Investment Weekly

For inquiries related to this article, please contact:

Alain.Marckus@bankfab.com
Christofer.Langner@bankfab.com

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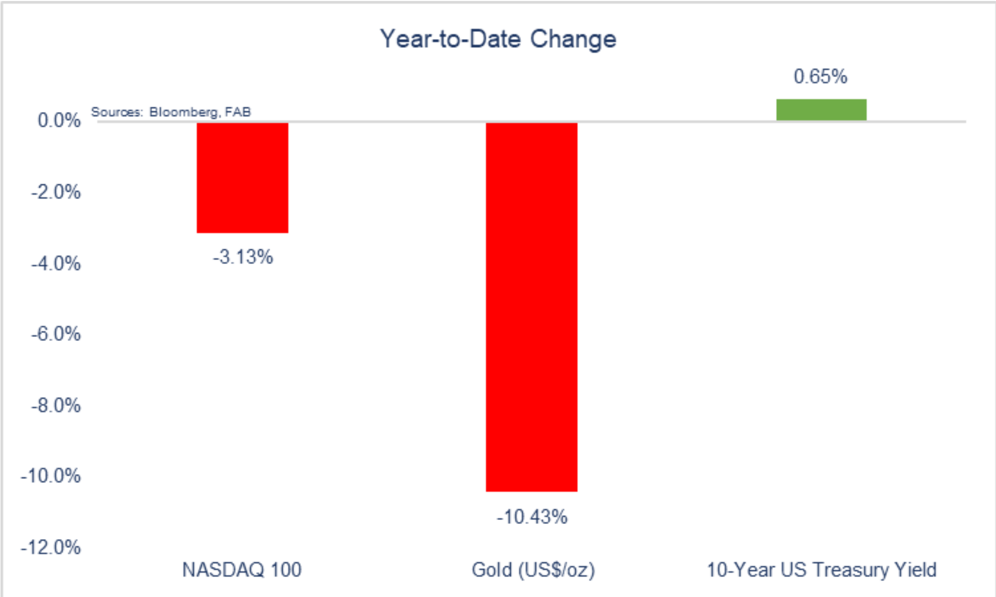
These days, it seems like investors just want to get paid quickly

- **The US Treasury sell-off seems to have shifted investor focus towards some income-generating assets.**
- **Growth stocks and gold have been hit since February, as investors favoured dividend-paying stocks and beneficiaries of economic growth.**
- **The move in Treasuries, however, is likely to stabilize and even reverse depending on the FOMC decision.**
- **Part of the driver for the sell-off in the safest assets, however, is positive for risk assets as it signals strong economic growth ahead.**
- **The FAB AAC is overweight in equities, IG and EM bonds, and gold, and is underweight in alternatives.**



Duration is a concept mostly associated with fixed income. It refers to how fast the money invested gets repaid, and is a measure of sensitivity to interest rates. That makes sense: the higher the interest rate, the less interested people will be in anything which pays very little or no regular income and, therefore, takes a long time to return the value invested. If government bonds, considered the safest, are paying good rates, why would investors be taking risks in other assets that are riskier and do not pay much?

The past two weeks have been a lesson in this concept. The yield on long-dated US Treasuries has been rising since November, when the first vaccine against Covid-19 proved efficacious, but that rise has accelerated since 10 February. Gold, which does not pay a coupon, peaked in August, with losses having accelerated in the past month.

Technology stocks, as represented by the NASDAQ 100 index, have had three consecutive weeks of losses, and by Thursday the index was down 9.73% from its recent high on 12 February. The index comprises mostly high-growth companies in the US stock market, many of which do not pay dividends because they reinvest profits into research and growth.

Meanwhile, large-cap energy stocks, which used to be known for steady and good dividends, have rallied. The S&P 500 Energy subindex has gained 13.96% since 12 February. High-yield bonds have also held steady, with the Bloomberg US Corporate High-Yield index dropping only 0.67% in the same period.

