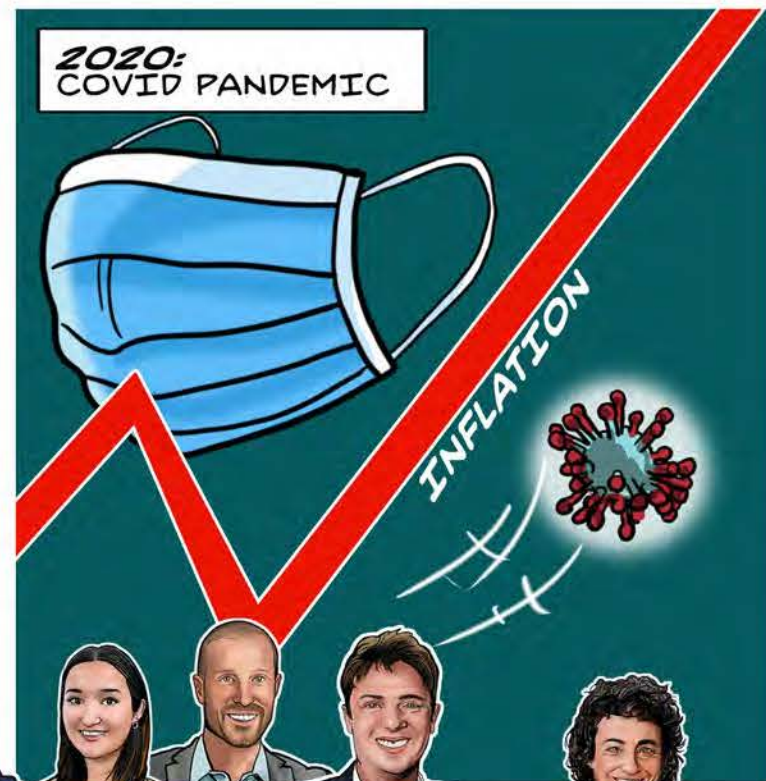


The Bond Vigilantes

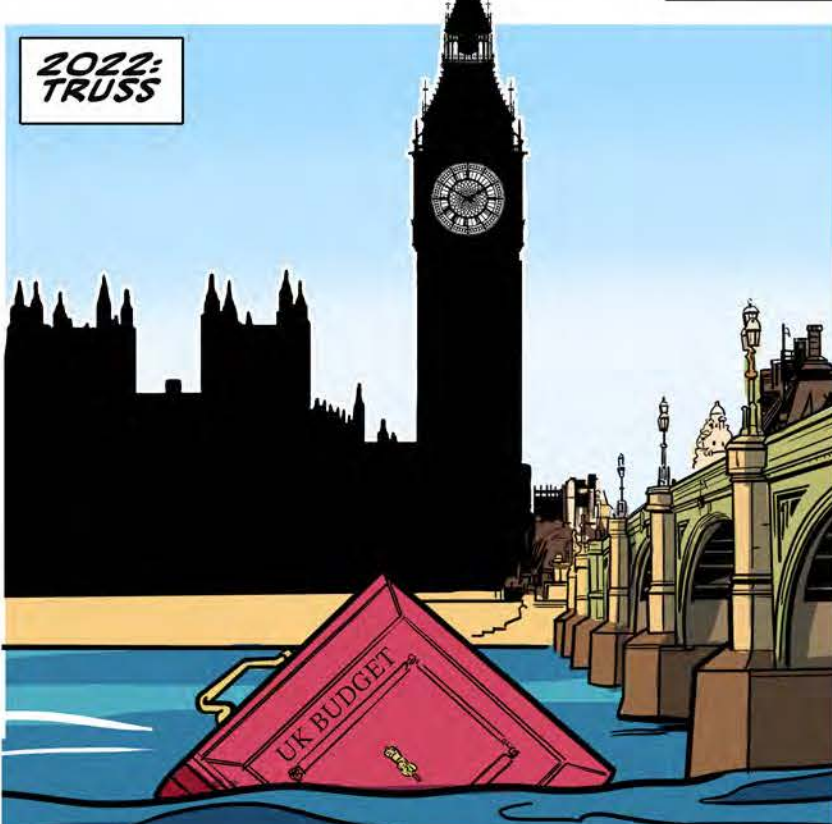
BLOG TEAM



INTRODUCING!
ANDREW
CIO FIXED INCOME

WHAT ARE THE ORIGINS OF THE **BOND VIGILANTES**? DO THEY REALLY EXIST AND, IF SO, WHAT DO THEY DO? THESE **UNSUNG HEROES** ARE SAID TO HAVE PULLED THE STRINGS FOR DECADES

COULD THEY BE ABOUT TO SPRING INTO ACTION YET AGAIN?



