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### **Bad News In Interest Rates**

- We have been expecting the next phase of the post-bubble contraction to become apparent by mid-year.
- The typical rebound out of a typical fall crash would culminate with considerable enthusiasm for stocks corporate, bonds and commodities around May. This would include a restoration of confidence in the establishment's policy remedies, as well as "overbought" readings on the hot games.
- Short and long-dated corporate interest rates would likely decline into May and then increase. The numbers on treasury bills are rather small and volatile, but after the crash low of zero they increased to 30 bps in February and declined to 11 bps last Monday. Friday's close was 20 bps.
- On the same move, the two-year declined from 1.10% to .92% on Wednesday and closed the week at 1.31%. Friday's increase of 35 bps really caught our attention.
- This following the surge in long treasury yields from 2.53% at year-end to 4.62% – also a new high for the move has been foreshadowing and guaranteeing the next dislocation in credit markets.
- With the party to May, long-dated corporate yields were expected to decline and as we have been noting, the decline has been fabulous. Friday's closes were at new lows for high-yield and junk. However, the BBB increased from 7.25% on Wednesday to 7.59%. Traders in investment-grade bonds are more sophisticated than "high-yield-reachers".

The potential reversal has not been on long enough to be called a reversal, but Friday's action should be considered a serious alert. Especially when a reversal in credit conditions was expected around May. Also, it is worth noting that while the long trend of steepening is one of the features of a post-bubble contraction, a burst of rising shorter maturities will be a shock. Particularly, if it encompasses credit spreads.

- As part of the revival in spirits, most spreads were expected to narrow from the crash to around May, and then widen. Also, there is a seasonal tendency for spreads to narrow into May, and then widen. We have used this to advantage, for example, on the Long-Term Capital Management (Google: ltcn crisis) of 1998.
- Another indicator of good fortune or the opposite has been the gold/silver ratio, which decreases during the good times and increases during bad times. This soared to 88 with the crash and declined to 61.7 on Thursday's close, which registered an oversold condition that has ended such moves in the past.
- The increase to 63.7 today is noteworthy, and confirming the reversal in shorter-dated interest rates. Friday's action has continued with the two-year increasing from 1.31% to 1.44%.

Considering today's follow-through, markets are returning to the path to severe contraction expected to become evident by mid-year.

## Green Shoots Update

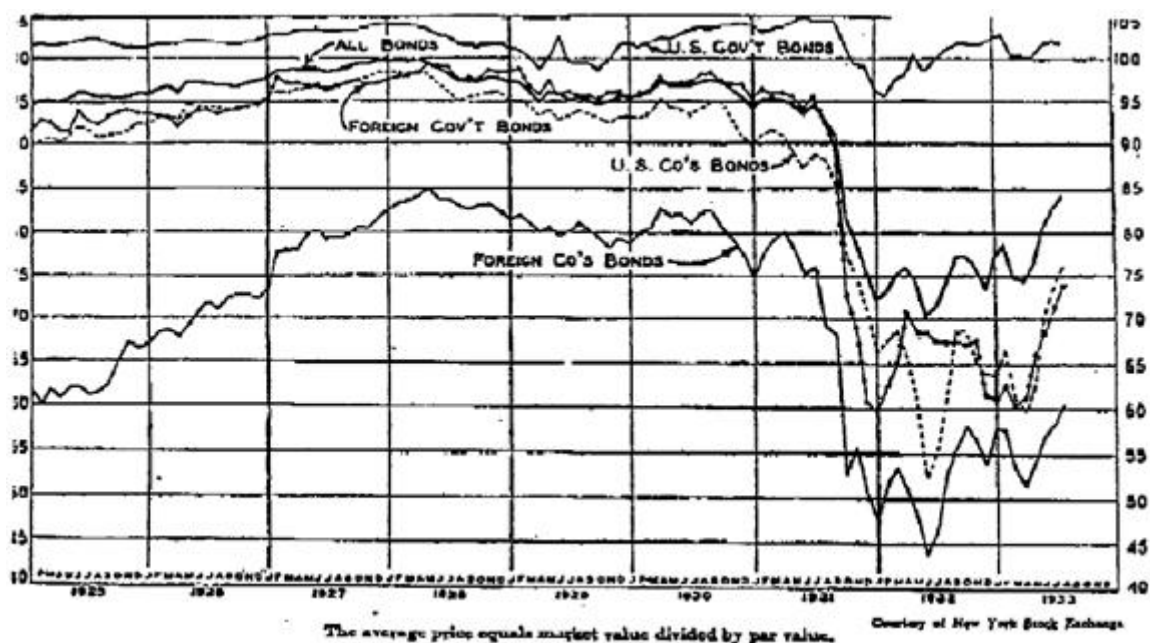
On May 9, we published a brief satire on the latest buzz-word describing visions about life returning to certain economic numbers. As this sort of "good stuff" had been expected to blossom around May we welcomed the term, and advised designing a selling program to begin when the purple lilacs came out.