In summary, since 12 February, as the yield on 10-year US Treasuries increased by 44 basis points to 1.56%, long-duration risk assets have suffered. Naturally, the higher yields in the long-dated government bonds are not the only reason for that, but they are part of the equation.

Gold and some tech stocks that do not pay dividends have fallen along with Treasuries

While the others parts of the story may change this week, one of the key backstops for Treasury yields is not available until the middle of next week: The Federal Reserve has gone into a mandatory quiet period ahead of the next rate-setting meeting on 17 March. That means Fed officials will not be able to talk-down long-term Treasury yields if they continue to rise.

Once they meet, Fed officials could announce extraordinary measures to ensure that financial conditions remain loose, in case stock markets sell off and long-term yields continue to rise. They had already debated in December whether it would make sense to buy more long-dated Treasuries, and that discussion is likely to return to the table.

The European Central Bank could help ease the stress in the US Treasury market, depending on their decision in a rate-setting meeting this week. Recent Treasury market action has already spilled over into European bonds. Since the start of the year, the yield on 10-year euro swaps has increased 30 basis points.

That move has caught the eye of ECB officials, prompting Chairwoman Christine Lagarde to say that the ECB was concerned about higher long-term yields. That comment alone helped to push yields down last week, but they started to rise again after Bloomberg News published a story based on unidentified sources suggesting that the ECB would only try to 'talk down' yields for now.

Madame Lagarde will have the opportunity to do that this week in the press conference following the ECB meeting. And there is a chance that the ECB decides to shift more of its bond purchases to longer-dated securities and to front-run some of its planned purchases.

Meanwhile, the Bank of Japan and the Reserve Bank of Australia have already started to move in that direction. Last week, amid still-rising yields, the RBA took its gloves off and announced it was buying more than US$3 billion in long-dated securities.

This happened on a day when there was already some short-covering, it seemed, and it accelerated the yield drop, pushing the return on the 10-year government bond down by almost 25 basis points (to 1.67%) on Monday. It was a reminder for traders 'down under' not to fight the RBA.

The Bank of Japan did its own milder version of that on Friday. In a testimony to the Japanese Parliament, Haruhiko Kuroda, the BoJ Governor, said he did not think it would be "necessary nor appropriate to expand the (yield) band" for Japanese government bonds.

The statement ended weeks of speculation on whether the central bank would widen its yield curve control band as part of a policy review due on 19 March. It also prompted the yield on 10-year Japanese government bonds to drop 8 basis points immediately after his comments.

Whether Madame Lagarde will drop her own version of Mr. Kuroda's bombshell this week will be key for Treasury markets, as it could drive more buying of US government bonds, or vice-versa.

Two weeks ago, the yield on 10-year euro swaps hit the highest since last year's crisis

Ultimately, however, higher yields are also a reflection of increasingly upbeat economic expectations. The median forecast among 82 economists surveyed by Bloomberg is for the US to grow 5.5% this year. These predictions got a boost last week, too, with a better-than-expected nonfarm payrolls report.

The Bureau of Labor Statistics revealed on Friday that the US added 379,000 new jobs in February, more than the 200,000 median expectation of economists surveyed by Bloomberg. The January numbers also saw a revision upwards to 166,000 new jobs created, versus the 49,000 figure originally broadcast.

Perhaps the most important was the breakdown of jobs creation. The leisure and hospitality industry created the most positions, 355,000. Retail trade also added 44,000 positions. These increases before the US has fully reopened are promising, even though the leisure and hospitality industry is still employing 3.5 million fewer people than a year ago.

While not all of those jobs are going to return, many will, as the latest current employment situation survey has shown. On top of that, other industries are likely to see employment pick up, too, after a US$1.9 trillion stimulus package passed the Senate this weekend.

This package brings the total amount of pandemic-related fiscal stimulus to US$5.4 trillion, or a quarter of the US gross domestic product as of December. All this money will be spent eventually, which is why commodities have been gaining.

