



07/06/2016

TRADE ALERT

Bonds are a Screaming Sell

Dear <<First Name>>,

Buy 3/3 ProShares UltraShort 20+ Year Treasury TBT

"If we look at the Fed's forecast of where they think their Fed Funds Rate will be at the end of 2016, it's up at 1.625%. That's five 25bps hikes over the next year? Look for this number to come down substantially, the US 10 Year note is heading below 1.50%."

Bear Traps Report, September 2015

Yesterday, the U.S. 10 year hit our long held 1.40% target. A sea of bond bears has become an ocean of bulls. On January 1st, Wall St's mean forecast for the U.S. 10 year was north of 2.85% (1.36% today). Brexit's risk to the global economy has created an opportunity for those willing to step in and short bonds in the face of a large group of clowns rushing to the exits (abandoning their long held bearish bond positions).

With U.S. equities within 5% of a 52 week high and Bonds and Gold on theirs where does one put cash? Stocks globally are not faring so well with Japan off 19% and Europe off 15%, everyone is hiding out in the U.S.

[Here's Why Bonds are a Screaming Buy, March 14, 2015 on CNBC](#)



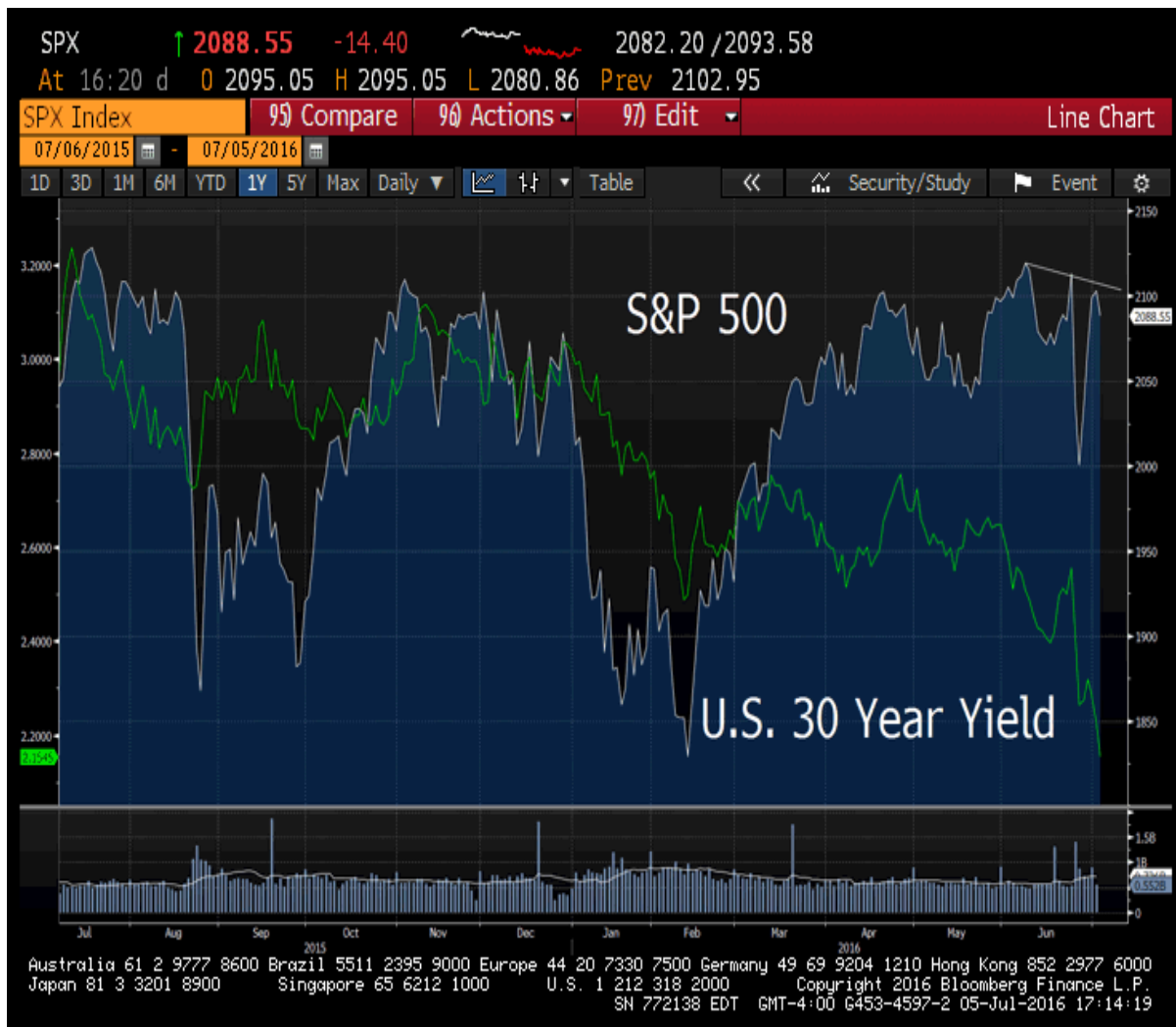
When patrons are falling over themselves to buy bonds, it's important to remember how fast the tide can turn. Last year, German yields soared from 0.07% to 0.98%, over \$550B was wiped out in European government bond values between April 15 and June 15.

