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Asset Management

# What to focus on in Global Macro for the week of June 8th, 2020

## Macro Themes on the Radar:

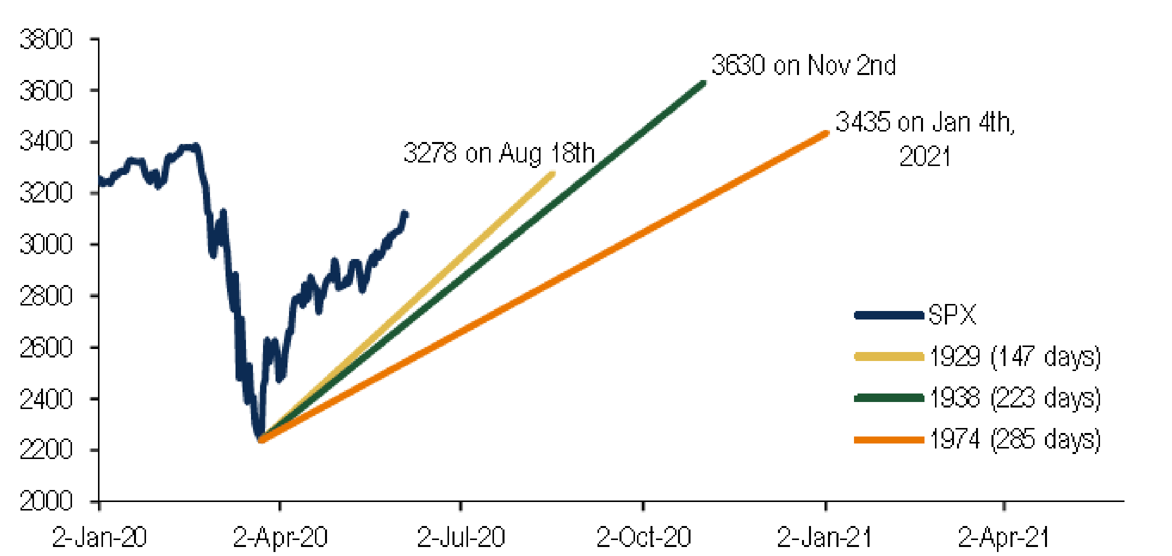
The economic data has continued to be all over the place globally; with some numbers coming in well below expectations, while others beat the forecasts by a wide margin.

Adding to the confusion is the unprecedented nature of the lockdown induced economic contraction and recovery.

Friday's employment data is a good example. The market was looking for -7.5m and instead got +2.5m, the biggest forecasting "miss" in history. While certainly good news for the economy, it was followed up by a statement that – for the third month in a row – data collectors had misclassified some workers as "employed not at work", when they should have been classified as "unemployed on temporary layoff." It seems that correcting this error would take the unemployment rate from the reported 13.3% to a revised 16.3%. Messy stuff, but markets are focused on direction rather than absolute levels at this point.

Despite all the noise, uncertainty and volatility in the economic data, markets have been betting that the combination of fiscal and monetary stimulus is sufficient to get us to the other side of the economic valley. BoA points out that while we have seen a $30trn drop in global market cap and a global GDP hit of near $10trn, we have seen global monetary and fiscal policy stimulus of roughly $18trn and $5trl in cash on the sidelines. The rally has been impressive.

Chart 3: Current rally of S&P500 vs greatest bear market rallies of all-time



Source: BofA Global Investment Strategy, Global Financial Data, Bloomberg

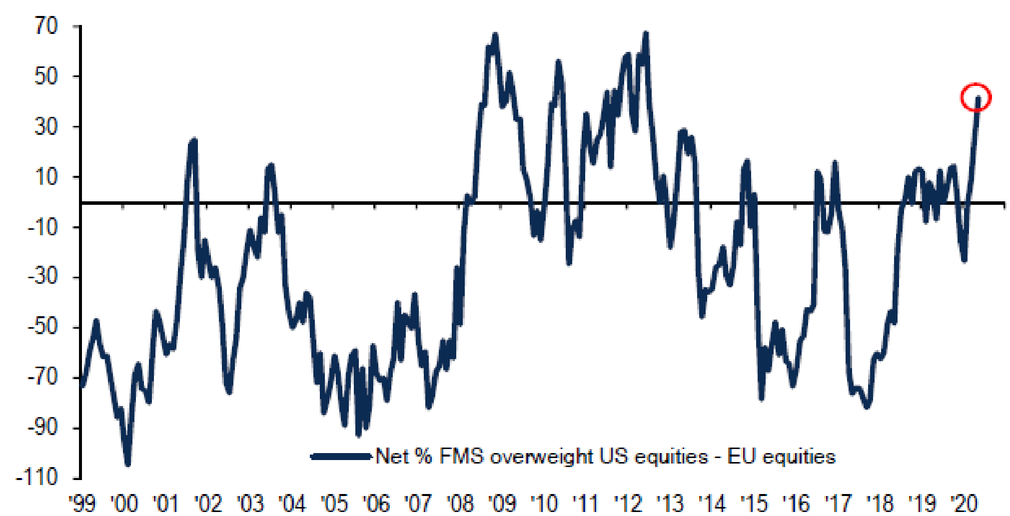
## Europe

The Europeans have had a busy two weeks as they continue to heap on more fiscal and monetary stimulus. Adding to the European Commission's recently proposed €750bln in loans and grants, Germany upped it's domestic stimulus by another €130bln and the ECB topped up its PEPP bond buying program with an additional €600bln.

Markets are starting to price a newly found sense of common purpose in Europe. While the divide between the north and south in both wealth and attitude remains, the size and scope of the initiatives being announced makes it feel and look like something is changing in Europe. There are still plenty of obstacles and potential roadblocks, but also a growing sense that Europe may find a way forward, having learned from some costly mistakes. As discussed last week, Europe has struggled to project itself as a viable investment alternative ever since the back to back shocks of the 2008 economic crisis and the European debt crisis.

It shouldn't be a surprise that European performance and positioning have suffered as a result.

**Exhibit 7: FMS investors most long US & short Europe since '12**




Source: BofA Global Fund Manager Survey

Until recently that is … over the last two weeks Euro Stoxx have rallied 16+%, nearly doubling the performance of the S&P500 over the same period. The combination of a market heavily positioned in the opposite direction and a potential catalyst for change can be powerful.

