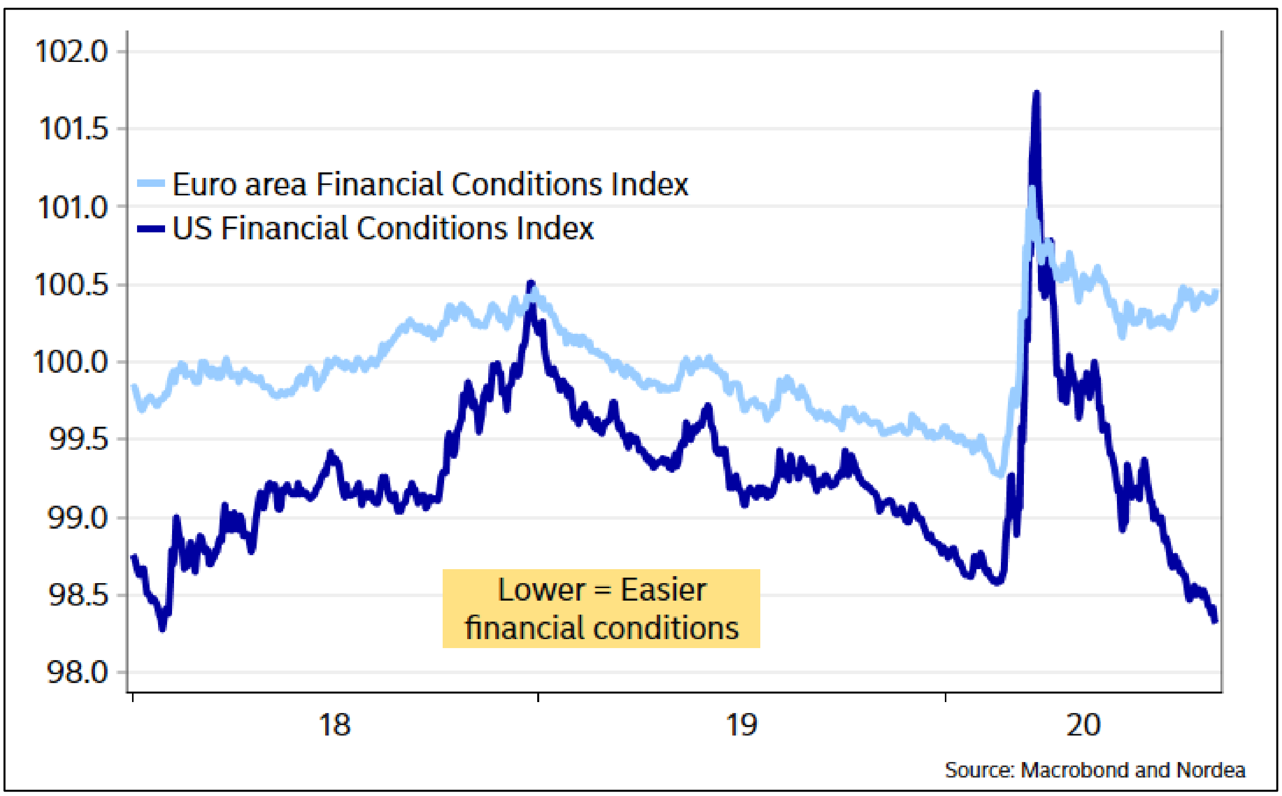
What to focus on in Global Macro for the week of September 7th, 2020

Macro Themes on the Radar:

This Thursday brings another ECB meeting. With more weak core inflation numbers last week (coming in at 0.4% vs. the expected 0.8%) investors are starting to wonder if the ECB will announce a further expansion of asset purchases or other additional policy measures.

Over the last few months, financial conditions in the US have become much easier, while in Europe they have only eased slightly. This isn't a surprise given that financial conditions reflect short term rates, longer term yields, corporate credit spreads, equity prices and currency values. In the US, the large rate cuts, plunging yields, tightening spreads, roaring stock prices and a falling currency have all outpaced what has occurred in Europe.



Already low short-term rates (NIRP) and bond yields in Europe means they had less room for accommodation. The rising EUR over the last few months has been counterproductive to easing financial conditions.

As the EUR briefly traded above 1.2000 last week, ECB's Lane indicated that while the ECB isn't focused on the EUR, the price level "does matter" to monetary policy. That was the first protest we have seen to the higher EUR. We will see if the currency is mentioned at Thursday's meeting or if the ECB commits to another increase in eurozone accommodation. They are currently undergoing an internal policy review, similar to what led the Fed towards its recent move to a soft form of average inflation targeting. With inflation as the ECB's primary mandate, a more structured form of AIT could be under consideration.

