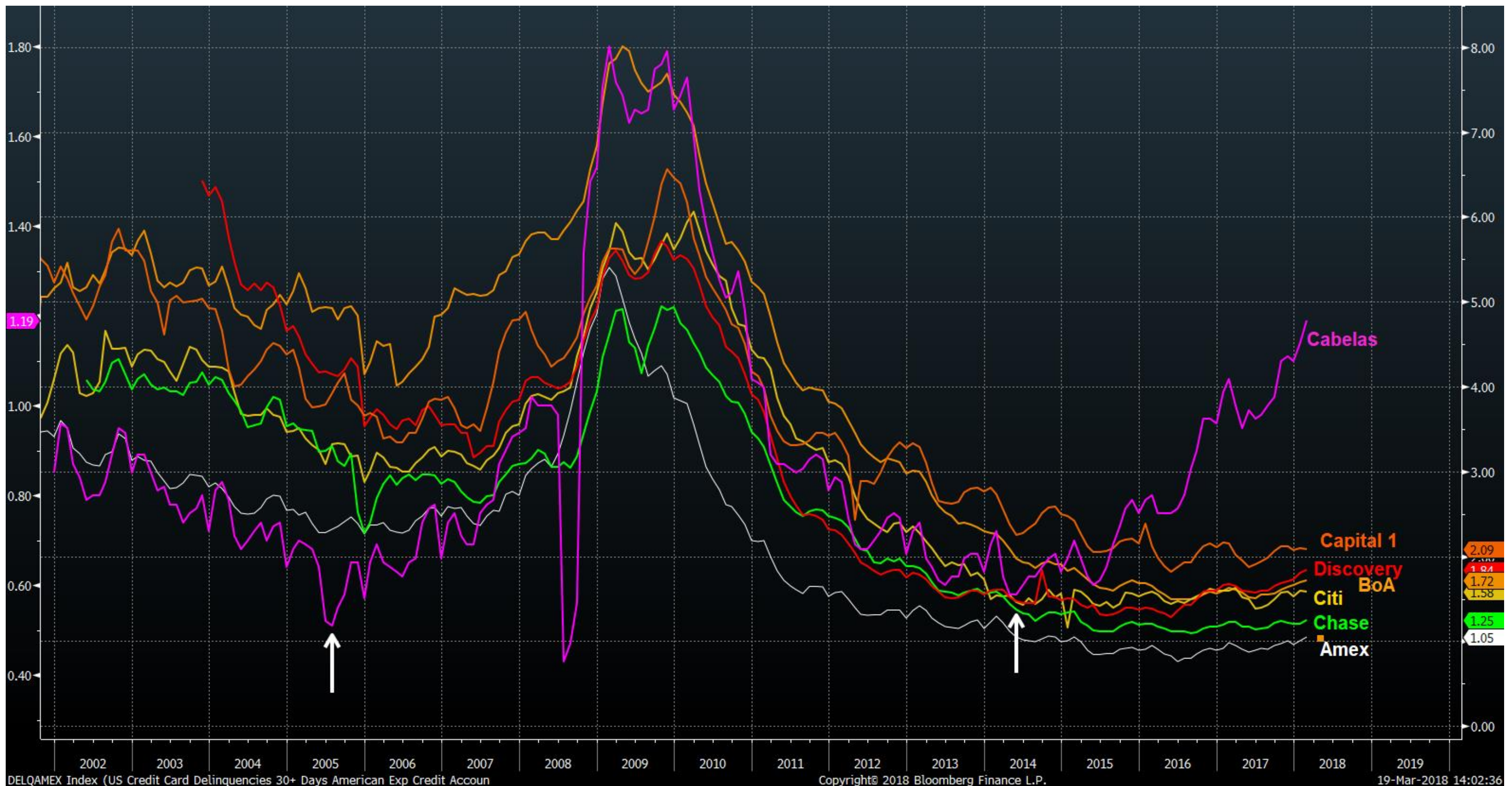
When you calculate affordability* its appalling so higher rates won't help

* Median cost of a home adjusted for mortgage rates and wages



Finally in the credit space we are starting to see signs of credit stress from consumer, which needs to be watched

