Bond Market Bubbles:The Future is Already Here—It's Just Not Very Evenly Distributed[1]. Part 3.

In the second half of 2009 global financial markets began to recover from the devastating 'Credit Bubble' crash. The recoveries in both bonds and equities began to overheat rapidly. In equity markets the nascent bubbles all burst in 2011 after the U.S. ratings downgrade[2], but bond markets continued to rise. Their future is the next bust in the boom-bust cycle. That future is already here in Emerging Market Bonds, and Corporate Bonds may not be far behind.

Unstable Expansions Signal the Presence and Extent of Overheating

Omega Analysis' risk measurement technology reveals predictable Risk Cycles that are leading indicators of asset price booms and busts. Unstable Expansion–unsustainable asset price increases–signal overheating and predict the correction levels that will result.

Equity markets the world over went into Unstable Expansion shortly after the market recovery began in 2009. The sharp downturn following the U.S. credit downgrade in August 2011 deflated the nascent bubbles worldwide and equity markets fell through our predicted Correction Levels[2].

But bond markets barely responded to the 2011 equity market shock. They continued their inexorable rise until 2013's 'taper tantrum'[3] that hit both Emerging Market and Investment Grade U.S. Corporate bonds (Figure 1).

Current Predictions

By the second half of 2014 the losses were shaken off and bond valuations regained their previous peaks. Since then, the price increases have pushed our Correction predictions to levels as high as those in most developed equity market bubbles. For example, at the end of last week, the iShares ETF LQD which tracks the iBoxx USD Investment Grade Corporate Bond Index had a predicted Correction of 39%. The iShares ETF EMB which tracks the J.P. Morgan USD Emerging Markets Bond Index had a predicted Correction of 47%.

Unstable Contractions Signal the Presence and Extent of Anti-bubbles of Panic Selling

Just as bubbles are identified by Unstable Expansions, 'anti-bubbles' of panic selling are detected by Unstable Contractions. And Emerging Market Bonds have now triggered this warning indicator.

Last week's two part What Just Happened described the prospect of bursting equity market bubbles. Bond guru Jeffrey Grundlach warned last week that Investment Grade Corporate Bonds were due for a major downturn[4]. It appears that the unevenly distributed future of bond markets has already arrived for Emerging Markets. Corporate Bonds may not be far behind.

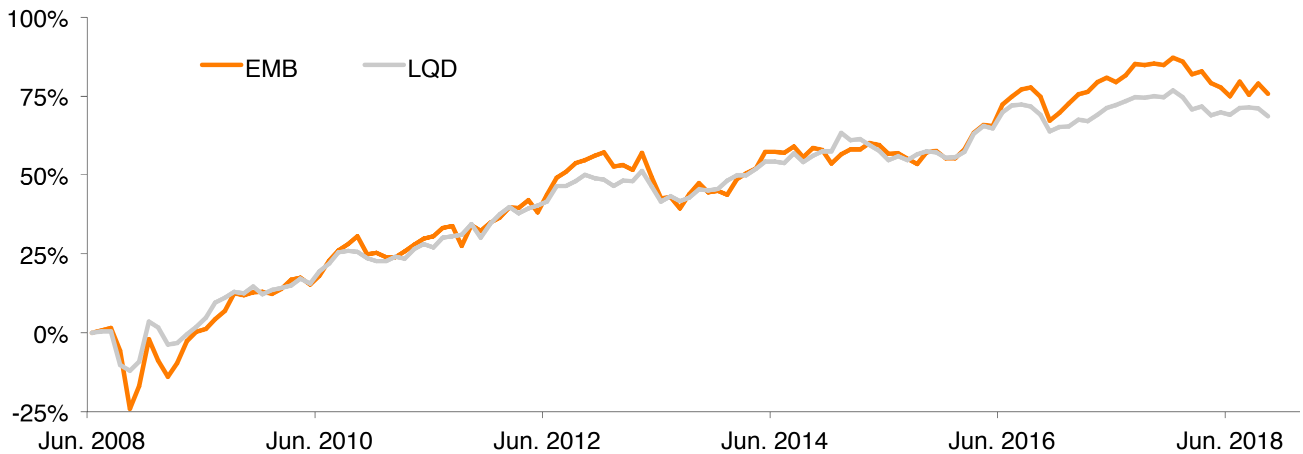

Figure 1. The inexorable rise of U.S. dollar denominated debt in developed (LQD) and emerging markets (EMB) from 2008 to the present. As the Fed raises rates both corporate bonds and emerging market bonds have shown the strain, with emerging markets bonds turning down quickly in 2018. Since June 2018 EMB has been in an Unstable Contraction ('panic selling') mode.

[1] William Gibson NPR Interview, 1999. https://quoteinvestigator.com/2012/01/24/future-has-arrived/

[2] Global equity bubbles started re-inflating in 2013 and some have since reached epic proportions. See WHJ 22 Oct 2018 and 24 Oct 2018, The Future is Already Here—It's Just Not Very Evenly Distributed Parts 1 and 2. Risk@OmegaAnalysis.com

[3] https://www.bloomberg.com/news/articles/2018-05-22/not-a-happy-anniversary-em-s-taper-tantrum-began-5-years-ago

[4] https://citywireusa.com/professional-buyer/news/gundlach-the-corporate-bond-market-is-going-to-get-much-worse/a1168355

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