



## Investment Outlook

From Bill Gross



### Bonds, Men, It's About Time

Women have gotten the short stick or metaphorically the short rib ever since Eve, and I'm with Oprah for president and much, much more but hey, guys have got a few positive qualities that need to be mentioned. I mean when basketball players miss a free throw these days, they still get "low fives" from all their teammates. So here are a few low fives for men, men, men.

1. Men need fewer pairs of shoes and purses.
2. Men live 10 years less on average. They truly are the weaker sex. Feel sorry for 'em ladies, not angry.
3. Men shouldn't be criticized for not putting the toilet seat down. If they need to put it down, they will. If women do too, they can use their foot just like everyone else.
4. Men run faster, jump higher and are much better at not communicating.
5. Sure men start wars but great things actually are a result of them. Canned foods owe their origin to Napoleon, microwave ovens to the invention of radar during WWII, and the Internet (not Al Gore) to the fear of Russia bombing U.S. telephone lines during the Cold War. Way to go guys. Keep starting those wars.
6. Men always know where the remote control is. Right next to them.

I could go on and on. I won't. I don't dare. Actually most of the world's problems would go away if men just stayed home, watched football and learned to talk to their partners during commercial breaks. There are certainly enough of them.

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Bonds, like men, are in a bear market. For both, it's hard to say when it all began. There was no Helen Reddy "I Am Woman" moment back in June 2012, and then again in July 2016 when the 10 year Treasury double-bottomed at 1.45%, but then in retrospect it should have been obvious that for bonds, like men – "their time was up". Eighteen months ago, it was obvious to most observers that the economy, measured by nominal GDP, was not going to go much lower than 3% and that the Fed was having second thoughts about quantitative easing. A 1.45% 10 year was at that time set up for perpetual QE and the possibility of a deflationary collapse in the economy. Neither condition prevailed, and so 1.45% for tens can legitimately be cited as the end of the bond bull market which began at 15.8% in 1981 and provided prescient portfolio managers with the potential for huge capital gains and the moniker of "total return", which previously had been the sole bastion of stocks and real estate.

Still, it is not quite legitimate to mark those yield bottoms as the beginning of a bear market. Although the 10 year rose from that point to plateau for several years around 2-2.25%, the price loss of 6 points or so was really not enough to even hint at the late 1970's bond characterization of "certificates of confiscation". Even indexed portfolios which included a mild percentage of HY bonds could show a total return of 5% or so in 2017 for instance. Aging boomer bond market investors were disappointed that they had not ridden the equity express, but hey, 5% ain't that bad.

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Now, however, that 5% number may be hard to duplicate. HY spreads are compressed and not likely to provide future capital gains. And the situation in Treasuries, although standing as I write at 2.55%, is not conducive to a "total return" environment either. We have begun a bear market although not a dangerous one for bond investors. Annual returns should still likely be positive, although marginally so.

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There are several significant reasons that should lead to a 2.70% + year end yield and a mild bear market total return of 0-1% for most bond portfolios. It's hard to prioritize one versus the other but let's start with the nominal economy. Long stuck in a 4% plus or minus range that led to mild bond price changes despite a series of Fed hikes, the nominal economy now looks capable of 5% for at least a few quarters. Tax cuts and increasing budget deficits are providing a temporary fiscal push that likely will increase future inflation to the 2% core target long desired by the Fed. 3% real growth, although perhaps illusionary in your author's opinion, gives the economy that 5% nominal number that overvalues 10 year Treasuries at 2.5%. Historically, or better yet, in this new era of financial repression beginning with the onset of The Great Recession in 2009, the spread between 10 year Treasuries and nominal GDP has averaged 140 basis points. When using that average, a 5% nominal GDP mindset targets a 3.60% yield on the 10 year over the course of 2018. I'm not that negative but you get this fundamental point.

Secondly, the Fed and importantly other central banks are cutting back on quantitative easing. Later this year, perhaps in September, net central bank purchases of sovereign and corporate notes and bonds may stop, or at least falter far below the \$1-2 trillion pace of recent years. The market's central bank buyers of last resort have perhaps accomplished "whatever it takes", and are set to allow artificially low yields, and artificially high bond prices to become a little less artificial. This is not to say that there will be any more than 2 Fed hikes this year or that the ECB, the BOE and certainly the BOJ will raise short rates anytime soon. They won't. But the diminution of QE check writing and a 5% nominal GDP should be enough to produce higher 10 year Treasury yields, near 0% total returns, and the legitimate characterization of the beginning of a mild bear market.

Oprah shouted, "Their time has come". The bear bond market's time has come as well. Many would say, including yours truly – "It's about time".

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