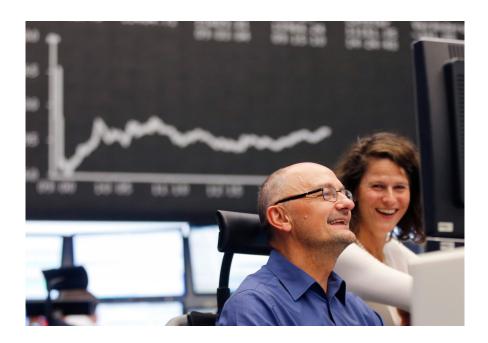
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# Rates: January, a month of Mondays? I don't think so

Often in January, we'd get some direction for the year ahead. Well this year, take your pick. We've been all over the shop, in rates, credit, equities, you name it. Direction be damned, it's all about volatility! To get back on track to hit a 1.5% US yield, volatility needs to calm considerably; that's not easy given how frothy risk assets are in valuation terms



## The roller coaster of the 10yr US yield, and we are not finished yet

It's been a remarkable January. The US 10yr yield shot out of the blocks as if it had awaited the switch for 2021 to be flicked on.

Having languished in the 90-basis-point territory for nigh on six weeks into the holidays, it broke above 1% and had the boldness then to attempt marking 1.2%, all before the first two weeks of the New Year.

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We're still looking for 1.5% on the US 10yr at some point in 2021, even if we did temporarily dip below 1%

But, it's been heavy going since. A good chunk of that good work towards high yields has been taken back, and the 10yr is now in danger of breaking back below 1%. It could... should the risk asset sell-off persist, but we doubt it will.

Even if it does, we think it can hold in the 90-basis-point area again. The reason for that is we continue to believe that this is a reflationary environment, and it will feel more and more that way as we progress through 2021.

### The mood in the risk asset space has been an important backstory for rates

But there is a problem - quite a frothy underpinning has been uncovered for equities and risk assets generally.

The S&P for example is trading at almost 23 times projected earnings, practically the highest levels since the dot com bubble. Some consolidation here is overdue, and we are seeing it of late.

Something similar is in play in credit markets, where spreads have been quite close to historic lows, and that at a time when we are still in the midst of a global pandemic. Markets are forward-looking operators, but still.

This whole combination has acted to heighten volatility, with the equity VIX index marking out its highest level since the fourth quarter of last year, and the volatility of volatility is also elevated. Usually, this means trouble for risk assets, and we are seeing a bit of that right now. This is also acting to push investor holdings back into the safety of Treasuries and similar core products, pushing down on yields (and weakening the reflation discount).

### The eurozone continues to do its own thing, but not very impressively. Lots of supply though

There has not been quite the same directional story for market rates coming out of the eurozone. The German 10yr yield remains in the -55bp area, not too deviant from all-time lows, and not too divergent from the upside extreme seen when the US almost hit 1.2%. These markets are still polls apart when it comes to the reflation story.

What is remarkable though is the tremendous demand for low and negative-yielding product in the eurozone as the primary market continues to get pinged with new and heavy core issuance, and on a promise that there is more to come.

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The only logical answer to this is asset managers matching liabilities that are discounted using something akin to those same low to negative rates, and/or need pure euro-denominated core bond exposure (practically at any cost).

Right now, issuance is not the driving force for market rates. The US re-funding announcement is due in the first week of February and will show more issuance. But it is unlikely to impact valuation; the demand is still very much there for core product during these uncertain times.

What is impactful is volatility and the mood of risk assets. To resume our projected uptrend in market rates, we would need to see volatility calm and risk assets to feel far less jumpy than they currently do.

We're still looking for 1.5% on the US 10yr at some point in 2021, even if we did temporarily dip below 1%.

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