Daily Market Note: August 21st 2023 by Larry Cheung, CFA

Tech Stocks attempted a technical rebound led by Tesla and NVDA in the context of higher yields

Forward-looking Conclusions of this note:

- Macro: U.S. Tech stages a counter-trend rebound in the first half of Monday's trading session, which was anticipated by us in last week's note, after QQQ shaved off 8% off its value since its peak at 388. This rally is on thin ice, until yields come down – in my view.
- U.S. Stock-Specific: Judicious stock selection and conservative sizing is essential in the next stage of the market.
- Bonds: The selloff in Bonds intensifies but I am not changing my view on Treasuries at the strike levels previously mentioned.
- China: Investor sentiment is greatly dampened by the real estate woes plaguing the country. But this does not fundamentally impact travel related themes like TCOM.

Daily Market Note & Context

Last week in Thursday's note, I shared my thinking that a rebound was brewing in technology but that its characterization would be one that may be feeble. On Friday, we saw indices stage an intraday rebound to reverse losses. And on Monday (today), we saw pre-market strength in both SPY ETF and QQQ ETF. Yet, with bond yields threatening the recovery, we got completely faded back down to breakeven – per my Pre-market note which I posted on Twitter while pre-market futures were still strong (all pre-market notes will be sent in private group chat once set up). The SPY ETF may of course rebound after my post here, but the point is that a fade happened as contextually described. My pre-market note, while never perfect, is designed to help investors avoid traps that could cost them dearly. Avoiding the temptation of chasing the gap up this morning was a relative win. Why? Because I'm sure many others attempted to do so.

My focus now is on the 10-Year Yield. It is making new local highs last seen at 4.35%, and every single basis point (which is .01%) higher can start stirring discomfort in Fund Managers that have heavy tech exposure. Most companies in the QQQ do not actually generate substantial cash flow like the Magnificent 7 do, and these higher rates will pose an immediate fundamental problem for their ability to access financing in the debt markets to fund their growth initiatives. Higher rates, which are coming at a time when student loans are going to be enforced, will have a meaningful impact on consumer sentiment later this Fall as household budgets are not necessarily ready to embrace student loan repayments after a 2 year hiatus. The selloff in Consumer Discretionary last week was not an over-reaction but a rational repricing of the risks that the consumer faces in the coming quarters.

Over in Asia Pacific, China's policy makers are stepping in to defend the Yuan by making it more expensive to bet against the currency by raising funding costs. This is helping the Yuan recover back to 7.29 CNH/USD from the 7.35 CNH/USD level from last week which marked a multi-year low. I expect the correlation between the Yuan and China Internet Stocks to remain high over the coming trading sessions, meaning that strength in the Yuan will mean that previously mentioned China ADRs BABA, PDD, TCOM, EDU may catch a bid. Within China, we have to be ultra-selective and select companies that have higher growth rates and better margins. Companies that are not demonstrating any form of margin expansion from latest earnings or seeing growth deceleration will not benefit from China's policy makers defending the Yuan. The only way to fight a deflationary narrative is to produce growth figures.

In the options market, a rising VIX is going to set up more opportunities, but being selective with opportunities is critical. Our current mindset should continue to be to aim for small wins in volume and preserve capital. Previous ideas that are working can be kept (or closed, whichever is desired). I'm simply holding previous ideas, not adding. We will have ample opportunity to increase bullish exposure later in 2023.