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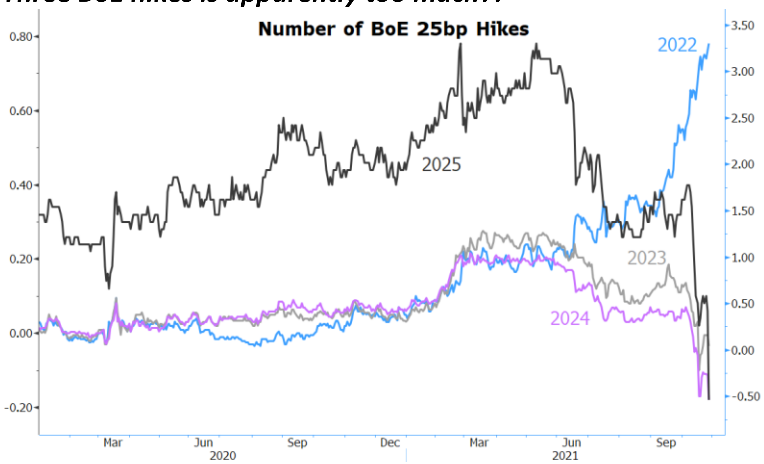
For a second day in a row it was the STIR market that shook the tree (*or stirred the pot…*) as everything in that front-end space was turned upside down by hawkish comments from the BOC and RBA with a number of popular trades being forced to unwind. Notwithstanding the aggressive flattening in the UST term structure as a result, and that EDZ2s are now pricing in more hikes than EDZ3s, what really blinded me was actually in the UK market – which has arguably been more aggressive than other front-end curves anyway – where investors are pricing in >3 hikes in 2022 but then *cuts* in 2023/'24/'25… I'm far from an expert in STIR trading, but the chart below just looks like a lot of positioning pain being taken.

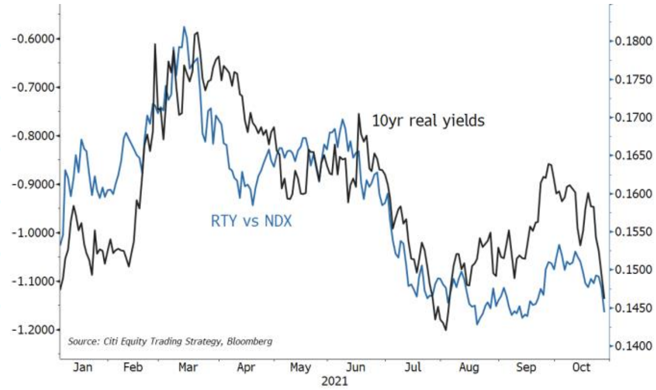
Three BoE hikes is apparently too much?!



Even in the US the STIR market is pricing in more hikes next year than in 2023

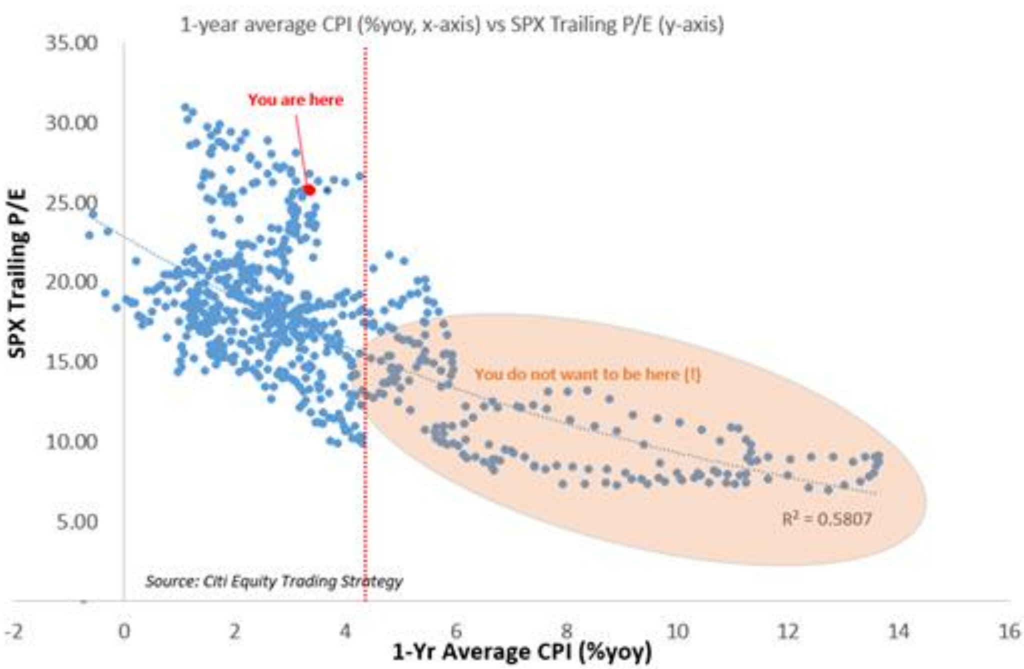
Here in the US, a combination of curve flattening and outright bids to the long end put pressure – although still well short of any CTA covering being done – on both the cyclical and Value complex with Energy -3%, Fins -1.7% and Materials -1.4%, although curiously the bid to Low Risk (CIISLRUT Index) was more muted than sector dispersion and some nasty below-surface price action suggested. Tech outperformed, but even that was hard to distinguish whether it was the result of strong results from MSFT and GOOGL (*collectively they contributed 127pts to NDX on a day where the index was only up 39 points!*), or thanks to the precipitous drop in real yields that are now within 7bps of the YTD (and multi-decade) lows. For all of the brouhaha around market leadership at present (and recent SMID underperformance), real rates sadly continue to provide the most elegant solution for equity market behaviour at present.