The lead-up to the final agreement on the European Recovery Fund led to a run-up in equity prices. Since early June however, they have not been able to make any headway.

There has been plenty to worry about and that probably hasn't helped. A renewed spike in European COVID, continuing Brexit discord over fisheries and industrial subsidies, and now the threat from Hungary to block the entire recovery fund over "rule of law" issues. One way or the other, we are gearing up for a move in prices after three months of sideways. Watch for resolutions to the above issues.

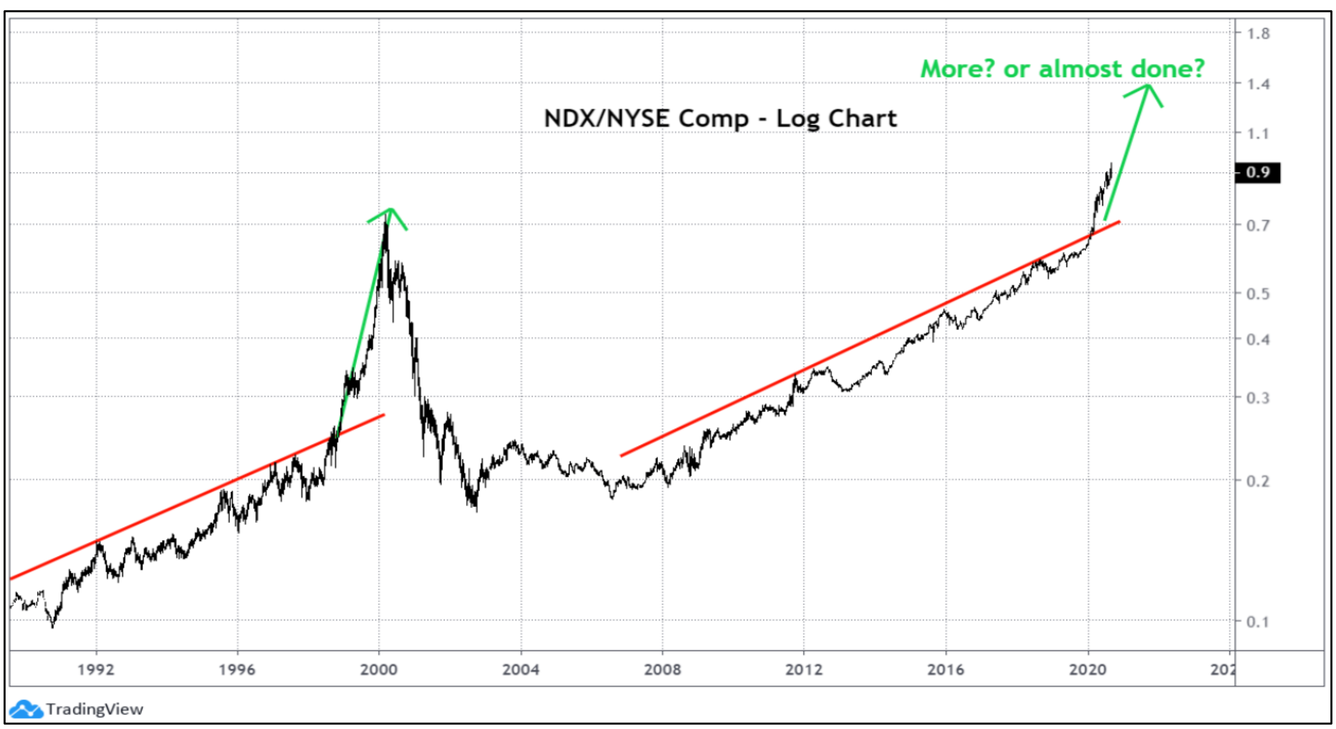
What to Focus on Now:

Equities

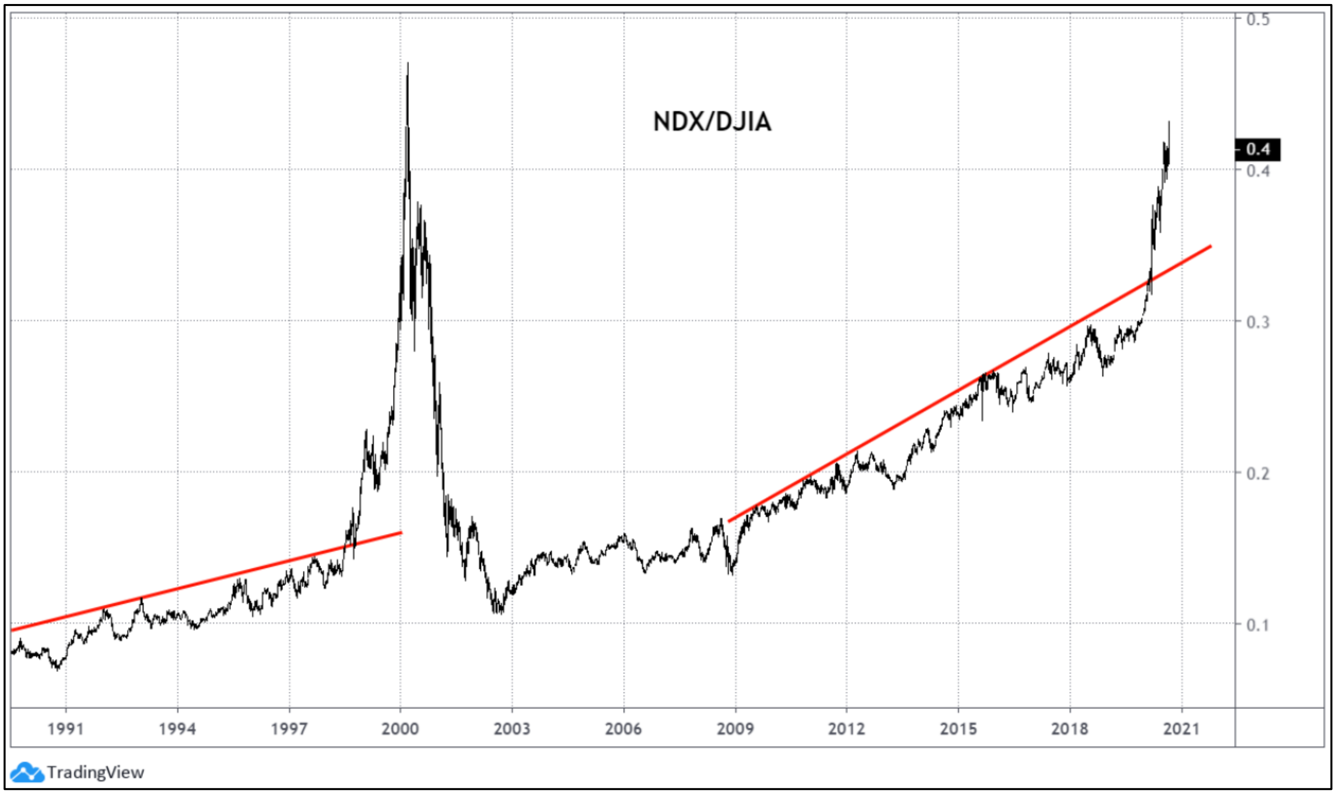
While the fundamentals are totally different now, the price action is very similar to 1999/2000.

The outperformance of the NASDAQ and particularly FAANGM stocks has been persistent and powerful for many months now, but recently they have "gone vertical". (ex-last two days)

The price action seems to be following a similar path to 2000, but where we are in that run is hard to pinpoint. The first is a log chart vs. the broader NYSE Composite.

