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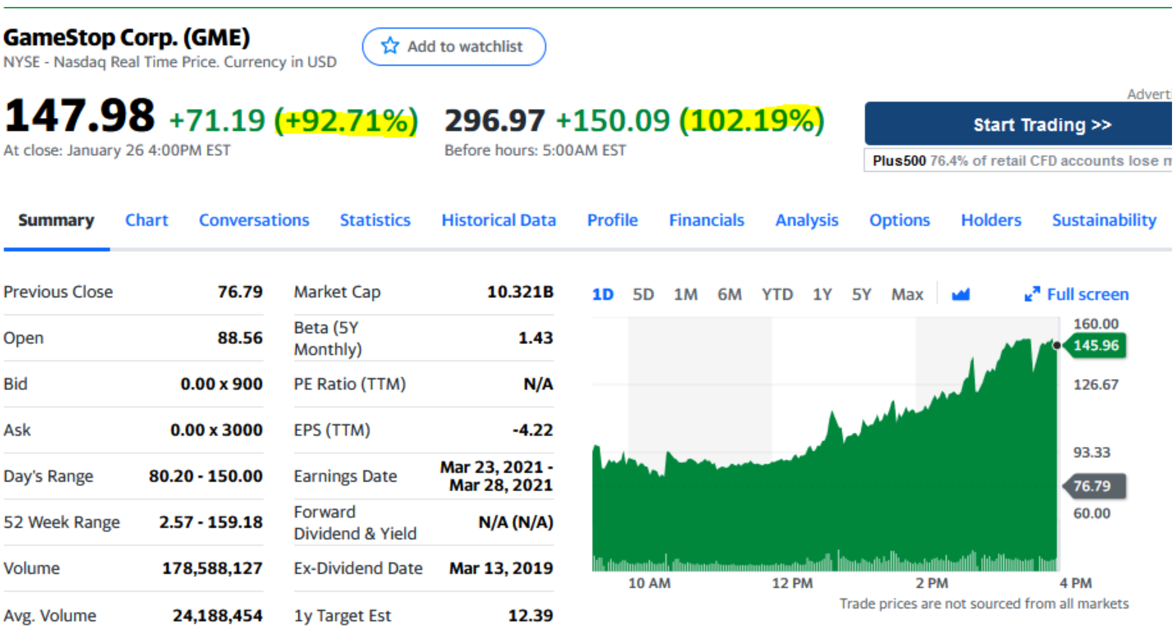
Irrational Exuberance: Retail investors are out of control

GameStop rose yesterday 92% during the trading session, only to be followed by another rise of 102% in the after-hour trading. Reddit (in particular r/walstreetbets) and robinhood.com are the preferred space where retail investors choose their target and push with like-minded peers stocks up. In this case short sellers were forced to close their shorts and option traders were forced to buy the stock for hedging reasons. This is because retail investors buy short-maturing call options, which forces traders constantly hedge their open call interest (aka gamma squeeze) by buying the underlying stock.

Similar exuberance happened before in Bitcoins. However, after having reached a new all-time high we see a correction.

Fig. 1: GameStop has risen 92% during one trading session only to go another 102% up in afterhours trading



