THE GREAT REVERSAL IN SECULAR TRENDS

VIRTUS INVESTMENT PARTNERS

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Back in January, I outlined six secular investing trends that were showing signs of a major reversal:

- Long Duration over Short Duration and Flattening Yield Curve
- Large Caps over Small Caps
- Stocks over Commodities
- International over U.S.
- Growth over Value
- Tech over Everything

Since then, the reversal of these major trends have continued, and in some instances accelerated. Let's take a closer look...

1. Yield Curve and Duration Reversal

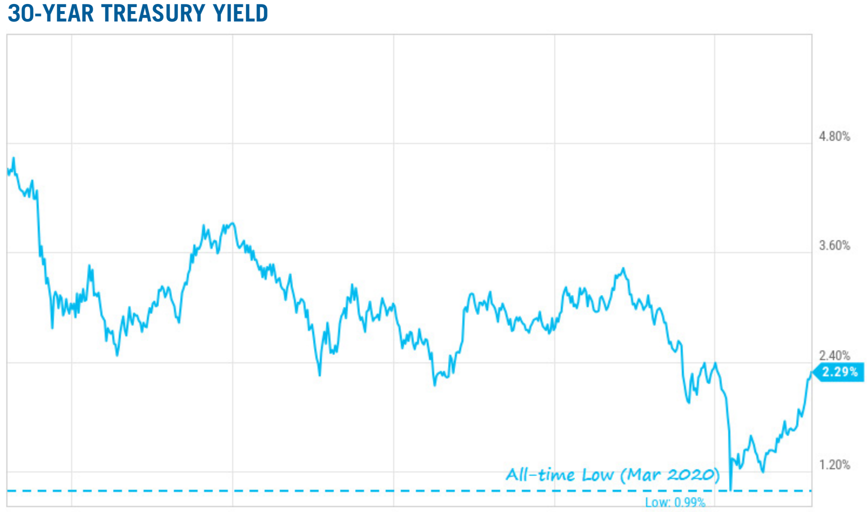
After years of flattening, the U.S. yield curve is now moving in the opposite direction. The spread between 10-year and 2-year yields now stands at 1.50%, its steepest level since 2015.

U.S. YIELD CURVE (10-YEAR MINUS 2-YEAR YIELD)

Past performance is not indicative of future results. As of 3/15/21. Source: YCharts.

The 40-year downtrend in long-term bond yields (30-year Treasury) culminated in a close below 1% last March. Since then, yields have trended higher with the 30-year now back to pre-pandemic levels.

30-YEAR TREASURY YIELD



Past performance is not indicative of future results. Last 10 years as of 3/15/21. Source: YCharts.

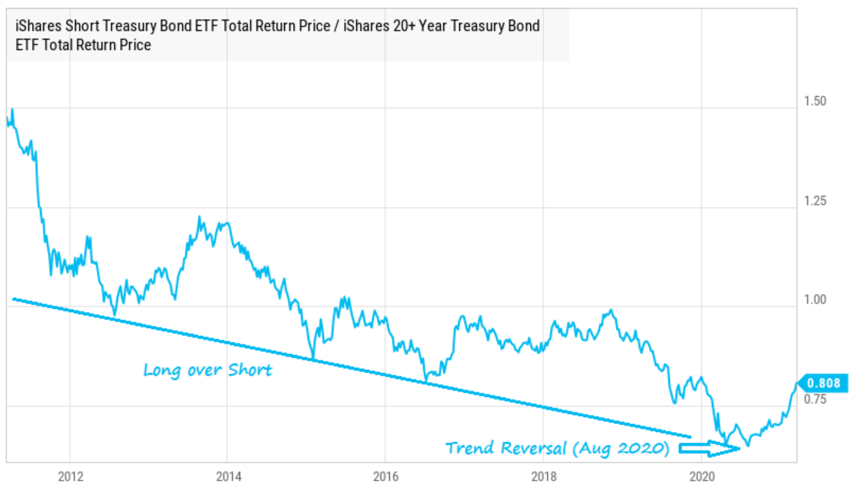
The underpinning of the move higher in yield was an unexpected shift in the inflation outlook. The deflation that many assumed was a given never occurred, and after a vertical ascent, inflation expectations are now at their highest levels since 2008.