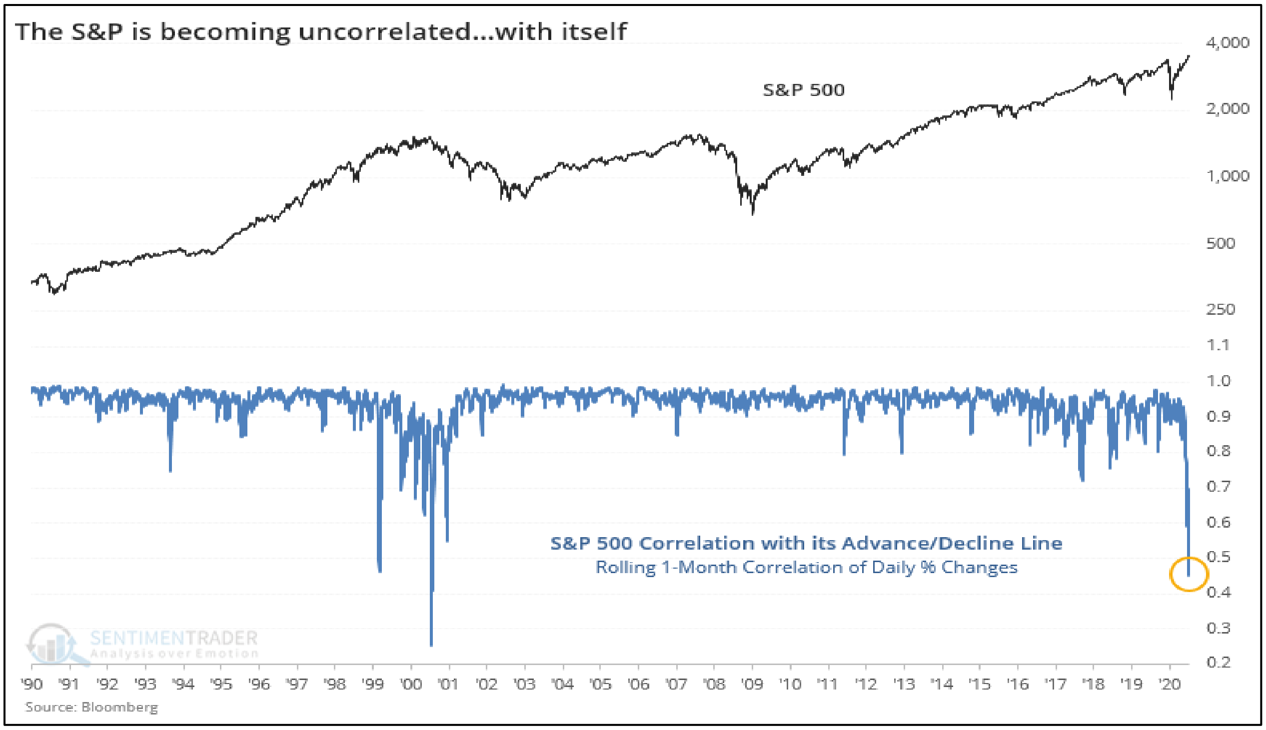


Then vs. the DJIA…



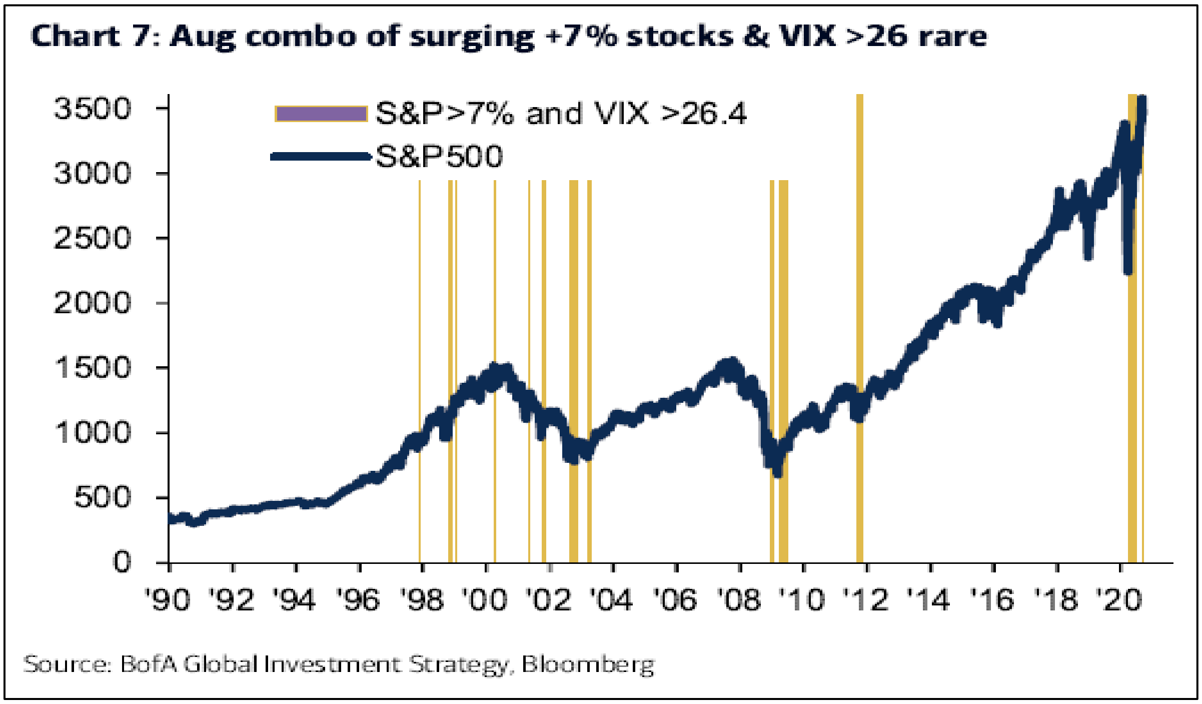
Vs. the Russell 2000 as a proxy for big cap growth over small cap value…

