Crossbow Partners
Experience & Discipline

New York Trip Report

November 27 - 30, 2017

Executive Summary

Most managers are trimming their equity exposures as the current rally is pushing valuations to high levels and it becomes easier to find attractive shorts

USD 1.5 trillion bond supply will have to be absorbed by private investors in 2018 which will lead to higher yields and a steeper yield curve

Short-term interest rates in the US should be 300 basis points higher compared to previous cycles, but this may not happen this time as the governments remain the largest debtors

Long-term interest rates however will be driven higher by up-trending inflation numbers which will also support higher commodity prices

Convertible bonds had a difficult time in the extreme low volatility environment of 2017, but could revive in a more volatile 2018

Geopolitical tensions are increasing in the Middle East, but also between Russia, China, Europe and the USA on trade issues

The USD is expected to strengthen on an inflation surprise that can be expected in 2018, but will longer-term weaken based on strongly increasing debt deficits in the coming years

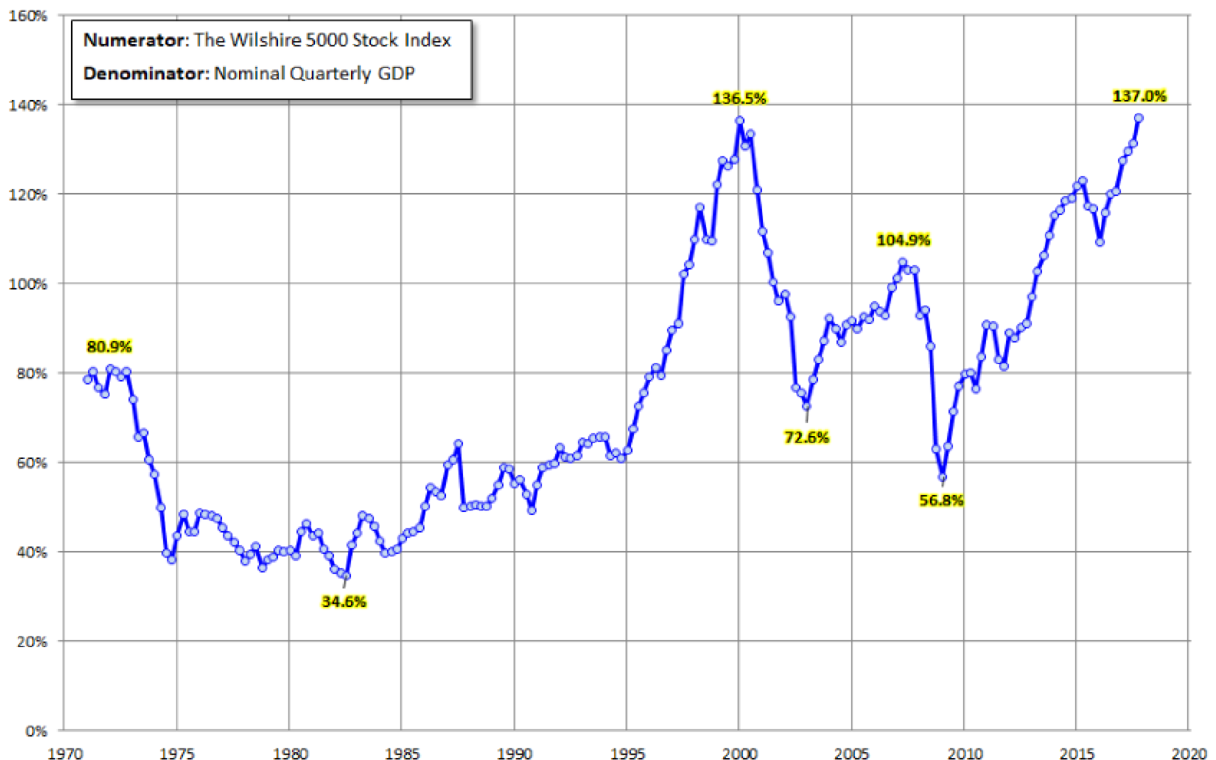
Equity Market Outlook

There is an intense debate whether equity markets can keep going up based on easy money, the US tax reform, deregulation, infrastructure projects, and technological achievements that will change the world. As outlined in our special market report in January, we are of the opinion that several risks have increased over the past year which will ultimately lead to a fixed income and equity market correction.

This opinion is also shared by some of the most successful money managers. According to the Warren Buffett indicator, equity markets are expensive in comparison to the US economic power. But also Ray Dalio from Bridgewater, the world's largest hedge fund, and Paul Tudor Jones, founder and manager of one the most famous macro hedge funds, are turning more cautious.

The "Warren Buffet Indicator"

The indicator measures the US market capitalisation over the US GDP. The relationship between the value of the equity market compared to the value of goods and services produced by the US economy gives an indication whether market performance is ahead of the real economy or vice versa. We are back at the all-time high of 137% in 1999.



