BOND YIELD PERSPECTIVES: EASING COMES, EASING GOES
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In "On Wall Street", Finley Peter Dunne's famed character Mr. Dooley declares: "They'se no intoxicant in th' wurruld, Hinnissy, like money. It goes to th' head quicker thin th' whiskey th' dhruggist makes in his back room." (The spelling is Dunne's.)

CONCLUSION

The dreadful economic crisis which emerged throughout the interconnected global economy after the departure of the Goldilocks Era in mid-2007 saw its darkest times in late 2008/early 2009. Politicians and central bankers around the globe took decisive action to escape and repair the disaster and to spark and sustain recovery. From late 2008/early 2009 through the ensuing years, dramatic United States Federal Reserve policy action, and especially massive quantitative easing (money printing), often has been associated with rising interest rates in the ten year US Treasury note. The ending of quantitative easing has connected with declines in the 10 year UST yield.

In the American theater, the past several years indicate that rising UST 10 year yields tie in with the reality of (or hopes for) at least a moderate economic recovery. Slumping UST rates are bound to the existence of (or fears about) more feeble US (and international) growth (or even worries that a downturn may occur). History of course need not repeat itself, and viewpoints change. Nevertheless, and despite America's strong 2Q14 GDP expansion, the decline in UST 10 year yields over the course of the Fed's current slow tapering program suggests that US and worldwide economic growth probably is and will remain mediocre.

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The European Central Bank probably will embark on a modest money printing adventure in the relatively near future. However, all else equal, that decision likely will boost- but not substantially- the key German sovereign 10 year note yield (and 10 year government note yields in America and many other key nations).

EASING COMES, EASING GOES: SOME RECENT HISTORY

The fearsome worldwide financial crisis accelerated in second half 2008. This sparked frantic quests by American politicians and the Federal Reserve, as well as by their key overseas allies, to rescue not only national economies, but also thereby the global one. Deficit spending spiked. Central banks slashed interest rates and ventured on extraordinary monetary accommodation voyages. The Fed and other central bankers have persisted for many years in their easy money policies.

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Of course in America and elsewhere, numerous variables influence interest rate levels and trends. Marketplace wizards debate the relative importance of and interrelationships between these factors. And interest rate playgrounds are not divorced from stock, currency, and commodity arenas.

Anyway, what has happened to key government interest rates, particularly in the United States, when leading central banks have embarked on these radical easing schemes? Focus on the

benchmark US Treasury10 year note, especially as the Fed's yield repression has pinned the short end of the yield curve near the ground floor.

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**In November 2008 and March 2009, the Fed announced its quantitative easing (QE1; money printing) program. The Federal Funds rate (monthly average) has been under .25 percent from December 2008 to the present. The UST yield almost doubled, leaping from 2.04pc on 12/18/08 (and 2.47pc on 3/18/09) to achieve two tops at 4.00pc (6/11/09)/4.01pc (4/15/10). QE1 ended in March 2010.

**The Federal Reserve unveiled its second round of money printing at end August/November 2010. The UST rose from 2.33pc on 10/8/10 to its 2/9/11 peak at 3.77pc, making a second high on 4/8/11 at 3.61pc. QE2 ceased in June 2011; the UST plummeted from 3.22pc on 7/1/11 to 1.67pc on 9/23/11.

**On 9/21/11, the Fed revealed Operation Twist. Though this creation was not nearly as stunning as the money printing schemes, UST yields edged up to 2.42pc on 10/28/11, achieving a second high at 2.40pc on 3/20/12.

**Yet the UST 10 year yield then resumed its descent.

In terms of assisting and the actual timing of the subsequent UST rate climb, European Central Bank and Japanese actions are especially relevant.

The ECB President gave his "whatever it takes" speech to preserve the Eurozone on 7/26/12. The ECB issued its outright monetary transactions policy (OMT) on 8/2/12. (The Bank of England once again rushed to ease around then; in July 2014, it offering another L50 billion in quantitative easing.) The German 10 year government note made a crucial bottom 7/23/12 at 1.13pc. The UST note established a major low at 1.38 percent on 7/25/12.

The UST edged up to 1.89pc on 9/14/12. However, its yield ebbed to 1.55pc (11/16/12)/1.56pc (12/6/12).

The Federal Reserve declared renewed money printing (QE3) on 9/13/12. To further bolster its highly accommodative scheme, on 12/12/12 it offered additional policy guidance (basically a revised QE3 or new QE4 deal). The UST 10 year yield blossomed to 2.08pc on 3/8/13.

Though UST yields shrunk to 1.61pc on 5/1/13 (German Bund low 1.15pc 5/2/13), Japanese policies helped push UST yields upward. Japan's "Abenomics" commenced after its December 2012 elections. This involved more monetary easing and fiscal stimulus. Moreover, on 4/4/13, not long before the UST's May 2013 low, the Bank of Japan expanded the scope of its monetary easing via its "Quantitative and Qualitative Monetary Easing" plan. The Japanese 10 year government bond (JGB) low was .33pc on 4/5/13.

