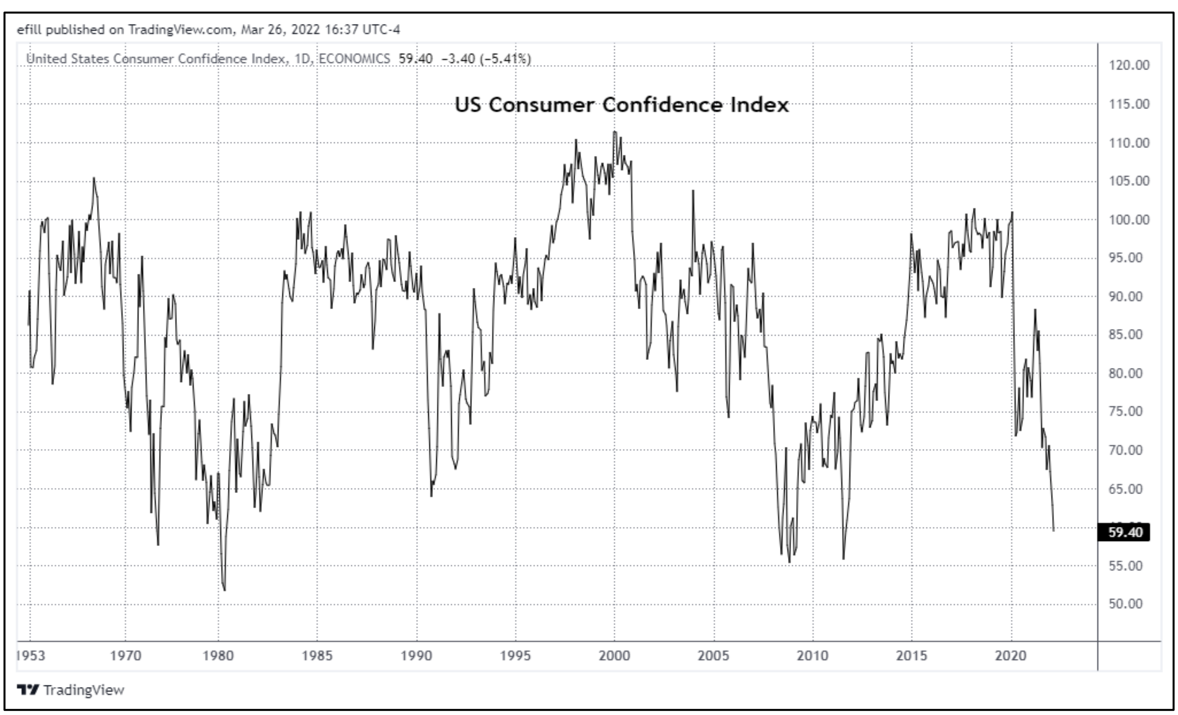
What to focus on in Global Macro for the week of March 28th, 2022

Last week, was another interesting one for markets. Front-end and long-end interest rates jumped again, stocks rallied, gold and oil both rallied, the VIX headed back into the low 20's, and the dollar rallied against EUR, GBP, and JPY, but fell against most EM and commodity linked currencies.

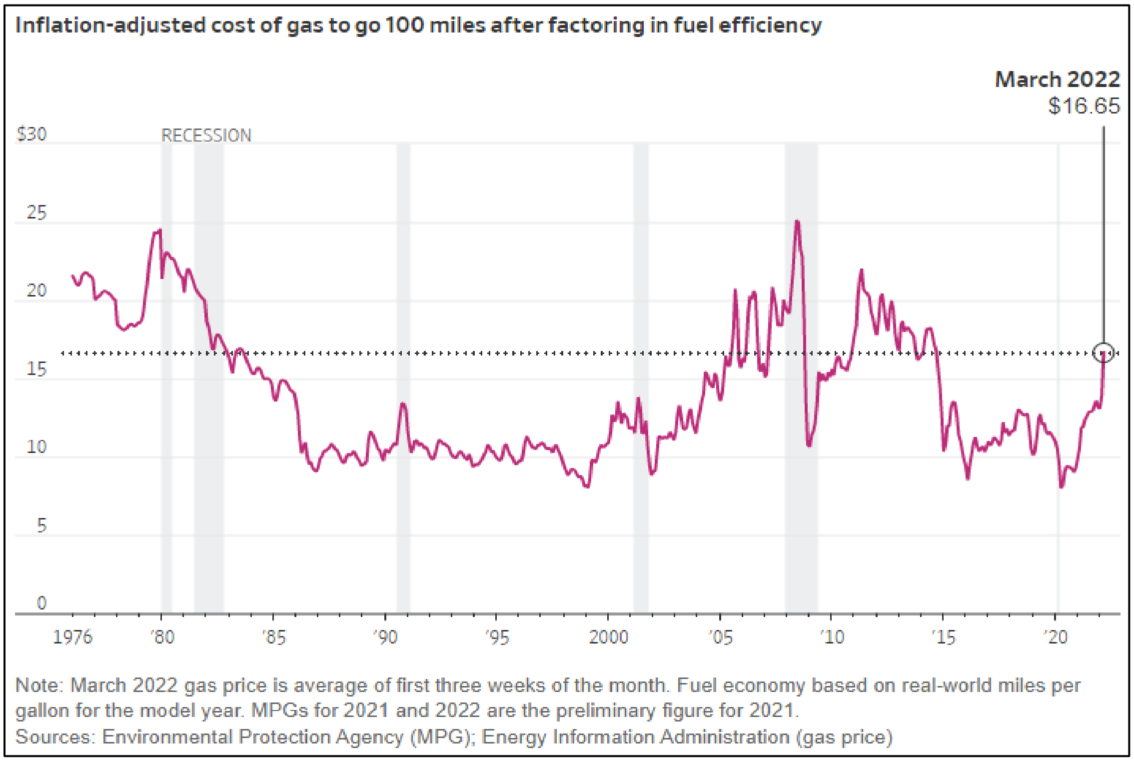
With encouragement from the Fed and various sell-side research departments, the markets had priced in another 40bps of Fed tightening by year-end, at the close on Friday. Fed Funds futures now say another 205bps of tightening is in the cards this year, with a high likelihood of at least one 50bps hike.

