# ACT LIKE A GOOSE – FLY SOUTH

**April 30, 2001**
**June Bonds – 100^15**

**Apocalyptic Apodosis**

It is all but certain that a crisic day will occur on April 30, 2001. The Monthly stochastic, harbinger of secular (i.e. long term) changes in the 30 year bond cycle, will close in the downcrossed position, thereby officially memorializing the termination of the secular bull market begun 02/00, and heralding the commencement of a 12-15 month secular bear market, auguring punk bonds out to 05/02.

**The Record Speaks**

For those stalwart readers of *StoMaster*, the phrase *"Be On the Northbound Train"* has special meaning. Written on 01/28/00, that prescient monograph sounded the clarion call for the termination of one of the most vicious and pernicious bear markets in the 30 year bond's history. Having collapsed 28 points from its recovery high of 135^08 on 10/98 to its nadir of 108^00 (adjusted to 89^00 for the proxy coupon change from 8% to 6% in the futures market), the long term stochastic indicator as defined by the Monthly Stochastic (see Tutorial for primer on Stochastic Analysis if this is not clear), upcrossed on 02/08/00 and memorialized that upcross (i.e. closed at month-end in the upcrossed position) on 02/29/00, thus heralding a 12-15 month secular bull market, which *StoMaster* predicted would take bonds to a final objective of 109^00.
In support of that belief, *StoMaster* had penned the aforementioned squib, and posited in its concluding paragraph:

> "Do not be swayed or influenced by the vapid fatuities of the consensus, especially those espoused by the ostensible cognoscenti. A perceived bear market in bonds is illusory. A 20 point secular bull market is imminent reality. Be on the northbound train with your Sto ticket in hand."

This admonition was particularly brazen, bold and bodeful, given the cognoscenti's conventional wisdom presuming that the Fed would bump the Fed funds rate 50 bps from the 4.50 % prevailing, if nothing more than to "take back" the 50 bps ease the Fed had allowed in order to ameliorate the looming liquidity crisis on the heels of the 10/98 currency meltdown and LTCM debacle. Bonds would suffer, their reasoning held, in that perceived tightening environment. In fact, the poobahs were spot on with respect to the Fed's monetary revanchism, but lamentably wide of the mark on bond price direction. Fed funds were raised back to 5% by the end of 1999, with an additional 100 bps addended by mid-2000 in the Fed's good fight against "irrational exuberance." Yes, the panjandrums were right on the money, so to speak, with respect to the Fed funds rate, but they could not, and did not see what the Sto saw. Touching a low of 89^00 on 01/19/00, the 30 year bond future rallied to 106^16 by 01/03/01, a stunning 17 ½ points vis a vis a 100 bps rise in the Fed funds rate! The Sto had divined this move almost a year in advance, carrying in its daily narrative the rallying cry:

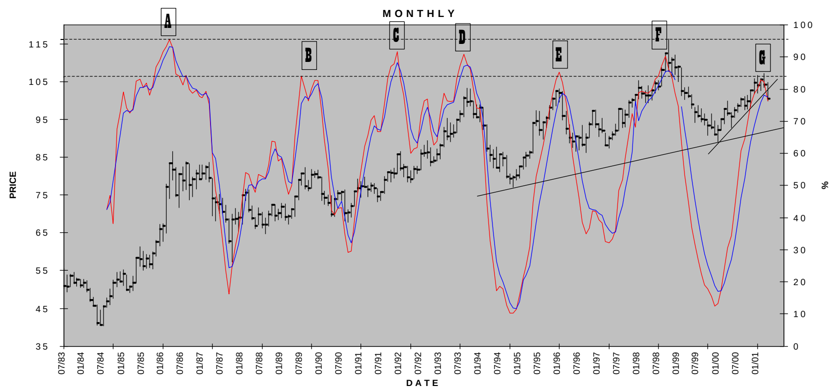
> "The Monthly heroically punched through to an upcross on 02/29/00, thus officially memorializing (i.e. closing the month in an upcrossed position) the conclusion of the bear market begun 11/98 and fugling the commencement of the secular BULL MARKET of 02/00-05/01, with a minimum upside target of 109^00."

