CLEAR HARBOR
ASSET MANAGEMENT, LLC

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Clear Harbor Flash – Rally in Sovereigns Signals More of the Same from the Fed

The Clear Harbor team spent some time at yesterday's weekly macro meeting discussing the somewhat dramatic rally in longer-dated U.S. Treasury yields since mid-March. Ten-year Treasury yields have fallen from approximately 2.05% to today's level of 1.67%. Sovereign debt yields have also fallen in the Eurozone periphery, with 10-year yields in Italy, Spain, and Portugal declining by 75bp, 63bp, and 21bp respectively. From Sweden to New Zealand, other sovereign yields have fallen significantly as well.

What is causing such a market move? While we do see some signs of caution within the global macro economy, we certainly cannot attribute the swift adjustment to some sort of "flight-to-quality" bid entering the market. The trend toward higher prices for sovereign debt has simply been too universal over the last six weeks, boosting the bonds of weak countries alongside the strong.

Global 10-year Bond Yields

Custom | 97) Settings | 99) Feedback | World Bond Markets
91) Bonds | 92) Spreads | 93) Curves
Maturity 10 Year | Trading Mode | 03/11/13 - 04/30/13 | Custom

Country	CMI	Security	Bid / Ask		Yield	Yld Chg	Yield	Low	Range (Avg / Now)	High	Hst Chg
1) United States		T 2 02/15/23	102-30 / 102-30+		1.672	+.2		1.663		2.058	-38.6
2) Sweden		SGB1 ½ 11/23	98.883 / 99.170	c	1.586	+2.4		1.538		1.967	-38.1
3) United Kingdom		UKT1 ¾ 09/22	100.520 / 100.540	c	1.687	+3.3		1.629		2.013	-32.6
4) Spain		SPGB5.4 01/23	109.950 / 110.145	c	4.112	-2.3		4.112		5.055	-62.7
5) Switzerland		SWISS 4 02/23	132.482 / 132.834	c	0.539	-.8		.539		.764	-18.3
6) South Korea		NDFB 3 03/23	102.279 / 102.413	c	2.768	-3.4		2.718		3.011	-24.3
7) New Zealand		NZGB 5 ½ 23	119.537 / 119.957	c	3.149	-1.4		3.147		3.830	-67.3
8) Japan		JGB 0.6 03/23	99.916 / 100.009	c	0.599	+1.8		.436		.650	-5.1
9) Germany		DBR1 ½ 02/23	102.600 / 102.615	c	1.215	+1.2		1.202		1.515	-30.0
10) Canada		CAN1 ½ 06/23	98.170 / 98.215		1.693	-.2		1.693		1.943	-24.5
11) Australia		ACGB 5 ½ 23	120.467 / 120.562	c	3.088	-1.4		3.088		3.680	-48.7

Source: Bloomberg

Instead, we think this trend reflects renewed demand for secure yield from investors who expect growth and inflation to remain subdued. These investors point to stagnant wage growth and global spare capacity in both manufacturing and employment. Indeed, in the U.S., the Fed's stated desire to see

employment fall below 6.5% and inflation rise toward 2% appears more of a hope than a near-term goal—particularly in 2013—even as bulls keep nudging equity indexes higher on generally solid earnings.

Inflation Expectations/U.S. 5yr 5yr Forward Breakeven Rate (nominal forward 5years rates minus US inflation-linked bonds forward 5-years)

Source: Bloomberg

The Federal Reserve will certainly debate this critically important topic during their Open Market Committee's two-day meeting this week, concluding with a statement at 2pm on Wednesday. Thursday and Friday will provide market participants with additional data points from government reports on wages, labor participation, and employment.

Unemployment Rate (Note: does not include those that are underemployed and seeking additional hours or higher skilled work):

Source: Bloomberg

Our belief is that the Federal Reserve will remain highly accommodative given the trajectory of inflation, growth, and employment. Moreover, we believe that that those members of the FOMC who contemplated abandoning the majority view will raise less of a fuss this time around.

One can never be certain how markets will respond to the statements of the Fed. But the recent rise in both equities and sovereigns suggests that in today's perceived environment of sluggish but stabilizing growth, there is room for cash to move into a broader spectrum of asset classes—and reason to expect the Fed to continue, and perhaps even extend, its remarkably dovish policy actions.
