MAM

MONACO ASSET MANAGEMENT

Global Research & Investment Strategy

MAM Insight No. 12

March 2, 2021

Yields Rising, Tech Frailing

The rise in long-term, and more recently short-term, bond yields follow good news about economic activity and rising inflation - which has been our view over the past twelve months. Last week, rising interest rates sent tremors through equity markets and more specifically the technology sector - extremely overbought and more sensitive to higher interest rates **(Chart 1)**.

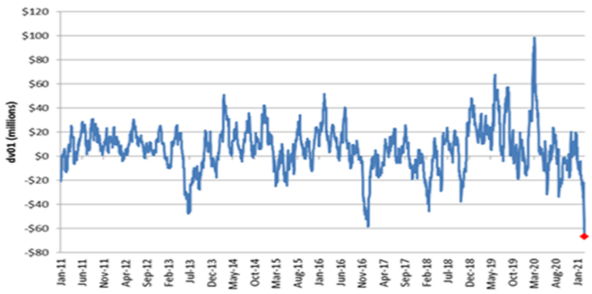
Chart 1. Nasdaq (RHS) vs US 10-Yr Yield (LHS, Invert.)

Source. Bloomberg, MAM Research

Higher yields are likely to limit aggregate market upside in due course. However, bull markets do not end because of rising yields but instead hawkish central bank actions. An earlier-than-expected start to Fed policy tightening can be a source of headwinds to financial markets. We do not expect this to happen just yet. The Fed is cornered. Previous stimuli and Biden's $1.9tn relief package will need to be finance through issuances - most likely bought through the Fed. As a result, the central bank has no choice but to remain accommodative otherwise borrowing costs would skyrocket. Yellen (US Treasury Secretary) and Powell (Fed Chair) are fully aware of this. A leading indicator of future central bank actions could be Powell's speech on March 4th. While investors will be closely monitoring any changes in tone or forward guidance, we think this event is occurring too early in the recovery to introduce material changes in tone. In our view, any tightening in liquidity is more likely to happen later this year (H2'21) when Yellen introduces higher taxes to finance the new infrastructure bill. Until then, the market liquidity profile is unlikely to change very much.

Bond futures positioning remain excessively short **(Chart 2)**. The last time it happened (Q4 2016/Q1 2017), bond yields declined for a few months while Tech stocks rallied. Assuming the Fed remains accommodative, we expect a similar scenario materializing now that US 10-Year inflation expectations have fallen back to below 2%. Additionally, brokers have seen short covering at the end of last week, suggesting 1.6% on the US 10-Year is a line in the sand for now. While we can expect a tactical rally in sovereign bond yields in the short-term, this is just transitory and we would not consider making changes to our recommendation to underweight fixed income .

Chart 2. US Treasury Fut. Positioning (30-Day Build)



Source. MS Sales and Trading

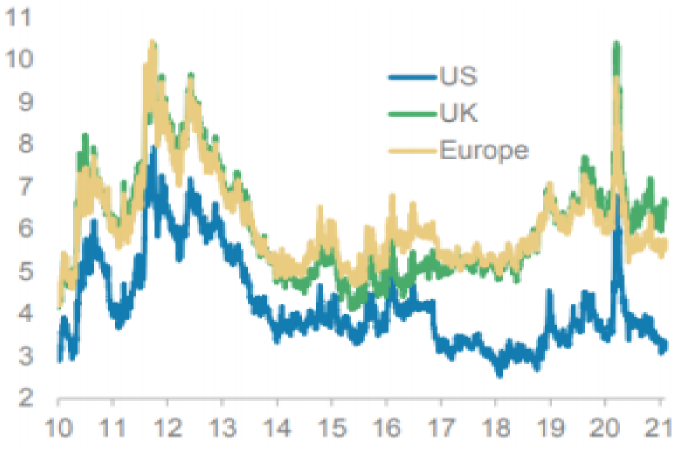
Admittedly, looking for a single level where rates "matter" is pointless precision. The more pressing issue has been the velocity of the rise in yields and US 10-Year breaking out of a 7-month range. It forces investors to imagine and worry about a wide range of possibilities. Ultimately, cross-asset rate risk is about three things: 1) shift in central bank policy, 2) "Bad inflation", and 3) the present value impact from a higher discount rate.

