MBS

MBS Mantra, LLC

MBS Mantra MBS High Income/Absolute Return Strategy November 2018 returns: 0.28% net, +0.35% Gross, +2.38% YTD

Hello. Please find attached the Nov 2018 Fact Sheet for our flagship MBS Absolute Return Strategy. This can be accessed from our website as well.

Our strategy is exhibiting less volatile returns than our benchmarks, and was up slightly for the month. YTD, we are outperforming the AGG by 4.2%, MBS by 3.2% and HY by 2.3%. The US Treasury market especially is being whipsawed.

With the volatility in the market, we waited till after Thanksgiving to buy a few bonds. We did not sell any bonds during November, but did have 2 bonds get 'called'.

With the rally in rates that accompanied the volatility and selloffs in equities, there is now talk in the market that, after 1 more hike in December, not only will the Fed limit or not raise rates in 2019, but the probability of rate cuts (easing) in 2020 has now gone positive!

There has also been much prognostication from various sources that the flattening, and indeed slight inversion (to 5 years), of the yield curve portends a recession.

We disagree.

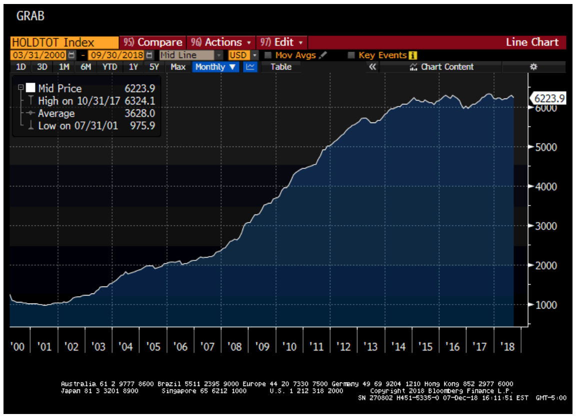
We believe that the US Treasury market and curve shape stopped having meaningful information starting in 2002, when foreign central banks started implementing their QE and currency activities through investments in US Treasuries. The shape of the curve no longer has meaning. Neither does the difference between TIPs and USTs, as predictors of inflation. Most traditional models of bond valuation taught in textbooks and CFA courses - real returns plus inflation expectations plus liquidity term premiums - are obsolete.

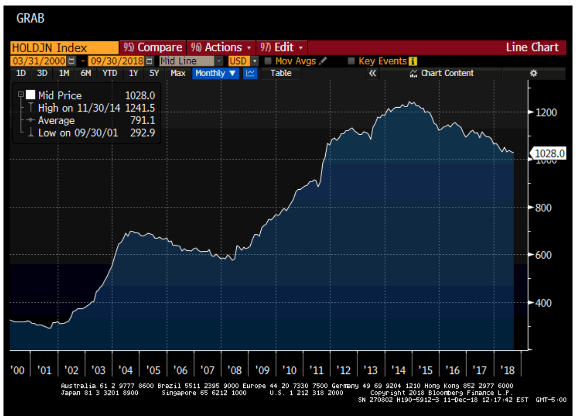
I fully expect that, in two months time when the data is released, we will discover that the Bank of Japan purchased a significant amount of US Treasuries in Nov/Dec, to offset the Yen strengthening that should have resulted from the equity market selloffs in November and December 2018.

When the S&P swooned in Jan/Feb 2018, from 2871 to 2581 (closes, with even greater intraday ranges), -291 points or -10%, the Yen strengthened 4.5% from 111.17 to 106.13, hitting my "what-me-worry" target of 105 yen intraday.

In the 2 recent selloffs in November and December, with the S&P declining 6.4% and 5.7%, Yen has barely strengthened, 1.3% and 0.97% respectively. This is highly unusual. However, notably, the US treasury market has rallied significantly, with the 10 year up around 2.86% from a 3.23% yield high.

To me, this smells of a Japanese intervention to keep the Yen weak. We last saw this in 2014. In the meantime, however, a bid for bonds appears to have redeveloped.





On Bloomberg, you can look up HOLDJN Index and HOLDTOT Index to track Central Bank UST Holdings.

Those of my readers that followed my Crisis Notes from 2007 to 2012, and that have read my subsequent analysis of Macro, Swaps, and Inflation, will have already much of the analysis that has led to these conclusions.

The bottom line: one needs to follow the activities of foreign central banks in addition to the Fed, as global money supply and inflows into the US are an important determinant of asset prices and US economic activity. Our analysis has shown that it is the tail that wags the dog, and that money supply inflated asset prices drive economic activity, through a combination of leverage availability, P/E expansion, and wealth effects.

For new readers of our Analysis and Viewpoints pages, the following analyses might be of interest.

Interpreting Benchmark Yields - Separating Inflation Expectations from Central Bank Activity

Interest Rate Swaps as a Benchmark

The first Crisis Note

Understanding Beta - Determinants of the US Stock Market

We welcome your questions and comments.

Regards, Samir

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Samir Shah
President and CIO
MBS Mantra, LLC (a CT Registered Investment Advisor)
"Alpha Through Analysis"®

203-388-8356 P
203-273-0360 C
sshah@mbsmantrallc.com
https://www.linkedin.com/in/samir-shah-6a9096a
Please visit our website www.mbsmantrallc.com for important disclosures.

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