"The current US Treasury yield curve shape suggests 60% odds of a recession."

Deutsche Bank (Wall St. is finally waking up to reality)

We are adding to our short bond position today (**we started on June 15th, early as usual, our apologies**). The capitulation panic inducing investors to buy bonds is reaching insanity levels. **We believe global bond markets are**

very close to a substantial near term top as well.



Bonds are priced for depression, U.S. stocks are priced for "solid" economic growth, someone is very wrong.

10 Year Yields

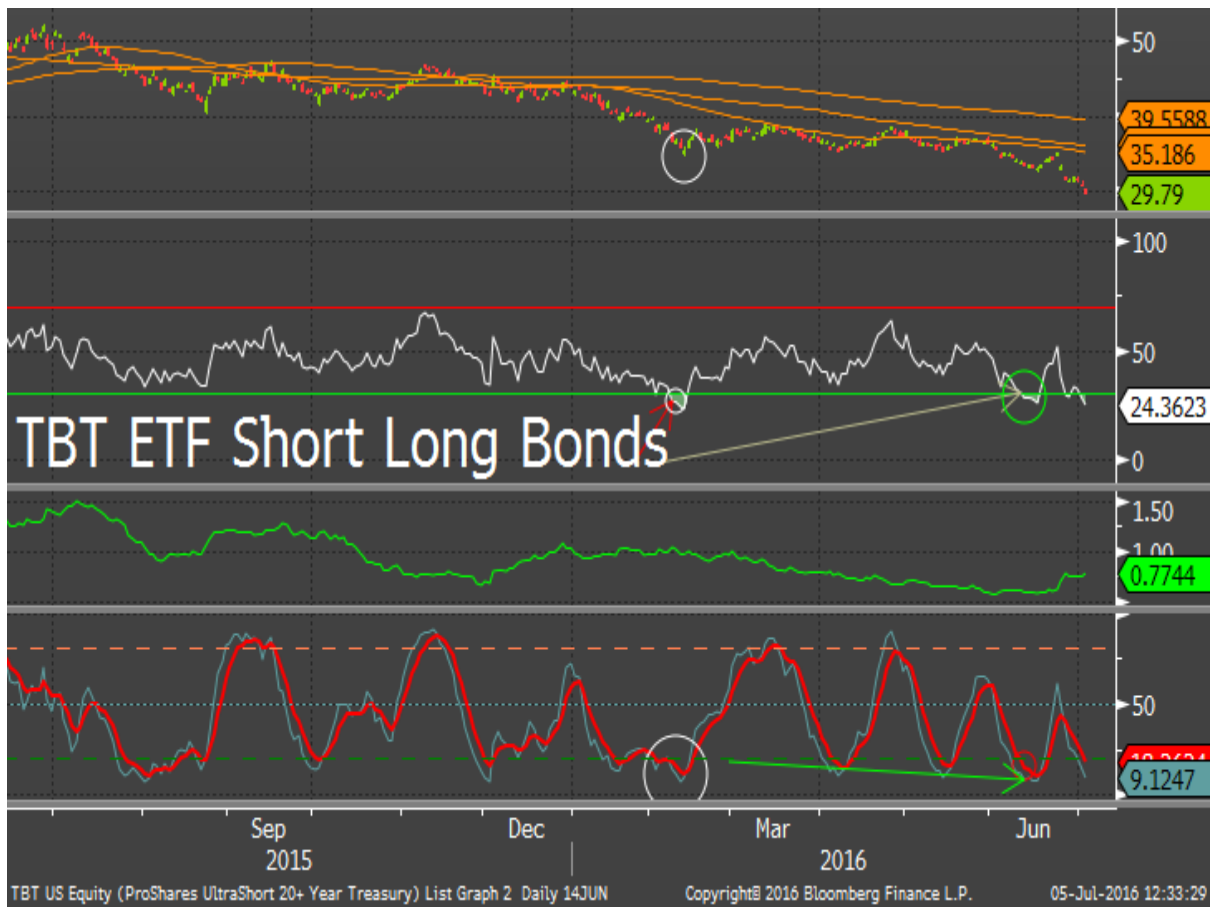
Portugal 3.02% (34bps tighter since June 23)

