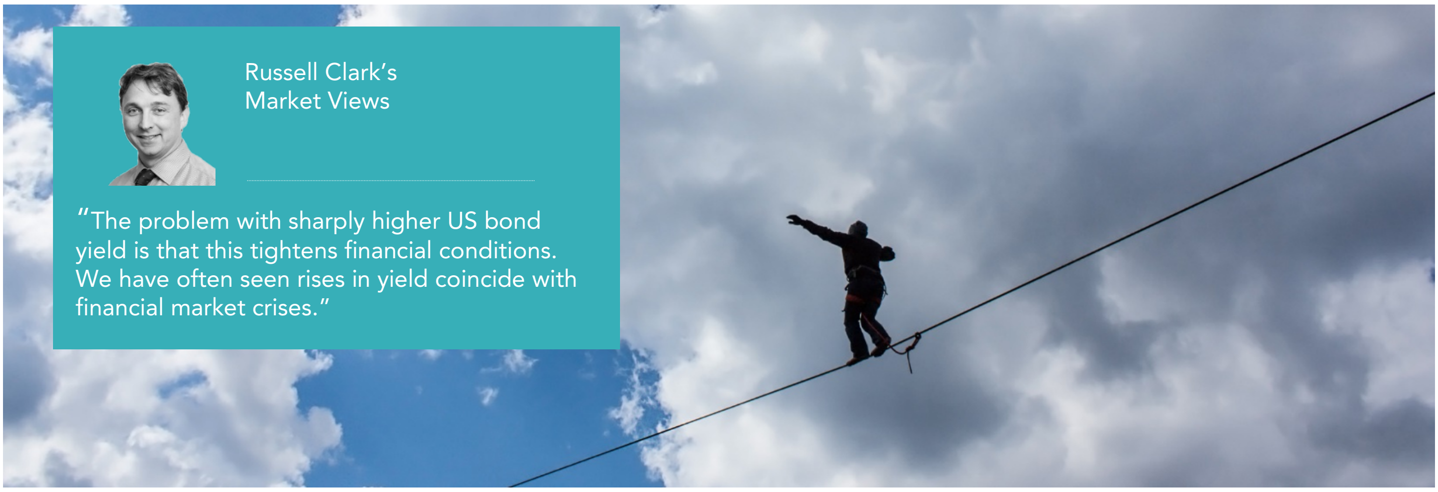
THE NEGATIVE SIDE OF HIGHER YIELDS

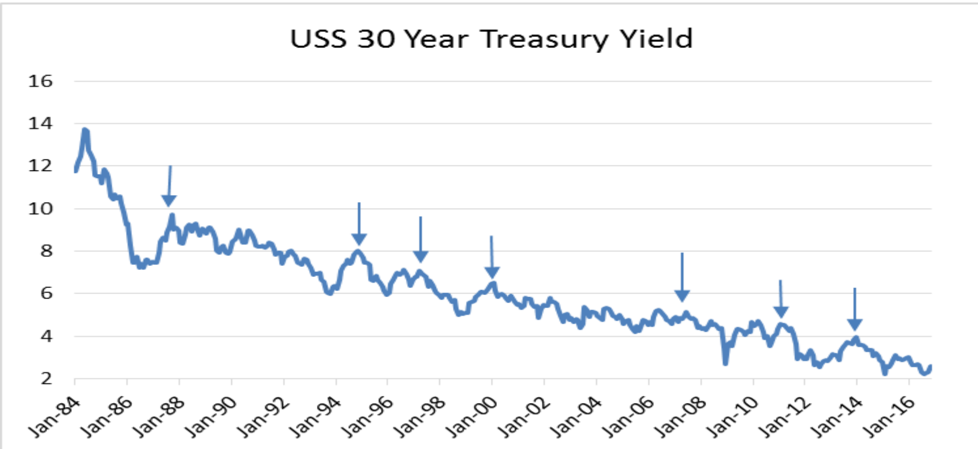


Russell Clark's Market Views

"The problem with sharply higher US bond yield is that this tightens financial conditions. We have often seen rises in yield coincide with financial market crises."

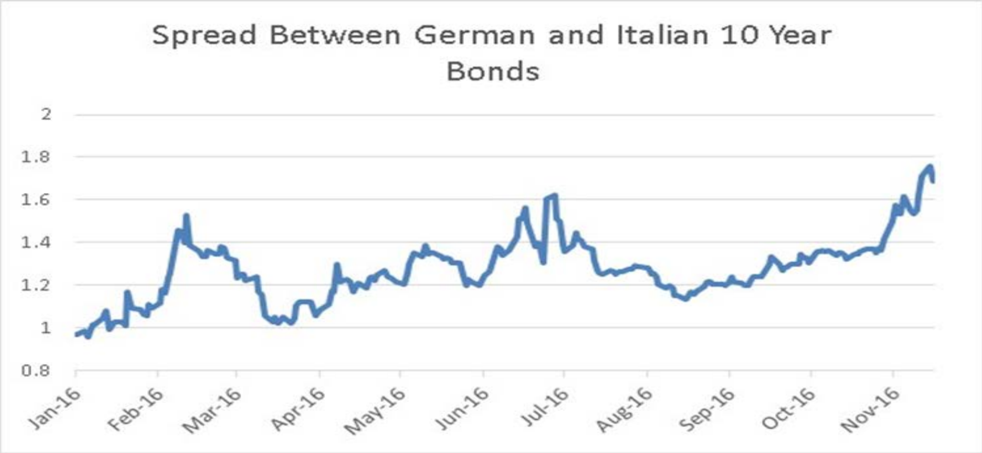
30 Year Treasury Yields started the year at 3%, before falling to a low of 2.1%. They have risen since then, and have had a rapid rise since the election of Donald Trump.