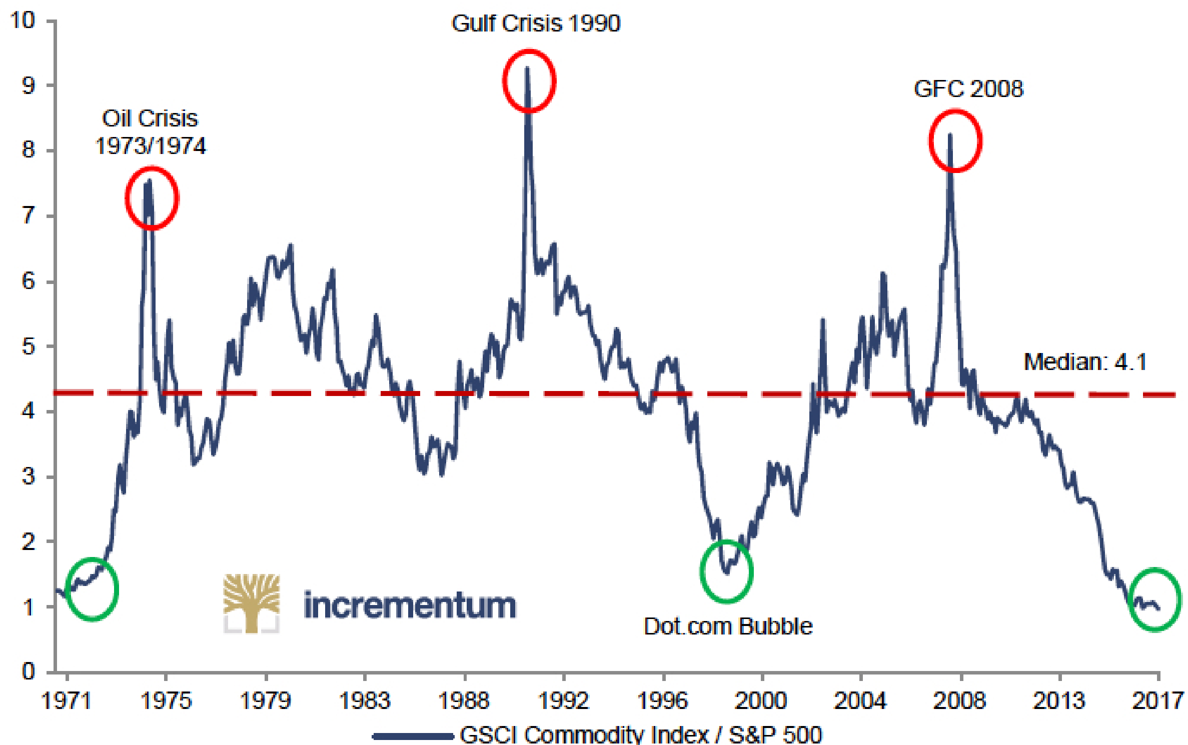
Based to historical data, the US stock market is positioned for an average annualized return of -2.1% over the next 8 years. This includes the returns from the dividends, currently yielding at 1.76% per annum.

Tudor Investment Corporation

Hedge fund billionaire Paul Tudor Jones, who called the October 1987 crash, believes markets are in a dangerous financial bubble thanks to Federal Reserve's "obsession" with

inflation targeting. The 2% inflation target has become a mania among central bankers and does not include the balance sheet factors, such as the stock market, real estate, commodity valuations, as well as the leverage held by households, corporations, governments and banks.

Typical late-cycle inflation is about to appear with a vengeance as this record economic recovery matures. This will boost commodity prices which are at record low levels compared to the S&P500 valuation. According to Jones, the Fed fund rates are 300 bps too low for the current state of the cycle. The payback for the market excesses and the overly easy monetary policy is going to be painful.



Bridgewater Associates

According to Ray Dalio, recent spurts in stimulations, growth, and wage numbers signaled that the cycle is a bit ahead of consensus. They are concerned the central bank will reduce its monetary stimulus and increase interest rates more aggressively as the economy continues to strengthen.

On top, the announced budget deal and infrastructure plan will produce both more fiscal stimulation and more T-bond selling by the Treasury, which is more bearish for bonds. There is a whole lot of hitting the gas into capacity constraints that will lead to nominal rate rises driven by the markets. The chances of a recession have definitely increased.

Bridgewater has shown its hand in Europe with a $22 billion bet against some of the continent's biggest companies, filings reviewed by Reuters show, part of a bigger shift by the world's largest hedge fund manager.

Bridgewater's bets against firms ranging from Anglo-Dutch consumer giant Unilever to French oil group Total, and from Deutsche Bank and German industrial group Siemens to the Italian banks Intesa and Unicredit.