REFLECTIONS ON GLOBAL MACRO: POSITION FOR HIGHER RATES

Jeremy Schwartz — Global Chief Investment Officer
06/10/2015

Last week I chatted with Jawad Mian, the author of a macro advisory letter called Stray Reflections. We talked about his process of approaching macro research from the perspective of valuations, growth, liquidity and technicals. **Macro Positioning** In assessing the likelihood that the Federal Reserve (Fed) will raise rates, Mian asks if the world economy is ready for its first Fed rate hike in nearly a decade. He recalls that prior to 2015, world growth was imbalanced: U.S. growth was in full throttle, while China faced the fear of hard landing, Europe grappled with recession and investors questioned the sustainability of Japanese growth. In contrast, Mian believes 2015 is characterized by a much more balanced growth picture, with Europe and Japan providing positive momentum to global growth and China experiencing a stabilizing property market. As a result, he is bullish on non-U.S. stocks and bearish on bonds. **Higher Bond Rates Coming?** The stronger jobs report pushed the German bund up toward 1%, and long rates in the U.S. rose closer to 2.4%. Mian believes rates are going to continue to rise from here, calling for the 10-year U.S. rate to rise to 3.2% in 12 to 18 months as deflationary fears dissipate and bond yields reconnect with economic fundamentals. He attributes higher rates to a re-pricing of macro fears and re-rating of global growth. **What Rate Cycle Means for Stocks** Mian believes that turning points in interest rates are a strong cyclical trigger for U.S. equities. His favorite macro chart depicts the secular downtrend in U.S. yields from 1980 onward. According to Mian, historically speaking, cyclical peaks and troughs in rates represented good buying and selling opportunities for U.S. equity markets. Sell signals were triggered prior to previous stock market crashes, ahead of the 1987 "Black Monday" stock market crash, the 1990 crisis led by higher oil prices, the 1994 Mexican peso crisis, the 1997 Asian financial crisis, the dot-com crisis in March 2000 and the 2007 and 2008 financial crisis. Mian believes the next sell signal will be triggered at the 3.5% range in 10-Year Treasuries. One fundamental reason Mian sees for the secular downward trend in yields and lower trigger points for selling equities is rising U.S. debt, making the country less able to endure a crisis. He adds that as long as nominal gross domestic product (GDP) stays above 10-year yields, all is well, as the cost to finance the corporate sector is easily managed. As yields rise, investors ought to be more cautious. **Riding the Secular Bull: Japan and China** Mian designates March 2009 as the start of the secular bull market in the U.S. Similarly, October 2012 signaled the start of a secular bull market for Japan—one that he anticipates will last many years. Japan's prime minister, Shinzo Abe, has been given a significant mandate to bring about change, and Mian is encouraged by land prices bottoming out and the banking sector starting to recover as credit growth picks up and deflation abates. While exporters are at the forefront today, he anticipates Japanese financials will do well in the future as bank lending starts to accelerate. Mian also believes 2014 was that moment for China. In his analysis, Chinese stocks are the least crowded trade and could present a good risk/reward opportunity. He is not in the camp that prescribes to China employing a one-time FX devaluation to give a boost to its exporters, nor does he believe that China is experiencing a credit bubble. **He also thinks that emerging markets have become more diverse, with a preference for the following:**

- Reformers such as India that are not populist
- Asia in the likes of Japan, Korea and Taiwan and not LATAM
- Services sector and not cheap manufacturing goods

2015 is a wider European moment, as risks of breakup recede and growth is expected to resume. European stock prices are at a 60-year low compared to stock prices in the U.S. Mian believes that Greece will remain in the eurozone and that it is not in the best interest of either Germany or Greece to risk an exit given cheap euro valuation and the pain Greece has undertaken over the years via austerity. **The Tale of the USD—Hedging Currencies in Europe and Japan** Mian is a proponent of currency hedging in both Japan and Europe. When asked about his longer-term views on the U.S. dollar, he presents the following thoughts:

- Since 2011, there has been one big macro trade on global deflation. August 2011 marked the bottom of the U.S. dollar, which coincided with the S&P downgrading U.S. debt. By the same token, global inflation was falling, and investors were confronted with sluggish growth worldwide. Unsurprisingly, U.S. stocks outperformed handsomely.

- However, Q1 of 2015 marked the end of the deflation trade, and Mian believes that we are bound to see an unwinding of these trades. He believes that when the Fed embarks on its tightening cycle, the dollar may be more vulnerable.

Important Risks Related to this Article

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

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

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Bullish : a position that benefits when asset prices rise.

WisdomTree Dynamic Bearish U.S. Equity Index : A rules-based long/short index that includes long equity positions or long U.S. Treasury positions and short equity positions. The Long Equity Index consists of approximately 100 U.S. large- and mid-capitalization stocks that meet Index eligibility requirements and have the best combined score based on fundamental growth and value signals. Stocks are weighted in the Long Equity Index according to their volatility characteristics. The Short Equity Index consists of short positions in the largest 500 U.S. companies, weighted by market capitalization, designed to act as a market risk hedge. The Index provides a dynamic allocation of exposure to the Long Equity Index ranging from 100% to 0% while employing a variable monthly hedge ratio ranging from 75% to 100% exposure to the Short Equity Index based on a quantitative rules-based market indicator that scores growth and value market signals. During times when the market indicator shows unattractive readings on valuation and growth characteristics, the Index can move to 100% exposure to the Long Treasury Index (and accordingly no exposure to the Long Equity Index).

German 10-year bund : a debt instrument issued by the German government with an original maturity of 10 years.

10-year government bond : a debt instrument backed by a government guarantee with an original maturity of 10 years.

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

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.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Currency hedging : Strategies designed to mitigate the impact of currency performance on investment returns.