

Matt King
3 March 2026

From exuberance to unwind

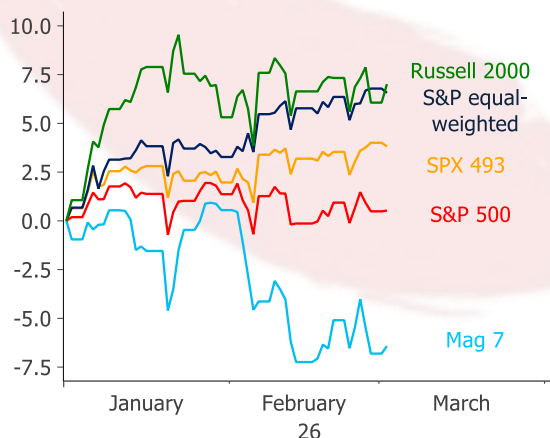
- **War in the Middle East is interacting with prior market vulnerabilities**
- **The problem lies neither with the growth outlook nor with the risk of an inflation spike**
- **It is that investors suddenly have multiple reasons to shift from what had already been violent risk rotation to outright risk reduction**

What makes markets interesting has always been their reflexivity. Just as the response to the [Citrini report](#) said more about the prior state of tech exuberance than it did about any new-found realization of the risks of AI job displacement, so the response to the attacks on Iran should be seen not just through the lens of risks to inflation and growth, but in terms of the interaction with prior vulnerabilities.

Even now, the market consensus is to advocate diversification and rotation. But as the stretched nature of many relationships helps demonstrate, the risk is growing that this turns into outright risk reduction.

Just a weighting issue?

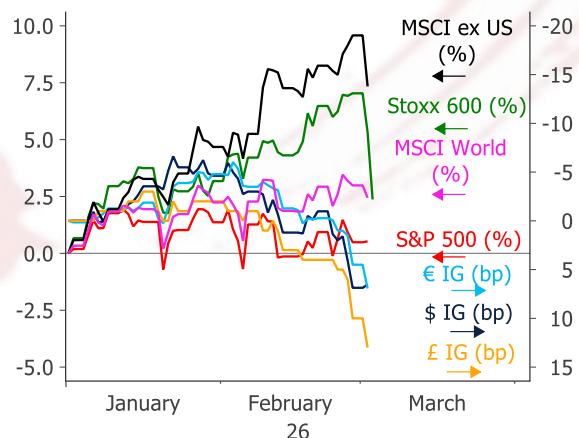
YTD performance in credit spreads and equities



Source: Bloomberg, Macrobond, Satori Insights.

Faltering

YTD performance in credit spreads (inverted) and equities

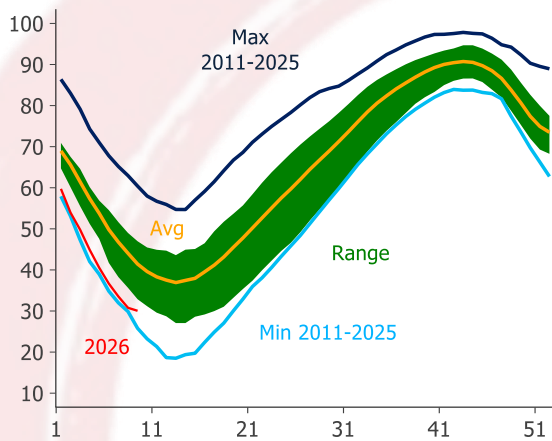


Source: Bloomberg, Macrobond, Satori Insights.

The most obvious problems may be the immediate fundamental ones, namely that many of the places people had been diversifying into prior to the Iran attacks suddenly now appear most vulnerable. European equities suddenly look vulnerable to energy price spikes, in particular given low levels of gas storage. Japan and Korea are likewise dependent on imports for almost all of their fossil fuels and around 85% of their primary energy needs – enough to make investors think twice before chasing eye-watering index highs.

EU running on empty again

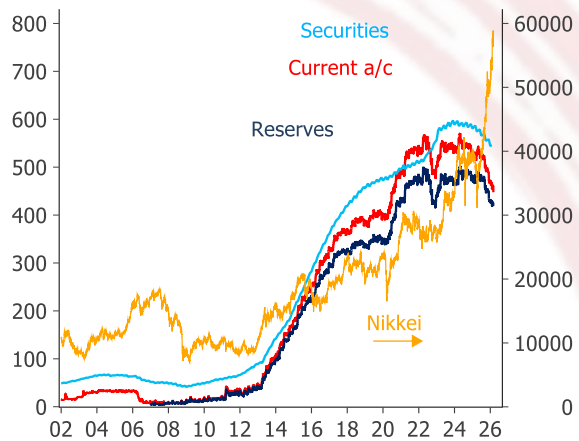
Europe nat gas stock levels by week, % full



Source: Gas Infrastructure Europe (GIE), Macrobond, Satori Insights.

