Stargazer Asset Management

What to focus on in Global Macro for the week of April 20th, 2020

Macro Themes on the Radar:

Europe

Next week's European Council meeting is likely to be very important for how Europe moves forward. Italy and Spain, with the support of France, continue to push for some sort of mutualization of debt, while the northern Europeans resist. Germany & friends have pushed the already existing ESM as the preferable solution, but the stigma of the facility and the fact that financing would only be available as a loan with plenty of strings attached makes it unpalatable. Italy is having a strong internal debate about whether it should utilize the ESM facility, while Spain has rejected it outright.

Last Thursday, via the Greek daily Kathimerini, the French finance minister Bruno Le Maire outlined a possible compromise currently being discussed. He hinted at a debt issuance structure that could supply the needed funds but not in a fully mutualized form.

"On the Recovery Fund – a proposal he himself presented to the world two weeks ago – and how it will be funded, the French finance chief repeats that his country would prefer a joint issue with guarantees by all EU member-states to underpin it, where each country is in principle liable for the whole of the debt that will be issued by the new instrument. However, responding to a question about the European Stability Mechanism model, where each member is liable only for its share as represented in the total capital of the organization, he says that "we are open to other options, but now is time to decide. And if we want to be able to decide, we need to be able to compromise. Everyone will have to take a step in the direction of other member-states. This is what we have done to reach this first decisive consensus on the global package among the 27 finance ministers." …

The money raised by the Recovery Fund, through a special purpose vehicle or through the European Commission, according to Le Maire, will be given to EU member-states in the form of "grants, not loans," based on the effect of the pandemic on their economy. The precise methodology, he says, should be set up by the Commission; it won't be for the members *themselves to decide. Investments "will be between three and five years," while debt servicing shares will be based on the gross domestic product of each country and will take place over 10-20 years. Noting that a coordinated recovery "will cost a lost," he gives a ballpark figure for the size of the Recovery Fund of 1 trillion euros."*

Not one to miss an opportunity, the Bundesbank's Weidmann last week warned euro-area governments that they'll need to tighten their budgets once the coronavirus emergency has passed.

The Council meeting is on Thursday but expect lots of headlines ahead of it as the various blocks jockey for position.

The list of "firsts" keeps growing…

Investors like to have mile posts and precedents to guide them as they try to understand what might come next.

This crisis however is like no other crisis we have ever seen. Because of its "flip of a switch" nature it has unfolded incredibly quickly and with gut-wrenching results.

Over a 2-month period we have seen:

- the full bloom of a global pandemic
- a 30% drop in US equities off the all-time highs, followed by a meaningful rally
- a 65% drop in Oil and the gutting of commodities in general
- the economy contract more than during the GFC
- the Fed and US government unleash an unprecedented flood of stimulus, spending, loans and market intervention

Now what? Will we get a V, U or L bottom in the economy/markets? Is the presumed relationship between the two even as strong as it was?

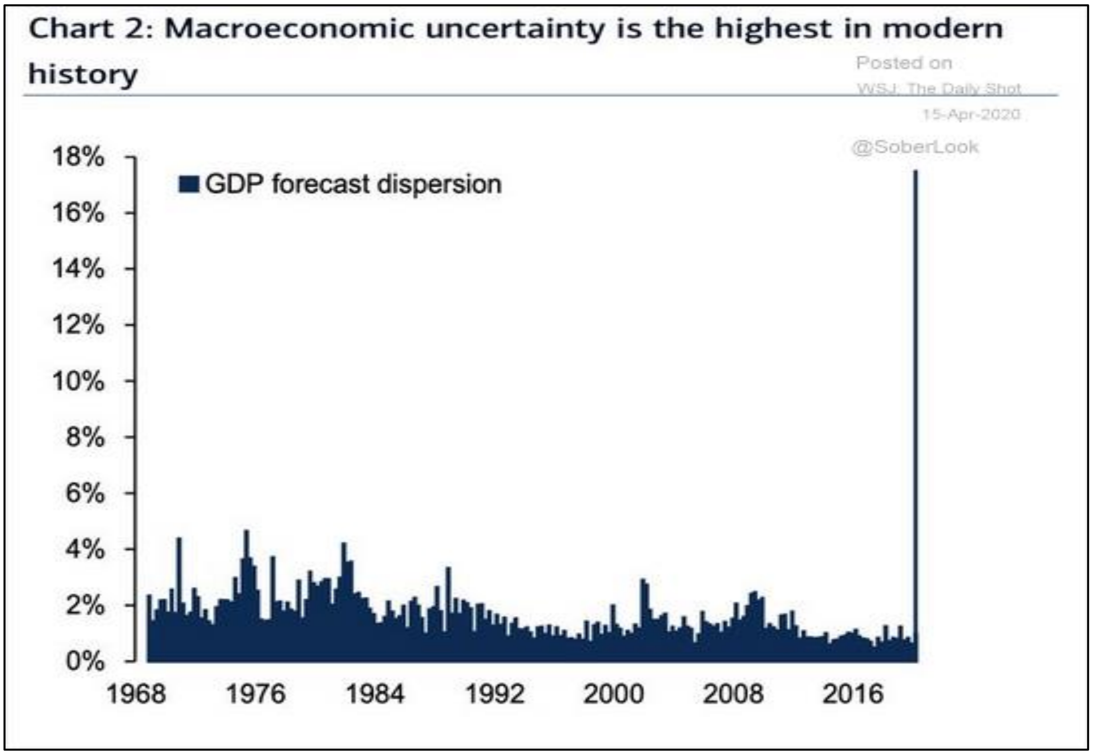


Chart 2: Macroeconomic uncertainty is the highest in modern history

Humans like to find patterns, trends and correlations that they can extrapolate and that help them figure out the highest probable future outcome. That's very hard now with so few signposts for either fundamental or technical analysis to point to. The "spikes" we have seen in everything has left people scratching their heads and wondering what to look at now.

Here is the US Federal budget deficit as a "spike" example…

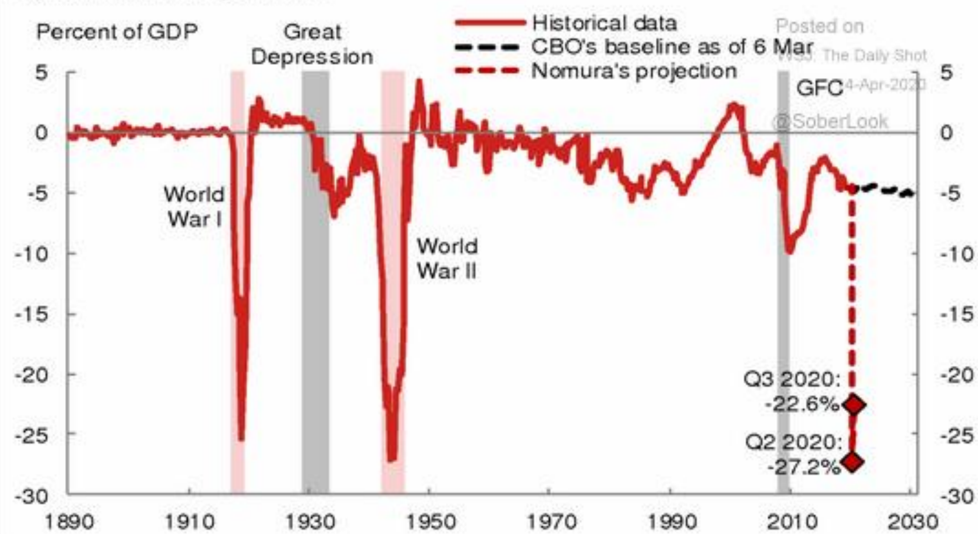


Fig. 3: Federal budget deficit

Source: Valerie A. Ramey & Sarah Zubairy, 2018; US Government Printing Office, CBO, US Treasury, Federal Reserve, Nomura

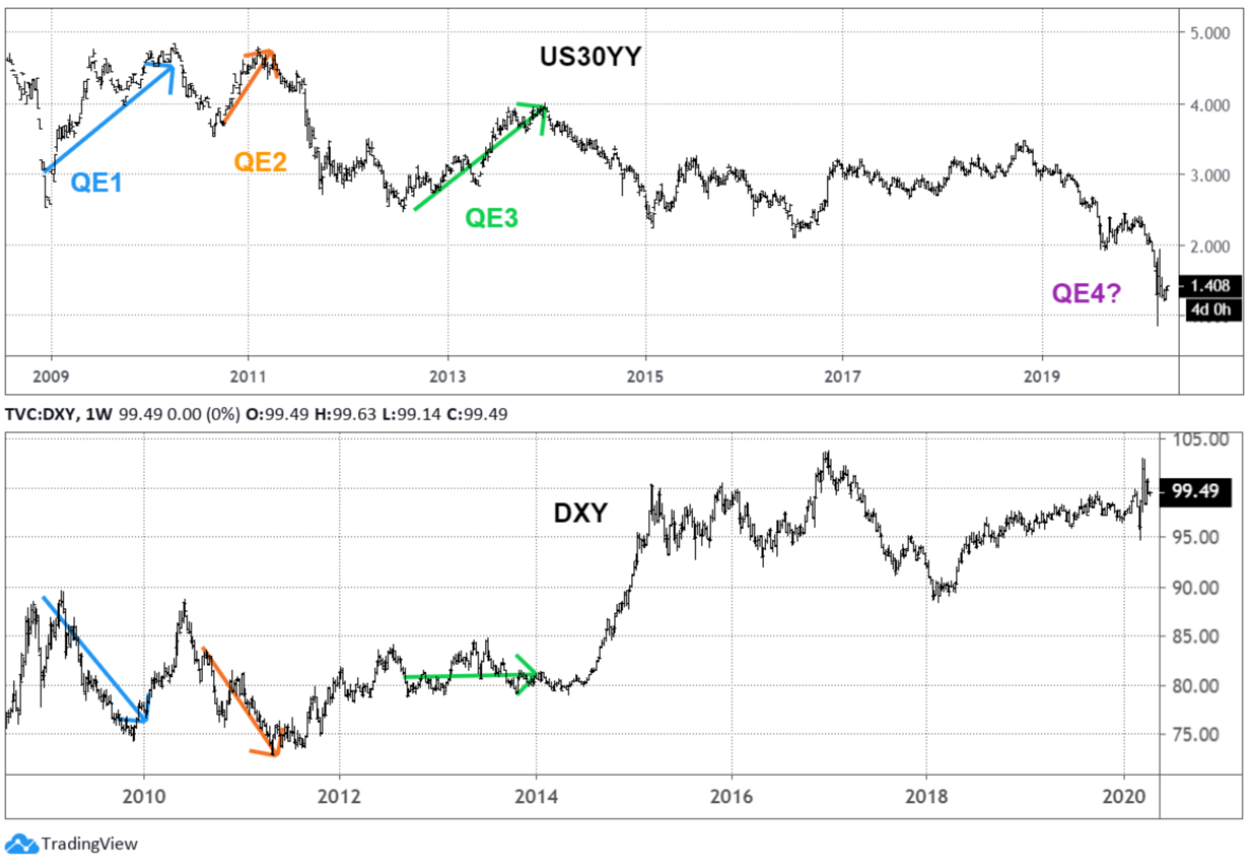
Or Yardeni's Boom Bust Indicator which is CRB/Initial Unemployment Claims….

