



- 1) A subject matter dealt with last Sunday and with which this writer will include in pieces going forward is that the average intra-year drawdown during the midterm elections is 18%. Therefore, expect a nasty equity correction at some point this year. The drawdown tends to be most pronounced in the 3rd quarter which makes sense. The largest drawdowns historically were in 2002 and 1974. No matter how popular a president, the Administration at the time almost always loses seats. Even Ronald Reagan, after winning 49 states in his 1984 election triumph, lost 5 House seats in the 1986 midterms. President Trump lost 40 seats in the 2018 midterms. Despite the huge drawdown in equities in 2002, one should be aware that Bush actually gained 5 seats that year.
- 2) Regular readers of these Sunday pieces know that my most important indicator for equities for reasons stated on numerous occasions remains HYG. This Index has kept me bullish from the lows of Liberation Day Week and has been relatively strong in the New Year. The Index closed Friday meaningfully above both the upward sloping 50 and 200 day moving averages. Given the noticeable uptick in yields in the Japanese bonds as well as the 10 year US bond (more on this subject later in the piece), it would be intuitive to expect an increase in yields in the junk market as well. Nevertheless, one cannot argue with the performance; thus HYG acts as a balm for equity investors nerves.
- 3) Continuing with the theme of the impact of the fixed income market on equities, Paul Shea (Miller Tabak Economist) continues to espouse views that are non-consensus but which have been uncannily accurate. In his piece this week (your inbox late Thursday US/early Friday UK-EU), he notes that the current jump in Treasury yields is "more concerning" than prior spikes which was caused by "misguided concerns over inflation." This current surge is due to higher Japanese yields and "fears" over weaker foreign demand for Treasuries which will take longer to dissipate. However, he strongly disagrees with the Deutsch Bank warnings that Europe could respond with a coordinated dumping of its \$2.3Tr in Treasury holdings, as much of this held by "private households and institutions." Yet Trump's "destabilizing actions" demands "higher term premiums." As a result, the consequences are twofold. First, he imagines overall foreign holdings

of Treasuries declining by \$1Tr (out of \$9.4Tr in total foreign holdings) over the next 2 years. Secondly, and more importantly, he has raised his target on the 10 year yield by Christmas, 2026 to 375 basis points from 350 bps. While this still appears to be the lowest forecast on the Street, that is a considerable change.

- 4) As displayed by the action in the VIX, equity investors are now becoming more immune to sudden policy shifts by the Administration, given their reversal as soon as there is a swoon in stock prices. Note that when the new round of tariffs was initially announced this week, the VIX climbed to only slightly above 20. Contrast that with moves in the VIX to 60.13 on April 7th, 2025 (Liberation Week), 28.99 on October 10th, and 28.27 on November 20th. The VIX closed this week at a relatively complacent 15.66.
- 5) Long suffering small cap investors have been delighted about the noticeable outperformance of the Russell relative to the other indices y/t/d. While the bulls will dismiss the distinct reversal on Friday as merely profit-taking in what has become somewhat of a crowded trade, the bears are salivating over this reversal as indicative of a fundamental view change about the regional banks which are a high single digit component of the Index. If this 10% cap on credit card interest rates were to actually succeed, the impact on the regionals will likely be indirect and much smaller than on the big card issuers, but it will depend heavily on how the cap is designed and to whom it applies.
- 6) The performance of the SMH, which many investors including this writer believe to be the most important etf in the equity market, was virtually flat on the week but did register a new all-time high. (The meaningful drop in Intel, which is about 5% of the Index obviously had its impact.) From a fundamental standpoint, the results of the implementation from the Big Beautiful Bill of accelerated depreciation cannot be minimized and the companies that compose the majority of this index are the major beneficiaries. The price performance of the SMH remains fodder for the bulls.
- 7) This writer has been noting since early December that the Transpos, after lagging badly for most of 2025, began displaying positive relative performance across all of the industry sectors that are components of the Index which has continued y/t/d. The Index was flat this week which appears to have resulted by the uptick in energy prices, but one can surely make the argument that the Transpos are a beneficiary of higher capex as well as a US economy that has been stronger than most observers have been predicting.
- 8) Performance of several markets outside the US remain impressive, particularly the Nikkei. Takaichi's (aka Mrs. Thatcher) decision to call for snap elections (February 8th) after just 3 months reflects a gamble on her strong public approval rating. While debt markets in Japan were stunned by her declaring a

plan for a two-year suspension of the 8% consumption tax on food, that proposal is extremely popular with the public as well as her \$135.4BB stimulus package and cash handouts for parents. As for the European markets, particularly the DAX, the upward move was abruptly halted by the change in the US\$ this week vs. the Euro. The DAX was unable to register a price above where it had closed the previous week. A move above high in the Euro vs the US\$ in 2025 of 119.19 registered on September 17th would portend poorly for both the DAX and EU investors in the US equity markets.

- 9) Physical gold/digital gold: The breathtaking performance of the GLD continued this week with the obvious reasons being the concerns over Greenland and Iran, with a more subtle reason being diversification by central banks given the action by the US Administration away from US\$ and into gold. Please also remember that the rebalancing of the Bloomberg Commodity Index which was completed a week ago Thursday is a positive for gold. As for digital gold, the positive momentum was abruptly stopped late this week when the Senate cancelled a vote on a major cryptocurrency bill due to the intense lobbying by the CEO of Coinbase. As for this week, the turmoil in the Japanese bond market was a major factor in crypto's poor performance. The yield on the 10 year Japanese bond rose 21 bps in a 6 day period reaching a 27 year high of 2.33% before modestly retracking to 2.3% as officials from the BOJ tried to calm the markets. The impact on crypto is the mounting fear a continuing reversal of the carry trade in which investors reverse the short yen/long crypto positions.

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Have a productive week.

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