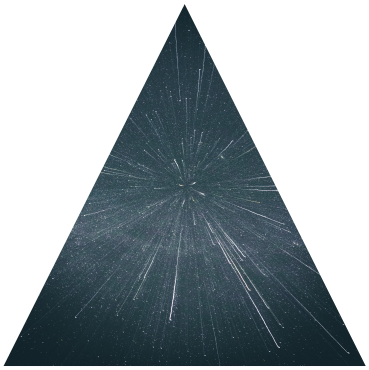
Quant insight



Factor Watch – Real Rates

- Equity investors typically have less visibility on shifts in macro factors. But even macro players may lose a degree of perspective. Qi looks at macro factors in z-score terms, capturing their moves relative to long term trend.

- The collapse in bond yields since March has been well documented. But, as the chart below shows, the move in 10y real rates is starting to look significant. **European real yields in particular are now 3 standard deviations below trend – a level only seen on a handful of occasions over the last 10 years plus.**

- The signal from the bond market would appear to be that inflation is indeed transitory & growth concerns are escalating. What are the implications?

- **Real rates do not look attractive from a long term valuation perspective**. They have seen significant inflows of late but TIPS & BUNDei's especially are not necessarily the best inflation hedges right here, right now.

- Real yield differentials are the key driver of EURUSD & the move above helps explain the downward pressure on the Euro over May-July. **Euro bears need to be on alert for any potential mean reversion.**

- Screening European equities for sensitivity to EUR real rates reveals it only a modest driver at both the index & sector level. At the margin, peripheral rather than core indices are the most sensitive; while Travel & Leisure plus Banks are the sectors that want real rates higher.

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