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Daily Commentary

In Search of the Next Momentum Trade

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For much of the past three years, **the "momentum" factor and "Artificial Intelligence" have been two names for the same trade**.
All you had to do was buy what was rising, and what was rising was chips, memory and data centers.
For some weeks now this is no longer the case, the two names sit on opposite sides of the same trade.
The year's review, prepared by a leading investment bank, shows that, if the factors are ranked by return in the first half and then in the second, the arrows connecting them draw an almost perfect X. **Whoever was at the top in June is at the bottom in November.**
The basket of high-beta, momentum technology stocks (the distillate of the fastest ones) was up **125**% at the end of June.
Since then, it has lost **56**%.
Put together, the two figures give about −**1.0**% year to date.
The best trade of the first half, for those who held it, returned nothing.
The 3-month momentum (+**57**%, then −**40**%) is down about **6.0**% on the year, the 6-month one (+**30**%, then −**43**%) about **26**%, while **the quality factor**, **meaning owning companies that actually make earnings, which nobody wanted in the spring, is up about 11**%.
It is an old lesson of the markets that is worth reviewing every now and then.

Trends that seem unstoppable do not slow down, they change course, and they usually do so when everyone is on the same side of the boat.

Source: Bloomberg, Reuters, Yahoo Finance, Financial Times, ECB, CNBC, The White House
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Last Wednesday, something never seen before happened.
The 12-month momentum basket beat its 3- and 6-month siblings by the widest daily gap since the series began (in 2016), more than during Covid, the 2022 bear market or Liberation Day.
How is it possible for the same factor to fight with itself?
Momentum is a strategy that buys what has risen and sells what has fallen over a certain time window.
The 12-month version looks back far enough to still see Artificial Intelligence as a winner (in the first half, semiconductors had more than doubled).
The 3- and 6-month ones see only the rubble from July onward and have sold the losers and sold them short.
The result is paradoxical, **today the momentum factor is long and short AI at the same time**, depending on which calendar you consult.

The November rebalancing made it official.
In the 3 and 6 month baskets technology was sold for about a third of the notional of each leg and almost all of it ended up in consumer discretionary.
The 12-month basket, instead, bought some technology and remains the last momentum basket still "married" to AI, with heavier short positions in industrials and consumer discretionary, precisely the sector just loaded up by the other two.
It is no surprise that the correlation between 12- and 3-month momentum, which normally lives close to 1, has fallen below zero, something that has

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happened very few times in ten years.

At the sector level, the momentum factor is getting ready to buy consumer discretionary, communication services and health care, and to sell energy and above all technology.
At the industry level, the rotation leads **out of semiconductors, into software** for two reasons, a mechanical one and a substantive one.
The mechanical one, the 3- and 6-month windows remember only the second half, in which AI themes paid the price (memory −**39**%, after the +**250**% of the first half, data centers −**32**%, inference chips −**31**%), while AI software is one of only two themes positive in both halves of the year (+**14**% **and** +**13**%).
The substantive one is the change of narrative that has been discussed for weeks: doubts about the return on capex, data center credit creaking, a Fed getting ready to raise rates and, lastly, the crisis at the top of Nvidia.
The exposure of AI semiconductors to the momentum factor has fallen to **0.89** from the peak of **1.48**, while software, which for eighteen months had been a short position of momentum (low of −**1.16**), has just turned positive at +**0.18**.
Beware, though, of mistaking a mechanical flow for an investment thesis, because software is still about **37**% behind semiconductors year to date and health care has just been sold by hedge funds at the fastest pace in seven months.
Machines buy what has risen recently, but what has risen recently is not necessarily the new leader.

Source: Bloomberg, Reuters, Yahoo Finance, Financial Times, ECB, CNBC, The White House
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Here we come to the point that matters most of all, **positioning**.
The net exposure of hedge funds to the momentum factor has collapsed from about **60**% of capital at the 2026 peak to less than **10**%, the **23rd** percentile of the last five years.
Crowding on the data center basket is at the **1st** percentile of the last six months.
The trade that in June had everyone in portfolio, today, no one has any more.
Not only that.
During last week's rebound hedge funds added short positions on single stocks and brought the long to short ratio on technology to an **all-time low**, that is, they sold the rally and also sold short the beneficiaries of the rotation, with consumer staples being sold short at a pace of **5.6** to **1**, right after their best month since October 2000.

What happens when everyone is light?
That it takes little to hurt.
Last week the best baskets were precisely the big losers of the second half: memory +**10.1**%, inference chips +**9.7**%, independent power producers +**9.4**%, data centers +**8.8**%.
Micron closed the week at +**12.8**%, AMD at +**18.9**%, Broadcom at +**18.2**% and the SOX semiconductor index at +**8.05**%, even though Nvidia lost almost **13**%, after Huang's exit.
Those who had sold them short in the November rebalancing had a difficult few days.
Then, on Friday, the script flipped again, with AMD −**8.75**%, SOX −**3.4**%, Nvidia −**2.0**% below the 4,000 billion market

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capitalization.
It is the picture of a factor in search of direction.
The 60-day realized volatility of the basket is at **54**, still about **3.5 times** that of the S&P500 index.

Three points for reflection, without turning them into a recipe.
The first, **momentum flows are mechanical and predictable** (rebalancing dates and estimated direction are information the market knows) and what is predictable tends to be anticipated.
The second, the spread between 12-month momentum and 3- and 6-month momentum is today the best barometer for understanding whether the unwinding of the AI trade is over, and as long as it moves with such wide daily bars the answer is that no one knows.
The third, **the only factor that gained this year in both phases is the most boring one, the quality factor,** that is, owning companies that really generate earnings.

The same investment houses read the picture in opposite ways.
The baskets desk sees tactical room for short positions on the beneficiaries of the rotation, where fundamentals do not justify the rally (lower-quality software and consumer staples), while the strategists of the same house see value again in the large cloud operators, traded at **19.7** times earnings versus **21** times for consumer staples.
Two different readings of the same market, that is the best proof that **a new leadership is not there yet**.

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The catalyst is around the corner, **Nvidia's quarterly results**, the first of the post-Huang era.
This morning the mood remains nervous, with US futures, which had risen overnight, back slightly below par (Nasdaq 100 −**0.2**%, S&P500 −**0.1**%), while in Asia technology weighs (MSCI Asia −**1.3**%, Taiwan and Korea −**2.7**%, Nikkei lower after an unexpectedly contracting third-quarter GDP).
We expect a wait-and-see session.
Momentum has lost its compass and until it finds it again, rotations and reversals will remain the rule, not the exception.

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