U.S. INFLATION EXPECTATIONS (5-YEAR TIPS/TREASURY BREAKEVEN RATE)

Past performance is not indicative of future results. Last 10 years as of 3/15/21. Source: YCharts.

With long-term yields and inflation on the rise, the ratio of short to long duration continues to move higher.

RATIO: SHORT DURATION TO LONG DURATION



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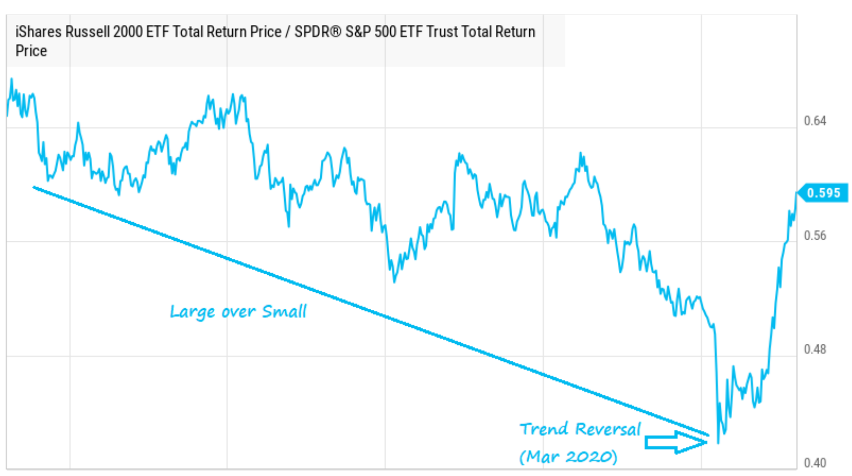
2. Size Reversal

The ratio of small caps to large caps bottomed last March, a few days before equity market low.

With news of the vaccines and subsequent stimulus bill, the ratio has exploded to the upside.

RATIO: U.S. SMALL CAPS TO LARGE CAPS



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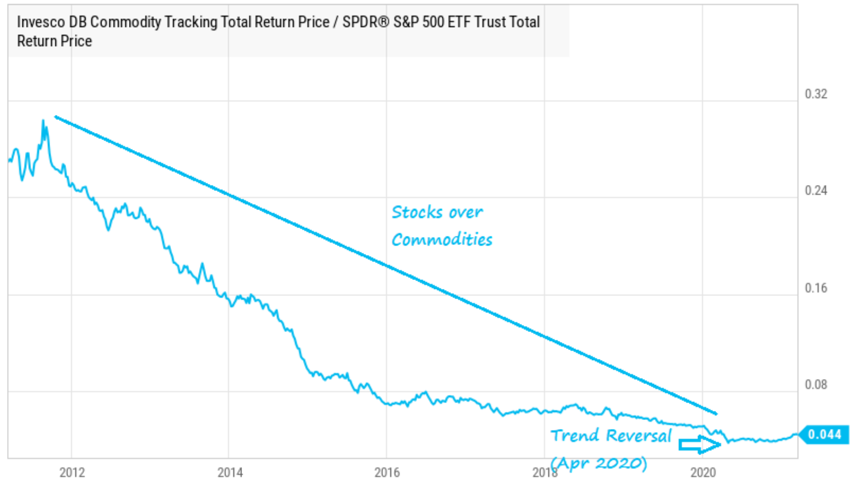
3. Commodity Reversal

Commodities were in a long-term downtrend relative to stocks well before COVID-19 hit. But with the worldwide lockdowns, demand collapsed like never before. Crude oil futures actually turned negative last April, a remarkable event no one thought could ever happen.

