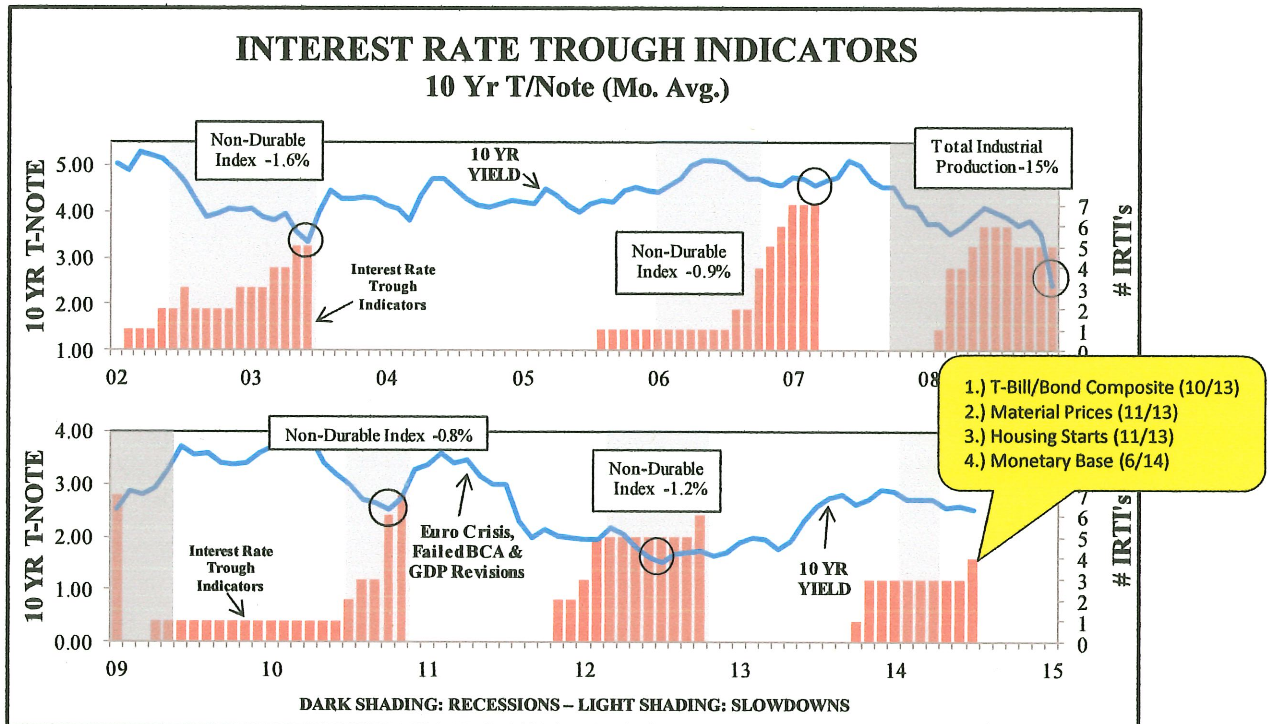
BUSINESS CYCLE DEVELOPMENTS

There are now **four** of seven **Interest Rate Trough Indicators (IRTI's)** signaling, instead of three. Monetary Base is the newest **IRTI,** which now projects a bottom in yields in **November 2014 (Sept. '14 to Jan. '15)** - see inset below for the **IRTI's.**

This forecast is based on the six interest rate troughs since 2000. As noted in previous reports, there is a distinct difference between market behavior post-2000 and pre-2000. Business cycles, equities and interest rate cycles are inextricably connected. The length of these business and interest rate cycles has been cut in half since 2000, from 36 months to 18 months, so it makes sense to re-focus on the six observations since 2000 to project a low in yields.

Yields typically bottom within a few months of the economic recovery. The U.S. recovery, from the 1st quarter slowing, is already occurring; however, the **IRTI's** are now pointing to yields bottoming later in the 4th quarter 2014. Fed policy, congressional legislation or exogenous shocks can push-out a low in yields quarters beyond an economic recovery. In the June 10, 2014 chart 25% of



the lows are 12 to 36 months beyond an economic upturn. This possibility of a 'pushed-out-low-in-yields' is beyond any empirical grasp, so it's a blue-sky dialogue.

Capricious discussions aside, the facts on the current T-Note yield can be projected either in percentages or basis points. Based on post-2000 data, a *monthly average* percentage drop from the **4th IRTI** to a trough in rates is -14% (+/- 12%). Interpolating these averages from the June 2.60% level projects a low at **2.24% (2.55% to 1.92%)**. Another way, which overlaps somewhat, is to look at the *monthly average* decline in yields based only on basis points. From the **4th IRTI** to the bottom in rates, centers a bottom in yields at **2.07% (2.55% to 1.59%)**. The Fed's heavy hand is going to prevail at least through the election in November and now the **IRTI's** are pointing in that direction. Whether this Fed policy will qualify as one of those exceptions, that cause yields to bottom quarters after output improves, is not a good bet – **Continue to sell bonds on strength.**