Stargazer
Asset Management

What to focus on in Global Macro for the week of December 7th, 2020

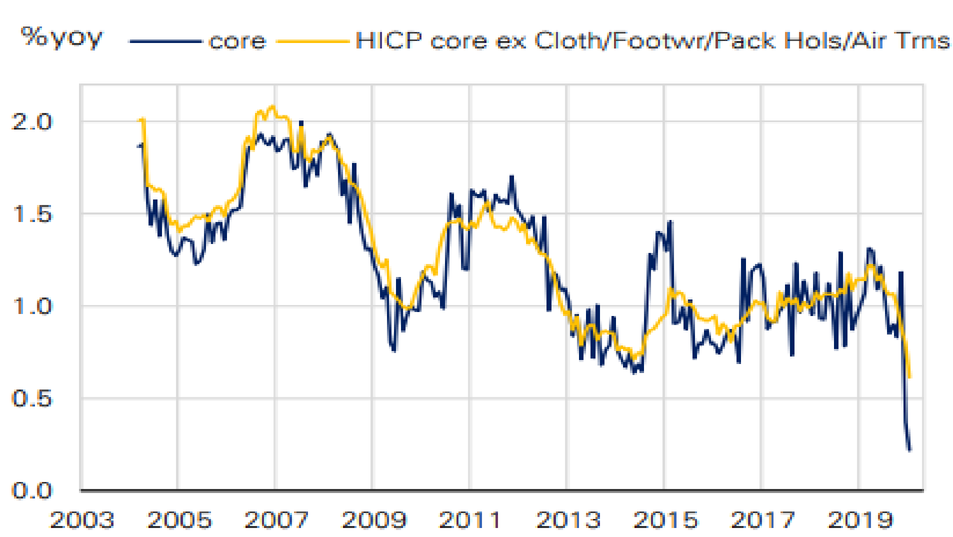
Macro Themes on the Radar:

Europe

On Thursday, we will finally find out what a pre-announced "recalibration" of monetary instruments means in practice for the ECB. The market is still focused on more and easier TLTRO funding for banks, and on an extension and possible increase in the PEPP program. A further reduction of the deposit rate is not expected. Since the market is already expecting something meaningful, I wouldn't be surprised to see some disappointment unless they add something surprising to the above script. Expect some concern and jawboning due to the recent EUR move, but they are limited in what they can do, and as it has played via a broader USD move, some concerns may be allayed by the reflationary effect on commodities. If EUR were to lead the charge, it would hurt both on a trade weighted basis and via net reflation impact. That might get them to look for other levers to pull, but I don't think we are there yet.

As per their mandate, we are a long way from 2%...

Figure 17: Underlying inflation remains too low



Source :Deutsche Bank, Eurostat

On Wednesday and Thursday, we also have the EU Council meeting. Hungary and Poland have continued to threaten a veto of the budget on rule of law issues. This only really matters because the EU Pandemic Recovery Fund is part of the 2021 budget. It has been assumed that the holdouts could be bought off, but so far, they haven't budged.

There is talk that a new solution may have been found by the European Commission. Under this new plan, the €750bn program of loans and grants would be removed from the EU budget. The new "off-budget" fund would be supported by voluntary member state guarantees, rather than budgetary commitments. With the wave of a bureaucratic magic wand they could remove Hungary and Poland's veto powers, leaving only the necessity for a vote by a qualified majority. While this route would undoubtedly open a new can of worms, it would be a very European solution.

Brexit

The endless Brexit saga continues as negotiations go down to the wire. Both sides are talking again as of this piece being written and so far, still no deal. National leaders are becoming increasingly involved. The issues have remained: Fishing in UK waters (French boats), national support for industry and of course the Irish border. In the end Europe wants to send the message that breaking up is hard to do and the UK wants national sovereignty. As this is now a game of pure politics it all depends on how the politicians see the risk/reward and how much political capital they want to expend. I'm still guessing we get a deal. One alternative to just crashing out would be no deal, but also a delay on tariffs. We shall see. I'll get to GBP later in the piece.

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

Melt-up

"The fruits of victory are tumbling into our mouths too quickly." Emperor Hirohito, April 29, 1942.

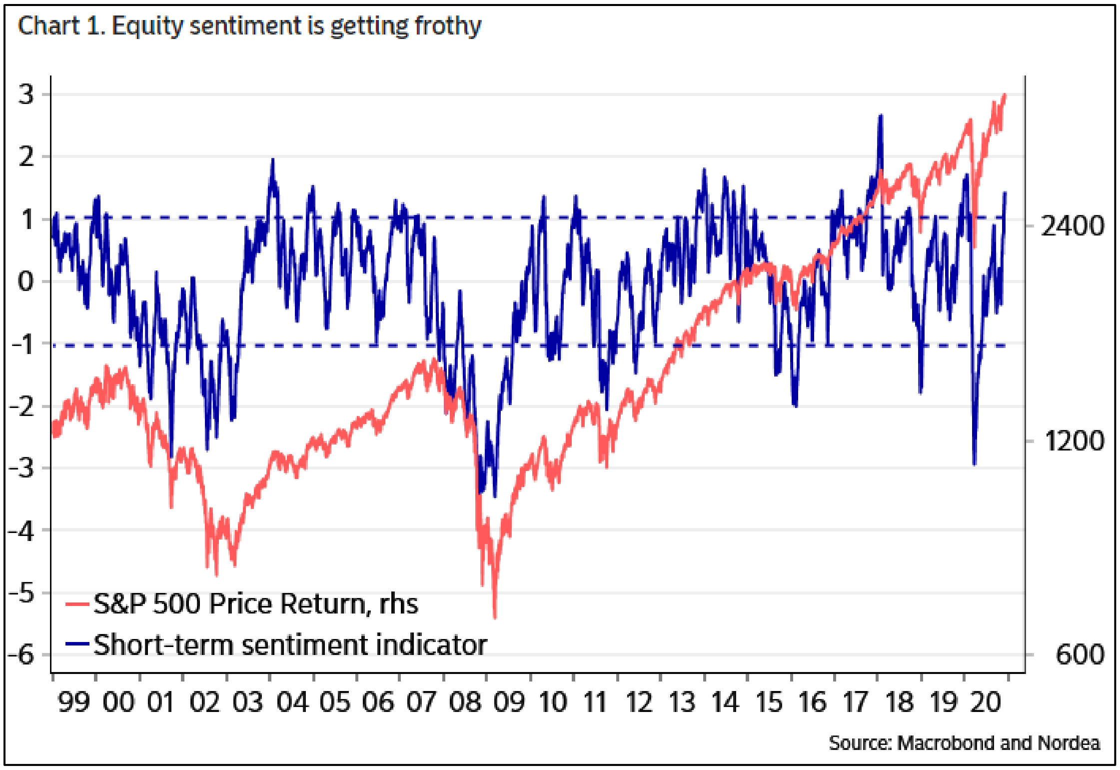
Five weeks later, Japan's defeat at the Battle of Midway arguably marked the beginning of the beginning, of the end, for Japan.

