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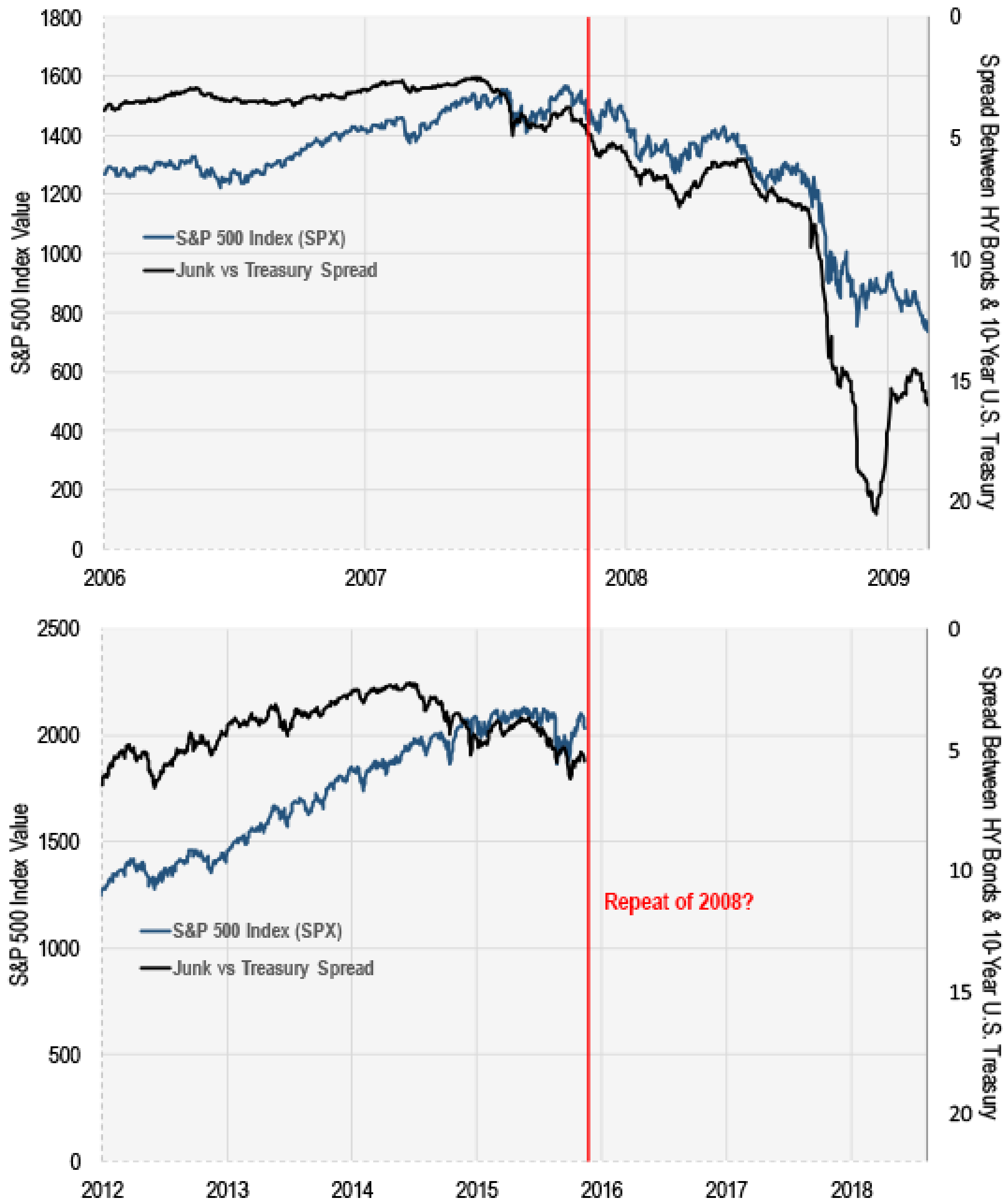

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CASEY DAILY DISPATCH

Why Isn't This Incredibly Bearish Development Making the News?

Editor's Note: This is one of the most important essays you'll read all year. In this special edition of the *Casey Daily Dispatch*, E.B. Tucker shares an urgent warning you're unlikely to hear anywhere else.

There's a very important warning signal flashing in the financial market right now.

Despite the importance of this signal, few people know about it…even fewer are talking about it.

Don't be one of the people who don't understand the vital importance of the bond market and what it's telling you right now.