There are idiosyncratic reasons too. The price of Brent crude closed at US$69.36/ barrel on Friday, its highest since May, 2019, after OPEC+ held back on increasing output. The limited supply, together with more signs of demand recovery buoyed the oil market. But it is also a sign that, as Treasuries are indicating, the US is going to have a great year, and that investors should look at risk assets even more closely.

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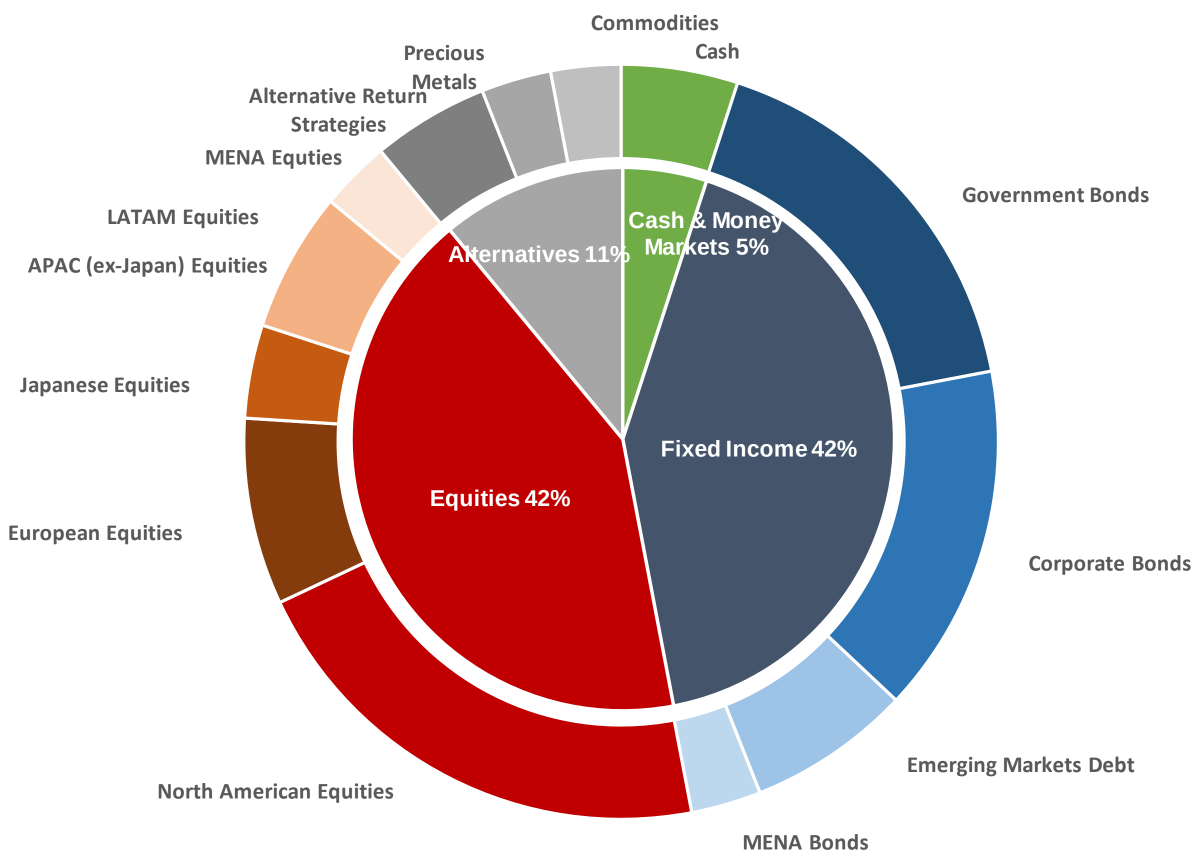
Current Tactical Asset Allocation



Asset Class	Positioning	Detail
Cash	Neutral	Moved into overweight equities position.
Fixed Income	Overweight	Keeping slightly overweight focused on EM dollar debt and corporate investment grade bonds
Equities	Overweight	Slightly overweight Japanese, US and Asia ex-Japan stock markets.
Alternatives	Underweight	However, still marginally overweight in precious metals

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