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Elixir News

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CREATING INCOME FOR EVERYDAY PEOPLE BY USING TECHNOLOGY
TO HARVEST VOLATILITY.

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Hi, everyone.

I trust that you are all enjoying spring. Based on my chats with friends across the country, it appears that everyone is appreciating the warm weather in all provinces. We at Elixir have been busy as usual. We are working with a human resources professional, Greg Pocherewny of Fifth Ring, to recruit a Director of Software Development. If you know of someone who is a good fit for this position, please have them formally **apply through this job posting**. Thanks for your support, and if you have questions, please reach out to me directly.

Warmest regards,
Bill and Eve McNarland
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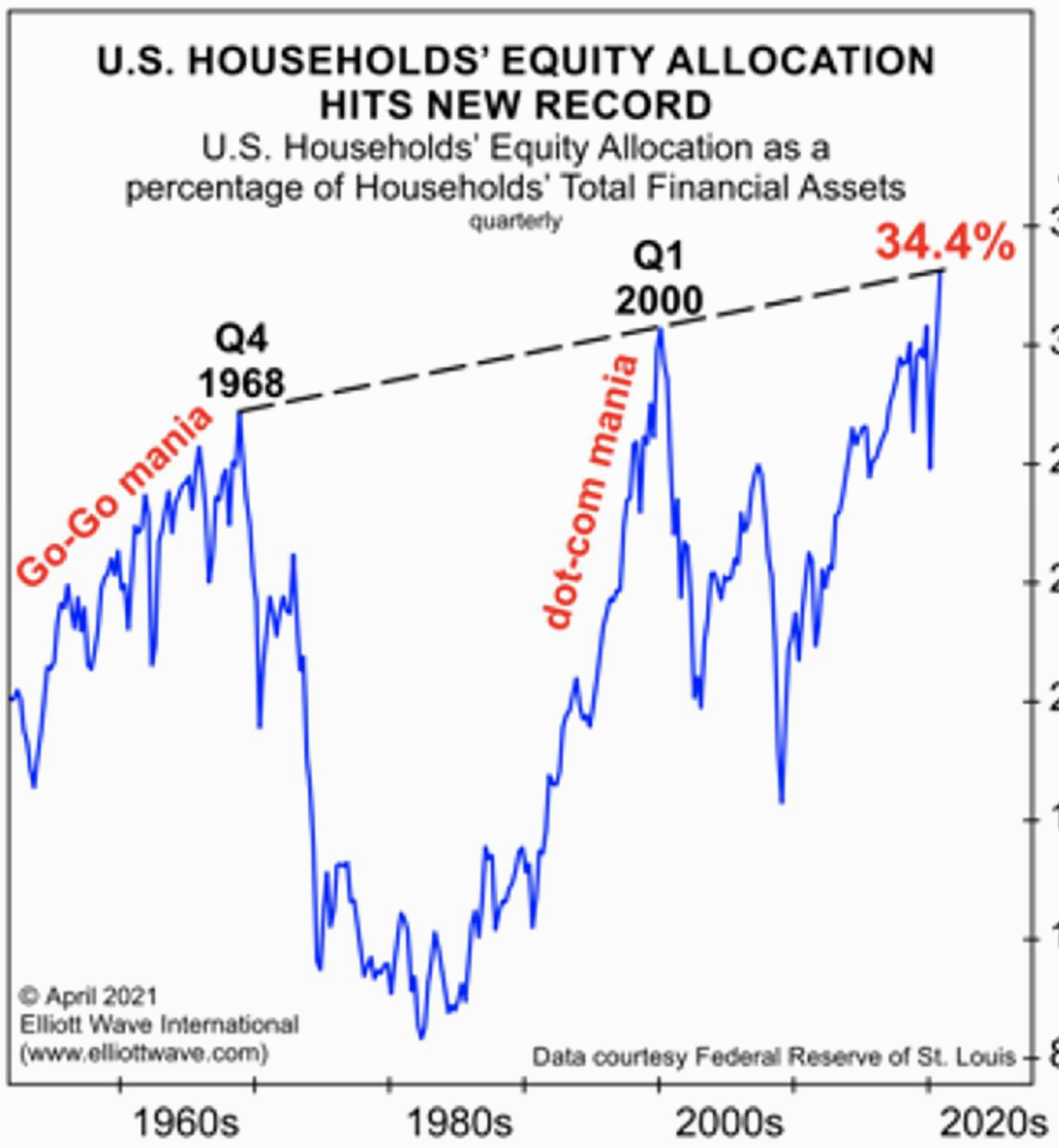
Economic Outlook and Market Observation

"Everywhere you look, there's a valuation lens that makes stocks look frothy," said Bloomberg on March 27. The chart below shows one representative extreme. At 34.4%, the percentage of U.S. household financial assets committed to equities is higher than ever. In fact, with all the main U.S. stock indexes advancing in the first quarter of 2021, the percentage of equities held by U.S. households will surely push past the 52-year trendline connecting the peaks of December 1968 and March 2000. Both prior periods marked the end of speculative market frenzies that led to major bear markets, as the chart shows.



Comparison of stock market capitalization to the U.S. GDP is another measure that value-minded investors cite. It is sometimes called the Buffett Indicator due to its affiliation with Warren Buffett, who is generally regarded as the embodiment of value investing. This past September, the indicator showed a record extreme in the Wilshire 5000 relative to the U.S. GDP. As of March 31, the ratio jumped to a new record of 1.95. Thus, the broadest measure of U.S. stocks is valued at almost twice the annual U.S. GDP.