If they can find a way around the "frugal four" (five if you include the recent comments from Finland) the mood vs. Europe could undergo a lasting change. That would turn a short covering rally in Europe into something more lasting.

## What to Focus on Now:

Markets have been positioned for: safety, low global growth, low bond yields and a strong USD.

The result has been a relentless rally in growth vs. value, not just in the US but globally.

In the US, this has been reflective of the dominance of the technology heavy NASDAQ over all the other indices.

In the global version of growth vs. value, it has meant that the US has outperformed every other region of the world. Again, US technology has been the biggest driver.

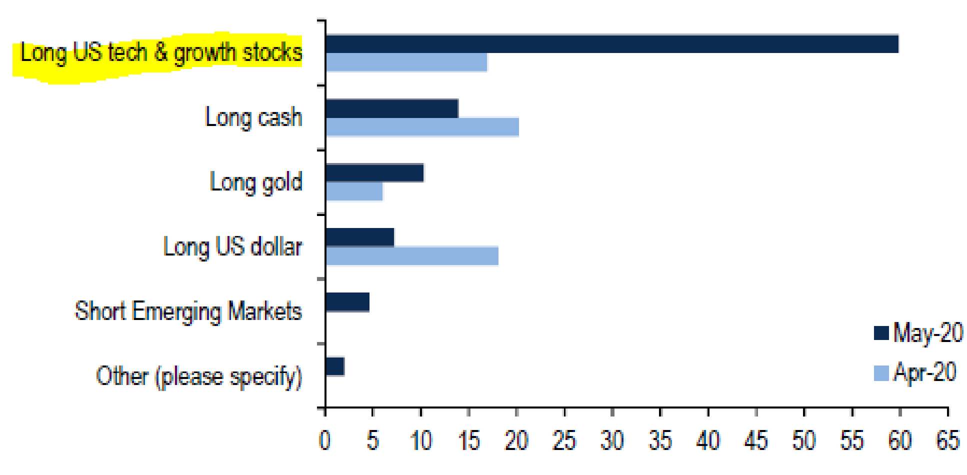
**Table 1: Polarization in numbers**

| | Market Cap ($bn) |
|---|---|
| US tech | 6,851 |
| FAAMG* | 5,603 |
| Emerging Markets | 5,143 |
| MAGA* | 4,944 |
| US healthcare | 3,935 |
| Eurozone | 3,679 |
| Global financials ex. US | 3,273 |
| China | 2,097 |

Source: BofA Global Investment Strategy, Bloomberg, MSCI, Datastream; FAAMG* = Facebook, Apple, Amazon, Microsoft, Google; MAGA* = Microsoft, Apple, Google, Amazon.

Sentiment and positioning became even more concentrated in May.

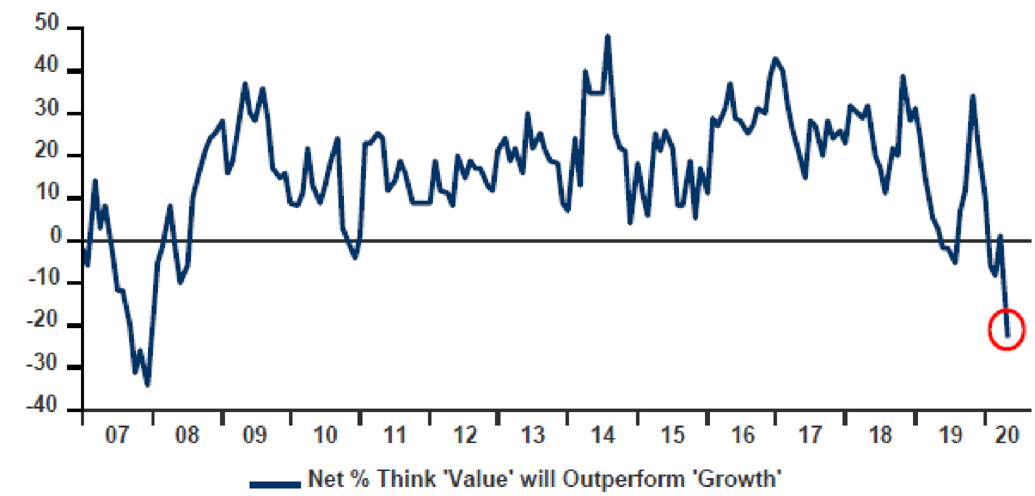
**Exhibit 29: What do you think is currently the most crowded trade?**




Source: BofA Global Fund Manager Survey

Until recently, no turn in sight…

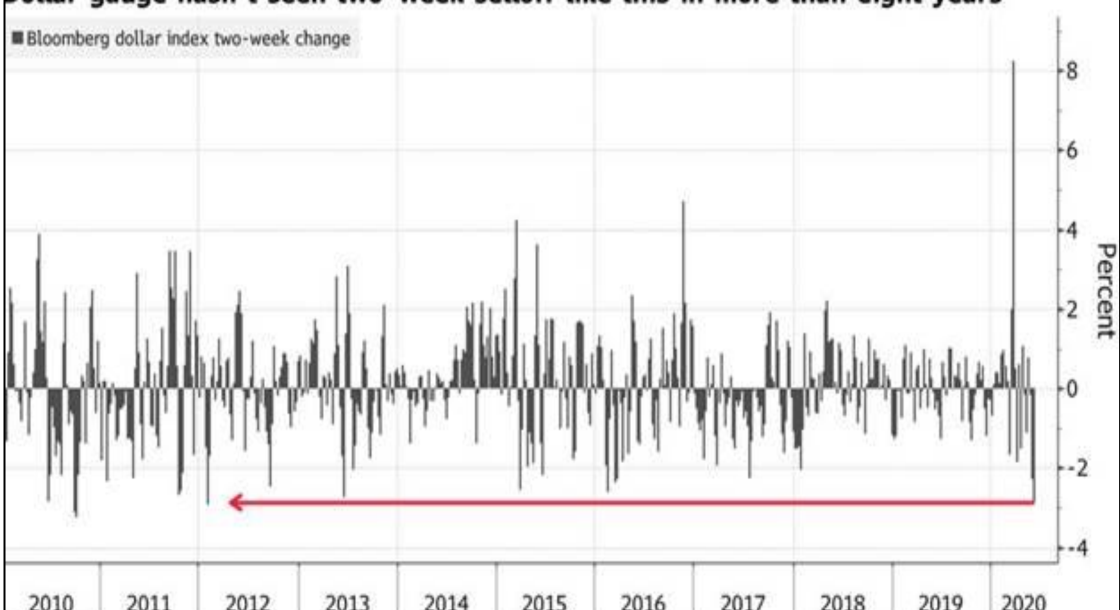
**Exhibit 6: Net % Think 'Value' stock will Outperform 'Growth' stocks**