Since then, the ratio of commodities to stocks has not hit a new low, but instead quietly moved higher.

RATIO: COMMODITIES TO STOCKS



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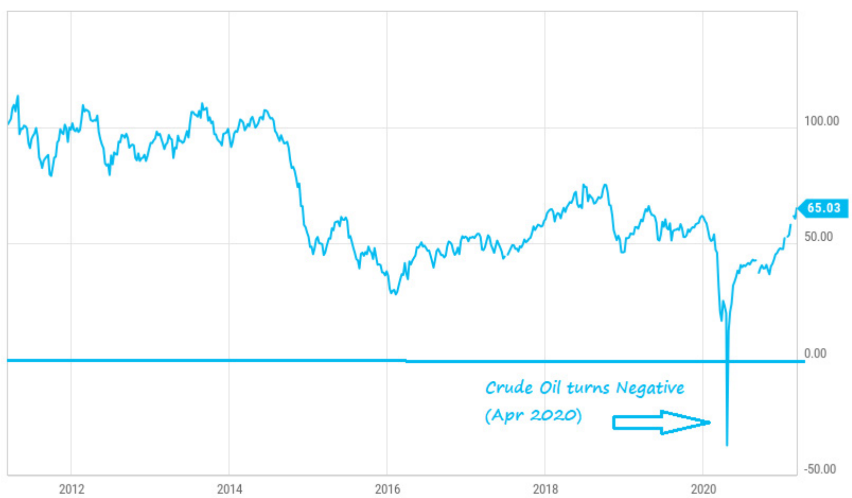
And, with crude oil now back above $60 a barrel, talk of a "reflation" has begun.

WTI CRUDE OIL (SPOT PRICE)



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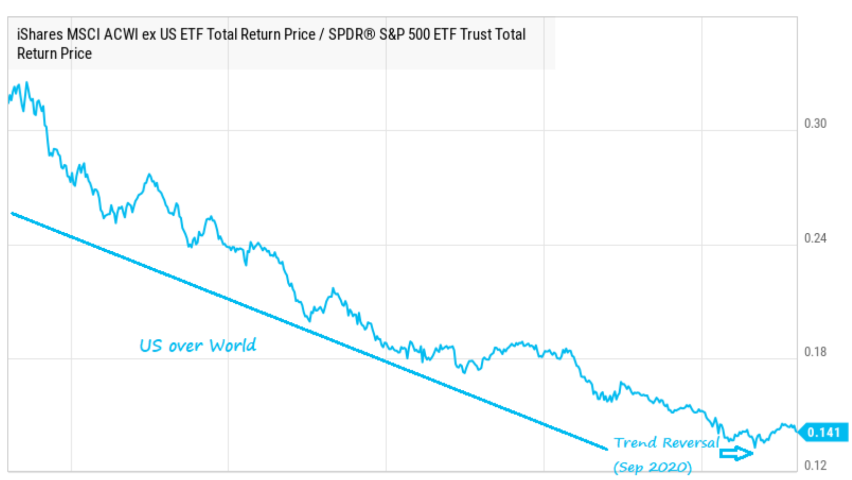
4. Geography Reversal

The dominance of U.S. stocks versus international equities has been a consistent theme over the last 10 years. That trend started to reverse course last September, with global equities showing outperformance.

