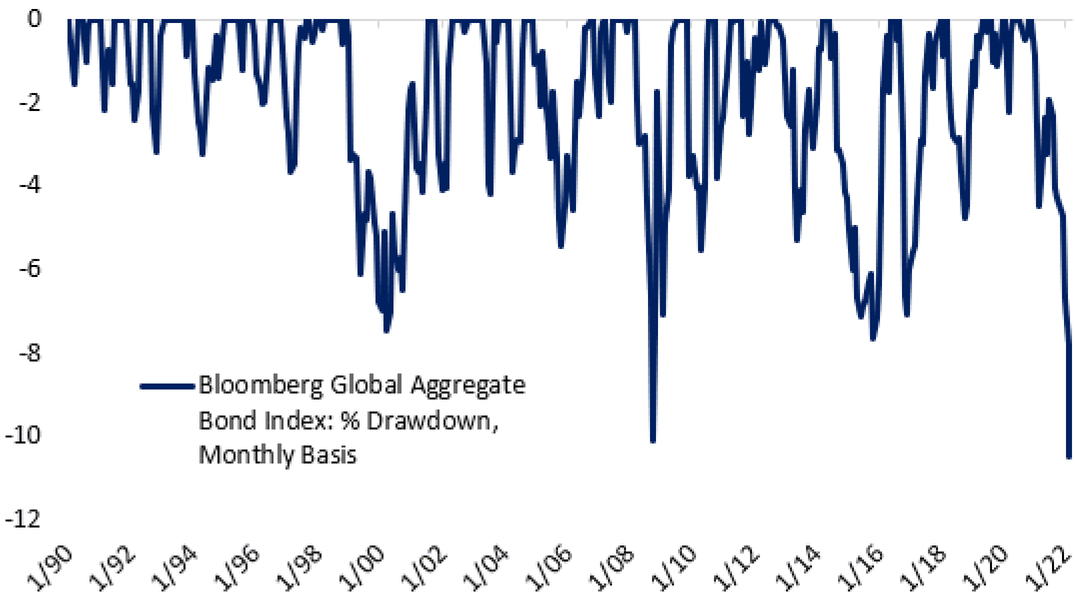
Yield Surge Yet Stocks Rally On

Over the last few months, bond yields have surged higher. Higher yields are a tax of sorts on economic activity. The steadily growing debt to GDP ratio strengthens the relationship of interest rates to economic activity. Despite the economic headwind caused by increasing interest rates, stock investors seem to be unconcerned. Since March 14th, the S&P 500 has surged 7%, all the while the yield on the 5yr UST note has surged from 1.95% to 2.40%. One explanation for the recent bullish sentiment is that the yield surge might take pressure off of the Fed to raise rates by as much as expected. The bond market may do their work of slowing economic activity which should temper inflation. The graph below shows the Bloomberg Global Bond Aggregate is having its worst drawdown in at least 22 years.



[dmc]

What To Watch Today

Economy

- 7:00 a.m. ET: **MBA Mortgage Applications,** week ended March 18 (-1.2% during prior week)
- 10:00 a.m. ET: **New home sales,** February (810,000 expected, 801,000 in January)

Earnings

- **General Mills (GIS)**&#2013266080;is expected to report adjusted earnings of 78 cents per share on revenue of $4.55 billion