Source: BofA Global Fund Manager Survey, Bloomberg

However, over the last couple of weeks, flows and prices have started to turn. The positive developments in Europe and the potential implications for global growth are almost certainly responsible for some of the shift in mood. The potential for a better outcome in Europe has also boosted the EUR and helped weaken the USD as a result. The EUR move has goosed what was already a potential turn in the USD as higher beta currencies started to rally.

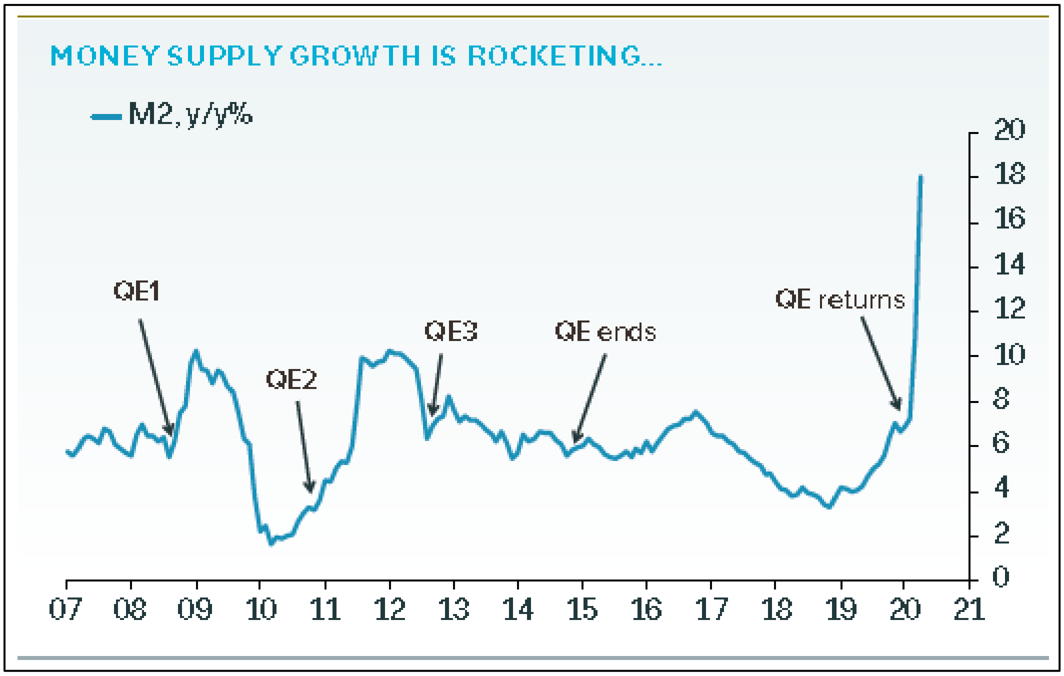
**Dollar gauge hasn't seen two-week selloff like this in more than eight years**

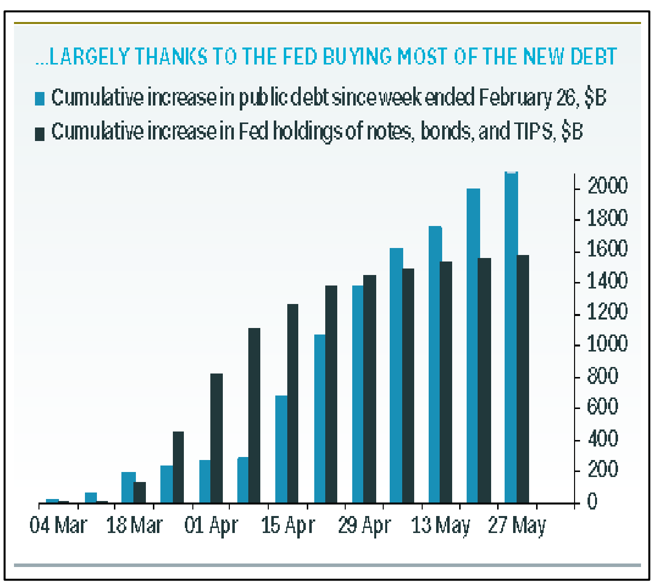


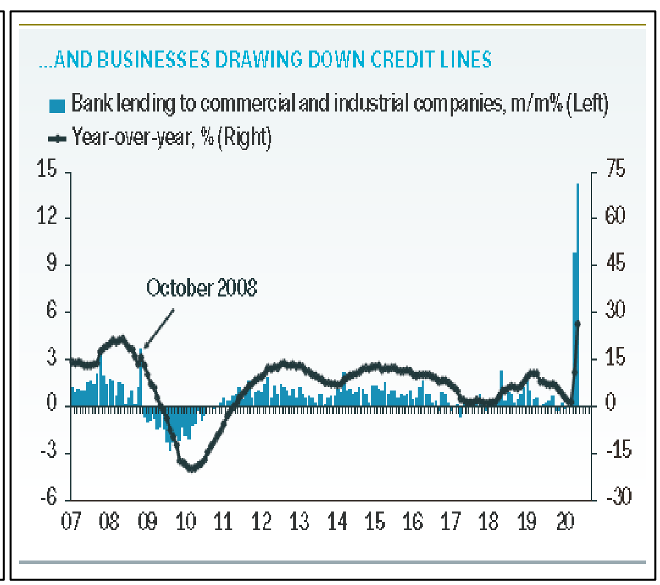

Source: Bloomberg

The dollar, as the global reserve currency, is always an important indicator of global liquidity. USD rallies often go hand in hand with slower global growth and deflationary environments. The opposite it true for a falling USD.

