Markets Update: January's Record Flows

JAKE SIEWERT: Welcome to our Exchanges at Goldman Sachs Markets Update for Friday January 29th. We're taping this on Thursday, January 28th. And each week we check in leaders across the firm to get a quick take on what they're watching in markets. I'm Jake Siewert, Global Head of Corporate Communications here at the firm. And today we're joined again by Scott Rubner of our Global Markets Division to talk about inflows we've seen into the global equity markets this January. Scott last joined us back in November and made a rather prescient call on the presence and importance of retail investors in the market.

Scott, welcome back to the program.

SCOTT RUBNER: Thanks for having me, Jake.

JAKE SIEWERT: Scott, I mentioned that on our last podcast just a couple months ago you talked about the fact that retail investors were a real structural force in the market. And you said it's here to stay. Well, January certainly has seen a lot of proof of that theorem. What exactly has been happening?

SCOTT RUBNER: Retail trading activity has been the largest story in the marketplace this year. Period. So, let's get a few stats straight. According to the Federal Reserve Board, households own 36 percent of the 57 trillion US equity market. While hedge funds just own 3 percent. Retail owns 12 times more market cap than hedge funds do. And now the most active owner of the equity market has become the most active trader. And we have not seen that since 1999.

And we have a basket of GS retail trading favorites. It's something I follow everyday. This is the stock positions which show up most often on Twitter, the trading apps, and the message boards. This basket is up 14 percent year to date. It's up 90 percent last year. And 170 percent up the March lows. Activity has been through the roof. Daily average revenue trades, or DARTs, which is the common metric to use retail trading activity, hit a record of 15 million trades per day in 2021. Retail single stock trades represent 25 percent of the overall market volume compared to just 10 percent in 2019. And small options, that's 50 contacts or less, now make up 10 percent of the total options market.

As you mentioned, there's been a high correlation between our

retail trading favorites and our most short basket. The most short basket has outperformed the S&P 500 by over 50 percent in the last ten weeks. And that's the largest move since we started tracking the data in 2008. Bottom line, retail activity remains robust.

JAKE SIEWERT: So, stocks have been pretty interesting during January. Inflows into global equities have been setting records. Characterize what you've seen in the equity markets during the first few weeks of the year.

SCOTT RUBNER: January has been incredibly eventful in markets. The idea of roaring '20s has gained steam as investors look past the pandemic for a strong second half recovery to global growth. There is a new regime shift in the markets as new investors return back into the equity market at levels not seen since 1999. How active have the markets been? Let's take a look at yesterday for example. Here in the US, 23.6 billion shares traded across all US exchanges yesterday for $880 billion worth of notional exposure. This is the largest cash volume day ever. This is 15 percent higher than the prior record of 20 billion shares set in October 2008. And for options, also the same. 57 million option contracts traded in the US yesterday. This was the largest option volume day in history.

And specifically let's look at the calls. A record 37 million calls traded in the US yesterday. And Jake, get this, seven out of the ten largest call option days in history happened so far in January. That's data going back to 1992 with 7,000 observations. And the VIX spiked 62 percent higher yesterday, the third largest one day increase in history. And that's with the VIX going back to 1990.

Our GS most rolling short basket outperformed the hedge fund VIP long by 13 percent yesterday. It was the largest one day move since 2012. And the spread between these two baskets is now 55 percent on the year.

So, where are we? Global equity market cap is now 108 trillion, which is an increase of 5 trillion so far in 2021. And the S&P 500 closed Monday at an all time high. And there has been a competition for dip alpha. That's who can buy the dip the fastest. Let's think about where we are big picture. Since 2008, 95 percent of inflows have gone into global bonds while just 5 percent have gone into global equities. And more recently, since March 2020, global bonds have registered 42 out of the past 44 weeks of inflows. And there's a stockpile of money markets worth

$1 trillion. And that is getting unwound brick by brick. Inflows into stocks in January has been the core theme.

JAKE SIEWERT: That's a lot of activity. What's been driving the inflows and the optimism? And how much is the virus, and potential new strains or variants, still a little bit of an overhang on the market?

SCOTT RUBNER: Investors are euphoric and looking forward to the second half of the year. Let's take a step back for a second. GS financial conditions index is the most accommodative since we started tracking the data in 1989. And the Fed's balance sheet last week rose to a new high of 7.4 trillion, which is an increase of 4.1 trillion from a year ago. And the US M2 money supply expanded by 369 billion last week, the most since March. And the year over year growth is now 26 percent. But there has been little indication for now that individuals are interested in boosting savings any further from here.

So, looking at the three month change in Google searches, there has been little interest in further move back into money market flows. Where we are in the equity market is prime for a rotation.

