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Macro Market Insights

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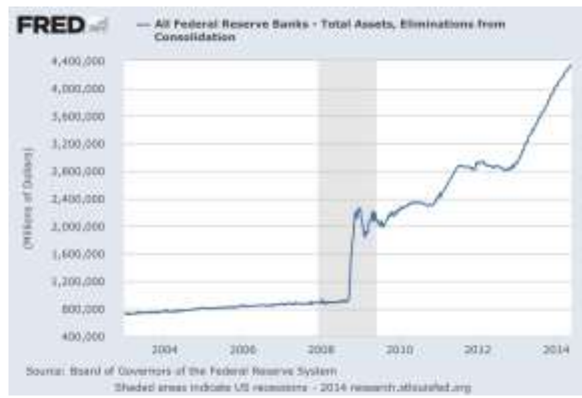
Robert Levy
MA (Economics)
Director
rlevy@bordergold.com
(604) 535-3287
www.bordergold.com

Back to the Bond Market

Gold has not closed outside the range of 1,282 to 1,311 US per oz. since April 14, 2014. It has made the market action over the last six weeks decisively boring. That being said, the low level of volatility in the metals market has been accompanied by seesawing equities. Fridays close on the S&P500 above 1900, despite sitting on record levels, marks the fourth time since March the benchmark US index has attempted to breakout past that physiological barrier. Nonetheless, the one market that has made a significant move in one direction has been US treasuries. While it remains difficult to draw conclusions from passive metal prices or volatile stock markets, it's the bond market that highlights the perplexities of the western economies stalling economic recoveries. Additionally, it questions whether the outlook for increasing long term interest rates is still intact.

The prospect of the US economic recovery yet again losing pace seems to be what has brought investors back into the US bond market. This too is what has prompted many analysts and money managers to suggest the equity markets are long overdue for a correction; however, the inflation story is what is retarding the earlier notion of an all but certain rise in interest rates. Minutes from the US Federal Reserve's most recent April meeting even revealed that inflation expectations still remain relatively low for the remainder of 2014, and markets were left indecisive as to whether policy will return to normal perhaps sooner than later.

To make matters even more complex, New York Fed District President William Dudley (who may be one of the more recognized voting members amongst the FOMC) suggested this past week that the Fed keeps their 4.3 trillion dollar balance sheet status quo (see chart below). Quantitative easing was accomplished by expanding the Fed's balance sheet to purchase Mortgage backed securities and treasury bonds. As these debt instruments mature, instead of removing the proceeds from the Fed's balance sheet, Dudley suggests they reinvest in what is still a struggling mortgage market. Thus, the question of the long term implications or consequences of an inflated Federal Reserve balance sheet hangs over financial markets.



Famed bond investors have grabbed headlines over the last year for the comments on the end of the bull market in bonds. Most memorable was a tweet from Bill Gross of PIMCO, which read, "The secular 30-yr bull market in bonds likely ended 4/29/2013…" The misconception might have been that bonds were now entering a bear market as the economy springs back to life, but this leaves out another scenario, and perhaps the one currently playing out. And that is that interest rates are at historical lows, but they will remain at historical lows for some time. There is no question that is what a country like Canada has seen, when our 10 year yields recently touched a level not seen since June of last year. Furthermore, maybe some of the forecasts for 2014 like an 85 cent Canadian dollar, 3 percent GDP growth in the US, or US investment banks calling for $1,000 gold prices have to be rethought.