Japan suddenly looks vulnerable

Nikkei vs BoJ balance sheet items, ¥tn

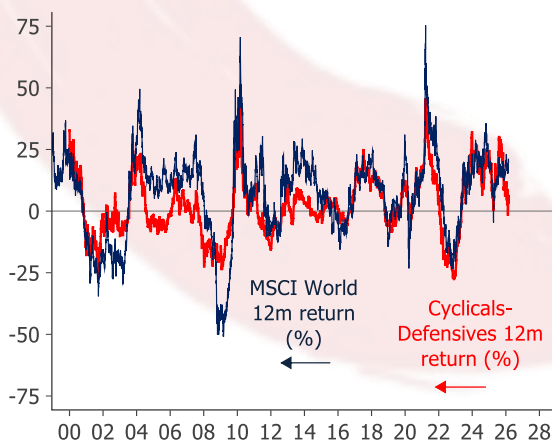


Source: BoJ, Nikkei, Macrobond, Satori Insights.

If fundamentals were the only consideration, you can see why the right response might have been just to rotate into, say, US small-caps (given strong earnings growth expectations and US energy independence), materials (given the squeeze from both AI capex and increased military spending) or defensives. But a moment’s glance at the strength of many of these sectors’ performance gives pause for thought.

Defensives outperform on way down

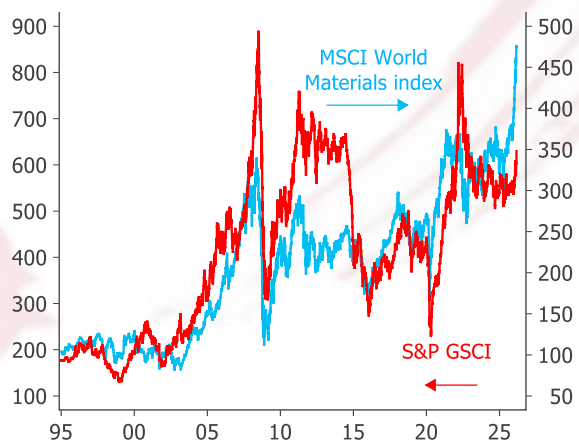
MSCI World sectors, rolling 12m return, %



Source: MSCI, Bloomberg, Satori Insights.

Financial assets > real assets

Commod-producing equities vs commods

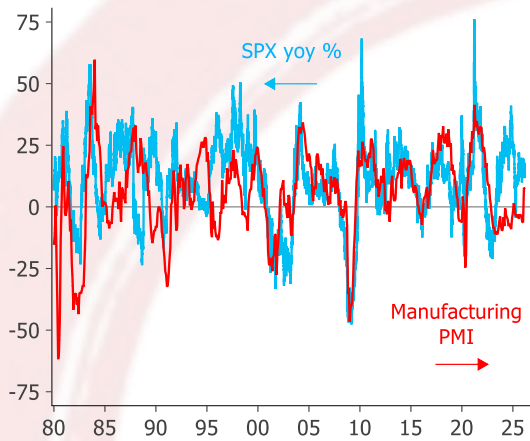


Source: MSCI, S&P Global, Satori Insights.

It is not just that credit is sharply underperforming vs equities, and that it is unusual for defensives to outperform cyclicals by this much without the broader indices themselves falling. It is that the extent of outright performance of many popular sectors – like Materials or Korean equities – smacks strongly of financial exuberance simply rotating from one overpriced asset to another. Its real justification was never fundamentals – it was always money flow.

The problem isn't with the economy

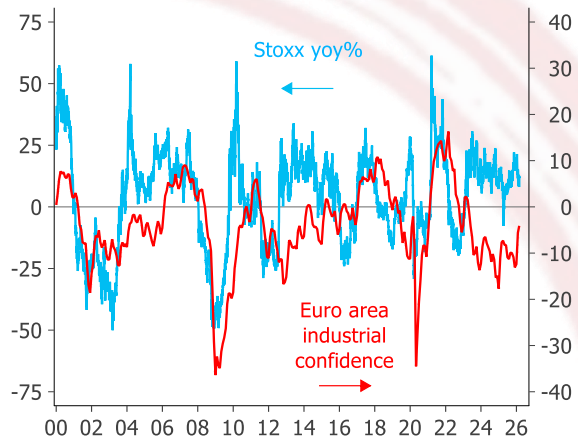
US ISM vs equities



Source: ISM, S&P Global, Macrobond, Satori Insights.

It's the extent of recent exuberance

DG ECFIN Euro area confidence vs equities



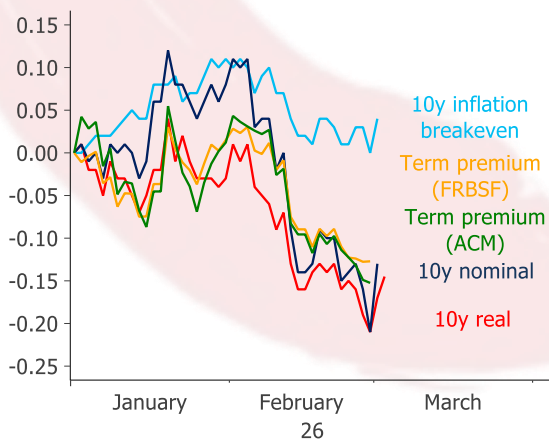
Source: ISM, S&P Global, Macrobond, Satori Insights.

Rates no longer to the rescue

To see why this is the case, consider the YTD price action in govies. Now that yields are backing up sharply, the standard explanation is to blame it on oil-induced inflation fears. But up until this week, the most notable feature of rates price action was a remarkable and global decline in both real yields and term premia.

