MV CAPITAL MANAGEMENT

Weekly Market Flash

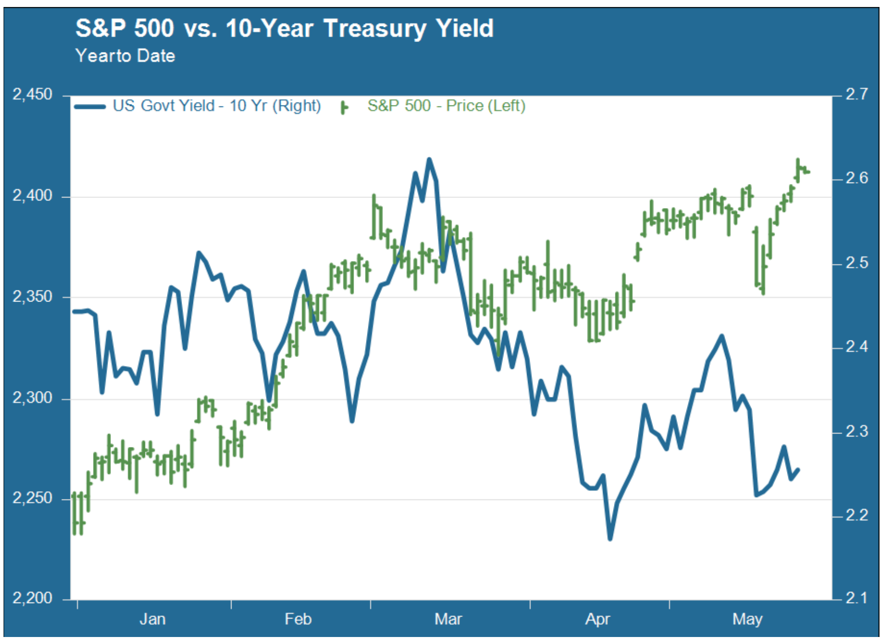
Stocks Are From Mars, Bonds Are From Venus

May 26, 2017

Another week, another record for stocks. Sadly for those of us inclined to jump at "buy the dip" opportunities, the window now appears to bangs shut almost before we even know it's open. It took a mere five trading days to fully atone for last Wednesday's mini-squall, with two new all-time highs following in quick succession. C'mon stockpickers, haven't you ever heard the phrase "sell in May?" Throw us bargain hunters a bone or two!

Bond Bears, Beleaguered

Whatever is in the water in equity-world still has not made it over to the more subdued climes of fixed income. While the S&P 500 is just shy of eight percent in price appreciation this year, the yield on 10 year Treasury securities ambles along in the neighborhood of 2.25 percent, well below where it started the year and further still below the 52 week high of 2.6 percent. The chart below illustrates the alternative mentalities driving stock and bond trends this year.



Source: MVF Research, FactSet

The dourness is showing up in other credit markets as well. Average rates for 30 year mortgages finished this week at their lowest level for the year. Long-dated Eurodollar futures contracts, which reflect what traders think Libor levels will be up to 10 years in the future, indicate that we should expect a world of low inflation and low real interest rates well into our senescent years. The "10-2 spread" – the difference between intermediate and short term yields that we discussed in some detail a couple weeks back – is narrower than at any time since last November's election. Reflation trade, we hardly knew ye!

Macro Monotony

On one level, the bond market's lackadaisical drift is not all that surprising. It dovetails with the relentless monotony of an overall macroeconomic narrative that – at least according to the usual "hard" data points of labor, prices and output – has barely changed over the past twelve months. Low growth and restrained inflation are entirely consistent with sub-3 percent 10 year yields (unsurprisingly, the forecasting mandarins at banks such as JP

Morgan and Goldman Sachs have lowered their 2017 expectations accordingly). The shiny veneer of the reflation trade has been wiped clean to reveal the same old undercoat of modest growth, with no evidence of a productivity-driven catalyst to bring the growth trend closer to the norms of decades past. Yes, the world's major economies are aligned to a remarkable extent in their growth trajectories – GDP growth rates are trending in near-lockstep in the US, Europe and Japan. That alignment alone, though, does not suggest some emergent property to drive the trend higher.

Minutes Waltz

And then there was the other dog that didn't bark this week to send yields soaring. The minutes from the FOMC's last meeting earlier this month made their way into public hands on Wednesday, offering a peek into the Fed's thinking about starting to wind down its $4.5 trillion balance sheet in the coming months (the vast majority of which is in the form of Treasuries and mortgage backed securities). This winding down, many have noted, will involve some fancy footwork on the Fed's part to avoid the kind of tantrums that sent bond markets into a tizzy back in 2013.

As it happened, though, the minutes gave little indication of anything other than that the Fed feels comfortable getting the process underway sometime in 2017. There's also a question about how much "winding down" will actually happen. A recent study by the New York Fed suggests that a "normalized" balance sheet of $2.8 trillion should be achieved by 2021. Now, in 2010, before the second and third quantitative easing programs kicked in, the Fed had about $2.1 trillion on its balance sheet. So "winding down" would not mean going back to anything close to earlier "normal" balance sheet levels. Higher for longer. Tantrum fears may once again be somewhat overblown.

Red Bull and Tech Stocks

So what's still driving equities? "No reason to sell" is about as good an answer as any, and that sentiment was clear in the market's quick snap-back from last week. Tech stocks continue to lead the way while the former reflation trade darlings – financials, industrials and materials – lag. We appear to have reached the point where politics and global events are utterly irrelevant to market movements (the VIX's retreat from last Wednesday's spike was even brisker than the stock market recovery). Q2 earnings are expected to be decent, no recessions as far as the eye can see…what's not to love? As Jo Dee Messina would say – "it's a beautiful day, not a cloud in sight so I guess I'm doin' alright." For now, at least.

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