

So Bill Ackman Is Short Treasuries, Now What? – Market Commentary

July was a positive return month for world markets. The MSCI World Index returned +2.9% where the US, comprising 70% of this global equity benchmark, returned +3.2%.

Value mildly outperformed Growth with relative performance of +3.8% vs +2.9%, while Emerging Markets outperformed Developed Markets with +6.2% vs the MSCI World's +3.4%.

South Africa performed well this month with a +4.0% ZAR return but +10.5% in USD due to ZAR appreciation. This is in the context of a poor June, however, and for the year-to-date SA is still close to half of the EMs' return at +6.2% vs +11.4%

These various returns are summarised in Table 1 below.

Table 1. South African and global equity returns (USD) for July 2023*

	Jul-23	YTD 2023
FTSE/JSE ALSI (ZAR)	4.0%	10.1%
FTSE/JSE ALSI (USD)	10.5%	5.4%
MSCI World	3.4%	19.0%
MSCI EM	6.2%	11.4%
MSCI Value	3.8%	8.0%
MSCI Growth	2.9%	30.8%
S&P 500	3.2%	20.3%
Nasdaq 100	3.8%	44.7%

*Total return indices, Source: Factset

Bill Ackman announced in early August on Twitter, pardon us, X, that he (presumably through funds on behalf of his firm's clients) had taken short positions in US Treasuries via options. The tweet can be found here

<https://twitter.com/BillAckman/status/1686906272937869312>

and seemed to prompt widespread social media commentary, which, in turn, prompted this market commentary. As is usual in markets, however, things move quickly and what was news yesterday is today quickly forgotten with the latest news these days being that Michael Burry, of Great Financial Crisis fame, has shorted the US equity market.

Be that as it may, we found Mr Ackman's tweet interesting and the widespread commentary it prompted somewhat surprising.

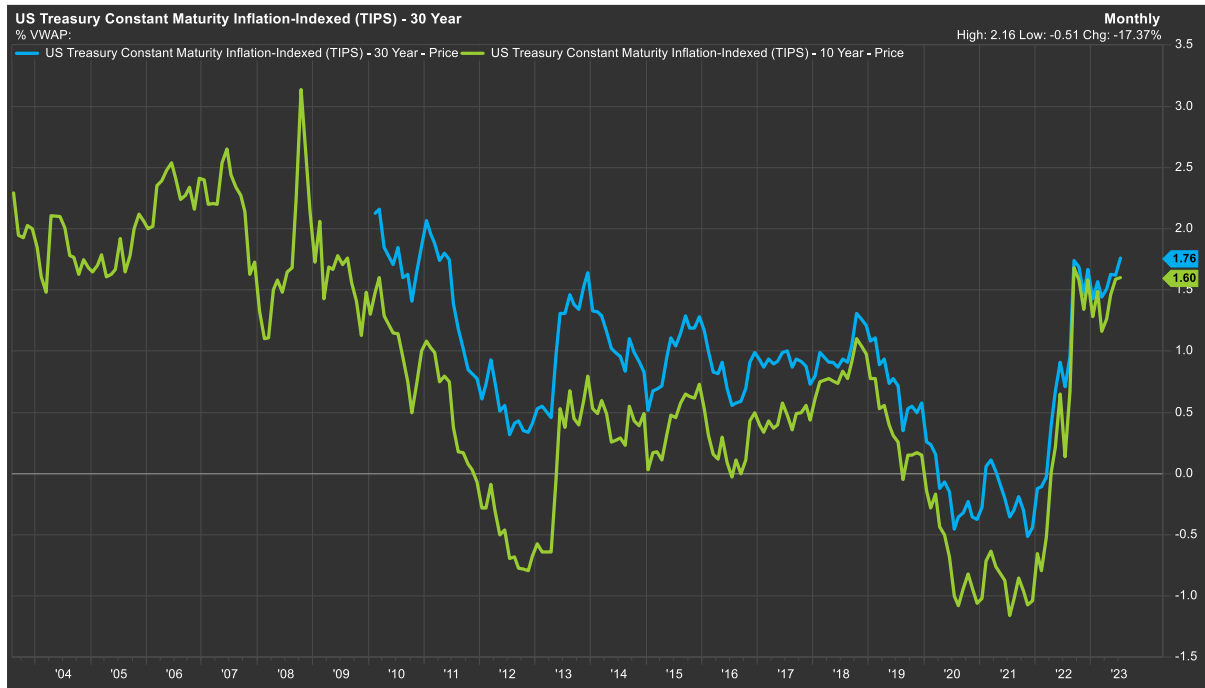
Mr Ackman's rationale seems to hinge on long term inflation averaging 3% p.a. vs the US Fed's 2% p.a. target. Assuming a real yield of 0.5% and a term premium of 2%, he suggests, a long term yield should be equal to 0.5% + 3% + 2% = 5.5% vs the current 4.0% on the 30-year US Treasury.

