# Tipping Point?
## Don's Blog 2018.02.12

Things have changed. It's my opinion that a "Bear Stearns" event has taken place. If you might recall, it was in July 2007 that Bear Stearns, a real icon of Wall Street, had several structured credit funds blow up. This was the beginning of the end of the housing bubble that led to the Great Financial Crisis of 2008-2009. I also don't believe the change will lead to a serious financial crisis right away. Timing is the one thing most difficult to predict with any degree of confidence. What was this event? It was the closing of one of the exchange traded funds which had become so popular over the last decade. At one time, the fund had $2 billion in assets. When it shut down last week, the value of its assets was $15 million.

What was their asset? An exchange traded stock called the Velocity Shares Daily Inverse VIX Short-term Exchange Traded Note. Boy, is that a mouthful. Wall Street dreams up many unbelievable instruments whereby one can bet on almost anything happening or not. In my mind, most of them are pump and dump vehicles that in the long-run serve only those who dream them up. Financial innovation is mostly not your friend. Anyway, it was a bet on low and lower volatility which surely has been a winner since 2010. As a matter of fact, those who played the game attained a 46% annual rate of return. Of course, had they stayed the course (bought and held), the return would be next to nothing depending on when they were suckered in. My guess is there will be many of these types of blow-ups to come. Do you remember the Carpenters old song, "We've Only Just Begun?" Will the regulators ever come to realize that—well, I'm not going to finish that thought. Regulation never keeps human nature in check. Prices are determined at the margin and there are always those that will bet on anything.

Again, I do believe this is the beginning of the end of this long nine-year counter bull cycle within a bear market. Let's speculate on what may develop. First of all, the 40 basis point rise in long-term government bond yields will have a major effect on the business cycle. All other yields are based upon government yields. How long can an economy move upward when there is little growth in income and there are all-time highs in debt? Consumers don't look at rates, they look at monthly payments. Well, the monthly payments are going up, and higher rates make it happen. So, first of all, consumer quits spending. Second, business profit margins will decline due to the lack of sales. Third, businesses will cut back on employment and a recession seems sure to follow. It doesn't have to happen in this order, but the fact is, higher interest rates are a major hit with debt levels at all-time highs. It's safe to say: Houston, we have a problem.

Markets will probably act in the following manner. The stock market will move lower once it is understood that inflation is not the problem; but rather debt, interest rates, and lack of income. Less than prime bonds will continue to decline in price, however I would expect to see a sharp decline (increase in price) in long-term government bond yields. This will result in an inverted yield curve, which is almost certain to signal the above-mentioned recession.

I would think the chances of all this happening is very high. Things have changed. The worm has turned. Psychology (mood) starts the change, and fundamentals make it happen.

## A Final Thought

Please note the following charts which reveal how the day traders have positioned their portfolios. As mentioned many times before, the speculators most hated asset is long government bonds. I have successfully traded them for over forty years and have done so again. We will see if it works this time.