Market Clears Resistance - Bulls Back In Control

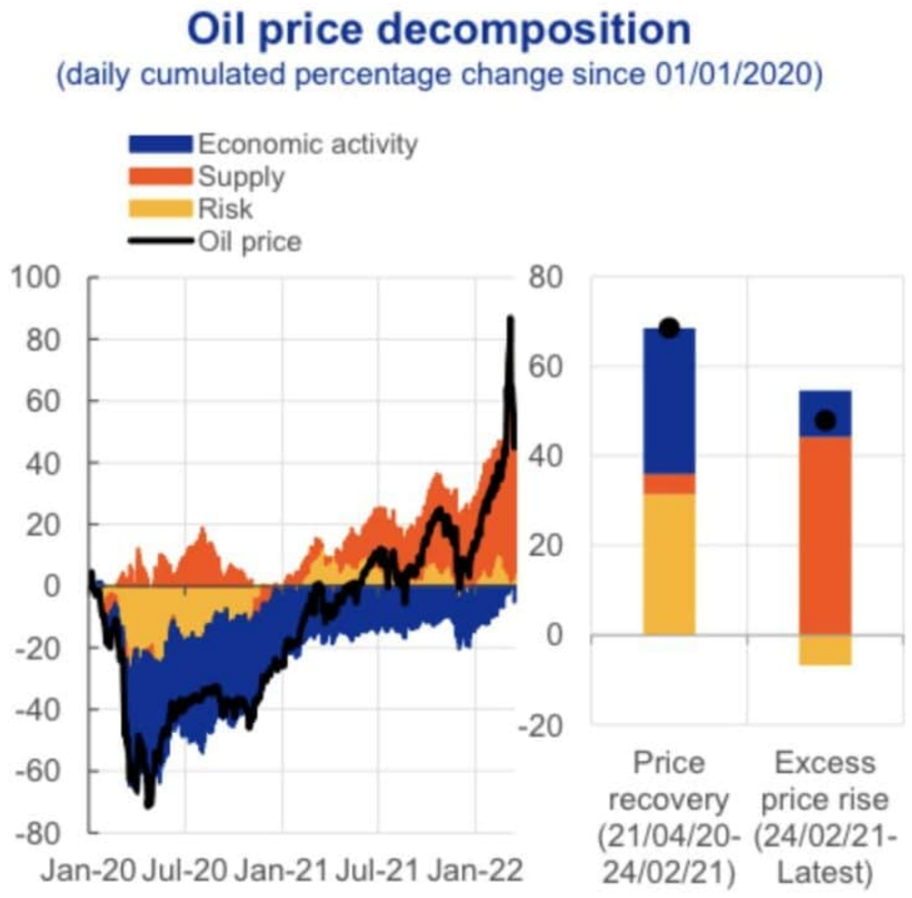
On Tuesday, the bulls regained control of the narrative despite a yield surge, Russia/Ukraine war, and a more aggressive Fed. Such is not surprising given the excessive negative sentiment seen lately in both retail and professional investors. As we noted previously, a positive month in March would not be surprising given the very rough start to the new year. For now, it's "rally on Garth," but with markets now back to extremely overbought levels, we will be looking to rebalance risks here soon.

[Charts courtesy of SimpleVisor.com]

Who to Blame for Higher Energy Prices

The graph below from the European Central Bank (ECB) decomposes the percentage change in the oil price into three categories: Economic activity, Supply, and Risk. The takeaway appears that economic normalization is no longer a significant driver of the recent surge in oil prices. Instead, we should blame the Russian invasion and global environmental policies that dissuade investment and exploration into new oil sources.

Supply accounts for most of the “excess” oil price



Sources: Refinitiv and ECB staff calculations.
Notes: Structural shocks are estimated using the spot price, futures to spot spread, markets expectations on oil price volatility and stock price index. "Excess price rise" refers to the model decomposition from the time when oil prices were back to their pre-pandemic levels.
Latest observation: 15/03/2022.