Drama is all in real yields & premia

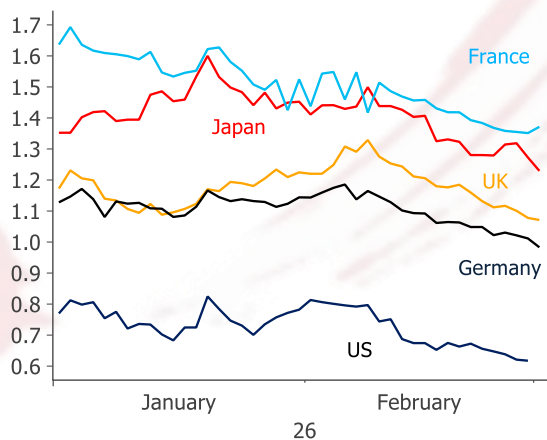
YTD chg in 10y UST yield components, %



Source: Macrobond, Satori Insights.

Decline in term premia was global

10y govt term premium metrics, %

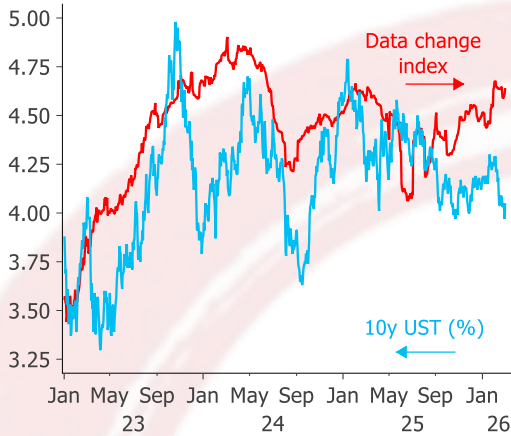


Source: New York Fed, Daiwa, AOFM, Bloomberg, Satori Insights.

We have yet to see a good fundamental explanation for this. It flies in the face of both strong economic data and surprises, and declining expectations for global rate cuts.

Strong data shrugged off

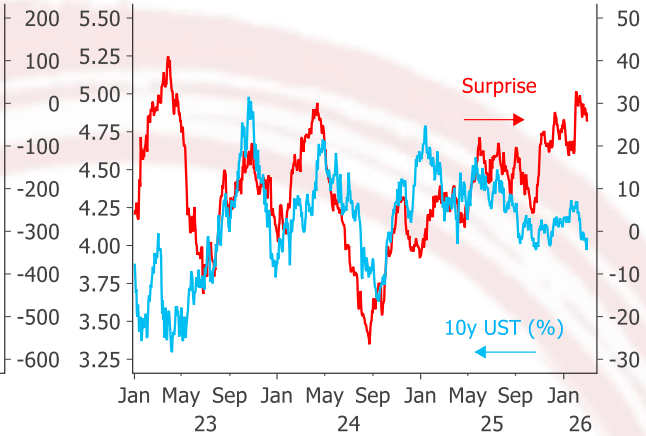
US economic data change index vs yields



Source: Citi, Bloomberg, Satori Insights.

Surprising positively again

Global surprise index vs US yields

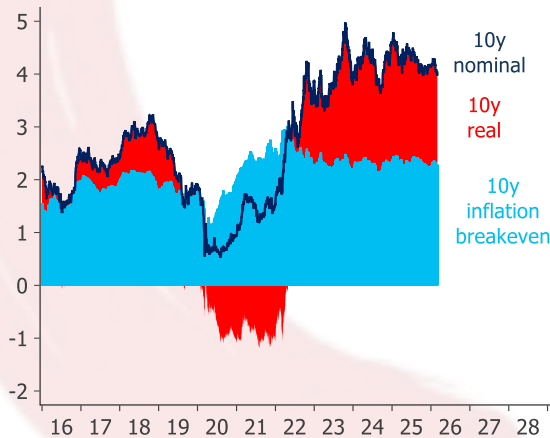


Source: Citi, Bloomberg, Satori Insights.

The most convincing story we have seen is that yields rallied in response to negative wealth effects from losses in tech equities and fears of AI deflation – but even this is undermined by the lack of a broad equity sell-off and by the failure of inflation breakevens to move much.

The rally is all in real yields

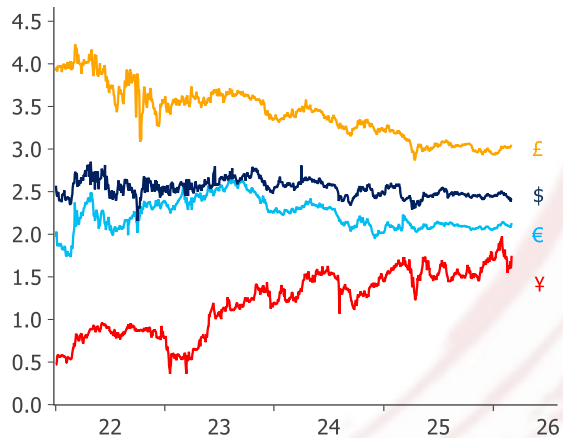
US Treasury yield decomposition, %



Source: Macrobond, Satori Insights.