U.S. 1.37% (38bps tighter since June 23)

Italy 1.26% (30bps tighter since June 23)

Spain 1.19% (44bps tighter since June 23)

TBT ETF



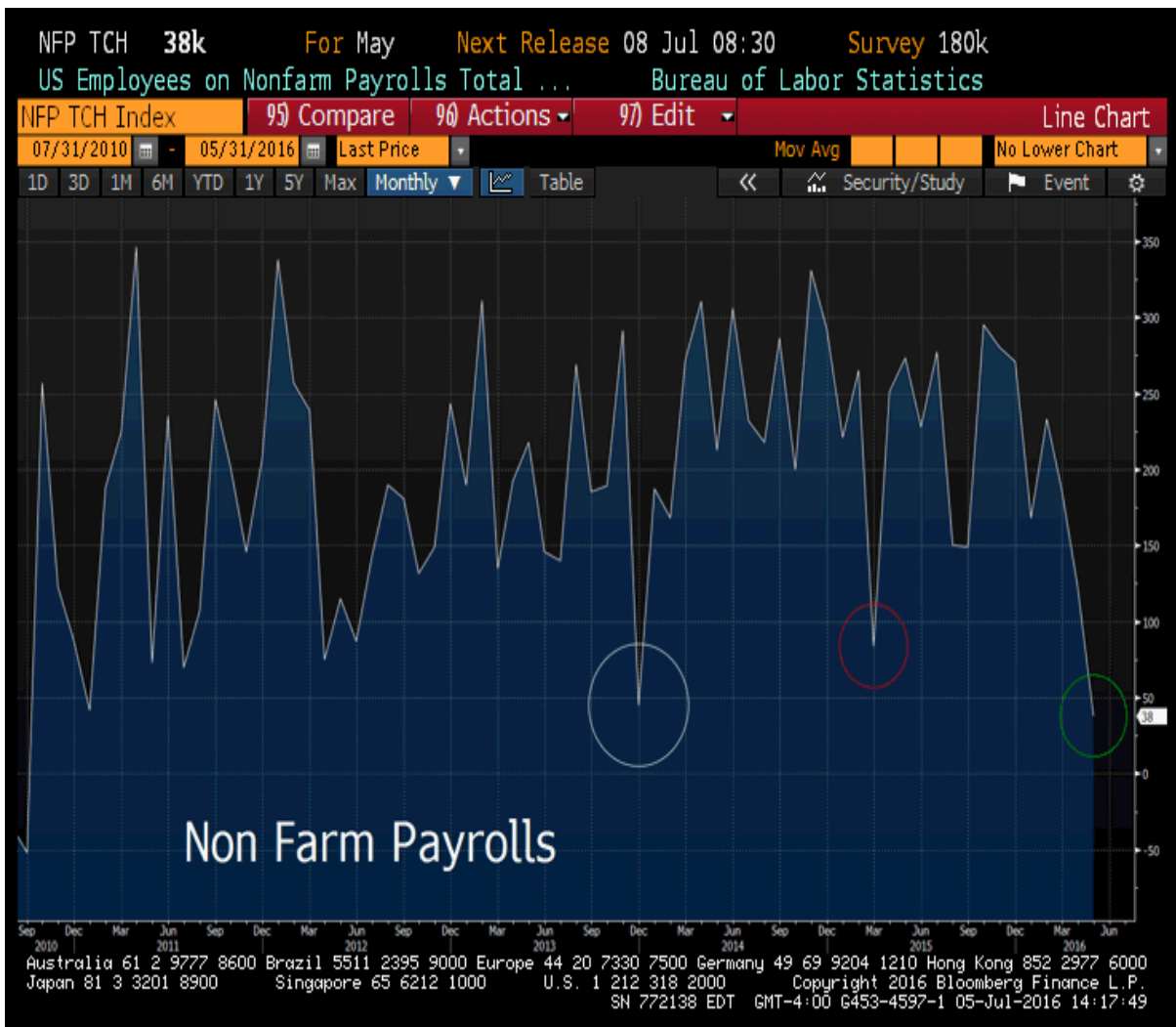
*The TBT ETF is at one of its most oversold levels in years. Our 7 factor capitulation model is giving us a **strong buy** reading for a 1 to two month bounce. Keep in mind, on February 10th and 11th in our Bear Traps trading alerts we were TBT buyers, next we sold the position on February 17th and March 4th, for an 8% profit (see our Bear Traps Trade Alerts sent to subscribers).*



Jobs Friday

Possible Catalysts for a Bond Sell Off?

Expectations are down at 180k for the Non-Farm Payroll report this Friday. For most of this year, economists hopes have been above 200k month after month, but recently the street has been lowering the bar. We have the Fed Minutes today (at 2pm) as well as Fed governor Dudley, expectations are very high on the dovish side.



Europe's Impact on U.S. Treasuries

Last year, in our bullish call on U.S. Treasuries we cited the growing yield differential between government bonds issued by the U.S. and those issued in Europe. True, the yield advantage in Treasuries is attracting buyers. Moral hazard in Europe = Moral Hazard in the USA.

Late last week, the ECB's leaked a proposal for capital key expansion sent periphery bonds into colossal buy mode. The European Central Bank is using the rumor mill to weigh potential political backlash on their potential policy moves. See our explanation below.

Italian Banks Write Downs

Distressed Loans: \$215B to \$90B

High Yield Loans: \$180B to \$80B

Troubled Still: \$200B

Troubled banks in Italy: 1200

Non-Performing Loans: \$300-\$400B or 16-20% of lending

The proposed \$43B bailout will need to be \$140B at least.

A BOND SELL OFF in Europe will trigger a SELL OFF in the US

Markets have spent the last three days pricing this in, "capital key expansion" is trading like a *fait accompli*. There are many political hurdles left for capital key expansion, the bond market has priced in far too much ECB love for now. This makes us even more bearish on bonds over the near term.

