ANALYST WEEKLY

Why bond yields matter

AUGUST.14.2023

Summary

The US 10-yr bond yield winners and losers

Rise in US 10-yr bond yields over 4% a threat to market but should ease and be a tailwind ahead. Rise as much technical as fundamental and set to now calm. Benefited savers, US dollar, and cheaper Value stocks. Whilst the higher bond yield losers have been borrowers, and overall stocks, especially tech and real estate. Every 0.5% 10-yr yield move is +/- 8% our S&P 500 fair value. Higher 4% yields have taken market to a near record 30% premium to fair value. **See Page 4**

Reassuring US inflation calms markets

Tech stocks hold markets back again as reassuring US inflation balances weak China trade and double hit from Moody's US banks downgrade and Italy's windfall tax. US dollar DXY index held at 102 and 10-yr bond yields over 4%. NVO and LLY surged on weight drug progress. TPR agreed $9 billion luxury takeover of CPRI, and long-suffering BABA posted best sales growth in 2-years. See Q3 Markets Outlook **HERE** and at twitter @laidler_ben. **See Page 2**

Mixed inflation message an important test

Its most important number in markets and temp acceleration in US prices a mixed message. But we see underlying price pressure easing, and any market weakness likely to be bought. **See Page 2**

Windfall tax add to Europe valuation discount

Windfall tax popularity in UK and Europe is only widening yawning valuation gap vs US, by cutting profits and boosting uncertainty. No surprise oil and banks valued 40% lower than US. **See Page 2**

Three big crypto-adoption catalysts to watch

Institutional crypto ownership missing-link in this retail dominated asset. Catalyst 1) new company accounting rules, 2) global bank regulations, and 3) first central bank investor. **See Page 2**

Uranium's perfect supply storm

Prices catch up to other 'green' commodities as nuclear and investor demand turns up, and with 25% mine deficit. See URA to CCJ. **See Page 2**

Crypto catalysts to come

Major crypto coins BTC and ETH rangebound and holding asset class leading YTD gains. And seeing lower volatility and tech sector correlation. SHIBxM was boosted by high developer activity. Whilst XRP lower on SEC lawsuit appeal plans. PYPL to launch own US-dollar stablecoin. Next SEC spot BTC ETF deadline near. **See Page 3**

Commodities energy rebound broadens

Energy rebound broadens as Brent hits $87/bbl. after Ukraine attacks on no.1 exporter Russia infrastructure. Summer heat lifts US natgas prices, and a potential Australia LNG strike see's EU prices soar. China centric industrial metals, from copper to iron ore, fall on weak trade data. Cocoa to sugar see supply-side relief. **See Page 3**

The week ahead: Walmart, FOMC and China

1) US big retail earnings WMT, HD, TGT plus July retail sales slowdown. 2) Minutes of FOMC 'last hike' meeting. 3) Struggling economy check-in (Tue) w/ China monthly data dump, and German ZEW. 4). UK inflation among the world's highest with est. fall under last 7.9% (Wed). **See Page 3**

Our key views: A positive markets breather

Markets due a breather after the strong 1H, with weaker seasonality, low volatility, and coming growth slowdown. But fundamentally positive on lower inflation and coming rate cuts. Focus on defensive growth and long duration assets from healthcare to big tech. Cautious growth exposed cyclicals, commodities, and banks. **See Page 5**

Top Index Performance

	1 Week	1 Month	YTD
DJ30	0.62%	2.24%	6.44%
SPX500	-0.31%	-0.92%	16.27%
NASDAQ	-1.90%	-3.32%	30.37%
UK100	-0.53%	1.21%	0.97%
GER30	-0.75%	-1.69%	13.71%
JPN225	0.98%	0.17%	24.45%
HKG50	-2.38%	-1.74%	-3.57%

*Data accurate as of 14/08/2023

Market Views

Reassuring US inflation calms markets

- Tech holds stocks back as reassuring US inflation balances weak China trade and hit from Moody's US banks downgrade and Italy's windfall tax. US dollar DXY index held at 102 and 10-yr bond yields around 4%. NVO and LLY surged on weight drug progress. TPR agreed $9 billion luxury takeover of CPRI, and long-suffering BABA posted best sales growth in 2-yrs. **See NEW Q3 Outlook** HERE. See Page 6 for resources and videos.

Mixed inflation message an important test

- July's US inflation report was a key market test. After 12-months of falls headline inflation started rising, to 3.2%. Whilst temporary, driven by commodities and tough comparisons, it dents the goldilocks view of ever lower inflation and coming rate cuts coming. Better news came from more crucial core inflation, falling to 4.7%, with a clearer trend of easing shelter and jobs pressures.