With this, we also advised completing the program by the time the white lilacs were in blossom.

With the understanding that different geographic regions may have differing blossom times, Vancouver is our base and the purple ones are out in early May – followed a few weeks later by the white ones.

Like the financial markets, the white lilacs are fading quickly and have served their purpose.

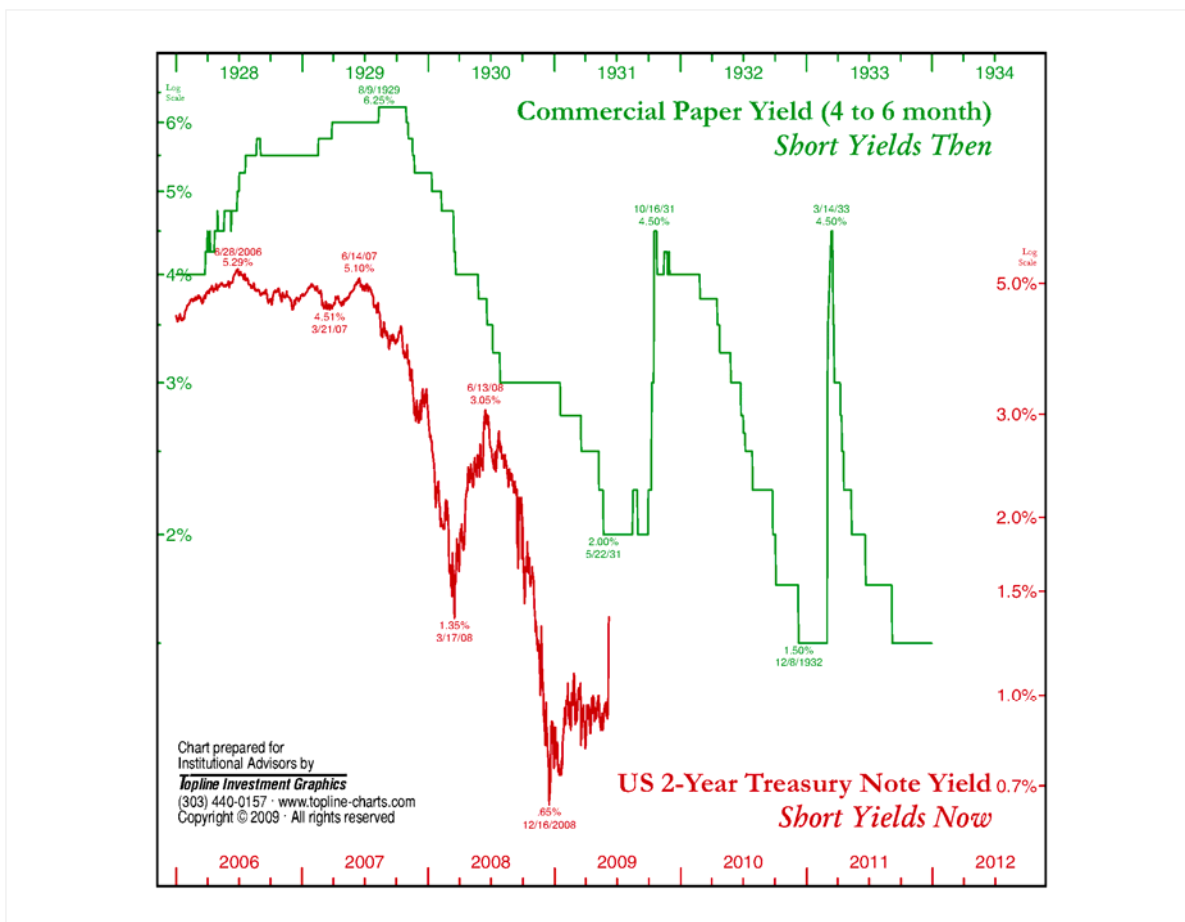
This, at the time, was noted as a refinement on the old "Sell in May and go away." Seems to be working.



- With apologies for the poor quality of the scan – the original photo copy of the Barron's article has been in our files for decades.
- Note the downturn in most bond prices in mid-1931.
- This was some 20 months after the stock market high in 1929.
- This time around, twenty months counts out to June.

## INTEREST RATES

### POST-BUBBLE CONTRACTIONS 2007 AND 1929



- In the 1930's the main market was in corporate interest rates – not in treasuries.
- Yields declined to May 22, 1931 and as the global banking crisis resumed in late May, 1931 short rates turned up.
- The recent sharp rise in yields, as represented by the two-year, is likely signaling the next crisis rather than a strong economy.
- It also suggests that liquidity is disappearing at the shorter end of the curve.