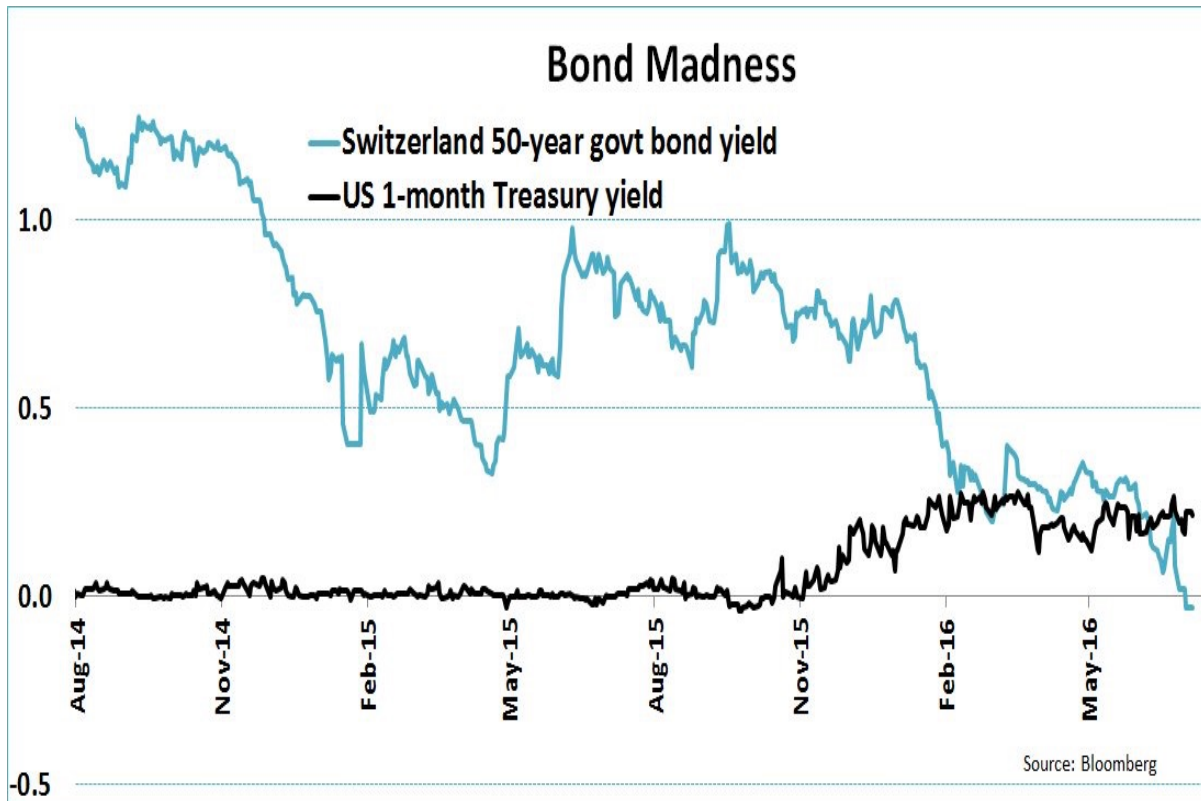
US 10 Year Bonds and European Banks Tied at the Hip



Italy market regulators to ban short selling of Monte Paschi shares beginning tomorrow - press

In a powerful move, Spain's 10 year bonds have plunged in yield. Last week bonds traded with a 1.63% yield to rest at 1.14% Friday. Mario Draghi and the

ECB brought out the **fire hose** to contain markets. Just a leaked story to the press over a possible “Capital Key” expansion had shorts running for cover and buyers stampeding in. It’s amazing how regulators are putting stock market players in jail for trading on “inside information” while central bankers are creating their own every other week. Expanding the capital key would allow the ECB to buy even more, low credit quality, periphery (Spain, Italy) debt.



Swiss 50 Year bond is trading inside the U.S. one month Treasury in yield, SELL SIGNAL.

Pursuant to Article 29 of the Protocol of the ECB the capital key are weighted according to the shares of Member States in EU GDP. More than of half of German Bunds are now ineligible for QE, the ECB will have to make a very politically unpopular move (in Germany) if they want to expand the capital key.



