WHAT MIGHT POP THE BOND BUBBLE?

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On last week's episode of the "Behind the Markets" podcast, we spoke to Dave Donabedian, chief investment officer for CIBC Private Wealth Management, and Kevin Muir, market strategist for East West Investment Management. We had a timely discussion on market volatility and the outlook for global markets; with Muir, we particularly focused on what he calls today's global bond market bubble.

Donabedian looks at valuations around the world, and despite the uncertainty over trade policy and a view that markets get worse before they get better, he has a favorable outlook for the U.S. over global markets and for emerging markets and Asia over developed markets. He sees an interest rate cut coming in September from the Federal Reserve (Fed) and indications from the Fed that more rate cuts will follow.

The discussion with Muir was especially interesting, as we've witnessed interest rates dropping to ever-lower negative yields across Europe and the rest of the world. He understands why people are flooding into U.S. Treasuries today on worries of a recession. When investors are guaranteed to lose money on a real and nominal basis by investing in German bunds, unless they can find someone else to sell those bunds to at an even greater negative yield, he finds it hard to describe this environment as anything but a bubble.

Muir has shared his thoughts on Twitter, and the conclusion of his 25-tweet thread summarized his thoughts as: We are on the cusp of a seismic shift in government attitudes toward fiscal spending that he believes will ultimately pop the bubble. To read more of his views on this topic, you can view the Twitter thread here.

Muir is not quite ready to short German bunds and get paid the negative interest rates, but he believes ultimately the short German bond trade will prove to be one of the great shorts of a lifetime.

Many are worried that demographics are creating this ultimate deflationary wave that justifies these low yields and that governments cannot create inflation.

Muir believes we have been wrong to rely only on monetary policy to stoke inflation but that as the governments step up with much greater fiscal spending, they ultimately will create the inflationary pressures that will move interest rates higher. That subject is a continuation of the modern monetary theory discussion we had last week with Samuel Rines and Danielle DiMartino Booth.

Please listen to our full conversation with Muir and Donabedian below.

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DEFINITIONS

Bubble : when market participants drive stock prices above their “fair value” in relation to some system of stock valuation.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Recession : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemploymen.

German bunds : A debt security issued by Germany’s federal government, which is the German equivalent of a U.S. Treasury bond.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

Deflation : The opposite of inflation, characterized by falling price levels.

Inflation : Characterized by rising price levels.