The problem with sharply higher US bond yield is that this tightens financial conditions. We have often seen rises in yield coincide with financial market crises. A rise in yields preceded the 1987 market crash. A rise in yield in 1994 preceded the Tequila crisis, when the Mexican peso devalued by half. After both events, yields quickly fell to new lows.

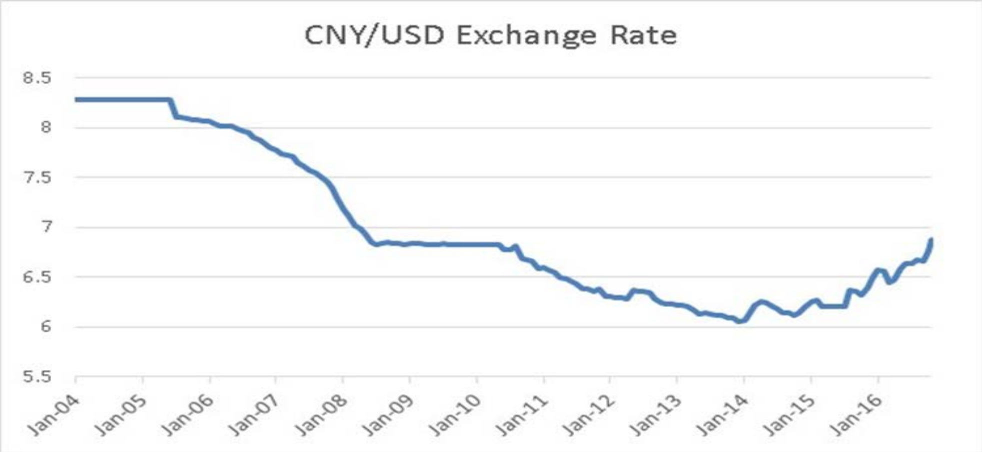


Yields rose in 1996/7 before the Asian Financial Crisis, and yields again rose in 1999 before the dot com crash. After both events, yields fell to new lows. More recently, bond yields rose in 2006 before the Global Financial Crisis, and again in 2010/1 before the Euro-crisis. There was also a rise in yields before the crash in oil prices in 2014. In all cases yields fells to new lows.

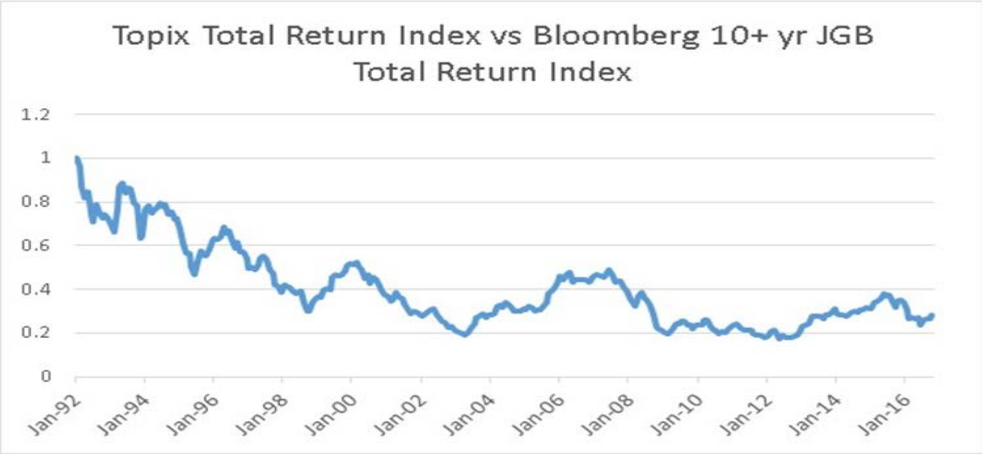
Intriguingly, the rise in yields post the election of Donald Trump, has been associated with several financial moves that would usually be associated with lower yields. One has been the widening of spreads between Italian and German bonds.