There are other similarities …

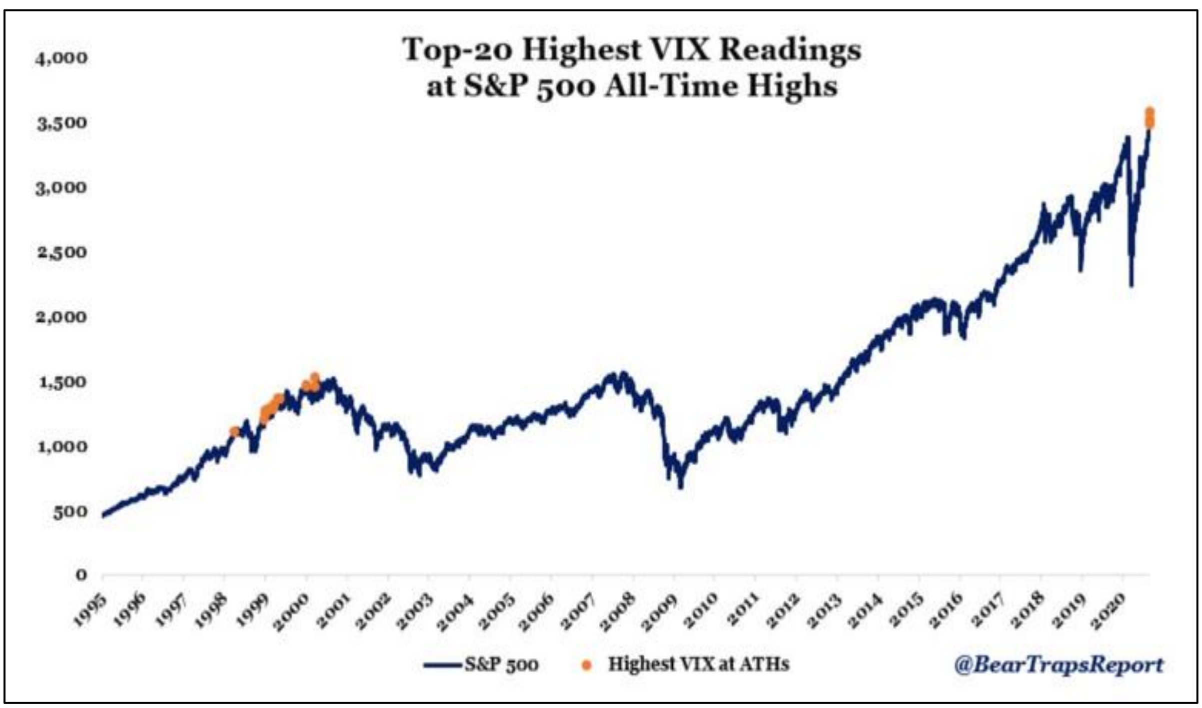


Then it was a broader rally overall and more diverse than the current big tech run.

We are again seeing the rare combination of explosive upside and continued high implied vols. Usually you get this off a low as the fall in volatility lags the rally. Sometimes, as in the leadup to the 2000 high, you get it during a runaway rally.