2025: THE BOND VIGILANTES RISE AGAIN?

FROM **ROBIN HOOD TO BATMAN**, VIGILANTES ARE A FEATURE OF POPULAR CULTURE, TAKING MATTERS INTO THEIR OWN HANDS WHEN THE LEGAL AGENCIES ARE THOUGHT TO BE INADEQUATE, USUALLY WITHOUT LEGAL AUTHORITY BUT OFTEN WITH A DEGREE OF **MORAL RIGHTEOUSNESS!**

THE FINANCIAL MARKETS HAVE THEIR OWN SELF-APPOINTED GUARDIANS, THE **BOND VIGILANTES**, A TERM COINED BY ECONOMIST **ED YARDENI** IN THE 1980S TO DESCRIBE INVESTORS WHO SOLD OFF TREASURY BONDS TO **PROTEST FED POLICIES.**



IS IT A BIRD, IS IT A PLANE?

NO, IT'S **THE PROTECTORS** OF LONG TERM, DEBT-BASED, STATE-ISSUED, INVESTMENT!



I PREFERRED BIRD



UNLIKE THEIR FICTIONAL COUNTERPARTS, THESE VERY REAL TRADERS AREN'T PROWLING DARK ALLEYS TO TAKE ON THE DENIZENS OF THE UNDERWORLD, INSTEAD THEY **WIELD POWER BY SELLING BONDS TO DRIVE UP** BORROWING COSTS AND FORCE POLICY CHANGE...

HOW DOES IT WORK?



THE WEAPON OF CHOICE FOR A BOND VIGILANTE IS THE BOND YIELD, THE **INTEREST RATE GOVERNMENTS PAY TO BORROW** FROM INVESTORS. BOND PRICES FALL AS YIELDS RISE. AS SUCH, WHEN THERE'S AGGRESSIVE SELLING BY BONDHOLDERS, **PRICES FALL** AND BORROWING COSTS FOR GOVERNMENTS **RISE**. IN PRINCIPLE, THE THREAT OF HIGHER BORROWING COSTS SHOULD BE ENOUGH TO CHANGE THE BEHAVIOUR OF GOVERNMENTS AND PRESS FOR **GREATER FISCAL DISCIPLINE.**

BOND VIGILANTES IN ACTION

LET'S LOOK AT THE BOND VIGILANTES AT WORK. THERE IS SCEPTICISM ABOUT THEIR IMPACT ON US MARKETS, BUT AS WE WILL SEE, THEY HAVE DEFINITELY MADE THEIR MARK. WHAT IS MORE CERTAIN IS THE **BOND VIGILANTES' REACH** ACROSS SMALLER ECONOMIES.



1993-94 BVs VS CLINTON



IN HIS CLINTON BIOGRAPHY, *THE SURVIVOR*, JOHN F HARRIS QUOTED THE THEN PRESIDENT AS SAYING, "YOU MEAN TO TELL ME THAT THE SUCCESS OF THE PROGRAM AND MY RE-ELECTION **HINGES** ON THE FEDERAL RESERVE AND A BUNCH OF \$%@! BOND TRADERS?"

