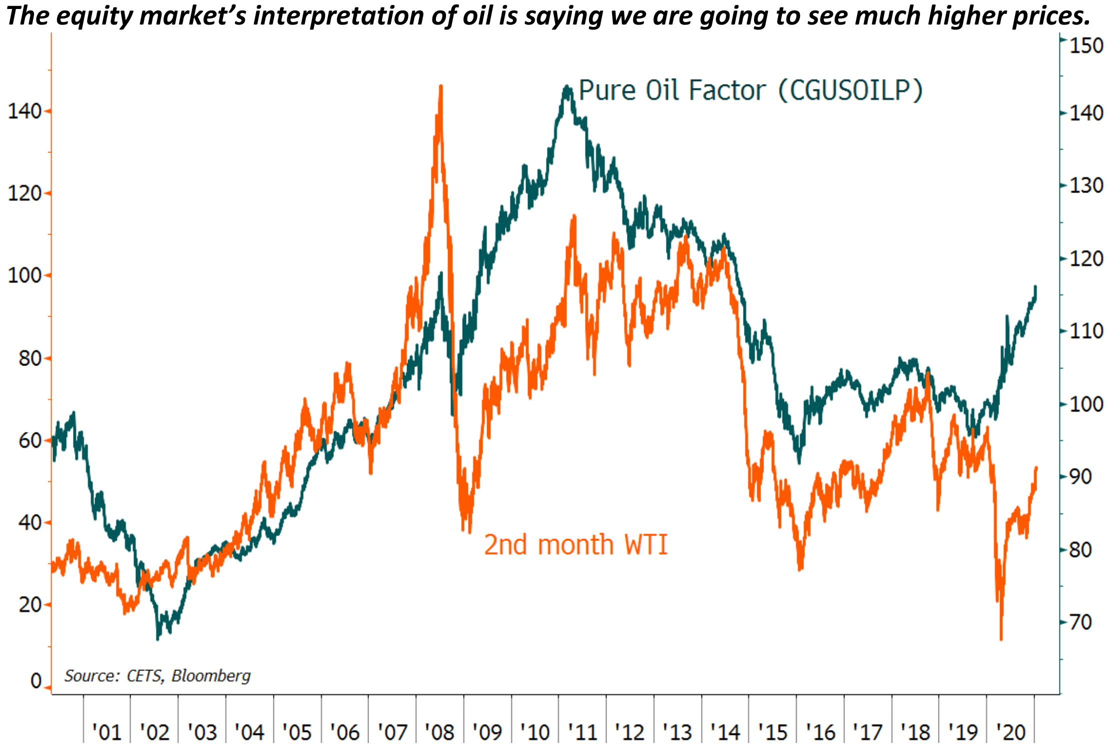
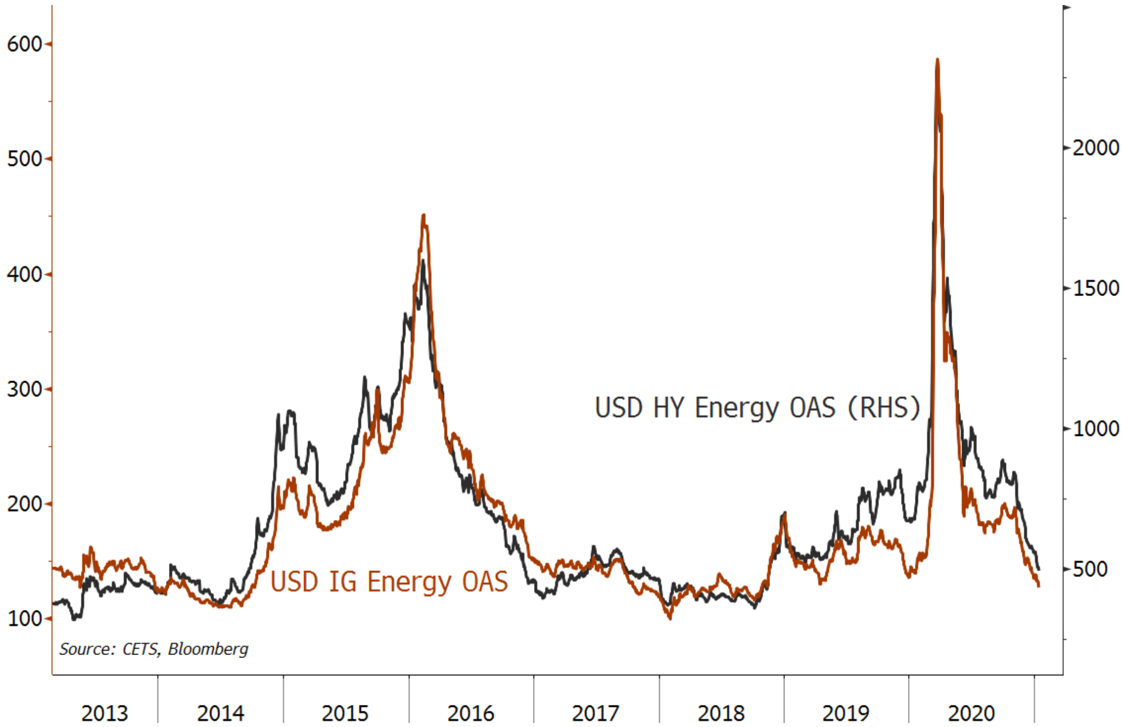
A late turn in broad indices took us into the red by the close of session today, but it was clearly the Russell that stole all of the attention, closing +2.4% and taking the YTD outperformance vs SPX to 8%. Some attributed this to Powell's **comments** in the afternoon that got breakevens off to the races (10s now trading within a whisker of the YTD highs again), but I did hear from my ETF team that there was also a large midcap rebalance taking place that was only announced last night, forcing institutional money into the liquidity vacuum of buying SMID. Regardless of the trigger, RTY has now outperformed SPX and NDX by 38% and 21% respectively since the March'20 nadir, which is all the more impressive if you consider that the midcap index only has a 15% combined weight of Tech and Comm Svcs.

