STARBOARD
ASSET MANAGEMENT

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Starboard Weekly Report Ending May 20, 2016
Graph and Chart of the Week

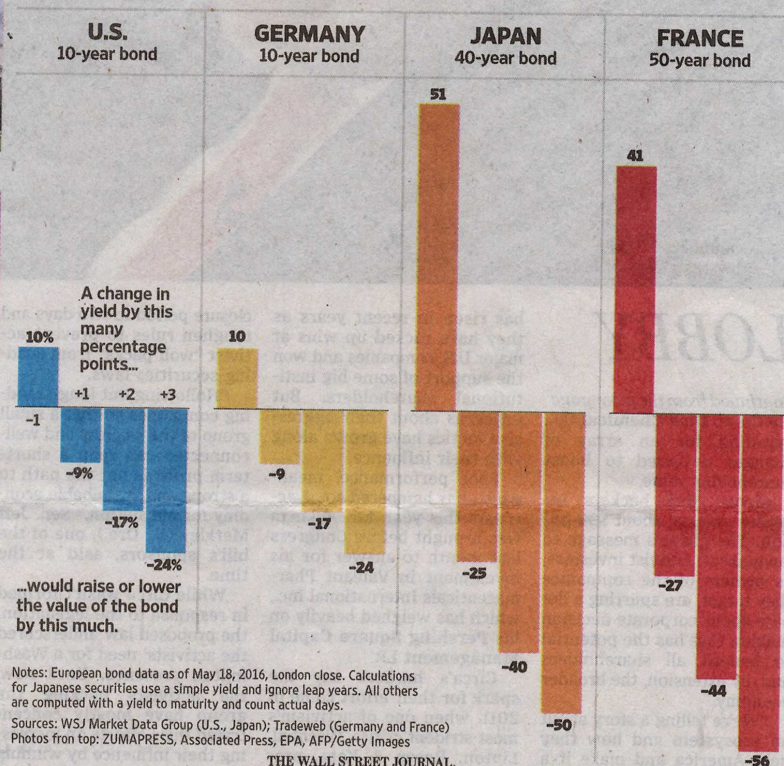
The World's Safest Bonds May Be Wild Risks

Federal Reserve in Washington

Bundesbank in Frankfurt

Bank of Japan in Tokyo

Bank of France in Paris



Notes: European bond data as of May 18, 2016, London close. Calculations for Japanese securities use a simple yield and ignore leap years. All others are computed with a yield to maturity and count actual days.

Sources: WSJ Market Data Group (U.S., Japan); Tradeweb (Germany and France)
Photos fron top: ZUMAPRESS, Associated Press, EPA, AFP/Getty Images

THE WALL STREET JOURNAL.

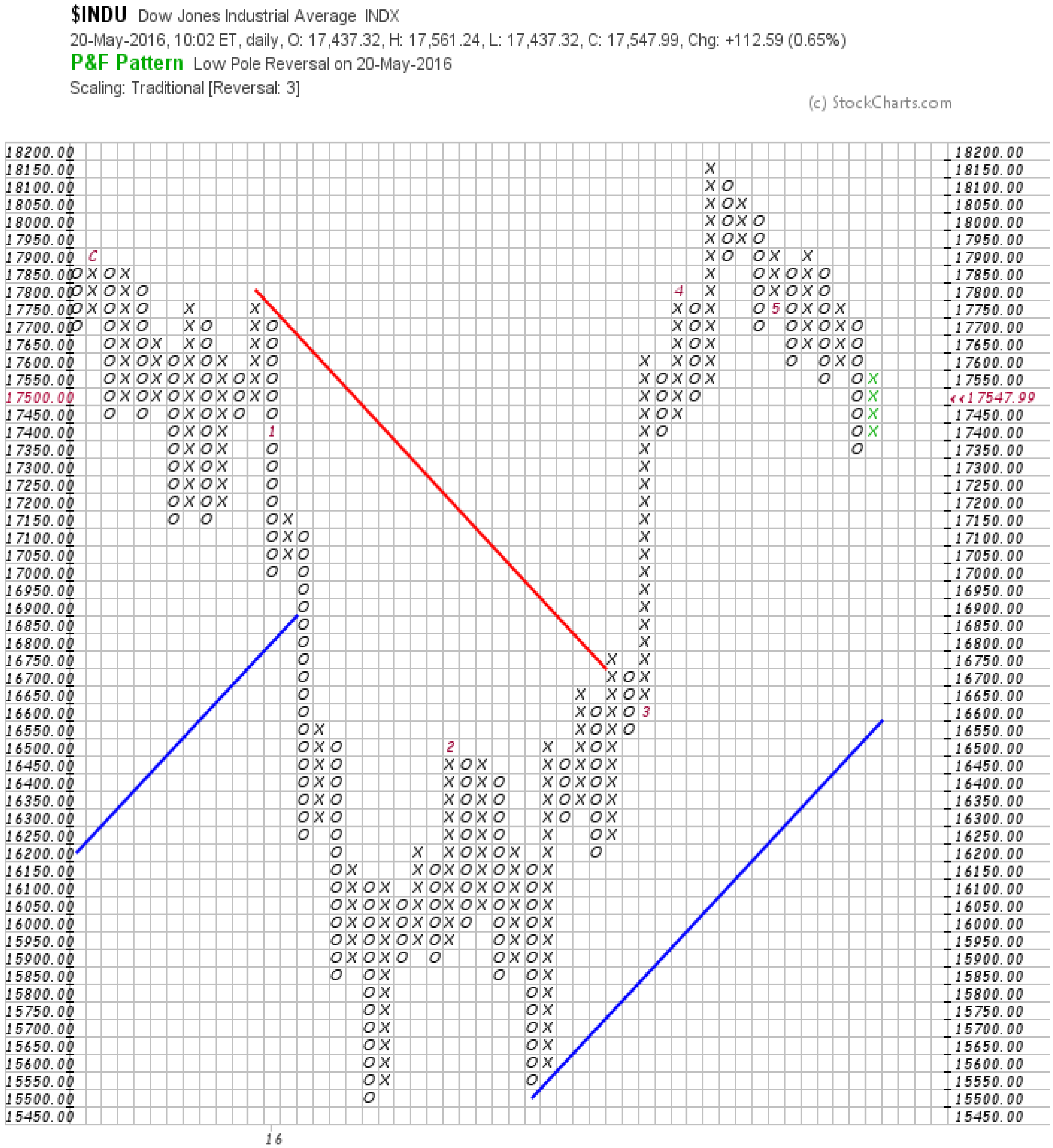
Desperate for yield, investors are buying government bonds that come due further and further in the future. If you lend your money to the government, you expect to get it back. What could possibly go wrong?