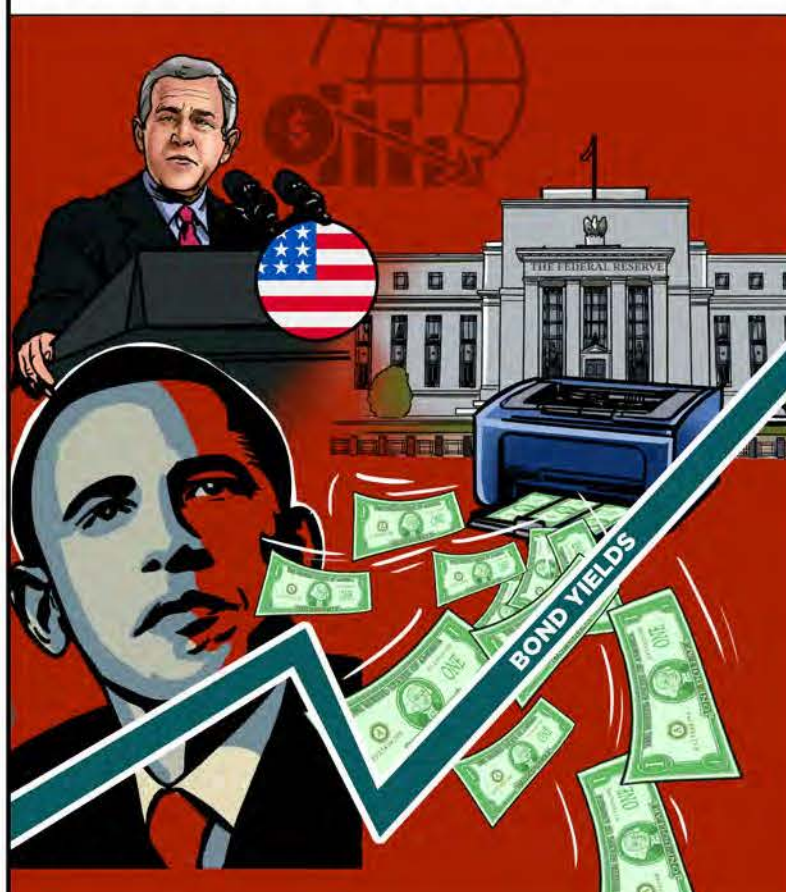
THIS IS INTIMIDATING...

BOND TRADERS BECAME FRUSTRATED WITH THE CLINTON ADMINISTRATION'S SPENDING, DRIVING YIELDS ON 10-YEAR TREASURIES UP FROM AROUND 5% TO 7%. AS A RESULT, CLINTON SCRAPPED PLANS FOR HEALTH REFORM AND BROUGHT IN A SERIES OF MORE CONSERVATIVE POLICIES, RAISING TAXES AND REDUCING SPENDING.

2008-10

GLOBAL FINANCIAL STIMULUS FOLLOWING THE FINANCIAL CRISIS AND RECESSION OF 2008, BOND MARKETS REACTED STRONGLY TO INCREASED GOVERNMENT BORROWING AND STIMULUS SPENDING TO BOOST AN ECONOMY IN TATTERS.

YIELDS ROSE AS **INVESTORS FEARED** INFLATION AND UNSUSTAINABLE DEBT LEVELS, ALTHOUGH FED POLICIES LATER HELPED **CONTAIN** THESE EFFECTS.



2011: EUROPEAN SOVEREIGN DEBT CRISIS

THE 2008 **FINANCIAL CRISIS** LED TO A EUROPEAN DEBT CRISIS. PORTUGAL, ITALY, IRELAND, GREECE AND SPAIN ALL SAW **YIELDS EXPLODE**. WAS THIS THE WORK OF THE **BOND VIGILANTES**? ULTIMATELY, POLICIES CHANGED, **IMF SUPPORT** CAME IN AND THOSE BOND YIELDS CAME DOWN.



THE **BOND VIGILANTES** WILL COME TO THE RESCUE!

2020-2021 (PANDEMIC SPENDING)

AFTER A DECADE OF LOW INTEREST RATES AND QUANTITATIVE EASING, THE MASSIVE STIMULUS IN RESPONSE TO THE PANDEMIC LED TO A **SPIKE IN BOND YIELDS** IN EARLY 2021.



THE 2021 SPIKE ULTIMATELY MARKED THE BEGINNING OF A NEW ERA, **INFLATION ROCKETED** AND CENTRAL BANKS HIKE INTEREST RATES. ALL OF A SUDDEN DEBT WAS **NO LONGER CHEAP**.

SEPTEMBER 2022 UK MINI BUDGET

ONE OF THE MORE **DRAMATIC** EPISODES OF BOND VIGILANTISM RESULTED IN THE RESIGNATION OF UK PM LIZ TRUSS AFTER 50 DAYS IN OFFICE. THE BUDGET CONTAINED **£45 BILLION** OF TAX CUTS. THE MARKETS **REACTED**, BOND YIELDS SOARED AND THE POUND **PLUMMETED**, TRIGGERING ONE OF THE MOST **DRAMATIC SELL-OFFS** IN RECENT HISTORY.