Real yields continue to explain sector and size rotation



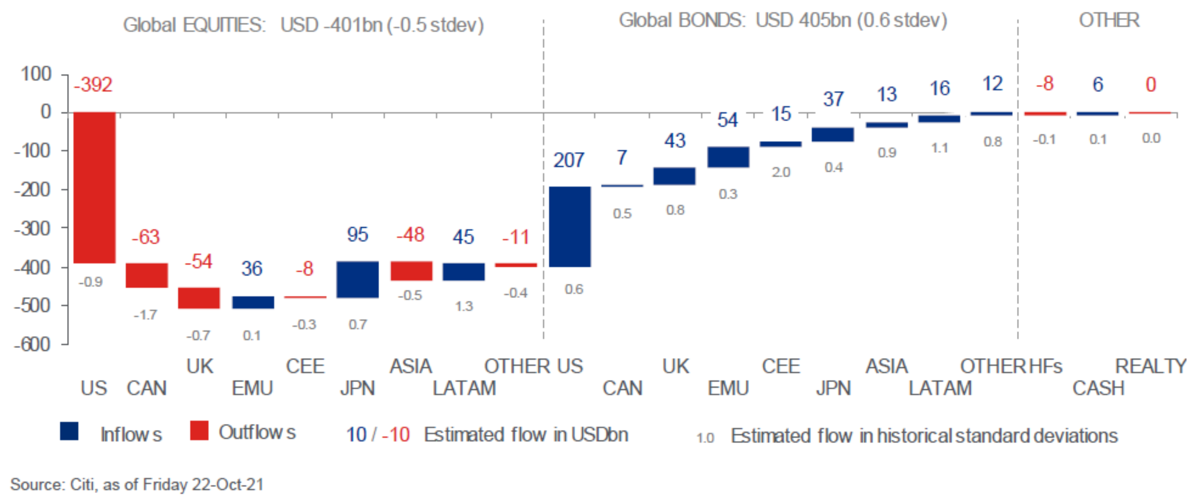
Payment companies took a shellacking on some bellwether weakness and an afternoon DOJ investigation announcement, whilst a high-profile secondary placing traded decently through the strike. The tone of sentiment in general was definitively the most sour since the October rally got some momentum, and this all feeds into the recent narrative that CETS has been articulating of equities having reached a point of extremity and need a period of consolidation before marching higher. One colleague conversation highlighted the paradoxical phenomenon that a flatter curve via more hikes should not be positive for equities, yet our asset class is naively taking cues from the supportive backdrop of lower real yields in the face of higher inflation. Ultimately, he may prove to be correct (*but when?*), and this plays into the discussion in **yesterday's EOD** that equities may eventually start seeing a change in correlation to the real yield dynamic, which I think may happen if we see persistent 4%+ headline CPI heading into 2022. Again, this is a thematic that may prove to be critical in terms of articulating a macro-thematic framework over the coming year.

Will a 4% average CPI environment start to see a change in real yield vs equity P/E dynamic?

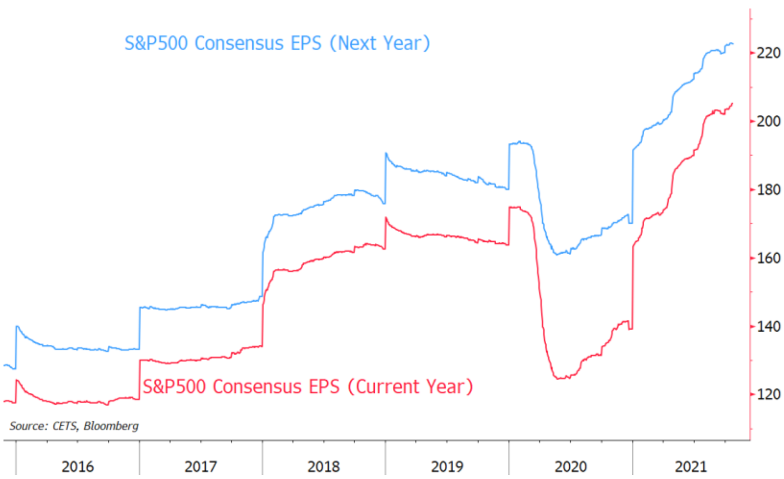


Back to the tactical time horizon though, I believe that any near-term equity weakness should not only be welcomed as an opportunity to add to risk given the constructive backdrop of a better-than-expected Q3 results, ongoing loose financial conditions, and indeed relatively light positioning in the context of YTD levels. Investors also have to contend with month-end flows, where our Quant team recently highlighted c$400bn of equity outflows, which may also be weighing on sentiment until we get through the coming weekend. However, these are small speed bumps, in my opinion, given a broadly favourable positioning backdrop; POLLS remains below the critical threshold of 16 too.

$400bn of theoretical equity outflow as a function of month-end rebalancing



So sticking to the game plan here: let the lunacy in the STIR market subside, pick equity levels into potential month-end weakness, and look for markets to stabilize and then rally as November gets going in earnest. Perhaps the most encouraging chart I saw today was that despite concerns about a slowing EPS environment, consensus forecasts for both 2021 and 2022 continue to creep higher… and that's a dimension to help all investors sleep just a bit easier at night.



Alty

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All charts/data sourced from CETS, Bloomberg and Citi, unless otherwise indicated.