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# Answering Your Questions



## WHY BONDS ALWAYS RALLY?

I received a very insightful question from a professional trader. I thought this was ripe for the answering in a general forum.

> Marty,
>
> First of all I want to thank you for all the work you've done over the years. I only heard of you and started reading your papers about 4 years ago, and to say that you have been a tremendous inspiration for me would be an understatement. Thanks for all that you've given to your readers!
>
> Let me start by saying that I am a trader of currencies and commodity futures (with the occasional bond/stock index trade here and there) so I watch markets first, and then I develop my theories on what makes the world tick. I let my charts speak for themselves and I never judge the price action, I just go along with it, as any trader worth his/her salt should do.
>
> That said, I admit to being a little stunned by the price action in US Sovereign Debt. To me, it makes absolutely no sense. I watch the US 10 year closely and I've had some very profitable trades on the long side of bonds, but I'm still hugely skeptical when I see the things go up in price.
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> It seems a paradox that whenever we have a problem related to the complete and utter unsustainability of the US fiscal situation, bonds rally. Earthquake in Japan? Bonds rally, the EU banking sector on the brink of collapse? Bonds rally, the US slows down mainly as a result of the political uncertainty and complete chaos in the US political scene? Bonds rally. And now, to top it all out, the whole shenanigans of the debt ceiling debate REVEALS the lack of political will in Washington to tackle these issues, all but ensuring default/massive devaluation on the horizon, and bonds rally! Let's face it, this whole debt ceiling episode revealed but one thing: Politicians are in no condition to address this issue. This screams of default down the road.
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> But it seems the markets have become absolutely complacent on this point. For so many years the world regarded US sovereign debt as the default safe haven investment that most observers and investors just cannot fathom the fact that we are where we are mainly as of the Western world's massive increase in Gov't spending and debt.
>
> Yet we are all used to saying that the markets are never wrong, but on this point, any objective observer can see see the fallacy in the situation. How is it that the markets haven't begun their

exodus from US sovereign debt yet? How is it that the world sees it as safer than say owning gold, or buying Asian debt, or heck the debt of ANY nation that's a net CREDITOR not a DEBTOR?

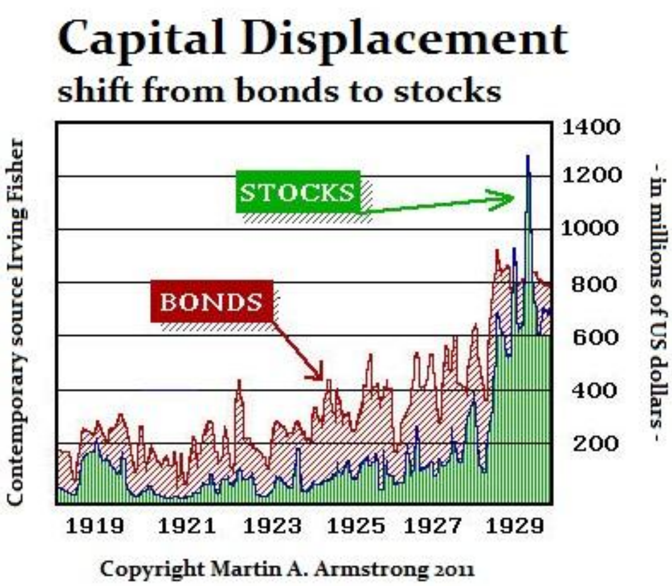
Martin, you've been around for a while, what am I missing here? What's missing in this equation? How come the US interests rates are SO low?

Thanks in advance for your response!

JMV

When you are trading billions and advising on trillions, you are faced with a totally different set of rulebooks. You really have to parse out the economy in detail to understand its function and role. It is easy to make bold statements like return to the gold standard as some sort of solution if you overlook the problems of existing debt structures. It is easy to say balance the budget if you do not comprehend the inherent natural growth in spending. It was easy for Volcker to raise rates to 17% in 1981 if you did not stop and think that you were also increasing the cost of borrowing for government and that would cause the deficit to explode starting 10 years later.

In this case, there is still much prejudice that exists concerning the private sector markets. We have yet to escape the guilt trip that it was the greed of corporations that caused the Great Depression and not the sovereign defaults they conveniently left out of school history books. Because of this prejudice that will vanish during the last phase of this current **Private Wave** of 51.6 years peaks in 2032.95, what may appear to be down can still be up.




Here is a chart showing the shift from bonds to stocks that we will see in the future. It comes toward the tail-end of the cycle, so we are premature just yet. As it currently stands, the amount of money in ***bonds vs. stocks*** is at least 10:1 far greater than it was in the 1920s. This means the eventual bubble we will see should be catastrophic and when I say the Dow could easily hit **50,000**, I am not kidding! The vast pool of cash out there has to park some place. This means the bonds are the only spot to hide for now. You can't cash out and put it in a bank. You can't buy all the debt of everyone else. Only the US$ is the reserve currency and that means the central banks around the world need it. As I said, **two-thirds** of world reserves by central banks are held in US treasuries. So yes, the game will change. This debt crisis put a lot of people on notice US politicians are clueless. They kicked the can down the road but after the next election, look for this debt crisis to start to come apart at the seams. Then capital will start to shift as we get closer to 2016. That will be the biggest reservoir of capital to propel the stock market and gold to the outer stratosphere when it begins to pour out of the bond markets into assets.