Note how Cabelas signalled the low in the previous cycle



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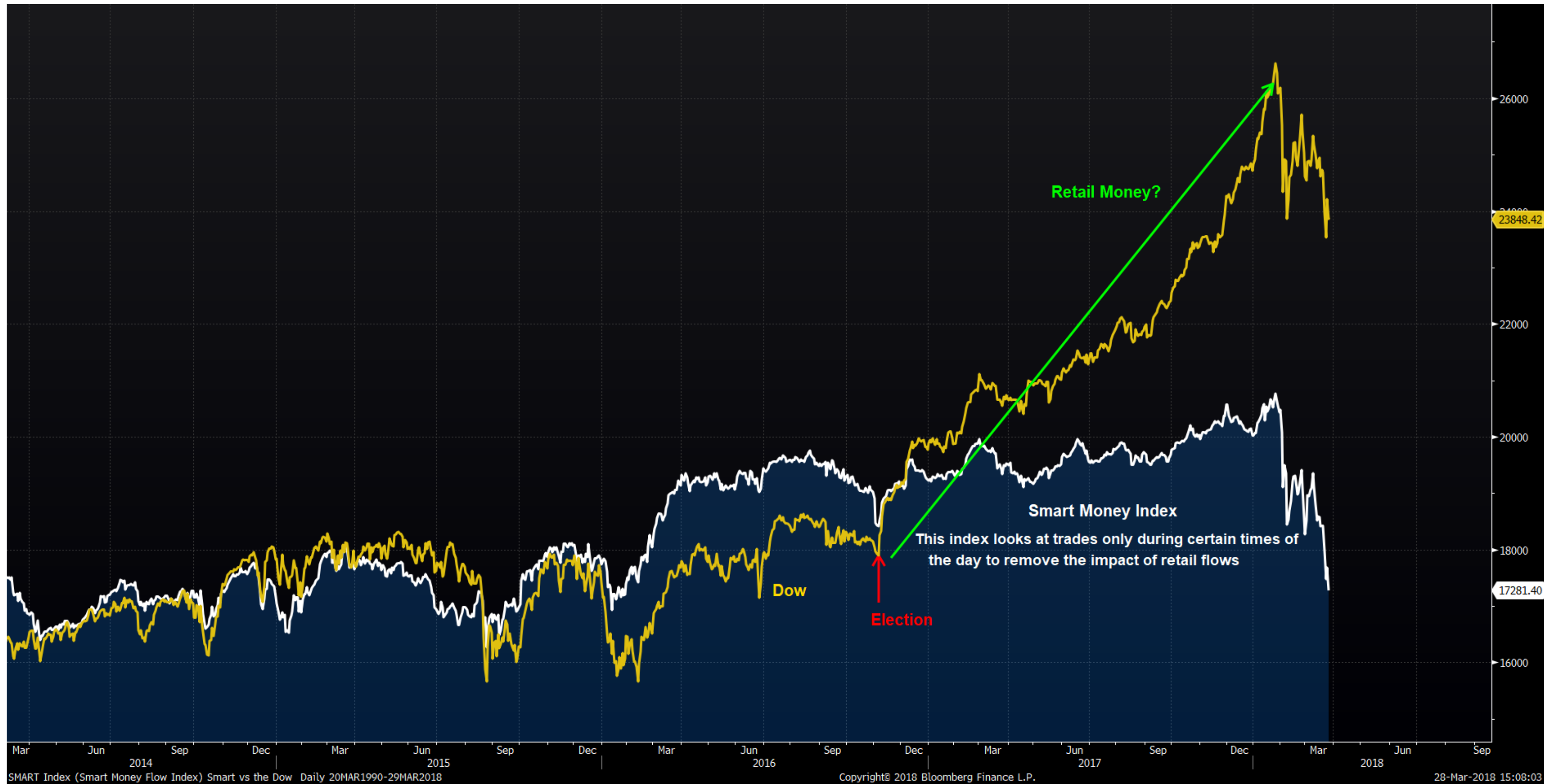
But the real issue is the equity market

Its in a Mexican standoff with the Fed and the bond market

Stocks either collapses under their own weight or the Fed/yields do it for them!

