



THEIA INVESTMENTS
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Daily Commentary

Is It Time to Rotate?

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A curious session, yesterday's.

Wall Street opened a week full of appointments with trading reduced to the bone.

On the S&P500 index ETF, about **18** million shares changed hands, **the lowest volume on a non-holiday day since 2003**.

Yet, beneath the surface, a lot moved. The Dow Jones gained **0.4%**, the S&P500 index closed practically flat (**-0.06%**), the Nasdaq lost **0.4%** and the Nasdaq 100 **-0.7%**.

The heart of Artificial Intelligence paid the price.

The **semiconductor** index lost **2.7%**, with SK Hynix **-4.0%**, Micron **-3.9%**, Intel **-3.2%**, Oracle **-2.8%**.

The spark came from China.

ChangXin, the main Chinese producer of DRAM memory, announced progress on a

new architecture, that is, more competition in the server segment that AI has made so profitable.

On the other side, almost all the rest of the market: ExxonMobil **+1.9%**, Chevron **+1.4%**, Coca-Cola **+2.0%**, AbbVie **+1.7%**, Procter & Gamble **+1.3%**, Visa **+1.0%**, that is, energy, staples, financials.

Small caps, for once, did not participate (Russell 2000 **-0.4%**) and we will see shortly why this is not a detail.

There is one detail worth reflecting on.

All of this happened on the day the Treasury market was closed for Columbus Day.

The rotation started precisely when the only ingredient that should justify it was missing, **the drop in rates**.

In fact, the ten-year futures were signaling



a rise of one or two basis points, with Brent oil near 107 dollars and the president of the Cleveland Fed calling for small, frequent rate hikes so that inflation does not take root.

The probabilities of a tightening in December have returned to recent highs.

Are we starting a rotation?

Let's go slowly.

Just look at who sold and who bought.

Last week **hedge funds** sold the technology sector at the fastest pace in seven weeks and bought industrials as they had not since January (defense, construction and airlines).

But the how matters more than the what.

Overall exposure rose to **213%**, while net exposure (the real bet on a rise) is stuck at **46.9%**, the second percentile of the last

year.

Many positions, very little direction.

The paradox is that, while selling technology, those same funds have never been so exposed to the seven large companies that lead Artificial Intelligence, equal to **22%** of American exposure, a historic record.

Nobody is underweight Artificial Intelligence, but everyone is underweight everything else.

Why do they sell, then?

Not out of conviction, but out of fear of falling behind the benchmark.

Analysts have christened it **FOBU**, the fear of underperforming the benchmark, the less noble cousin of FOMO.

Last Tuesday, when the S&P500 index set a new all-time high, the first ninety minutes



were "the most frantic in months", with aggressive purchases of bullish options and implied volatility rising together with prices.

This happens when you buy because you have to, not because you want to.

There are just over fifty sessions left until the end of the year, and those who are underweight will have to explain to their clients why the index rises and the portfolio does not.

Here is the key to reading yesterday's session.

Those who are full of Artificial Intelligence-related stocks are lightening up, because the position is crowded and a single piece of news, like the news on OpenAI's revenues last Thursday, is enough to shake it.

Those who are empty of everything else

are covering, because small caps are at record short positions and the biotechnology and utilities sectors have suffered the heaviest sales in years.

It is the rebalancing of portfolios stretched to the extreme, not a change of mind about the world.

Wall Street's earnings today are those of Artificial Intelligence.

According to the estimates of an investment bank, semiconductors could account for about **60%** of the expected earnings of the S&P500 index for next year, and technology as a whole about **75%**.

For the quarter that opens today, consensus estimates index earnings growth of **27%**, while the median stock stops at **9%**.

Taking Artificial Intelligence out, the



earnings season becomes much more ordinary.

This narrative, however, has recently been cracking because of the **cost of debt**.

To build data centers, the large cloud companies are borrowing, and the market is starting to demand more: the spreads on bonds linked to data centers have gone from about 120 to **180** basis points in six months, and the weakest issuers already pay double-digit yields.

Last Thursday, the news of OpenAI's disappointing revenues, that is, the idea of less issuance linked to AI, was enough to push Treasury futures higher.

Here is the short circuit.

For the rotation to be real, rates must fall, because utilities, real estate, biotechnology and small caps live on the

cost of money.

For rates to fall, the amount of paper to be placed must fall.

For the paper to fall, the large cloud companies must slow down their investments.

However, if they slow down their investments, the Artificial Intelligence narrative, which supports the earnings of the whole market, loses its fuel.

A dog biting its own tail.

An index that falls while the average stock rises is, by definition, a rotation.

However, it is not the scenario that today's valuations are pricing in, and it is not a scenario in which leadership changes without making noise.

Do we need to prepare for a change of leadership?



Not yet.

Some signals point in the right direction. Market breadth is improving, new lows are falling and new highs are rising.

Today, the rotation is the offspring of positioning, not of conviction.

The options say so too.

Protection is being bought against a spike in volatility, but not against a fall in the index.

It is a market that believes neither in a crash nor in a rotation.

In the end, everything depends on rates.

If the ten-year, today at **5.24%**, falls again because of a less hot inflation reading, because a Treasury that reduces long-term issuance, or because of less aggressive investment in Artificial Intelligence, then utilities, real estate,

biotechnology and small caps have a lot of room to recover, starting from such depleted positioning.

If instead rates stay where they are, yesterday's move will have been only a temporary reversal, that is, the breath of managers frightened by the benchmark.

Today, **JP Morgan, Citigroup and Wells Fargo** open the **earnings season**.

A session led by the banks, with the technology sector under observation and an eye on oil.

But the real question remains another: **is it time to rotate?**

The answer will not come from Wall Street, but from the bond market.



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