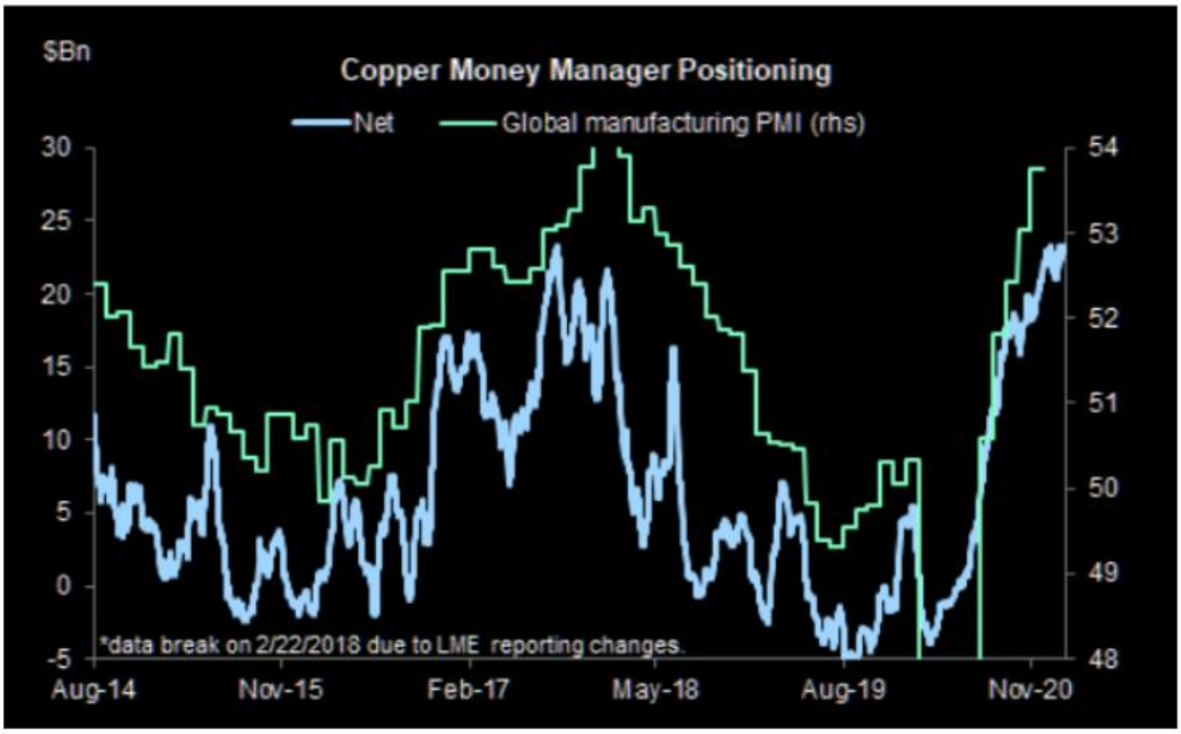
US treasury yields have started to come down. This rally is against the broad consensus. However, we have said that the Fed might intervene and control the yield curve through bond buying. So far there is no confirmation that the reduction of yield was Fed driven, the only thing we can observe is the Fed's balance sheet growing at a faster pace since year start.

We believe that the global economy will continue to accelerate driven by China (and other Asian countries) and the US. The global PMIs and Dr. cooper indicate that we will see a strong economy in 2021, although in Europe the latest PMI data indicates a double dip recession due to the various lockdowns.

Fig. 2: Bitcoin is consolidating after the exuberant price move in recent weeks.

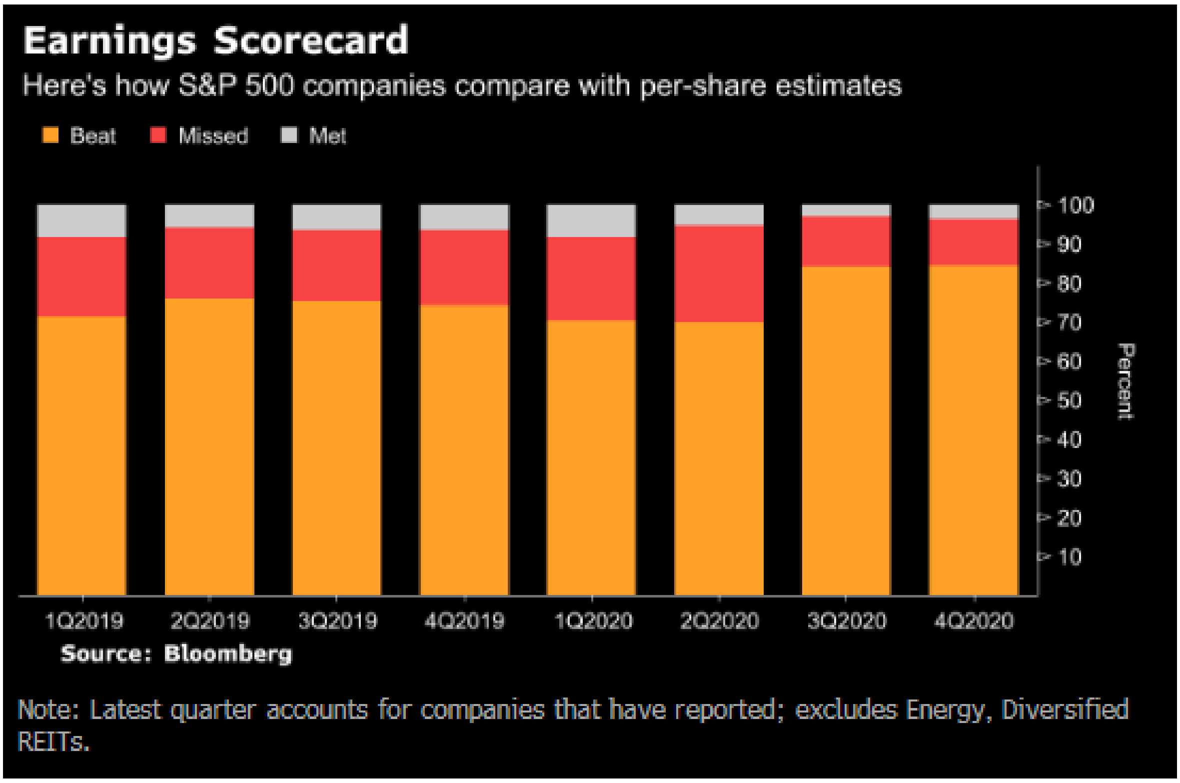
Fig. 3: 10-year Treasury yields have risen more than 25% to 1.185% but are now mean reverting