The market has been impressed by the Fed's now almost single-minded focus on inflation. Not only is the Fed now expected to remove all accommodation, but to go past the neutral rate and into a tight policy stance. With a strong employment picture as the backdrop, the terminal rate has been rising as a result. Still, it is seen by both the Fed and the market to be front-loaded. A quickly flattening yield curve has been the result. With the Fed actively looking to soften demand and tighten financial conditions, the big question remains, how will the economy react to the mix of very high inflation and quickly rising interest rates.

There are signs that higher food and fuel prices, combined with rapidly rising mortgage rates are starting to sour the mood of consumers. However, in terms of energy and food prices, the US is better off than many others.

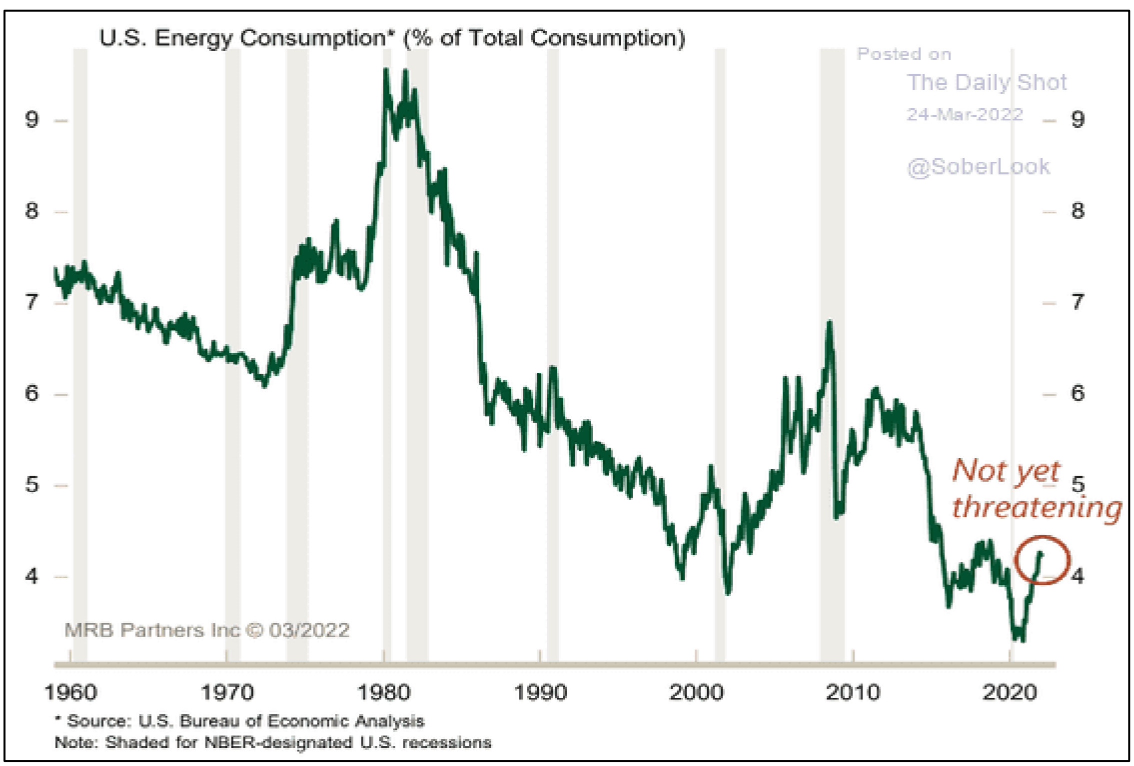


The jump in fuel prices has been very fast and is hitting the economy unevenly. It is creating volatility in earnings and growth rates across the economy. For consumers, however, some historical data suggests that the rise so far remains manageable.



Inflation-adjusted cost of gas to go 100 miles after factoring in fuel efficiency

Note: March 2022 gas price is average of first three weeks of the month. Fuel economy based on real-world miles per gallon for the model year. MPGs for 2021 and 2022 are the preliminary figure for 2021.
Sources: Environmental Protection Agency (MPG); Energy Information Administration (gas price)



U.S. Energy Consumption* (% of Total Consumption)

* Source: U.S. Bureau of Economic Analysis
Note: Shaded for NBER-designated U.S. recessions

Still, it is hard to know in real-time the magnitude of the effects, given higher overall leverage in the economy. Margin pressure has been building and EPS estimates falling.

This note from BoA's Flow Show was interesting… *"asset prices are driven by two things and two things only…rates & earnings; past 60 years plenty of years stocks have risen as EPS decelerates but on 5 occasions when EPS decelerates AND inflation accelerates AND bond yields rise, SPX struggled bigly…1969 -11%, 1974 -30%, 1977 -12%, 1990 -7%, 2005 +3%."*

The combination of continued supply disruptions and huge geopolitical uncertainty, put the ever-louder discussion of de-globalization front and center last week. Will the Ukraine conflict be the inflection point that ends up splitting the world into East vs. West, as a weak Russian/Chinese alliance faces off against the US and Europe, with the rest of the world having to pick sides or try and remain neutral? Blackrock's Larry Fink, Oaktree's Howard Marks, and Adam Posen of PIIE (via Foreign Affairs) all suggesting that the swing towards de-globalization, already underway, has now accelerated and may be lasting.

The Russian sanctions and prospects for a splitting of the globe into two blocs have people again talking about the demise of the USD, as the global reserve currency. Putin's demand that Europe buy energy via RUB payments going forward was not well received, but India is expected to sign an agreement shortly doing just that. At the same time, it appears that Saudi Arabia is considering accepting CNY as payment for its energy exports to China. So far, 61% of global reserves are still held in USD, and 71% of FX volume includes the dollar in the currency pair. The rule of law issues that some of these countries have, will in my view, ensure the dollar's dominance for a while still.

