



## **CIO OFFICE MORNING MARKET WRAP – Thursday 18th February 2021. ALSO AVAILABLE ON ALEXA.**

The quick rise in global Treasury yields did not go down well with markets and stocks saw one more mixed-to-weak session. The dollar strengthened, gold declined and oil gained following an unprecedented cold spell which shut almost 40% of US production. Losses in the government bond indices generated the worst start to a year for fixed income investors since 2013. Should yields continue to march higher, at some point mortgage-related hedging could kick in and in turn accelerate the process, as mortgage originators would be short-selling similar-maturity Treasuries.

The inflation levels discounted by the Treasury-Inflation-Protected-Security markets have already reached the highest point since 2014, slightly north of 2.2% on the 10-year tenor, leaving no choice for real rates other than to follow the nominal ones higher. This makes for a more challenging environment for risk assets, long addicted to prolonged periods of falling real yields after the Great Financial Crisis. Although we reiterate the view that equities, given the broad gap between earnings and bond yields, have ample room to absorb rising rates, we acknowledge that high absolute valuations and overly optimistic investor sentiment could trigger temporary setbacks.

According to Citigroup's equity strategist a pullback seems "very plausible". Yet, should markets weaken, we should also be mindful that we are exiting a recession and strong monetary and fiscal measures warrant a constructive outlook. Traders are pulling forward expectations of Fed rate hikes, with eurodollar futures, priced off three-month Libor, pricing almost 40bps of tightening by the end of 2023. The publication of the FOMC January meeting revealed that Fed officials did not see the conditions for reducing asset purchases being met for "some time" and that they laid emphasis on distinguishing between temporary and persistent inflationary bursts.

The dovish-leaning record of the gathering promptly supported stocks as it was released. Data for retail sales, industrial production and consumer prices for the month of January all were above consensus, pointing to the rapid progress of the economy supported by the fiscal relief measures signed into law last year in December. Berkshire Hathaway revealed new sizeable bets on Chevron and Verizon, as well as the trimming of positions in Apple. Longstanding trend-followers and digital-economy enthusiasts must have winced at these choices. They should not. After all, successful longer term trades are the ones the crowd can only see after the fact. They should also be mindful that some major investment houses have just proclaimed the start of a new commodity super-cycle.

Stay safe.

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