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Daily Commentary

Everyone Lost Together

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Yesterday was a nightmare day for **hedge funds**: the long positioning on Artificial Intelligence against the rest of the market, the short on defensives and the short on Treasuries.
Every crowded trade moved in the wrong direction at the same time.
According to prime brokerage data, the service that large banks offer to hedge funds for securities lending, leverage and settlement, from a leading investment bank, already at mid-session long/short funds were losing **1.1**%, systematic funds **1.2**% and multi-strategy funds **1.4**%.
It is the first time since Covid that all three families lose more than 1.0% on the same day.
The basket, which measures the funds' pain, that is, their favorite stocks against the most heavily shorted ones, closed at −**4.2**%, the worst move since 2011.
To find a worse one, one has to go back to August 8 of that year, the day after the downgrade of the United States' credit rating.

When the crowded longs are all in Artificial Intelligence and the crowded shorts are "everything else", a day like yesterday hits both legs together.
Lam Research −**11.8**%, Meta −**7.0**% (first net cash outflow in over ten years and CDS contracts at record levels), Nvidia −**4.4**%, semiconductor index (SOX) −**6.7**% with all thirty components in the red, Nasdaq 100 over −**3.0**%.
Meanwhile, precisely what had been sold short was rising, Allegion +**11.0**%, Roper +**9.7**%, Procter & Gamble +**5.6**%, consumer staples +**3.3**%, and Treasuries were also

Source: Bloomberg, Reuters, Yahoo Finance, Financial Times, ECB, CNBC, The White House
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rising, where systematic funds were short.
The result is an index that tells you nothing.
The S&P 500 index lost **1.21**% with **335** stocks out of 500 higher, one of the widest gaps between breadth and performance since the 1990s.
As many as **155** stocks moved by at least two standard deviations, as had not happened since the US-China truce of May 2025, but that was a relief rally.
Yesterday, **there was a liquidation in disguise**, with cereals and toothpastes moving like meme stocks.

Who was buying?
No one.
The desk at the same bank speaks of "zero signs of attack" on Artificial Intelligence, and not even of rotation into defensives, as last week.

Asset managers were net sellers by about **20**%, mainly in large-cap technology and ETFs, while hedge funds were net sellers by **10**%, with long sales in semiconductors and hardware equal to new shorts and short positions in ETFs twice as large as long sales.
This is the point.
No one bought the defensives with conviction; they rose because those who were short had to cover.
It is the hallmark of forced deleveraging.
One does not sell what one wants, one sells what one must, that is, longs are closed and shorts are covered together, to cut a gross exposure that risk managers and prime brokerage banks no longer tolerate.
On Wednesday, we spoke of "a continuing yo-yo effect".

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Yesterday, the thread snapped, with real panic, from forced selling.

Usually, there is a rebound.
This time?
History is on the side of the buyers.
The high-beta momentum basket, that is, the stocks that had run the most, which in June was up **70**%, has erased its year-to-date gain.
In the 13 cases since 2021 in which it lost at least **10**% in a month, the subsequent median was +**4.2**% at one month and +**16.4**% at three months, with a positive outcome in **77**% of cases.
The Artificial Intelligence basket is at −**23**% from its June highs, the same drawdown from which it rebounded in July.
We know the script: leverage is reset to zero and those who stayed liquid go back to buying Artificial Intelligence.

Could this time be different?
Yes, for three reasons.
This month's decline, −**13.65**%, is the deepest in the series.
The previous precedent, in July 2026, was not an entry point: −**15.4**% in the following month and −**25.8**% at six months.
This time, the trigger is **credit**: Meta's CDS at record levels, data center CDS at their highs, Jensen Huang saying that neoclouds do not have the working capital to grow.
The problem is not demand.
It is financing, and a reduction in leverage does not solve a financing problem; if anything, it worsens it, by draining liquidity.

Now let's look at the side that matters

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most.
While Artificial Intelligence was falling, the US ten-year yield went back below **5.0**% for the first time in a month, closing around **4.95**%, the strongest rally in over two years (on October 7 it was at **5.36**%, the highest since 2002), and it did so with oil (Brent) at **113** dollars a barrel and with the French government bond (OAT) above the Treasury for the first time since 2013.
A full-blown **flight to quality**.
Options confirm it.
Protecting against a further rise in Treasuries costs as much as it has not since March and, for the first time in seven months, calls on long-dated bonds cost more than puts.
A position of about **65,000** contracts, 7 million dollars of premium, is betting on a ten-year yield at **4.6**% within a month.

Meanwhile, those who had opened new shorts on Wednesday's futures have come under pressure, and CTAs, the systematic trend-following funds, once the **5.02**% threshold was broken, are now buyers: about **19** billion dollars of futures in the next week and **78** billion USD in the next month with the market unchanged.
Next threshold to watch: **4.85**%.

As summarized by the bank's desk, **what is creating the problem for equities is solving the one for rates**.
Every dollar of capital expenditure that Artificial Intelligence does not make is a dollar of bonds that does not have to be issued, since that paper competes with the Treasury for the same duration buyers.
The market has already removed almost an entire rate hike from next year.

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This is where the equation that really matters comes into play, ROI minus cost of debt.
With the ten-year yield at 5.36%, the cost of debt ate into the return on Artificial Intelligence investments and the numbers did not add up.
Below 5.0%, financing costs less.
The US government finances itself on cheaper terms, large technology companies can return to issuing bonds at more favorable rates, and the equation starts working again.

Here is the paradox: the reduction in leverage, which brought hedge funds to their knees, could be the temporary solution to the financing problem.
If getting there takes a few sessions of selling in technology, so be it.

However, with oil above **110** dollars a barrel, with the crisis in French public finances and with jobless claims at **194,000**, the Fed would still have arguments to raise rates.
If energy were to ignite inflation, the cost of debt would rise again.

This morning, Asia is weak (Nikkei −**1.3**% and Kospi −**1.7**%), while the US ten-year yield holds at **4.96**%.
Today, the flash PMIs; next week, the Fed meeting (October 27-28) and the big earnings reports from the Magnificent 7.
We are in for another nervous session.
Until the leverage reduction is over, Artificial Intelligence will struggle to find buyers, but the ground for the rebound is being prepared elsewhere, in Treasuries, because, in the end, **what matters is that**

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the numbers add up, and with a ten-year yield below **5.0**%, they add up a little better than yesterday.

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