I don't know that we are there yet in terms of markets, but it is time to start paying attention as this move becomes progressively extreme. I am increasingly looking for evidence that the under-positioning that has acted as fuel for these markets has been spent, as investors again approach "all-in".

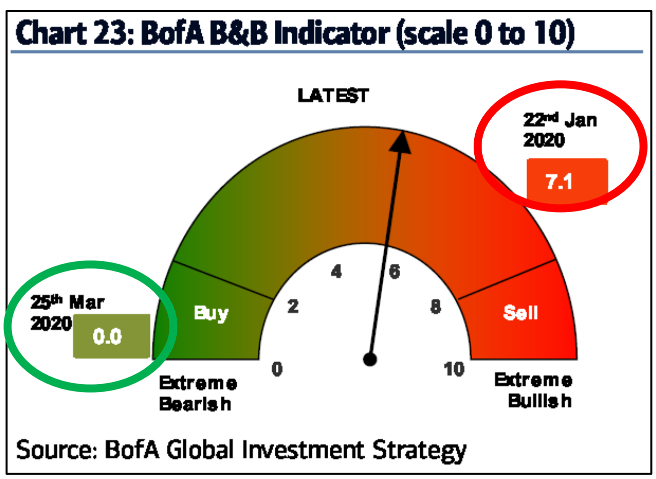
As BoA points out, November was a month for the record books. *"Dow +13% (best since '87), SPX +11% (best Nov since '28), Russell +20% (best month ever), energy +37% (best ever), industrials +18% (best ever), financials +19% (best since '09), Spain +25% (best ever), Italy +23% (best ever), Bitcoin +39% (to record 20k), US dollar (DXY) plummets to 32-month low."*

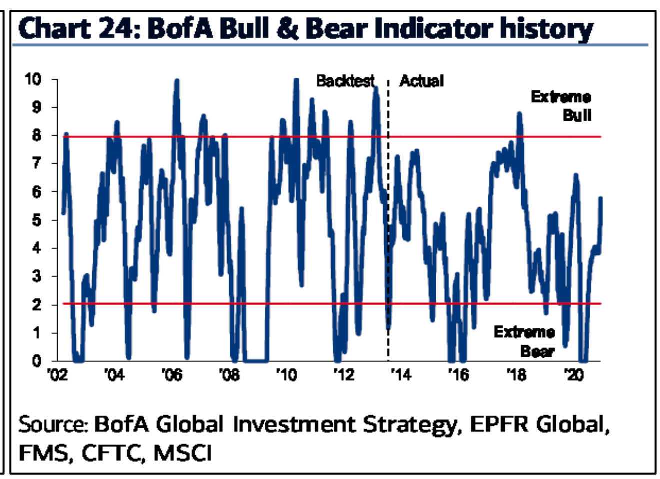
We have come a long way from the March lows in price and sentiment.

Sentiment is now back in “stretched” territory.



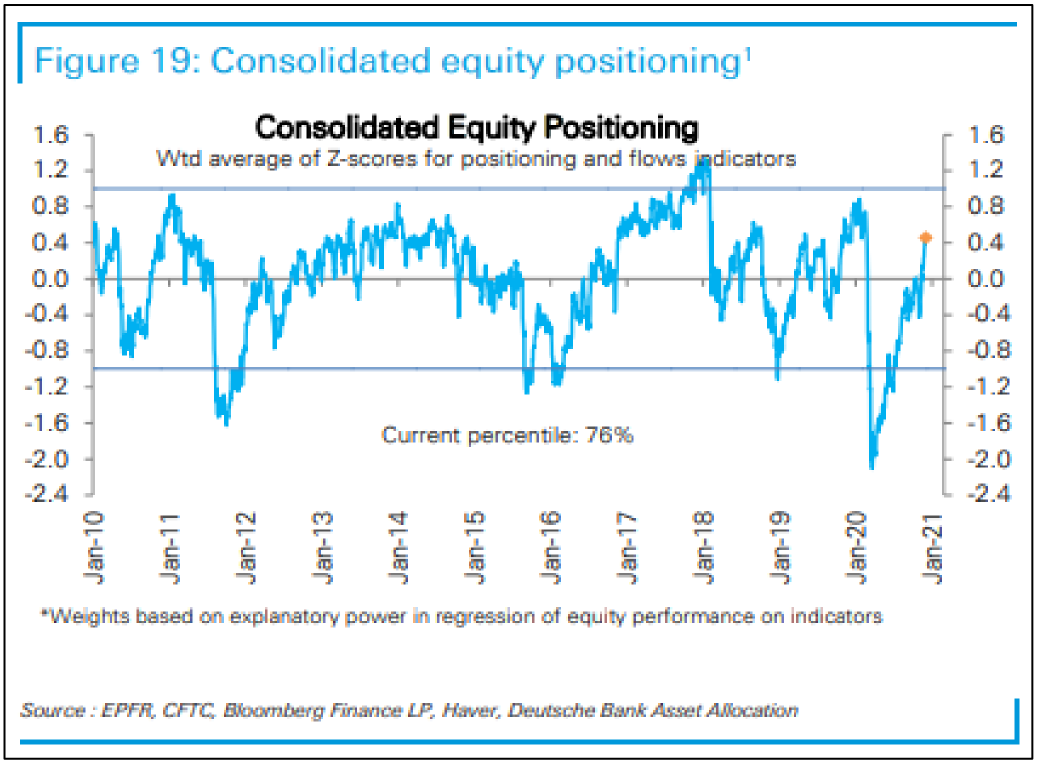
However, while far off the lows, and gaining ground quickly, we are not yet at extreme levels for many indicators.



