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INVESTMENT WEEK

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23 November 2017

Plurimi's CIO Armstrong: 10-year Treasury yields to widen beyond 4%

By Tom Eckett

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Patrick Armstrong, CIO of Plurimi Investment Managers, has said 10-year Treasury yields will surprise many investors by rising dramatically, as a result of interest rates being hiked much faster than markets anticipate."

Speaking at the Thomson Reuters Lipper European Alpha Expert Forum in London, Armstrong (pictured) said he expected 10-year Treasury yields, which are currently at 2.3%, to reach 4.2% in the near future, far beyond veteran bond investor Bill Gross's 2.4% yield barrier, which could signal a bond bear market.

This also exceeds forecasts in a recent Cross-BorderCapital report entitled Why are the bond bears growling?, which suggested 10-year Treasury yields could rise to 3.5% due to the "renormalisation of cross-border capital flows" to Europe and China.

Armstrong said: "You will go from an environment where China, Japan and the ECB did not care about the yield [when purchasing bonds], to where you have to attract investors to buy bonds with [a higher] yield.

"Also, interest rates will move much higher than the market is expecting and a 4% yield is not a shocking end point."

The Federal Reserve has raised rates three times since its first hike for over a decade in December 2015, and the CIO said investors were "naïve" to think they will be not be affected by this and the quantitative tightening (QT) cycle; the Fed has also begun tapering its $4.5trn balance sheet, which it started in October, on the back of "good" US economic performance.

Armstrong said: "The beginning of QT from the US has been signalled relatively well. Investors know it is coming so it will not shock markets.

"But what we had was an eight-year tailwind from QE that will turn into an eight-year headwind from QT.

"I do not see why the fortunes work in [just] one direction," he said. "It is naïve to think as it turns into tightening those forces do not work in the opposite direction."

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US valuations

Turning to his equity positioning, Armstrong, who manages the Plurimi Global Macro Diversified Dynamic Solution fund, said he had a 22% net short position in US equities due to "extreme valuations".

He pointed to the Shiller P/E ratio of 31.6, the highest point in history barring the lead-up to the dotcom crash in 2001 and Black Tuesday in 1929.

While this position has caused some pain this year, he recognised asset prices had been driven by central bankers' QE programmes.

Furthermore, he said increasing deregulation and President Donald Trump's aim of US growth reaching 3% would result in an overheating economy and not structural long-term growth.

"It is an expensive multiple," he said. "Our portfolios have been skewed to short US equities, which has not been good this year but will come good.

"Short-term valuations do not mean anything when you are looking at five to ten-year periods."

Another area the CIO has been playing is shorting the yen due to Japan's increasing debt levels as a result of the Bank of Japan's (BoJ) bond-buying programme.

By January next year, Armstrong said the BoJ would own half of the bonds issued by Japan and 70% of all ETFs in the country.

"The risk of shorting the yen is it rallies whenever there is a risk aversion event so [buying gold] is a natural hedge.

"It is a game where I would be attracted to go long Japanese equities but it is a scary game and I do not know where the end game is," he added.

European bias

However, the CIO said he was overweight equities overall, with a bias to Europe where he was expecting cyclical stocks to rise on the back of a "robust" European economy and European Central Bank (ECB) tailwind.

Despite the ECB cutting its bond-buying programme in half from €60bn to €30bn-a-month from January, he said QE should remain supportive until September 2018.

"Investors should be taking cyclical risk," Armstrong said. "Industrials and banks are very good value and are set to best benefit from loose monetary policy.

"As there are no bond yields, you have a lot of equity 'tourists' who think they are in bond proxies. If we get a higher interest rate environment and there is no growth then bond proxy multiples will get revised."