MOMENTUM SEPTEMBER MASSACRES:THE BEGINNING OF THE GREAT UNWIND OR JUST ANOTHER TANTRUM???

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- The week of the 9th of September was a very eventful one on the global financial markets.
- Although you would not suspect anything major happened in the US equity markets for instance – the SP500 was up barely 1% on the week – things were far more dramatic under the surface.
- Indeed what was the biggest weekly rise in the US 10 years yield since 2016 US election day, triggered a massive unwinding of the Growth to Value trade.
- We will take a deep and thorough look at what actually happened during this week, to assess whether it was a one off event or the beginning of the long awaited (by some at least…) Growth to Value shift.

•The trigger: a massive selloff in Treasuries.

What a difference a couple of weeks make….August 2019 was the best month for US Government debt since December 2008, at the peak of the GFC. So the slight increase in US Treasuries yields seen during the first week of September did not worry anybody really because it was no more than a mild consolidation due to profit taking. But what happened from Monday the 9th of September onwards was much more surprising. As the violent rise of nearly 35bps in the 10 year US T-Note yield almost erased all the gains made in August!

To get a real sense of perspective, let's look at the following chart which is provided by the financial blogger The Heisenberg. It requires some explanations:

- The top panel is straightforward. The S&P is riding a three-weeks winning streak having recovered from the four-week slide in August.
- The bar chart in the bottom panel shows the weekly change, in basis points, in 10-year US yields on the right axis. The area chart on the left axis is the 10-year yield itself. The vertical yellow line, as indicated, marks the 2016 US elections. When 10-year yields are above where they stood when the election was held (i.e., above the "Trump line"), the chart is shaded purple. When they're below that level, the chart is shaded blue.

Chart 1 source: The Heisenberg

Looking at the lower panel of this chart, the scope of the Bonds selloff is clear: it was a massive move!

But pain was not only felt by Bonds investors, it was chaos as well in all the Bonds proxies, especially the crowded Growth and Momentum factors. And the factor reversals which started on Monday the 9th were nothing short of dramatic! To get a proper sense of the violence of the move, here is how Nomura described it: “In fact, Monday saw **an 8.5-standard deviation move** in our "Pain Trade" index (basically the ratio of a Value factor proxy versus Momentum):

Chart 2: Source: Nomura

The 7.7% Monday move in our one-year price Momentum factor was the second-largest single-session drawdown in history going back to 1984, eclipsed only by a -8.2% bloodbath on April 4th, 2009.” Black Swan territory…

These astonishing rotations played out across popular Growth and Momentum vehicles, many of which are widely owned. Let’s see two examples provided by the Heisenberg:

- The iShares S&P 500 Growth ETF (IVW) underperformed the iShares S&P 500 Value ETF (IVE) by the largest margin since 2009 this week. See chart below:

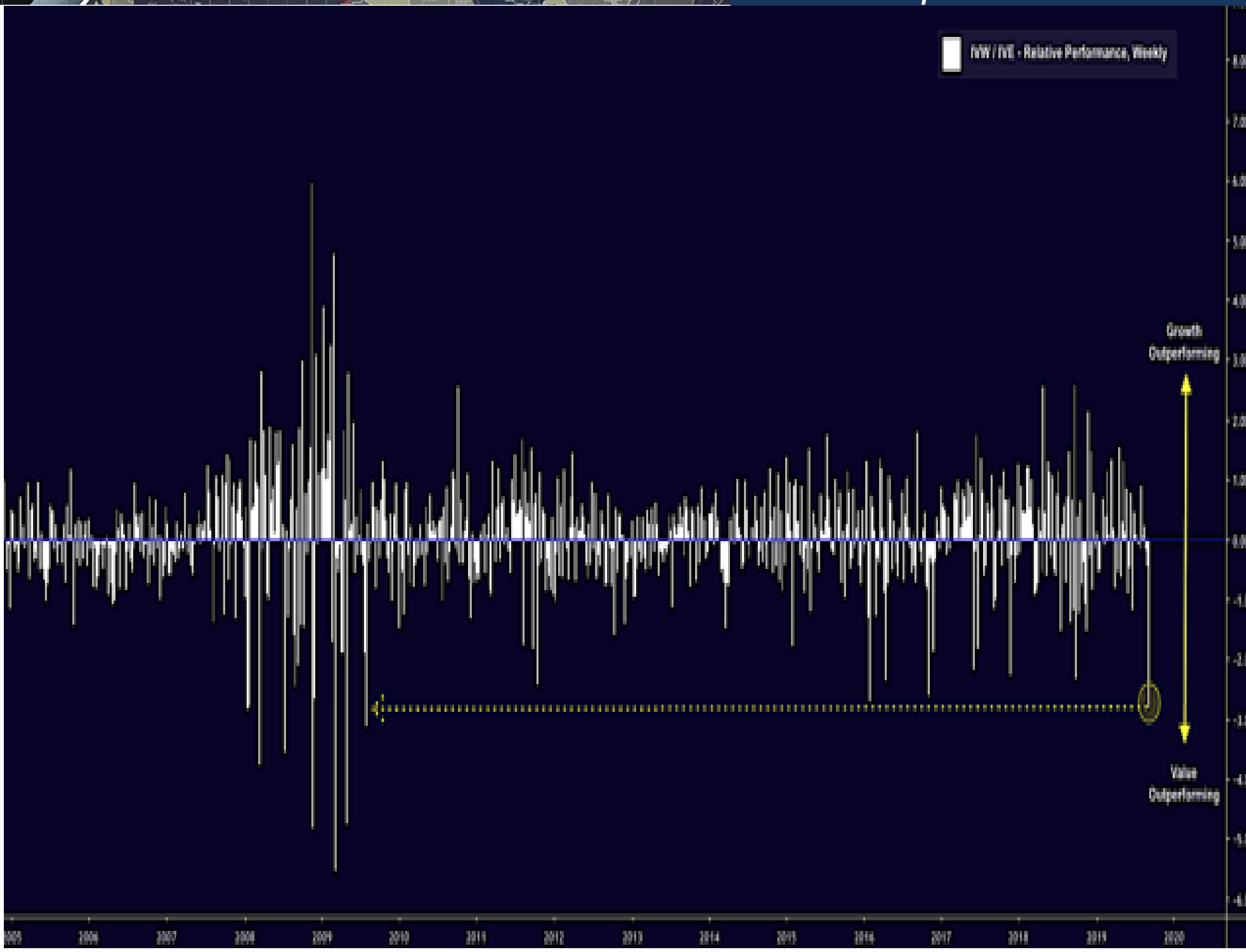


Chart 3 source: The Heisenberg

And he goes on:
-"In the same vein, the Momentum factor underperformed the Value one by a black-swan-*ish* margin. The chart below isn't a perfect way to visualize the rotation, but it *is* the most reader-friendly for general audiences as these are widely recognizable vehicles."
The corresponding chart on the next page is updated through Monday the 16th