POUND PLUMMETS, INTEREST RATES SOAR!



THE INDEPENDENT RESOLUTION FOUNDATION CALCULATES THAT THE TRUSS GOVERNMENT WAS RESPONSIBLE FOR ABOUT **£30 BILLION** OF THE **FISCAL HOLE** WHICH THE TREASURY PUTS AT **£60 BILLION**.

THE BOND VIGILANTES RETURN

MANY ARE SPECULATING THAT THE BOND VIGILANTES COULD RETURN IN A BIG WAY IN 2025. GOVERNMENT DEBT RATIOS ARE AT RECORD LEVELS IN EVERY COUNTRY APART FROM GERMANY. GLOBAL DEBT AMOUNTED TO \$250 TRILLION IN 2023, THAT IS 237% OF GDP. HOW WILL THIS DEBT BE SERVICED?



THE US

THE US DEFICIT HAS **BALLOONED** OVER RECENT YEARS, WITH PANDEMIC SPENDING AND LOOSE FISCAL POLICIES SUCH AS THE INFLATION REDUCTION ACT. NOW, THE TRUMP PRESIDENCY PROMISES TAX CUTS COSTING AS MUCH AS **\$400 BILLION** A YEAR.



BOND MARKETS ARE WAITING TO SEE THE IMPACT OF TRUMP'S POLICIES. **WRANGLING** OVER THE US DEBT CEILING, DOWNGRADES TO THE US CREDIT RATING OR A FALL IN FOREIGN DEMAND FOR US TREASURIES COULD MAKE MATTERS **WORSE**.

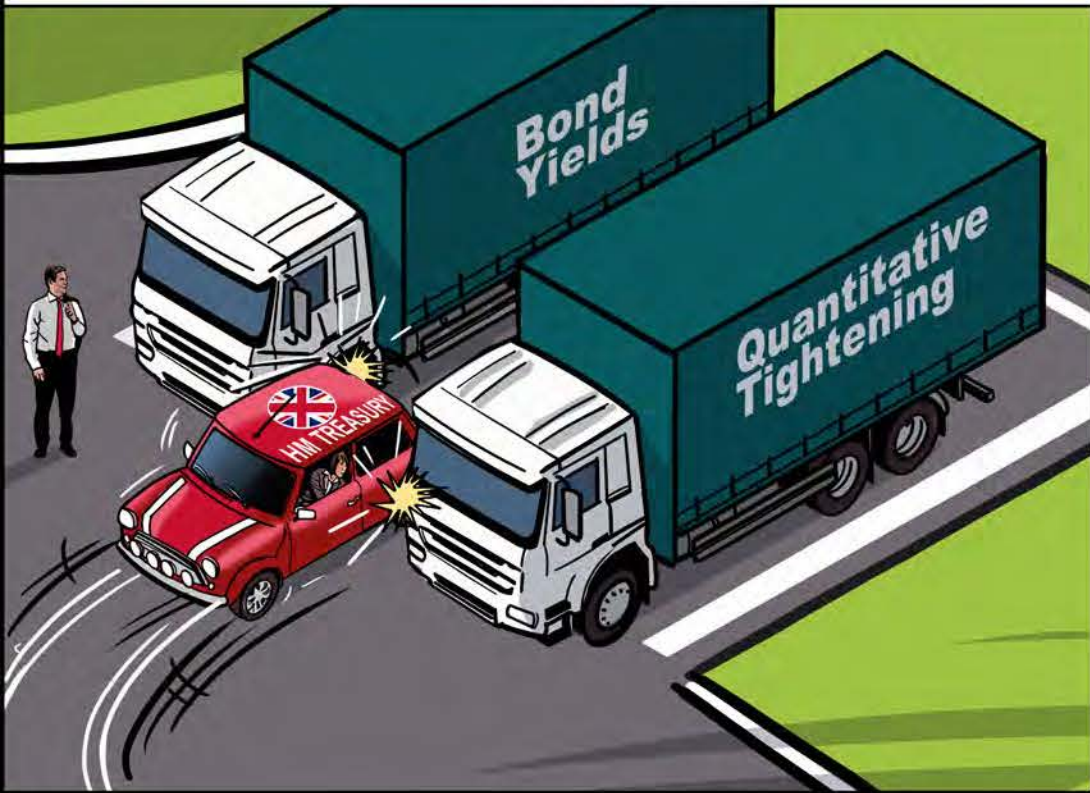
EUROPEAN PILLARS TREMBLE

FRANCE HAS BEEN A **PILLAR OF THE EU** BUT ECONOMIC AND POLITICAL INSTABILITIES ONCE MORE THREATEN THE STATUS QUO. FROM **BREXIT** AND **COVID** TO THE **DEBT CRISIS** AND **WAR** IN UKRAINE, IT LOOKS LIKE THE BLOC'S RESILIENCE WILL BE TESTED **YET AGAIN**.



