HALF WRONG IS BETTER THAN ALL WRONG
DON'S BLOG 2017.12.18

This will be my last blog of the year. As Davey Crockett once said, “the hell with you, I’m going to Texas.” The first part is an attempt at humor, but going to Texas is for real. I can again count the year 2017 as being wrong on the stock market, but right on bonds. It appears I have a good chance of achieving double digit returns on bonds, being long the 20-year plus government bond all year. As for stocks, no gain or loss, and was at least smart enough to not go short. One of the really interesting things about the government bond market is who the major buyers have been over the last three years or so. It certainly has not been Wall Street. With the exception of many insurance companies, U.S.-based bond managers have been universally bearish, particularly on the long end (10 years plus). So, who has it been? Foreigners have purchased in excess of $1 trillion. Why? Maybe the reason is the U.S. 10-year rates have been somewhere around 2% higher than their counterpart in Europe. Note the following average 10-year yields: Germany 0.29%, France 0.62%, Switzerland 0.24%, Finland 0.45%, and on and on.

Many say misery likes company. With that in mind, please note the following comments from Stanley Druckenmiller’s thoughts on the market:

> CNBC (Tae Kim): “Stanley Druckenmiller believes the overly easy monetary policies by global central banks will have disastrous consequences. ‘The way you create deflation is you create an asset bubble. If I was 'Darth Vader' of the financial world and decided I'm going to do this nasty thing and create deflation, I would do exactly what the central banks are doing now,’ he told CNBC's Kelly Evans… ‘Misallocate resources [with low interest rates], create an asset bubble and then deal with the consequences down the road,’ he said. The investor noted how this boom-and-bust cycle has happened time and time again. ‘Deflation just doesn't appear out of nowhere and it doesn't happen because you are near the zero bound. Every serious deflation I've looked at is preceded by an asset bubble and then it bursts,’ he said. ‘Think about the '20s, a big asset bubble that burst, you have the Depression. Think about Japan. Asset bubble in the '80s. It burst. You have the consequences follow. Think about 2008, 2009.’” - Adapted from Credit Bubble Bulletin

This sums up nicely my opinion concerning the asset bubbles created by the Federal Reserve. When will all of this end? I wish I knew. Markets have long ago left reason behind. Greed and hubris abound. Human nature never changes.

Since the first of the year I have been calling for an inverted yield curve, which historically has pre-dated a recession. In reality, the curve has been flattening since 2014, however has accelerated in 2017. As you will recall, an inverted yield curve—long rates lower than short rates—has preceded almost all recessions since WWII. That doesn't necessarily mean it will this time, however it does remain a good bet. Please note chart #1 below.

A final comment concerning Bitcoin. To quote a phrase concerning the Lone Ranger of my youth. Nowhere in the pages of history can one find a greater champion of justice (a greater sign of rank speculation), from out of the past comes the thundering hoofbeats of the great horse silver (of the world's greatest asset bubble), the Lone Ranger rides again. See chart #2 below. Enough said. See you next year.