As mentioned, we do not see the Fed turning hawkish at its next meeting. CPI inflation is still contained and the level of employment remains too low to justify a change in policy course. Nonetheless, markets are now pricing a faster than initially anticipated recovery and rate hikes. The dop-plot hints at a potential first hike in 2022 and as much as three rate hikes before 2024. The market is probably right that the Fed will be behind the curve once again. Yet, we think it is still too early to worry about liquidity tightening.

So what does it mean for equity markets? We believe that a rise in sovereign bond yields will continue to exert pressure on certain areas of the equity market but will not derail the current bull-market at play.

Equity risk premium in the US is already extremely low **(Chart 3)**, even per historical standards. If the equity risk premium (ERP) cannot compress, higher yields increase the required rate of returns on equities, to which the more expensive stocks are highly sensitive. Simply put, stocks trading at a 30x P/E would fall c.3% on a 10bps increase in the required return, twice as much as a stock trading at 15x (excl. convexity). As yields fall it helps expensive stocks, but hurts when they rise **(Chart 4)**.

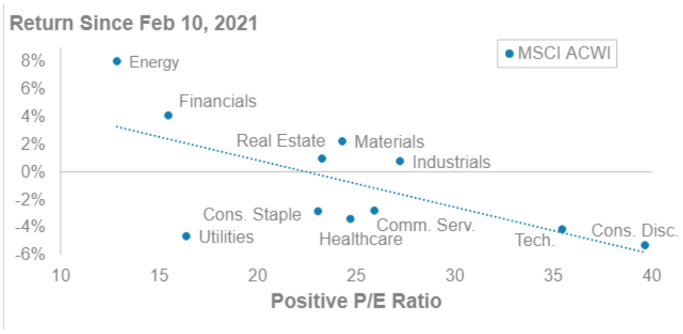
Chart 3. Equity Risk Premiums (% pt)



Source. Bloomberg, MS Research

This simply means that as yields rise under a positive economic environment, value stocks (cheap valuations) will outperform growth stocks (expensive valuations).

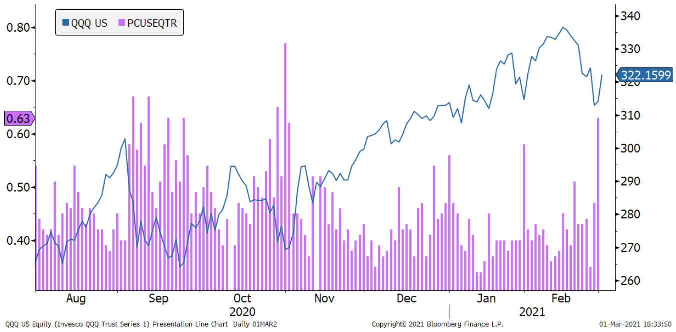
Chart 4. Cheap Sectors Outperform in Real Yield Sell-Off



Source. Bloomberg, MS Research

In equities, S&P 500 futures are trading on their 100 day moving average, Nasdaq has yet to find a real bottom and still have room to give up some more ground over the next couple sessions, but technicals are oversold. Positioning indicators such as the Put Call Ratio are high, meaning investors were hedged into the recent correction **(Chart 5)**. Positioning in tech saw a large unwinding in the futures market last week - 2 SD event - suggesting the lion-share of repositioning (for now) may be done short-term. International equity markets held up remarkably in comparison, European equities hover near recent highs, the EuroStoxx 600 was down -2%, supported by a lower P/E multiples and higher ERP.