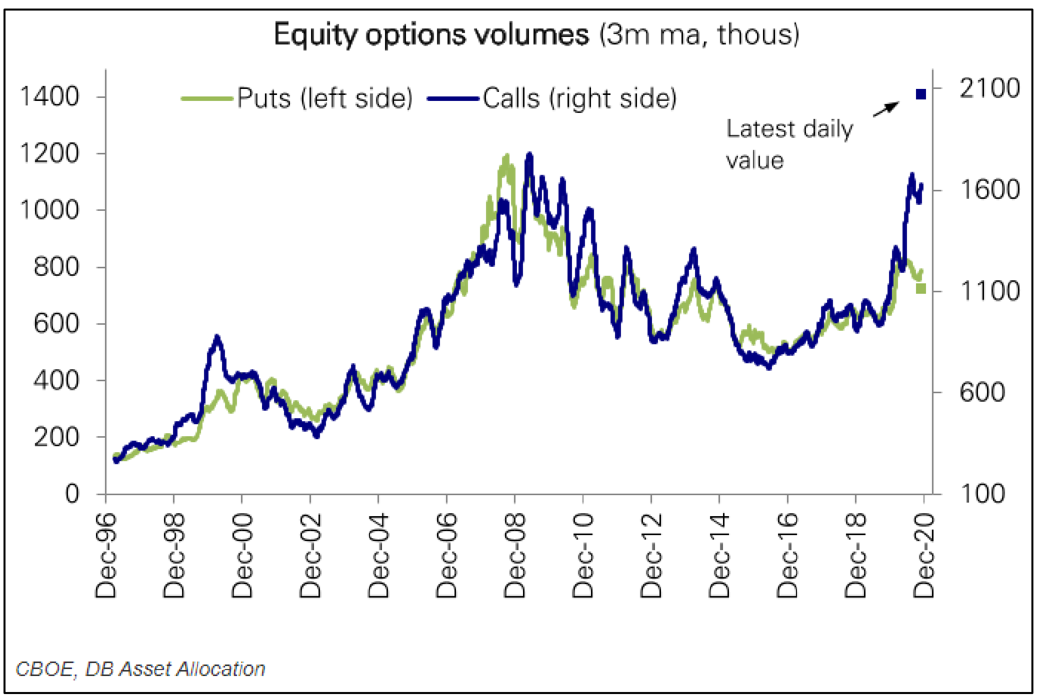


While that doesn’t preclude a top in the near-term, it isn’t yet screaming at you.

Here is another version from DB. Air is getting thin, but momentum still there for now.

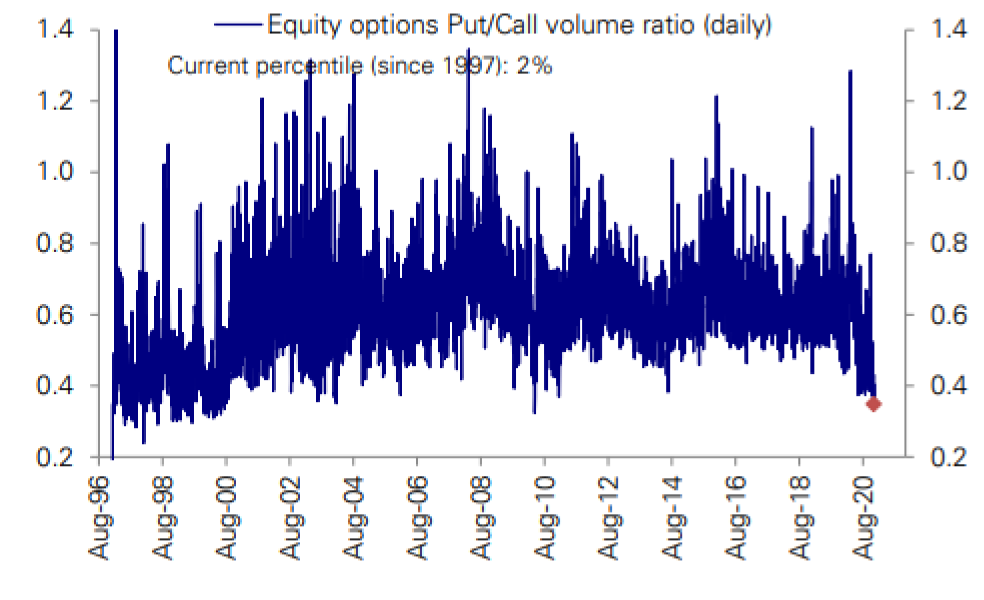


Call buying has again accelerated. Seems to be a mix of fear of the Wall St./Main St. disconnect and FOMO.



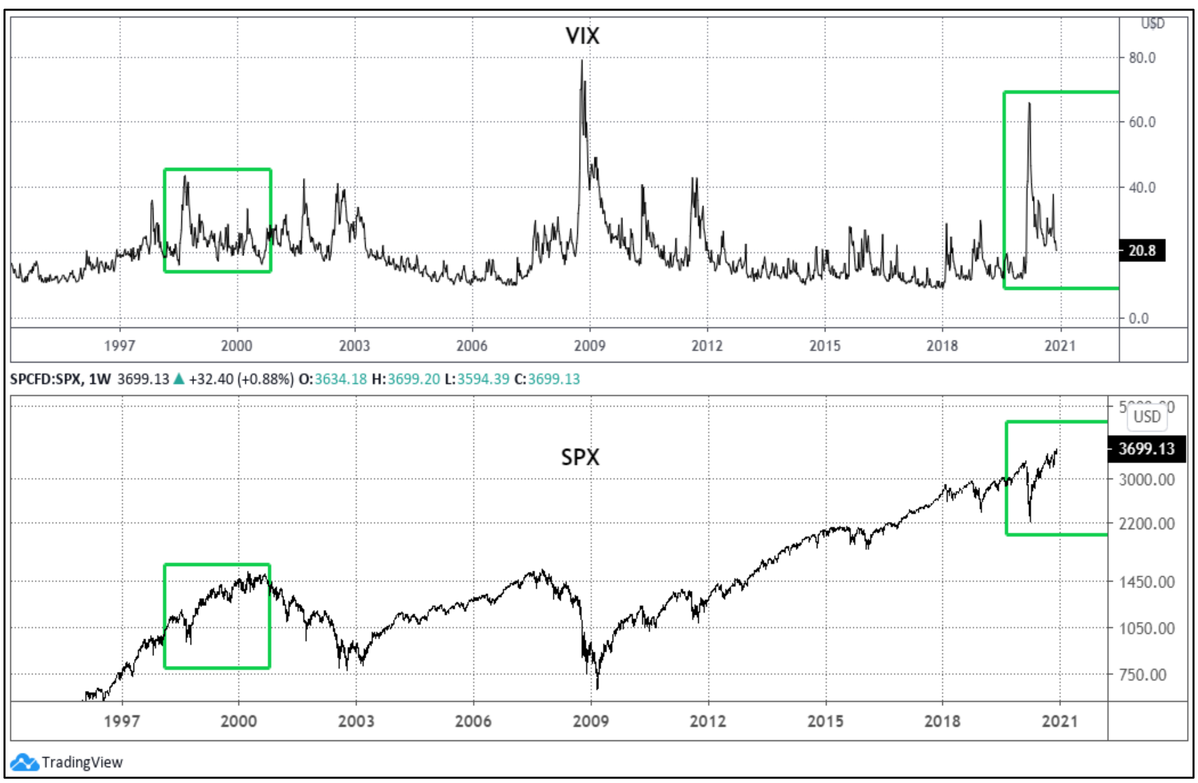
Yet, put buying is lagging. Again, the fear is that you don't have enough, but don't dare buy any more?