No big move to price AI disinflation

5y5y inflation swaps or nearest proxy, %

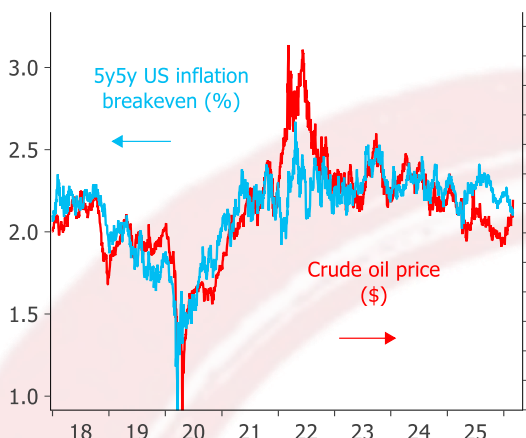


Source: Bloomberg, Satori Insights.

More plausible to us is that some of the excess liquidity which had been rotating out of US tech equities rotated into govies (and gold). This would help explain the drop in real yields, the divergence between inflation breakevens and commodities – and the attacks on Iran as a catalyst causing these investors suddenly to have second thoughts.

Oil higher, breakevens not

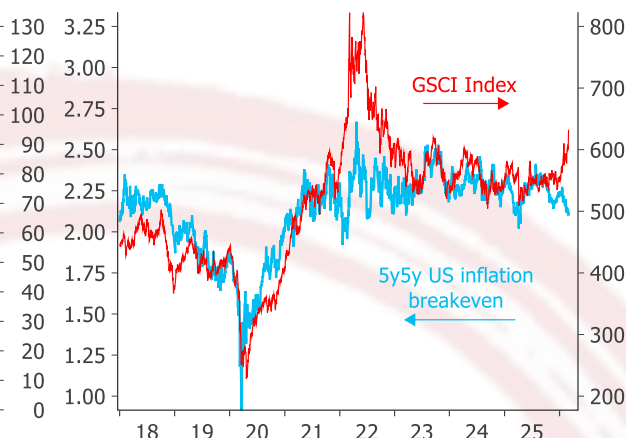
WTI vs inflation breakevens



Source: CME Group, Macrobond, Satori Insights.

Commodities higher, breakevens not

GS Commodities Index vs TIPS breakevens



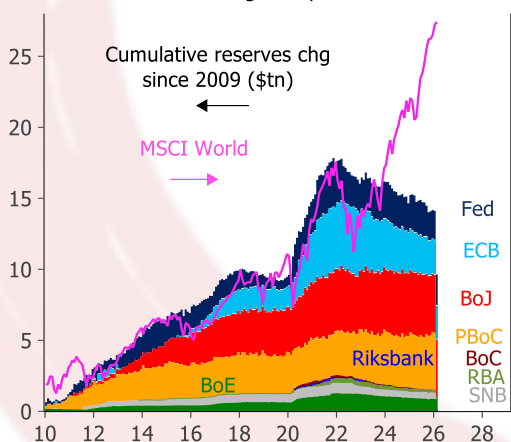
Source: Bloomberg, Macrobond, Satori Insights.

From risk rotation to risk reduction

This, then, is the lens through which we contemplate everything from the growing concern around software disruption sparking self-reinforcing outflows from private credit¹ through to the risks to the remarkable rally in gold.

Tide going out

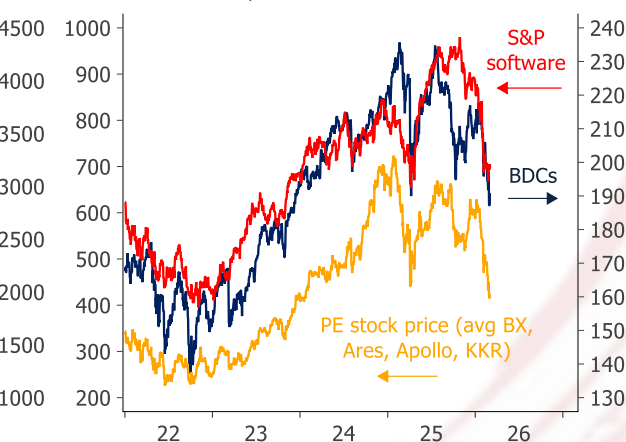
Central bank reserves chg vs equities



Source: national central banks, Macrobond, Satori Insights.

Who's swimming naked?

Total return indices, Jul14=100



Source: Morningstar, Bloomberg, Cliffwater, Macrobond, Satori Insights.

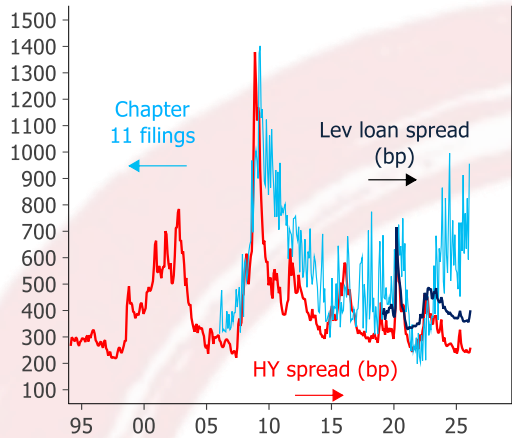
It is not just that the unprecedented pace of advancement (and associated investment in) AI risks exposing vulnerabilities in everything from corporate to sovereign solvency. It is that for years fundamental problems have been masked, and fair valuations across assets distorted, by an unprecedented wave of liquidity. Driven initially by central banks but for

¹ ["Blackstone flagship private credit fund hit with wave of redemptions"](#), FT, 2 Mar.

the past two years surviving almost solely on its own momentum, it created valuations which were always going to be vulnerable to seemingly unconnected catalysts.