**The Sto Don't Lie**

Now the apostates out there might dismiss this laudable call with a contemptuous "just got lucky" scoff. But then they would not have delved a bit deeper to discover that, and I quote a key assertion from *"Be On the Northbound Train:"*

> "In the 23 years of the 30 year bond trading history, the Sto has never lied in its prognosis of major (secular) market turns."

Take a gander at the chart below:




This is the Monthly Stochastic chart tracing cyclical movements in the 30 year bond since 07/83. Note that each vertical black line represents the high, low and close of a month. The red and blue lines, which appear to oscillate in a sine wave pattern, are the essence of the stochastic measure. Abstracting from the intricacies and subtleties of the stochastic calculation, it is readily seen that when the red line crosses the blue line from above, at relatively high levels on the graph, the price of the bond tends to fall. Conversely, when the red line crosses the blue line from below at relatively low levels on the graph, the price of the bond tends to rise. Observe that since 07/83, there have been six completed peaks in the Monthly Stochastic, lettered "A" through "F", each demarking the top of a secular bull market cycle, which typically averages 12-15 months. From each of these peaks, even the unknowledgeable, unpracticed and ill-advised casual observer will notice that the bond consistently falls in price after the downcross. The two horizontal, dotted lines at the top of the graph mark the highest and lowest levels from which a downcross occurred, respectively. The last peak, marked with the letter "G", reflects the current situation as of 04/30/01. One observes that a downcross has been forged. Should that downcross remain as such by the end of trading on 04/30 (i.e. month's end), a formal "memorialization" will have occurred, officially fugling the commencement of a secular bear market, enduring for an average of 12-15 months. Though downcrosses have been swaged at higher levels, represented at points "A", "C", "D" and "F", should this most recent downcross be memorialized at "G", it will join the downcrosses that were stithied at almost identical levels at points "B" and "E"; this by way of pointing out that the instant downcross is well within the high probability range of downcrosses for the history of bond trading.

Please note that although bonds may wiggle and jiggle about after a downcross, even to the extent of retracing a move back to the highs, there is no instance where the bonds have not been substantially lower than they were two months after the downcross. Those who would controvert the indicia of the Monthly Stochastic walk on parlous ground, indeed. Or to coin a phrase in the pithy patois of tech traders: *"Never fade the Monthly Sto."*

**The Way It Works**

When the Fed kicked off its aggressive easing cycle on 01/03/01, lowering the Fed funds rate 50 bps to 6.00%, the received wisdom of the punditry plumped for much lower long bond rates. Visions of "the commencement of the GREAT bond rally" were bruited with great vociferous vigor. Talk of a sub 5.00% bond yield was all the rage. Back in the good old days (pre-Greenspan tenure as Fed Chairman) before 1986, that potential was more generally realized, but it is patently not the case any longer. Perceptions and expectations, NOT the reality, drive the bond market. Indeed, upon the news flash resounding the Fed demarche, bonds rallied to 106^16, yielding 5.32%. But the moment was fleeting, as the bond vigilantes mercilessly hammered the bonds to a 104^10 close, yielding 5.50%, .15 bps higher than the prior day's close. What went wrong to rain on the bond Panglossians' parade?

The Fed's commitment to a policy of easing ameliorated the market's expectation of a severe economic downturn. Whatever perceptions of future weakness that prevailed prior to the announcement were irremiably altered. The expectations of the recessionary levels of economic activity that COULD have prevailed but for the ease were no longer adjudged possible. All else being equal, expectations of mitigation by this and future rate eases, within the context of a full Fed easing cycle, meant that bond prices could not rally to the higher expected levels had the diminution in the Fed funds rate not occurred. Without the achievement of extraordinarily high rates of productivity gain associated with a now waning IT revolution, strong economic growth, it was perceived, would result in higher inflation.