Figure 7: Equity put/call ratios are in the 2nd percentile and at Tech bubble levels

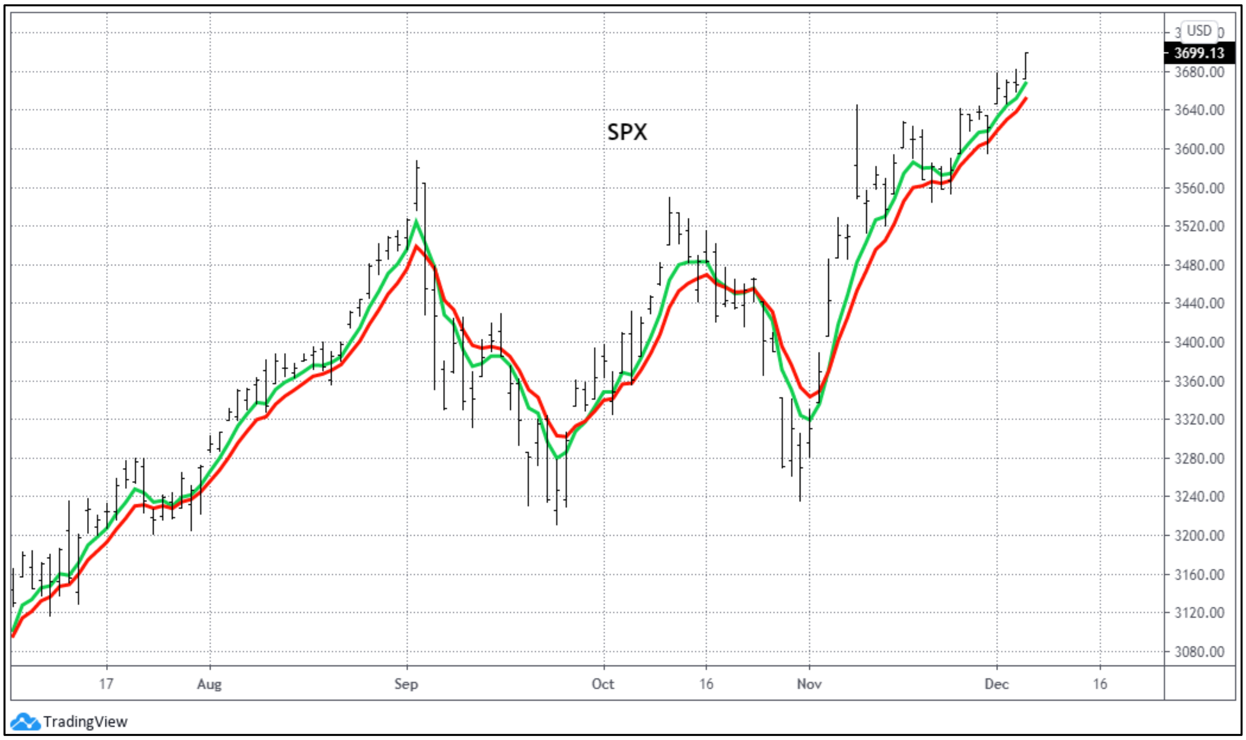


Source : CBOE, DB Asset Allocation

The price action in the VIX and stocks looks like the big brother of the '98 to 'oo period when the stimulus reaction to the Asian crisis and fear of Y2K, combined with the technology sector boom, to keep stocks going for a while longer.

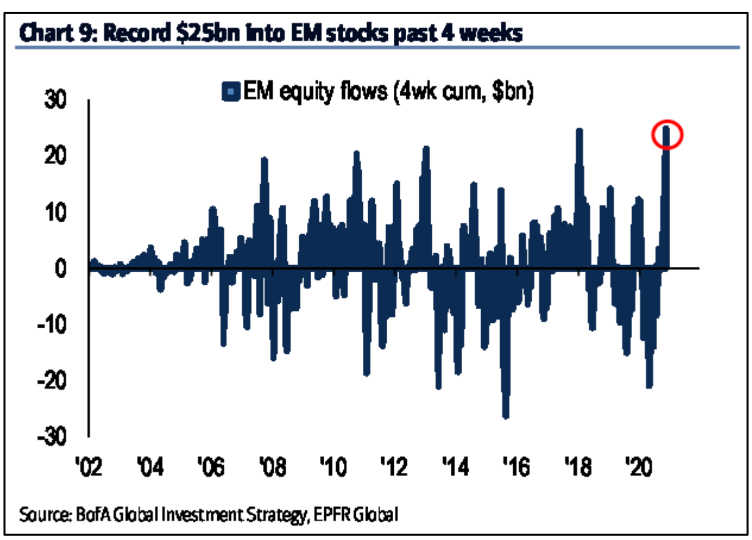


With the fast sprint higher, many of my longer-term "trailing stop" signals have been left in the dust. They will need some time to catch up. In the meantime, I'm watching shorter-term momentum indicators for signs of rising danger. Still holding up for now.



One idea is to look at adding some 6-month delta hedged puts to a long stock portfolio here. Yes, you would be buying volatility, but implied vol. is cheap, and with the delta hedge there is a potential to recoup options premium if we continue melting up, while you have gamma on the downside if we roll.