* Weekly average of CRB raw industrials spot price index divided by initial unemployment claims, showing four-week average.
Note: Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: Commodity Research Bureau and Bureau of Labor Statistics.

Given all the dramatic moves, I want to zoom out a bit on Macro to see if we can bring things into better focus by looking at the bigger picture and the most liquid markets.

When contemplating the last three rounds of QE there are a few things to think about.

In the past, QE has been seen as reflationary by the markets and prices have reacted accordingly. Despite the Fed's claims that QE lowers bond yields, at least initially, it has always raised them. Stocks have clearly gone up with QE and people have pointed to the correlation between the Fed's balance sheet and equities, although the direct mechanics of that are challenging, so perhaps it is mostly signaling as well. The USD's price action has largely fit the "reflation" story as it has tended to weaken during bouts of QE. Although during QE3 the effect on the USD was milder.

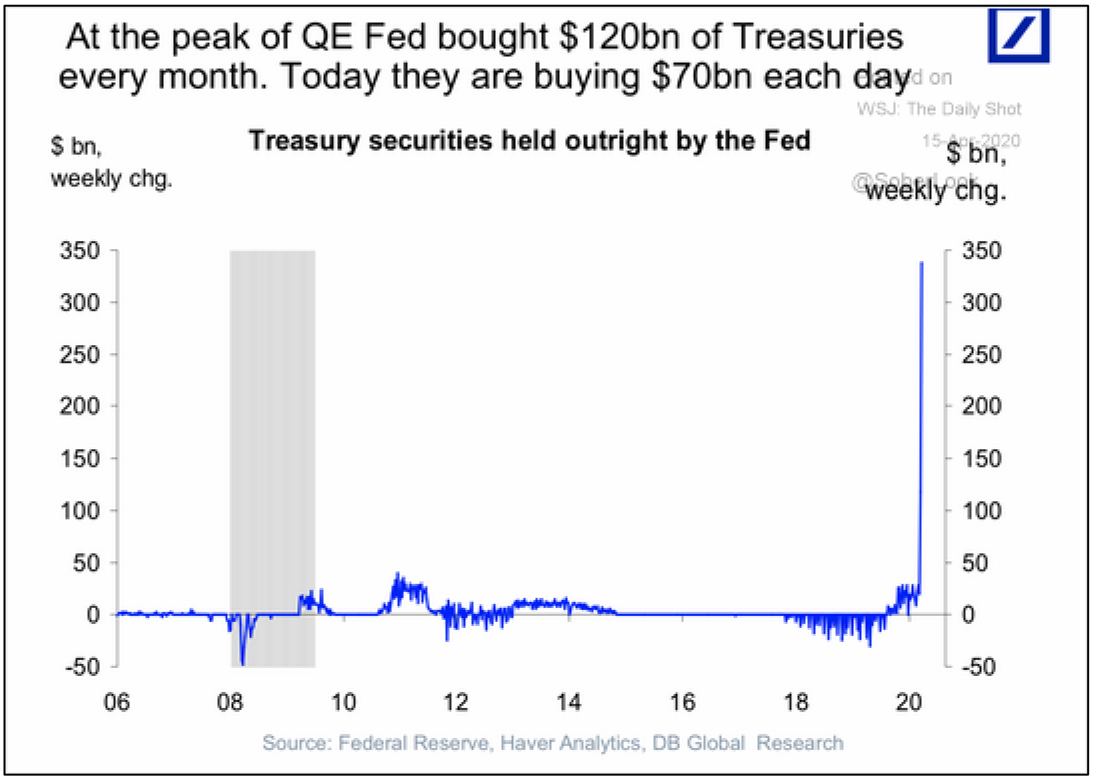


If QE is to have the same effect on markets again (and this ignores the size and scope of the other recent programs) we should see the USD weaken, Bond yields rise.

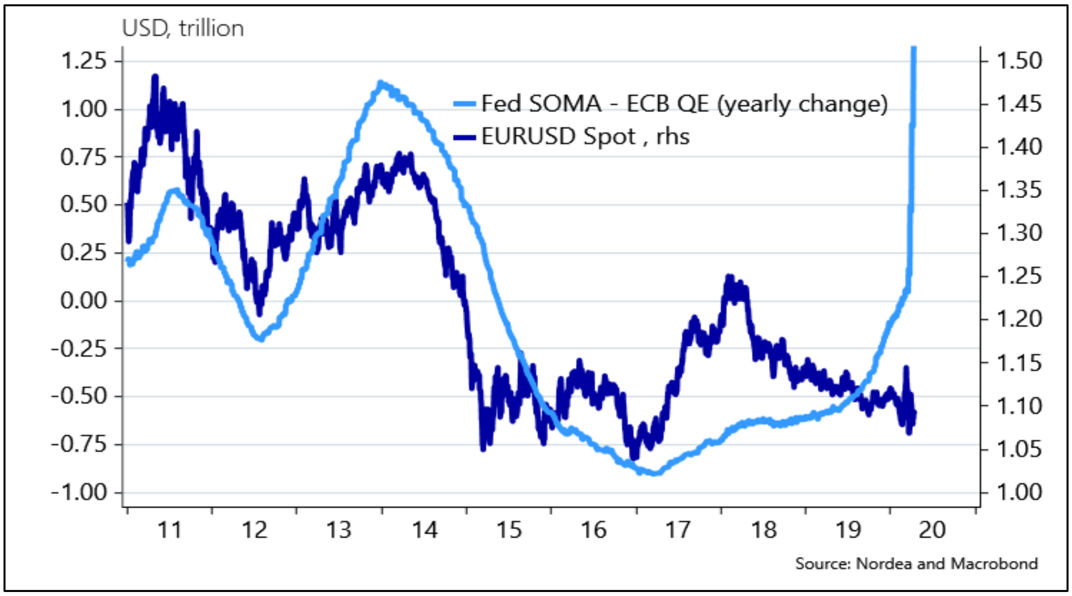
There are three potential outcomes here to watch for:

1) The usual happens and reflation is priced. Yields rise, the USD falls and stocks rally.
2) Bond yields start to rise but the Fed decides that Yield Curve Control is needed to arrest the rise. Some would argue this is already happening in practice because of

the large amounts of QE being done. So much, that any Treasury selling by the market this time is being fully absorbed by the Fed. In this case, if the bond market is not allowed to act as a pressure release value for pricing higher expected inflation, the USD should take the strain.



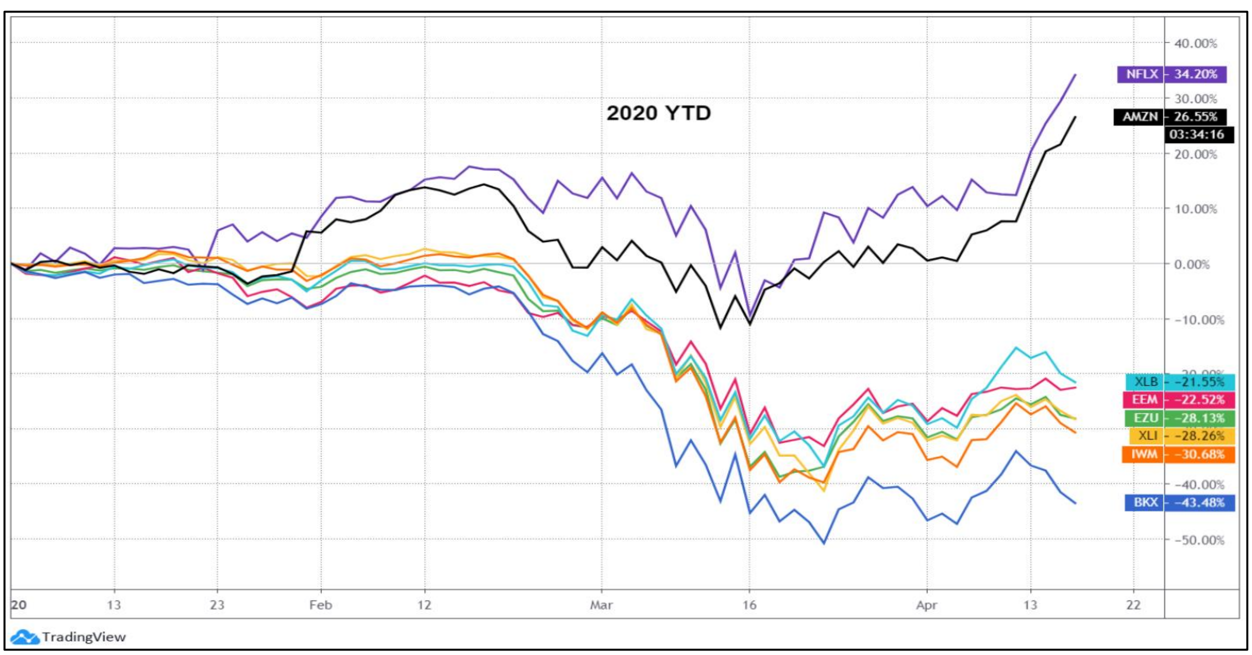
3) Bond yields don't rise, and the USD doesn't weaken. This could spell trouble as it would indicate that inflation expectations are not rising. The alternative reason would be that it reflects US inflows, and that could be very toxic for the world ex-US, especially EM. The USD should fall given historical precedent, but will it?

