Where Are We? A Market Assessment
Presentation to Columbia Business School’s Program for Financial Studies
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Today – How Historic
Global Yields are at Historically Low Levels

Absolute yields have only been this low after crises and wars

Source: Global Financial Data
What is extraordinary about the movement in bond yields is the length of time for which they have been falling and, as a result, the huge returns that they have generated.
Today – How Historic
Bond Returns Have Outpaced Equities

Ratio of Equity Return to Bond Returns

Only twice in recent memory have bonds outperformed equities on total return!

Source: Credit Suisse

Bond outperformance of last 15 years is rivaled only by Great Depression
Today – How Historic
The Role of Growth

Recovery around the corner?

U.S. Real GDP vs. long-term trend

3.1% growth trend
Actual

13% gap

Source: Bureau of Economic Analysis, Calculated Risk

Job market finally recovered?

Source: Bureau of Economic Analysis, Calculated Risk
Today – How Historic
In Most Cycles, Equities and Rates are Positively Correlated

This relationship persisted through mid-2010...but then ended. Why?
Today – How Historic
The Role of the Fed…

Source: Bloomberg
Rate expectations have plummeted, which has given investors confidence to reach for long duration yield and equities
Market Reaction

The Expectation of Low Long-Term Rates Has Created Demand for New Asset Classes that only Work in an Environment of Low Rates

Source: Citibank

Lower rates leading to new products
Market Reaction
Frac Sand MLPs - HiCrush

Frac sand pricing is highly correlated with oil prices and end-market demand—bond-like?
Market Reaction
High Income ETFs - PGP

PGP—dividend maintained through additional leverage and NAV premium goes up?
Market Reaction
European High Yield Tighter than US Since Draghi “Put”

Since 2009, US GDP growth has outperformed Europe by 14%

Source: Bank of America, Bloomberg
Future
Markets Could be Right; Equities and Bonds are Tracking Global Growth and Inflation

Growth in the face of low inflation means low rates can coincide with significant valuations

Source: Bloomberg
Future
But Also Worth Noting that Markets are Rarely Right about Future Rates…

What happens to MLPs if rates rise?

Source: Bloomberg
Future
And When Markets Reset Expectations, It Happens Fast

In 1994, Greenspan raised rates much faster than anticipated by the market

Source: Bloomberg
Future

We Have Already Seen Violent Market Selloffs in this Cycle

Moves happen quickly, and HY underperforms

Source: Bloomberg
If Rates Did Change Quickly, Changes to Bond Market Could Exacerbate Price Moves

This time *is* different in one respect; low liquidity means the exit could be bumpy.
Future
The Price of Liquidity

Puerto Rico General Obligation Prices

Cross-over buyers emerge

Source: Bloomberg

This isn’t theoretical; Puerto Rico provides an interesting example
Future
And Once Rates Move, HY Credit Won’t Look as Good

How do you refinance if rates rise and you’re already at 4x interest coverage?

Source: Deutsche Bank
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