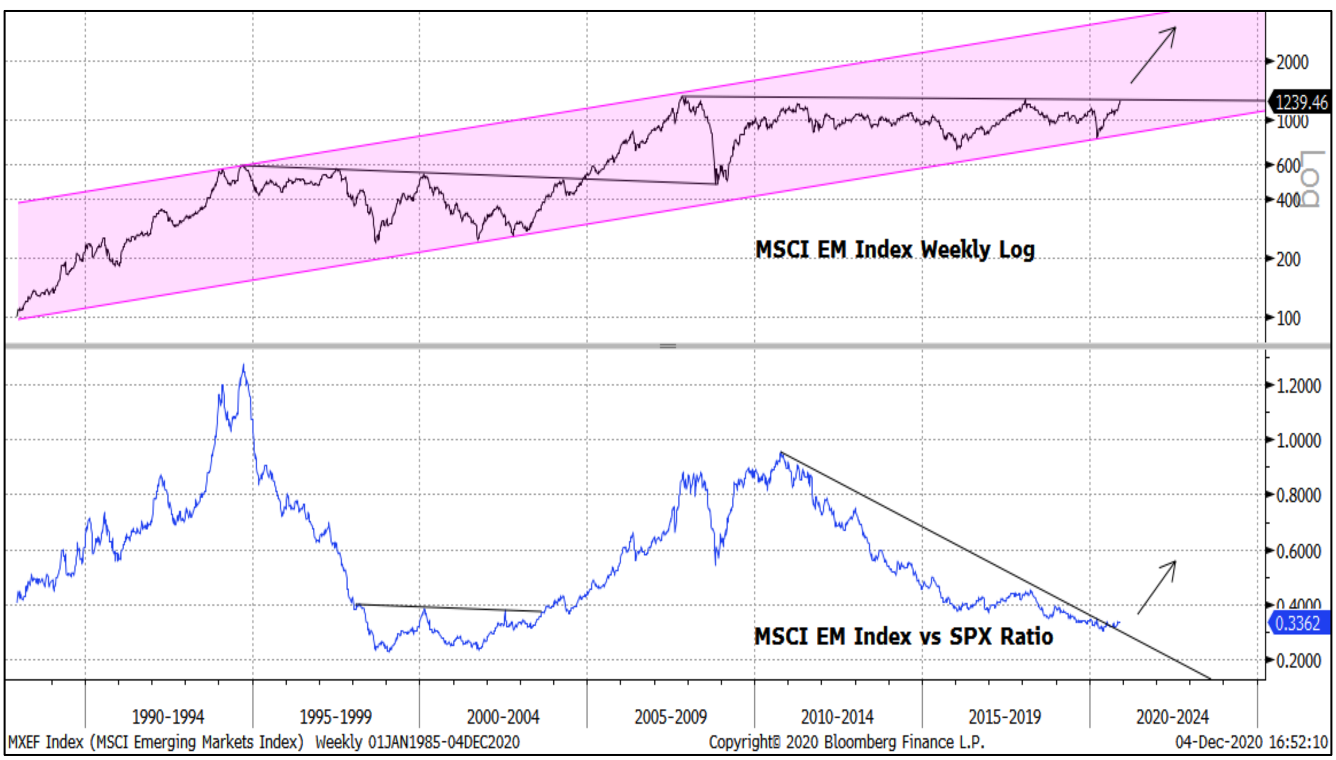
EM



EM inflows have been dramatic as well over the last four weeks. The combination of higher equities and a falling USD has been powerful. South Korea has been one of the biggest beneficiaries.

However, despite the flows, EM ETF's like EEM have not been able to substantially outperform the S&P.

The big picture for EM looks interesting but needs higher commodities and a lower USD trend.

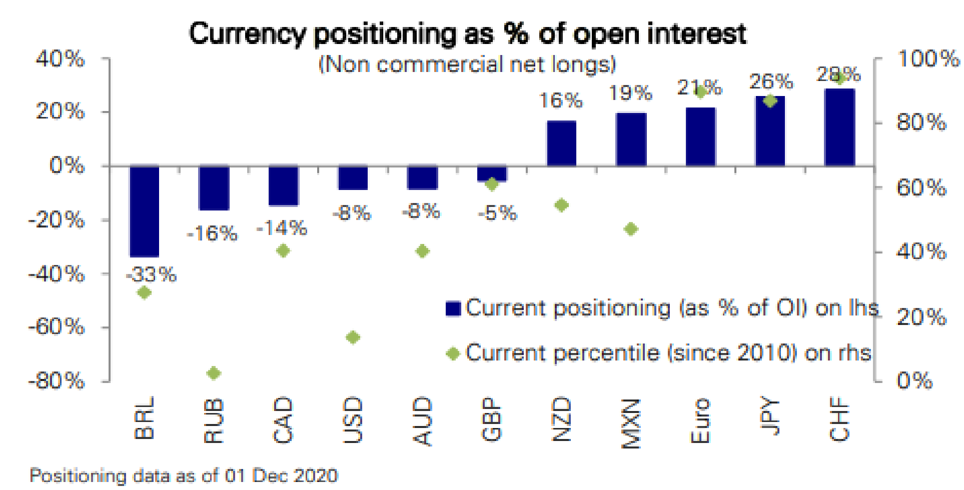


USD

Last week saw a big break lower in the dollar.

While the dollar down trade shows some extended positioning, it varies substantially by currency.

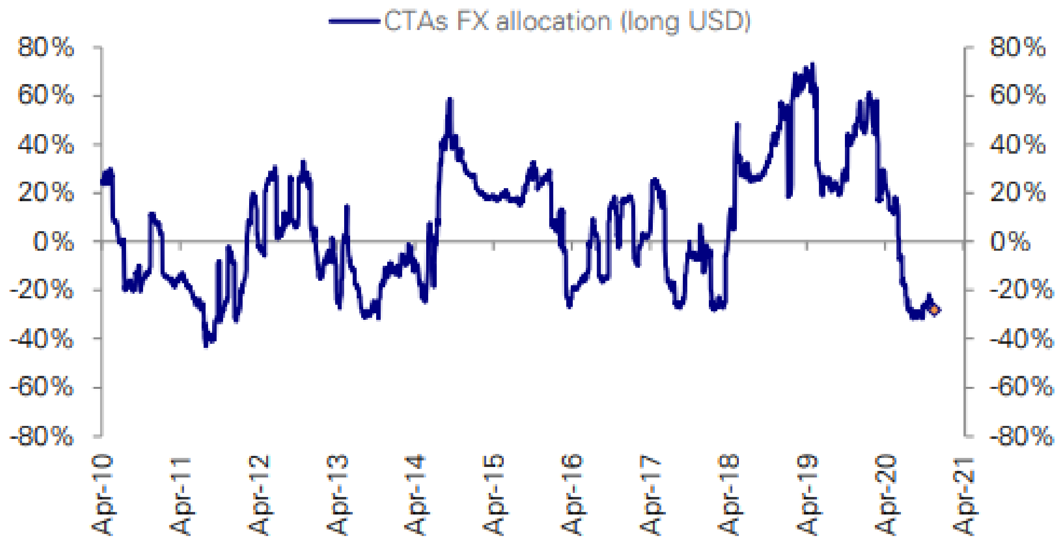
Figure 17: Futures positioning is very long the euro, yen and Swiss franc but still underweight the more cyclical currencies