RATIO: WORLD VS. U.S. STOCKS



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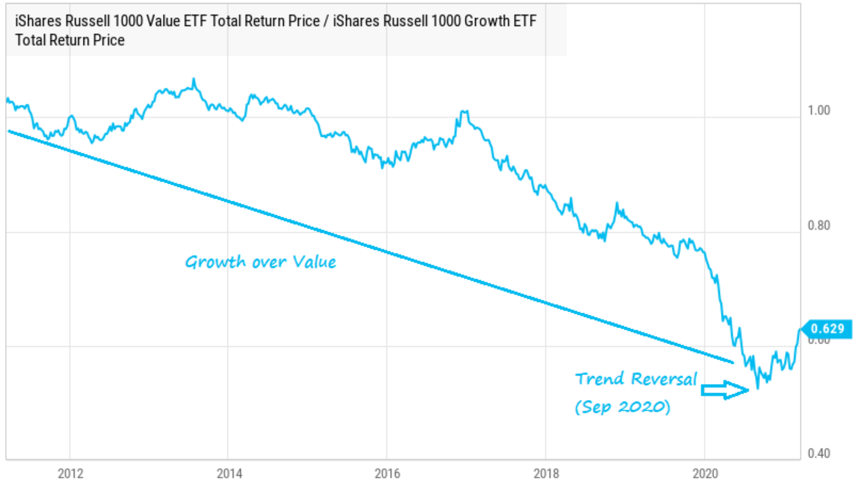
5. Style Reversal

Over the past 14 years, value investors faced their most challenging period since 2000, with a significant underperformance relative to growth.

That trend reversed course last September, with value stocks taking the lead, and has continued to start the year.

RATIO: VALUE TO GROWTH



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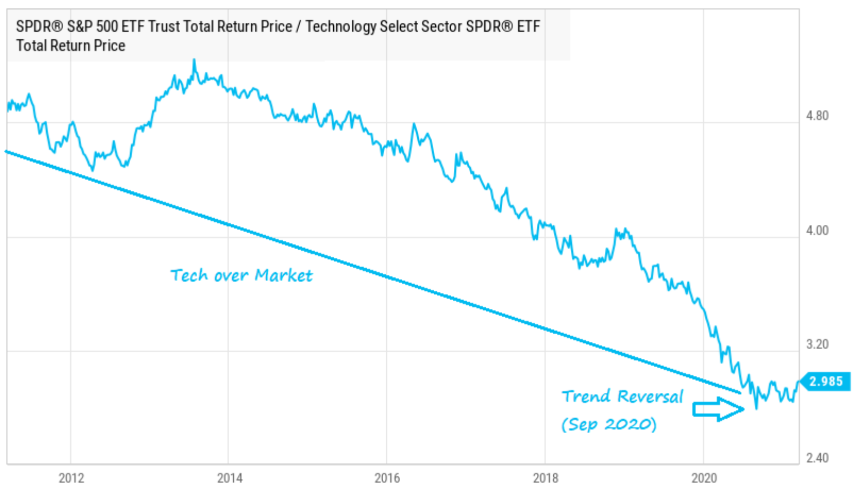
6. Sector Reversal

The most powerful story over the last decade has been the supremacy of technology. When the pandemic first hit, this only accelerated, as the lockdowns made tech more essential to daily life than ever before.

But, last September, things started to change, and tech stocks have actually underperformed the broad market. That has continued this year, as the end of COVID-19 and a return to normal is now within sight. This is a potential change in trend that few investors envisioned a year ago and fewer still are prepared for.

RATIO: BROAD MARKET VS. TECH



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When secular trends reverse, no bell is rung, and no one can believe that a shift has actually occurred.

But, as narratives follow prices, the longer they are sustained, the more the story changes and the more people believe it. In January, there were few believers in a change to the status quo. Today, as the great reversals have continued, there are more believers.

The investing narrative has shifted 180 degrees from where we stood a year ago. We went from doomsday predictions of the next Great Depression to current expectations of an economic boom.

The current narrative is that a) small companies will benefit more from stimulus measures than their larger counterparts; b) global stocks will benefit from a falling dollar and higher global growth; c) value stocks will improve with the rise in interest rates and the steepening yield curve; d) technology will underperform as the vaccines and herd immunity will allow people to leave their homes again; e) bond yields will rise with inflation pressures mounting; and f) commodities will move higher with a resumption of growth and demand.

When COVID-19 first hit a year ago, all of these narratives would have seemed absurd. And yet, here we are. Where the story turns next remains unknown, but the fact that we're even entertaining these great reversals is remarkable, and more proof that the only sure thing in markets is that they are full of surprises.