At least so far, the Fed's efforts to flood the markets with USD seem to be working. M2 growth is exploding. Although you should expect both drivers of this M2 growth to moderate shortly.



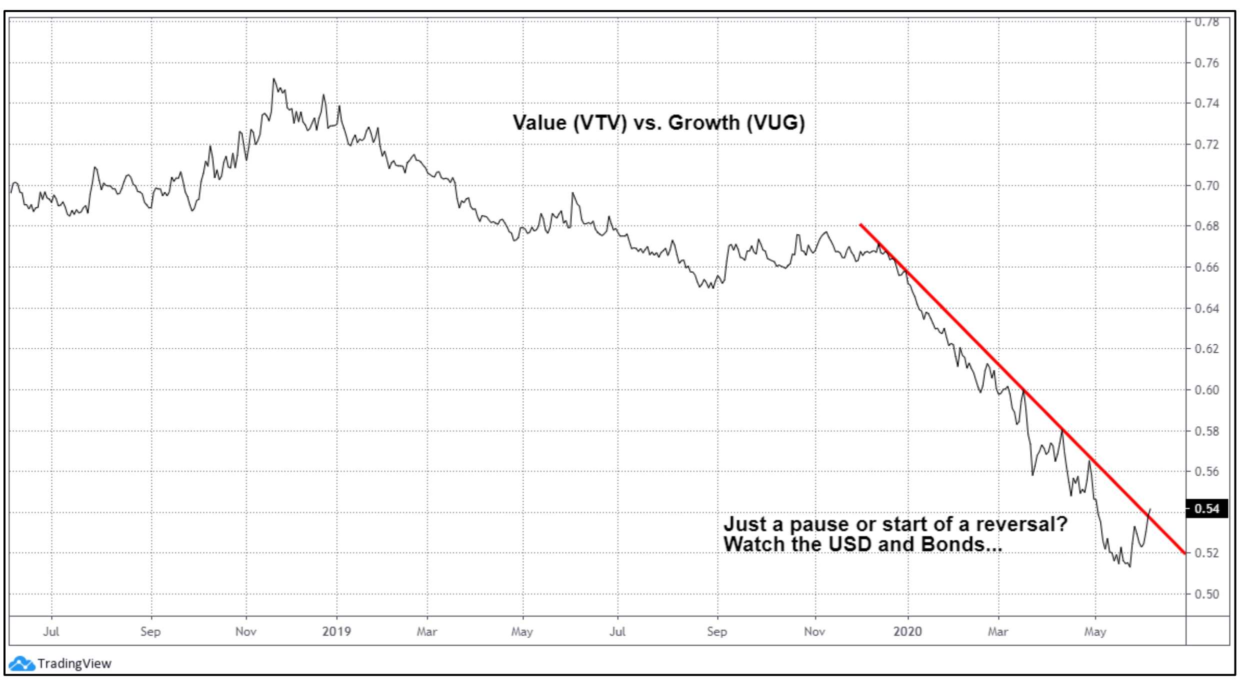



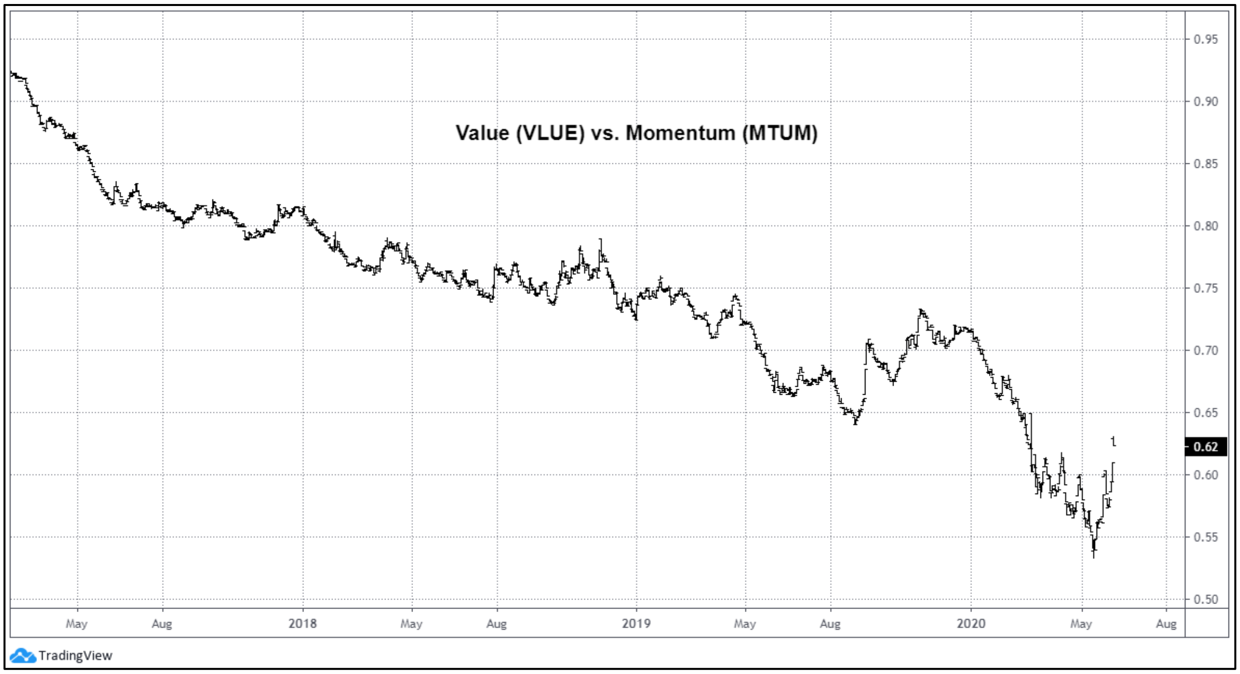

(Source: Pantheon Macroeconomics)

The acceleration of the dollar down move is providing some relief for "value" globally. As noted above, European markets have had improved relative performance recently, but so has EM. When looking at EU and EM ETF's, the performance clearly has a direct currency effect built in for US investors, but that is certainly not the whole story.