Retail has been sucked into the market since the election

The relative movement in the SMFI vs the Dow suggests the "dumb" retail money is still heavily invested and that the drivers of the recent weakness has been "smart" institutional investors selling



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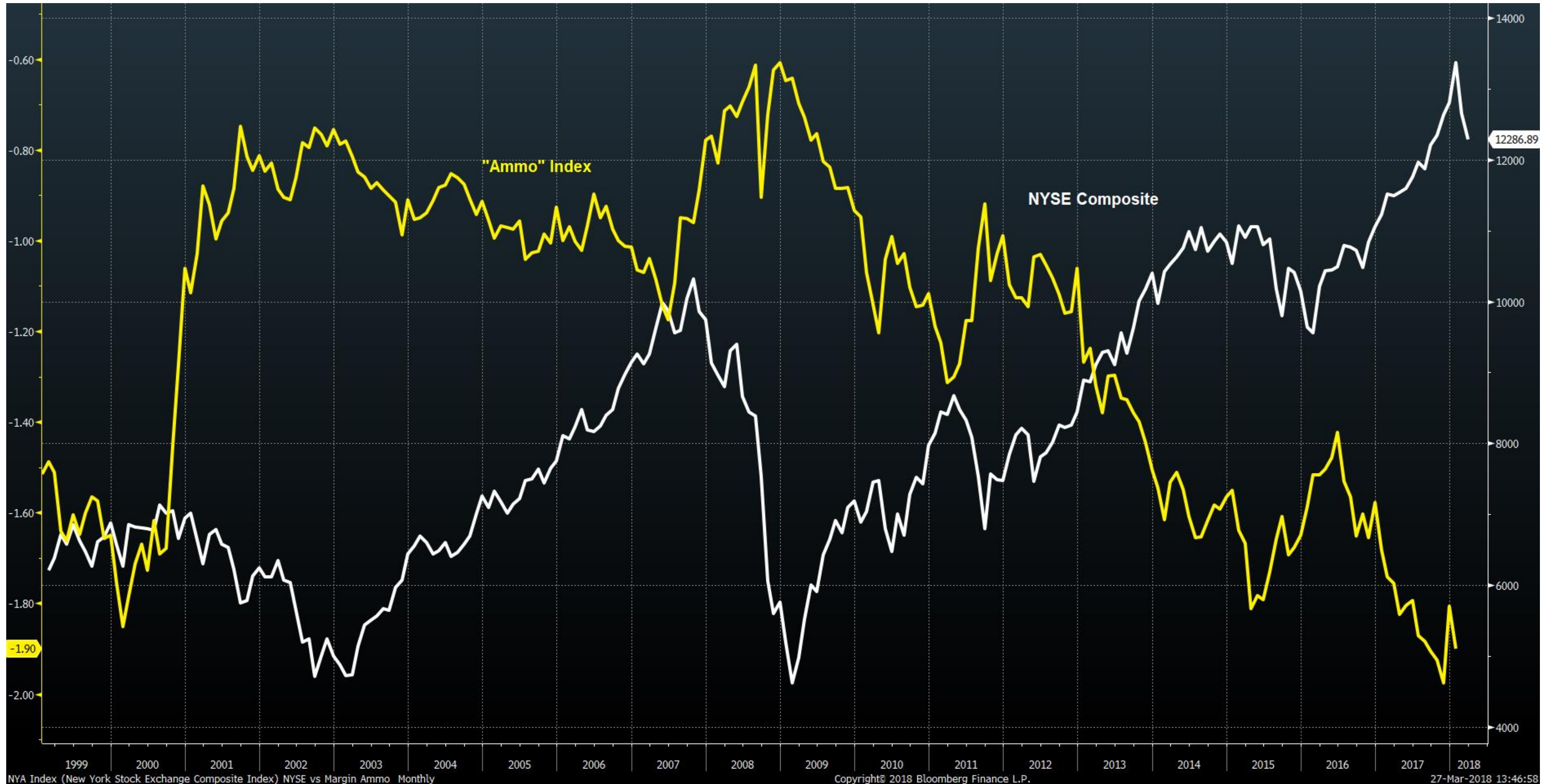
While leverage players are extremely stretched

