

INSTITUTIONAL ADVISORS

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“Credit Is Spreading!”

Credit Markets

The action in credit markets is getting interesting.

Flattening, 2s to 20s, is moving quicker, and getting overbought. But, it could go further before reversing. As noted above, China’s yield curve has already inverted.

Credit spreads, as determined by JNK/TLT, are working on reversing to widening. Narrowing from the end of the disaster into February 2016 was outstanding. And became the most overbought since 2011. On that roll, taking out the 20-Week ema was critical. On this roll, the exponential moving average was taken out on the week of May 15. Two attempts to restore the rally failed at the ema, and this week’s decline has formalized the downtrend. Otherwise known as spread widening.

A chart showing spreads and the S&P follows.

We have been expecting such a reversal at around now and it has been accomplished. Another success by Mother Nature on the way to credit distress later in the year.

The melancholy probability would be confirmed by the yield curve reversing and industrial commodities turning weak again. Perhaps after August.

The long bond (TLT) continues to rally. Now at 127, the target has been the 135 level.

The action in JNK, itself, continued up 37.41 late in May. Last week, it completed a Sequential Sell.

After one attempt, the 50-Day ma was taken out this week and the 20-Week ema is being threatened. The ema is at 36.95 and JNK is at 36.92.

It is time to seriously reduce positions in lower-grade stuff.

Bonds are always quoted or traded as a percent of par, as in 102, 88 or 44. However, the bond bust could be severe enough that some failing issues will be quoted (only) in parts per million, or PPM.

We have used this on previous big highs for Junk, with the knowledge that when such bonds get that bad there are no bids or quotes.

However, quite unusually there has been just such an example.

One of the very high-flying stocks of the DotCom Bubble was Nortel, the telecommunications giant. The May 27th Financial Post covered a settlement for creditors. Some will receive as little as US\$.0415 on the dollar. And that works out to 415 PPM.

‘Nuff’ said on this curiosity and sector.

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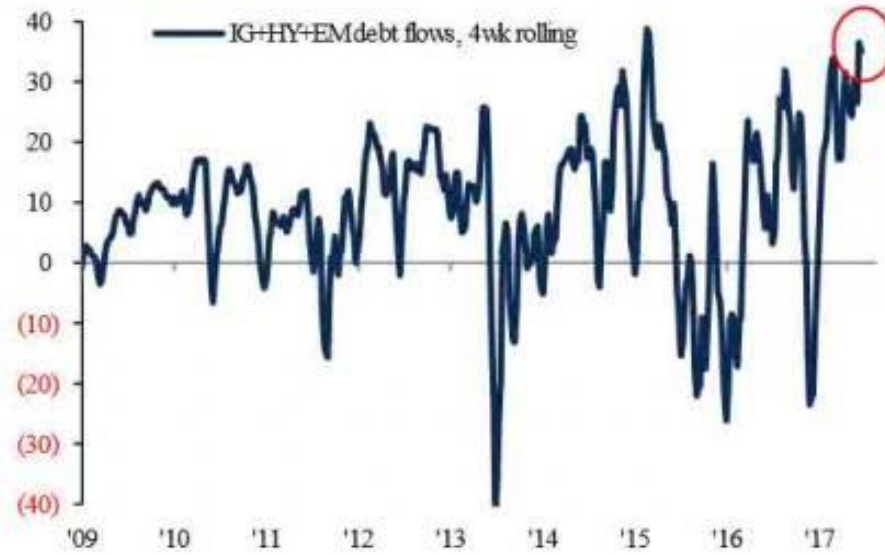
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Credit Spreads Violate Support

We have monitored the credit spreads and yield curve for years. This week's violation of support in the spreads (PHDAX, HYG & HYC versus LQD and TLT) is combined with a break in the high-yield markets below their June 5th supports. Each such break in credit since the 2009 bottom in equities has been followed by a 10% decline or more in the S&P.