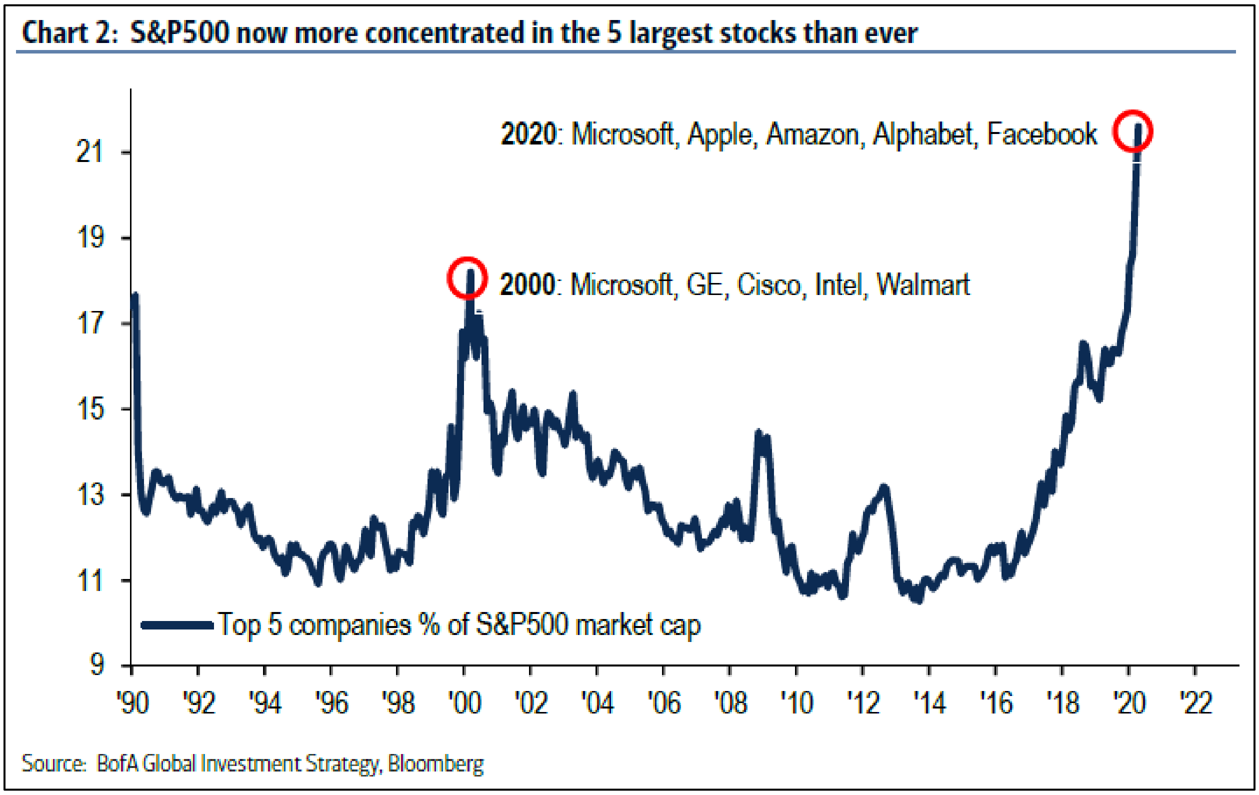


In a market where the price signals are being increasingly broken by government intervention, bonds, FX and global equity indices still offer the potential of price discovery. They are well worth watching as a result.

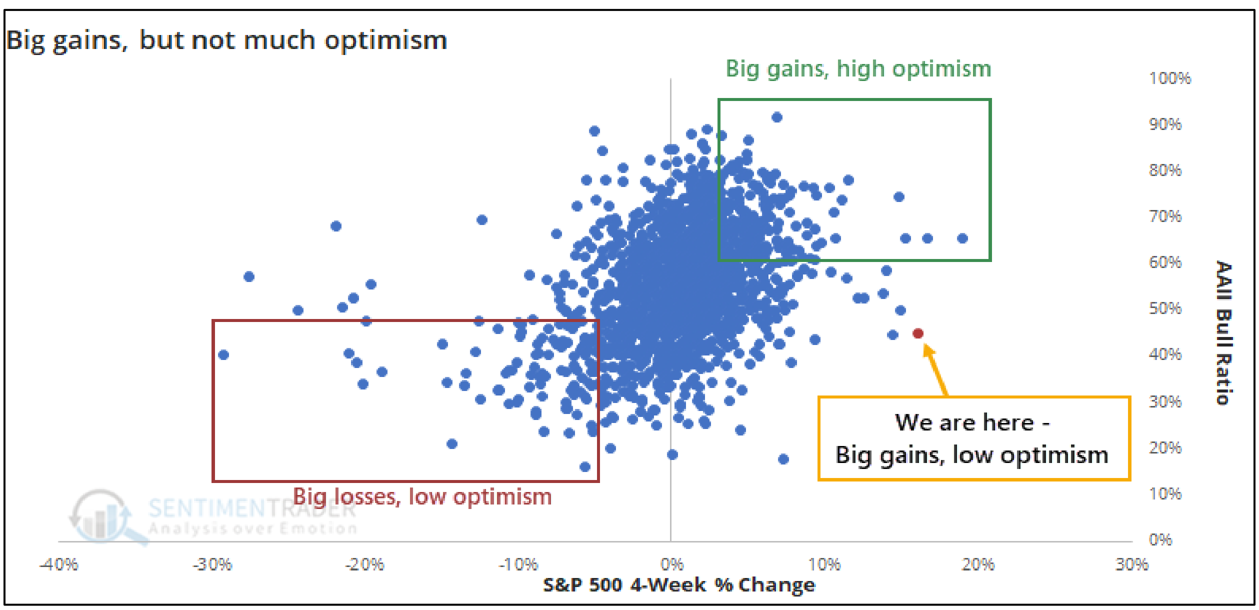
<u>What to Focus on Now:</u>

Equity markets have seen massive dispersion as the FAANGM stocks have held up brilliantly while most everything else has remained soft.





Indices have been dragged higher by technology and healthcare, but confidence remains low.



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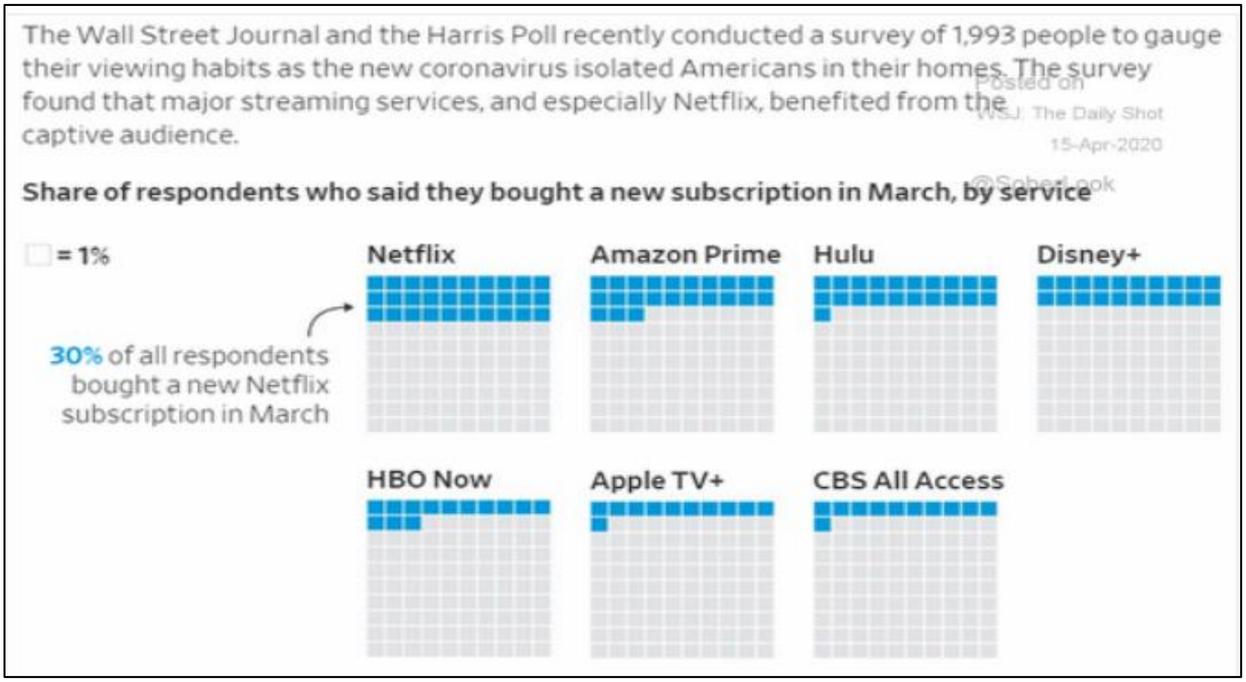
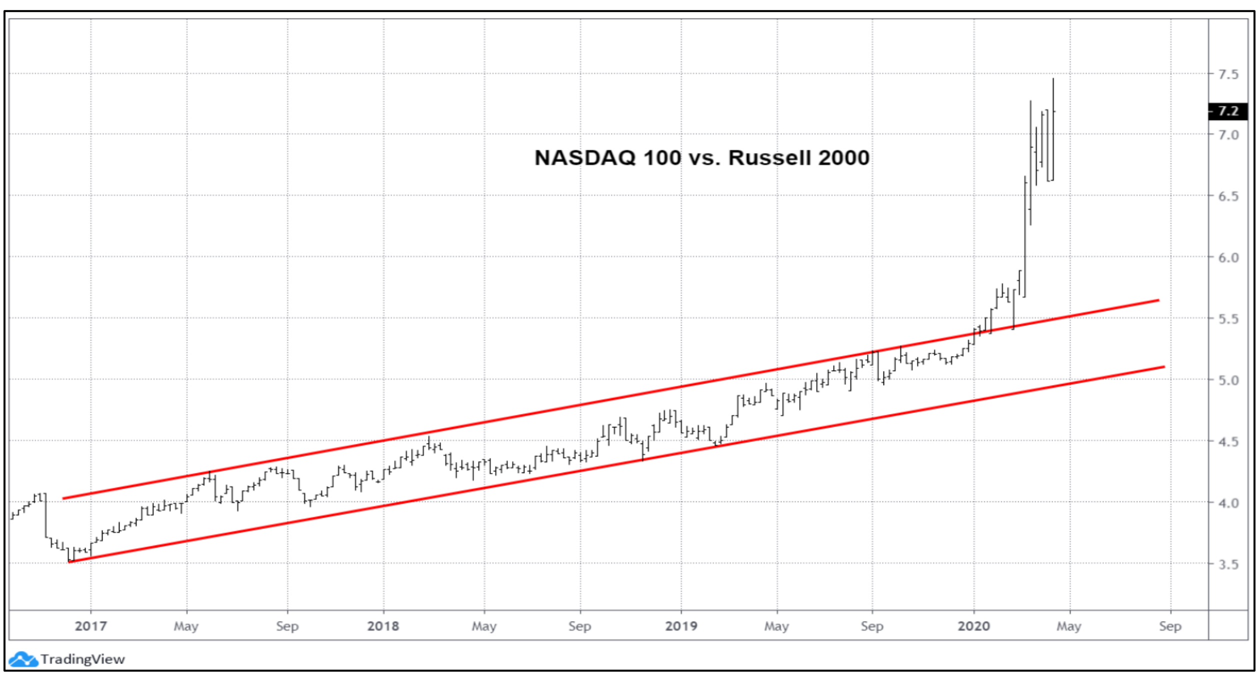
As homebound consumers desperately search for entertainment and fill shopping needs from the laptop, demand for the services provided by the tech companies has exploded.

