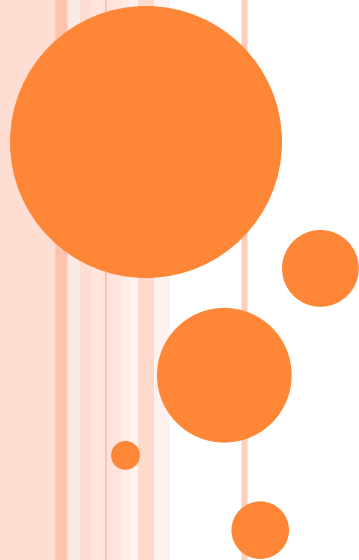


# Wild Swings in Bonds, Currencies: Are Stocks Next?

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# RISK DISCLOSURE

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# THE BULL MARKET IN BONDS

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**Brought to us by ...**

## **1) Massive Structural Imbalances**

- Lopsided trade – U.S. over consuming, China over producing
  - ❖ The U.S. consumer sends dollars to China, China sends the dollars back to the U.S. consumer via investment in U.S. Treasuries.  
**RESULT:** Bond prices go up, yields go down. Rinse and repeat.

## **2) Safety, Plus Yield in a World of Zero Interest Rates**

- U.S. Treasuries represent a safe haven in a world of global risk and uncertainty.
- Zero interest rate policy, QE, ultra-slow growth, deflationary pressures – all drives global capital into U.S. Treasuries.



# IS IT OVER? ALL RISK, NO REWARD.



Sources: FxTraderProfessional.com, Reuters

[FxTraderProfessional.com](http://FxTraderProfessional.com)



# GLOBAL QE

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Central banks buy government bonds to suppress interest rates, inject capital into the system, promote lending and stimulate demand.

- Fed: After three rounds of QE, the Fed on path to raise rates for the first time in nine years.

Meanwhile ...

- BOJ: Open ended QE
  - The BOJ has promised aggressive QE until two decades of sustained deflation is beaten and sustained inflation is achieved.
- ECB: The last holdout.
  - Draghi has vowed to expand the balance sheet by \$1 trillion.

# CONTRADICTIONS OF QE

Impact of QE on bonds yields => Yields go UP not DOWN



Sources: FxTraderProfessional.com, Reuters

[FxTraderProfessional.com](http://FxTraderProfessional.com)