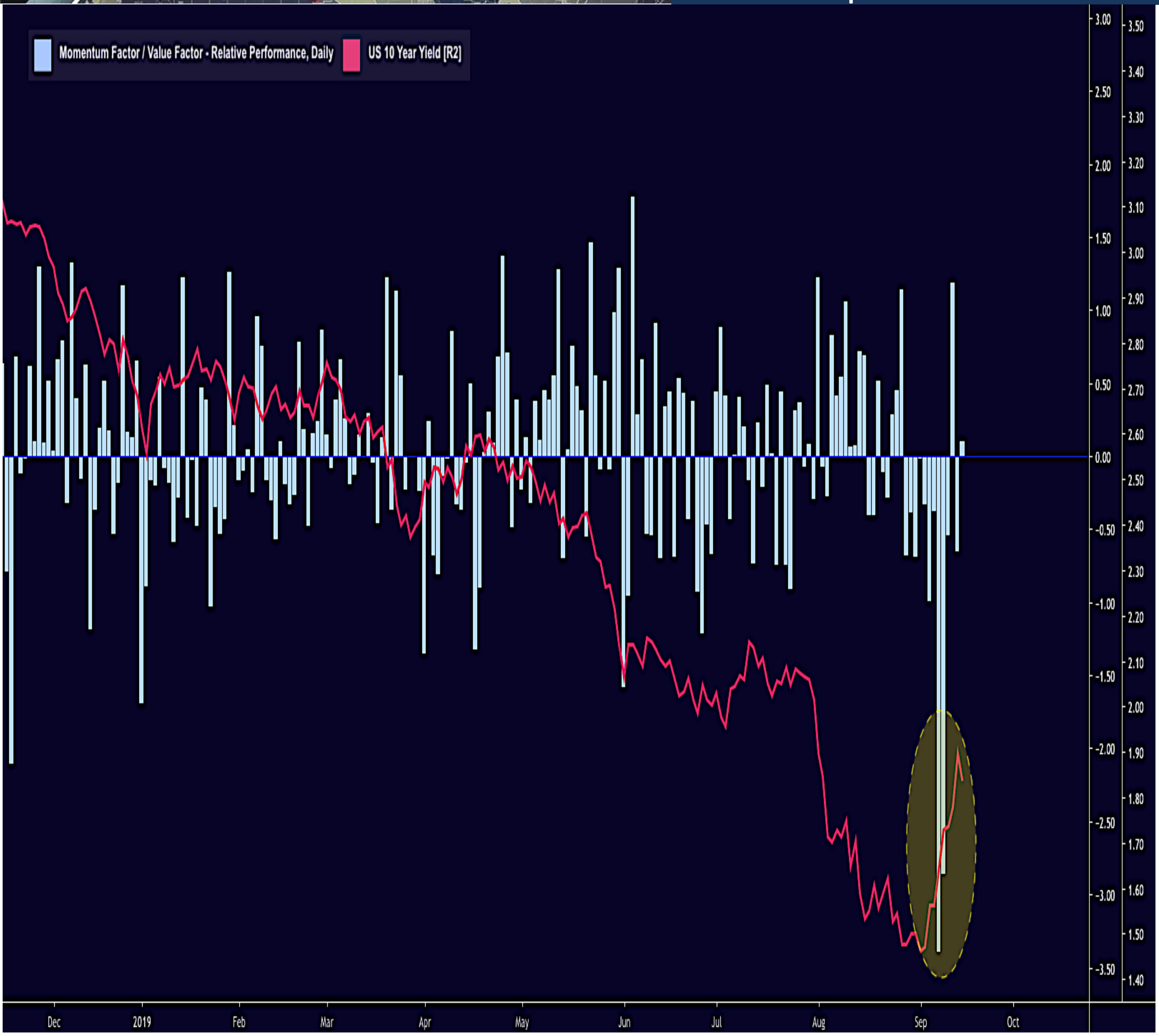


Chart 4 source: The Heisenberg

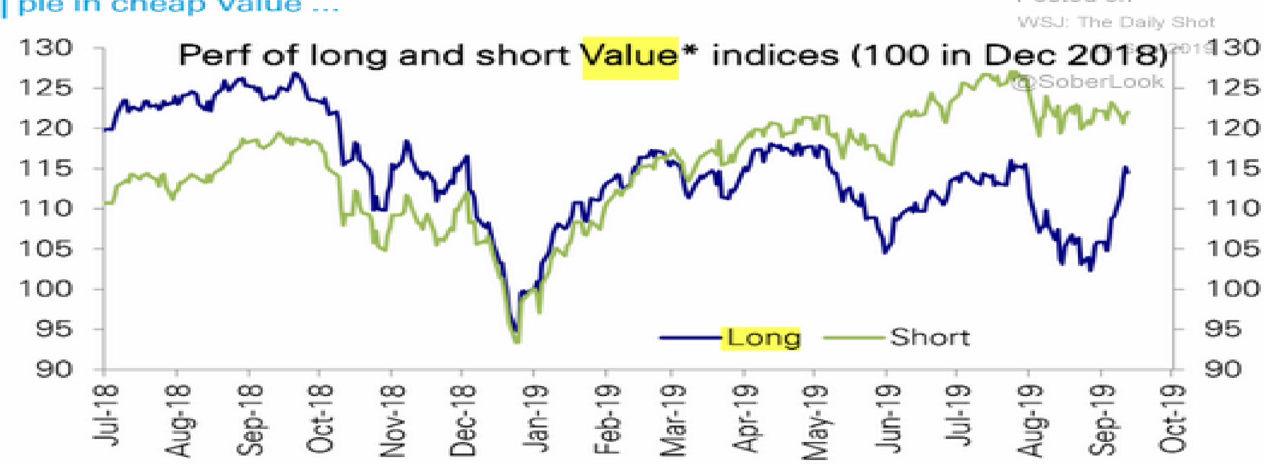
This charts also provides a good visual of what Goldman wrote this week: "our recent Factor Barometer shows Momentum and Volatility are both significantly inversely correlated to rates currently at ~-50-55%; < 5th %ile vs history, suggesting the recent backup in rates has been a likely catalyst for the rotation."

•The end of week result: an unprecedented rotation between momentum and value.

Monday sharp moves were only sending the signal that the rotation had begun. It went on ALL week.

Mainly, investors boosted long positions in Value, perceived as cheap, more than they sold Momentum, as the next couple of charts will show you.

Figure 6: The large moves in equity factors came from only one side, for example in cheap Value ...



*short position in growth companies and long in value

Source : Dow Jones, Bloomberg Finance LP, Deutsche Bank Asset Allocation

Figure 7: ... and low momentum ...

*short position in low momentum companies and long in high momentum

Source : Dow Jones, Bloomberg Finance LP, Deutsche Bank Asset Allocation

Chart 5 source: WSJ The Daily Shot

And the weekly results are fairly clear as shown by the following charts: first the Value factor, over the last 5 years:

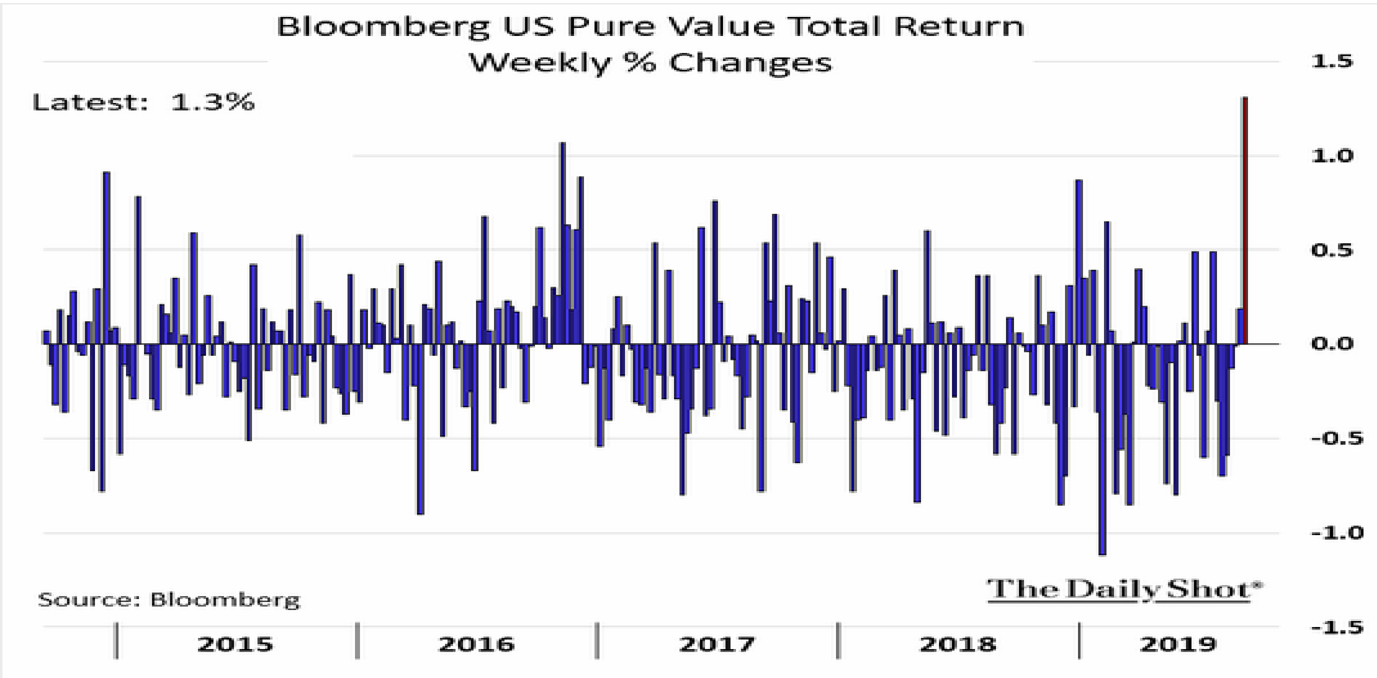


Chart 6 source: WSJ The Daily Shot

And Value against S&P 500 Index: look for the red spot: Flying high….

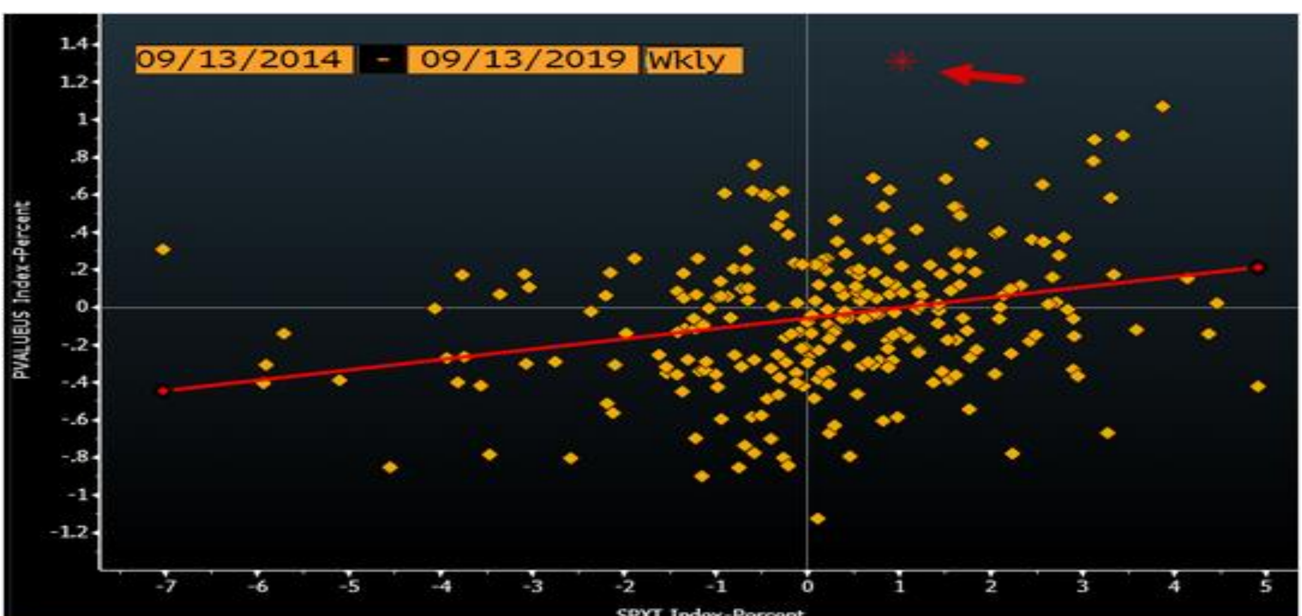


Chart 7 source: WSJ The Daily Shot

And compare these to the following two charts on Momentum:

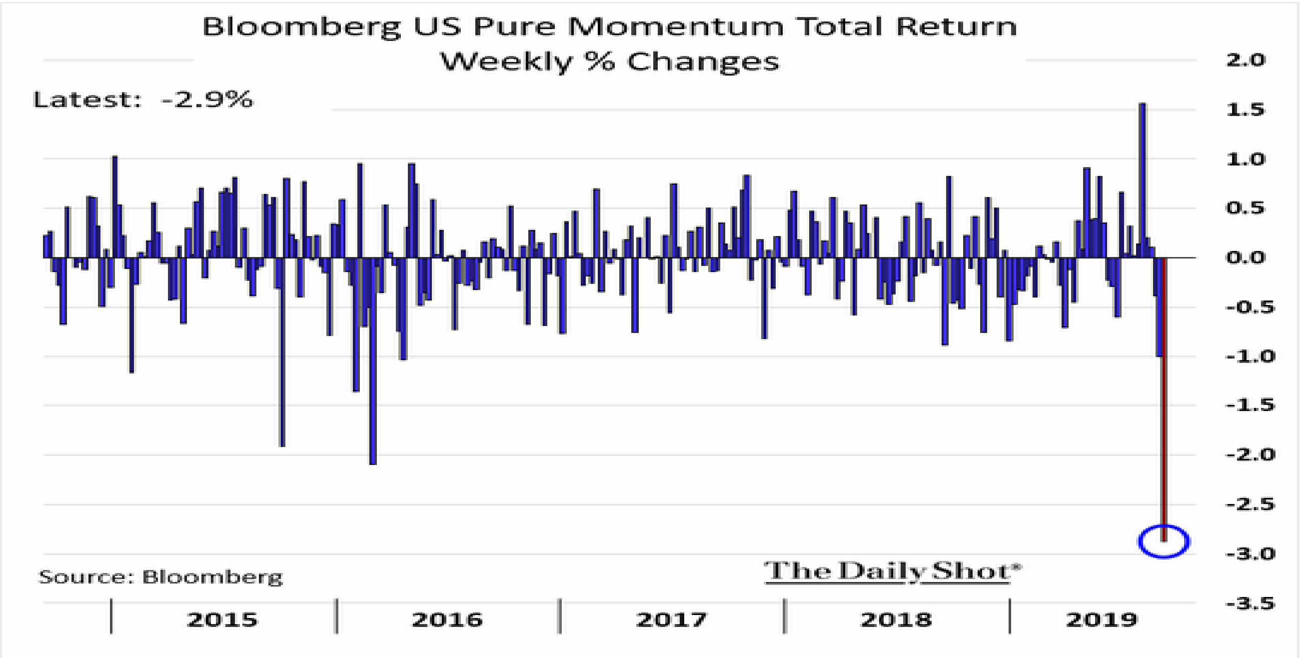


Chart 8 source: WSJ The Daily Shot

Momentum factor vs the S&P500: look towards the abyss for the red spot…

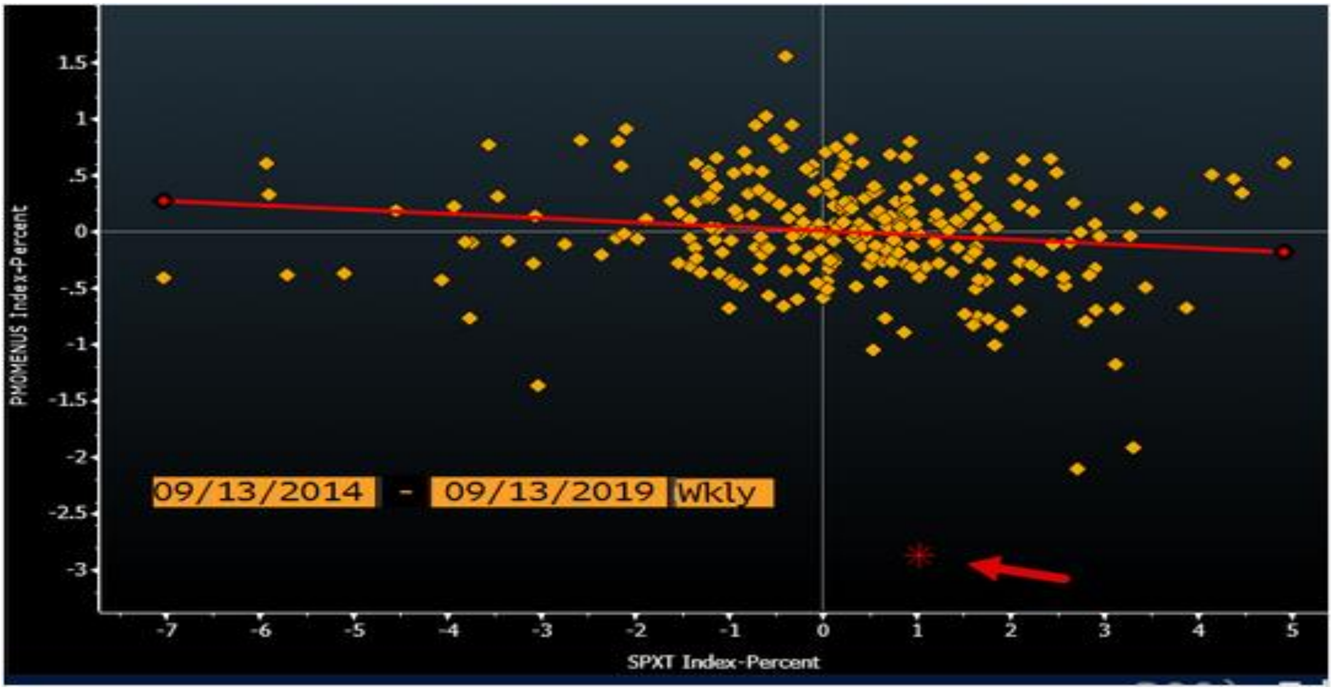


Chart 9 source: WSJ The Daily Shot

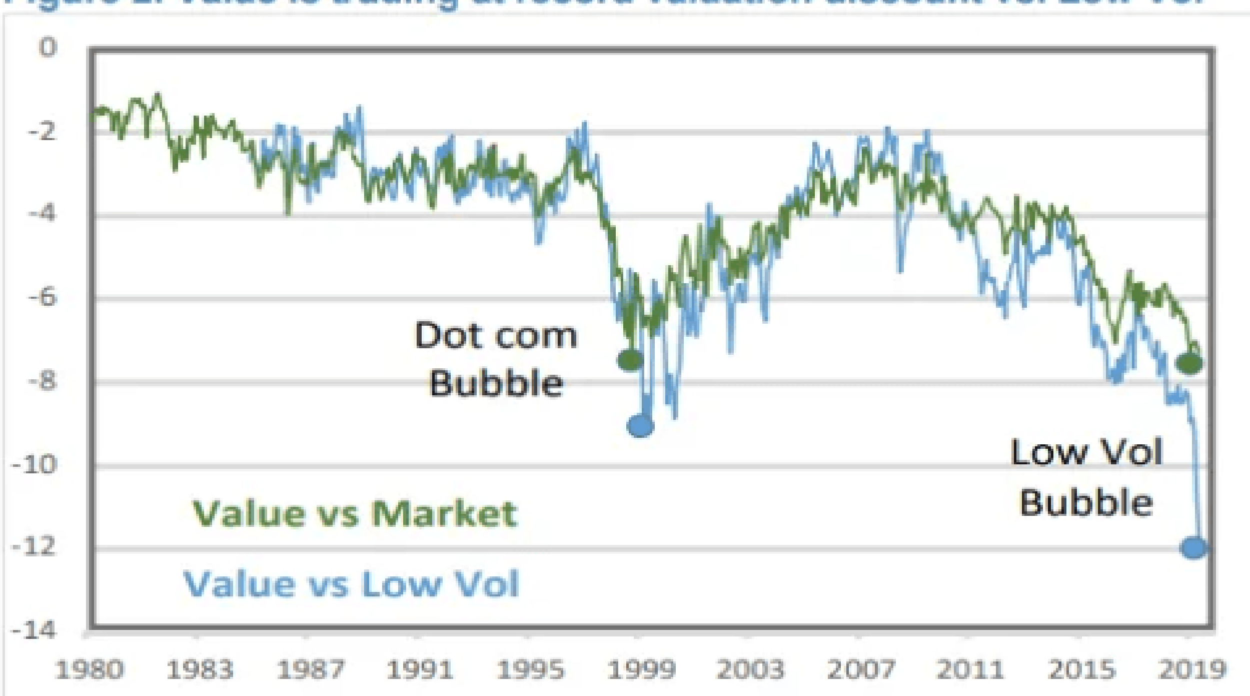
•So has the long awaited Growth to Value rotation finally arrived ?

Or, in other words, can we expect, from now on a real outperformance from Cyclicals and other battered sectors (Energy for instance)?

The debate is still going on between analysts who think the rotations seen last week are sustainable and those who opine that these events merely reflect a positions cleansing catalyzed by a similar washout in the rates space, where the bond rally had clearly run too far, too fast!

On one side you have people like Marko Kolanovic, JPMorgan quant analyst, who, in August, warned of an epic bubble in the Low Vol factor which he illustrated with the following chart:

Figure 2: Value is trading at record valuation discount vs. Low Vol



Source: J.P. Morgan QDS.

Chart 9 source: JPMorgan

He went on to write that it was at this point "an historic opportunity to position for a strong convergence move". So some people clearly think that given the size of the bubble, there is more to come….