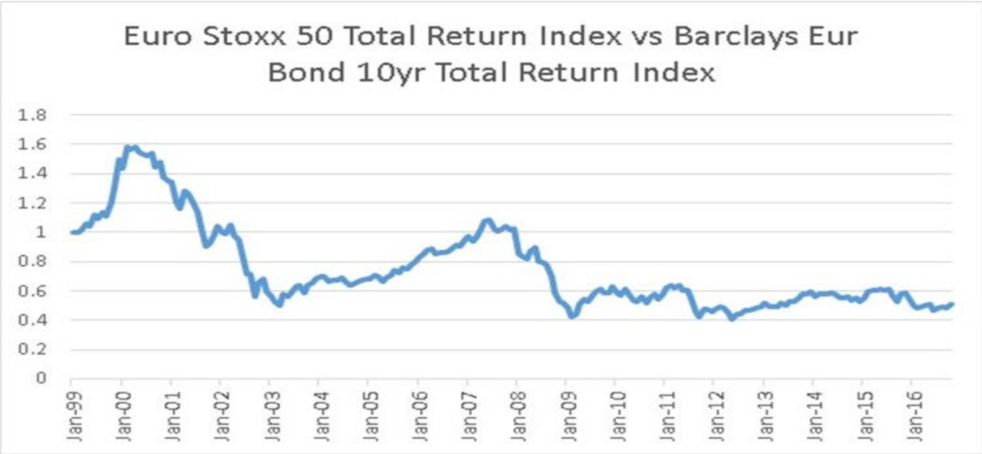


The Trump victory has also seen an acceleration in Asian currency weakness, which historically been associated with weak equities and strong bonds. Much of the weakness has come from a very weak Renminbi, which is now weaker than where it was in 2008.

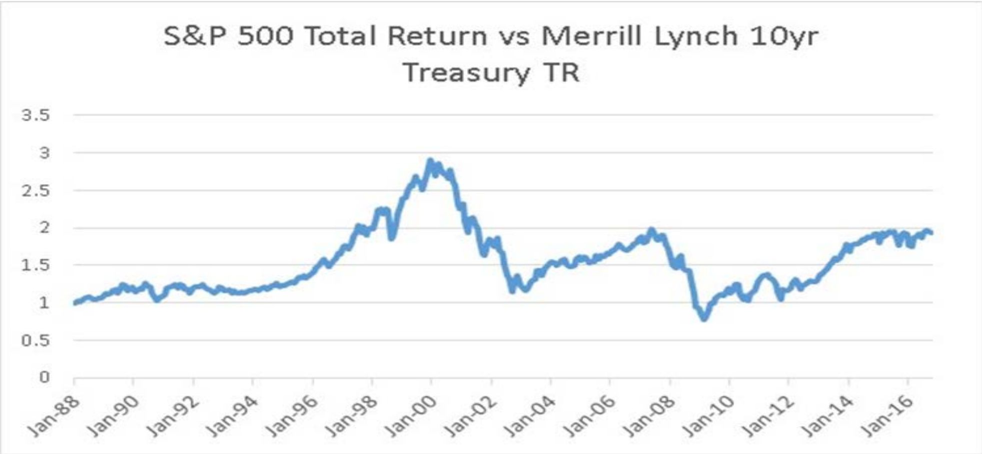


In my view, quantitative easing ('QE') and zero interest rate policies tend to artificially weaken the currency of the country undertaking QE, and incentivises capital and credit to flow to trade partners. This can create a credit bubble and an overvalued exchange rate. When the trade partner devalues, or the credit bubble bursts, this leads to a prolonged period of equities underperforming bonds. In Japan, this has held true since its bubble burst, and in Europe since the dot com bubble.

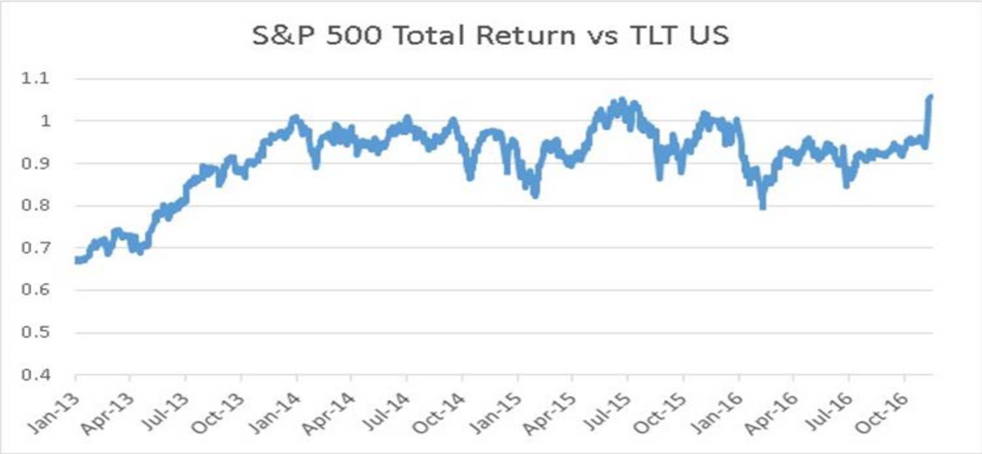




The US with its QE policies, has performed much better than either Europe and Japan, but even here, its has still not confirmed that its equities can outperform bonds.



However the weakness in bonds and the strength of equities in the US since the Trump victory has pushed it to the very extreme of this ratio.



While many financial commentators and investors have become very bullish since the election, the weakness in the Renminbi, and widening spreads in Europe lead me to think that weaker equities and stronger bonds look more likely.

INFORMATION

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