# THE PERFECT STORM FOR BONDS

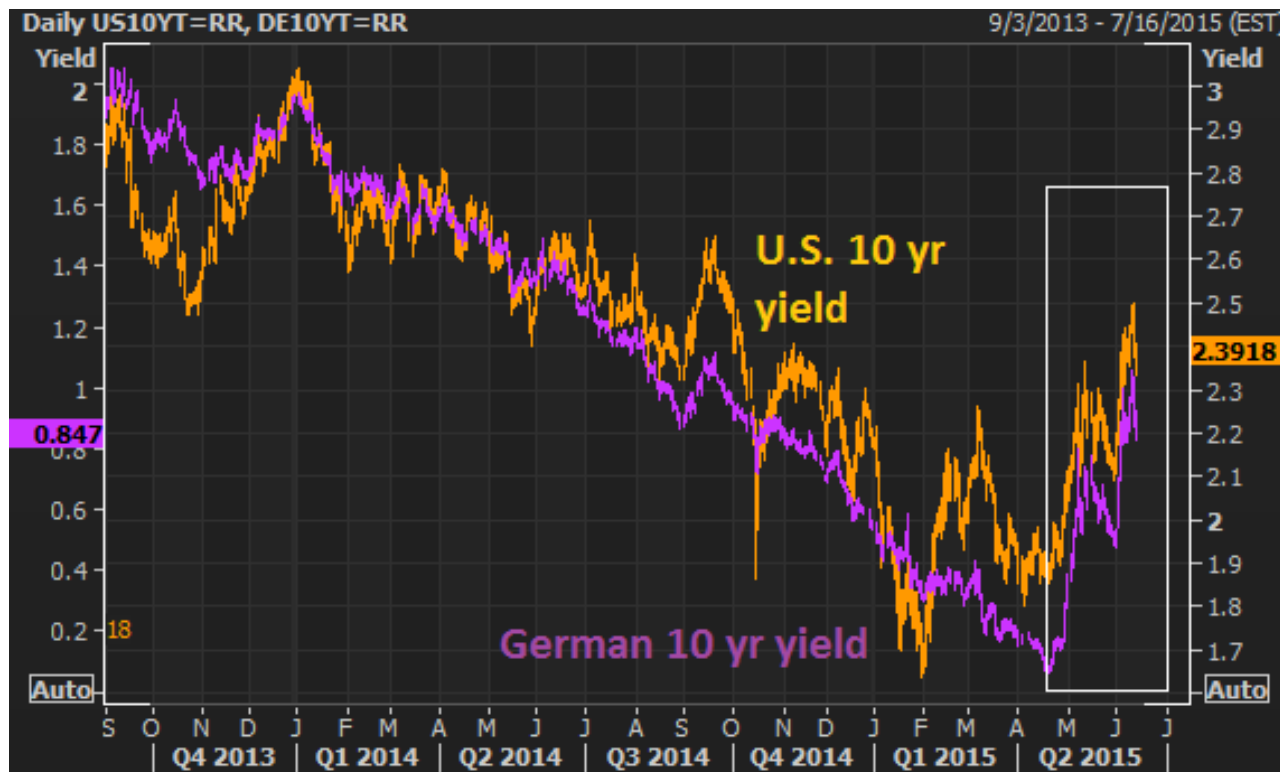
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- 1) Rate hiking cycle in the U.S. upon us, plus physical bond buying in Europe and Japan (i.e. yields should go UP, not down)
- 2) Enter catalyst: German 10-year government bonds near a negative yield
- 3) Bill Gross calls German bunds, “The short of a lifetime”
- 4) The great bond market sell-off ensues