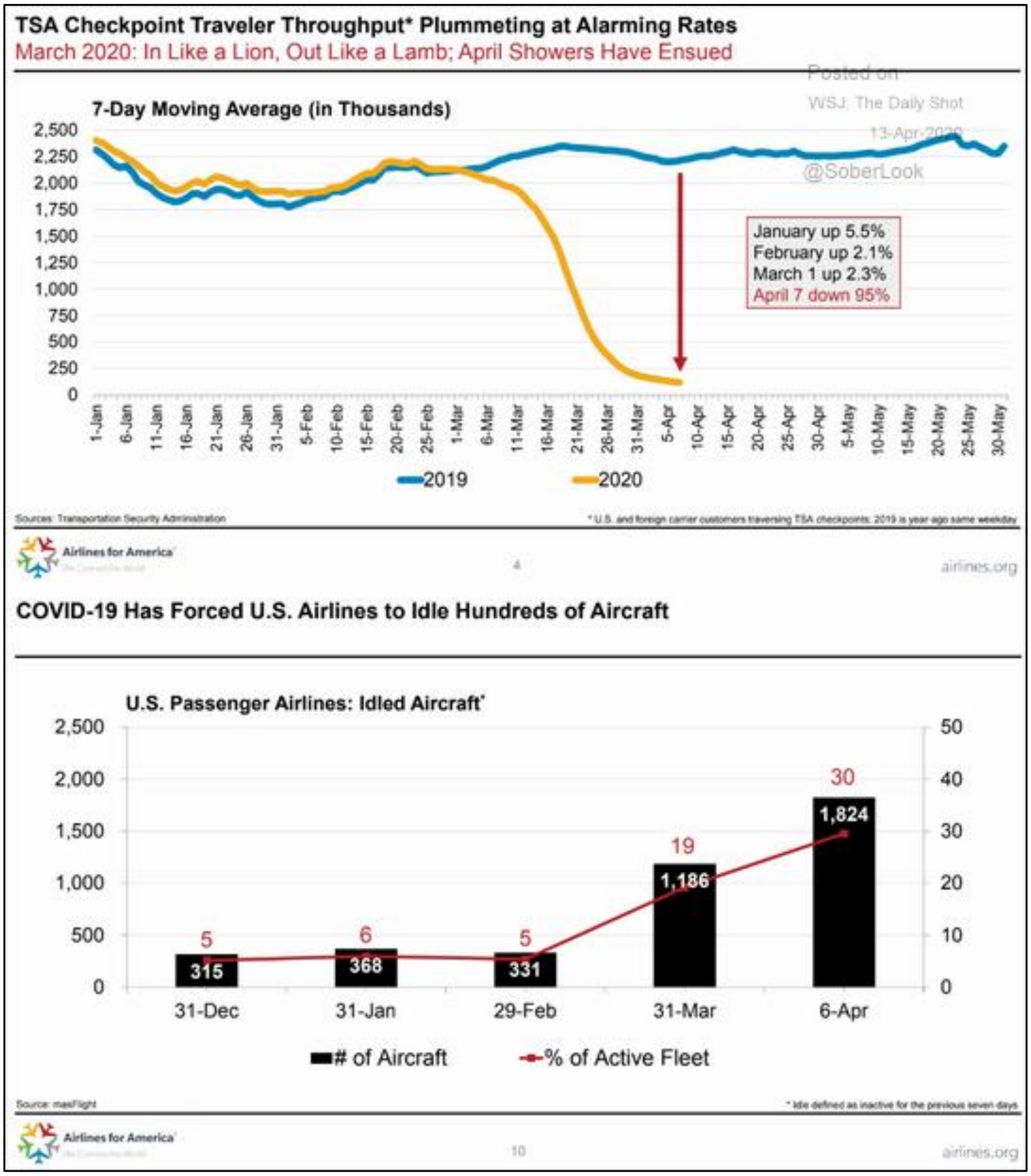


The acceleration of existing trends by the outbreak will be a big part of the legacy that COVID leaves behind.

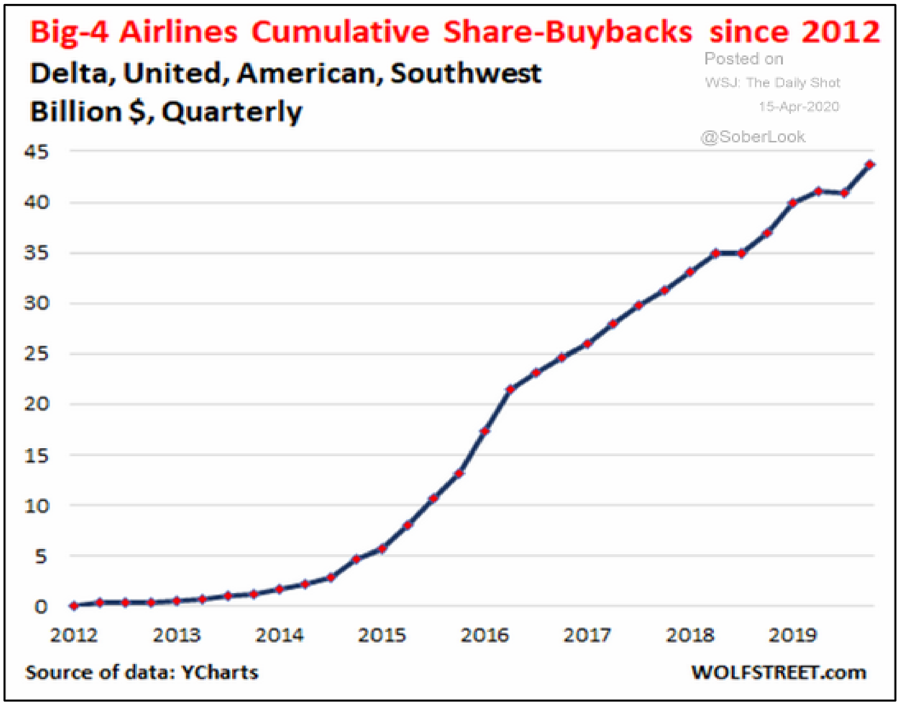


For the few tech winners there have been many losers. Obviously, Accomodation, Retail and Food Services have been crushed. There has been a lot of goodwill for these enterprises, especially those that are small businesses.

Airlines have been hammered as well, as passenger flow has all but stopped.



However, expect the Airline bailouts to create growing furor as these companies become increasingly vilified for their buyback activities over the last few years. Spending all your free cashflow on buybacks in a highly cyclical business will be hard to defend. This will become a political football in the coming months. There is ammunition here for both the Right and the Left.



Commodities

COVID has been especially difficult for commodities. Plunging global growth fears are one thing, but in this case, they have been magnified with a sudden demand shock. This extends far beyond the energy sector. Lots of stories about dairy farmers pouring milk into the ground and eggs being plowed under as the producers find no outlet for the supply.

Prices have gotten so ugly so fast that there is lots of potential opportunity, especially given the strong connection to the dollar and EM.

Given the company specific leverage and product knowledge required here, there are a lot of potential alpha sources. When the broader recovery finally does come it will be powerful.

Because it is difficult for retail to invest in these commodities directly given the painful rolldown for most commodity ETF's, money may be concentrated in a few names when it does start.