Fig. 4: Dr. Cooper and Global PMIs point to an acceleration of growth in 2021



Source: Goldman

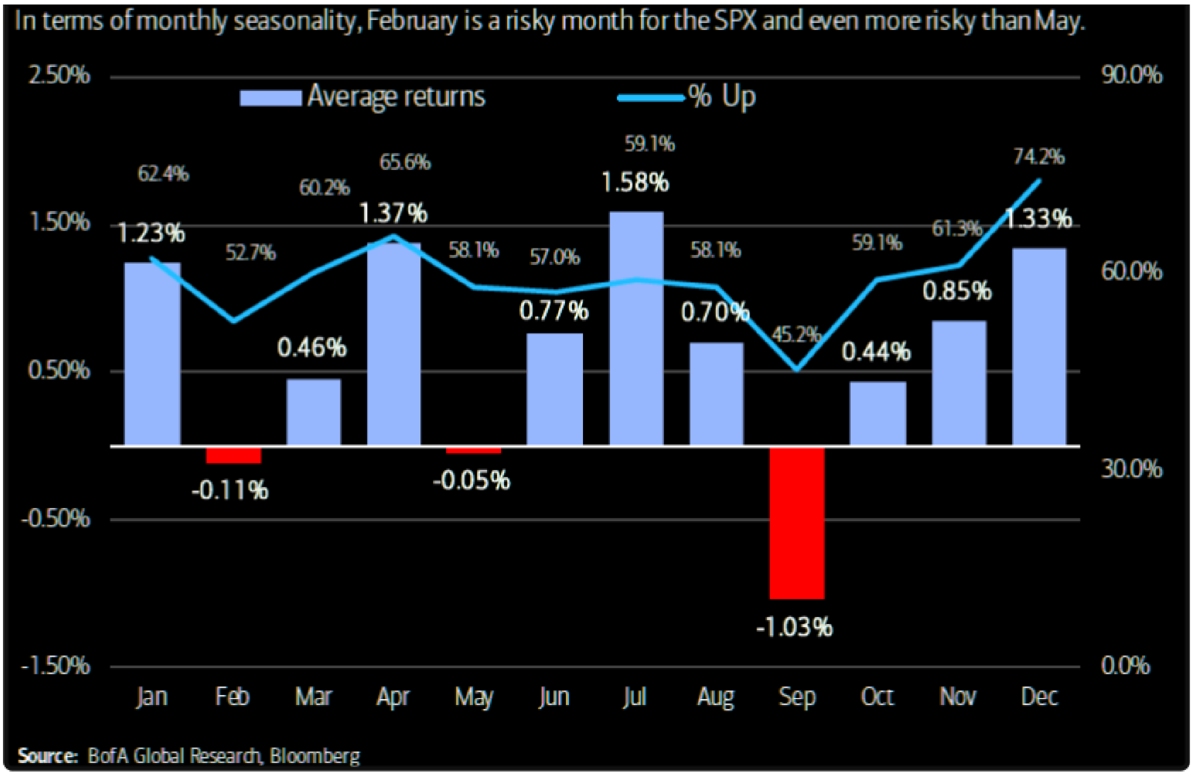
Fig. 5: 84% of 83 S&P 500 companies beat EPS estimates after publication of reported earnings



In short-term besides exuberance in stocks like GameStop we do also see an overheating in most equity markets. So far, we have seen a traditional November to January rally. If we were to follow the traditional patterns the next step would be a consolidation (or correction) in February followed by another leg up.

