

# LayLine InterMarket R-EView

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## **INTEREST RATES**

All the Rates covered here (5yr, 10yr, 30yr) are trending lower since their recent highs in mid-June, with lower highs and lower lows, characteristics of a downtrend. However, on the very short side, 3-month T-Bills, they continue their upward trend that started in earnest around the beginning of the year. The 2-10 (2yr to 10yr) yield curve is very much inverted, by .48%. In bond lingo that's 48 basis points and that is a lot of inversion. The 5-30 yield curve followed here is very close to being inverted, with only 3 basis points separating the two. Even though that is very close, close doesn't count for much in yield curves.

What are the Rates telling us? The 30yr is moving lower suggesting inflation, long term inflation, is not a concern to those investors. The 5yr is also moving lower suggesting that economic growth is a bit challenged, but not in any severe way. The 10yr as arbiter, suggests that they are both correct this time around. The take away is less upward pressure on inflation and slower or challenged growth in the economy.

To add some perspective, let's compare the current situation in Rates with just prior to the pandemic, late in 2019. What we see is that all three Rates, 5yr, 10yr, 30yr, are now noticeably above their levels at that time. The 5yr was at ~ 1.68% it's now 2.98%, the 10yr was at ~1.85% it's now 2.80%, the 30yr was at ~ 2.35% it's now 3.01%. We know that the FED raises Rates to slow down the economy to fight inflation, so it's worthwhile to look at growth, as measured by GDP (gross domestic product) between then and now. Looking at the GDP rate for the 4<sup>th</sup> quarter of 2019 it was 2.1%. Currently, for the 2<sup>nd</sup> quarter of 2022, GDP was -1.9 (will get revised one way or another, but still likely to be negative). It looks to me that Rates are higher and growth is lower. Amazing how that works.

If you are wondering, PCE, personal consumption expenditures, (an inflation measure) has risen from 1.5% in the 4<sup>th</sup> quarter of 2019 to 6.8% in the 2<sup>nd</sup> quarter of 2022. Apparently rising Rates have less effect on dampening inflation and more effect on dampening growth.

## **US DOLLAR INDEX**

The US\$ has settled into a fairly narrow sideways channel for the past month. Traders would consider it a bit of a breather after the dramatic upward moves since March. The US\$ is still at historic high levels and the difficulties of a very strong US\$ continue to compound. US products are harder to sell overseas. Commodities, priced in the US\$ are still quite high, adding to inflationary pressures, when they should be lower due to the strong US\$. It's also more expensive for foreigners to buy US stocks and bonds with their weaker, relative to the US\$, currencies. For US consumers, it's a good time for buying goods and services produced overseas.

There are other economic issues related to countries whose currencies have weakened significantly against the US\$. This is probably the most difficult aspects of the surging US\$, and beyond the scope of this conversation. But, suffice it to say, if the US\$ hangs around these elevated levels or goes higher, more angst is going to be forthcoming from countries with emerging economies depending on their ability to maintain their currency's relative strength to the US\$. If they can't, everything they import is going to cost more, and that's not a good economic option for them.

### **COMMODITIES**

The DBC has also settled into a fairly narrow sideways channel, emulating the short-term trend in the US\$. This is actual good to see. For some time now we have seen commodities and the US\$ move up at the same time. This is not what is expected in the traditional InterMarket relationship between commodities and the US\$, which is inverse, one moves higher the other lower and vice versa. With both moving sideways, this suggests that they are starting to reconnect that inverse relationship. The good news is that would suggest that supply constraints, one of the main culprits for the rise in commodity prices, are starting to balance with demand. The concern is if the US\$ starts to decline, commodity prices would then rise, complicating the problems with inflation. On the other hand, if the US\$ re-establishes its march higher, it would drive commodity prices lower, good for lowering inflation pressures, but not so good for US based businesses doing business overseas, adding to growth concerns. Rock and a hard place come to mind.

### **US EQUITIES**

US Equities continue their move off the June low, and by any stretch of the imagination, an impressive move, especially given the weaker Fundamental backdrop. Recent data continues to suggest weaker Fundamentals; weak GDP growth for two quarters, weak labor productivity for the past two quarters, higher FED funds Rates with more likely coming, higher prices for labor and inputs pressuring operating margins lower, and while earnings have held up, they are not stellar by any means. While the jobs number last Friday was impressive, it appears that many of those new jobs went to folks who already had a job, as the labor participation rate actual went down. More jobs but fewer folks in the labor pool. Not that awe inspiring jobs number after all.

On the Technical side, US Equities are bouncing up against some significant overhead price resistance. Basically, a resistance level of price is where in the recent past, buyers have not wanted to step in and buy at that level, so sellers are forced to sell to sellers and that's a recipe for lower prices. If prices can break through, with confirmation, that level of resistance then there are more buyers than sellers and they will drive the price higher. US Equities did move up though its 50-day MA (moving average of prices) with confirmation. Nice, but with the 200-day MA hovering above, it's likely going to provide a significant degree of resistance. On the bright side, a move through the 200-day MA, with confirmation, would be promising for more upward moves. It goes without saying, but I will, any failure to get above the 200-day MA or a drop back below the 50-day MA will signal more downside.

### **WHAT DOES THIS MEAN TO INVESTORS?**

Rising Rates have hindered growth but have shown less ability to subdue inflation. Similarly, the strong US\$ has negatively affected growth by making US products and services more expensive for overseas consumers, but has had little effect on reducing inflation. Commodity producers may be

getting the supply problems straightened out, but as of yet it has had little effect on lowering inflation. What this means for investors is that inflation is responding to some other stimulus and that is likely to be M2, money supply. Milton Friedman, in 1963, stated that, "inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money". Looking at how fast M2 and inflation increased last year, Friedman observation looks to be right. If the recent slowing in M2 proves to be lasting, it would suggest inflation will come down, regardless of what the InterMarkets do. Something to consider.

You can follow the four InterMarkets on our web site [www.LayLineinvest.com](http://www.LayLineinvest.com), on the LayLine EView page. A one-year chart for each of the InterMarkets is provided and updated on Fridays after the close.

**REFERENCES:**

5yr: 5 Year Treasury Yield (FVX)  
10yr: 10 Year Treasury Yield (TNX)  
30yr: 30 Year Treasury Yield (TYX)  
US\$: Invesco DB (Deutsche Bank) US Dollar Index Fund  
DBC: Invesco DB (Deutsche Bank) Commodity Index Tracking Fund  
Yield Curve: The difference between the 30yr and the 5yr.  
FED: Federal Reserve  
ECB: European Central Bank  
US Equities: S&P 500  
EURO: Eurozone Currency  
IMF: International Monetary Fund

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