Our ammo index measures the ability of leveraged players to absorb a VaR shock before they are forced to liquidate their underlying positions. It's lower than in 2000



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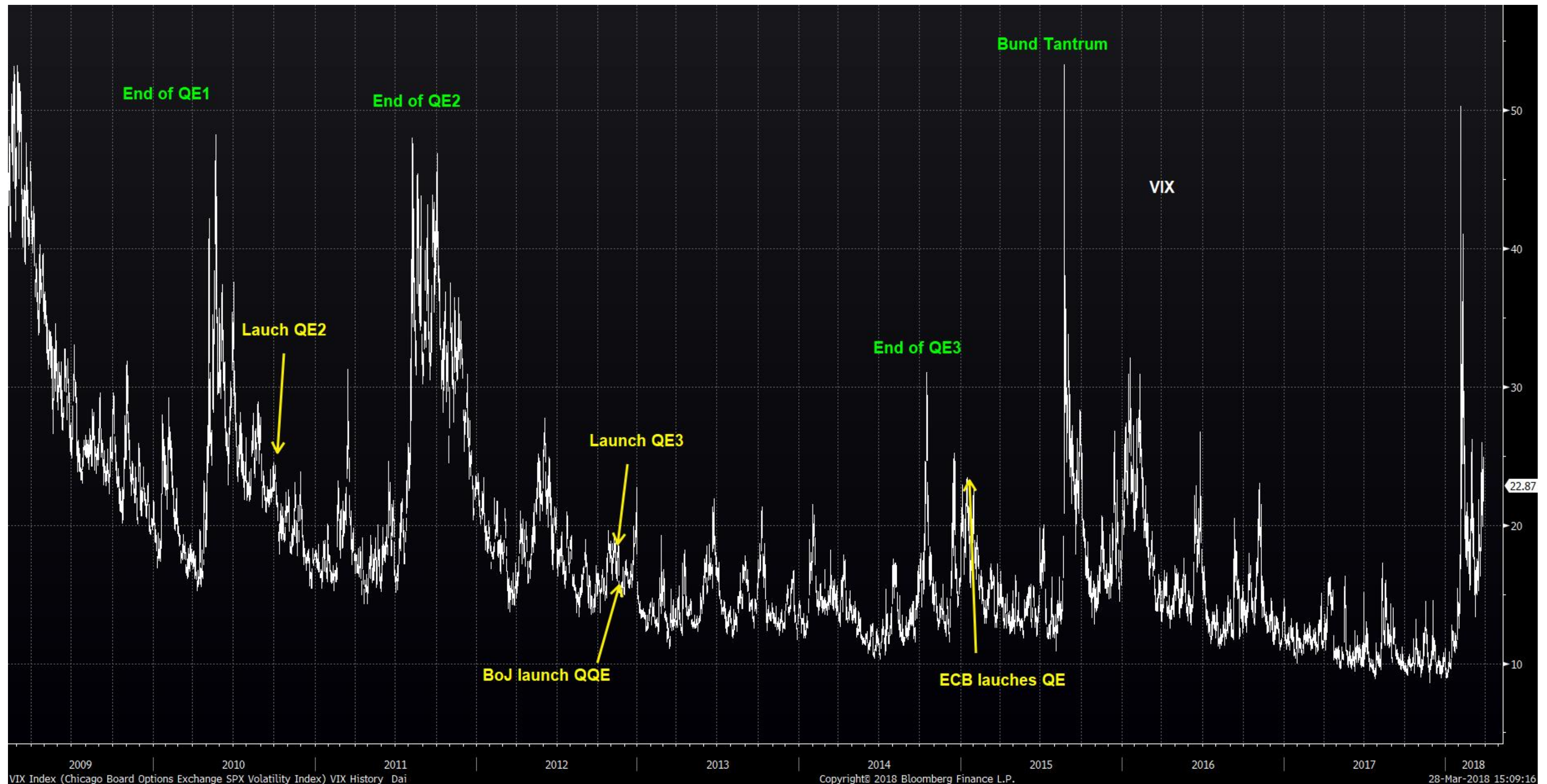
That's a massive problem if vol doesn't fall!

Since the GFC every major spike in vol has been met by yet another policy easing
But with inflation rising how the CBs do the same again?



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