This knowledge could help you avoid a huge hit to your net worth over the next 12-24 months. Here's why…

Most investors focus on just one area of the investment market: Stocks. After all, stocks have a long track record of generating solid, long-term returns. Plus, the idea of owning shares in a small business that grows large - and making 500% along the way - can capture almost anyone's attention.

But what most people don't realize is that ***the bond market is far more important and far larger than the stock market***. The bond market is where companies, countries, and individuals go to borrow money. For every $1 worth

of stock outstanding, there’s $2 worth of bonds.

Take the U.S. for example. The total value of every traded stock is $23 trillion. That’s a huge number, but it’s around half the value of all the U.S. bonds outstanding. Between corporate bonds, treasury bonds, mortgage bonds, and other varieties, there’s $40 trillion worth of bonds outstanding in the U.S.

Stock investors share in a company’s future profits. They’re optimistic by nature.

Bond investors are pessimists. They only get a promised rate of interest. That rate is usually fixed, so the bond investor doesn’t care about the promise of big profits. While stock investors daydream about the future, bond investors study the borrowing entity’s ability to repay.

It’s this great focus that makes bonds the ultimate canary in the financial coalmine. ***The bond market spots trouble long before the stock market wakes up to find it’s already here.***

There are two types of corporate bonds: Investment grade and junk. Investment grade bonds are issued by the most financially sound companies. Junk bonds are issued by companies with weak financial positions. They are riskier than investment grade bonds.

Sometimes, things work out and investors realize larger gains by owning junk bonds. But when the economy slows down, these companies feel the pain. They don’t always come through with repayment. This makes junk bonds very sensitive to what is happening in the economy. They often flash warning signs before other assets.

The vital thing to watch in the junk bond market is the amount of interest these bonds yield over the amount of interest risk-free government bonds yield. This is called the “spread.”

For example, if government bonds are yielding 2% annually and junk bonds are yielding 5% annually, the “spread” is said to be 3%. If the yield on junk bonds

was to rise to 7%, we would say the spread over Treasuries is 5%.

The spread is vitally important to watch because it shows you what bond investors think about the future. If the spread is declining, it means bond investors aren't worried. They aren't asking a lot more in interest above what they could earn in government bonds.

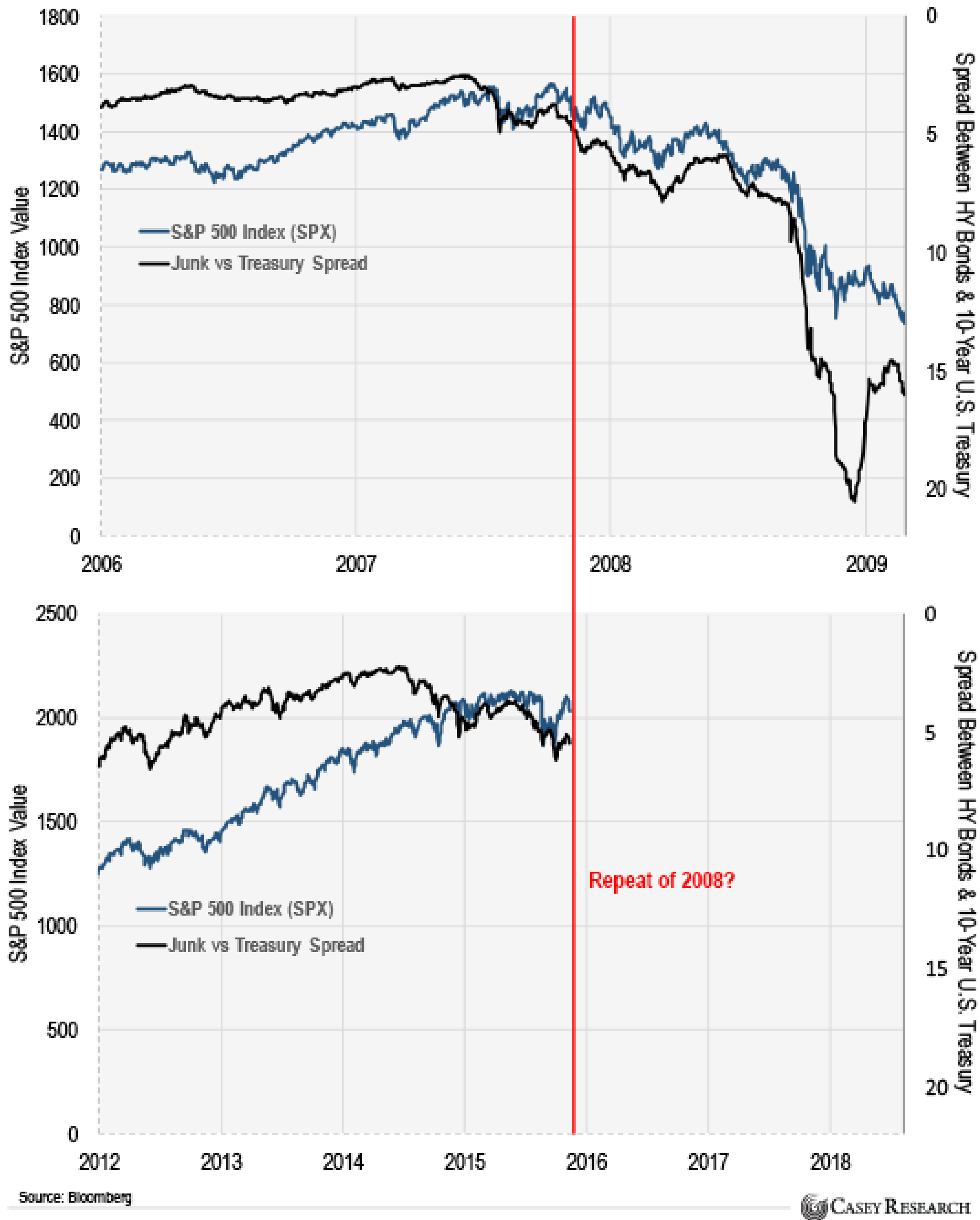
If the spread is rising, it means bond investors are asking for more and more interest to compensate them for making riskier loans. It means they are growing more concerned about the ability of borrowers to repay them.