Markets

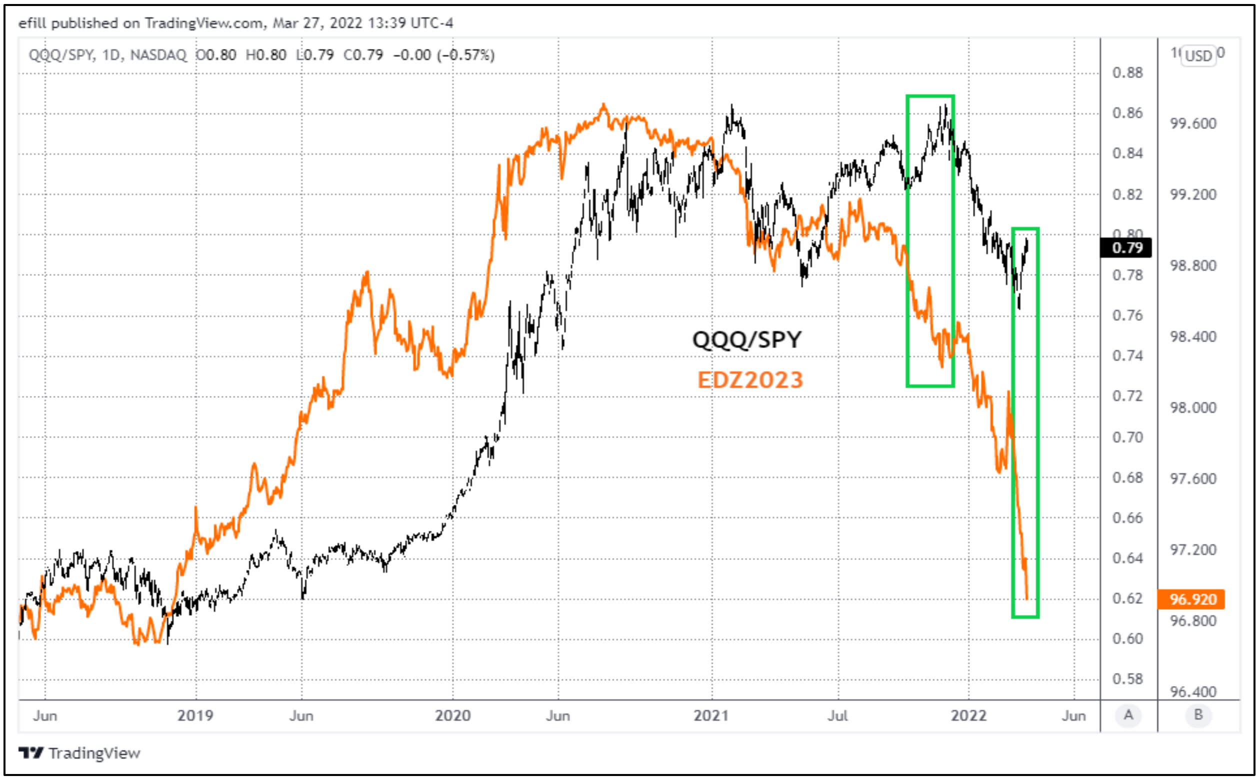
Equities overall had a good week. Hopes for some kind of resolution to the Ukraine conflict continue as the Russians, unable to make much progress, talked of refocusing on the Donbas. The Fed continued to talk about how strong the economy was and how they could achieve a soft landing.

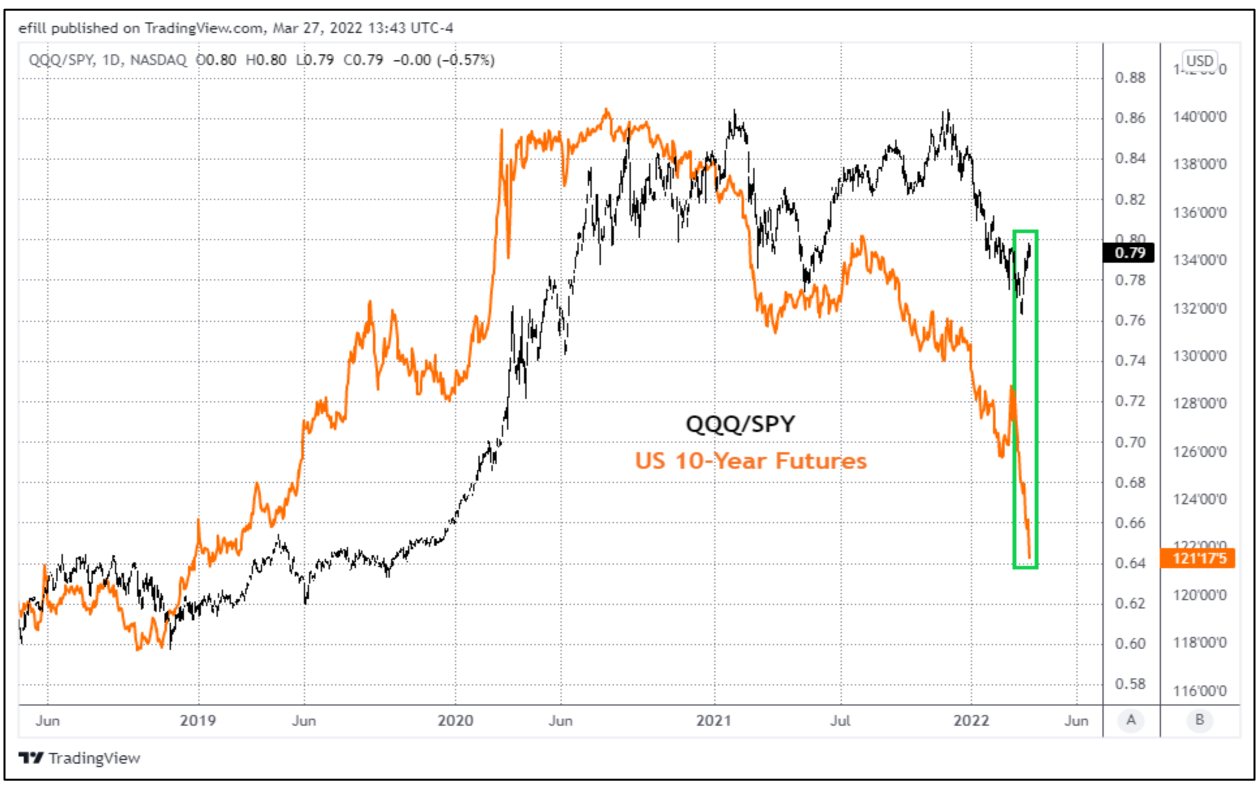
Maybe more importantly for the price action, the week started with investors still rather bearish. As per DB, aggregate equity positioning was in the 13th percentile, while systematic equity positioning was in the 8th, and vol. control strategies were in the 7th percentile for positioning.

