GRANT'S
INTEREST RATE OBSERVER®

Vol. 34, No. 14a Two Wall Street, New York, New York 10005 • www.grantspub.com JULY 1, 2016

Remember the Shell Union Oil 2½s of 1971

Long-trending cycles are the standard in bonds. The once-in-5,000-year interest-rate event is non-cyclical and nonstandard. Today's negative bond yields are that non-cyclical singularity. They are the first of their kind since 3,000 B.C., at least, according to *A History of Interest Rates* by Sidney Homer and Richard Sylla. We mentioned that fact here two weeks ago but thought we'd bring it up again. In one short lifetime, you can expect to see only so many multi-millennium occurrences.

Indeed, in one middling-length Wall Street career, you may not see interest-rate markets change their fundamental direction. Bonds entered what would prove to be a 35-year bear market in 1946. They began what has proven to be an almost 35-year bull market in 1981. The wise ones who bought bonds at yields of 13%, 14% and 15% in the first Reagan administration have probably long since stopped working.

"Black Hole for Bond Yields" read the headline over *The Wall Street Journal*'s story on Monday morning about the relentless collapse of interest rates (this was juxtaposed to bulletins about new highs in the stock market—go figure). It put us in mind of the power of conditioned experience in investing, of looking backward for well-remembered signs rather than squinting into a fathomless future. Squint we must, even when we can't see a thing.

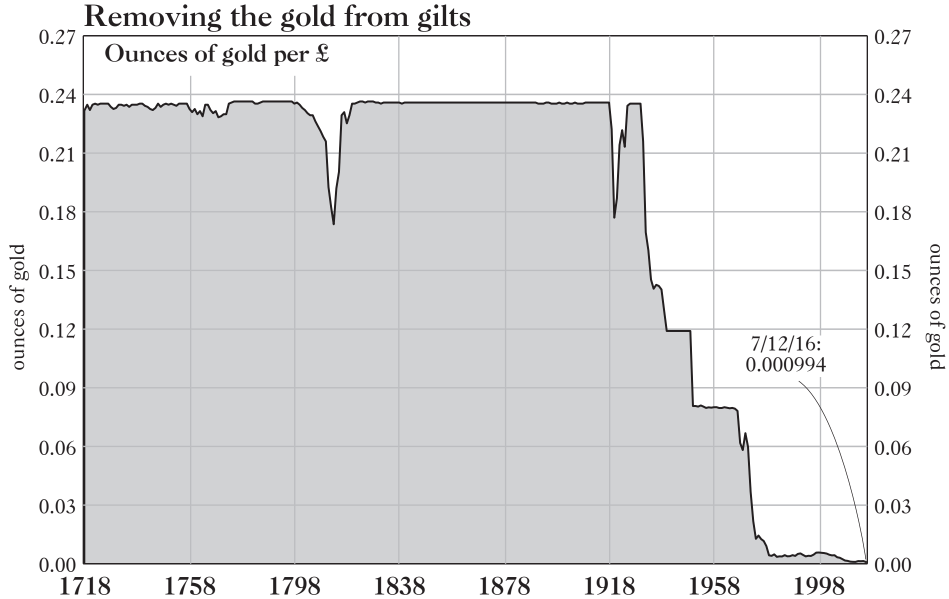
If practice makes perfect, *Grant's* is unrivaled in calling the top in bond prices. We have done so repeatedly and over the course of many years, even if not lately; since 2014, our line has rather been "one last gasp" for the bulls. We now say that the last gasp has been gulped. With all the fluency that comes with study and repetition, we say that sovereign debt is the biggest bubble since the Bronze Age, or maybe since ancient Sumer. The notion that negative-yielding bonds, denominated in a fiat currency, are a "safe" asset is a misconception that belongs in the next edition of *Extraordinary Popular Delusions and the Madness of Crowds*. We are bearish on bonds, especially the ones that, like new cars on a dealer's lot, positively guarantee the owner a loss as soon as he takes possession of his property.

You rub your eyes: How can sane and sobersided fiduciaries toss their clients' savings into the bonfire of sub-zero yields to maturity? There is an answer: A fiduciary must take the world as it is. Then, too, our world is familiar to us. Tumbling yields and manipulative central banks are what we know.

We form opinions from what we have seen with our own eyes. The grandfathers of today's fixed-income investors were looking the wrong way at the bottom of the prior bond bull market, which had begun in 1920. Interest rates fell during the Roaring Twenties and throughout the groaning '30s (with only bill yields, not bond yields, occasionally punching through zero). They stopped falling in April 1946.