An excellent example of the continued euphoria is the early March opening of a Tokyo bar that caters to patrons who want to trade stock tips, to show the bull market's unprecedented popular caché. Bloomberg reports that the bar, called Stock Pickers, "has been almost full every day." The bar's owner says that younger investors come "for advice on how to get started in investing and understanding stock valuations." More seasoned investors show up because "people care about what retail is thinking." Appropriately, you can slurp down a "Lehman Shock," "I.T. Bubble," or "Margin Call." Likely, my view that people should be at home drinking tea while reading a book about equity valuations would be considered outdated.

CUSTOMERS SIT NEXT TO A SCREEN DISPLAYING FINANCIAL INFORMATION INSIDE STOCK PICKERS, A TIP-TRADING BAR FOR INVESTORS, IN THE GINZA DISTRICT OF TOKYO ON MONDAY.

While the stock market is screaming extreme bubbles, an excellent opportunity is brewing in U.S. bonds and U.S. dollars. Currently, people are selling lots of USD, and U.S. bonds and prices are becoming very attractive for Canadians. As a Canadian, you have four potential benefits:

1 – Potential increase in the value of USD

2 – A yield of 2.4% while you wait

3 – Protection from a potential market fall out

4 – Increase in the value of the bonds

Our feature article will analyze the pricing of the U.S. bond market compared to the rest of the world.

Feature Article:

Even bond risk analysis has gone out the window

Bubbles and craziness have come and gone. However, usually, the bond market is one of intelligence and sensibility. Presently, the bond market is completely irrational when pricing at risk. Below I present examples in the government bond market.

The most remarkable current example of absurd pricing is the long bonds of significant countries. A long bond is typically 30 years long, but other, similar measurements may be considered if a country does not have a maturity that currently ends in 30 years. One basic process of bond analysis is a relative risk/yield analysis. The goal of a relative process is to compare the yield available to the unit of risk taken. Let's walk through the process of comparative analysis. We will look at 16 countries: Canada, Denmark, Finland, France, Germany, Greece, Italy, Japan, the Netherlands, Portugal, Singapore, South Korea, Spain, Switzerland, the U.K., and the U.S. The analysis is based on data from Bloomberg, government agencies, and Statista.com.

A country with a reserve currency, high credit rating, and lower debt to GDP should have the lowest yield on debt. Additionally, we expect countries with high vaccination levels to have lower debt yields, as these countries will more quickly return to their routines.

1 BOND RATING

Bond ratings—like personal credit ratings—are not perfect. However, even if you're concerned that credit rating agencies are more optimistic than they should be, they are still valuable on a comparable basis. The theory is that bonds with the highest credit rating should offer the lowest yield, as they are less risky. What do we discover when we conduct an analysis based on yield compared to rating?

Canada and Singapore are both in the AAA category, with bond yields of 1.96% and 1.99%, yet the yields of Italy, Portugal, and Greece are all lower, at 1.64%, 1.23%, and 1.89%. This is shocking, as these Southern European countries are rated BBB or B.B., which is considered junk debt or almost junk debt. Why Southern European countries have lower borrowing costs than AAA countries is a mystery.

2 RESERVE CURRENCY

The bonds of countries with large currency floats should have lower yields than those of countries with small currency floats. The explanation is that the demand for popular currencies should provide lower yields to countries with popular currencies. For example, only a few people need the national currency of South Africa. Hence, South Africa is more challenging to issue bonds than countries with significant currencies like the USD or Euro. Currently, there is no advantage for a country to have a large currency float. For example, Denmark has a tiny currency and can offer a yield of only .42% compared to France (Euro) at .8% and the U.S. at 2.4%. There is no yield saving for countries with significant currencies.

3 DEBT TO GDP LEVELS

In theory, the bonds of countries with large debt to GDP levels should be punished for their high debt. Asia provides an example of how this logical reasoning is not playing out currently. South Korea, which has 56% debt/GDP, must pay a yield of 2.04% on its bonds, while Japan, which has a Debt/GDP of 260%, is paying only 0.63%. Again, this shows how Debt/GDP levels are not being priced into bond yields.

4 COVID-19 THIRD WAVE

With the third wave of COVID-19 coming on strong, countries with low vaccination rates could have more trouble paying their debt obligations. In theory, a country with high vaccination rates should be rewarded in the bond market with a lower yield, as the country faces a lower risk of economic challenges. Some people present the thesis that everything—including the bond market—is different this time, as COVID-19 is leading to the repricing of assets. Yet even this does not pan out when analyzed further. Japan has the lowest vaccination totals, with less than 2% of the population receiving a vaccine, and its bond rate is 0.63%. Meanwhile, the U.K. and the U.S. are leading with 54% and 46%, respectively, yet the bond yields that these countries have to pay are 1.31% and 2.4%. So, it appears that COVID-19 vaccination rates are not factors in either.

Based on these four pieces of analysis, it seems that the bond market is not following any rational analysis for the first time in history. The bond market's former comfort made sense when equities or other markets focused on speculation no longer holds.

When I review the information, the one country that sticks out to me is the U.S., whose bond yield of 2.4% is very high compared to those of the other major economies. With the U.S. having reasonable comparative Debt/GDP ratios, an A.A. debt rating, and a robust recovery from COVID-19, it seems to be an excellent relative opportunity. Additionally, as Canadians, we have the once-in-a-decade opportunity to purchase these bonds with a strong Canadian dollar. This is a perfect opportunity—one to consider taking advantage of.