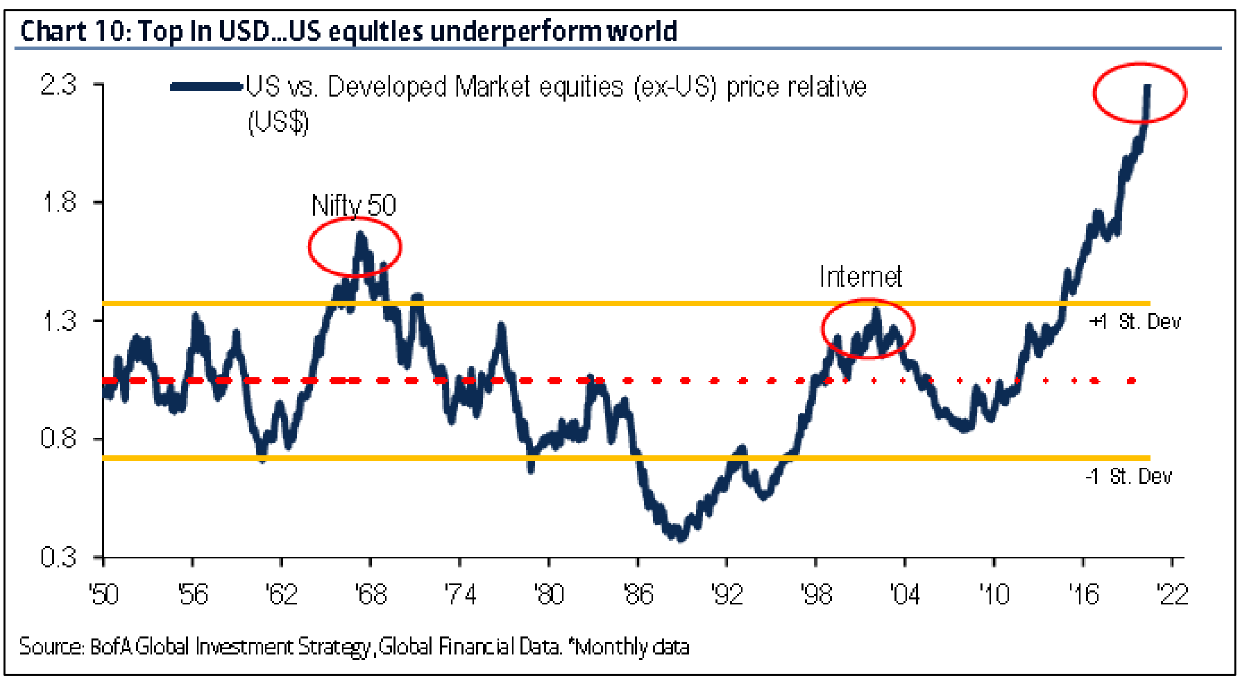

Continued USD weakness would matter a lot for relative performance both globally and domestically. US Value is trying to turn vs. Growth too…



And vs. Momentum…




In this chart previous USD tops after bouts of US equity outperformance are circles in red. A continued trend lower in the USD now could support a similar outcome.




For US equities, the dollar trend provides either a tailwind or headwind for the growth vs. value allocations. Here too a durable trend reversal in USD would be important.

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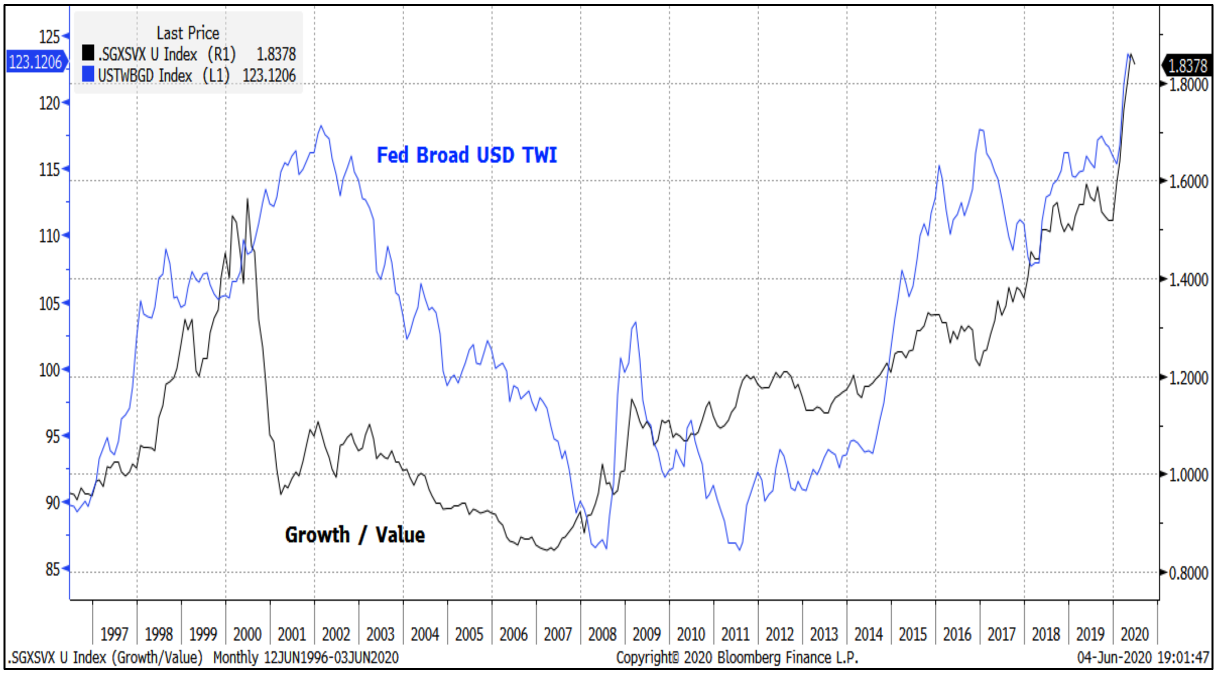
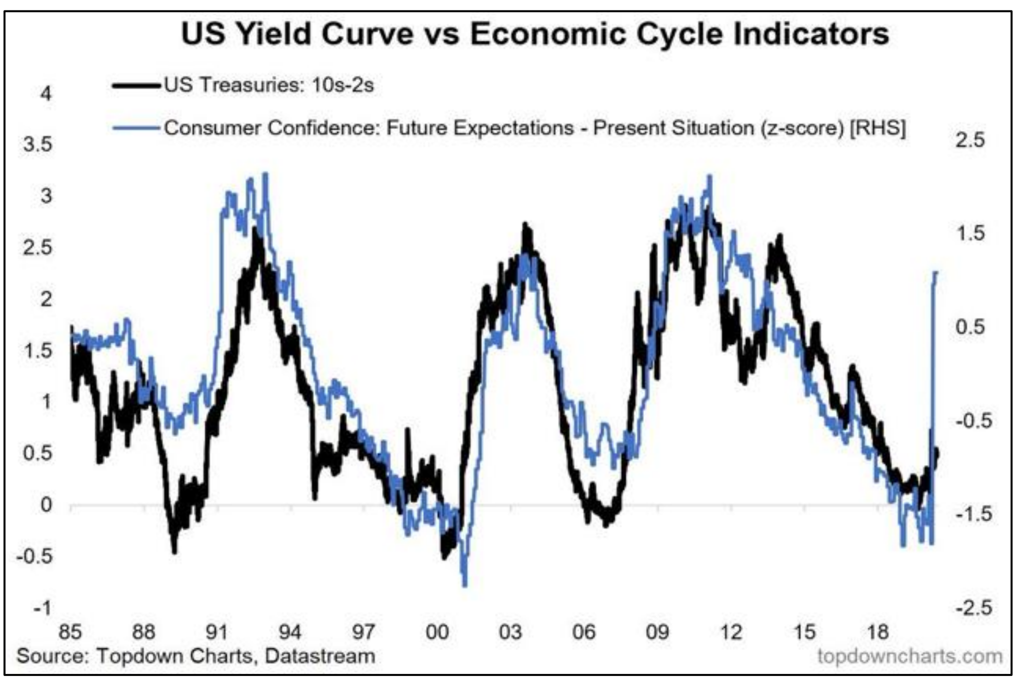



