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## The bond and the stock market are telling different stories

◆ Bonds have been rallying for the past week together with stocks.

◆ A bond rally usually suggests that investors are getting wary.

◆ Gold is also moving higher in further indication of unease about risk assets.

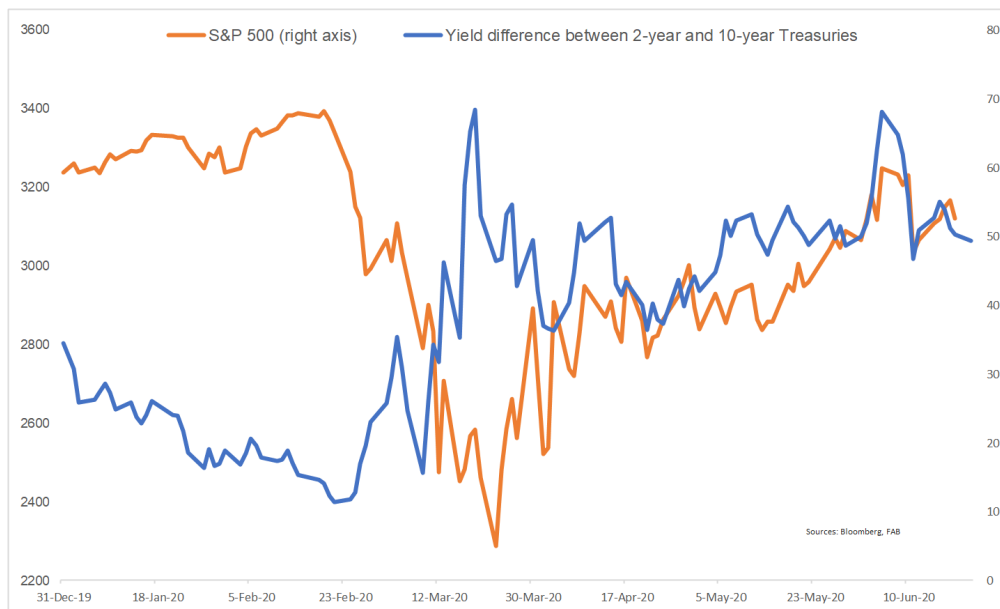
◆ Stocks could be buoyed this week by so-called 'window dressing', when funds pick up market winners to report those holdings at quarter-end.

◆ FAB AAC remains overweight high quality investment grade bonds.

Window dressing is one of the urban legends of Wall Street. It is supposedly a practice in which many mutual and hedge fund managers engage to look smarter than they are. It consists, normally, of going with the trend at the end of the quarter, just before it is time to report holdings. If the quarter was mostly negative, these investors then sell the losers at the end of the quarter, and if it was positive, they buy the winners.

This should translate into a tendency for the last week of the quarter to reflect the trend of those three months, especially if that trend was strong. Unfortunately, the numbers do not really support the myth. A bit more than half of the times, the last week of the quarter followed its trend in the past 10 years. That is a bit stronger in quarters when there are sharper moves, but, it is still a coin's toss whether following the trend in the last week will work out.

That said, there is some anecdotal evidence that window-dressing does happen and it could be happening this week. At least one indicator suggests so.



Over the past week, Treasury yields have been dropping as investors began to weigh the potential impact of what is increasingly looking like a second wave of coronavirus infections in the US and China. The Treasury curve has also flattened, with the difference between yields on two-year and 10-year notes narrowing more than 18 basis points in the past 15 days. Then there is gold, which is seeing increased demand from retail investors and hedge fund managers and has rallied in the past week as well.

These asset classes tend to move this way when there is volatility or when investors are getting bearish. In the meantime, however, the S&P 500 continues to rally. That could be partly a result of window-dressing. If it is the case, then this week could actually see some gains, particularly among the stocks that have done best throughout the quarter. While that explanation hardly passes the quantitative test, the stock market lately has been less driven by rational behavior.

### Stocks have gained in the past couple of weeks even as the Treasury curve has flattened

As irrationality goes, investors will be particularly keen to see what happens if the S&P 500 approaches 3,200 again before the quarter ends. If it is able to breach that level, there is a chance it could keep going, mostly driven by sentiment, as investors continue to fear missing out.

If, however, the index retreats as it nears that key level, bears could be emboldened and a correction could ensue. Any sell-off, however, may not be very deep given the amount of cash sitting on the sidelines. According to the Investment Company Institute, money market funds have received inflows of US\$1 trillion since the end of March. In the past two weeks, US\$100 billion went back to risk assets, but there still is US\$900 billion to go.

## Investment Strategy Update

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