This positive outlook is supported by the actual US Q4 earnings season. 84% of all reported companies have beaten their consensus estimates by a large margin, like for instance Microsoft or AMD. We expect that also Q1 2021 earnings will be compared to last year and to the estimate earnings surprise positively. Therefore, we expect that after Q4 20 we will see another strong earnings season in Q1, which supports our thesis of another leg up before we might see more turbulence in Q2 and Q3 2021.

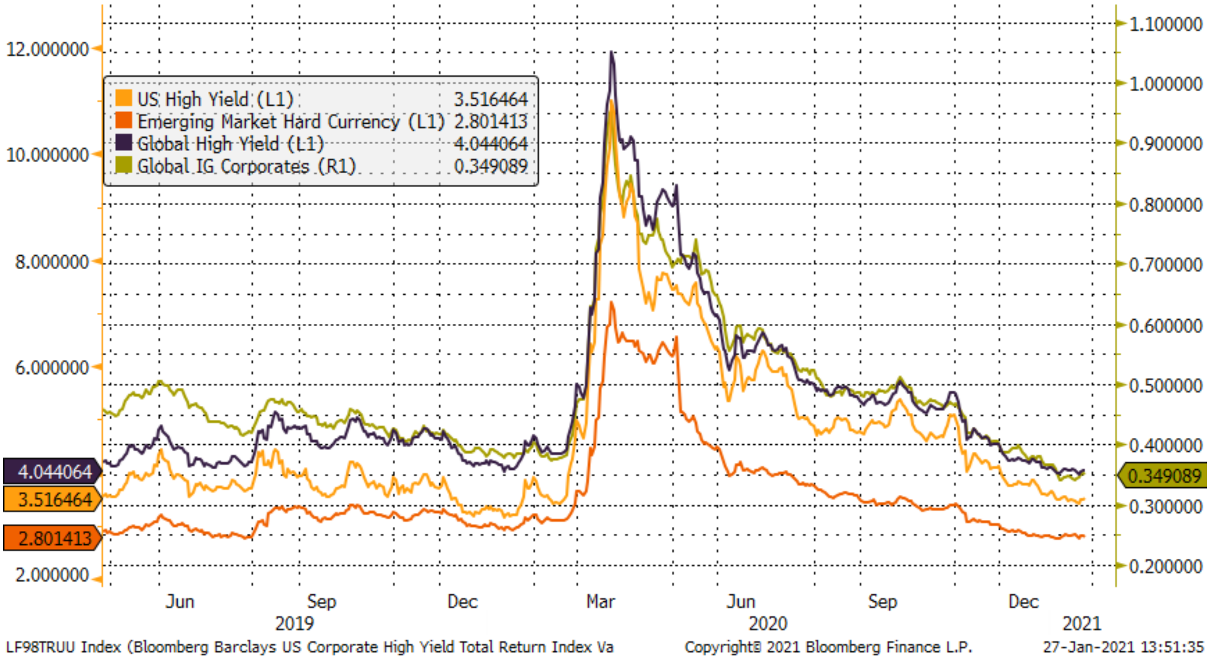
Fig. 6: Seasonal return patterns and the overbought situation speaks for a weak February



Source: BofA

Meanwhile corporate bonds have continued to rally, but differently to two weeks ago they were supported by lower treasury yields. But what is true for equites is also true for bonds: We have reached very high valuations and a consolidation is overdue. For instance, the yield of the US High Yield bond index stands at 3.51%, which is not compensating for the taken risks. The same must be said for investment grade USD corporates which yields 0.34%. If we take into consideration the latest US inflation figures of around 1.5% the real yield is extremely low or negative for IG bonds. Globally the total amount of negative yielding bonds (e.g. in EUR, JPY, CHF, GBP) stands still at around USD 17.3 trillion.

Fig. 7: Corporate bonds have rallied and are over extreme low yields



We expect that all G4 central banks will continue to artificially keep bond yields at low levels. These nudges investors are even further to deploy money in higher risky assets, like long maturing low rated bonds corporate bonds or equities.

Fig. 8: The amount of negative yielding bonds is still above USD 17 trillion

We continue to believe that this rally will end in euphoria, with a final melt-up of most asset prices. We can see now more sings of it in, for instance the tech sector, the clean energy space or bitcoins, but not (yet) across the board.

Short-term we expect a pullback and a sector rotation. It is also possible that once stocks like GameStop correct (crash) we could see a spillover which might intensify the market correction, but we would use such weakness to buy the dip.

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