

## **BNN BLOOMBERG MARKET CALL**

**eResearch Corporation** is pleased to provide two excerpts from Monday's BNN Bloomberg Market Call Newsletter.

Set out below are the respective Market Outlook commentaries from two leading investment analysts, plus Links to their respective 45-minute video interviews.

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### **MARKET OUTLOOK**

**Josef Schachter, President of Schachter Energy Research Services Inc.**  
**Focus: Energy and Energy Service Stocks**

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When I was last on Market Call, I had switched from being a bear to a bull and showed off our SER energy bull mascot. At that time, our three checklist items to turn bullish on both oil and natural gas had all occurred. Those three conditions were: we wanted to see (1) WTI below US\$60 a barrel (low was US\$49.41 a barrel on November 28), (2) the S&P/TSX energy index below 160 (it was 144 on December 10), and lastly (3) the S&P Energy Sector Bullish Percentage Index to fall below 10 per cent (it fell to 3.45 per cent on November 27).

We previously mentioned that investors should take advantage of the tax-loss selling season in the first and second week of December to get appropriately invested. The energy bargains are there now!

The cathartic tax-loss liquidation was the final phase of this bear market. A new energy bull market which could last five plus years should start early in the new year. Natural gas will become the best performing commodity and this is clearly being seen by the sharp rise in the NYMEX natural gas, as low inventories and colder winter weather affect demand.

**VIDEO:** Josef Schachter's 45-Minute Video Interview <CTRL-CLICK> [HERE](#)

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## MARKET OUTLOOK

**Richard Croft, President and Chief Investment Officer at  
R N Croft Financial Group**

**Focus: Options and ETFs**

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Investors are constantly trying to decipher the cause and effect of macro events. OPEC meets this week and will probably announce production cuts. Investors must ask whether the cuts will have a meaningful impact on the supply glut that exists in the energy space. Does the modern-day OPEC even matter? How someone rates those issues will be reflected in an investment decision to buy or sell energy or transportation stocks.

This week, we witnessed first-hand the impact macro events can have on the global landscape. A Saturday evening dinner between President Trump and Chinese Premier Xi at the G20 summit set the stage for an easing of trade tensions between the world's two largest economies. Global markets reacted positively on Monday but quickly retreated on Tuesday as Trump's Twitter finger rehashed the "trade deal" as he saw it. Apparently, he was the only visionary to see it!

Certainly Trump's Art of the Deal negotiating strategy was partly to blame for last Tuesday's 800-point sell-off on the Dow Jones Industrial Average. But there may have been more to the sell-off than can be explained by Trump's vitriol.

There has been growing anxiety around points on the U.S. Yield Curve that have inverted. Some analysts think that may be indicating an economic slowdown which could be exasperated by rising interest rates. In my view, the bond market will drive global equity values over the next two quarters and overshadow other macro events related to trade and GDP growth.

What spooked the market is the inversion that occurred at junctures of the U.S. Treasury Yield Curve. Notable at the close of trading on Tuesday, was the inversion between five-year treasury notes (yielding 2.79 per cent) and three-year notes yielding 2.80 per cent.

Minuscule blips may not seem noteworthy, but traders fear that the three and five inversion may be a precursor of further disruptions along the curve. The worst-case scenario would be an inversion across the entire yield curve (long-term bonds yielding less than short term notes and treasury bills) which is seen as an early indicator of recession.

Mind you, it was not just the three and five inversion that caught the attention of analysts. There was a dramatic, at least for the bond market, slippage in the differential rate between 10-year Treasury bonds, yielding 2.91 per cent, and two-year treasury notes at 2.80 per cent. The differential slipped 6 basis points (.06 per cent) in one day which, for bond traders, is akin to a 500-point decline in the Dow Jones Industrial Average.

If the yield differential between two-and ten-year Treasuries should flip (become inverted), that would signal a recession. It could happen! The differential between two-and ten-year Treasury is now 11 basis points (0.11 per cent) which has not been seen since 2007 just before they flipped. We all know what followed!

So, what are we to make of these events? Are they a dire warning of an impending slow-down in growth, perhaps even a recession? Or are these simply dislocations caused by some unusual behavior? One could make a case for either scenario but what is important is how the U.S. Federal Reserve (FED) reads the tea leaves.

## Understanding the Yield Curve

Before getting to the cause and effect of yield curve inversions, we need to understand the minutiae of the yield curve. Effectively, the yield curve is a line that plots interest rates at a point in time for bonds having equal credit quality but differing maturity dates.

A normal yield curve slopes upward from left to right reflecting higher yields as the term-to-maturity rises. That is considered normal, because the longer the time the bond has to mature, the more potential disruption there is in the value of the bond. Traders measure the risk associated with time using a concept known as “duration”.

Duration measures how many years it will take for you to be repaid the total cost of the bond through the cash flow from the bond. Duration leads to another measure of bonds, referred to as “modified duration”, which calculates the present value of the bond’s cash flow in years.

A flat yield curve is the closest observation to the current environment and typically occurs when the economy is transitioning from expansion to slower development and even recession.

Long-term yields tend to contract as portfolio managers shift allocations away from more volatile equities into fixed-income assets. That causes bond prices to rise (and longer-term rates to fall) as equity values decline. The potential end game is the inverted yield curve where longer-term maturities trade at lower yields than shorter maturities in anticipation of a major economic slowdown, and even a recession.

## Headwinds or Tailwinds

Returning to the main question of what is the yield curve telling us?

Fact is, we are in a unique situation where the FED is raising rates while reducing their bloated balance sheet from three rounds of quantitative easing after the financial crisis. In other words, the FED is selling massive amounts of bonds in the two-to seven-year maturity spectrum, which may be the cause of lower values for those maturities. Lower bond prices result in higher yields which may be distorting the curve within that spectrum.

If this is the cause of dislocations along the yield curve, then it may not be predicting a recession, but simply the market's reaction to unusual activity. Even if it is not the case, one can take solace that the yield curve's notoriety as a leading recession indicator is not grounded in fact. As many analysts contend; the yield curve has correctly predicted 12 of the last five recessions.

**VIDEO:** Richard Croft's 45-Minute Video Interview <CTRL-CLICK> [HERE](#)

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