We further noted with interest a Bloomberg chart (Chart 1 below) indicating widespread shorting of Treasuries by hedge funds. At the same time Warren Buffett's company, Berkshire Hathaway, was reported to be buying Treasuries albeit of short duration.

What about real yields?

Chart 2 below presents the real yields over time for the US 10-year and 30-year Treasury Inflation-Protected Securities (“TIPS”).

Chart 2. US 10- and 30-year TIPS



Source: Factset

Some observations from Chart 2 include

1. There is hardly any stability in real yields over time. If we had to take a guess we’d suggest a 30-year real yield of 1% p.a. (with a lot of volatility)
2. Note the negative yields initially in 2012 and more recently over 2020-21. We published commentary in May 2021 (“An Inflation Opportunity”) here

<https://www.m1capital-funds.com/pdf/Insight-21-05.pdf>

where we argued for the unsustainability of negative real yields and suggested the shorting of US TIPS as a viable strategy.

3. The current real yields on offer, of 1.6% on the 10-year and 1.8% on the 30-year respectively are historically high, and potentially equally unsustainable, although this last matter should be the subject of separate discussion.

Treasury yields have not reflected inflation expectations for some time ...

Potentially controversial but factual. Consider Chart 3 below setting out the 30-year Treasury yield vs CPI inflation since 1977.

Chart 3. US 30-year Treasury yield vs US CPI



Source: Factset

The consistent, steady decline in the Treasury yield is readily observed vs the fairly stable fluctuation in inflation. Certainly the implied real yield and any risk premium from the difference in Treasury yield and CPI were shrinking consistently over 40 years. Inflation is also quite frequently outside the 0-2% Fed target.

We suggest that

1. Declining Treasury yields had less to do with declining inflation (though that too) and more to do with demographic factors and structural demand from pension funds and life offices. This is unlikely to have disappeared
2. The recent jump in real yields probably had more to do with the Fed funds rate rising rather than inflation itself rising, though of course we recognise the two are not independent

What if a recession materialises?

We consider this a likely scenario. The interest rate channel of monetary policy operates with lags of a year or more, so we won't be surprised to still see the full effects of the interest rate rises.

Moreover, if a recession materialises yields can be expected to *decrease*.

Mr Ackman comments that his firm's short Treasury exposure is through options and that the position is also part of an equity hedge. So if yields rise (and equities fall), then the equity position is hedged and, let's say, the return is 0%. What if a recession materialises and equities decline and Treasury yields also decline? Then equity values fall but the Treasury put options expire worthless leaving the equity losses. In the first case it is the

interest rate that causes the equity decline, while in the second scenario falling company profits cause the decline.

Come to think of it, unless company profits rise i.e. no recession (and Nasdaq earnings have been declining for most of the year), equities don't appear to be particularly attractive ... so perhaps Michael Burry is right?