Unfortunately, a lot. A small move in the yield on these increasingly popular 40-, 50- and sometimes even 100-year bonds can have a crippling effect on their capital value.

Anyone who might be thinking about selling those bonds before they mature (hint: that's everyone alive today for the longest-dated bonds) should consider how they'd feel if their supposedly safe bond lost a quarter of its value in two months. It happened to the rock-solid German 30-year bund just last year.

The operative word is duration: the sensitivity of bonds to changes in interest rates. For U.S. Treasurys, duration rose to its highest level last week in 15 years, according to Barclays PLC data. The risks of an interest-rate surprise were underscored Wednesday by the minutes of the Federal Open Market Committee's meeting in April, which showed markets have underestimated the possibility of a rate hike by the Fed.

The chart shows how moves of one or more percentage points would affect the value of government bonds around the world.



Since there will be no weekly report next Friday and therefore no chart, I wanted to offer a double feature on the bond and stock markets. This week's top graph was cutout from Wednesday's Wall Street Journal. Also included above is a point and figure chart from StockCharts.com on the Dow Jones.

TECHNICAL

It takes a little study to grasp the WSJ interest rate graph because of the inverse relationship on the impact of rising rates. When rates rise then bond prices drop and the graph shows the impact of 1, 2 and 3 percent increases along with a 1% decrease in rates. The reason that the price increase on the top part of the graph only gives 1% examples is that most rates are below 2% and negative rates are not accounted for. A maximum increase of 3% in rates would be hurtful to values in United States and Germany, but catastrophic to Japan and France. The second feature above is of the Dow Jones point and figure chart that shows a very bearish pattern. There have been a series of lower lows since a high of 18,150, but the real takeaway is the lack of support below the recent breakdown at 17,350. Support does not come in until 16,600 (Blue Line) if that is broken and I believe that will be the next support that comes in to play at 15,500. When that breaks it is *"Nellie bar the door".*

FUNDAMENTAL

The bond market graph from the WSJ is quite telling regarding the world wide impact on interest rates. If rates were to rise 3% then the losses on institutional bond portfolios would be enormous and devastating to the balance sheets of the world's financial institutions, this also would include governments and pension plans. The massive amount of debt purchased since the great recession is sitting on the balance sheets of these various institutions and as rates raise the value of the low interest bonds will fall creating a gigantic loss of value. This is why rates must stay low for the foreseeable future. Debt in the US is so large that a 1% interest increase to the government would mean 1.2 trillion costs to the budget. Think of these graphs and the budget effect the next time some Fed Head talks about increasing the interest rate. They are locked into small increases because of the damaging effect of major rate advances. However, the FED speculative announcements regarding rate increases still move markets. We had such an example this week with crazy volatility in almost all of the markets. This was created by 3 Federal Reserve Governors, along with the April FED minutes, discussing the possibility of a June rate increase. We have become a nation of PR rather than substance by responding like the pavlovian dog to government and celebrity announcements. Eventually reality wins and this week's point and figure chart, with the X's representing demand and the O's representing supply, are showing that supply is taking over.

ASIDE

"Reality must take precedence over public relations, for nature cannot be fooled."
Richard P. Feynman

These are very true words from this Physicist; if only our government and the central bank elitist would take heed.