The UST 10 year yield expanded to 3.01 pc on 9/6/13, establishing a second slightly higher top on 1/2/14 at 3.05pc, more than twice the July 2012's 1.38pc bottom.

The Fed announced its actual first round of "tapering" (closing down of its current money printing program) 12/18/13, not long before January 2014's UST top. It followed that initial tapering with a second cut on 1/29/14. Subsequent reductions in purchases of longer term UST and agency mortgage-backed securities followed. The 10 year yield dropped to under 2.40pc

recently. The Fed likely will close down its money printing (finish tapering) in October 2014. It meets 9/16-17/14 and 10/28-29/14.

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Thus, in the United States, major Federal Reserve policy action, and especially quantitative easing (money printing), often has linked up with rising interest rates in the ten year US Treasury note. This US pattern at times has interrelated with (been assisted by) highly accommodative policies elsewhere. The ending of a Fed quantitative easing round has connected with retreats in the 10 year UST yield.

EUROPEAN CENTRAL BANK: WILL IT JOIN THE MONEY PRINTING PARTY?

The European Central Bank's deposit facility rate has stayed very low since first half 2009. The ECB in principle probably would prefer to depreciate the Euro FX currency to boost growth rather than introduce quantitative easing. It also probably would like to see the consequences of its recent easing actions (negative interest rate of .10 percent on the deposit facility and targeted longer-term refinancing operations; 6/5/14).

However, many economic (and political) players have increased pressure on the ECB to engage in some version of money printing, most howling for quick rather than delayed action. Deflation (or at least too low inflation) horrors beckon. For several months, inflation has stood far below the ECB's target of roughly two percent (August 2014 annual rate only .3pc). Yields for the 10 year German government notes have tumbled beneath the 1.13pc 7/23/12 bottom and broken under one pc; Spanish and other Eurozone sovereign debt yields have continued their collapse. Moreover, Eurozone economic growth has been persistently low (flat in 2Q14), unemployment levels have remained obstinately high (11.5pc in July 2014). Concerns regarding social unrest lurk in the background.

Some recent ECB remarks and actions increase the odds that the ECB will embrace quantitative easing. The ECB has "intensified preparatory work related to outright purchases in the asset-backed securities market" (8/7/14). It has retained Blackrock as an advisor for this potential event (Financial Times, 8/28/14, p1). The ECB President stated in late August 2014 ("Unemployment in the euro area", 8/22/14) at the Kansas City Federal Reserve's Jackson Hole conference that longer run inflation expectations have slipped below two percent (see also Financial Times articles- 8/23/14, p1; 8/26/14, p1; and 8/27/14, p18).

Consequently the ECB probably will introduce QE sometime in the next few months, perhaps even in its 9/4/14 assembly. What will be the near term consequences for Eurozone government note yields of such money printing? Take the 10 year German government note as the benchmark. Since 10 year UST and German sovereign yields have trended in roughly the same direction in recent years, and as they have made marketplace turns around the same calendar time, they probably will respond in approximately the same fashion to any ECB money printing introduction.

Interest rates probably will rise. Recall especially the history of United States money printing schemes; yields tended to rise alongside the commencement of massive easing. Keep an eye on the QE experiences of Japan and the United Kingdom (as well as China's gigantic stimulus program of 2008-09). Remember the German Bund and UST yield ascents after the ECB's inspiring "whatever it takes" speech and the revelation of the OMT framework.

However, any increase in 10 year government interest rates probably will be modest. This ECB money printing plan probably will not be massive. It probably will deal only with asset-backed securities. Thus its scope does not seem terribly ambitious. And how large is the marketplace of European ABS currently suitable for purchase? The ECB, unlike the Fed, Bank of England, and Bank of Japan, is not acquiring sovereign debt. The ECB does not want to be seen as (face legal issues regarding) monetizing deficits. Moreover, recall that ending of Fed QE programs have been associated with declining yields. Given the current Fed tapering situation (UST yields having fallen since 1/2/14's 3.05pc high), that will help to mitigate yield rises ensuing from any ECB money printing plan.

If indeed the US economy is achieving sufficient GDP growth momentum (note the 2Q14 GDP 4.2pc increase and the trend of declining unemployment), then perhaps the upward yield move associated with the ECB's money printing easing will be greater. But in any event, the Fed remains determined to repress policy rates (Federal Funds levels) for the next several months at least, which will reduce any yield increases. The ECB likewise will retain its yield repression policy.

Consider another important viewpoint. In the United States in recent years, rising interest rates generally have been associated with ("sufficient") real economic growth (or hopes for it; note the consequences of quantitative easing beginnings and endings). Yet after various rounds of QE, and notably even with the gradual ending of the most recent round starting at end 2013/early 2014, US 10 year government rates have headed downhill. In addition, the 10 year UST yield high of 2011 at 3.77pc (2/9/11) falls under those of 2009 (4.00pc on 6/11/09) and 2010 (4.01pc on 4/15/10). And the UST's 1/2/14 summit at 3.05pc stands beneath 2011's. In general, interest rates tend to rise during a sustained recovery. If the US economy is "strong enough to stand on its own two feet" (achieve ongoing moderate economic growth without Fed money printing), why does the UST 10 year yield keep eroding?

