

# WESTMINSTER

## ASSET MANAGEMENT

### **Dress Rehearsal. Investment Strategist Peter Lucas reviews recent market action against his longer term view**



Our July article *Buckle up!* warned of an imminent period of volatility in which we would see a rotation from growth into value triggered by a rise in bond yields. In the past six weeks, much of this has come to pass: bonds yields rose, the VIX almost got to 40 and large cap technology shares took a beating. However, this was not the big one. This was just a dress rehearsal.

The rise in bond yields, such as it was, was not big enough to be of any great consequence. Plus it has been substantially retraced in September. The sell-off in tech shares was dramatic but simply took share prices back to where they were just weeks before. For instance, although Tesla shares fell 34% from their September 1<sup>st</sup> high, they were still higher than where they were at the beginning of August. Markets do not fall simply because they are expensive. There needs to be a catalyst – usually rising interest rates and/or bond yields – that stems the flow of liquidity into the ‘hot’ market. That did not happen here, which leads us to conclude that this was just a normal bull market corrections rather than anything more sinister. Indeed, the subsequent fall in bond yields is laying the foundations for another leg higher (Tesla shares are already up 34% from the September 8<sup>th</sup> low).

COVID-19 continues to cast a long shadow over the global economy and international markets and as long as the threat of more lockdowns remains, investors will be reluctant to abandon the ‘safety’ of bonds and to fully embrace the equity bull market. There are two ways that we can get to the end of this tunnel. A vaccine is still months away and will probably only be partially effective. Herd immunity is also a distant prospect, with lockdowns pushing that outcome further out into the future. So on the face of it the overvalued bond market is not in imminent danger. Or is it?

Popular opinion on COVID-19 remains as polarized as ever, but in the past week or so there seems to have been a shift in opinion against a continuation of the lockdown policy. If nothing else, many have been influenced by the experience of Sweden, a country that pursued a largely voluntary, light touch approach. Their death toll was high early on – due to a failure to protect the vulnerable in care homes – but more recently has plunged towards negligible levels, with much less collateral damage in the economy. **There may be a set timetable for developing vaccines, but politics can change in the blink of an eye.**

The bottom line is that we should be on high alert for a significant top in bond prices. And when the bond market peaks, we can start to talk about a rotation from growth to value. But until then, large cap tech will probably remain the only game in town.

**Peter Lucas**

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