The NDX, with an outside range week in place, followed through last week, despite the jump in US rates.

Not only did it rally, but it also outperformed the SPX. It just goes to show how hard it has been to trade the constantly shifting correlations, occurring, despite what the prevailing narratives would suggest.

It has been rare to see NDX outperformance in the face of falling EDs and Treasuries.



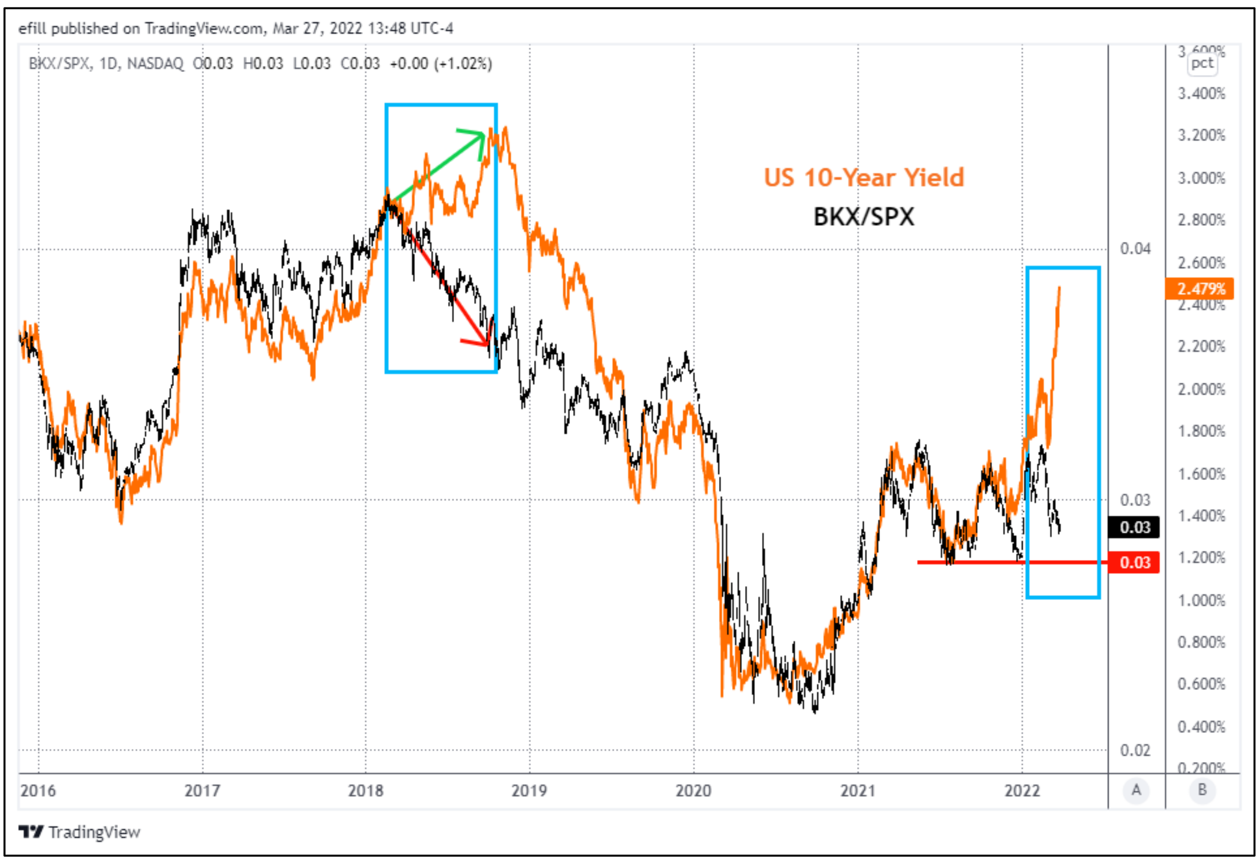


With the Fed intent on getting tighter Financial Conditions, and the "Fed put" nowhere in sight, it does seem like stocks and bonds are playing a game of chicken at the moment.

The big gap between Fed Funds and inflation has resulted in the fastest pricing of a hiking cycle in history. As of last week, that was still carrying on and extending. The Fed's aggressive guidance has effectively already enacted the tightening. We will now see how the economy reacts and if/when it starts to bite.

With the curve flattening so far driven by the front-end rates rally, the next shoe to drop in the cycle should be the eventual roll-over of bond yields. Given last week's price action, are not there yet.