- Inflation is the most important number in today's markets. July's report was relatively reassuring. We see underlying price pressure easing and dovish Fed outlook unchanged. Any weakness should be, and likely will be, bought. See Page 2

Windfall taxes add to Europe's discount

- The UK and Europe have taken the lead imposing excess profits or 'windfall' taxes on their energy and utility sectors and recently on the banks. The US has not, maybe learning from its miss-steps at using this tax tool last century and with its high share ownership levels boosting the political cost. It's become a driver of Europe's widening 35% sector-by-sector P/E valuation discount vs the US.

- Italy's bank windfall tax joins Spain, Czech, Hungary. Whilst Sweden and UK have financial crisis linked levies. Energy taxes are more common, from EU's 33% 'solidarity contribution' to UK's up to 35% 'energy profit levy'. @Italian-Heritage. See Page 2

Three big crypto-adoption catalysts to watch

- $1.2 trillion crypto asset class by far smallest but best performing this year. Its correlation with tech has plunged, and its volatility now below competitor gold. The near investment case focuses on approval of first spot Bitcoin ETFs, emerging regulatory clarity, and next April's bitcoin 'halving'.

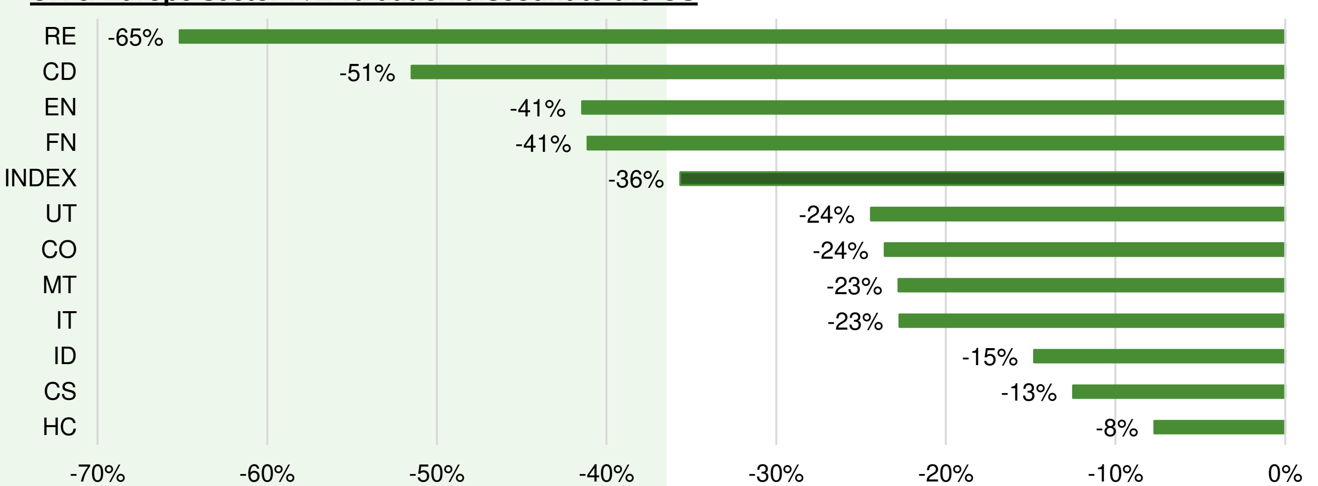
- A slower moving driver is institutional adoption, with asset class pioneered, and already well-owned, by retail investors. We see three big catalysts. 1) New accounting rules set to make corporate ownership of crypto more attractive. 2) New global bank rules allowing $200 billion crypto ownership. 3) A first central bank announcing owning crypto among reserves. @BitcoinWorldWide. See Page 2

Uranium's perfect supply storm

- Uranium seen belated catch up to rally across renewables metals lithium, cobalt, copper, nickel. Uranium is seeing growing reactor and investor demand and tight supply. Its use as reactor fuel seeing a net zero re-appraisal, and development of new smaller and modular reactors (SMRs).

- Its low prices history widened mine supply deficit to 25%. Now worsened by supply fears from Russia, with sanctions disruption, and Niger, after its recent coup. See URA ETF and producer CCJ. See Page 2

UK & Europe sector P/E valuation discount to the US



Source: MSCI. MSCI USA versus MSCI Europe prospective 12-month P/E. RE=Real Estate. CD=Consumer Discretionary. EN=Energy. FN=Financials. UT=Utilities. CO=Communications. MT=Materials. IT=Technology. ID=Industrials. CS=Consumer Staples. HC=Healthcare. For illustration purposes only

Market Views

Crypto catalysts to come

- Major cryptos BTC and ETH rangebound and holding leading year-to-date gains, with volatility low and correlation to tech stocks fallen sharply.