It was not for nothing, then, that *StoMaster* posited on 01/03:

> "The Fed's first salvo to an easier monetary policy has set in motion economic forces which will preclude 109^00 as a minimum objective and established it as the maximum. Such is the stark difference between the prior neutral policy directive and a committed declination in the Fed funds rate. The magnitude and repercussions of 01/03's Fed announcement have reformulated strategy from a running game to an endgame, with an eye to ultimately exiting at or below the final 109^00 objective."

**The Goosey Outlook**

Where do we proceed from this point? The Monthly Sto, as suggested in the opening salvo of this morceau, will memorialize today (*04/30/01*) the first instance of its downcross, which was cobbled on 04/16/01. Taken together with the violent penetration of its long term bullish trendline on 04/10/01, the bearish course of this Sto is graven in stone. A 12-15 month bear market for bonds will have commenced, with an ultimate objective twenty points off the high water mark of 107^08 (*5.24%*), or roughly 87^08 (6*.85%*). The path to ineluctably higher long term bond rates and lower bond prices will not be uni-directional. The typical sawtooth pattern of trading, eliciting weak rallies followed by lower lows in bond prices will obtain. Such runcination will be driven by perceptions as to whether the Fed is "ahead or behind the curve" of perceived economic activity. That determination will be assessed at each iteration of policy implementation. In support of this organon, *StoMaster* has held that:

> "The potential strength of the secular bull market has been weakened, but not negated by 01/03's Fed easing. Ultimately, lower interest rates will induce reflation. But in the meantime, the Fed's 01/31 50 bps ease was just what the bond doctor ordered. WHY? Because the market expected more (75 bps), given the rapidly deteriorating economic environment. Again , on 03/20, with the vigilantes hoping for 75-100 bps ease, the Fed allowed only 50 bps. With the Fed still adjudged "behind the curve," the market will rally bonds strongly until it is satisfied that the Fed is on, or ahead of the curve. Once the latter obtains, the party is over and the top will have been put in." Note 03/27's adjudication that the firm *Consumer Sentiment* number puts the Fed ahead of the curve, but 04/10's *NonFarm Payroll* put it behind the curve. 04/10's bullish Fedspeak has moved perceptions again ahead, but the jury is still out. Make no mistake, the damage down on 04/10 is technically desolating, but in the Monthly Sto perspective, not unexpected."

And in summation of the entire Fed easing cycle to date, *StoMaster* stated:

> "Reviewing the Fed's 4 rate cuts from 6.50% to 4.50%, the bond vigilantes adjudged the first two .50 bps cuts in January to be behind the curve, rallying bonds to their 107^08 high. The March 20th cut radically altered that perception to the view that the Fed was then well ahead of the curve, tanking bonds into the April 18th cut, which perpetuated the same. Irrespective of intracycle perceptions, *StoMaster* had posited on the first ease on January 3rd that: "The Fed policy to active easing from neutral, ensures that bonds cannot achieve the higher metrics possible had the easing not occurred."

Though the damage visited upon the bonds to date has been desolating, a 7 ½ point free fall from the 107^08 high on 03/22, there is flinder of light. The Daily Sto has been jonesing on a roborant upcycle for nearly two weeks. Once catalyzed, it should provide a decent relief rally, taking the bonds north to at least fill the near bullish gap up to 104^03. During this period of at least 15-20 days, softer economic numbers should be forthcoming, providing corroborating fundamental support to the strong techs. It is imperative at that time to eschew the hectoring calls by the *soi-disant* "advised" and "knowledgeable" economic Cassandras, who will undoubtedly be plumping for much lower long bond rates consistent with a deep recession. DO NOT BE SWAYED. Use the opportunity to complete exit strategies to shorten duration if you are of the institutional kidney, and exploit strength to get short, if you are of the intrepid trader variety. Do not fight a bear market. Like our anserine brethren in winter…fly south.

*When bond vigilantes,*
*Play down fast and loose,*
*Don't ruffle your feathers,*
*Fly South…like the goose.*

**James L. Grauer**
***StoMaster***