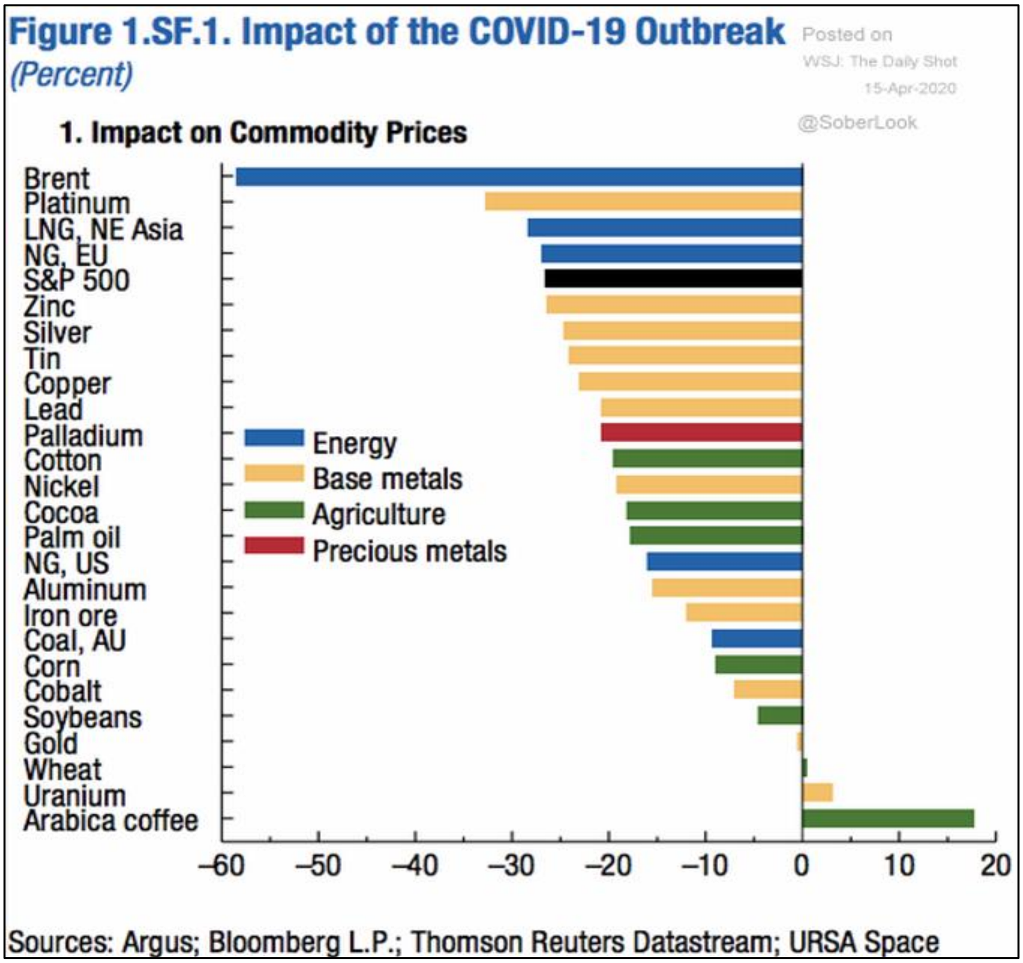


Figure 1.SF.1. Impact of the COVID-19 Outbreak
(Percent)
Posted on
WSJ: The Daily Shot
15-Apr-2020
@SoberLook
1. Impact on Commodity Prices
Brent
Platinum
LNG, NE Asia
NG, EU
S&P 500
Zinc
Silver
Tin
Copper
Lead
Palladium
Cotton
Nickel
Cocoa
Palm oil
NG, US
Aluminum
Iron ore
Coal, AU
Corn
Cobalt
Soybeans
Gold
Wheat
Uranium
Arabica coffee
Energy
Base metals
Agriculture
Precious metals
–60
–50
–40
–30
–20
–10
0
10
20
Sources: Argus; Bloomberg L.P.; Thomson Reuters Datastream; URSA Space


Managed Money Copper futures positions
Net long contracts (thous, lhs)
Copper ($/lb, rhs)
Posted on
WSJ: The Daily Shot
15-Apr-2020
@SoberLook
120
70
20
-30
-80
3.4
3.2
3.0
2.8
2.6
2.4
2.2
2.0
Jan-17
Apr-17
Jul-17
Oct-17
Jan-18
Apr-18
Jul-18
Oct-18
Jan-19
Apr-19
Jul-19
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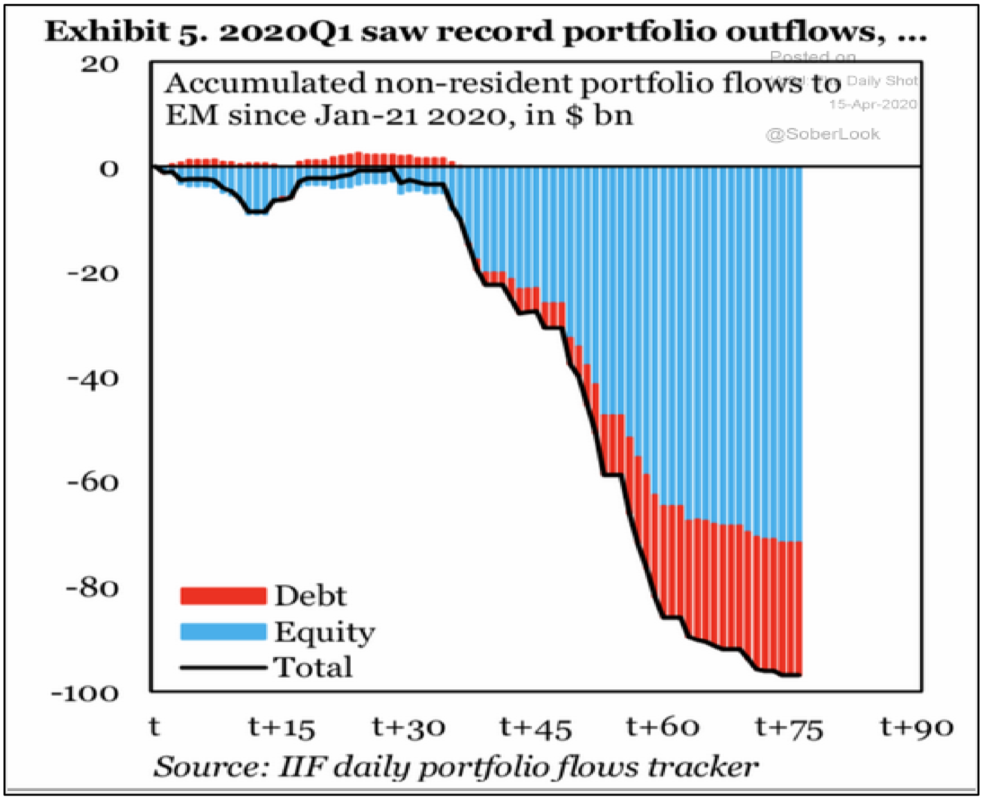
Jan-20
Apr-20
Positioning data as of 07 Apr 2020

EM has suffered from commodities and the strong USD combined … again the USD will be very important here.



Besides the straight commodity plays, there are global growth and inflation proxies that are worth watching. This could get especially interesting should the Fed embrace Yield Curve Control more clearly.

Markets

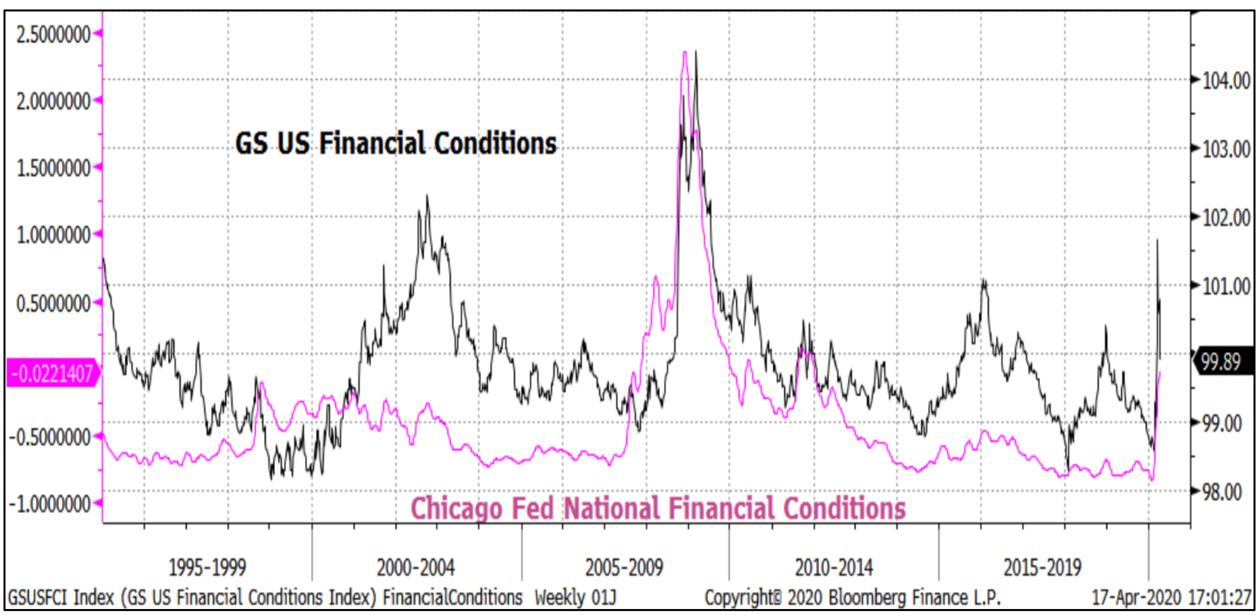
For the moment Bonds and the USD are tracking sideways as they are being buffeted by opposing forces. However, it feels like a decision is coming soon.

