

# Bond market turmoil as Wall Street speculation reaches new heights

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A conference of US economic and financial regulators to be held tomorrow may have more on its agenda than was originally planned as signs of turbulence in financial markets continue to grow.

The 2021 US Treasury Market Conference, which is being held virtually, will hear a series of reports from Fed officials, representatives of the US Treasury and the stock market regulator, the Securities and Exchange Commission.

The conference, an annual event, was first convened in 2015 following a “flash rally” in the US Treasury market in 2014. Bond prices rose sharply during a 12-minute period, sending yields plummeting, and then reversed with no apparent trigger—an event that was not supposed to take place in the world’s biggest debt market.

The agenda for tomorrow’s meeting is to consider “proposals to improve overall market functioning and reliance.”

It is being held in the shadow of the events of March 2020 when the Treasury market froze. No buyers could be found for US government debt at one point, an extraordinary occurrence in what is supposed to be the deepest and most liquid financial market in the world.

The crisis was only halted through the intervention of the Fed which injected more than \$4 trillion into the financial system and initiated a program of buying \$120 billion of financial assets a month.

At its last meeting the Fed decided to taper its purchases by \$15 billion a month. There is uncertainty about what effect this will have under conditions where the rise in inflation over the past months has completely changed the financial landscape. Price rises hit a 30-year high of 6.2 percent for October, the fifth straight month the inflation rate has topped 5 percent.

With the Fed’s assurances that inflation is

“transitory” having been blown out of the water, there are indications of growing instability.

Last week, as the latest inflation figures were announced, yields on the two-year Treasury note climbed nearly 10 basis points—0.1 percent—as bond prices fell in the biggest movement since March of last year. The downward movement went across the board with a government auction of \$25 billion of 30-year debt reported to have met only “weak demand” from buyers.

The uncertainty in the debt markets was articulated by Peter Tchir, head of macro strategy at Academy Securities, in comments to Bloomberg.

“The current structure enables the markets to function well when volumes are running around average levels,” he said. “But it leads to these periods of large and aggressive moves that seem inexplicable relative to the data. It also makes it hard for asset managers to manage their risks.”

Bloomberg reported that an index it has constructed to measure liquidity in the government debt markets “showed conditions were the worst since March 2020.”

In comments to Bloomberg, the weakness in demand for the 30-year Treasury bond last Wednesday was described by Michael Cloherty, head of US rates strategy at UBS Group AG, as a “clear sign of illiquidity.”

“For the past two weeks the market’s been extraordinarily erratic and is having difficulty in handling large transfers of risk,” he said.

The volatility has gone against expectations that markets would calm somewhat following statements by Fed chair Jerome Powell. He said that he was not going to raise interest rates any time soon following the central bank’s decision to begin tapering its asset purchases. These assurances are being overwhelmed by

the belief that the Fed will have to move because of the continued rise in inflation.

Writing in the *Financial Times* (FT) last week, economic commentator Mohamed El-Erian repeated his warnings that the Fed's monetary policy, based on the claim that inflation is "transitory," was continuing "to fall behind realities on the ground."

"The lack of a credible central bank voice on inflation also leaves markets in somewhat of a muddled middle. Witness the high volatility in government bond markets that is managing to whipsaw even the most sophisticated and seasoned investors," he wrote.

El-Erian voiced some of the most significant fears in financial circles, noting that "wage demands are going up across more sectors, as is the threat of strikes."

Asked on the CBS program "Face the Nation" on Sunday whether price rises would be down in a year's time, US Treasury Secretary Janet Yellen said: "It really depends on the pandemic. The pandemic has been calling the shots for the economy and for inflation. And if we want to get inflation down, I think continuing to make progress against the pandemic is the most important thing we can do."

However, the policies of the Biden administration, like its counterparts around the world, are going in the opposite direction as virtually all public health measures are scrapped.

Yet, even as a new surge of COVID infections develops, financial speculation continues to accelerate, driven not by improving economic conditions but by what the FT characterised as the "fear of missing out."

In an article published at the weekend, the FT noted that the MSCI All-World Market share index had almost doubled since its lowest point in March 2020 and the crypto currency market was valued at \$3 trillion compared to \$500 billion this time last year.

It reported that on November 5, a record \$2.6 trillion of stock options changed hands in the US, the highest trading volume on record, according to Goldman Sachs. The majority of these options were "calls," a derivative that allows investors, using large amounts of borrowed money, to make bets that share prices will continue to rise.

This allows the making of massive profits if the prediction is met, but large losses if it is not.

Goldman Sachs has estimated that option trading volumes are greater by about 50 percent in dollar terms

than all actual stock trading.

While the general sentiment is the rise in share prices will continue and may even become more ferocious, warnings are being sounded about when the speculative binge will end.

"There's more volume in options than in actual equities," one unnamed senior executive at a big trading firm told the FT. "I don't think this can go on forever."

Erik Knutzen, chief investment officer at the investment management firm Neuberger Berman, told the newspaper: "Everything seems crazy, there are bubbles here, bubbles there, everywhere. It's become a cliché, but we are really in uncharted waters, very unusual territory."



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