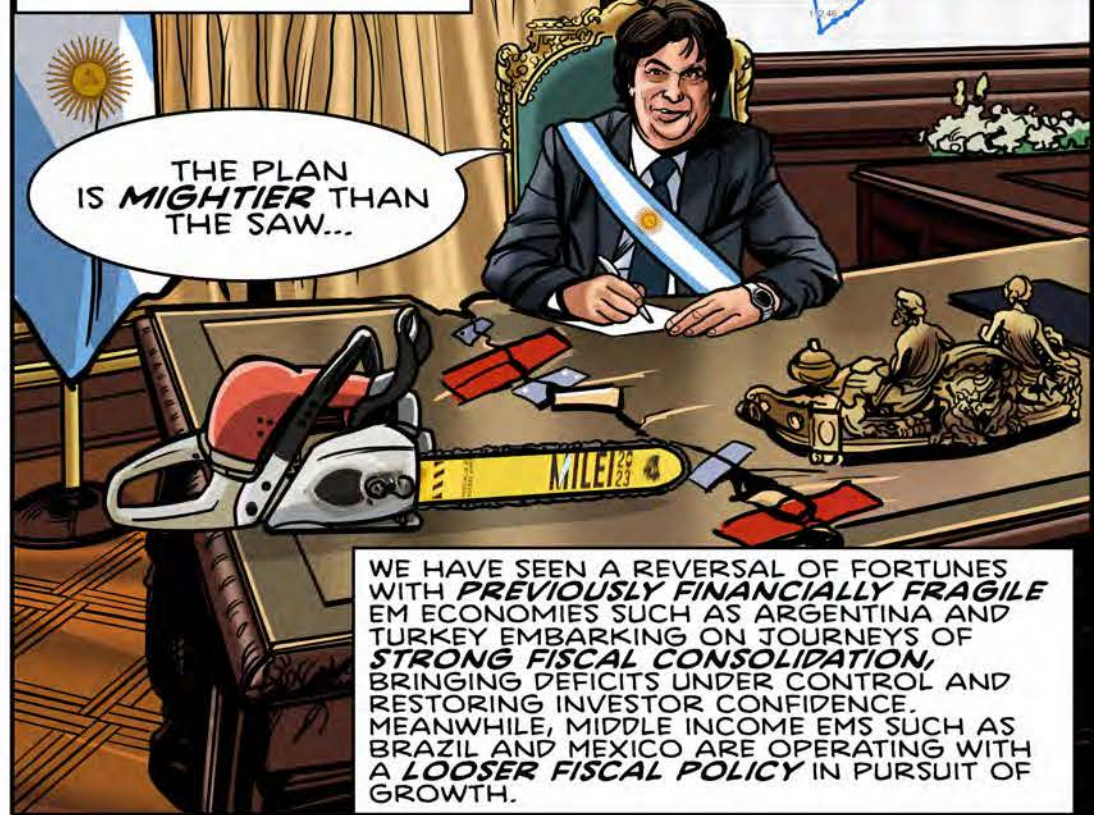
MEANWHILE IN THE UK...

BOND VIGILANTISM HAS AGAIN REARED ITS HEAD, WITH GILT YIELDS BEGINNING 2025 BY **SPIKING TO HIGHS** LAST SEEN IN 2008 WHILE THE BANK OF ENGLAND ACTIVELY PURSUES A **QUANTITATIVE TIGHTENING** POLICY. IT ALL LEAVES THE NEW LABOUR GOVERNMENT WITH **LITTLE** FISCAL ROOM TO MANOEUVRE.