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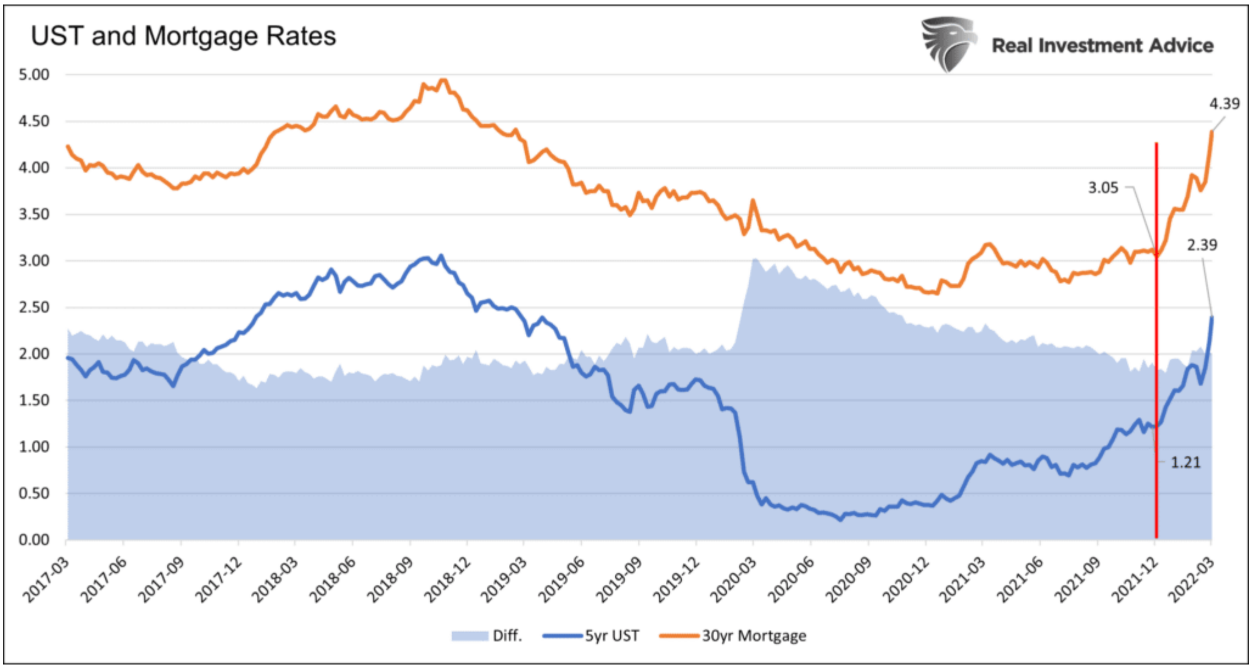
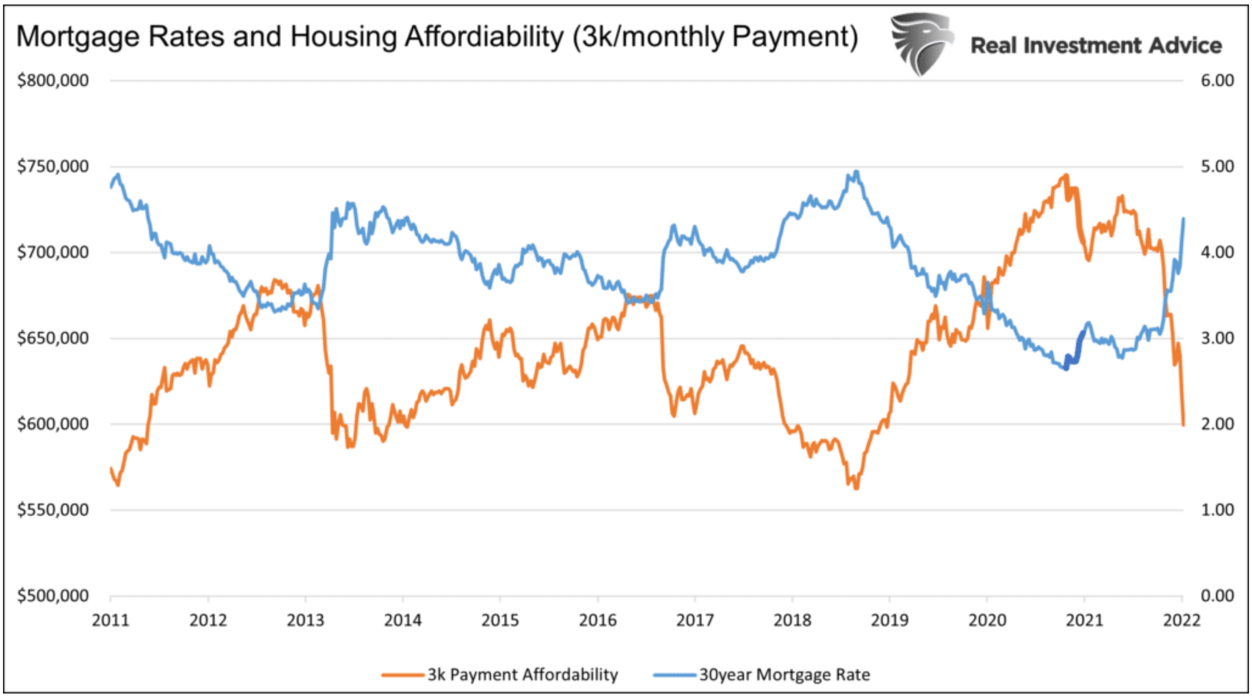
Mortgage Rates Are Rising Rapidly

