

Interim Market Update



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NOW WHAT?

We are enclosing for your edification our most recent papers on “Operation Twist.” Over the years we have mentioned this Fed operation many times (way back in 2002 for example). The last time the twist was used was in the early 1960s just after we went to work for Bank IV here in Wichita. It is a desperation move just short of the ultimate desperate move of pegging long-term rates, which occurred during World War II up until the Treasury Accord in 1951, and still may well happen. This is a validation of our long held view that we are in a new style depression that will be with us for years to come.

As you know, for the last several years we have been working on programs for all of us to use when “game over” is declared on this long 30-year bull market in long government bonds. The end has not arrived yet, but is getting closer. We have initiated several programs, but have not decided upon a flagship entry. We will have that accomplished before this year end.

There will be further upside and downside volatility in long governments between now and exit time, however, we should not be too quick to move. Remember, the realization by the Fed that the economy is in terrible shape just means they will buy even more of the 30-year if need be. The timing of sales needs to be centered around the upturn in the economy. What makes this so hard is that psychology is so difficult to assess. We do know, however, that all the pigs end up in the slaughter house. The spread between the 10-year and 30-year governments has been approximately 130 basis points of late (it’s currently 116) – and normal is 80. There is room for further gain.



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LET'S DO THE TWIST

WEB BUZZ 2011.09.19

From where we sit, the Fed just has no tools that will benefit the U.S. economy in a meaningful way. Frankly, they are out of bullets. Also, from a financial standpoint, the old tax and spend policy plus the huge increase in consumer debt that are largely responsible for our troubles today have hit the brick wall - the law of diminishing returns is in full effect. Only the reduction in debt either by default, reorganization, or payback out of income will right the ship of state. That, of course, means we are destined to be in a long period of slow to no growth (how many times have we said that over the last ten years or so?).

Let's say the above is a given, then let's take this period to get our financial house in order as it pertains to the government bond market. If we were the policy makers at the Fed here is what we would do:

1. Put in place "operation twist," which is selling short-term treasuries and in its place buying long-term treasuries. This should not drive the inflationists into hard assets as no new liquidity is added to the marketplace. What it should do is lower the 30-year government bond to around 2% - 2.5%.
2. At a later date, say the first of the year, have the treasury announce that for the first time they will issue 50-year government bonds - say the coupon would be something like 3%. This would lock in a rate that would be amenable for carrying the debt. Our interest expense would become more known and mitigate what we all know will be higher rates later on.
3. Maybe down the line the treasury should sell 100-year bonds at say 4%. We all know that one can obtain very little interest on quality fixed-income investments now. Another five years of 0% interest rates might make these very attractive.

4. The final step would be to inflate away the principal after deflation has run its course. Bing, bang, boom we have solved our treasury debt problem.

An After Thought

It might be that if all of the above would not get our government out of its self-inflicted mess, they could confiscate private pension funds and in its place swap out low coupon long-term securities and pay down debt with their newfound money.

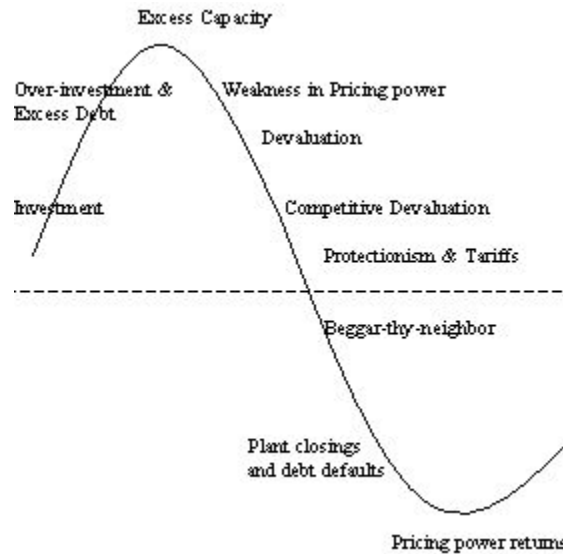
Don't laugh at this. As terrible as it is other countries have done it, and a year or so ago there were hearings in our congress on this very matter. What is the old saying, "We're from the government and we're here to help you!"

Performance Update

For those of you who have been with us since 1/1/10 and have made no additions or withdrawals in your Bison Bond I account, your numbers before fees are up approximately 40%.

A RACE TO THE BOTTOM WEB BUZZ 2011.08.08

A grand rush to 0% interest rates and competitive devaluation is developing across the world. The Central Bank of Switzerland recently announced that they were going to intervene in the currency market to reduce the value of the Swiss franc. This is going to accelerate the competitive devaluation of currency. This is a part of our favorite chart - the deflation cycle:



Adapted from prudentinvestor.com

Why do we say 0% interest rates are in our future? This is due to the level of debt all over the world. Debt of every kind and particularly sovereign debt is a major problem and countries will do everything in their power to keep rates low. In that regard we expect the Fed to initiate a new stimulus package, such as an operation twist* program, before long. The economic conditions demand that interest rates remain low in those countries which still command the confidence of the financial markets. At the present time, there are only a handful of such countries. The U.S. remains one of those select turfs in spite of the downgrade.

Of course, at the same time exports remain one of the better ways to pull an economy out of the doldrums - thus the intervention in the currency exchange markets to keep one's export items cheap. Friends, it's a race to the bottom!

*operation twist - Fed sells short-term treasuries and buys long-term bonds. This will flatten the yield curve and make investment more attractive. In case short rates get too high, they then might just buy long bonds period.