However, the USD trend is only part of the story. What bonds do now is also very important. With the potential for improved global growth and massive debt issuance, bond markets have been hit over the last week.

Yield curves have been steepening and this in turn is also supporting the value stocks.

Is this just the start?



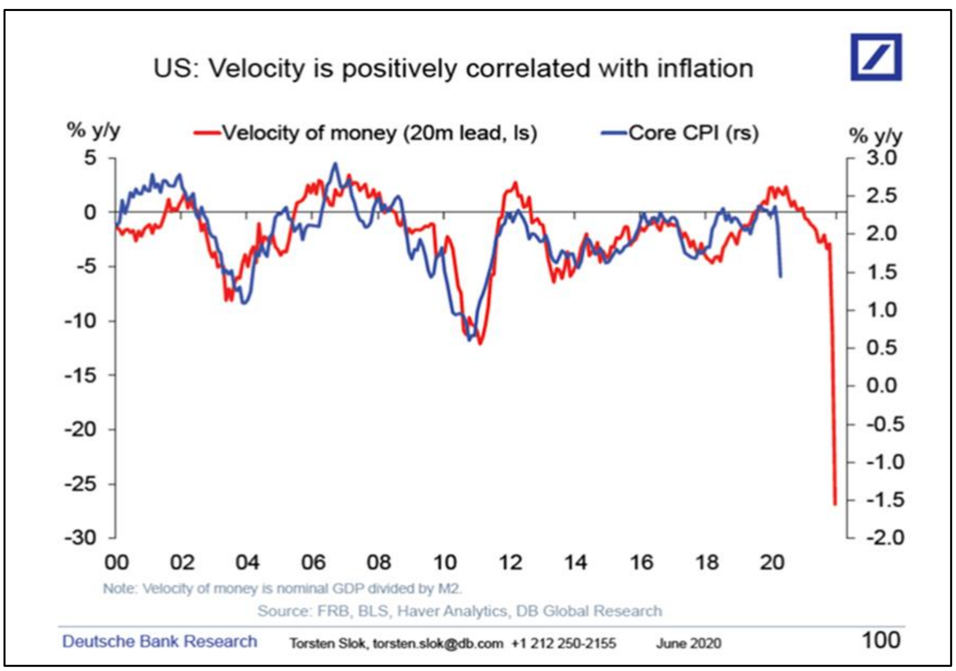
The market has been very reluctant to sell the long end of the curve as it has been viewed as providing a continued safe haven for investors.

However, over the last week or so safe havens of every flavor have increasingly fallen out of favor. Not only have Treasuries been sold, but so have CHF, JPY, Gold and money market funds.

The upcoming Fed meeting will be important as the market has increasingly convinced itself that Yield Curve Control is coming. If this notion is expressly rejected at the press conference, look out in the bond market.

If the Fed doesn't clearly define any thoughts around YCC, the market may assume it will be followed implicitly rather than explicitly. However, any mention of a reduction in the rate of Fed purchases going forward will call the viability of implicit YCC into question as well.

Another thing to ponder for the bond market, is that the move from monetary to fiscal policy may represent a more inflationary potential outcome. Monetary policy tends to act indirectly via financial assets, while fiscal policy goes straight to the bloodstream of the economy. With continued emphasis on fiscal policy going forward, there is the potential that the velocity of money actually starts to rise. "GDP transactions vs. asset transactions."

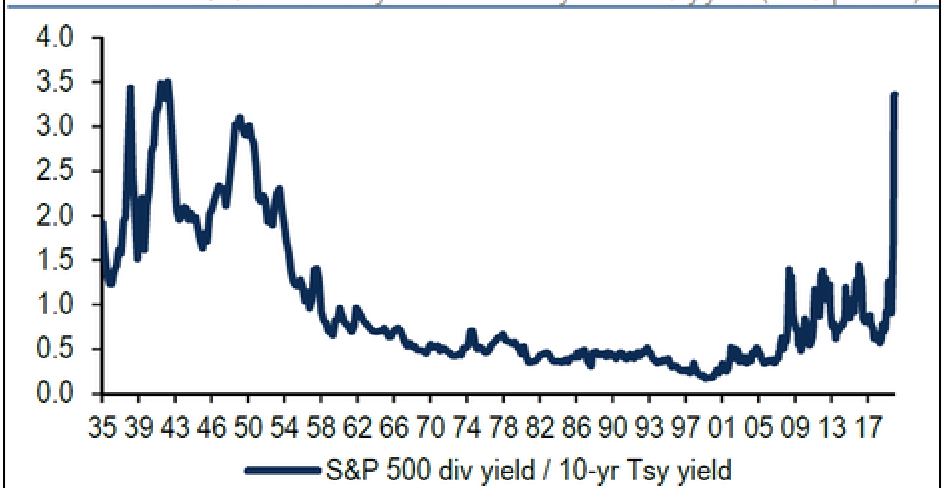



Of course, a disorderly rise in bonds yields could rattle the equity market in the short-term. The discounting of global front end rates at the zero-bound for the foreseeable future, has almost certainly had a hand in the powerful equity market rally we have seen off the lows.