Source : Deutsche Bank Asset Allocation, EPFR, Haver Analytics

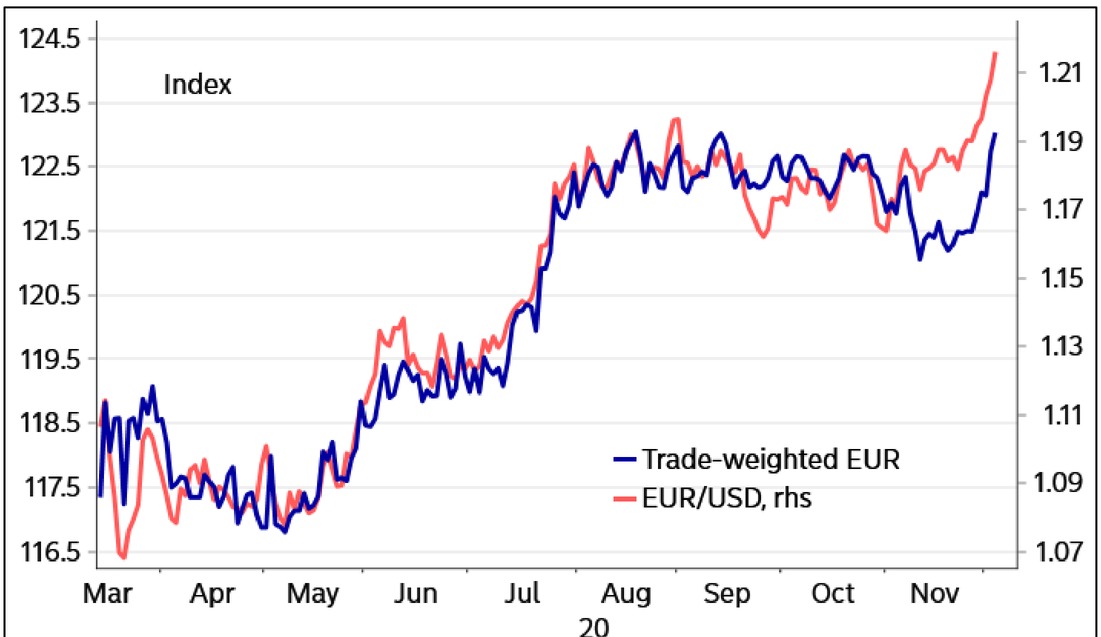
Most of the dollar shorts are vs. developed markets. The EUR is a big driver vs. historical positioning.

Figure 16: CTAs are near max short on the US dollar



Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

However, it is not clear what reverses the price action in the near-term. The recent trade-weighted move is not yet so large to cause major concern at the ECB. Their options are limited in any case.



Source: Macrobond and Nordea

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Given the impending Brexit resolution the market remains under-positioned in both Sterling and UK equities. While some volatility should be expected here, I think we eventually break higher in GBP.

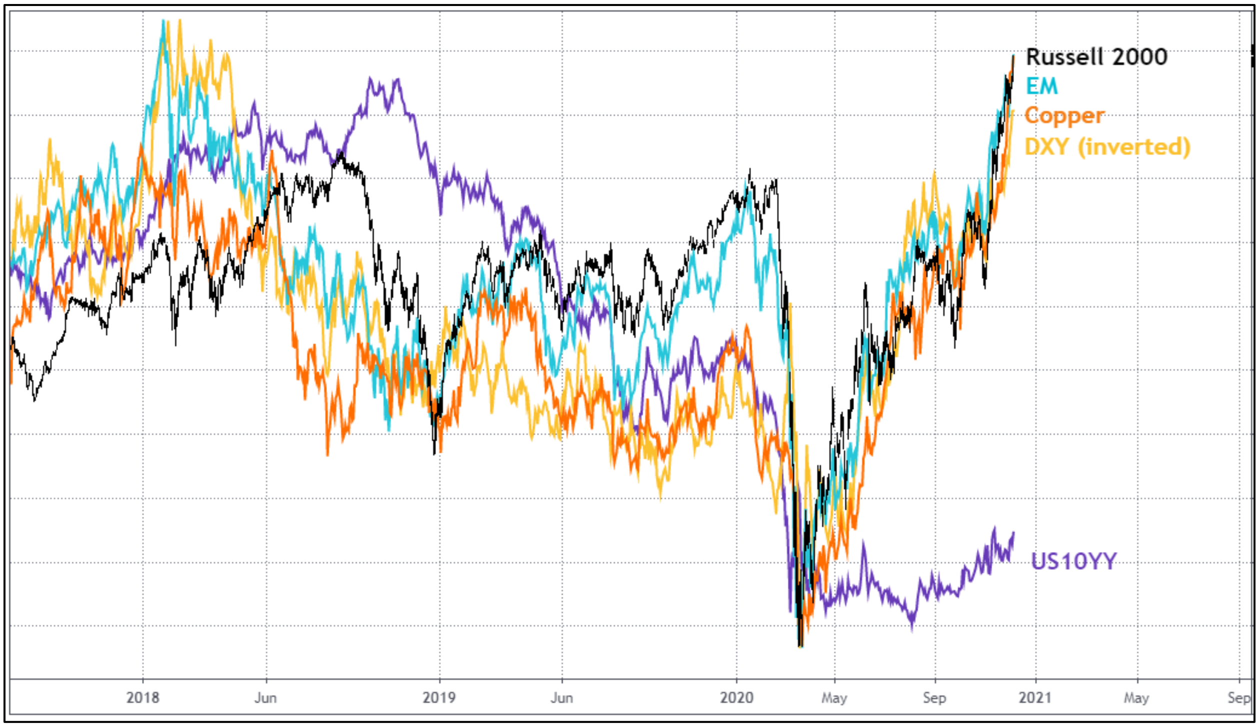
Bonds

How bond yields evolve from here potentially holds the key to the price action in many markets. Their divergence to risk-on and reflation trades in general has become extreme. There are good reasons for this, but increasingly bond yields feel like a beachball being held underwater. These reasons continue to include:

- negative and zero interest rate policies in many of the world's largest economies
- forward guidance from many central banks that rates are not going up for a long time
- the growing assumption that an uptick in yields will be met with increased buying of longer dated paper via existing QE programs
- worries that the current virus wave continues to do meaningful damage to the real economy.