# THE BIG SQUEEZE

- German yields move 19x in two months, U.S. yields move with it, in lockstep

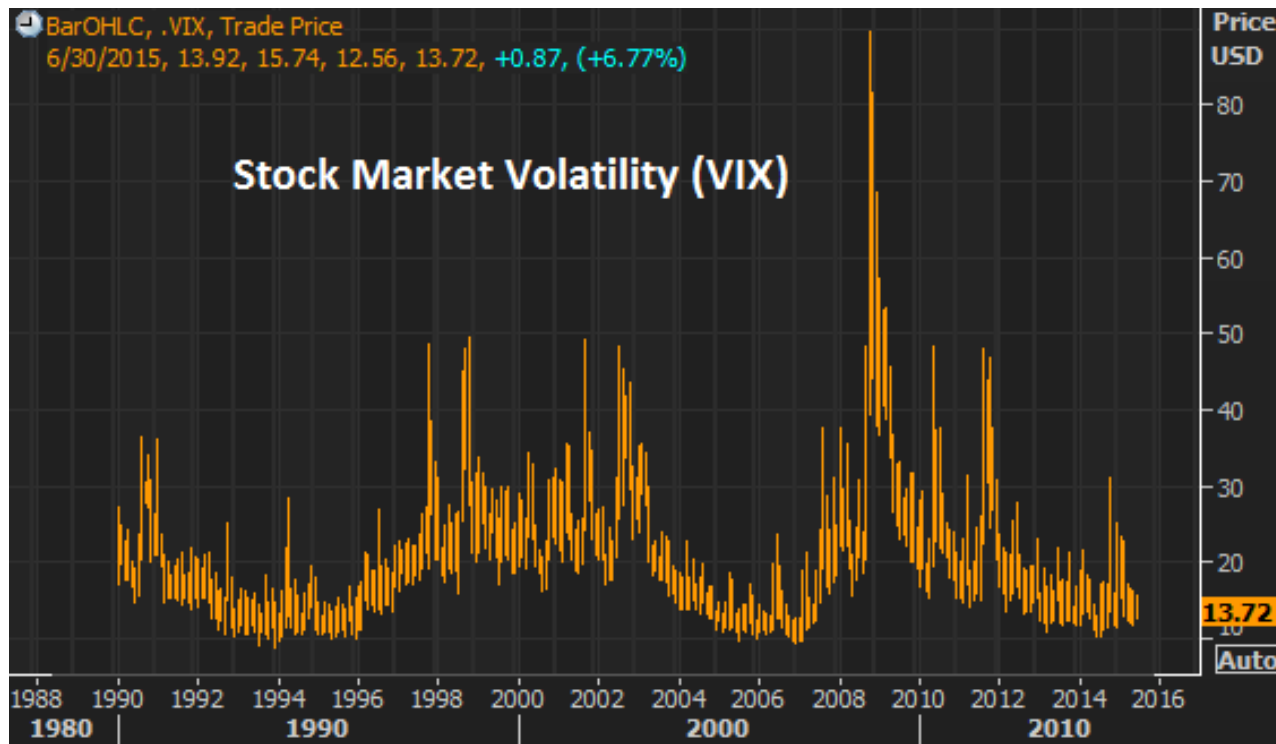


Sources: FxTraderProfessional.com, Reuters



# BOND MARKET JOLT

- Signal of increasing risk in the system or just the beginning of rate normalization?
- Stock market volatility remains at very low levels – argues the latter.



Sources: FxTraderProfessional.com, Reuters

[FxTraderProfessional.com](http://FxTraderProfessional.com)



# SPANISH YIELDS: "GREECE? NOTHING TO SEE HERE."



Sources: FxTraderProfessional.com, Reuters

**FxTraderProfessional.com**



# ITALIAN YIELDS: "GREECE? NOTHING TO SEE HERE."



Sources: FxTraderProfessional.com, Reuters

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# RATE NORMALIZATION SCENARIO

- An end of the bull market in Treasuries means bond investors are in store for negative returns.
- When money moves out of U.S. Treasuries following a 35-year bull market, where does it go?
  - Flows to other asset classes
    - Stocks?
    - Real Estate
    - Commodities
    - Currencies?



# CAPITAL FLOWS: HUGE CONSEQUENCES

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- From bonds to stocks?
- Stocks: If we apply the long-run annualized return of the S&P 500 to its pre-crisis highs, we get 2,917 by the end of 2015; 3,150 by the end of 2016.

		8%	Actual
July	2007	1,576	
July	2008	1,702	1,282
July	2009	1,838	976
July	2010	1,985	1,102
July	2011	2,144	1,345
July	2012	2,316	1,350
July	2013	2,501	1,692
July	2014	2,701	2,040
July	2015	2,917	2,000
July	2016	3,150	
July	2017	3,402	

# CAPITAL FLOWS: HUGE CONSEQUENCES

The great monetary policy divergence ...  
favors the dollar.



Sources: FxTraderProfessional.com, Reuters

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# ADVANTAGES OF FX OPTIONS

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- Why FX Options offer an advantage
  - Leverage
  - Survivability
  - Controlled Risk
  - Volatility Benefit
  - Directional &
  - Non-directional

	Quoting Convention	Symbol
<b>Euro</b>	EUR/USD	XDE
<b>Japanese Yen</b>	JPY/USD	XDN
<b>British Pound</b>	GBP/USD	XDB
<b>Swiss Franc</b>	CHF/USD	XDS
<b>Canadian Dollar</b>	CAD/USD	XDC
<b>Australian Dollar</b>	AUD/USD	XDA
<b>New Zealand Dollar</b>	NZD/USD	XDZ

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