

Biiwii Commentary

eResearch Corporation is pleased to provide an article and video, courtesy of Biiwii.com, and written by Michael Ashton of E-piphany (link to the Author is provided on the following page).

The article, starting on the next page, is entitled: “**Are Rising Yields Actually a Good Thing?**”.

Biiwii.com was created in mid-2000 solely as a way to help get the message out about deeply-rooted problems about too much debt and leverage within the financial system. The concerns were confirmed and the message proved justified 3 to 4 years later as the system began to purge these distortions, resulting in a climactic washout extending from October, 2008 to March, 2009.

Along the way, a geek-like interest in technical analysis, a long-time interest in human psychology, and various unique macro market ratio indicators were added to the mix, with the result being a financial market newsletter (and dynamic interim updates), Notes From The Rabbit Hole (NFTRH) that combines these attributes to provide a service that is engaged and successful in all market environments by employing risk management first, and opportunity for speculation second.

But It Is What It Is: You can access Biiwii at its website: www.biiwii.com.

Notes From The Rabbit Hole: You can access NFTRH at its website: www.NFTRH.com

eResearch was established in 2000 as Canada's first equity issuer-sponsored research organization. As a primary source for professional investment research, our Subscribers (*subscription is free!!!*) benefit by having written research on a variety of small- and mid-cap, under-covered companies. We also provide unsponsored research reports on middle and larger-sized companies, using a combination of fundamental and technical analysis. We complement our corporate research coverage with a diversified selection of informative, insightful, and thought-provoking research publications from a wide variety of investment professionals. We provide our professional investment research and analysis directly to our extensive subscriber network of discerning investors, and electronically through our website: www.eResearch.ca.

Bob Weir, CFA
Director of Research

Note: All of the comments, views, opinions, suggestions, recommendations, etc., contained in this Article, and which is distributed by eResearch Corporation, are strictly those of the Author and do not necessarily reflect those of eResearch Corporation.



Are Rising Yields Actually a Good Thing?

By [Michael Ashton](#)



February 7, 2018

I have recently been seeing a certain defense of equities that I think is interesting. It runs something like this:

The recent rise in interest rates, which helped cause the stock market swoon, is actually a good thing because interest rates are rising due to a strong economy and increasing demand for capital, which pushes up interest rates. Therefore, stocks should actually not mind the increase in interest rates because it is an indication of a strong economy.

This is a seductive argument. It is wrong, but it is seductive.

Not only wrong, in fact, but wrong in ways that really should not confuse any economist or strategist writing in the last twenty years.

Up until the late 1990s, we could not really tell the main reason that nominal interest rates were rising or falling. For an increase in market rates there are two main potential causes: an increase in real interest rates, which **can** be good if that increase is being caused by an increasing demand for credit rather than by a decreasing supply, and an increase in inflation expectations, which is an unalloyed negative. But, in 1995, we would have had to just guess which was causing the increase in interest rates.

However, since 1997, we have had inflation-linked bonds, which trade on the basis of real yield. So we no longer have to *guess* why nominal rates are rising. We can simply look.

The chart below shows the decomposition of 10-year nominal yields since early December. The red line, which corresponds to the left scale, shows “break-evens,” or the simple difference between real yields and nominal yields; the blue line, on the right-hand scale, shows real yields.

So, if you combine the two lines at any point, you get nominal yields.



Real yields represent the actual supply and demand for the use of capital. That is, if I lend the government money for ten years, then in order to entice me to forego current consumption the government must promise that, every year, I will accumulate about 0.68% more 'stuff.' I can consume more in the future by not consuming as much now.

To turn that into a nominal yield, I then have to add some premium to represent how much the dollars I will get back in the future, and which I will use to buy that 'stuff', will have declined in value. That, of course, is inflation expectations and, right now, investors who lend to the government are using about 2.1% as their measure of the rate of deterioration of the value of the dollar.[1]

So, can we say from this chart that interest rates are mainly rising for "good" reasons? On the contrary! The increase in inflation expectations has been much steadier; only in the last month have real interest rates risen (and we don't know, by the way, whether they are even rising because of credit demand, rather than credit supply). Moreover, although you cannot see this from the chart, I can tell you based on proprietary [Enduring Intellectual Properties](#) research that, at this level of yields, real yields are usually responsible for almost all of the increase or decrease in nominal yields.[2] So, the fact that real yields are providing a little less than half of the sell-off? That does not support the pleasant notion of a 'good' bond sell-off at all.

As I write this, we are approaching the equity market close. For most of the day, equities have been trading a bit above or a bit below around Monday's closing level. While this beats the heck out of where they were trading overnight, it is a pretty feeble technical response. If you are bullish, you would like to see price *reject* that level as buyers flood in. But, instead, there was pretty solid volume at this lower level. That is more a bearish sign than a bullish sign.

However, given the large move on Friday and Monday it was unlikely that we would close near unchanged – so the last-hour move was either going to be significantly up or significantly down.



Investors chose up, which is good news. But the bad news is that the end-of-day rally never took us above the bounce-high from yesterday's last hour, and was on relatively weak volume...and I also notice that energy prices have not similarly rallied.

[1] In an article last week I explained why we tend to want to use inflation swaps rather than break-evens to measure inflation expectations, but in this case I want to have the two pieces add up to nominal Treasury yields so I am stuck with break-evens. As I noted in that article, the 2.1% understates what actual inflation expectations are for 10 years.

[2] TIPS traders would say "the yield beta between TIPS and nominals is about 1.0."

Biiwii/NFTRH on the Web

[NFTRH](#) and [Biiwii.com](#) commentary and technical analysis have regularly been published, highlighted and/or quoted at [SeekingAlpha](#), [Investing.com](#), [MarketWatch](#), [Yahoo Finance](#), [Ino.com](#), [TalkMarkets](#) and many more since 2004.

Biiwii.com is proud to be included in the **50 Blogs Every Serious Trader Should Read** from [TraderHQ.com](#).

Biiwii: but it is what it is

NFTRH: Notes From The Rabbit Hole