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10-Year Treasury Yields Will Rise Into 2021, Citi Says. This 'Aggressive' Equity Strategy Can Outperform.

By Callum Keown Updated Nov. 16, 2020 1:52 pm ET / Original Nov. 16, 2020 11:25 am ET

The U.S. and U.K. national flags on the Mall ahead of the visit by U.S. President Barack Obama on May 23, 2011, in London, England.
Getty Images

Investors should adopt an "aggressive" strategy rotating from U.S. stocks to their U.K. counterparts, Citi strategists said, as they expected U.S. Treasury yields to rise heading into 2021.

Citi bond strategists said they expected U.S. 10-year Treasury yields to rise to 1.25%, from 0.9% on Monday, as markets "look through bad fundamentals towards recovery in 2021."

They expected the move to drive further rotation from Growth to Value sectors, recommending an aggressive equity strategy that should outperform: overweight on U.K. stocks and underweight on U.S. equities.

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However, they said it wasn't the moment to call a "giant multiyear shift" back to Value strategies.

"We expect the bond selloff to stop when yields reach 1.25%, so removing a key driver of current rotation. We have neutralized our exposure to Growth in our core equity strategy but not shifted wholesale back towards Value."

The "Value-heavy" FTSE 100, with strong exposure to energy and financial stocks, has climbed 9% since drugmaker Pfizer's positive vaccine update last Monday, while the S&P 500 has risen 3.2% over the same period.

Bond yields also climbed last week as news that Pfizer and partner BioNTech's experimental Covid-19 vaccine was 90% effective, according to interim Phase 3 findings, boosted hopes of a sharp economic recovery in 2021.

With bond yields set to continue to climb, at least for now, Citi said U.K stocks would outperform, while in emerging markets Russia and Brazil should lead the way. They expected the U.K. to outperform the U.S. by another 15% if nominal yields to rise to 1.25%. They also favored cyclical sectors over defensive sectors.

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Citi analysts said Pfizer's news led to the biggest daily price move from U.S. Growth into Value since 1999, adding that U.S. equities underperformed.

The investment bank's strategists ranked the major global markets based on their exposure to the classic Value/rising bond yield sectors. They said the U.K. ranked the highest, while the U.S. was the lowest. "The U.S./U.K. is a classic Growth/Value trade, so it is hardly surprising that the vaccine [Pfizer news] triggered a big daily price switch between the S&P and FTSE 100. "

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