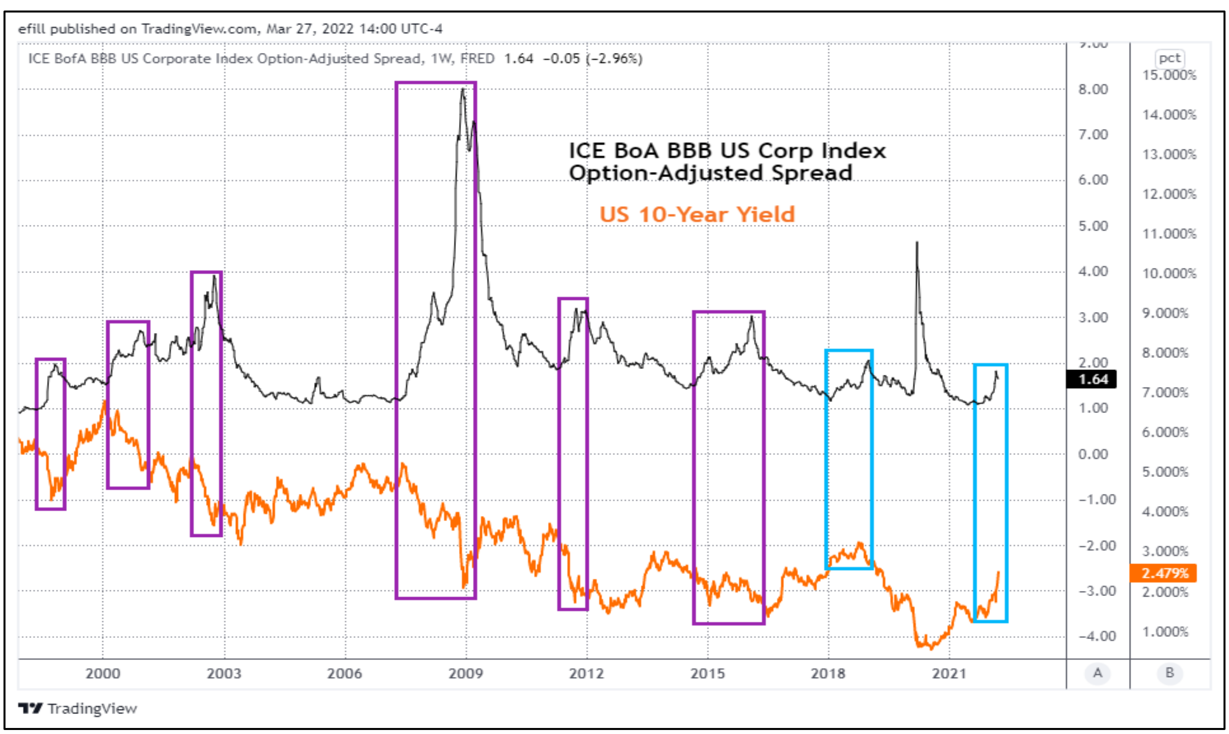
It is worth noting that the flattening curve has started to impact the relative performance of financials. Clearly that divergence to Treasury yields can go on for a while and even grow. However, it is worth keeping an eye out for increased underperformance by the banks.



We are in the process of testing how much of this rapidly rising interest rate environment equities and credit spreads can take.

With last week's move in Treasuries, we are now at historically overbought levels in 10-year yields. Now, that doesn't mean they have to go down, but it does mean it is time to pay attention to any loss of momentum and to be on the lookout for what might cause it.

It is probably not surprising that most credit spread widening episodes over the last 20-years occurred when yields were falling and there was a growth scare. Now, and to a lesser degree, 2018, show a fear of inflation. That is a return to the price action of the 80's and early 90's.



This chart's red vertical lines show when the monthly RSI on the 10-year yield printed similar extreme readings as now. Interestingly, the set-up of 10's vs. 2's (flattening) is similar at each of the points.

What stands out for me is how very different the equity market outcomes are following these points in time.

Moving on to FX and foreign markets, commodity-linked FX and EM has been doing well.

With Europe now again on the back burner for many investors, given the geopolitical situation and the recent flush in positioning, capital looks like it's exploring other themes.

If we are looking at a higher degree of de-globalization going forward, the battle for natural resources is unlikely to fade anytime soon.

LATAM in particular is in focus. A potential source of raw materials and labor for a US policy initiative looking to manufacture and source goods closer to home?

After being out of favor despite its natural resource wealth, Brazil has been seeing a big rally. Over recent weeks, the interest looks to be spreading across LATAM.

With the recent shift towards risk-on, DM commodity-linked markets are also catching a bid. Australia had underperformed due to China growth fears, but now equities and FX are improving.

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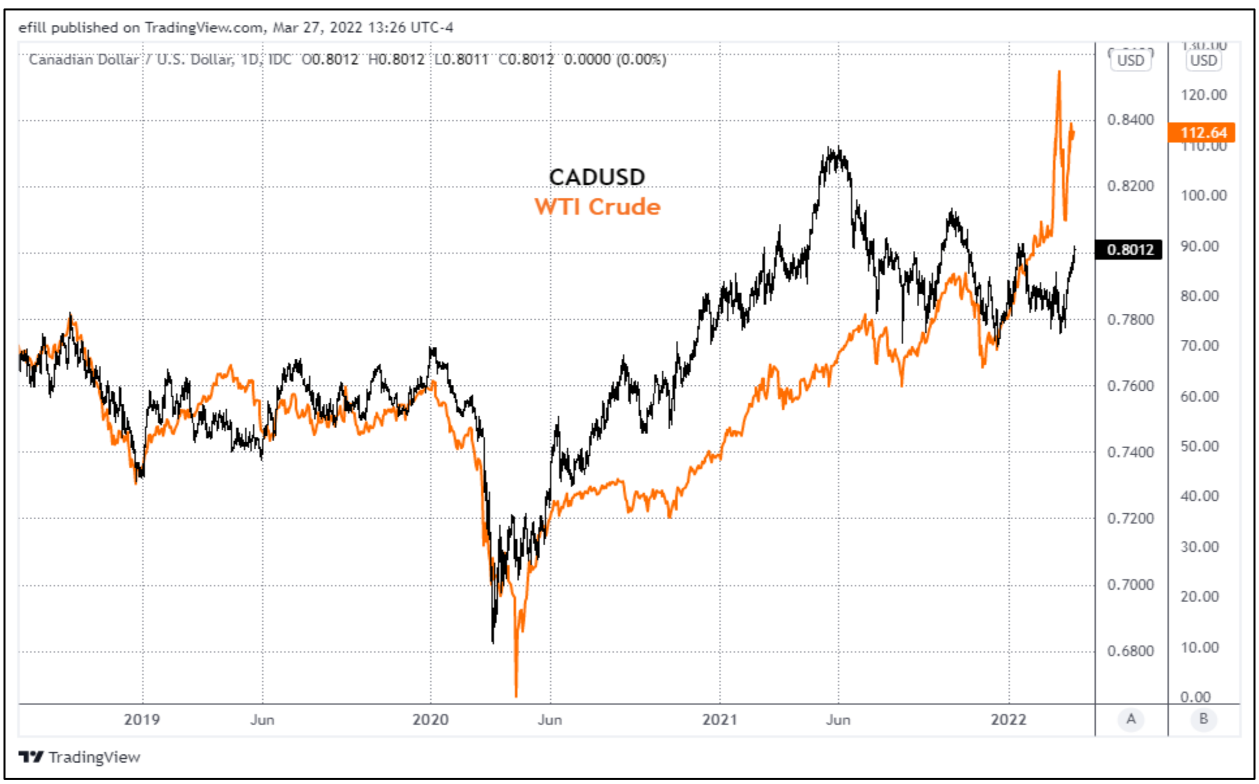
Canadian and Norwegian markets are performing too. Neither is expensive to oil now.