During good times, this spread is low. Risky investments only pay 2-3% more than U.S. Treasuries. As long as good times persist, that's enough compensation for greater risk. During bad times, the spread expands to 5%...10%...even more than 15% occasionally.

The spread indicator flashed a major warning sign back in 2007. The spread started widening before the stock market started heading south. Something spooked junk bond investors in June of 2007. Stocks took a hit, too, but recovered. They finished 2007 higher than where they started. Meanwhile, the junk bond spread was widening all year. Bond investors knew trouble was coming.

If junk bonds are the canary in the coalmine, that bird died in late June of 2007. Investors who noticed and took action saved 50% by sitting out the market crash. Most people, even professional investors, completely ignored the signal. They continued chasing profits right off a cliff.

You can see it happen in the chart below. The blue line tracks the S&P 500. The black line measures the spread between junk bonds and U.S. Treasury bonds. Focus on the year 2007. You'll see the black line start heading down (which means the spread was widening) while stocks finished the year just fine.



Thanks to the Federal Reserve's massive E-Z-Credit program, the economy recovered from the 2008/2009 crisis, and junk bond values recovered with it. But since the crisis, the Fed has kept interest rates at essentially zero.

This has encouraged an incredible amount of corporate borrowing…much of it has been reckless. Money is being loaned to companies that won't survive the next recession. Junk bond issuance was up 130% higher last year than it was in 2007.

But recent price action in the junk bond market says the party is over… and it's time to get cautious. If you look back at the chart above, you see the junk bond market sent the exact same telling signal in December of 2014. Just like in the months leading up to the September 2008 crash, nobody seems to notice. ***The junk bond market is making it clear trouble is right around the corner***.

It is signaling that we could be in for another economic downturn, or worse, a crash. Meanwhile, stocks are still near their highs.

Junk bond spreads are widening and junk bond prices are falling. **This means the bond market is not confirming the stock market rally. Bonds are saying, "Don't trust the stock rally."**

If you have a lot of your wealth tied up in stocks and bonds, I urge you to pay attention to this warning. The bond market is far larger and far more important than the stock market. And right now, the most sensitive part of the bond market is falling while stocks are rising.

With this in mind, consider moving to a very conservative financial position, which means holding plenty of cash and avoiding speculative stocks and junk bonds.

Make sure to own some gold as financial disaster insurance. And continue paying attention to what bonds are saying about the health of corporate America. I expect it will continue to say, "*The boom times are over*."

I also urge you to watch a special video we've recently released. It explains other critical steps you should take immediately to protect yourself from the next

financial crisis. **Click here to start watching now.**

Regards,

E.B. Tucker
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