Thus it is at least rather questionable that the US economy is sufficiently strong to induce a sharp move upward in UST 10 year (clearly above the 3.00 to 3.50 percent range) without the assistance of US quantitative easing. Plus, as is very relevant for American rates as well as the future of intertwined global economy, not only is the Eurozone economy feeble, but also arguably the Japanese and Chinese economies have started to weaken recently.

GOING FURTHER: FURTHER THOUGHTS

Is very low inflation in the United States and much of Europe an entrenched secular trend? Has Japan managed to definitively escape deflation?

Did worldwide deficit spending and sustained highly accommodative central bank policies to some extent evade or postpone a "deflation" (correction) of the credit (leverage) excesses of the Goldilocks Era?

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Or, to what extent is there pent-up inflation in America and elsewhere, hidden by vigorous yield repression schemes? Ask to what extent the ending of yield repression will enable inflation to increase.

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Over the past several years, the major rising and falling interest rate patterns of many important countries have roughly followed those of the United States.

In recent years, the 10 year government debt yields of many key nations have made important marketplace turns (trend changes) "around" the same time.

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The Fed and its central banking allies preach a gospel that stable prices and sufficient inflation (inflation around two percent) are good and that deflation (or insufficient inflation) are bad. In the stable price and inflation rhetoric context, note their focus on inflation measures such as consumer prices, personal consumption expenditures, and wages.

The hunt for yield (return), substantially propelled by Federal Reserve and other central bank yield repression programs (and assisted by money printing and forward guidance), has had enormous consequences for price advances in assorted securities marketplaces. Despite their preaching about stable prices, should central bankers view the explosive price rally in the S+P 500 (whether from its 2009 low or some later bottom) as a sign of price instability (or a risk for price stability in other arenas)? What about the gigantic price rally in many corporate bonds (picture junk bonds)?

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Keep an eye on credit spreads, whether government versus corporate ones or those between sovereigns. For example, the Spain less Germany spread peaked at around 638 basis points during the Eurozone crisis on 7/24/12. Compare the time of the low in the German Bund at 1.13pc, 7/23/12. The Spain less Germany spread cratered to 120 basis points on 6/9/14.

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Many factors, not just central bank policies, of course influence stock price levels and trends. For example, strong corporate profits and share buybacks, not just low interest rates and enormous money printing, have helped the S+P 500's mammoth rally. But underline that the S+P 500 declined after the ending of the first two US QE rounds in 2010 and 2011.

The S+P 500, despite the gradual ending (tapering) of the most recent money printing program, has continued its bull move in calendar 2014, recently edging over 2000, almost three times 3/6/09's 667 major trough. However, Fed tapering has not been completed (money printing has persisted), though these debt securities purchases probably will cease soon. Will the recent rally (since January 2014) in UST prices (lower yields) eventually "lead" a decline in the S+P 500? Suppose the S+P 500 starts a noteworthy decline. All else equal, a S+P 500 tumble probably will encourage US (and other government) 10 year note rates to stay relatively low.

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US federal deficits have declined substantially (fiscal 2014's is 2.9 percent of GDP; compare almost ten pc of GDP in 2009). However, they still persist and rise significantly in later years. Federal debt held by the public will reach 74pc of GDP at the end of this fiscal year, twice that of 2007 and higher than any year since 1950. See the Congressional Budget Office's "August 2014 Baseline" update to the 2014 to 2024 outlook (8/27/14). If doubts substantially increase regarding US fiscal responsibility, interest rates may march significantly upward.

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Inflation levels obviously influence UST 10 year levels and trends. However, the relative sufficiency of high-quality government (or other) securities, whether American or otherwise, also

affects yield patterns. The International Monetary Fund's "Global Financial Stability Report" stated over two years ago (April 2012, chapter 3, p2): "In the future, there will be rising demand for safe assets, but fewer of them will be available, increasing the price of safety in global markets."

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Since end 2008, the US Treasury 10 year less two year spread has made highs (lows) around the time of yield tops (bottoms) in the UST 10 year. For example, the 10 less two year UST spread made a key low 7/24/12 at 117 basis points (settlement basis); the UST major low was 7/24/12 at 1.38 percent. The 10 less two year spread attained highs on 8/19/13 at 253 basis points and 265 basis points on 12/31/13; the UST's recent highs were 3.01pc on 9/6/13 and 3.05pc on 1/2/14.

Highs for the 10 year less two year spread in the past several years are around 290 basis points (291 on 2/22/10, 289 on 2/4/11).

Using history as a guide, assuming a given yield level for the two year note enables estimates of the potential ranges for the 10 year note. So if the two year yield stayed around .50pc, a hypothetical top for the 10 year UST would be roughly 3.40pc (.50 plus 290 basis points).

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