



Mark Sampson

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# Are We At The End of Record Low Rates?

By Dick Lepre

Technical analysis of the 30-year Treasury future indicates that we are at the end of the secular bull market for Treasuries and that yields are headed higher for the next 12-15 months. *This implies that home loan rates have already hit their bottom. Home loan rates are no going to skyrocket.* They will have their ups and downs but the point is that we are not going to get back to that 1.43% yield on the 10 year Note.

At present there are a couple of unusual things about the relationship between home loan rates and Treasuries:

(1) The Fed is buying home loan debt which will support home loans relative to Treasuries, and

(2) The wholesale markup — the profit that banks are making by selling home loans to FNMA — is, by historical standards, gigantic. If one of the big banks wants to get aggressive and lower their markup to get market share, this would help. While this is the way markets are supposed to work, the problem is that the regulations pursuant to Dodd-Frank have made lenders afraid to make loans.

The core issue is that **CFPB still hasn't defined** what lenders must do to make sure that they do not have to buy mortgages back. A sane lending institution might well decide that it does not want a larger share of a problem. The political and social climate remains antagonistic to lending.

If you were thinking of refinancing, it's unlikely that rates will fall to their recent lows. Regard this as a last call.

*It looks as if this is not the end of low rates but it is the end of very low rates.*

## **Watching Rate Charts Is Like Watching A Drunk Guy Walk**

What has been said here is based on the technicals. Let's look at what technical's are.

If you listen to radio or TV reports of what the market is doing they sometimes say things like "technical selling caused the Dow to drop 50 points."

I have become a believer in the value of technicals in trying to see where home loan rates are going.

I also believe that technical's can more successfully forecast Treasury yields than most any other commodity for a couple of reasons: (1) the size of the market is gigantic and (2) Treasuries are less subject to unexpected exogenous forces.

People's decisions in regard to buying and selling securities are based not only on external circumstances, such as weather or strikes but also on the "poker game" interplay of greed and the desire to anticipate the actions of the other players. The timing of many investment decisions is therefore based not on educated guesses as to what the economy is going to do, but on guessing what other people are going to guess the economy is going to do.

The movement of securities prices is the result of the collective decisions of a large number of people. Some working together and some at odds.

The movement of prices resembles the "random walk" of a drunk.

When you first look at a drunk walking you might conclude that he is not walking toward any particular goal. If you follow him for a bit you will conclude that he is headed in some general direction, say, home. You can actually draw some conclusion about how many steps the drunk will take in any one direction on the way home. Our statistical conclusions about the "path" of the drunk may be seriously affected by external circumstances. He may run into some friends and head to a new bar. He may be stopped by the police and have his path very seriously altered, but when he is moving there is a measurable pattern to his unpredictable steps.

Bond prices and thus, interest rates, move in a similar manner.

They have (usually) a particular long term goal but get there by a circuitous path, instead of running into other drunken friends they run into hard economic data and press releases. Instead of getting picked up by the police they get deterred by the Federal Reserve. The variations in the prices of commodities thus resemble statistical processes. Various

mathematical models have been developed to predict the price of commodities such as treasury bonds.

BTW when I first wrote about this over 10 years ago someone sent me a nasty e-mail criticizing my use of the expression “random walk of a drunk.” I did not create that expression. Mathematicians have been using it since before I was born.

### **Technical Trading**

It is these mathematical models which constitute the basis of “technical trading.” Technical trading is based on the analysis of certain data and the commitment to making decisions to buy or sell based on what the data is doing rather than listening to what analysts are saying.

Technical traders make their decisions on one or a combination of several technical indicators. The technical indicators are derived from a constant charting of certain data, if one looks at the data as graphs, the technical indicators say things like “sell when this line cross that line.”

The technical indicator discussed here each week is the Stochastic. The value is that Jim Grauer has been doing this for decades.

### **Stochastic**

When the price of a security is rising its closing price is close to the top of the range for the day. When the price is falling it is close to the bottom of the range for the day. A quantification of this is called the Stochastic Process. The calculated Stochastic variable is called %K

$\%K = 100[(C-L)/(H-L)]$  where,

C= Close, H = High, L = Low for the period in question

%K may vary from 0 to 100%, measuring the closing price as a percentage of the total range. Depending on the time frame desired, %K may represent this relationship for a selected number of minutes, hours, days, week’s months, years, or any other interval. One on-line technical treasury bond analyzer StoMaster (see Note 2) presents this data as cycles of 60 minutes, 100 minutes, daily, weekly and monthly. This is useful for very serious technical traders. The Stochastic variable %D is simply a moving average of %K and will, therefore, describe the movements of %K on a smooth lagged basis. A buy/sell Stochastic indicator occurs when the graph of %K crosses the graph of %D.

Back at the top when I said “we are at the end of the secular bull market for Treasuries” I was referring to the fact that the daily, weekly and monthly were all bearish (lower prices, higher yields.)

### **Treasury Technicals**

The Daily Sto did indeed upcross last Friday as prognosed last week, but alas, it was too little too late. On the following Tuesday, then in the 15th day of its upcycle (avg.=15-20 days), it downcrossed leadenly and the 10 year Treasury Note was crushed (price), gapping down leadenly and in the process, causing both the Weekly and Monthly Sto to downcross. This presented a very ugly situation, with ALL five Sto's in bearish mode. That condition was punctuated on Wednesday, with the Note gapping down yet again in free fall, its yield touching a high of 1.81%. The only relent from this pogrom on the near horizon is the expectation of a relief rally (price) in the Note, given that the short term Sto's (i.e. the 60 and 100 Minute Sto's) are unconscionably oversold. But that will only represent a very short term respite. You see, the Daily Sto, on its downcross, also completed the construction of a rather formidable bearish divergence at “AB”, the ongoing workout of which has been patently evident this week and remember, the Daily cycle has a good two weeks more to play out. Where will that likely take its yield? The near term upside (yield) is the high Note yield reached on 09/14/12 at 1.88%.

With a view to the longer horizon, the likelihood that the Note has entered the early stages of a secular turn to a bear market is increasingly likely.

Why? Because the Monthly Sto, which has been in a secular bull cycle since August 2011, is now long in the tooth with respect to duration (avg.=12-15 months).

The final fill of the most distant overhead bullish gap would mark the yield at 1.42% but that is increasingly looking like the triumph of hope over experience. With the Monthly Sto slowly turning from a secular bull market to a secular bear market, the underlying bearish gaps will become prepotent...powerful technical phenomena working to draw the Note's price lower (yield aka rate higher).

The 10yr Note Note closed 10/18/12 at a 1.83% yield and it rallied to close 10/19/12 at a 1.77% yield.

For those interested in delving further into the analyses and details of how the Stochastics, Divergences, Pattern Recognition and Bullish and Bearish Gaps all came together to contribute to StoMaster's phenomenal call last August 2011 of the currently realized yield (July 2012) on the 10 year Treasury Note, **read this**.