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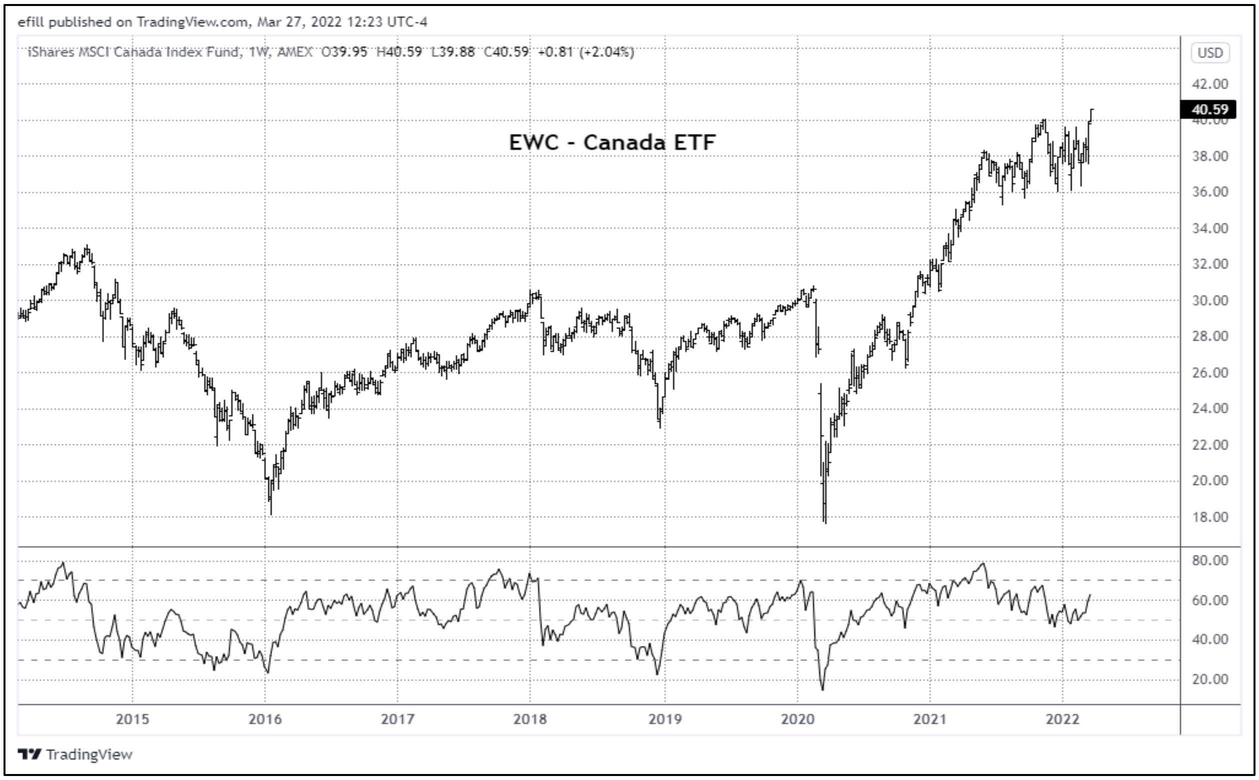
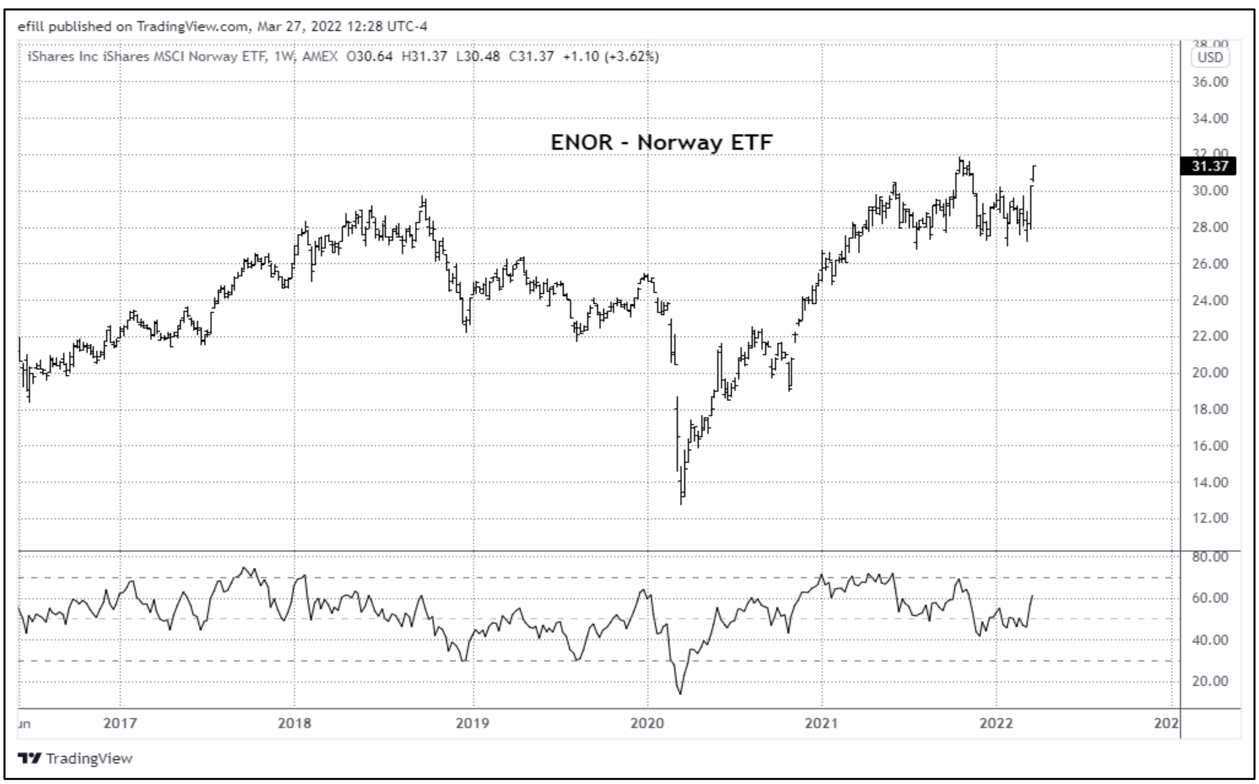
Stargazer Asset Management