Credit has been saved by the Fed for the moment as they buy both IG and HY. The HY decision I find amazing and disturbing to be honest. Talk about killing off another of the price signals! The move into HY is a real crossing of the Rubicon and means anything is now possible with Treasury fist-loss slug of capital and Fed leverage. It will be increasingly hard for markets to know what is going on in the economy if prices no longer have information value. They are busy removing both information and hedges from market participants. To me that means more volatility in those things that do trade freely.

Even Trump seemed surprised at the equity market gains off the lows during last Fridays press conference. As discussed, technology and healthcare are pulling one way while much of the market remains unimpressed. I would guess that passive index flows are also working their magic as people sell the lows and are then forced back in.

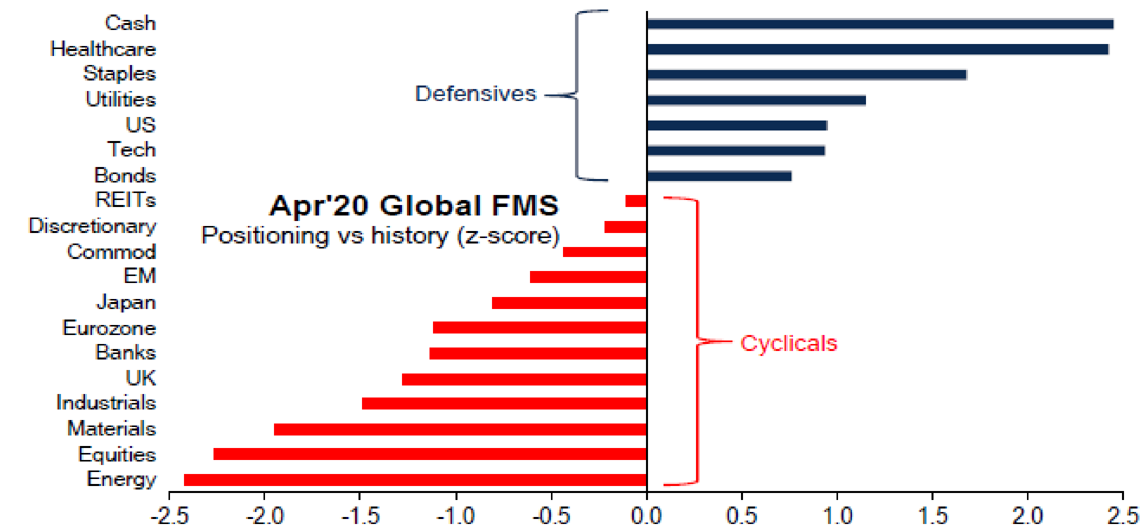
Most equity indices are now in the sell zone.

And despite all the Fed and government initiatives Financial Conditions remain relatively tight… granted a lot of this is equities and USD.



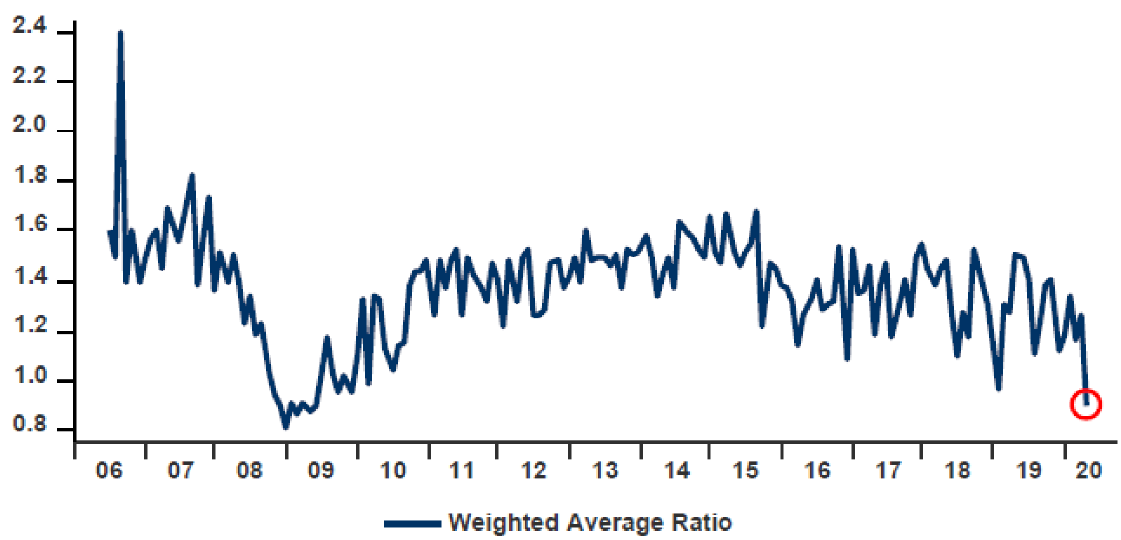
However, positioning remains defensive.

Exhibit 9: FMS positioning vs. history



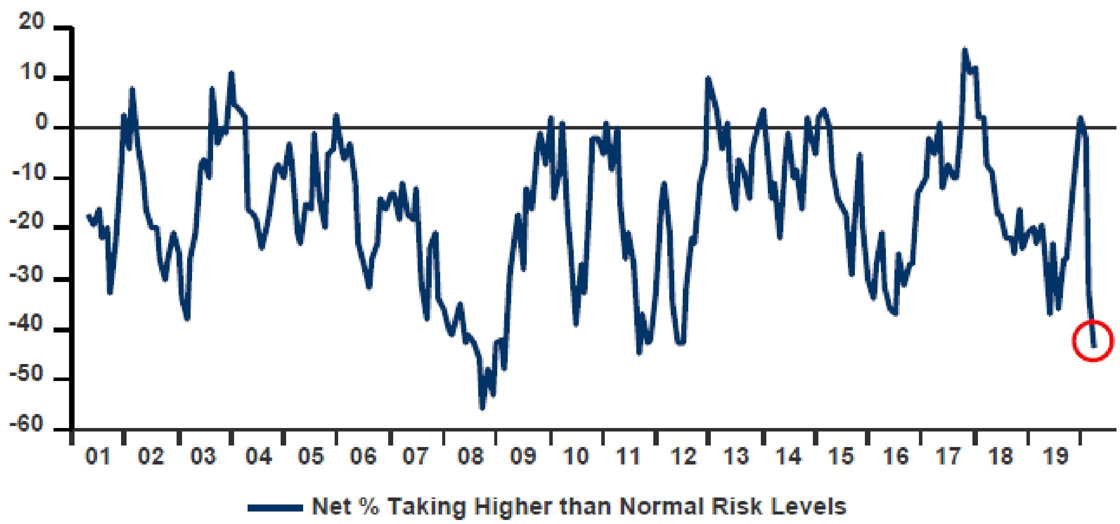
Source: BofA Global Fund Manager Survey

Exhibit 13: FMS investor asset to capital ratios lowest since GFC



And investors remain worried …

Exhibit 30: What level of risk do you think you're currently taking in your investment?



About earnings…

Investors on EPS & Leverage

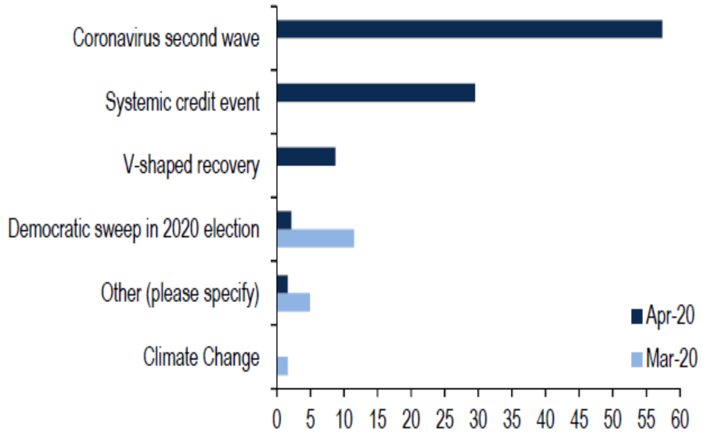
Exhibit 31: Profit expectations

Global corporate profit expectations remain low this month, up only 1ppt MoM to net 63% of FMS investors saying they do not expect profits to improve over the next 12-months; note last month were lowest profit expectations since Oct'08.

Source: BofA Global Fund Manager Survey

A second wave of the virus and credit…

Exhibit 28: What do you consider the biggest "tail risk"?



Biggest "tail risks" in Apr'20:

1. Coronavirus second wave (57%).
2. Systemic credit event (30%).
3. V-shaped recovery (9%).
4. Outcome of 2020 US Presidential election (2%).

Source: BofA Global Fund Manager Survey

With lower earnings, credit concerns and bad press, buybacks may be noticeably absent as a driver going forward…

Exhibit 7: FMS investors desire for buybacks at 20-year low…EPS pessimism

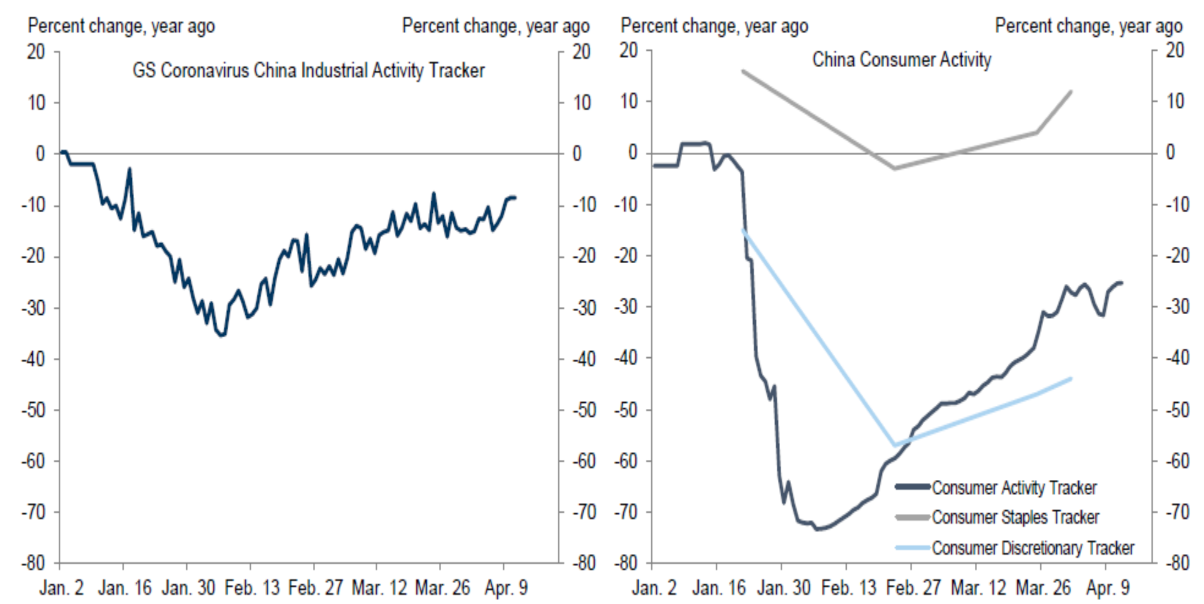
Source: BofA Global Fund Manager Survey, Bloomberg

Re-opening

Despite the concerns about China's transparency and forthrightness it remains the template for what a loosening of the lockdowns in Europe and the US might look like.