Energy led (again) taking the YTD performance to an impressive 18%, and yet client conversations remain rather lukewarm towards the sector. Granted, it is more receptive than back in October when outlining the original thesis on the **Texas Hedge**, and yet over the past week our flows have suggested a stronger appetite to top slice any profits in the commodity space than necessarily let them run. I have some sympathy with this perspective given that USD is so far unchanged in January, but I believe that this is far outweighed by the reality that commodity assets have a degree of scarcity value in a world that is awash with both liquidity *and* tech companies. I highlighted on **Tuesday** (*apologies for no EOD yesterday – I was having a remote connectivity disaster*) that in a strange turn of events from five years ago, commods are now scarce, and tech is now commoditized; where would you want place an incremental dollar at present? Our commodities team are **constructive on crude in 2021**, **however the equity market is telling us that we should be thinking about oil prices in the $70-80/bbl range, rather than in the 50s, so I still like some form of Energy-linked upside; whether it is via XLE call spreads, EWY (Brazil), RSX (Russia), or any macro-driven flavour, this thematic has a lot of runway, in my opinion.** Energy credit is already giving us a strong indication to how equity should be behaving too…

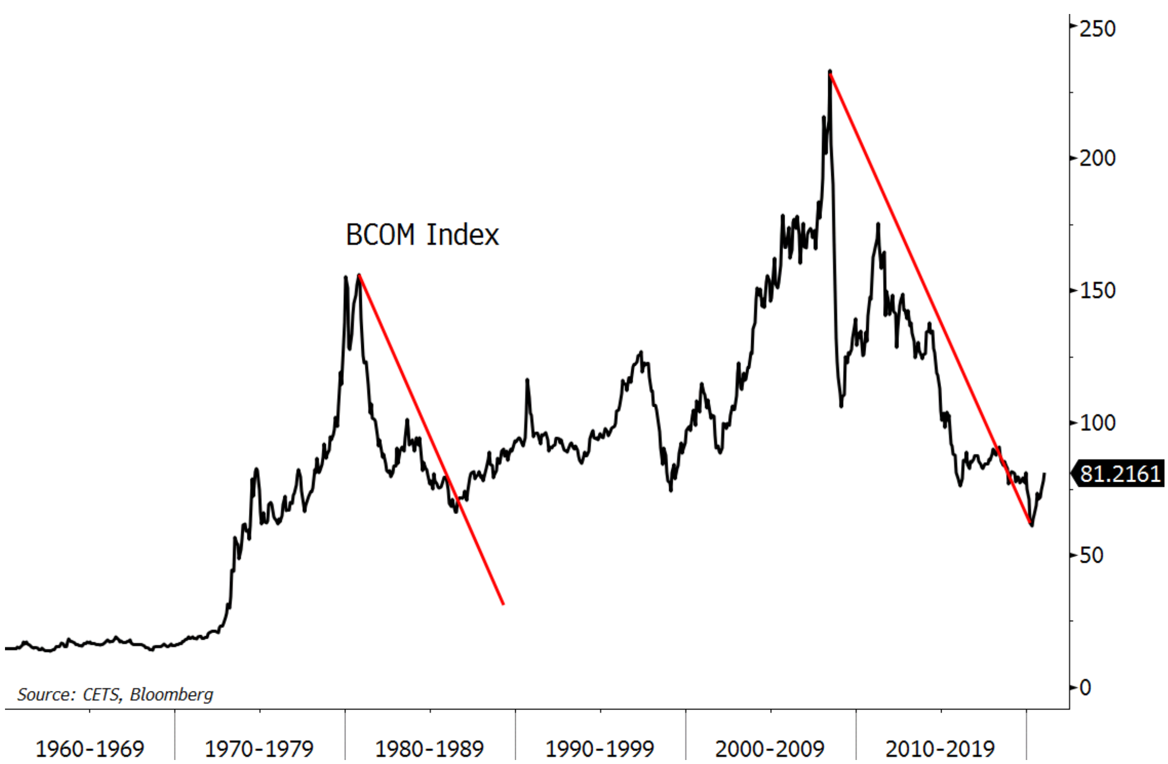
The equity market's interpretation of oil is saying we are going to see much higher prices.