The flow into bonds of all types, including corporate (both IG and HY) and EM, has been massive this year. A sudden and unexpected move higher in yields would be very disruptive to many assumptions and portfolios.

Is the US long-end the odd man out?



What is interesting from a timing perspective, is that we are at big levels now. Make or break!

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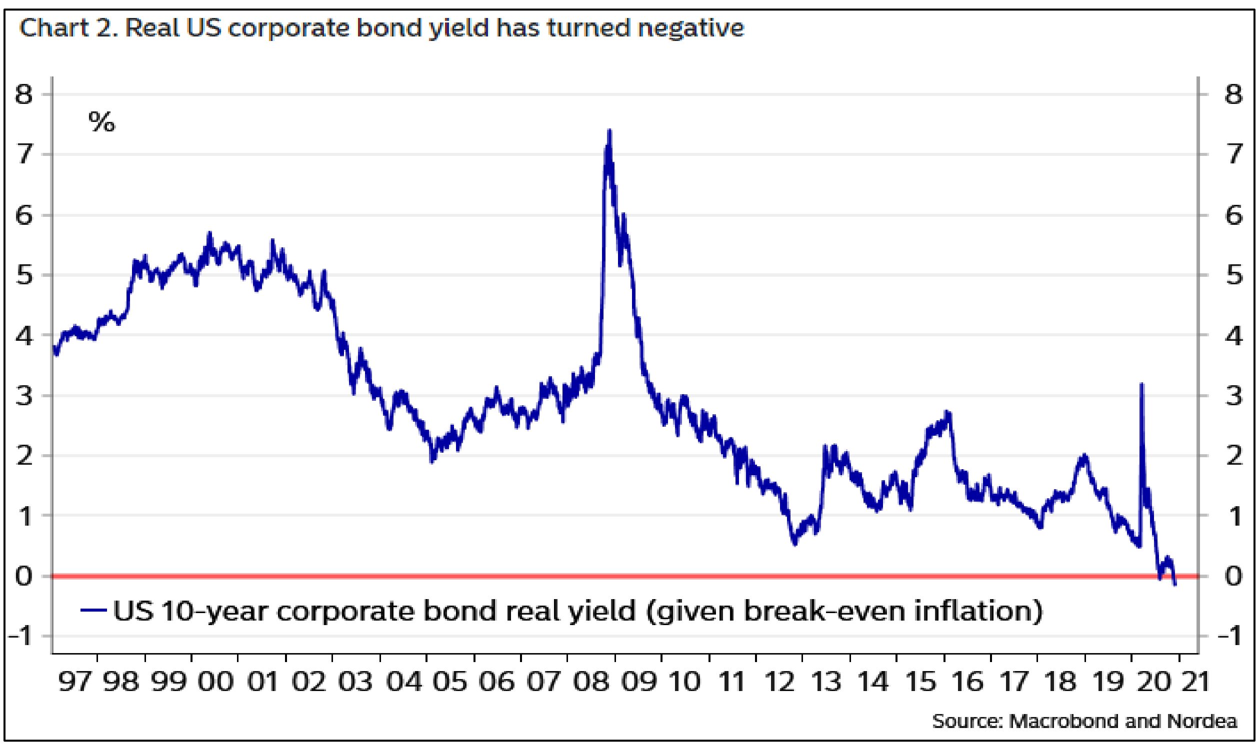
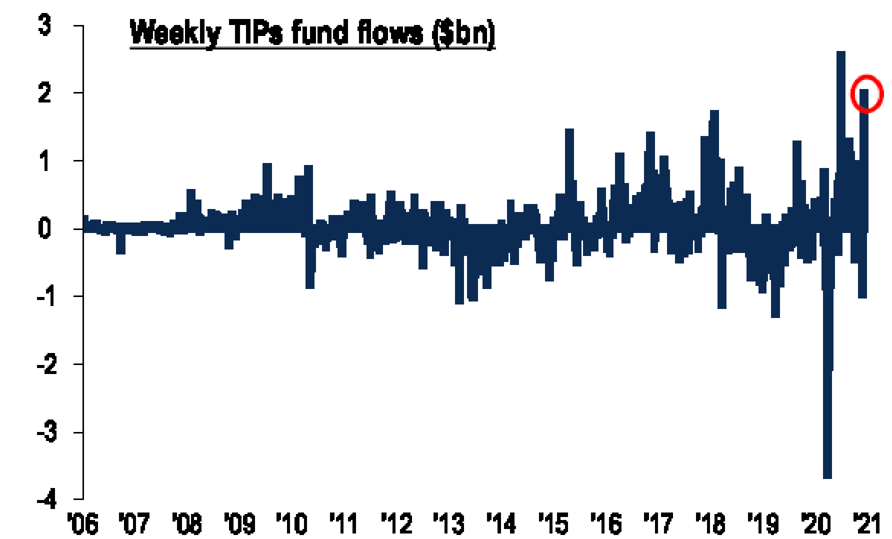
Even corporate bond yields have now dipped into negative territory as inflation expectations rise, but bond yields don't.



Inflows into inflation protected bonds have been picking up.

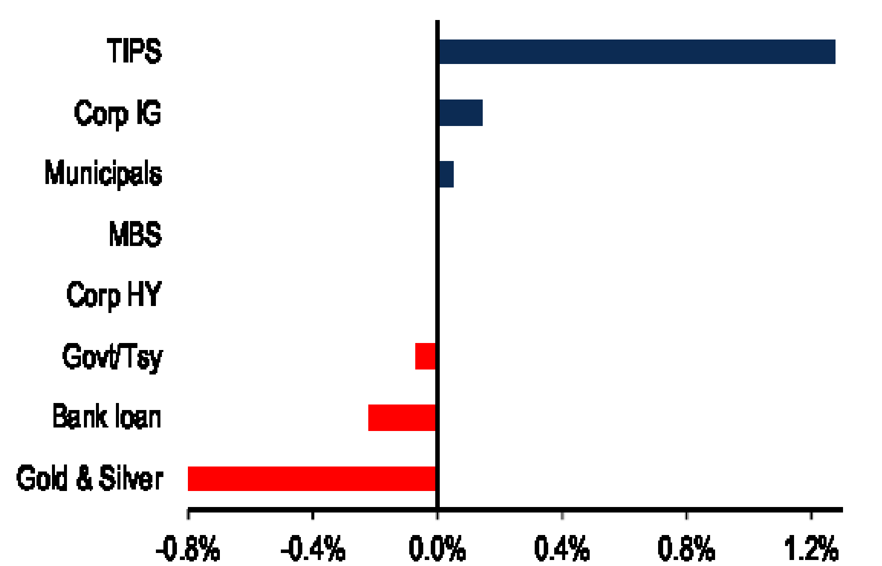
Chart 11: 2nd largest inflow to TIPs ever this week



Source: BofA Global Investment Strategy, EPFR Global

Potentially this is happening as people want inflation protection but worry that it will eventually mean that yields rise. Notice how investors have been selling Gold and buying TIPS.