- SHIBxM continued gains boosted by a sharp pick up in developer activity. Whilst XRP was lower on news the SEC intends to appeal its partial lawsuit loss to Ripple, that had catalysed its recent rally.

- PYPL first global payments company to launch its own US Dollar backed stablecoin, with the Monday launch of PYUSD. We also see the next deadline for the SEC approval of the ARK and 21Shares bitcoin spot ETF proposals. Any action would impact much anticipated BLK proposal.

Commodities energy rebound broadens

- Rebound gained steam with a broadening energy rally. Brent oil hit $87 on Russia export concerns after Ukraine infrastructure attacks. US natgas gained with higher hot weather demand, and EU prices soared off lows on possible Australia LNG export disruption from CVX and WDS.AX.

- China centric industrial metals prices, from copper to iron ore, fell back after the country posted very weak July trade data with exports -14.5% versus last year and imports -12.4%.

- Some high-flying agricultural prices also fell after recent gains as supply fears eased. Cocoa fell back as Ivory Coast harvest outlook improved. Also, coffee on Brazil data of fast harvest pace.

US Equity Sectors, Themes, Crypto assets

	1 Week	1 Month	YTD
IT	-2.14%	-1.76%	36.11%
Healthcare	2.05%	3.25%	0.09%
C Cyclicals	-0.74%	0.21%	28.31%
Small Caps	-1.65%	0.61%	9.30%
Value	0.26%	1.45%	2.44%
Bitcoin	1.17%	-3.40%	77.45%
Ethereum	0.60%	-1.41%	54.07%

Source: Refinitiv, MSCI, FTSE Russell

The week ahead: The quietest week of summer

1. The end of US **earnings** season includes big retail WMT, HD and TGT results that come alongside the est. slowdown in July retail sales as higher interest rates and gasoline cut into consumer resilience.

2. Investors will pore over the last **FOMC meeting minutes** (Wed) when it made likely final hike this cycle. For insights into length of hike pause and conditions needed to start cutting interest rates.

3. International focus on **China** monthly data dump, with struggling retail sales & industrial production to edge up. Also, the **German** ZEW economic sentiment index with economy now in recession.

4. July **UK inflation** to be watched by many, with the world's worst dose of high inflation among major economies, that has been forcing ever higher BoE rate hikes. Inflation est. to fall from prior 7.9%.

Our key views: A positive markets breather

- Markets due a breather after very strong 1H, with weaker summer seasonality, too low volatility, and the still-coming GDP growth slowdown. But are fundamentally positive markets, with a stronger Q4 and 2024, as economies avoid recession, with lower inflation and coming interest rate cuts.

- Faster slowdown hurts earnings. But lower bond yields helps valuation. Focus on defensive growth and long duration assets, from healthcare to big tech. More cautious on assets most exposed to recession risk, like cyclicals, small caps, and commodities. Or with lower yields, like banks.

Fixed Income, Commodities, Currencies

	1 Week	1 Month	YTD
Commod*	-0.33%	0.95%	-6.40%
Brent Oil	0.67%	8.92%	0.86%
Gold Spot	-1.64%	-0.69%	6.32%
DXY USD	0.82%	2.94%	-0.65%
EUR/USD	-0.58%	-2.50%	2.29%
US 10Y Yld*	10.82	32.19	27.46
VIX Vol.	-13.22%	11.24%	-31.52%

Source: Refinitiv. * Broad Bloomberg index. * Basis points

Focus of Week: Winners and losers from higher bond yields

Rise in US bond yields has been a threat to markets, but should ease and be a tailwind ahead

US 10-year bond yields have risen back over 4% (see chart) on economic growth optimism and bond supply indigestion. This has wide repercussions. By cutting the ‘present value of future cash flows’ this has taken US stock valuations to a near record 30% premium to our ‘fair value’ estimate. With a particular impact on high valued tech, and highly leveraged real estate. It also makes cash and bonds more attractive relative to stocks and supports the US dollar. So-called Value stocks, like banks and energy, are cheaper and better placed. We see this threatening bond yield rise running out-of-steam and to reverse as the US economy and inflation cool. We look for opportunities in beaten up tech losers and see the S&P 500 well-supported.