Charts like this…

**Chart 7: Stocks have not been this attractive vs. bonds since the 1940s**

The ratio of the S&P 500 dividend yield over the 10-year Treasury yield (1935-present)




Note: based on Long-Term Treasury Composite prior to 2Q53

Source: S&P, BofA US Equity & Quant Strategy

A sudden rise in bond yields would require some adjustment and almost certainly meaningful further rotation in portfolio allocation.

In Fixed Income, we have seen increased selling of Treasuries and Money Market funds and buying of Investment Grade and High Yields bond funds. Certainly, some of this flow is encouraged by the Fed's support of the corporate bond market. However, it could also reflect the view that higher Treasury yields will be at least partially compensated for, by tightening credit spreads.

## Fixed Income Flows (Chart 14)

Largest **IG bond** fund inflows ever ($20.8bn)

2nd largest **HY bond** fund inflows ever ($10.2bn)

Largest **EM debt** fund inflows in 19 weeks ($2.3bn)

Largest **Muni** inflows in 14 weeks ($1.6bn)

Small **MBS** inflows ($0.5bn)

Largest **Govt/Tsy** fund outflow in 9 weeks ($3.4bn)

(Source: Flow Show first week of June BoA/ML)

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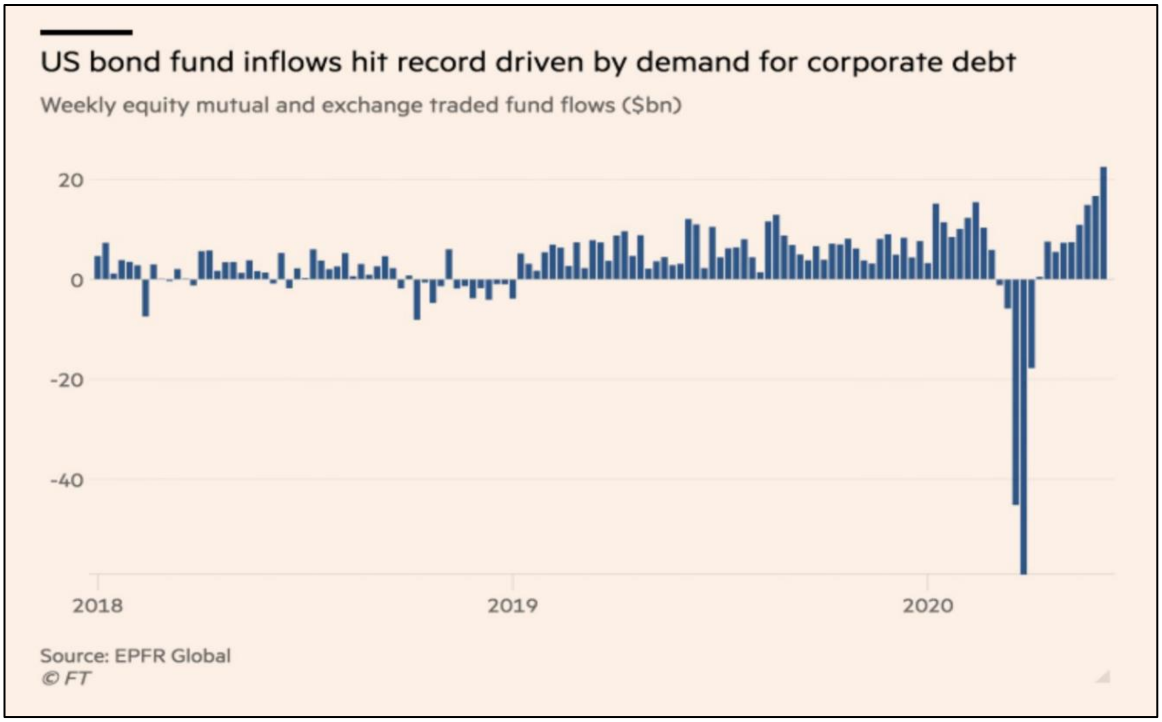
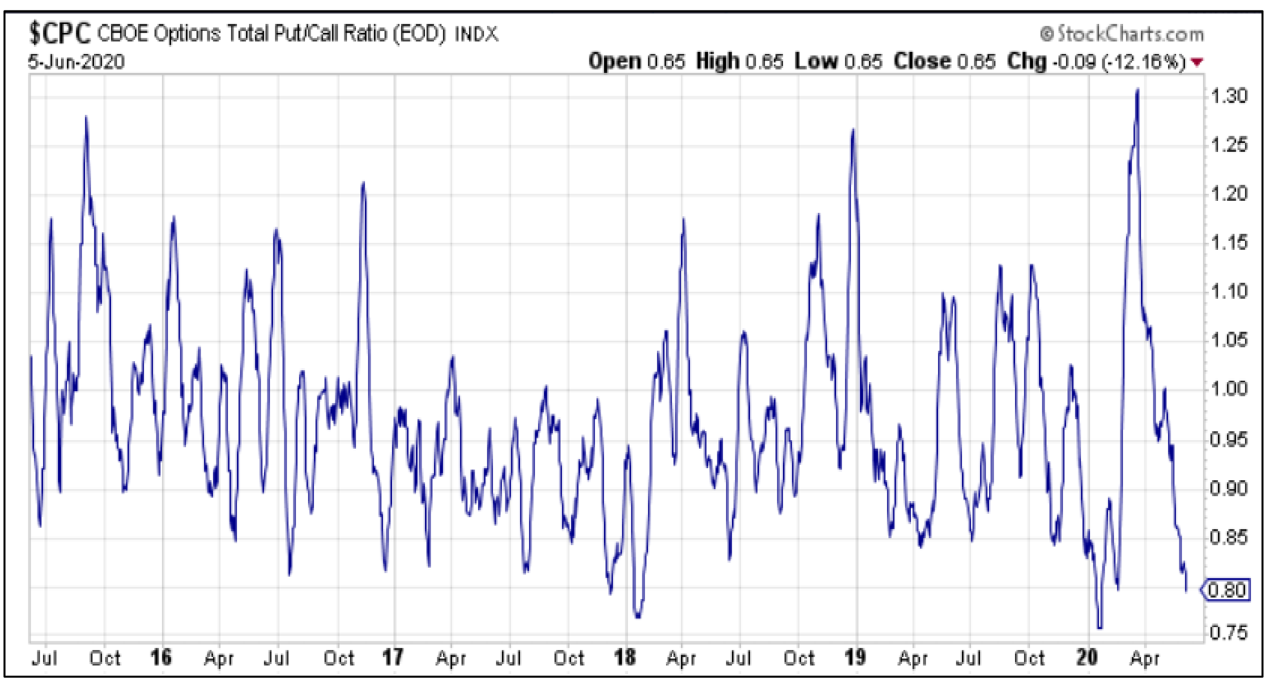
Here are recent flows into corporate bonds relative to the last few years, seen another way (FT).