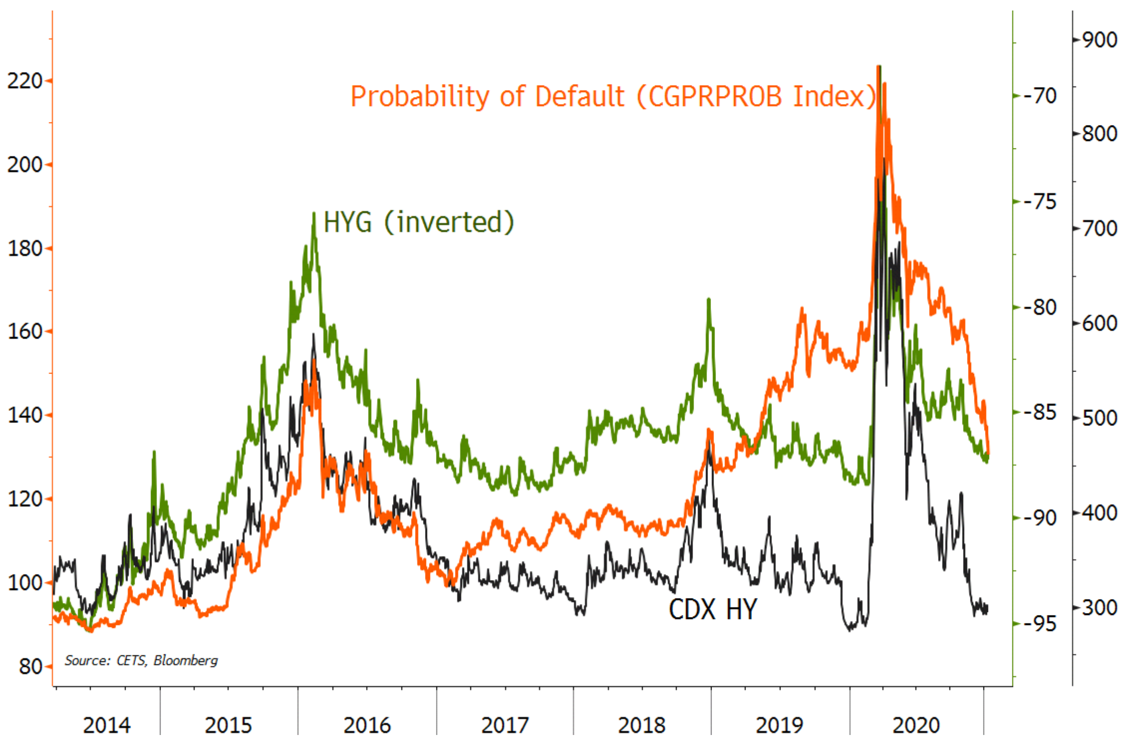
Energy credit is now trading at 2018 tights… when crude was trading above $70/bbl