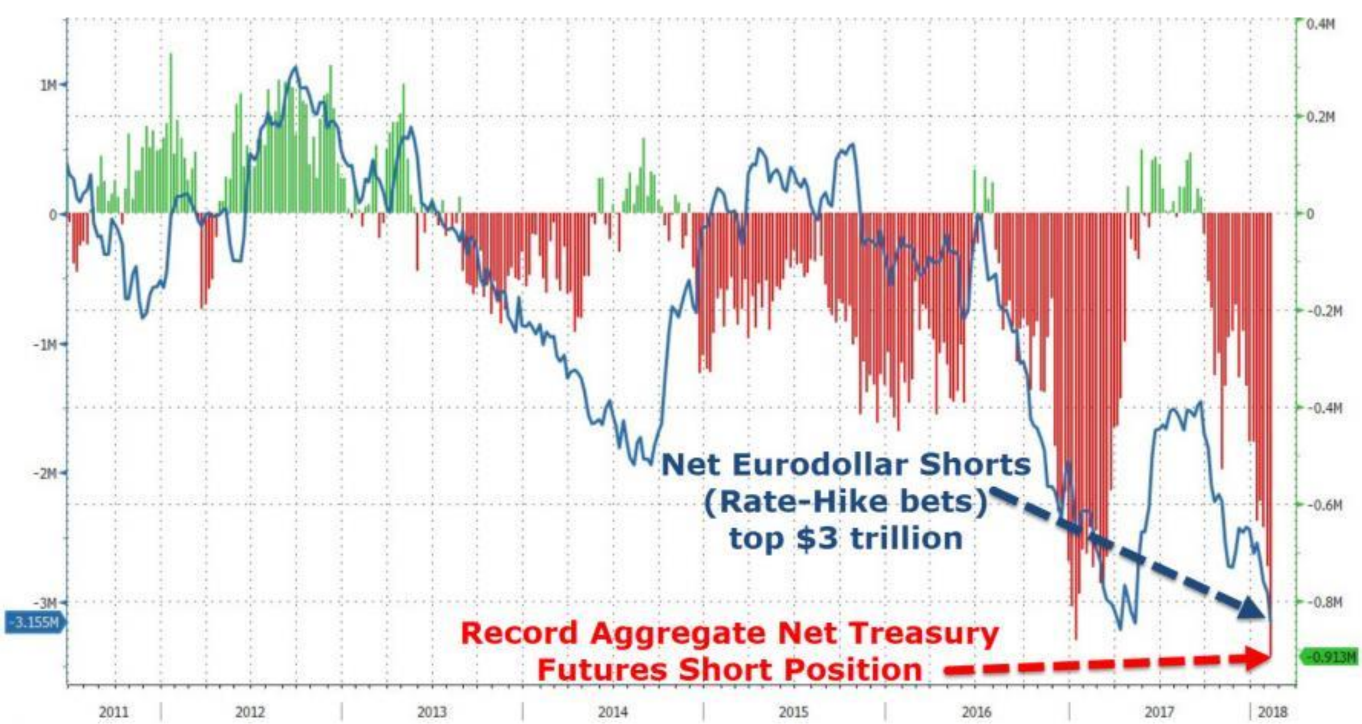
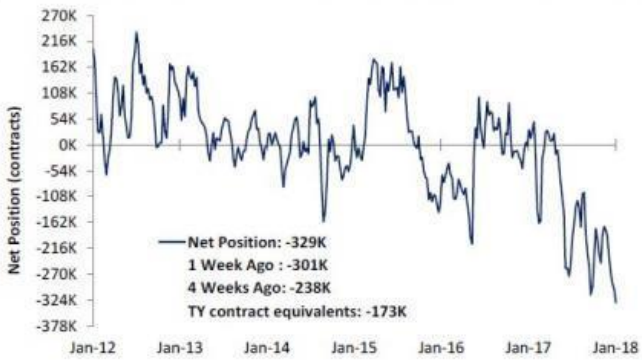
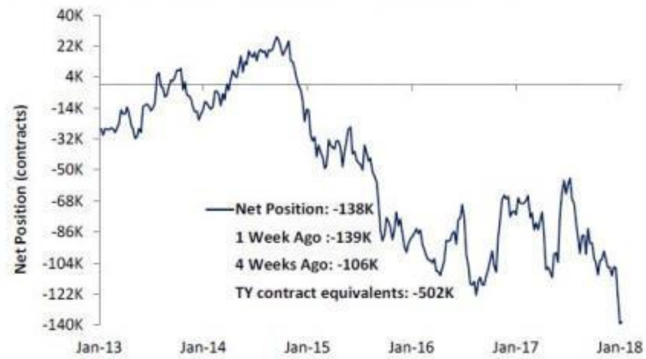


Figure 17: 2Y futures spec net positions




Source: CFTC and Deutsche Bank

Figure 7: Ultra-Long futures spec net position




Source: CFTC and Deutsche Bank