Chart 15: Weekly FICC flows as % AUM



Source: EPFR Global

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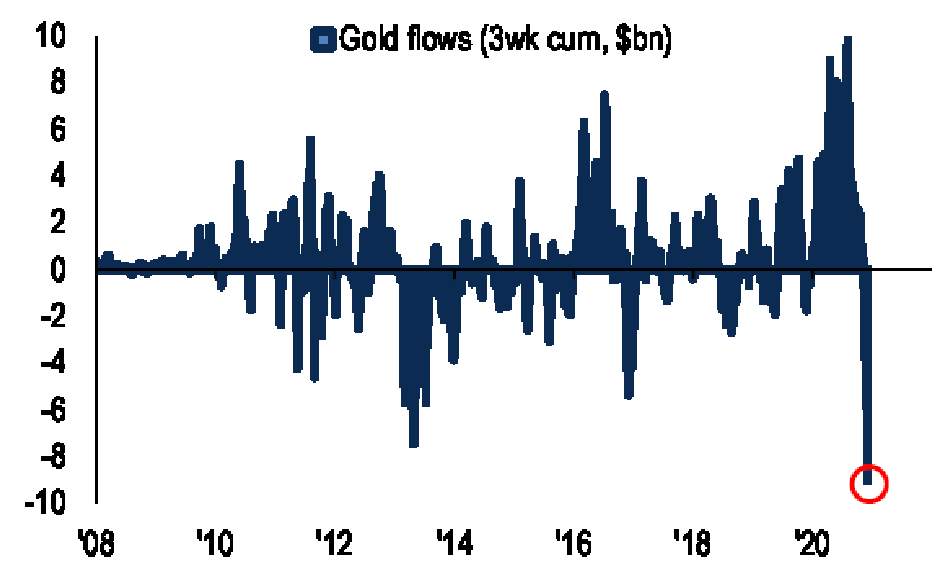
Gold

Over the last three months, Gold flows have seen a large reversal. If stocks are flying, who needs a safe haven, after all.

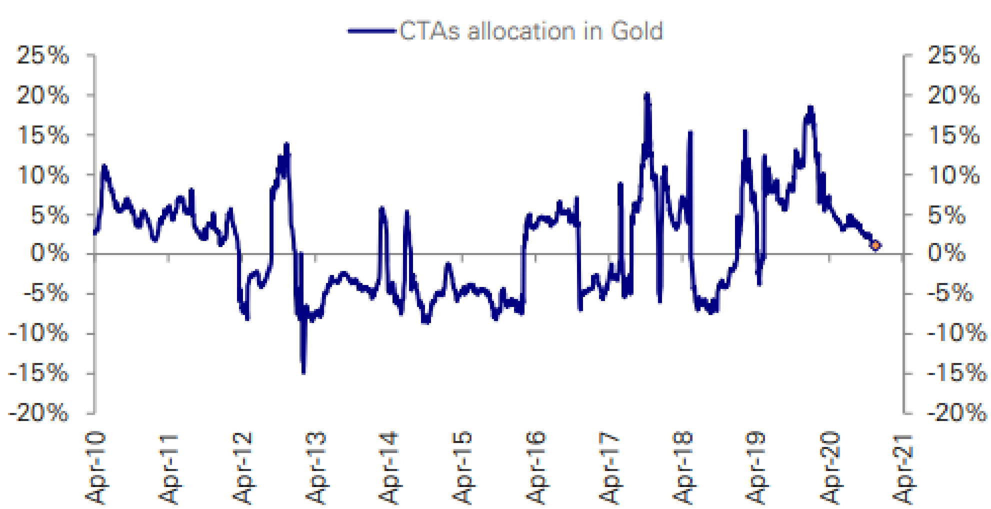
Chart 10: Largest gold outflows ever past 3 weeks



Source: BofA Global Investment Strategy, EPFR Global

At least one category of participants is now nearly back to a zero allocation to Gold.

Figure 15: CTAs gold positioning has been trimmed steadily and is close to neutral



Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

Gold popped back up off the recent lows, but neither hit the buy zone, nor has been able to break back above the 1850 breakdown level. I'm waiting for a reason to get involved again.

Platinum is much more interesting. Its industrial uses give it a different profile than Gold. Last week saw a big break higher out of a multi-year range.

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Important Macro Data Releases and Events for the Week

Monday 12/7/2020	Industrial Production s.a. MoM (Oct) Forecast: 1.5%, Prior: 1.6%
	Ivey Purchasing Managers Index s.a. (Nov) Forecast: 51.5, Prior: 54.5
	GDP (QoQ) Forecast: 5%, Prior: 5%
Tuesday 12/8/2020	ZEW Survey - Economic Sentiment (Dec) Forecast: -, Prior: 32.8
	GDP s.a. QoQ (Q3) Forecast: 12.6%, Prior: 12.6%
	GDP s.a. YoY (Q3) Forecast: -4.4%, Prior: -4.4%%
	ZEW Survey - Current Situation (Dec) Forecast: -69, Prior: -64.3
	ZEW Survey - Economic Sentiment (Dec) Forecast: 35, Prior: 39
	CPI YoY (Nov) Forecast: 0%, Prior: 0.5%
Wednesday 12/9/2020	BoC Interest Rate Decision and Policy Statement - Current 0.25%
	European Council Meeting
Thursday 12/10/2020	**ECB Interest Rate Decision and Policy Statement/Press Conference**
	CPI ex-food and energy Forecast: MoM 0.1%, YoY 1.8%
	Initial Jobless Claims Forecast: -, Prior: 712k
	Initial Jobless Claims 4-week ave. Forecast: - , Prior: 739.5k
	Continuing Jobless Claims Forecast: -, Prior: 6.52m
	European Council Meeting

Friday
12/11/2020

- Harmonized Index of Consumer Prices YoY (Nov) Forecast -0.5%, Prior: -0.7%
- PPI ex-food and energy YoY (Nov) Forecast: -, Prior: 1.1%
- Michigan Consumer Sentiment Index (Dec) Forecast: 77, Prior: 76.9