Vulnerabilities suddenly manifest

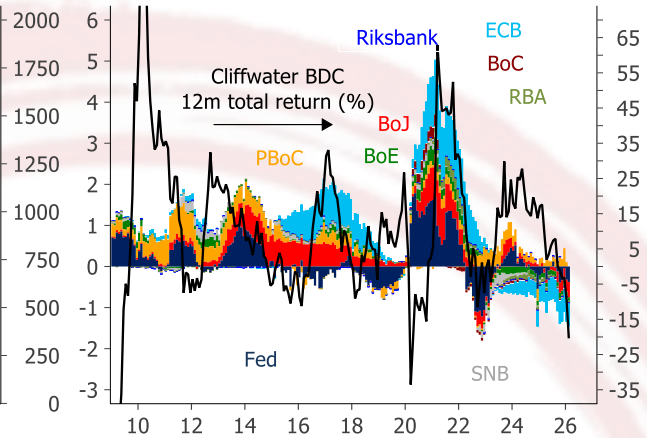
US bankruptcy filings vs spreads



Source: US Federal Courts, Bloomberg, Satori Insights.

As Fed and other CBs drain liquidity

Global CB reserves (\$tn) vs credit, rolling 12m chg

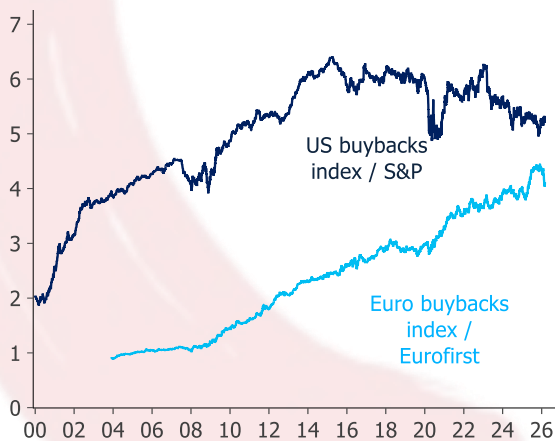


Source: national central banks, Bloomberg, Macrobond, Satori Insights.

Worse, it created a situation where a reversal of inflows was always likely to lead to an exposure of hitherto-suppressed fundamentals. It's been telling that share buybacks have been started to struggle to drive stock outperformance, first in the US and now in Europe, and that the surge in M&A has been dominated by private equity sellers desperate to exit.

Buybacks no longer a panacea

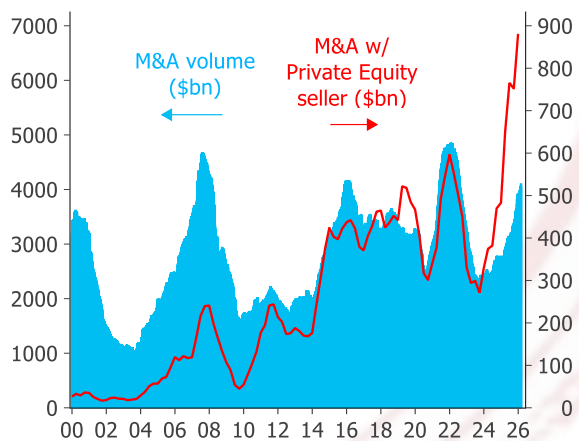
Names with buyback programs vs equity indices, ratios



Source: S&P Global, MSCI, Macrobond, Satori Insights.

PE especially keen to get out

Global M&A transactions (rolling 12m, \$bn) vs equities

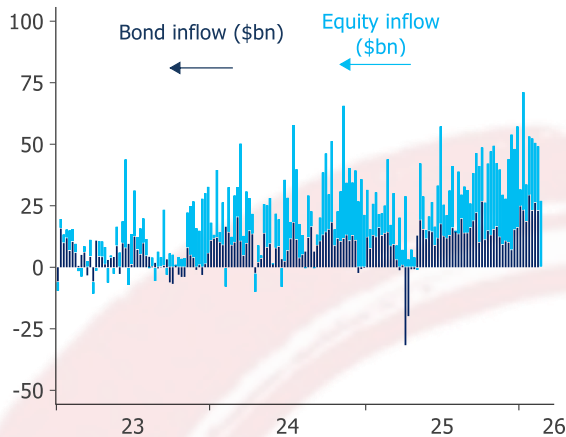


Source: Bloomberg, MSCI, Satori Insights.

As such, the critical questions for us at this point revolve not so much around fundamentals – which will inevitably lag – as technicals.

Fund inflows still remarkably sticky

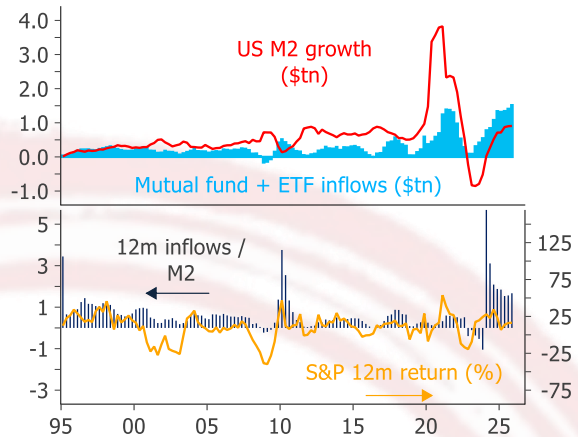
Mutual fund+ETF flow, rolling 1w



Source: national central banks, ICI, Satori Insights.

