20th January 2014

the technical analyst AWARDS 2011 FINALIST

Market Update:

Reasons for not buying bonds

UPDATE
Technical
Fundamental

Full performance of our Key Trades recommendations 2006-13 here

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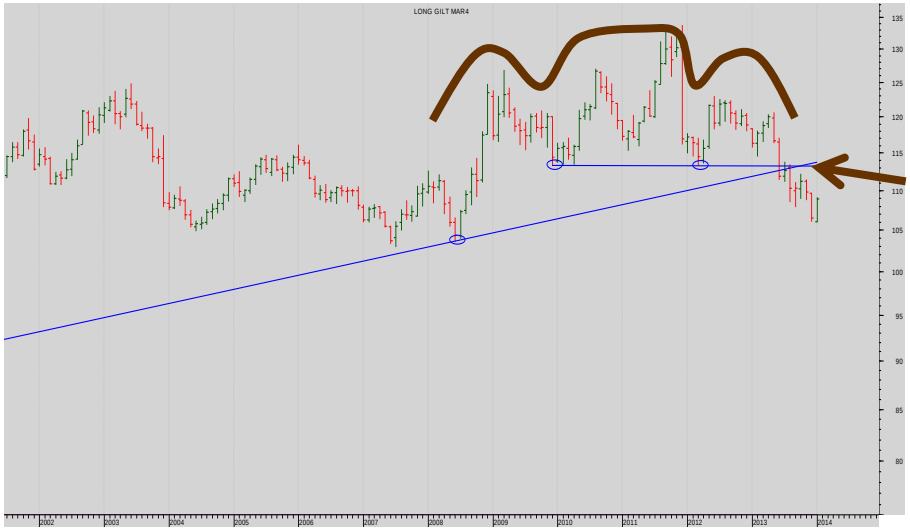
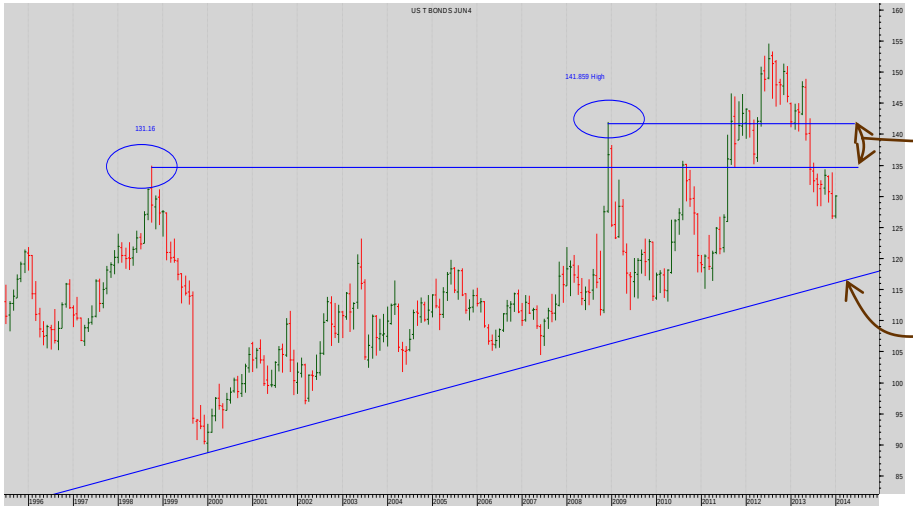


Monthly UK Gilts

The clear H&S reversal pattern in the long-term charts place the recent really in context.

Note well the simultaneous completion of the H&S pattern with the break of the long bull trend



Monthly TNotes chart

The break-back through the powerful support from the Prior Highs has set the seal on the end of the long bull trend.

The actual diagonal trend line remains a long way beneath the market.

There is a lot more of the bull trend from 1984 to unwind before it is even threatened.

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More

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After what was shaping up to be a bear market late in 2013, bonds have seemingly found a new lease of life in the early weeks of 2014. But why?

In the Euro zone economic activity remains subdued with all except the German economy struggling for growth and even German growth isn't that exciting. Add in exceptionally low inflation which the head of the IMF only this week warned could morph into deflation and it is possible to argue that Euro zone Bonds have some excellent support.

Looking to Japan, the bond market there is around all-time highs. And when one considers the yet again flagging economy it is hard to make the case to go short JGBs. In fact, the economic recovery that looked so dynamic in the early months of 2013, now looks on its knees and although national CPI is around 1.5%, the highest in years, there is still much work left to do before the Japanese economy looks truly on the road to long term sustainable growth. So the JGB market continues to offer a separate case from other leading bond markets.

Coming back west, the UK Gilt has also enjoyed a New Year rally. Only here, conditions are different. UK economic growth looks very robust ultimately leading to strengthening tax revenues and reducing welfare payments which will support the governments austerity drive as it seeks to cut the budget deficit back to a manageable size and eventually eliminate it. But should investors buy bonds or equities? Look at the FTSE!

Then the US. The recovery there continues at a reasonable pace with the last available measure of GDP; Q3 coming in at a more than respectable 4.1%, but here too, US Treasuries are enjoying a rally. Why?

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FUNDAMENTALS: CONTINUED

There are a few reasons. The most important are surely;

- At the December 2013 FOMC meeting policy makers finally committed to their much anticipated taper policy,
- The US experienced some of the worst winter weather in living memory which led to non-farm payroll released last Friday falling significantly short of expectations, and
- The US earnings season is now under way and results so far have been mixed.

But look at equities.

The US S&P is around all-time highs. Clearly traders there see conditions differently and are expecting the economic recovery to strengthen despite the Fed reducing it's QE3 monthly Bond purchases by US$10Bn and announcing their intention to reduce their monthly purchases by a further US$10Bn at each subsequent meeting.

And barely had markets time to digest the weak payroll report, when US retail sales released this week, beat expectations on both the headline and Ex-Autos reports, meaning the payroll figure was distorted heavily by the freak winter weather.

The Fed may be in no rush to change interest rates, but it does want to end QE3 and that program has offered bonds support. We judge the recovery in the US remains on track. The recovery in the UK looks vibrant and stocks are a clear bull market, at some point soon the bond market rallies will be recognised for what they are: a correction.

However, with inflation rates globally still low, there need not be a headlong rush to sell bonds. Yet faced with the choice of buying equities or bonds which would you choose?

Our money is on stocks.

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