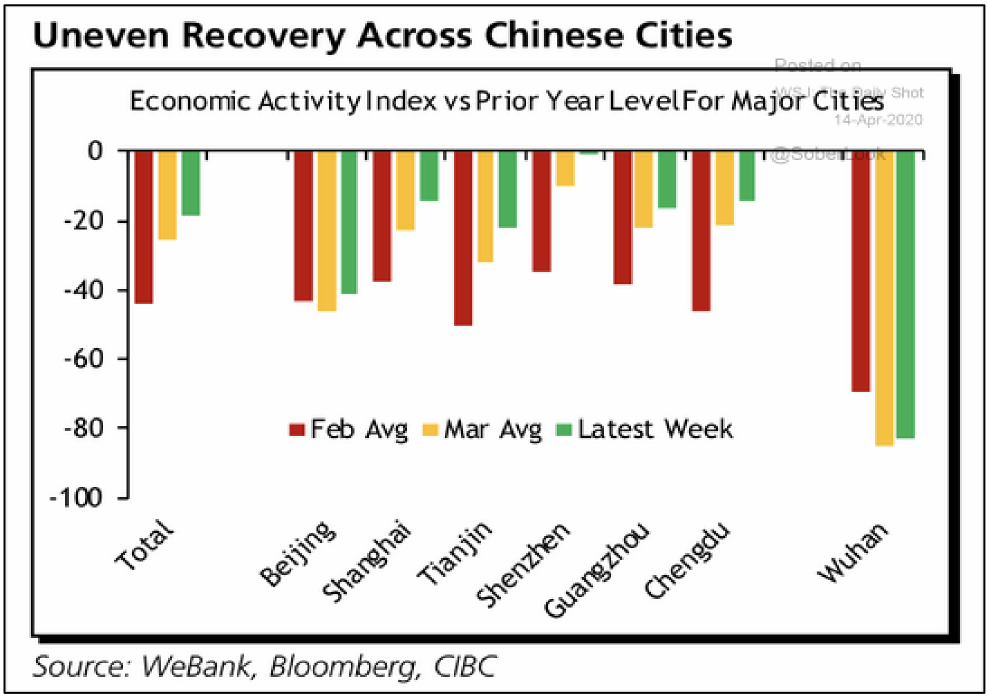
As things have opened up in China the consumer has continued to be more cautious.

Exhibit 8: Industrial Activity in China Is Closer to Recovering than Consumer Activity

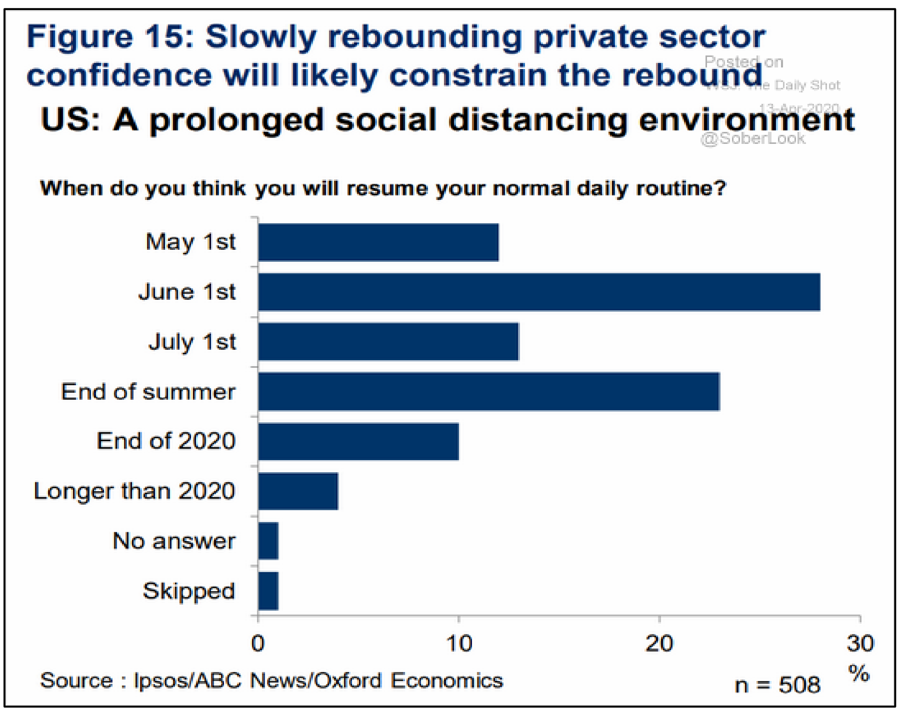


Source: Goldman Sachs Global Investment Research

As you would expect the bounceback has also been uneven.



With uncertainty in Europe and the US about the speed and degree of re-opening I expect a similar initial outcome here.



The big question is will the crisis leave long lasting or even permanent behavioural changes?

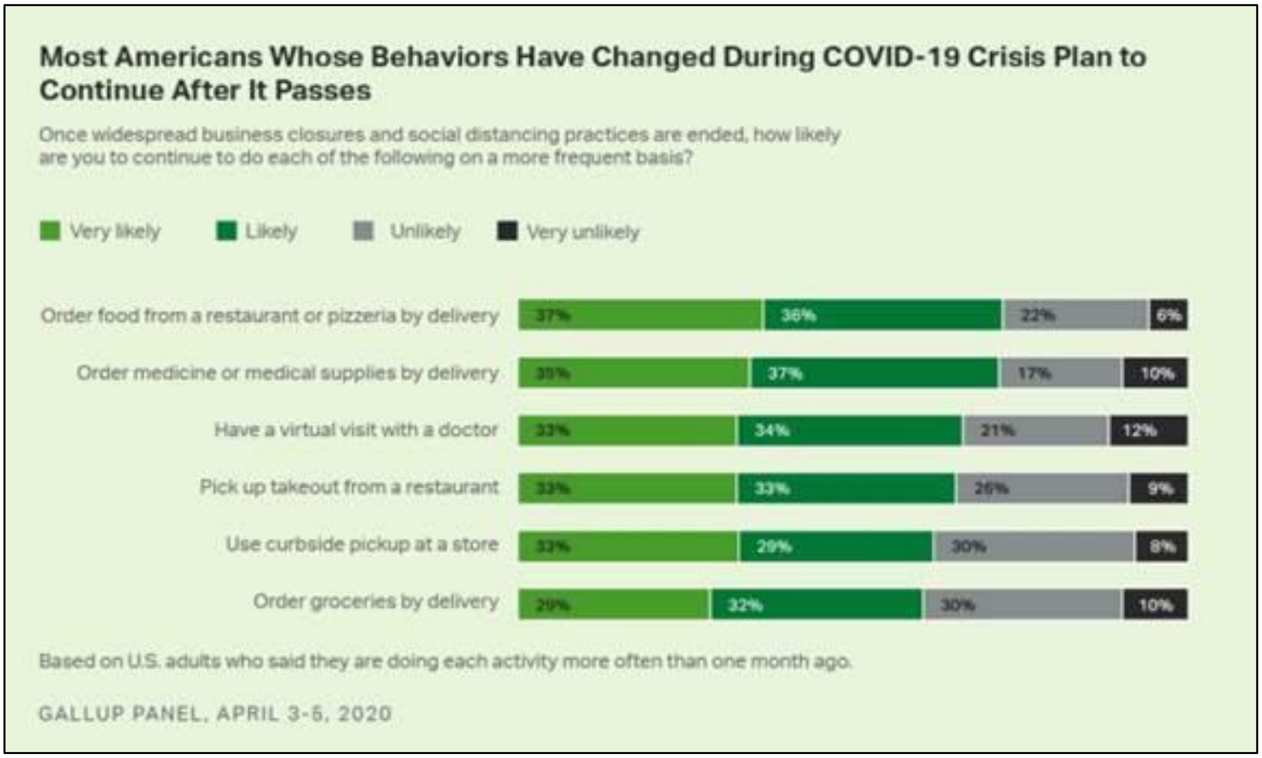
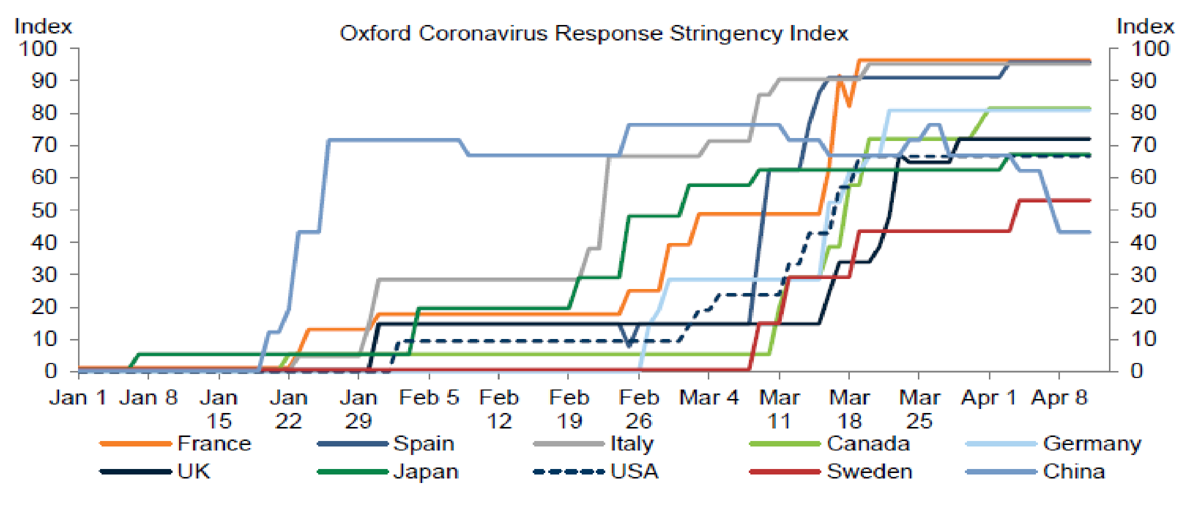