The equity + FX combo has EWC at new highs.





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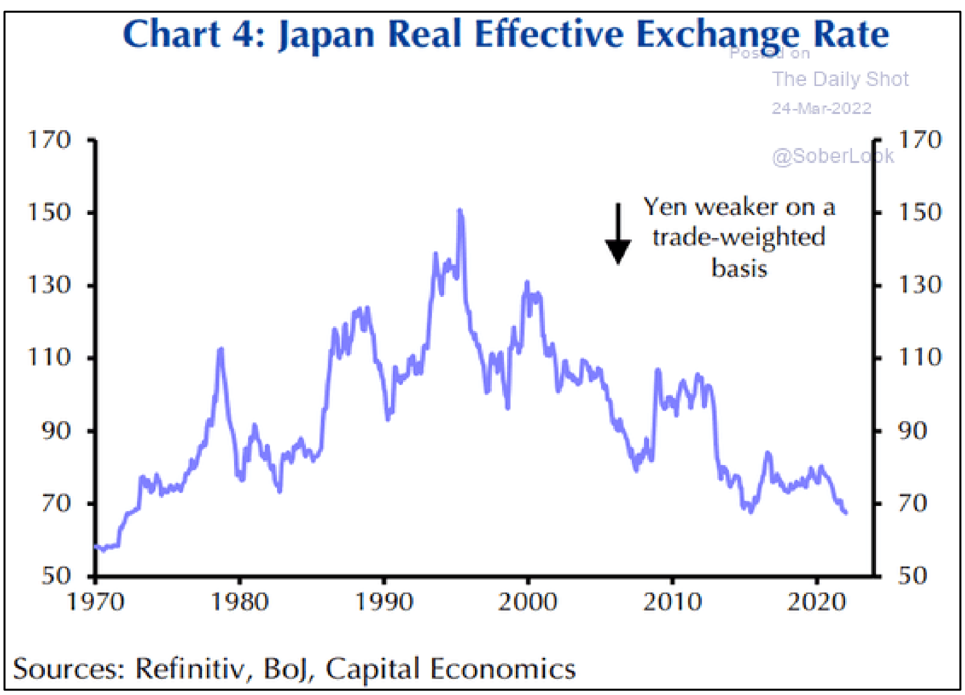
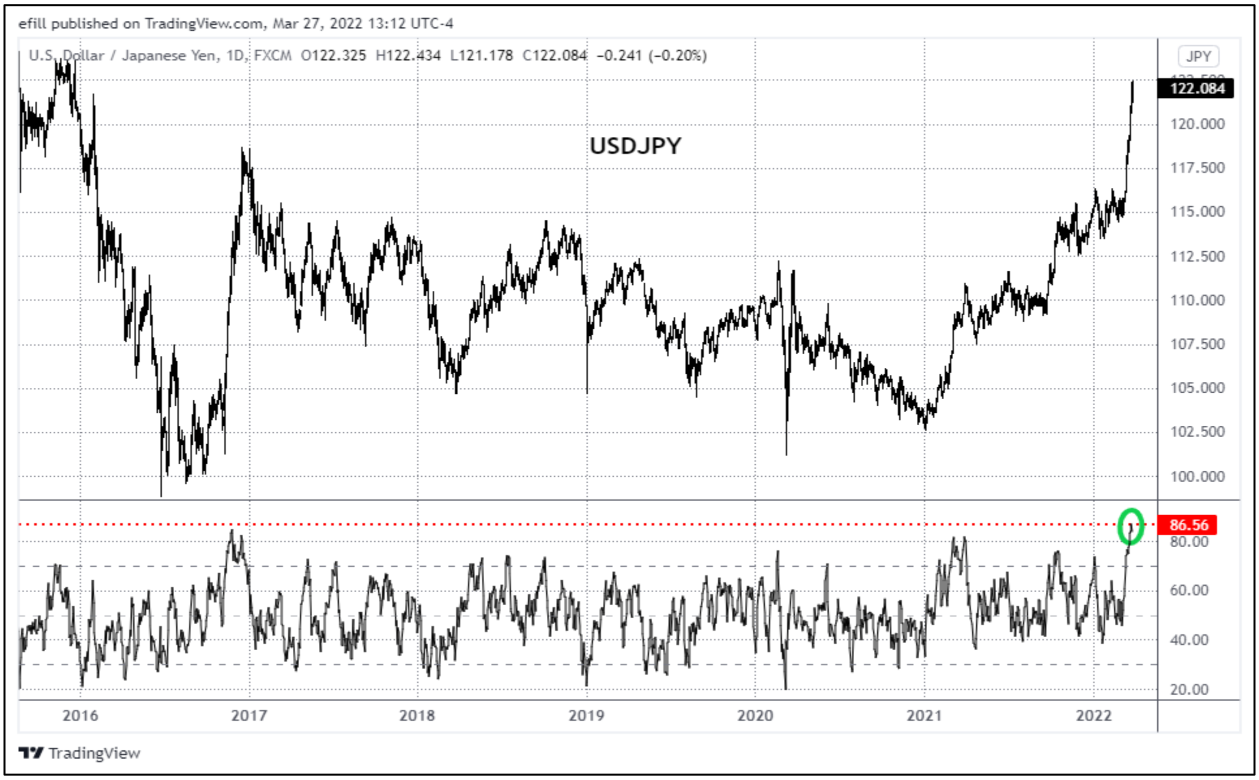
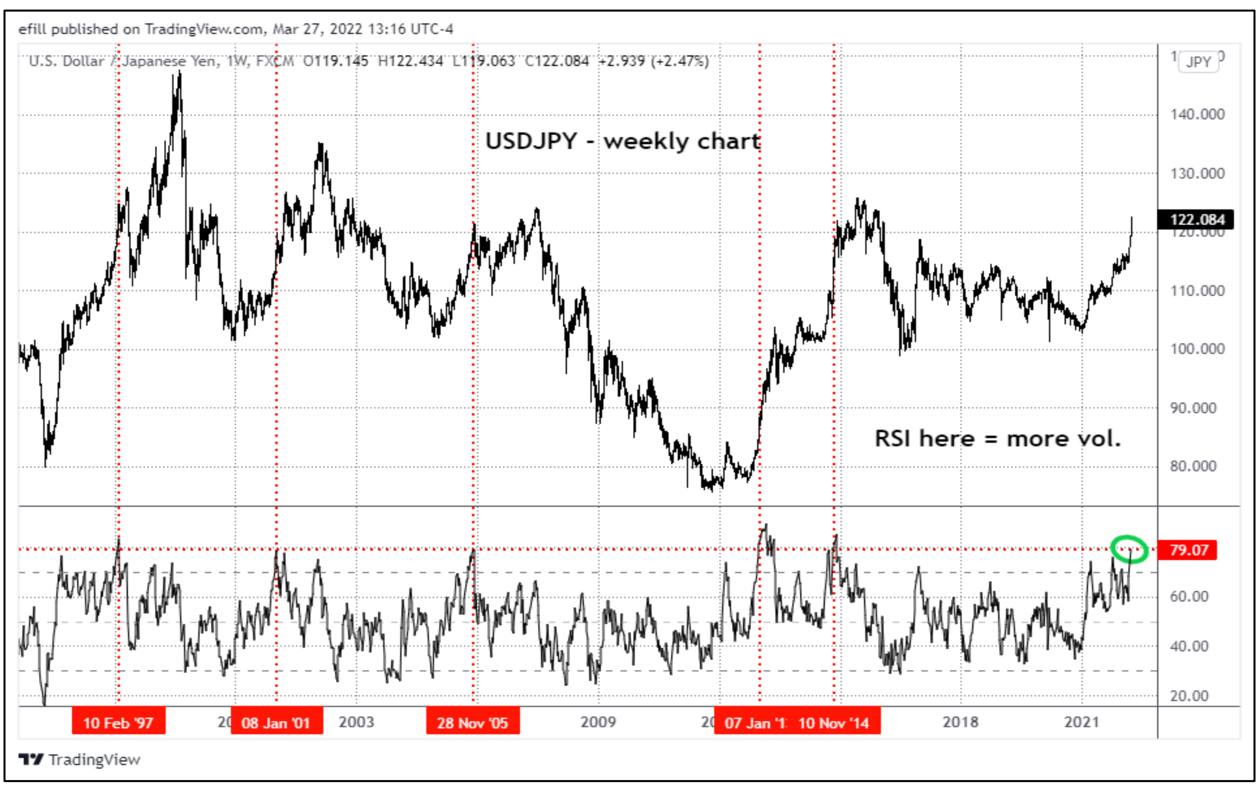
The DXY is not telling the story in FX as dollar strength persists vs. the EUR. Geopolitics and yield differential keeping it under pressure for now. I'm ignoring between 1.0800 and 1.1150.

