Bridgewater Associates

Bridgewater's Prince warns on risky assets after bond decline

Hedge fund manager links boom in blank cheque companies and cryptocurrencies to Fed policies

Inflation expectations have picked up this year, hitting the price of US government bonds and pumping up their yields © Financial Times

Eric Platt and **Ortenca Aliaj** in New York MARCH 13 2021

The world's biggest hedge fund is warning that the recent sell-off in US government bonds could accelerate, in a shift that threatens high-flying assets including blank cheque companies and cryptocurrencies.

Bob Prince, who runs Bridgewater Associates with Ray Dalio, told the Financial Times that a new phase of the downturn in the $21tn Treasury market looms as economic growth improves and inflationary pressures push the Federal Reserve to consider reeling back its stimulus measures.

The rally in risky assets, which has been running for nearly a year, "really depends on . . . whether [the Fed] bumps into constraints", said Prince, "which will typically be inflation, currency deflation or call it the bond vigilantes, where people just say, 'Hey, forget it. With that much [money] printing I just don't want to own bonds.'"

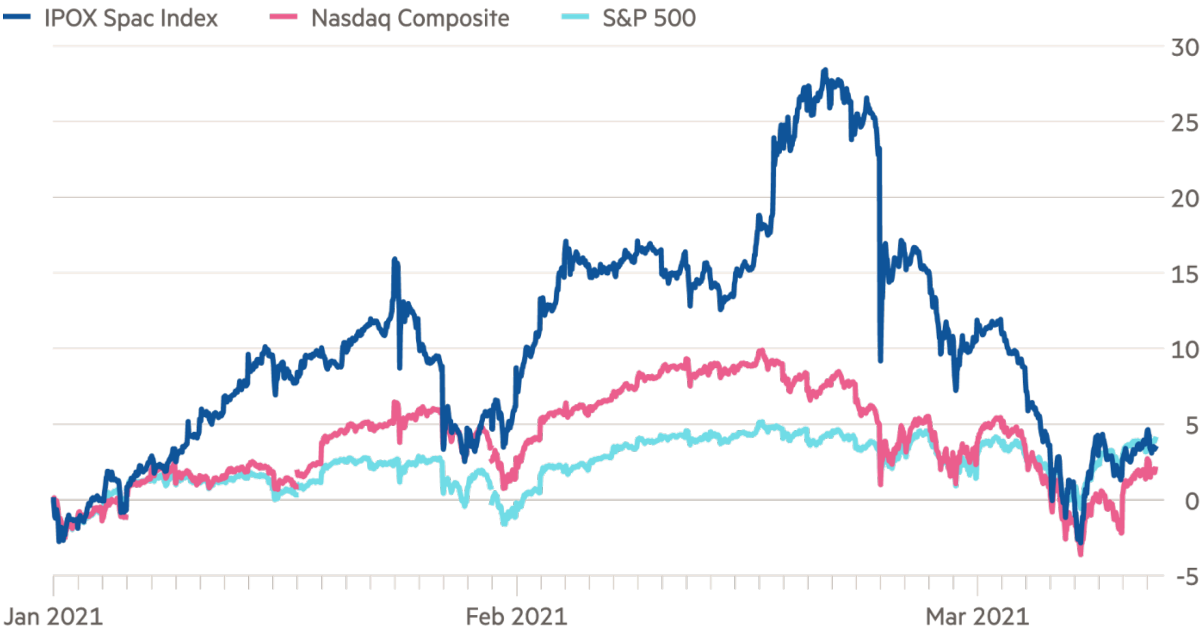
Inflation expectations have picked up this year, hitting the price of US government bonds and pumping up their yields. That has already hit fast-growing technology companies such as Netflix, Amazon and Tesla, since their elevated valuations have been underpinned by low rates.

The Bridgewater executive said he also believed the boom in special purpose acquisition companies and the surge in cryptocurrencies like bitcoin was a "manifestation of that environment" created by the loose monetary policy of the US central bank and stimulus provided by Congress.

Fed policymakers have brushed off the Treasury sell-off as a healthy reaction to the budding US economic recovery. But Prince said investors could face trouble as the central bank responds to higher long-term yields.

High-flying stocks have deflated during the Treasury selloff

Year-to-date performance (%)



Source: Bloomberg
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"Does the Fed come in and print money and buy the bonds to keep the bond yield from rising in that environment?" he asked. "And with inflation rising and the economy doing better and the bond yield going up, do they keep it from going up or do they let it go? If they do yield curve control, do they risk the dollar?"

"Either way it hurts you," added Prince. "Either the bond yield goes up or the dollar goes down. That's the risk of the second stage of a bond move."

Foreign investors, among the biggest buyers of Treasuries after the Fed, have already shown less appetite for US sovereign debt as their losses have piled up, traders say. The yield on the 10-year Treasury climbed above 1.6 per cent this week, up from 0.9 per cent at the end of last year. That has resulted in the worst quarter for Treasury investors in more than four years, according to Ice Data Services.

Treasury prices have slid as the US recovery has accelerated

Price of the average bond in the ICE BofA Treasury Index (cents on the dollar)

Source: Ice Data Services
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Prince — co-chief investment officer of Bridgewater, which manages $150bn in assets — said he was also troubled by the growth of index investing. With low rates leaving yield-hungry investors few alternatives to equities, he said, index funds were paying ever higher prices for stocks with lower future returns.

"It has the look of a Ponzi scheme," he said, "because if you can sell it on to someone else that's fine but what happens if you can't."

His criticism echoes a Financial Times op-ed last month by shortseller Carson Block warning that passive investing posed a global economic risk. Block and other investors have pointed out that because of their strategies, index funds held on to shares in companies like GameStop that have soared this year to record levels.

Prince said Bridgewater's performance was "pretty close to even" in 2021. Its funds include All Weather, a passive strategy that invests in a variety of markets, weighted by their volatility, and Pure Alpha, a more traditional macro fund that makes bets on the direction of stocks, bonds, currencies and commodities.