Fund flows still outsized vs history

Mutual fund+ETF inflows, rolling 12m, \$tn

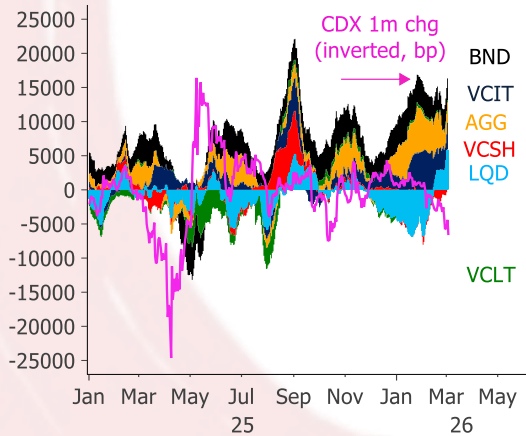


Source: ICI, Satori Insights.

First, the most important technical remains fund flows, which as late as last week showed net buying across almost all asset classes. On the one hand the desire to “buy the dip” remains deeply ingrained; on the other the size of fund inflows in general and equity allocations in particular remains outsized vs history. It also seems notable that credit spreads have begun widening even as inflows have been merely waning.

IG widening despite inflows

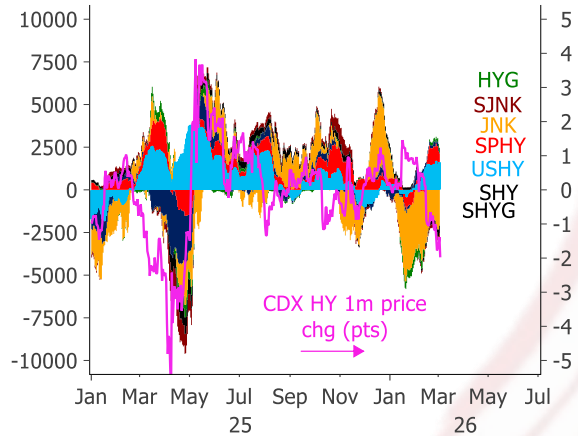
Largest credit ETF inflows, rolling 1m, \$m



Source: Bloomberg, Satori Insights.

HY inflows waning

Largest HY ETF inflows, rolling 1m, \$m

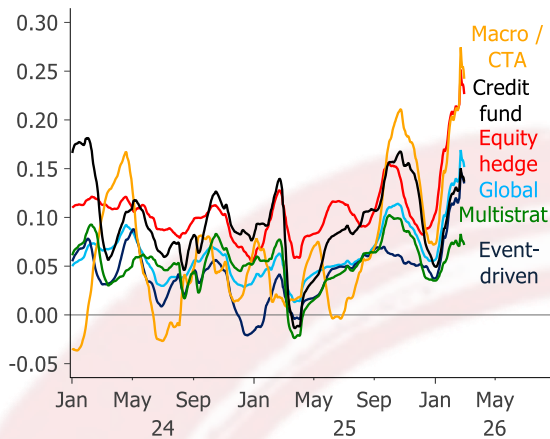


Source: Bloomberg, Satori Insights.

Second, in principle there is potential for moves across assets to be exacerbated by unwinds from hedge funds. The build-up of positions and increase in volatility inevitably create scope for liquidity events, and betas to the S&P are running at five-year highs.

Creeping longer again

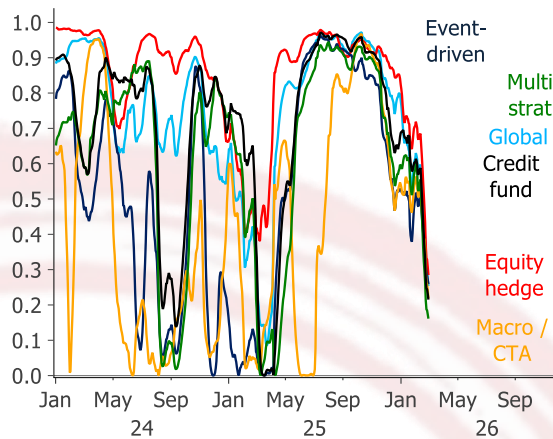
Hedge fund daily return beta to S&P 500, rolling 3m



Source: HFR, S&P Global, Macrobond, Satori Insights.

Albeit with much lower correlations

Hedge fund R-square to S&P 500, rolling 3m

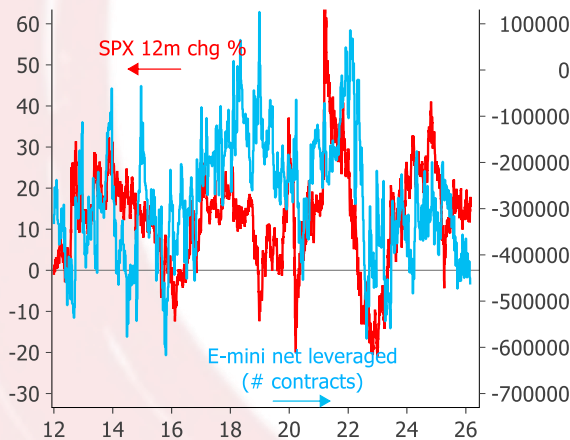


Source: HFR, S&P Global, Macrobond, Satori Insights.