The Yen has been hit by rising US rates and commodity imports. It is now getting to levels where BoJ/MOF protests are likely to become louder.



This is another market that is at overbought extremes you only get during high momentum moves. While the daily is “off the charts”, the weekly says more is possible. More vol. to come.





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Given the timeframe on this chart, it isn't meant for trading but rather to give some perspective. Longer-term I continue to like AUD. While this cross is potentially extended in the near term, it is one to keep in your sights given its potential.

Important Macro Data Releases and Events for the Week

Monday
3/28/2022

BoE Governor Baily speech

Retail Sales (Feb)

Tuesday
3/29/2022

Gfk Consumer Confidence Survey (Apr)

Fed's Williams speech

Housing Price Index (Jan)

Retail Sales (Feb)

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Wednesday
3/30/2022

- Business Climate & Consumer Confidence (Mar)
- Harmonized Index of Consumer Prices (Mar)
- ADP Employment Report (Mar)
- GDP Annualized (Q4)
- **Headline and Core PCE QoQ (Q4)**
- NBS Manufacturing and Non-Manufacturing PMI (Mar)

Thursday
3/31/2022

- Retail Sales (Feb)
- **OPEC Meeting**
- Initial Jobless Claims
- Initial Jobless Claims 4-week average
- Continuing Jobless Claims
- **Headline and Core PCE MoM and YoY (Feb)**
- Personal Income and Spending (Feb)
- Fed's Williams speech
- Chicago PMI (Mar)
- Tankan Large Manufacturing Index (Q1)
- Caixin Manufacturing PMI (Mar)

Friday
4/1/2022

- Markit Manufacturing PMI Final (Mar) across Europe
- **US Nonfarm Payrolls, Unemployment, Participation rate, and AHE (Mar)**

Markit Manufacturing PMI Final (Mar)

ISM Manufacturing PMI (Mar)

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