EMERGING MARKETS

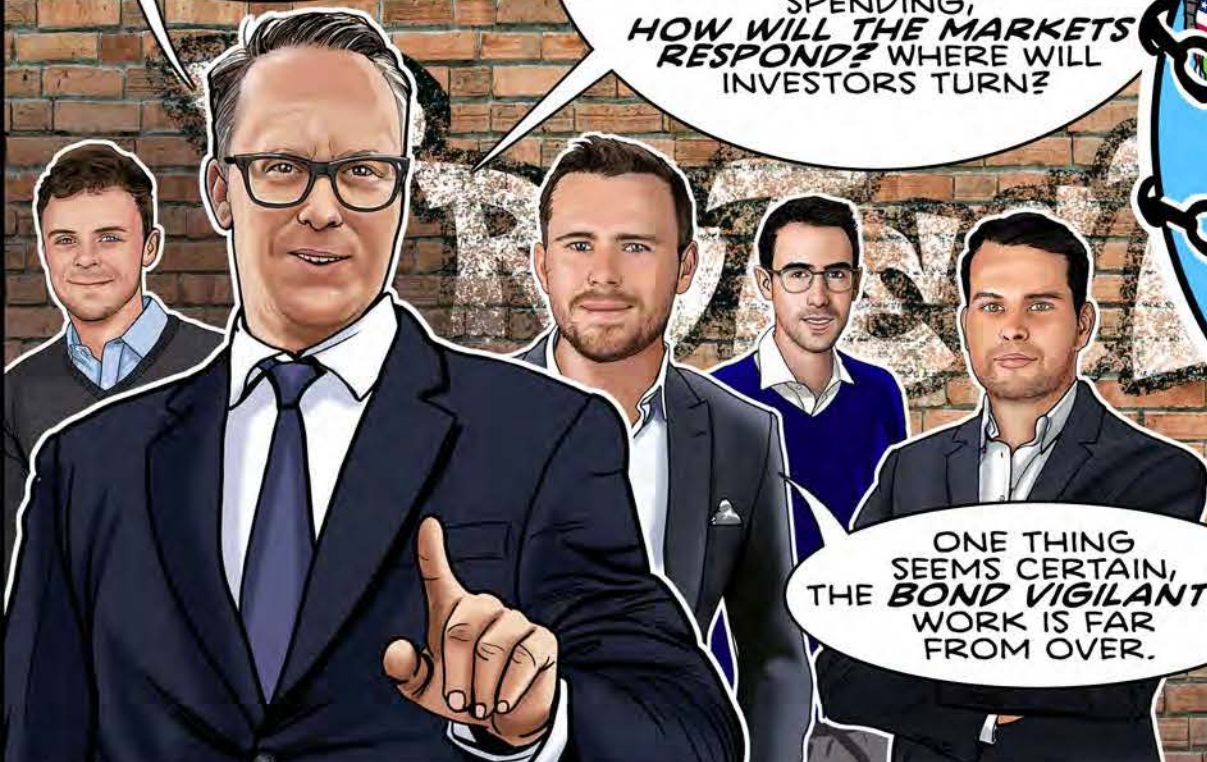
EMERGING MARKETS HAVE PROVEN AN **INTERESTING** CASE FOR SOVEREIGN BOND INVESTORS.



WE HAVE SEEN A REVERSAL OF FORTUNES WITH **PREVIOUSLY FINANCIALLY FRAGILE** EM ECONOMIES SUCH AS ARGENTINA AND TURKEY EMBARKING ON JOURNEYS OF **STRONG FISCAL CONSOLIDATION**, BRINGING DEFICITS UNDER CONTROL AND RESTORING INVESTOR CONFIDENCE. MEANWHILE, MIDDLE INCOME EMS SUCH AS BRAZIL AND MEXICO ARE OPERATING WITH A **LOOSER FISCAL POLICY** IN PURSUIT OF GROWTH.

AS WE HAVE SEEN, FOR DECADES, **BOND VIGILANTES** HAVE CALLED NUMEROUS HALTS TO PROFLIGATE GOVERNMENT SPENDING.

WITH THE WORLD NOW **STRAINING** UNDER AN EVER-INCREASING **DEBT BURDEN** AND FACTORS SUCH AS DEMOGRAPHICS, DECARBONISATION AND DEGLOBALISATION PLACING GREATER **STRAIN** ON GOVERNMENT SPENDING, **HOW WILL THE MARKETS RESPOND?** WHERE WILL INVESTORS TURN?



ONE THING SEEMS CERTAIN, THE **BOND VIGILANTES'** WORK IS FAR FROM OVER.