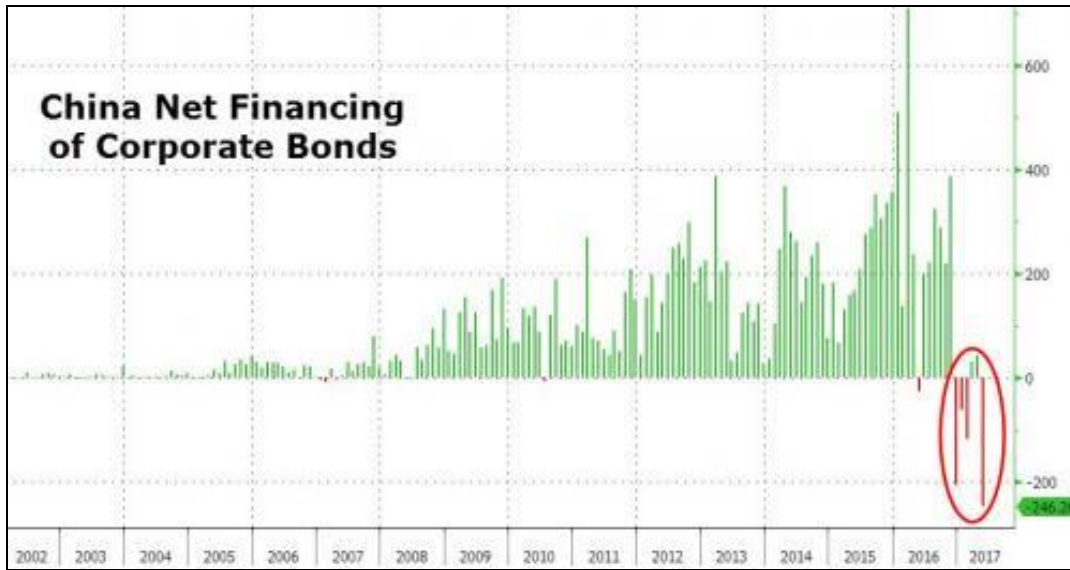
Chart 2: Investors piling into "yield"



Source: BofA Merrill Lynch Global Investment Strategy, EPFR Global

- Reaching for yield.
- In a bubble.
- Almost as high as in 2015.

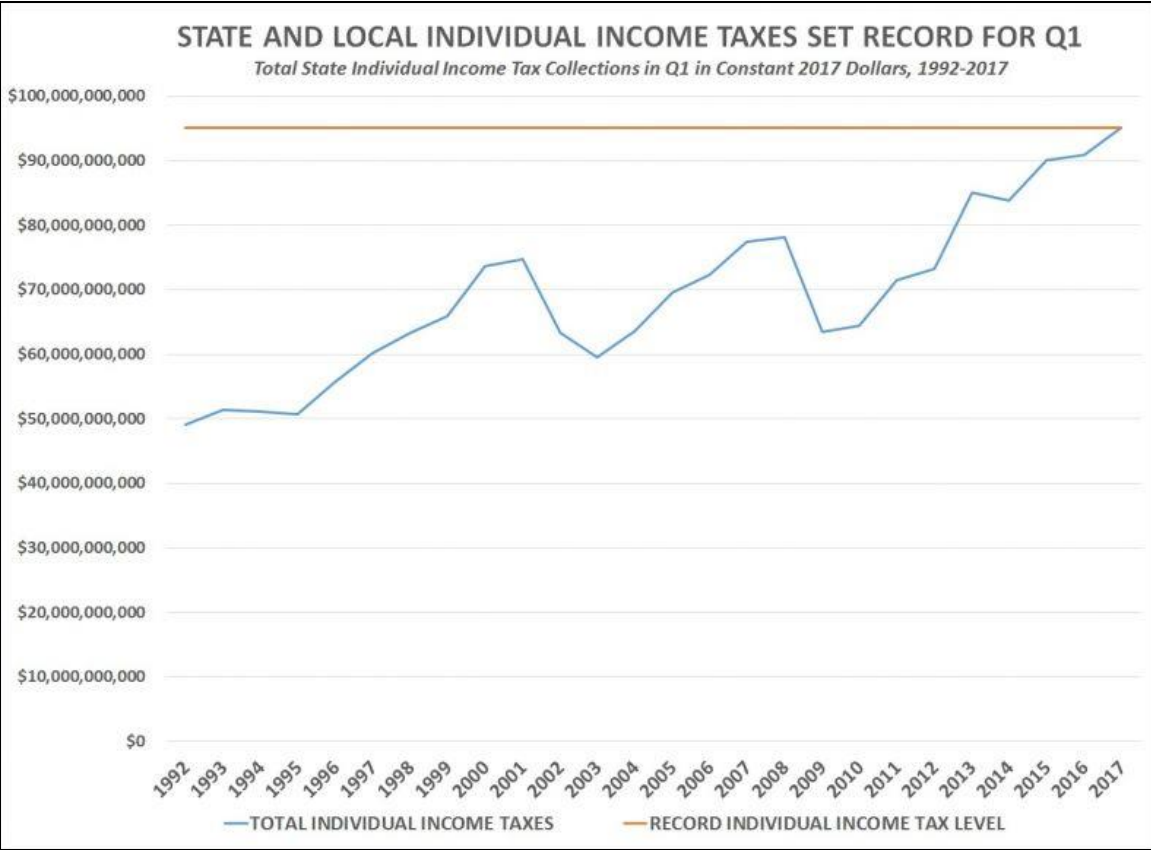
Credit Expansion!



Source: Zero Hedge

Credit Contraction?

Tax Booms and Busts



Source: CNS News