US bond yield rises are as much technical as they are fundamental, and set to now calm

The rise in US bond yields has partly been in reaction to the less-bad economic growth outlook, the stalling in inflation declines, and Japan’s yield-curve-control widening. Investors are asking to be rewarded for higher inflation risks. But it's also technical, with US Treasury announcing an outsize $1 trillion bond issuance plan for the next three months to fund its yawning fiscal deficit. Higher yields compensate investors for this supply overhang. Our gold/copper ratio proxy for fundamental bond yield pressures has stopped falling but is not rising. Similarly, recent Treasury offerings have come at lower yields than feared.

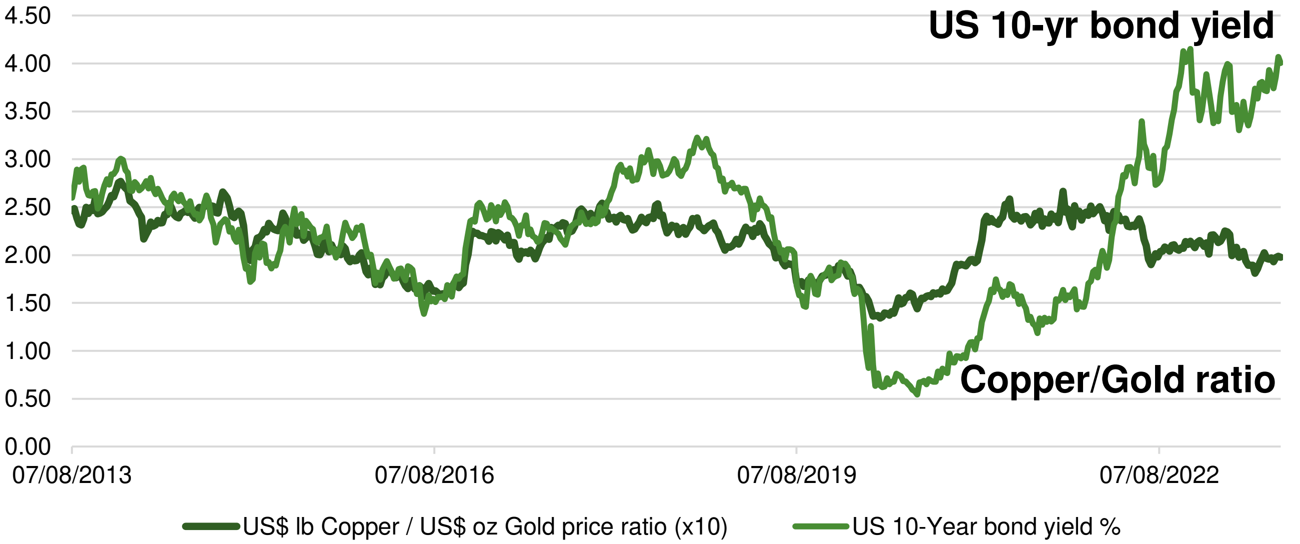
Who benefits from rising bond yields? Savers, the US dollar, and cheaper stocks

The best US savings account and money market rates are now over 5%, helping savers. Whilst higher yields are making longer term bond products more attractive as well. Especially for so-called target maturity products that allow to lock in current rates. Value and cyclical stocks, often with heavily discounted single digit P/E valuations, are less exposed to the valuation pressure of higher bond yields. The US dollar has benefited versus the Euro and others from a re-widening of interest rate and bond yield differentials.

The losers are borrowers, and overall stocks - especially tech and real estate sectors

The average US 30-year fixed mortgage rate has been on the rise to 6.90% and closing on the Oct. 2022 peak of 7.08%. This has helped drive lower home prices and sales. Though lower inventory, with many unwilling to give up low priced legacy mortgages, has boosted new home sales and builder stocks. Our S&P 500 fair value multiple has been pressured and is at a near record 30% discount to the market. Every 0.5% 10-yr yield change impacts by +/ 8%. High flying tech, with average 27x P/E valuations, are particularly vulnerable to a lower ‘present value of future cash flows’. Similarly, real estate stocks, as the most highly leveraged sector and with highest P/E (34x), are especially exposed to expectations for interest rates.

The Copper/Gold price ratio versus US 10yr bond yield



Source: Refinitiv. For illustration purposes only.

