newnormal Insight

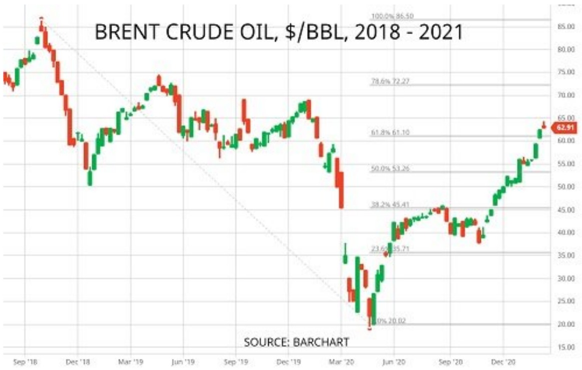
Investor mania is a classic sign of a late-stage bubble

22 February 2021

Retail investors typically have little experience of major downturns. When they decide to go "all in" on equities, as with the dot-com mania in late 1999, it is normally a sign of trouble ahead.

Oil

Brent tried to move higher this week, boosted by the outages in the USA, but ended weaker at $62.84/bbl



✦ HIGHLIGHTS

- ✦ As suggested last week, today's oil price is high enough to raise global output
- ✦ Saudi Arabia announced it would reverse its unilateral 1mbd cut from April, as Riyadh suddenly realised it was losing market share
- ✦ Other OPEC+ members now expect current cuts to be rapidly relaxed, even though demand is still lacklustre
- ✦ Typically, weather-related hits to US oil output are quickly reversed as conditions improve
- ✦ The coming week will also start to reveal the freeze's impact on US oil demand

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Oil market volatity to continue as OPEC+'s hopes for increased output clash with weak demand.

S&P 500

The S&P was down 0.7% on the week at 3907, as the markets began to worry about the impact of higher interest rates. The VIX volatility index rose 10% to 22.

✦ HIGHLIGHTS

- ✦ Current equity valuations have been "justified" by the all-time lows in interest rates – but these are now rising very fast
- ✦ They may well be the 'trigger event' for a market correction
- ✦ Worryingly, retail "investors" have moved on from silver and cryptocurrencies to leveraged VIX derivatives (e.g. UVXY) as their next 'enthusiasm'.
- ✦ Renewables are another "enthusiasm" with P/E multiples for 'green stocks' up 24 points during 2020 vs 2 points for sector peers
- ✦ Total CEO Patrick Pouyanné also points to "crazy valuations" being paid for acquisitions in renewables

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Equity cheerleaders increasingly forced to rely on hopes that a strong V-shaped recovery is inevitable by Q2

Interest rates

The rate moved up sharply to 1.34%, whilst the MOVE volatility index jumped to 60.

✦ HIGHLIGHTS

- ✦ Fear is rising in fixed-income markets.
- ✦ The rise in government bond yields will soon pressure junk bond yields
- ✦ Centene's new 10-yr bond is paying just 2.5% versus the "risk-free" 1.34% yield available on Treasuries
- ✦ Investment grade yields at 2.2% confirm the mis-pricing in junk
- ✦ A major rise in junk yields to reflect inflation fears will pressure equity markets, given these are currently priced for perfection

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Equity and junk bond markets to start to react to rising bond yields

China

China's new 'dual circulation' policy places a high priority on moving up the value chain with its exports.

✦ HIGHLIGHTS

- ✦ China's export-led recovery last year meant that it overtook the US to become Europe's most important trading partner
- ✦ A key part of the 'dual circulation' policy involves the use of next-generation technology to support its position as the 'manufacturing capital of the world'
- ✦ The Industry & IT Ministry's new plan for 2021-23 focuses on digitalising traditional industries; building the Internet of Things; 5G and robotics
- ✦ The idea is for production to become cheaper, cleaner and more efficient, with major support from government

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China aiming to boost its manufacturing capability to offset the downside created by its dependence on fragile global supply chians.

Summary

We don't believe in the idea of a V-shaped recovery which will permanently increase inflation and bond yields. But equity markets are starting to realise that you can't have one without the other.

	Oil	S&P 500	Interest rates
Market view today	Some concerns	Some concerns	Expecting inflation
Our current view	Negative	Reversion to mean inevitable	Expect long-term deflation
Positioning began	December 2020	December 2020	December 2020
Confidence level			
Initial	◐	◐	◐
Today	◕	◐	◕
Relevant positioning	Cautiously bearish	Cautiously bearish	Neutral 10-year and longer-dated Treasuries

Confidence level: ● = 100%, ◕ = 75%, ◐ = 50%, ◔ = 25%

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