JAKE SIEWERT: When you were on in November, you talked about the January effect. What have we seen in terms of the January effect inflows that you mentioned back then?

SCOTT RUBNER: That's right, Jake. The January effect inflows was the biggest source of demand in the equity market so far in 2021. The core theme of flows have been saying flows over pros. And I've written a lot about this this year. But the simple premise here in the environment in 2021 is that flows matter more than fundamentals.

Let me give you a few stats. Global equities have logged 255 billion worth of inflows in the past three months. This is the largest three-month period worth of inflows on record. And in January, global equities logged 60 billion worth of inflows in just the three weeks, which includes a few holidays. So, this is above what we forecasted. And the move into stocks is real.

January is the largest month of the year, as I mentioned last time. Where 37 percent of the yearly allocations take place in January as a result of rebalancing 401(k) portfolios. So, we're definitely seeing this in the market. The most important dynamic has been tracking where the new capital is flowing. And there is

a clear rotation going on with investor preferences. Let me name a few. It's value over growth. Small cap over large cap. EM over DM. Non dollar over the SNP. Cyclicals over defensive. And maybe the most unusual shift of them all, active over passive.

JAKE SIEWERT: Expand a little bit on the active shift. We, for years, have just seen all the new money, not all the new money, but the vast majority of new money going into passive product. What's driving this change of investor sentiment?

SCOTT RUBNER: You're right, Jake. This is a welcome shift in investor preferences back into the markets. And there is a clear preference of active stock selection. So, let's take a step back for a second. There has been a $1 trillion shift out of active into passive over the past year. And a $2.3 trillion shift over the past five years out of active. And get this, Jake, over the past decade there has been $3.2 trillion worth of inflows into passive. And $3.1 trillion worth of outflows from active. 50 percent of global equity assets under management is now passive. And that's up from just 28 percent in 2010.

So, for every one dollar out of active and into passive over the decade, you might be saying what's the catch? So, this passive shift has large index implications. It's typically a long momentum strategy, which benefits the largest cap with the largest weights and the highest stock prices. Think FANG. Here's a quick example. For every one dollar worth of inflows into the S&P 500 tracker fund, 23 cents goes into the top five tech meg caps. And for every one dollar worth of inflows into the NASDAQ 100, 45 cents go into the top five. This has helped put a decade long trade that has been difficult to match the index returns each year. And when I look at small caps, for example, the weighting of US small caps in the US market is at a 42-year low.

But 2021 is different. We've started to see this dynamic change back with a desire for active stock selection. I'll give you one example. ARC Investments, which manages active ETFs, have seen the second largest inflows year to date after Vanguard, with $5 billion worth of inflows year to date and $26 billion worth of inflows since March. So, active ETFs have been a major source of investor preferences for high beta, high flying, single stock selection, rather than the S&P 500 tracking funds. What happens if the newly minted retail investor forces flows out of passive into active with a heavy pivot to value? This is something I've been tracking.

JAKE SIEWERT: So, Scott, it's been a busy, busy, active

January. What are you hearing from clients in terms of sentiment and positioning going into February?

SCOTT RUBNER: Clients have become a bit worried of a market correction in February. And we have started to speak to investors about hedging alternatives. And it's really focused on three key elements. Investors have been looking to heading a consultation in February and the core thesis is what happens if FOMO and YOLO turns into "oh no"? And it's really about the rate of change on liquidity.

February is historically a tricky month for markets. Most investors worry about May. But February reads a weaker monthly seasonal than May going back to 1928 with an average return of actually down 11 basis points. And the January effect is done and dusted as we close out the month. So, February, sees inflows slow down by 40 percent when compared to January.

The core element here is margin debt has increased substantially in the markets. According to FINRA, margin debt increased by 18 percent in November and December to a record 778 billion. So, from March of last year, margin debt has increased by 62 percent. And that's an increase of 300 billion in nine months. And there have been only four other times such euphoria has happened, which was August of '97, July of '83, March of 2000, and June of 2007. So, these have been pretty important days in history.

So, bottom line, while Q1 is still optimistic for most investors, we think a large element of the move has been made and it made sense to add some hedges here.

JAKE SIEWERT: All right, Scott. Well, it's a fascinating time to be watching that market. Thanks for joining us today and sharing your insights.

SCOTT RUBNER: Thanks for having me, Jake.

JAKE SIEWERT: All right, that concludes this episode of Exchanges at Goldman Sachs. Thanks for listening. And if you enjoyed the show, we hope you subscribe on Apple Podcast and leave a rating or a comment.

And in case you missed it, check out our other episode this week with Pierre Hudry, head of the firm's Paris office on the economic environment in France for both small businesses and big corporations.

This podcast was recorded on Thursday, January 28th, in the year 2021. Thanks for listening.

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