Key Views

The eToro Market Strategy View

Global Overview	Aggressive and extended Fed interest rate hiking cycle and stubborn inflation accelerated our 2023 view. Of a coming GDP slowdown, but not recession, plus lower inflation, and a peaking Fed interest rate cycle. Will pressure earnings but also lower bond yields and take pressure off de-rated valuations. We are invested, believing Oct 2022 was the low, and focus on cheap and defensive assets for a faster 'V-shaped' market recovery. **See our Q3 Outlook** **HERE**

Traffic lights*	Equity Market Outlook
United States	World's largest equity market (60% of total) seeing slowing but resilient GDP and earnings growth. Valuations led the rebound this year and are supported high company profitability and peaked bond yields. Focus on cash-flows defensives, like healthcare and high dividend. And Big-tech supported by defensive growth, cost cutting, and AI. See gradual 'U-shaped' rebound as inflation slowly falls and de-risks market and boosts tech and crypto appetite.
Europe & UK	Favour defensive and cheap UK ('Economies not stock-markets') and continental European equities. Recession risk easing with lower natgas prices and reopening China with high 'buffers' of rising fiscal spending (defence and refugees) and weak Euro (50%+ sales overseas). Even as ECB hikes aggressively. Equities cushioned by lack of big tech sector and 30% cheaper valuations vs US. Banks better capitalised and regulated but loans/GDP much higher.
Emerging Markets (EM)	China, Korea, Taiwan dominate EM (60% wt.), and more tech-centric than US. Positive China as economy reopens, supports property sector, eases tech regulation pressure. Valuations 30% cheaper than US and markets out of favour. Recovery helps global sectors from luxury to materials. EM needs weaker USD and peak US rates catalyst.
Other International (JP, AUS, CN)	Canada and Australia have benefitted from strong equity market weight in commodities and financials, as global growth resilient and bond yields risen. Now could be becoming headwinds. Japanese equities among worlds cheapest with own and China-proxy growth and governance improving but threats of tighter monetary policy and stronger Yen.

Traffic lights*	Equity Sector & Themes Outlook
Tech	'Tech' sectors of IT, communications, consumer discretionary (Amazon, Tesla), dominate US and China. Expect better performance as 1) lower bond yields take pressure off valuations and 2) high profit margins and fortress balance sheets make defensive to recession risks. 2) Cost cuts and AI add to growth. 'Disruptive' tech much more vulnerable.
Defensives	More attractive as recession risks rising and bond yields have peaked. Consumer staples, utilities, (some) real estate attractive with defensive cash flows, less exposed to rising economic growth risks, and with robust dividends. Healthcare is the most attractive, with cheaper valuations, more growth, some rising cost protection.
Cyclicals	High risk cyclical sectors - like discretionary (autos, apparel, restaurants), industrials, energy, materials, and small caps - have cheap valuations, many with depressed earnings, and have been out-of-favour for many years. But they are significantly exposed to rising recession risks. Some especially cheap (energy) or see growth recovery (airlines).
Financials	Current stresses likely individual not systemic. Post GFC reforms boosted capital and size/speed of authority's response. But outlook for 1) less GDP growth, 2) lower bond yields and interest rates, and 3) valuation sensitivity after recent surprises, worsens outlook. Insurance and Diversifieds (like Berkshire Hathaway) more defensive.
Themes	Dividends and buyback themes attractive with resilient cash flows, rising pay-outs, and investor search for defensives. Power of compounding dividends under-estimated, at up to 1/2 of total long-term return. Small caps pressured by rising recession risk. Secular growth of Renewables and Disruptive Tech investment themes.

Traffic lights*	Other Assets
Currencies	USD 'wrecking ball' driven by Fed interest rates and 'safer-haven' bid. DM currencies hurt by still low interest rates and struggling growth. Strong USD hurt EM, commodities, US foreign earners like tech. But helps big EU and Japan exporters. See a stabler USD outlook in 2023 as near top of the Fed cycle and global risks remain high.
Fixed Income	US 10-yr bond yields supported around 4% by higher Fed rate hike and stickier inflation expectations. Set to ease as recession risks slowly build and inflation expectations gradually fall. US has widespread to other market bond yields, and headwinds of high debt, poor demographics, and low productivity. 5% bill yields an attractive cash alternative.
Commodities	Strong USD and rising recession fears hit commodities. But still above average prices helped by GDP growth, 'green' industry demand, supply under-investment, recovering China, Russia supply crisis. Oil helped by slow return of OPEC+. But commodities not to repeat their 2021 and 2022 performance leadership. Gold benefits from safer haven demand.
Crypto	Potential 'surpsise' after dramatic and early asset class sell-off and later specific risk events from Luna to FTX. See long term asset class development with small size $1 trillion, correlations low, regulation growing, development/catalysts continuing – Ethereum merge to proof-of-stake and coming BTC halving.

*Methodology:	Our guide to where we see better risk-adjusted outlook. Not investment advice.
Positive	Overall positive view and expected to outperform the asset class on a 12-month view.
Neutral	Overall neutral view, with elements of strength and weakness on a 12-month view.
Cautious	Overall cautious view, and expected to underperform the asset class on a 12-month view.

Source: eToro

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