On the other side of the argument you'll find the tenants of the systematic and/or quantitative investing, who feel that, as long as a recession is not imminent, there are just too many forces in place, including political ones, that are driving to push the market higher from here. With the Fed looking to cut rates multiple times over the next year and a trade war that can be used to drive the narrative, things are, according to them, set up for more growth segment outperformance…. Put it another way, a trend always last longer than one could think initially…

What might happen now?

If you believe Goldman's note published last week: "Sharp Momentum drawdowns similar to the one that has taken place in the last two weeks usually mark the end of the Momentum rallies rather than tactical buying opportunities. One reason Momentum rarely rebounds following sharp drawdowns is that the composition of Momentum frequently changes. From a macro perspective, Momentum typically performs best during extended periods of macroeconomic and market consistency. Looking forward, for Momentum to resume its outperformance, investors will need to either return quickly to the mindset of economic deceleration and recession risk, or wait until Momentum builds again in a form appropriate for an improved economic environment."

You will see three of the charts they provided on the next page.

The first two are quite interesting. They show that the convergence move of GS High Beta Momentum Index with the S&P500 was extremely fast and violent. But when your out performance drops from more than 40% to roughly 5% in a matter of a few weeks, maybe, just maybe, the mean reversion has already taken place. The Bernstein strategist seem to agree:"We do not see a catalyst for more mean reversion in the near term and do not think that the rotation this week is the start of a longer term cyclical value rally"

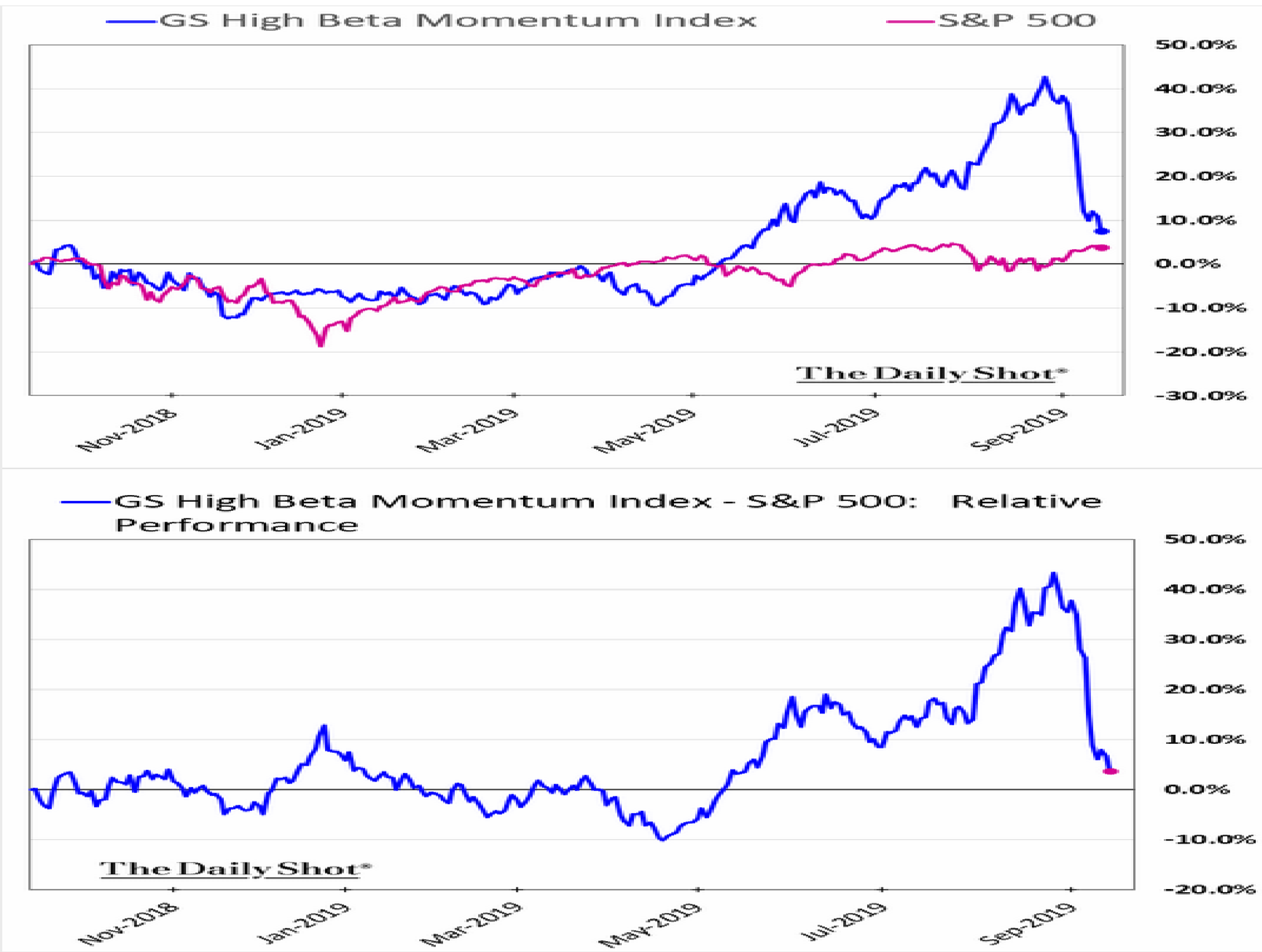


Chart 10 source: Goldman Sachs

At the very least it seems clear to us that the vast majority of this convergence move has been done already. And remember the chart 5 (Fig. 7) presented on page 7: the performances of the short and long momentum indices since 2018 are now almost exactly the same, so…