As we show below, mortgage rates have been increasing with U.S. Treasury yields. Since January 1st, as denoted by the red line, mortgage rates have risen by 1.34%. Housing is an integral part of the economy; thus higher mortgage rates will detract from economic activity. Each 1% increase in the 30yr mortgage rate has an approximate 8% impact on buyer affordability. The 1.34% increase over the last three months means homebuyers can afford almost 11% less house unless they are willing to have a higher mortgage payment. The second graph shows how much house one can afford, assuming a $3,000 monthly payment. Since mortgage rates bottomed in late 2020, affordability based on a $3,000 mortgage fell from $750k to $600k.

Currently, the inventory of homes is at record low levels. As a result, higher mortgage rates are not materially affecting prices. However, the combination of higher rates and expected increases in inventory has the potential to push home prices lower. While declining home prices is indeed a rarity, it should be expected later this year.

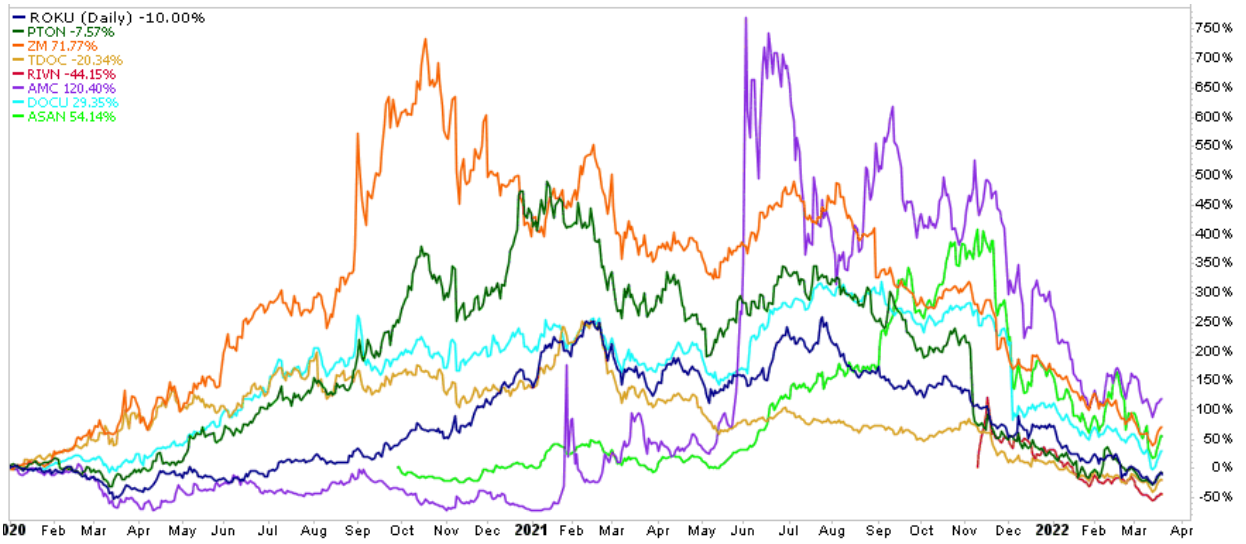




A Tech Bust Beneath The Surface

Well-followed tech, high growth stocks and ETFs, and related indexes are down significantly in the last year. At the same time, the NASDAQ has held up well. The first two graphs below show ARKK (Disruptive Technology ETF) and Hong Kong's Hang Seng Tech Index display a classic boom-bust pattern. In both cases, the similarities to the Tech boom-bust of the late 90s and early 2000s look eerily similar. The third graph charts a handful of stocks that were wildly popular and often called meme stocks during the pandemic boom. Between the onset of the pandemic and their respective highs, each of the selected stocks was up at least 200%. Like ARKK and the Hang Seng, these stocks and many others not shown have followed the same pattern as the Nasdaq circa 1997-2003.

Despite the massive losses in some constituents, the NASDAQ and broader S&P 500 show little similarity. Since January 2020, the NASDAQ has been up 66%, albeit 25% below its late 2021 peak. The S&P 500 is up 38% over the same period. Simply, the major indexes are hiding the carnage underneath the covers.



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