



CIO OFFICE MORNING MARKET WRAP – Monday May 17th, 2021. ALSO AVAILABLE ON ALEXA

Stocks are wavering on this Monday morning alongside US equity futures as rising virus cases in parts of the region are weighing on investor sentiment. Treasury yields are steady and the dollar is edging up.

US economic growth is expected to peak in the current quarter and we will know that investors have taken notice if we see non-US assets outperform. Usually, once US business confidence inflects lower, allocations across portfolios tend to shift. The US manufacturing Index has recently hit the highest levels since the 80s, a signal that the expansion rate of the economy could be close to its highs for the year. All else being equal, this in turn means that the growth differential between the United States and the rest of the world would become more favorable for non-US assets. Historically, following these turning points EM and DM x US equities have tended to perform better, growth and defensive styles have staged a comeback in the US, EM Sovereigns

have outperformed US high-yielding debt and the dollar has weakened. Each cycle is slightly different and this time US exceptionalism could last a tad longer and value stocks are still relatively cheap. Also, while EM debt is appealing in relative terms, the opportunity seems to be more tactical than strategic due to the possibility of the winding down of Quantitative Easing in 2022. The weaker link in the whole cross-asset chain seems to be the US dollar, highly dependent on strong economic releases and real rates which are still stubbornly low.

Bill Dudley, the ex FOMC-vice-chair, sees US long-dated yields at least double in value from current levels in the longer term, once the Fed has achieved its policy target rate of 2.5%, so well after 2023. This reflects the conviction that central banks this time will manage to reflate the economy with the help of government stimulus and, obviously, portends a bond bear market. Bond cycles tend to last at least a generation and as a matter of fact we have not had a Treasury bear market since the 80s. As a consequence, well-known allocation strategies like Risk Parity, which tend to leverage larger investments in lower-volatility assets, could be upended by the rising of volatility in government bonds. After all, torturing the data enough one cannot find asset classes which have been consistently well behaved: leveraged long positions in US Treasuries in the 70s, a period of high inflation, would have been a recipe for disaster.

Colonial Pipeline, the pipeline services company fallen victim to a ransomware attack, went back to normal activity on Thursday after its shutting down for days caused fuel shortages across the Southeast. This time it is the Russian-based cartel responsible for the attack to have got the shorter end of the stick, as it is ceasing operations following pressure from the United States on Putin. Yet, the incident could be a warning of worse to come. Innovative software has been rising alongside inadequate cybersecurity protection to the point that a modest outfit could stop the flow of oil in half of the United States. Pandemics are not the only risks looming larger for the normal functioning of societies.

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