Chart #1

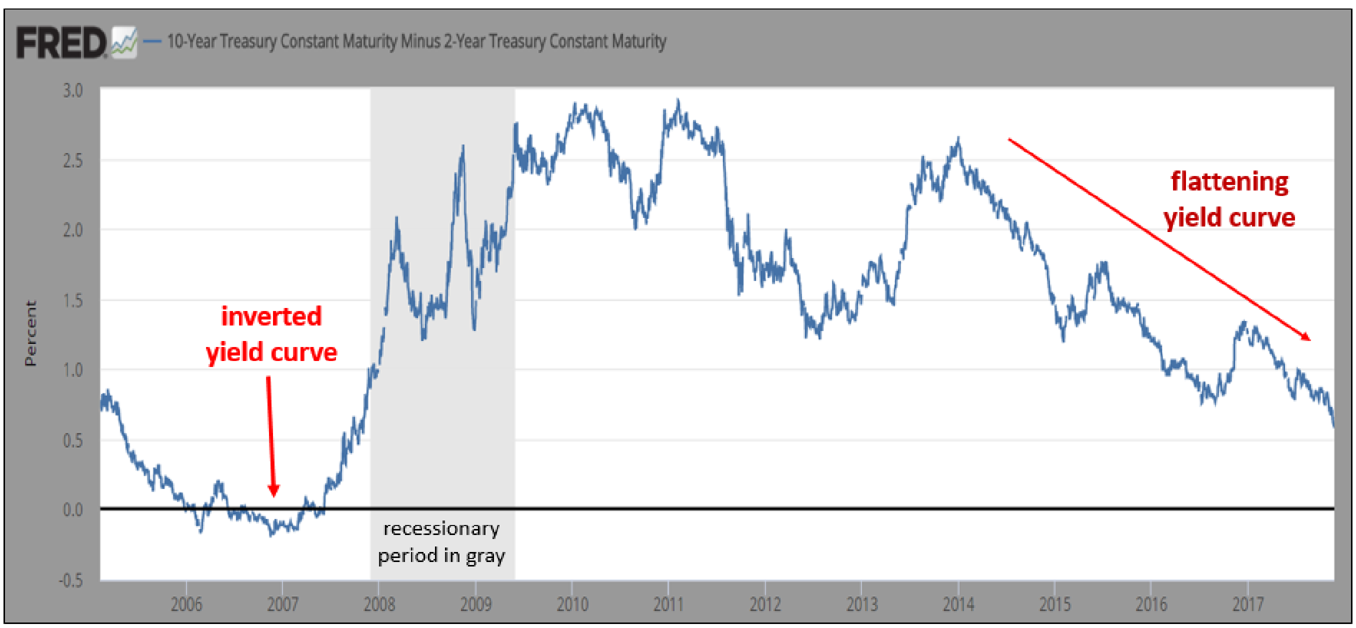
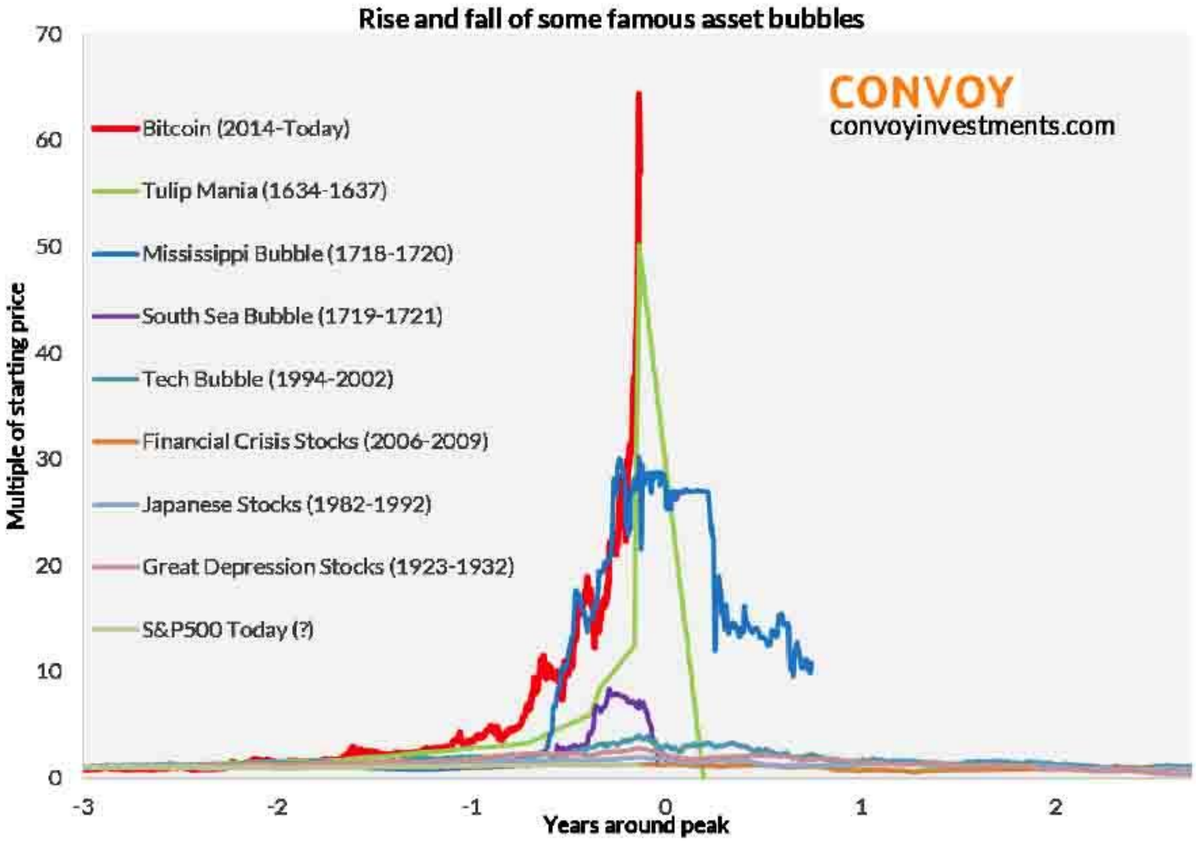


Chart #2



Source: Elliot Wave International, Yale SOM, St. Louis FRED, GlobalFin, and Convoy analysis