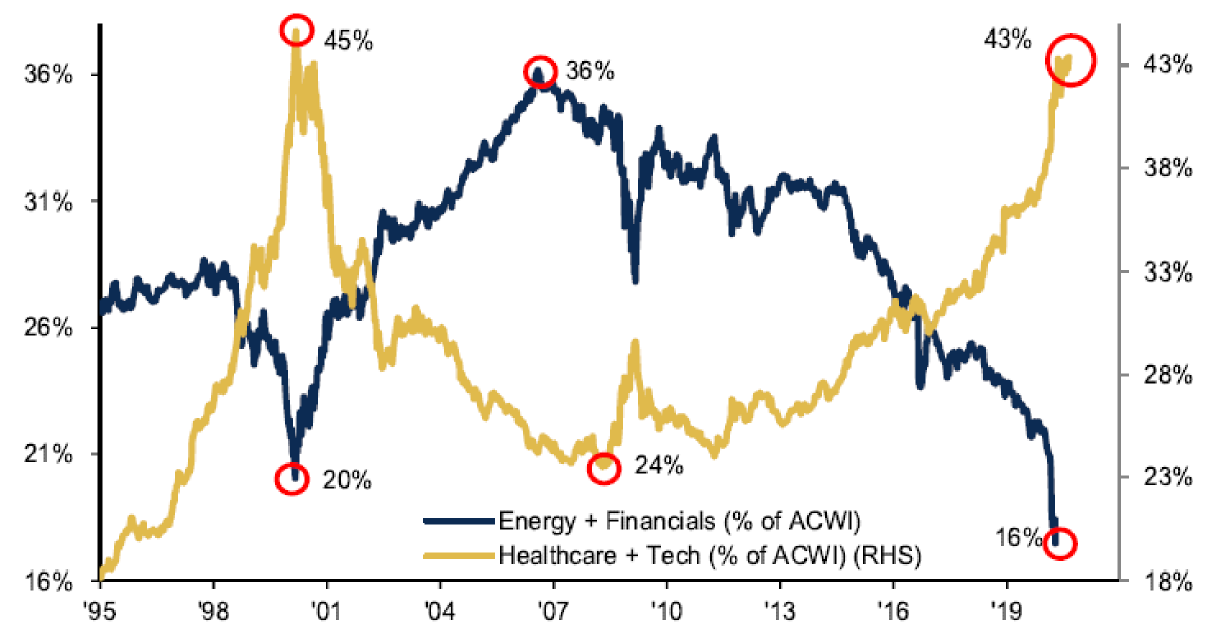


Here is the same idea seen from a different angle.



Again, the narrative is very different, but the price action is similar. Back then it was the promise of the internet vs. the outmoded brick and mortar of the old economy. Now it IS the new economy growth stocks vs. the old value stocks (that require reflation).

Exhibit 12: Tech & Healthcare versus Financials & Energy as a % of global equities



Source: BofA Global Markets, MSCI

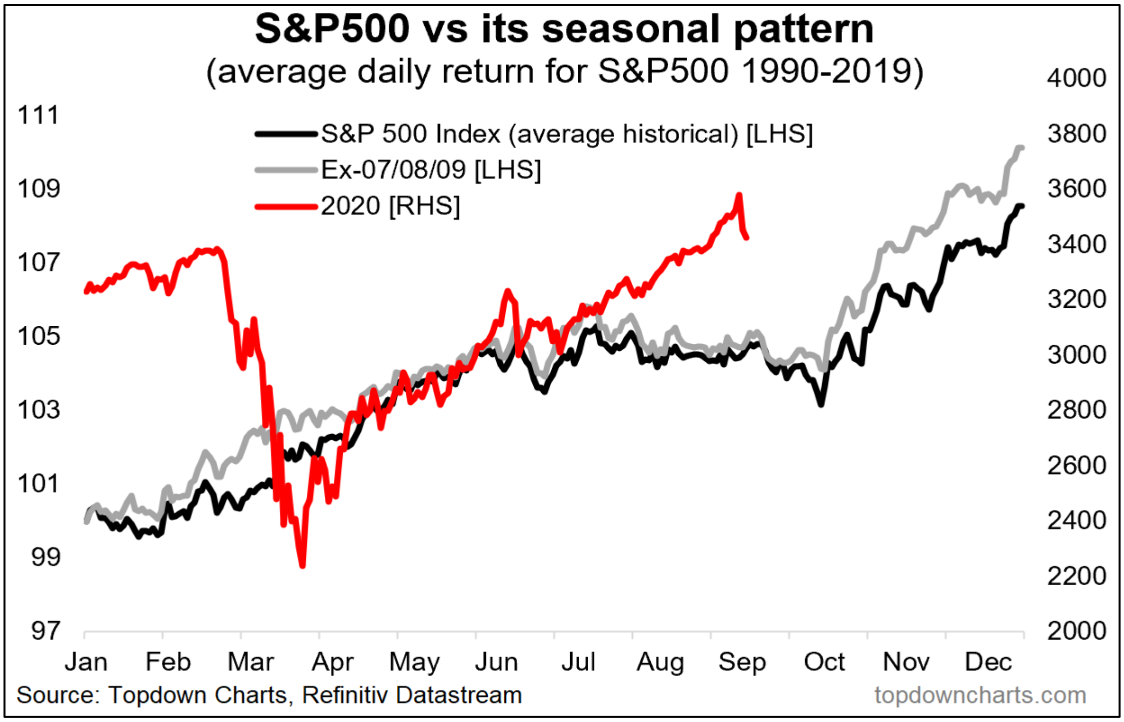
The most recent run higher, ending with the ugly drop in the second half of last week seems to have an interesting back story. As mentioned previously, there had been record call buying and it seems that at least part of the last run higher was due to a short gamma squeeze. This was essentially a short squeeze experienced by the options market makers/dealers who were unprepared for the price action and were forced to become aggressive buyers to hedge. The higher the price went the larger their short position became. With the put/call ratio hitting all-time lows, I can see how this could happen and it seems to have been at least partially responsible for the recent market dynamic. When the frenzy was over, the market found itself with few short-term buyers.

The recent price action aside, it is worth thinking about what could turn the market here.

With Central Banks unlikely to be the catalyst anytime soon, we have to look at a meaningful change in market expectations for growth or inflation to get us away from the “liquidity is everything” mantra.