U.S. banks continue to dramatically outperform their European counterparts from a credit perspective.

Pick your Poison ECB

1. Buy more Spanish and Italian 10 year bonds.
2. Make direct investments in banks that are on life support (sssshhh Bailout). Both are political high hurdles.

"Italy faces the risk of a full-blown banking crisis that could bring the rebel Five Star Movement to power as early as next year."

George Soros

We have a historic decision coming at us. If the ECB tries to expand their capital key, they will need far more political support from Berlin.



*Today, investors receive 0.30% more interest buying a U.S. 10 year bond over Spain's 10 year. **Front running the ECB has become a national pastime in Europe.** As someone who sat on the deck of the Titanic that was Lehman Brothers, this is pure evil, central bank induced moral hazard gone rogue.*

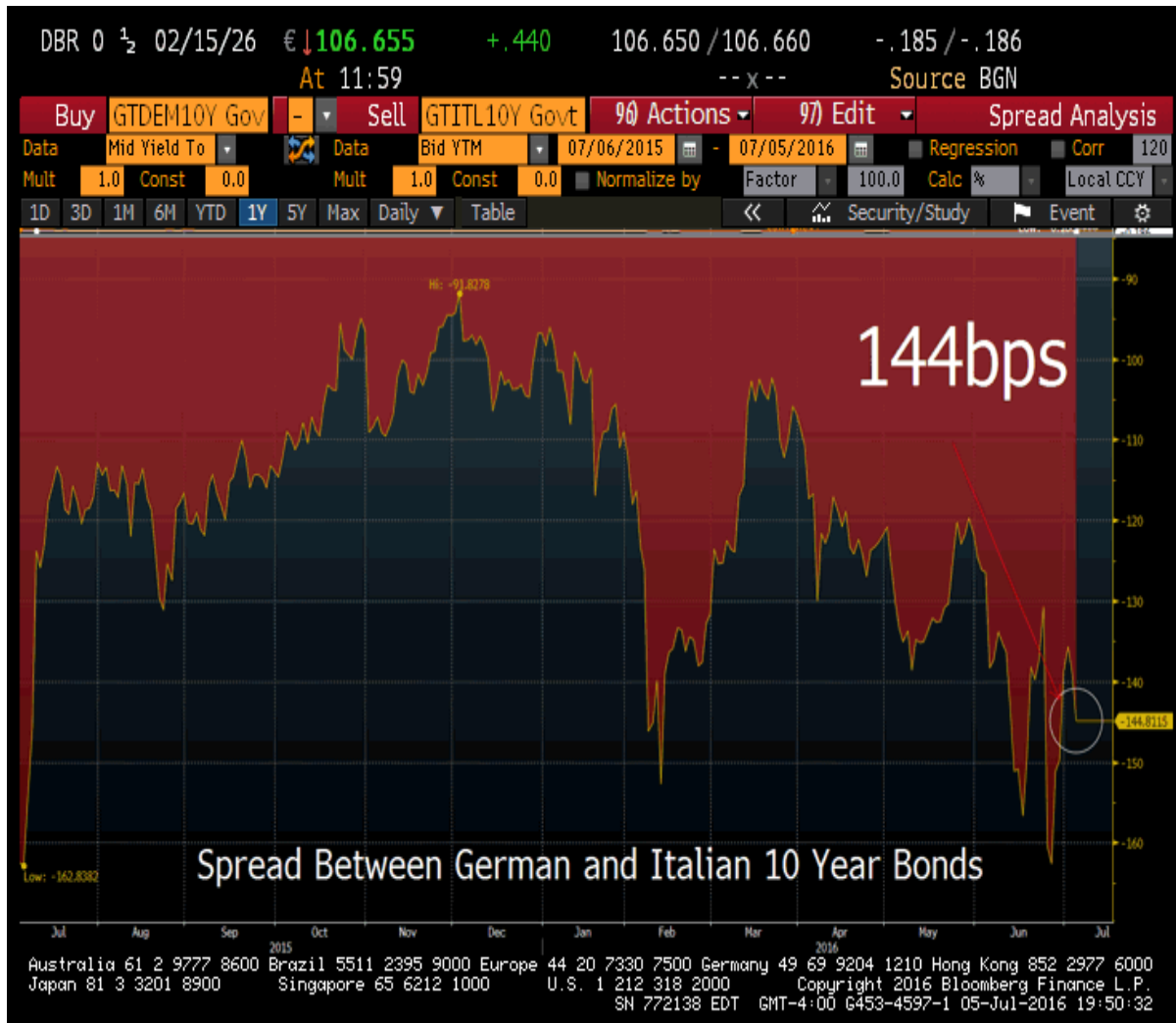
Italy and Bonds

ESM'S REGLING: ITALY IN TALKS WITH EU HOW TO APPLY FRAMEWORK

Can the ESM be used as a direct recapitalization tool? Conditions: 8% bail-in and Italy memorandum of understanding on a financial sector restructuring program.

Financials have been the big Brexit loser, Italian banks have been particularly affected by aggressive sell-offs. Although relatively well-capitalized, Italian

banks have **€100 - €200 billion worth of non-performing loans on their balance sheet that have not been provisioned for**. Furthermore, Italian banks' sovereign bond holdings are significant and widening spreads in peripheral government debt are a source of concern for investors. Hence, the ECB's capital key rumor launch provided a much needed relief in a Post-Brexit world.



Italy's 10 year bond pays 1.44% more than Germany equivalent debt maturity.

BRRD and Systemic Risk

“Germany’s VOeB association of public banks said that the law would have led to incalculable costs by undermining investor confidence in Austria. ***The country now faced “the considerable task of winning back the lost trust of national and international investors — which could be regarded as a Herculean task.”***”

Liane Buchholz, the VOeB’s managing director, response to the proposed

Austrian bank bailout (just imagine how northern Europeans feel about Italian banks?!)