However, we would not belabour this point given the significant drop in correlations. The investors running large beta longs at present are not hedge funds so much as private credit, private equity, unlevered asset managers and end investors generally.

SPX long not HF-driven

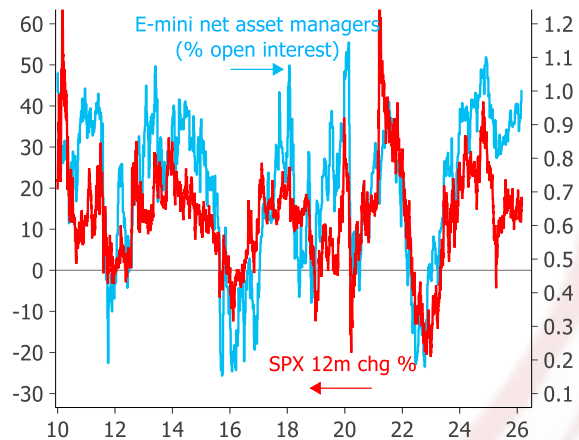
Equity futures & options positions vs prices



Source: CME, Macrobond, Satori Insights.

But asset managers still very exposed

CFTC net futures & options positioning vs equities

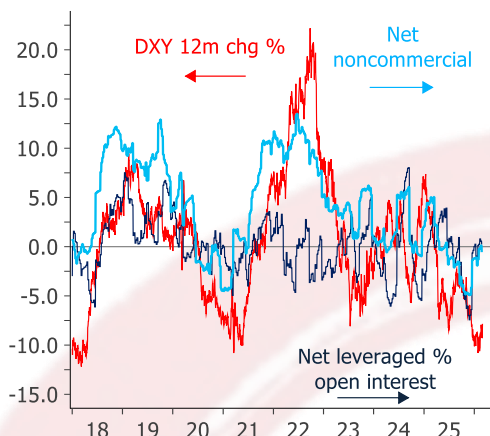


Source: CFTC, S&P Global, Satori Insights.

Even in explaining the viciousness of the \$ rally and sell-off in other currencies, we suspect real money reversals of YTD “diversification” trades in equities are as important as leveraged fund flows. CFTC data show US\$ shorts were cut already some months ago, and longs in other currencies – with the notable exception of A\$, and perhaps MXP - do not look particularly vulnerable.

US\$ shorts have already been cut

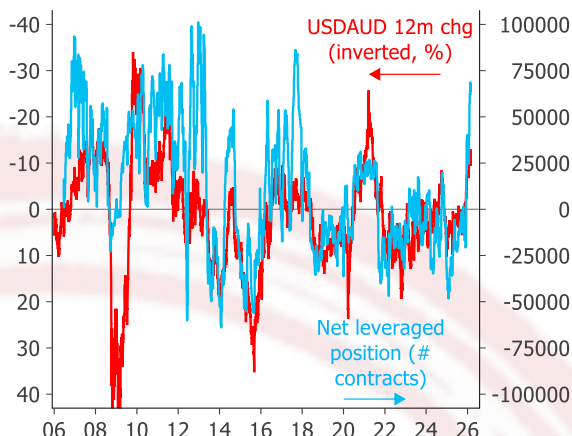
USD futures & options positions vs FX



Source: CFTC, Macrobond, Satori Insights.

Some non-US\$ longs remain

Net leveraged AUD position vs FX

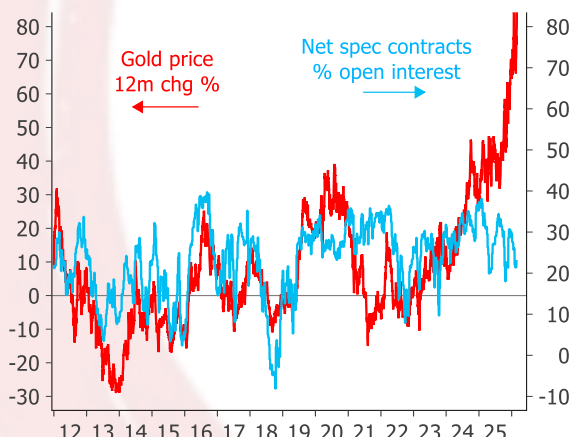


Source: CFTC, Macrobond, Satori Insights.

The same applies to gold. Even with the market taking another outsized wobble today, it's not hedge fund positions you need to worry about, but ETF inflows. We see no special sign of these either looking excessive or becoming vulnerable.

Not hedge funds driving gold

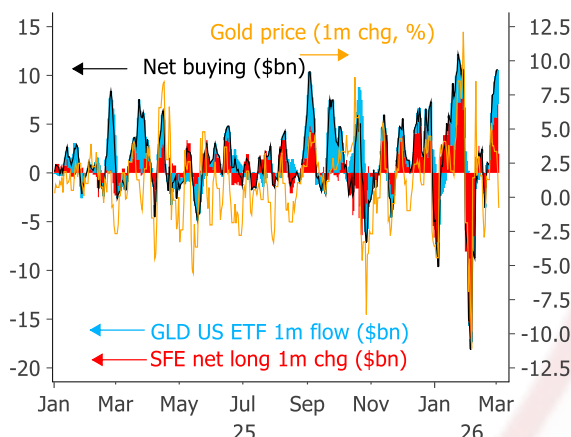
Futures & options positions vs prices



Source: CMX, Macrobond, Satori Insights.