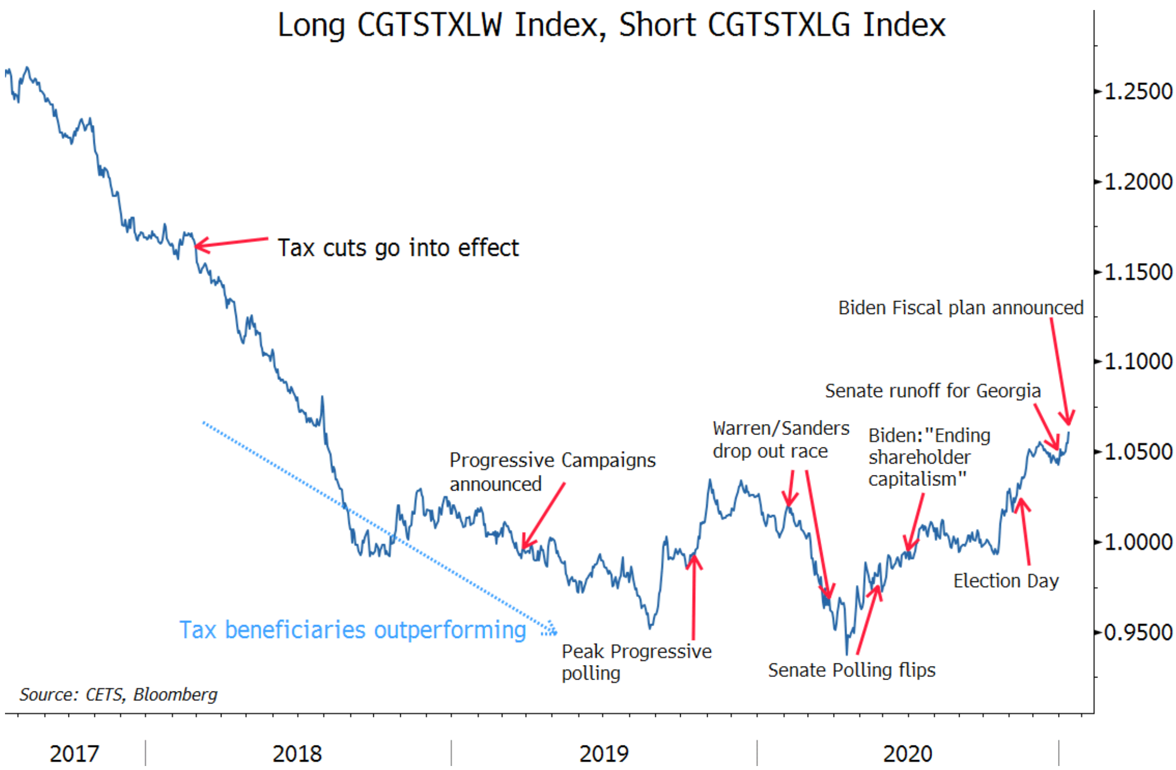
More broadly, and I should caveat that this is an idea *not* shared by my research colleagues, those that are saying the broader commodity complex has rallied too fast here should consider that we have in fact broken a multi-year downtrend that begun during the GFC. I'll caveat that this is still a work in progress but there is a debate to be had as to whether the structural undersupply that many parts of the commodity market have experienced in recent years (as capital has flowed to ever more profitless tech companies) will now result in a supply-demand imbalance that leads us to a new commodity supercycle. Now, I've been informed that a 'supercycle' needs <u>all</u> commodity components to participate (which they may not), but if we consider the outlook for ags, oil, and copper for example, it's not that hard to envisage the next 12-24 months seeing significantly higher prices. Again, it's a work in progress, but something to chew over this weekend (and feedback would be welcome!), and the implications for how far the cyclical/commodity-linked trades can run could be quite profound.



And staying on the commodity theme but at a tangent, I dusted off an old chart of our Probability of Default index (**CGPRPROB**) which fell by a hefty 2.4% today and is now down 9% for the year. The move itself is not enormous by historic standards, but serves to illustrate how the risk profile of the market is changing so dramatically. Given the historic relationship to HY spreads and oil prices (see chart below) we could make any number of arguments, but it probably indicates at the very least that concerns over corporate credit may be somewhat premature, even in a rising yield environment. As a reminder, CGPRPROB has historically been a pretty good indicator of future credit *stress* although it's quite clear from below that it has been lagging on the reversion trade. The index also feeds into our POLLS model, and is yet another reminder that whilst markets look pretty frothy on almost every metric, we are not seeing a sufficient number of *systematic* stresses that would suggest an imminent 10%+ pullback in risk.



So with that being said, I suppose the only thing left to really highlight today is detail within Biden's $1.9trn fiscal plans that are due to come out at around 7pm EST (*why so late?!*) and I'd be amiss not to mention that our Tax Basket (**CGTSTXLW vs CGTSTXLG**) rallied another 60bps today, taking the YTD rally +1.8% and the basket to the highest level since August 2018. As a reminder, I flagged that markets should be looking *beyond* the likely positive first 100 days in office that will see the pleasantries of further fiscal support and COVID-19 relief, and focus on the medium-term headwinds of tax hikes and onerous tech regulation (see **The Tax Trade is On**, and **Why are Equities Still pricing higher taxes?**). These proposals will not only push our tax basket higher, but also will have the effect of turbocharging our broader positive view on the Value narrative (and our technicians are calling for **2% in UST 10s now**), which in spite of the perceived 'consensus' view, is still not being committed to by the institutional community**. I remain firmly long this tax narrative, and equally continue to believe that the tech regulatory narrative is underpriced by markets at present. Stay long value.**



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