The largest industrial bond issue, quoted at the lowest yield, marked the bear-market inflection point: $125

Removing the gold from gilts



sources: The Bloomberg, MeasuringWorth.com million of 25-year, 2½% debentures by the Shell Union Oil Corp. The securities were priced at 101½, to yield 2.42%, and they flew out the window after the State of New York blessed them as safe.

Shell Union was a substantial and creditworthy borrower. In 1945, it showed net income of $28.7 million, cash and government securities of $118 million and a current ratio of 3:1. From such balance-sheet details as the press revealed, there appears to have been little net debt. Still, the New York State banking regulators, which sorted bonds on the binary basis of their eligibility for investment by savings banks, haggled over the covenant language. "The addition of the debentures to New York State's 'legal' list," *The Wall Street Journal* reported, "came last week following conferences between the State Banking Board, the underwriters and the issuer at which it was decided to write into the indenture provisions restricting the borrowing power of Shell's subsidiary companies."

In the spring of 1946, any clairvoyant could have seen that credit risk was yesterday's worry, particularly with so solid a citizen as Shell. President Truman had already signed the Employment Act of 1946, which opened the door to deficit finance. Obviously, interest-rate risk was the coming thing. Only later, and at much higher yields, did this great truth penetrate the mind of the market.

Certainly, everyone had come to understand it by the spring of 1984, when long-dated Treasurys fetched 13% and 14% in the context of a sub-5% inflation rate. At the 1946 lows in yield, the CPI was showing year-over-year gains of 3.4%, which handed the Shell Union bond buyers a starting real yield on the order of negative 1%. In May and June 1984, with the CPI running at 4.2%, buyers of 13¼% long Treasurys began their investment journey with real yields in excess of 9%. The bears—well-credentialed and numerous—made their arguments on the basis of such conventional criteria as Fed policy (too loose) and the Reagan deficits (gargantuan). Perhaps they were also contending from the vantage point of their long experience with runaway inflation and falling bond prices. Certain it was that the bulls of 1946 had not forgotten the Great Depression.

Arbor Quantitative Analytics reports that the 30-year Treasury bond delivered a 10% return in the 10 days ended last week, among the best such sprints on record (it was in the 99.5th percentile). Tuesday's *Financial Times* reported a drop in 10-year gilt yields to 0.71%, far below any yield recorded even when the pound was convertible into gold at a fixed price. "Across the world," the paper said, "government bond yields continue to collapse as economists forecast low global growth and greater stimulus from central banks in spite of years of monetary easing. Dutch benchmark 10-year rates are now negative, joining those of Japan, Germany and Switzerland." According to Bank of America Merrill Lynch, $13 trillion of bonds are priced with negative nominal yields, up from just about none two years ago.

Last Friday, a page-one story in *The Wall Street Journal* described the heated competition for bonds between central banks and private investors and the panicky feelings among the latter that the former would shut them out of the market. Thus, "a money manager in New York is worried that when he needs U.S. Treasury bonds one day, *he might not be able to get them*." And another: "You may be shut out of the bond market just *when you need it the most* [emphasis added]."

Mike Nolan, managing director of J.P. Morgan Securities, called these concerning remarks to our attention. "What kind of anti-anxiety psychotic drugs are we talking about here," he wondered. "Some fixed-income form of Xanax? Are fixed-income managers coming off a bond drunk high? Where does this all end?"

If we've said it once, we've said it a hundred times. It ends—it is ending—in a bond bear market.

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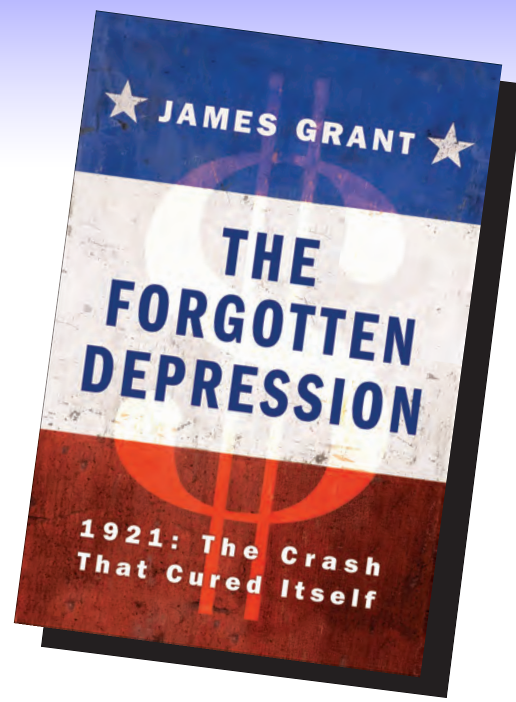

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