Prior selling from Shanghai - little now

GLD ETF vs Shanghai futures gold rolling 1m flow, \$bn

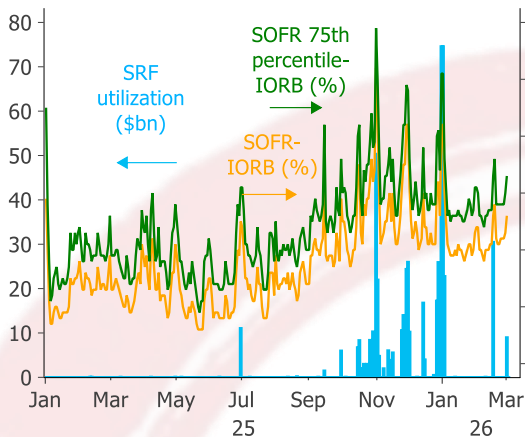


Source: SFE, LBMA, Satori Insights.

To sum up, the outsized price action so far this week across asset classes should not be seen solely in terms of the economic implications of a potentially protracted Middle Eastern war. Yes, the potential for a short-term inflation spike does curtail the immediate ability of central banks to respond with rate cuts, at a time when \$ liquidity conditions are already showing signs of modest tightness and when there is a risk of repo positions being cut.

Funding spreads haven't fully subsided

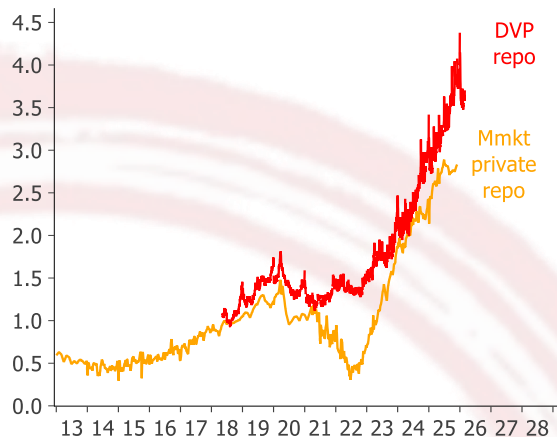
\$ repo rates vs Standing Repo Facility usage



Source: Federal Reserve, Bloomberg, Satori Insights.

Signs of short-term unwind?

Hedge fund borrowing by type vs MMF repo activity, \$tn

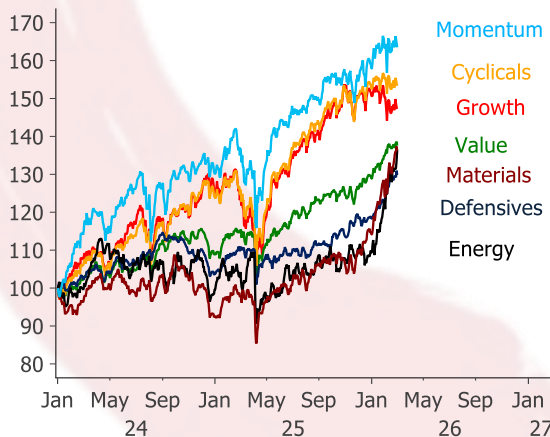


Source: The Office of Financial Research (OFR), Fed, S&P Global, Macrobond, Satori Insights.

But the unwinds investors really need to worry about are not those from hedge funds, but rather of the momentum- and risk-chasing by end investors which have characterized the last decade in general and last two years in particular. In this context Iran should be seen not so much as a cause as a catalyst, interacting with everything from the potential for outflows in private credit to the reaction to next week's DeepSeek model update.² For all the fuss about the failure of traditional havens³, the first and most obvious haven is not a rotation into some other risk asset but a reduction into cash.

First rotation, then correction?

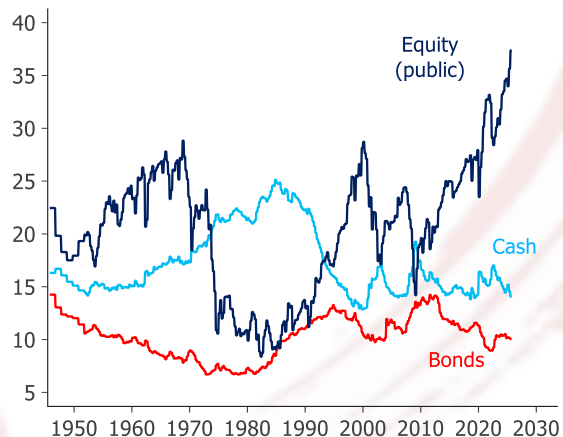
MSCI World equity factors, Jan24=100



Source: MSCI, Bloomberg, Satori Insights.

Boomers, you should rebalance!

US household asset holdings, % financial assets



Source: Federal Reserve, Macrobond, Satori Insights.

² ["DeepSeek to release long-awaited AI model in new challenge to US rivals"](#), FT, 28 Feb.
³ ["What's a safe asset now?"](#), FT, 3 Mar.