A sudden shift in the outlook for growth and/or inflation, either positively or negatively could rock the boat. Thinking back to the components of financial conditions, the ones least controlled by the Fed at this point are long-bond yields, USD and of course stocks.

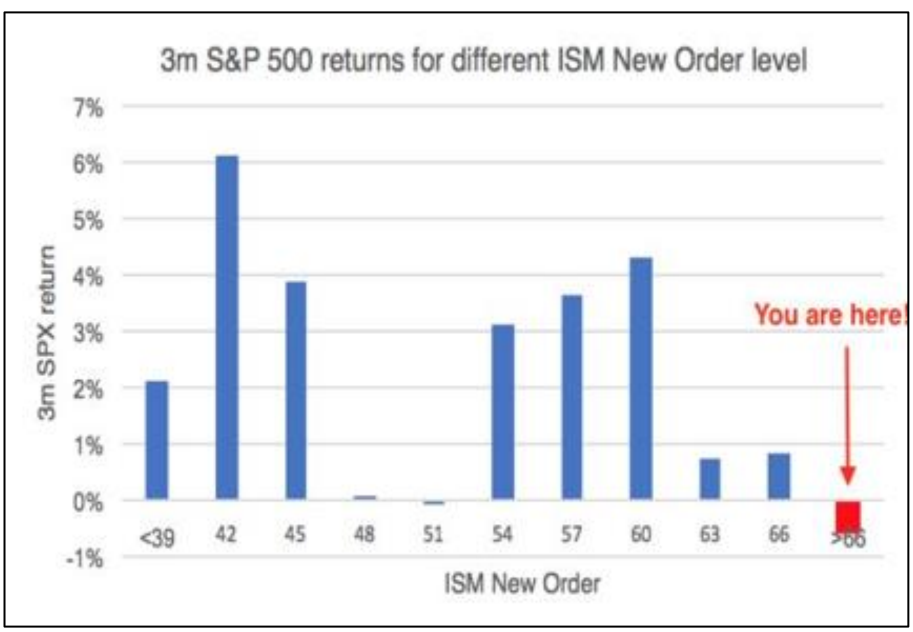
So far, we have broken the mold this year vs. the longer-term seasonal patterns.



Current financial conditions are often "as good as it gets" but remember that stocks are part of the calculation so there is an obvious feedback-loop. This gets most interesting when the conditions start to tighten despite continued equity resilience.

Economic data has continued to surprise to the upside over the last few months. By some measures we are getting into “as good as it gets” territory here as well.

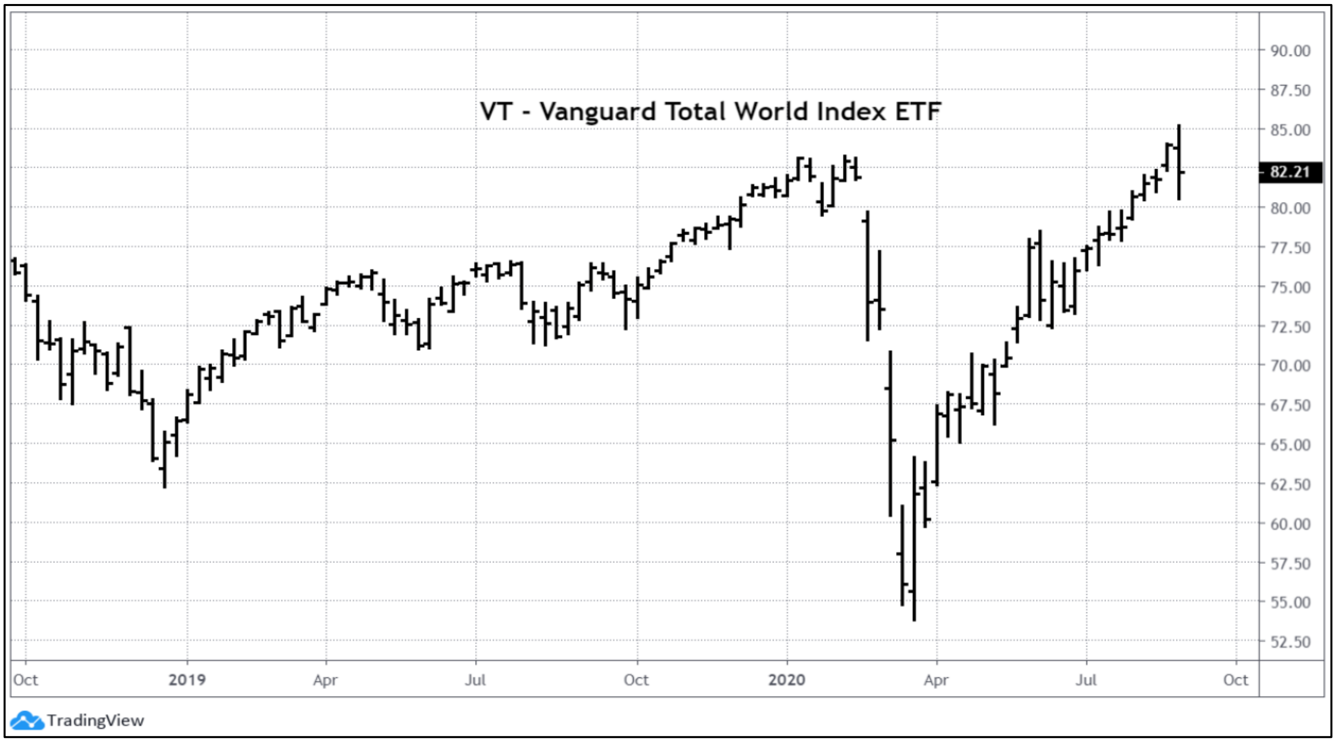
The most recent ISM New Orders index in the US printed 67.6. While the dispersion of outcomes can be a little misleading with this type of chart, it can be indicative of the price action once this much of the recovery has been priced.



