



CIO OFFICE MORNING MARKET WRAP – 13th December, 2021. ALSO AVAILABLE ON ALEXA.

Stocks have opened higher this morning in Asia, with the Nikkei 225 leading, while US futures are edging higher. Treasuries are weaker and the US dollar is range-bound alongside gold.

What was striking last week about the US bond market reaction to the highest inflation reading since 1982 was that the 10-year Treasury yield slipped slightly on Friday, rather than shoot higher as per textbooks. Yes, the interpretation that investors are expecting an appropriate Fed response aimed at capping inflation, hence curbing growth in the process, is correct, with relatively low longer-dated yields now discounting a post-tightening scenario. Yet, the removal of accommodation would be starting with the yield curve at its flattest in the last ten years, pointing to markets believing the Fed would not be able to hike many times before the curve inverts, that is before a recession occurs. That the Fed supposedly has so little breathing room, is a confirmation of the fragility of US growth. Indeed, growth forecasts for 2022 indicate GDP levels very much still above trend, but does that really matter? Does it matter, if projections just reflect unprecedented stimulus efforts, which by definition cannot be replicated, and if, even worse, the all-out efforts are not expected to produce sustainable results? Very short-term rates 3-years forward are already trading below the same rates 2-years forward, with this kind of inversion suggesting that rate cuts are already being priced in. Are the seemingly strong GDP projections a case of American exceptionalism, or rather of exceptional American stimulus?

Cathy Wood, the CEO and CIO of the asset management firm Ark Invest, must have been doing some soul searching of late, as she is seeing her strategies go down in a market that is up. It is largely known that her funds invest in innovative themes and disruptive technologies. On the one hand there is no guarantee that a new technology, in and of itself, will bring in above market returns. New ETFs on disruptive themes have been all the rage in the last two years, and although two sectors ripe for radical change seemed to be, amongst others, food and education, so far neither the Rize Sustainable Food ETF nor the Rize Education Tech ETF have lived up to the initial claims. The internet, at the time in its infancy, was all the rage as well in the year 2000, and the crowds rightly saw promises of a revolution as well as of stellar returns, which only came to pass much, much later. On the other hand, there is no doubt that picking the right disruptive technologies can be hugely rewarding. All we can say is that so far the Ark Innovation ETF has outperformed, since inception, the ETF on the Nasdaq 100 Index by more than 4% annualised as of November 2021, although its Sharpe ratio has been much lower. The performance gap was much higher earlier, so the Ark ETF is showing signs of reversion to the mean. We will see how pronounced the reversion to the mean can become, once Powell removes liquidity from the economy in 2022.

Geopolitical risk has come back to the fore under the Biden presidency, a rare sign of continuity with the previous Trump administration. US adversaries are feeling that they can up the ante in challenging the incumbent superpower. President Biden has warned Vladimir Putin that the invasion of Ukraine would have “devastating” consequences, and relations with China over the status of Taiwan of late have only got worse. It is hard to see Putin being granted the final say over NATO’s expansion, however unhappy he may be about the prospect for NATO inclusion of both of Ukraine and Georgia. And it is even harder to see Xi Jin Ping renounce the dream of reunification with Taiwan, all the more so since the separatist province, as Beijing sees it, has developed an enviable edge in the semiconductor industry. We can only hope that unintended consequences are avoided on both sides, though the tendency is clearly towards much diminished reverence towards the dominating superpower.

Please take notice that this week sees the last Daily Note of the year, which will be then resumed in January 2022.

Stay safe.

MAURICE GRAVIER
Chief Investment Officer
Wealth Management
Emirates NBD

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