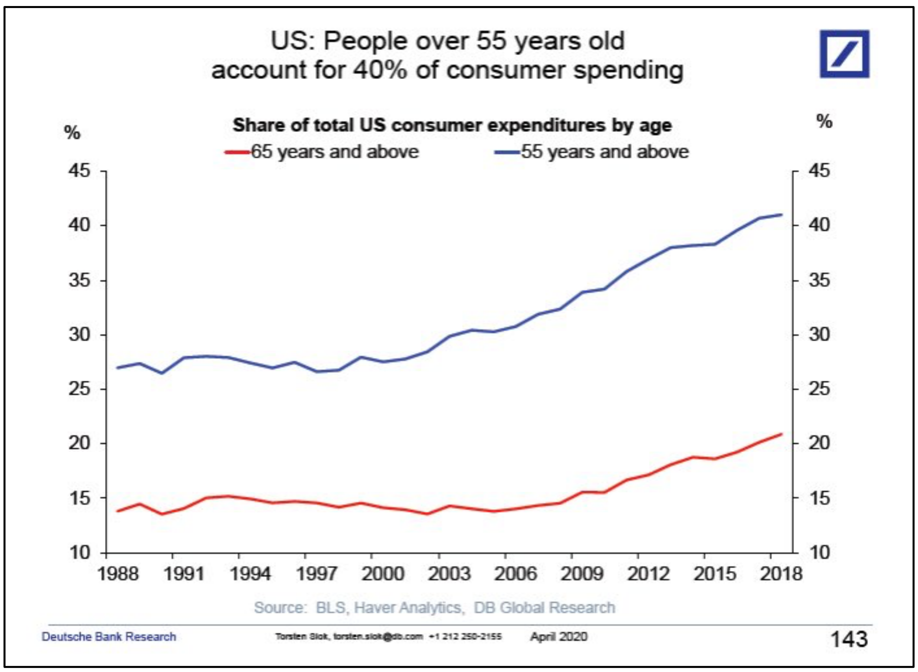
Exhibit 2: Current US Lockdown Measures Are in the Middle of the Pack in Terms of Stringency



Source: University of Oxford, Goldman Sachs Global Investment Research

Some business will continue to suffer for a long time. Restaurants are likely to have diminished turnover of tables as social distancing continues, leisure travel may be slow to recover and business travel may not come back to previous levels as the convienience and ease of video conferencing becomes institutionalized and stigma free.

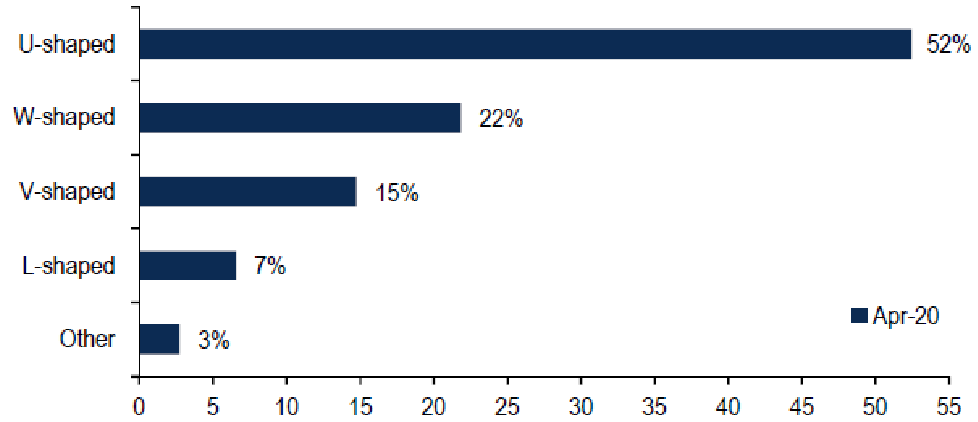
Older people will likely be slower to fully re-engage due to the remaining health risks for that age group. However, they represent a lot of the spending.



As globalization and dependence on other countries for essential materials and products is questioned we will see a meaningful uptick in products made at home vs. abroad. Eventually this will bring on shifting differentials in global growth and should support inflation.

For the moment investors seem to be looking for the U recovery, although I thought it was interesting how many seem to think the W is also likely. Is that a second wave or just a reality check when re-opening is slower than expected?

Exhibit 1: FMS investors expect U-shaped path out of the recession



Source: BofA Global Fund Manager Survey

It seems like herd immunity is still far away; vaccine and therapeutics the only solution.

Exhibit 5: Full Population and Random Sample Testing Suggests the Infected Share of the Population Is Higher Than Official Case Counts Imply, but Still Too Low to Achieve Herd Immunity Anytime Soon

Study	Results	Population Infection Rate
Diamond Princess	Over 700 out of 3,711 passengers on the Diamond Princess were infected, an infection rate of roughly 19%. There have since been 11 reported deaths.	19%
USS Theodore Roosevelt	Nearly all of the crew members of the USS Theodore Roosevelt were tested. As of Sunday, 585 sailors tested positive for the virus, while 3,921 tested negative.	13%
Gangelt	Preliminary results from a random sample of residents in Gangelt, a hard-hit town in Germany, suggest that roughly 15% of residents have been infected (either actively infected or having antibodies). The authors of the study estimated a 0.37% infection fatality rate.	15%
Vo	All 3,300 inhabitants of Vo, Italy, were tested. About 3% of residents were infected, with roughly 50% showing no symptoms. Following a a strict lockdown and quarantine, only 0.25% of residents were infected thereafter, and soon there were no active cases.	3%
Austria	A random sample of Austrians suggests that 1% of the population has been infected. Austria currently has roughly 13,000 total confirmed cases, or about 0.15% of the population.	1%
Iceland	Iceland has conducted a large number of tests (roughly 10% of the population). It has reported roughly 1,675 cases so far, or about 5% of those tested. About half of those who tested positive reported no symptoms at the time of testing.	~5%
Denmark	A study of 1000 blood donations found that 3.5% of donors had been infected.	3.5%
Colorado	More than 6,000 out of roughly 8,000 residents of Telluride took an antibody test. So far 0.5% of those tested were positive, 1.5% "borderline," and 98% negative.	0.5%
Wuhan	Japan, Singapore, South Korea, Germany, Belgium and Malaysia tested all passengers returning from Wuhan on chartered flights between January 29 and February 4. There was a small number of confirmed cases, typically 0 to 2 percent. A few pre-symptomatic or asymptomatic cases were confirmed.	0-2%

Source: Goldman Sachs Global Investment Research

The debate over bailouts, stimulus, deficit spending and government overreach is just starting. With the fear of deficits fading fast and MMT, UBI and Helicopter money sounding easy and consequence-free, volatility should remain high with active managers able to provide alpha.

Data remains of questionable value at this point, but here are the more noteworthy upcoming releases.

Important Macro Data Releases and Events for the Week

Monday
4/20/2020

- PBOC Interest Rate Decision
- Chicago Fed National Activity Index (Mar) Forecast - , Prior: 0.16

Tuesday
4/21/2020

- ZEW Survey - Economic Sentiment (Apr) Forecast: - , Prior: -49.5
- ZEW Survey - Current Situation (Apr) Forecast: -30, Prior: -43.1
- ZEW Survey - Economic Sentiment (Apr) Forecast: -43, Prior: -49.5
- Retail Sales
- Existing Home Sales MoM (Mar)Forecast: 5.4M, Prior: 5.77M

Wednesday
4/22/2020

- CPI

Thursday
4/23/2020

- Economic Council Meeting
- Leading Economic Index
- GfK Consumer Confidence Survey

Various Markit PMI's - might be interesting if start to bounce

Initial Jobless Claims Forecast: - , Prior: 5.245m

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 5.508m

Continuing Claims Forecast: - , Prior: 11.976m

Friday
4/24/2020

IFO - Business Climate (Apr) Forecast: 77.2, Prior: 86.1

IFO - Current Assessment (Apr) Forecast: -, Prior: 93

IFO - Expectations (Apr) Forecast: 81.9, Prior: 79.7

Durable Goods Orders ex Transportation (Mar) Forecast:-, Prior: -0.6%

Durable Goods Orders ex Defense (Mar) Forecast:-, Prior: 0.1%

Durable Goods Orders (Mar) Forecast: -11.4%, Prior: 1.2%

Non-Defense Capital Goods Orders ex Aircraft (Mar) Forecast: -0.4%, Prior: -0.9%

Michigan Consumer Sentiment Index (Apr) Forecast: 67.2, Prior: 71

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