



27<sup>th</sup> April 2018

# Market Update:

## Bonds look bearish across the board

UPDATE  
Technical  
Fundamental





## UPDATE Technical Fundamental

### Bonds look bearish across the board



### MONTHLY US TNOTES CHART

This is an extraordinary chart: the longevity of the diagonal trendline support and the clarity of its definition over the years renders it very powerful.

**And the bears think there is good evidence that it has been breached.**

The catalyst for the breakdown was the breakout from the horizontal trading range from 2012.

Once the market found itself beneath the two Prior Lows at 122.70, the pressure was on to test the long-run diagonal.

And it has probably been breached because there is a monthly close beneath.



### WEEKLY BUND CHART

This is bearish too:  
Surely we have the completion of a top formation because of

- The breach of the well-established diagonal trendline support from 2011
- the breach of the high in 2015 of 160.69 and
- the push beneath the Prior low of 158.73 in 2017.

Taken together these complete the creation of a Top. There is now massive resistance to rallies from the band 157.73-160.69, helping to lever the market lower and lower.

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## FUNDAMENTALS:

Since the middle of February the three leading Government Bond markets; US Treasuries, UK Gilt and Euro zone Bund, have all rallied. In the case of the US Note the rally always looked like a correction or short covering rally, where as in the Gilt and Bund the rallies looked more substantial. Indeed in the case of the Bund, if it had progressed very much further a fresh leg of the long Bull market would have looked about to begin.

However those moves have now largely exhausted. In all three markets the Bears seem to have regained control and the down side beckons.

But what has changed market sentiment?

In the case of the US Treasury market we judge traders and indeed policy makers have finally awoken to the impact Trump's tax cut will have and is already starting to have, on US public finances. But that isn't the whole story, in addition to the massive tax cut, he also intends spending heavily on infrastructure renewal and expanding the military.

All of these represent a significant loosening of fiscal policy at a time when the US economy is enjoying a strong period of growth with virtually full employment. The consequence of his fiscal policy is likely to not only mean much larger budget deficits that will need financing, but higher inflation resulting in US interest rates moving higher than would otherwise have been the case.

In addition to this the Fed has begun to run down its bond holdings built up during three rounds of QE, meaning a major reliable buyer of US debt is about to exit at the same time as the US is about to increase the amount of debt it needs to sell.

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## FUNDAMENTALS: CONTINUED

But what about the Gilt and Euro Bund?

The UK government continues to maintain a tight grip on public spending which will see borrowing fall below forecasts for this year and further out. That would normally be bullish for the Gilt. Additionally inflation has begun to decline from the highs seen in the aftermath of the “BREXIT” referendum, caused by the sharp devaluation of Sterling.

But the picture for the UK economy is far from bright. The NIESR have recently estimated growth over the last three months at a meagre 0.2%, if the UK measured its GDP on an annualised basis like the US and Japan, that would be a weak 0.8%.

Then there is the still uncertain outcome of the “BREXIT” negotiations and the UK/EU future relationship which will certainly have real implications for the health of the UK economy in the short and medium term and possible long term too, meaning the UK Government may at some point need to open its spending taps to support the economy; not a very appetising prospect for investors.

So what of the Euro Bund? Here too the ECB has run a sizeable QE program that it too has begun to scale back, with Germany wanting the ECB to do more to reduce policy accommodation as Euro zone growth looks solid, albeit with benign inflation.

Other factors that have conspired to support bonds recently have been geopolitical tensions. A trade war between the US and China has looked a very real risk as the US has imposed import tariffs on Chinese goods and China has retaliated, albeit in a restrained way, but sentiment has shifted to the extent that investors/traders sense a negotiated deal might be possible. Then there is North Korea. Suddenly the leader there is ready to talk and Kim Jong Un and US President Trump are set for a summit that holds out the possibility of denuclearising the Korean peninsula.

Clearly if that occurs and a trade war averted, equities will rally hard and Bonds would sell off.

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#### SEVEN DAYS AHEAD

Authorised and Regulated by the FCA  
124 REGENTS PARK ROAD LONDON NW18XL  
TEL +44 (0) 7849 922573

E-MAIL [msturdy@sevendaysahead.com](mailto:msturdy@sevendaysahead.com), [jlewis@sevendaysahead.com](mailto:jlewis@sevendaysahead.com)

WEB SITE [SEVENDAYS Ahead.COM](http://SEVENDAYS Ahead.COM)

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