Chart 5. Nasdaq (RHS) vs. Put Call Ratio (LHS)

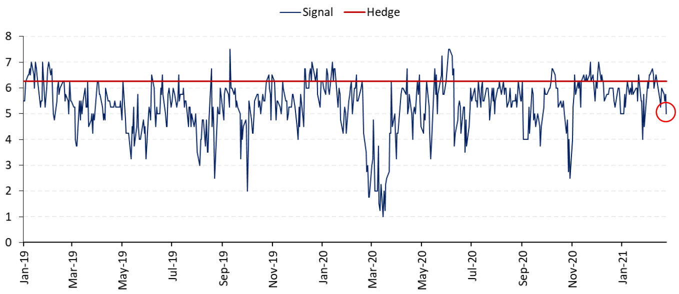


Source. Bloomberg, MS Research

Do we forgo tech exposure? We think not. The Biden package and subsequent monetization of this debt from the Fed should continue the theme of "buy the dip". After a 3-5% sell-off, or 10-20% in some cases, we are closer to a short-term bottom. After a correction of 25% from the highs and with technicals looking oversold, the return of "buyers of dips" on stocks such as Tesla will ensure markets regain their upward trajectory.

What are the MAM and sentiment indicators telling us? Our short-term model is back to neutral **(Chart 6)** with some sub-indicators highlighting the recent sell-off may be overdone. Market breadths fell substantially. Cash levels at fund managers may still be a concern, but it is hard to isolate just one factor the direction of the entire market. The CNN fear and greed index only has a moderate greed skew **(Chart 7)**. At the end of the day, Q1 and Q2 are seasonally strong periods for equity markets in an economic recovery year.

Chart 6. MAM Short-Term Indicator



Source. Bloomberg, MAM Research

Chart 7. CNN Fear & Greed Index

Source. CNN Business

Investment Implications. We recommend keeping the current exposure constant and tactically adding some tech through either the sale of put options on Nasdaq, the outright purchase of Nasdaq ETFs, or other tech funds. Other than that, our game plan remains intact. We look for inflation expectations to rise further in April to May 2021, when we will look to reduce equity market exposures across the board.

As always, please feel free to reach out to us should you have questions or comments regarding this research.

Kind regards,

MAM Investment Team

Disclaimer

This document has been prepared by Monaco Asset Management (MAM). It gives a general overview of the strategies proposed by MAM.

This document is confidential and is intended solely for the recipient and may not be duplicated, distributed or published either in electronic or any other form without the prior written consent of MAM.

This document has not been reviewed or approved by any regulatory authority. It is not a personal recommendation. It is for your information only and is not intended as an offer, solicitation of an offer, public advertisement or recommendation to buy or sell any investment or other specific product. Its content has been prepared by our staff and is based on sources of information we consider to be reliable. However, we cannot provide any undertaking or guarantee as to it being correct, complete and up to date. The circumstances and principles to which the information contained in this publication relates may change at any time. Once published, therefore, information shall not be understood as implying that no change has taken place since its publication or that is still up to date. Furthermore, MAM is not under obligation to update the information contained in this document.

The information in this document does not constitute an aid for decision-making in relation to financial, legal, tax or other consulting matters, nor should any investment or other decision be made on the basis of this information alone. All recipients of this document are urged to carry out their own due diligence into any investment opportunity. They should form their own assessment and take independent professional advice on the merits of investment and the legal, regulatory, tax and investment consequences and risks of so doing.

We do not guarantee the accuracy or completeness of information which is contained in this document that may have been obtained from or is based upon trade and statistical services or other third party sources.

We disclaim without qualification all liability for any loss or damage of any kind, whether direct or indirect, which may be incurred through the use of this publication.

The above information concern this document and any associated documentation, including the e-mail or cover letter.

MAM is registered with the Monaco Chamber of Commerce and Industry under the number 99S03612 and is approved by the Commission for the Control of Financial Activities under number SAF/99-03.