**Note of caution…**

Global equities have had a monster run off the lows. In the near-term, rotation and relative performance aside, we are starting to see some signs that we are getting a bit extended here. The Put/Call ratio is getting to levels that normally demand increased vigilance…



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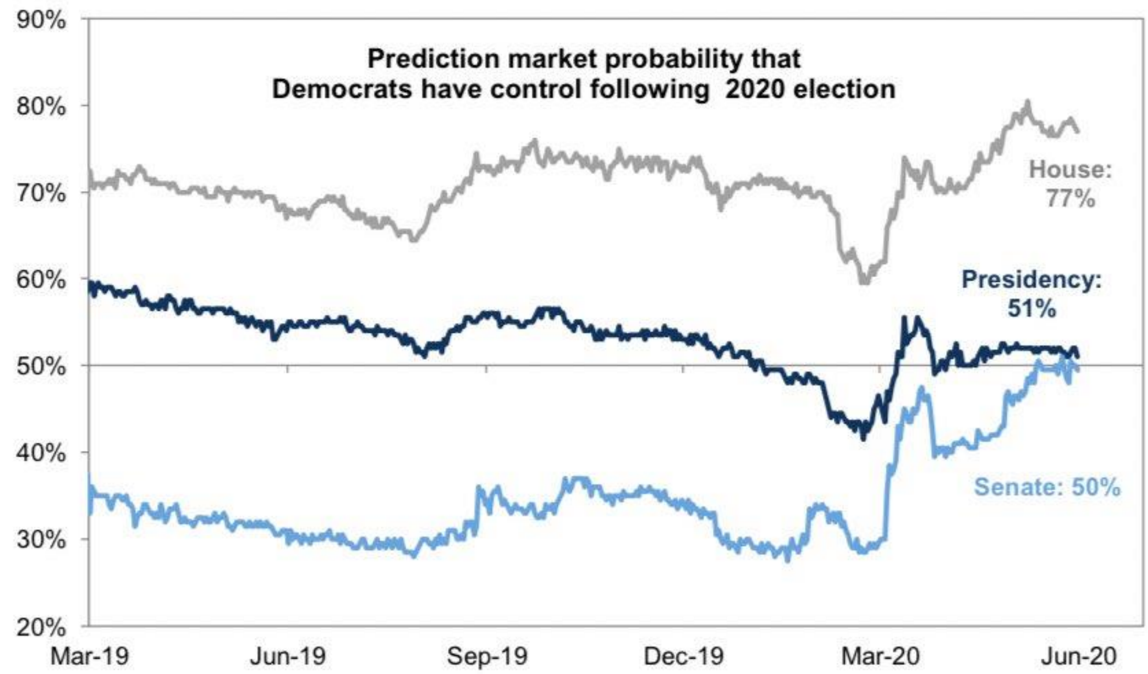
Also, as we start to near the election, expect increased uncertainty to provide some jitters…

Exhibit 11: The odds of a "blue wave" in November have risen
as of May 31, 2020




Source: Predictit.org, Goldman Sachs Global Investment Research

GS recently pointed out: "The odds of a blue wave in November have risen… such an outcome could lead to full or partial reversal of corporate tax cuts, and would lift the effective S&P 500 tax rate from 18% to 26% and reduce our 2021 EPS forecast from $170 by $20 (11%) to $150."

## Important Macro Data Releases and Events for the Week

| | | |
|---|---|---|
| Monday 6/8/2020 | Germany | Industrial Production s.a. MoM (Apr) Forecast: -15.5%, Prior: -9.2% |
| Tuesday 6/9/2020 | EU | GDP s.a. QoQ (Q1) Forecast: -3.8% |
| | EU | GDP s.a. YoY (Q1) Forecast: -3.2% |
| | China | Consumer Price Index YoY (May) Forecast: 2.6%, Prior: 3.3% |
| Wednesday 6/10/2020 | US | CPI in its various forms… maybe a high print matters |

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| | |
|---|---|
| | Monthly Budget Statement (May) Prior way -738bln |
| | **Fed Interest Rate Decision and FOMC Press Conference/ SPEECH** |
| | **Eurogroup Meeting** |
| Thursday 6/11/2020 | PPI ex Food & Energy YoY (May) Forecast: 0.9%, Prior: 0.6% |
| | Initial Jobless Claims Forecast: 1.5m, Prior: 1.877m |
| | Initial Jobless Claims 4-week ave. Forecast: - , Prior: 2.284m |
| Friday 6/12/2020 | **EcoFin Meeting** |
| | Industrial Production s.a. MoM (Apr) Forecast: -20%, Prior: -11.3% |
| | Michigan Consumer Sentiment Index (Jun) PREL Forecast: 75, Prior: 72.3 |