Previous reports have referred to the difficulty facing Italy with regard to interaction between its banking sector and EU rules on recapitalising banks using public money, namely the **bank recovery and resolution directive (BRRD)**.

The BRRD looks more like a political keg of dynamite every day.

In February, we highlighted the fact that Italy had been looking for revision of the rules, despite the fact that they only came into force on in January 2016. This was done to avoid any potential bail-in of Italian savers who hold an estimated 30% of Italian banks' subordinated debt. **Renzi has used the instability triggered by Brexit to double down on these efforts, invoking extraordinary circumstances to request a suspension of the BRRD in order to enable his government to inject €40 billion into Italian lenders. It's Not enough and he knows it.**

The Germans are clearly opposed to any suspension of BRRD. Strictly speaking, the Commission could grant a suspension of the BRRD without Germany's permission, although the history of Eurozone crises tells us that this is highly unlikely. The ECB is also opposed to the suspension of the BRRD, with Benoit Coeure describing it yesterday as the end of banking union. - ACG Analytics

In full tragedy, in recent years we witnessed suicides in Italy when 5 banks bailed in 100k retail investors.

Ultimately, the only solution is a massive bank recap, which, under current EU rules, would require 100% bail-in, and a substantial ESM contribution. EU rules prohibit the bailout of insolvent banks. Good bank - Bad Bank deja vu.

To be continued...

<<First Name>>, we look forward to sending you more trades and newsletters in the near future!

Best Regards,

The Bear Traps Report Team

Larry McDonald is the New York Times bestselling author of "A Colossal Failure of Common Sense," CNBC contributor and Political Risk Expert. He is the Editor of The Bear Traps Report, a weekly independent investment letter focusing on global political and systemic risk with actionable trade ideas. Former Head of U.S. Macro Strategy at Societe Generale and former vice president of distress debt and convertible securities at Lehman Brothers. He is one of the most well-respected risk managers on Wall Street.

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