And after having exhibited the magnitude of the September collapse with a comparison of their High beta Momentum Index with the S&P500 (Chart 10) they drive their point home with the following chart proving that Momentum downturns may take a little while to recover.

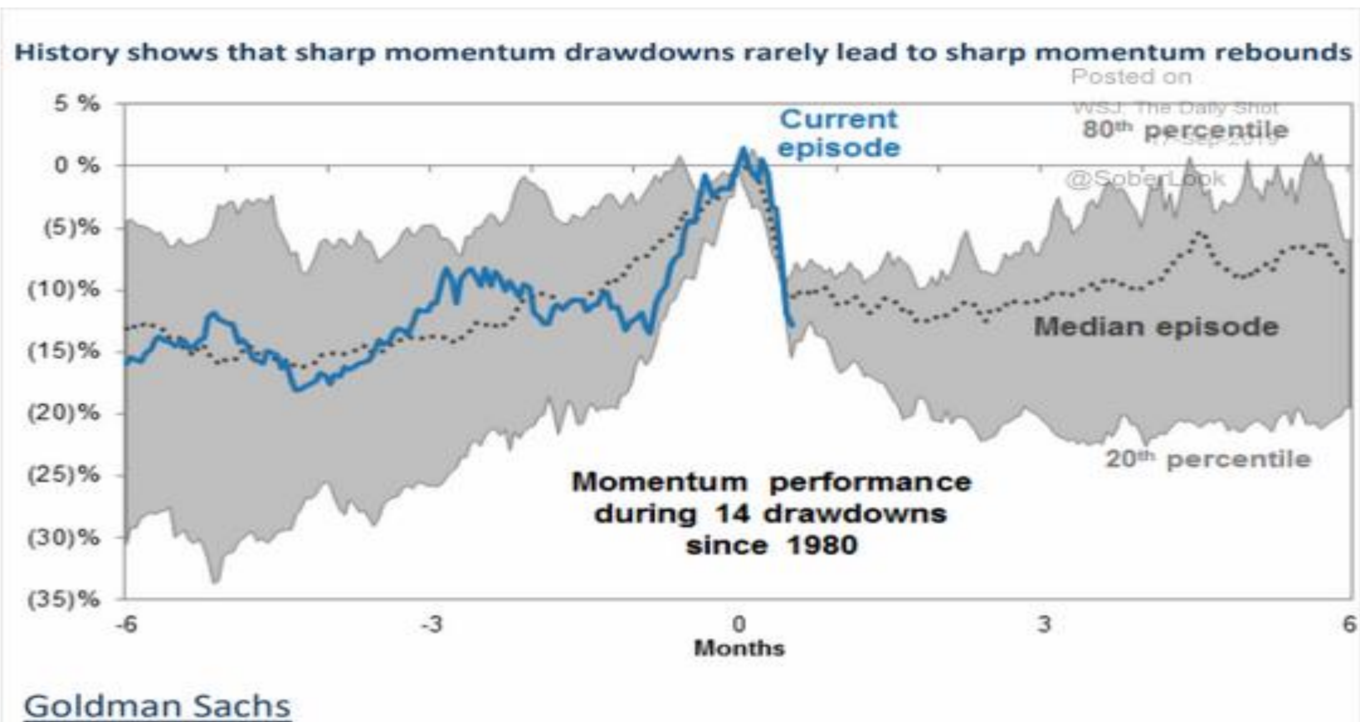


Chart 11: source Goldman Sachs

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Too many investors are poorly exposed to positive news. Value stocks, a portfolio of doom-laden stories as we have seen in recent days, provide such a hedge."

This is a valid point. Investors fairly happy to keep their Growth or Momentum exposure could consider adding exposure to some Value stocks as a (partial) hedge. But choose the sectors/stocks carefully, even after the massive Crude rally (+15% on Monday the 16th) the energy sector is still down about 18% year to date.....

We are on the side of those who think that for Value factor to fly over more than a few weeks, i.e longer than the short covering period we witnessed last week, you need **a NEW Macro story** that drives a **steeper yield curve.** And as we write it doesn't seem we have one.

The bottom line: even if you are a pure equity investor, you can **NOT** afford to **IGNORE** what happens in the Interest Rates markets.

You can think that you are isolated from the Rates markets tantrums, the reality is: **YOU ARE NOT…..**

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