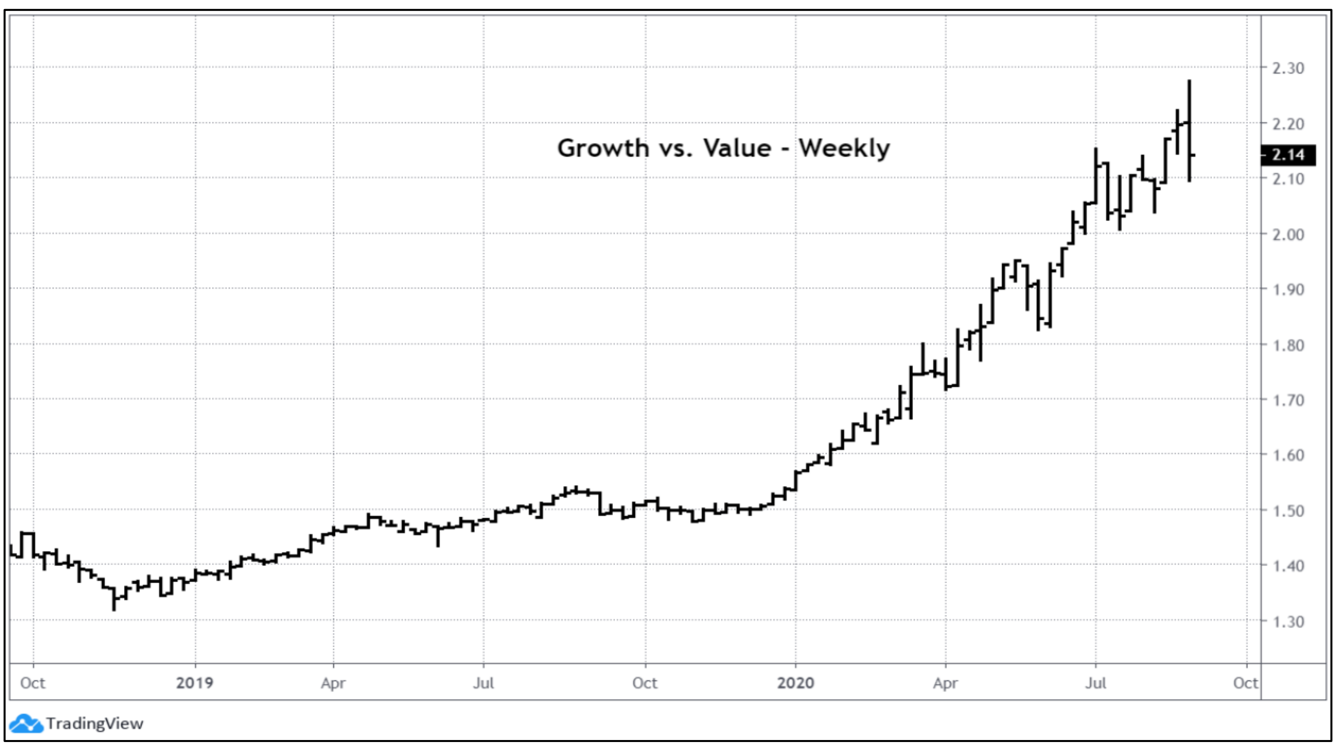
The price action at the end of last week was sufficient to generate outside reversal weeks in many US indices. This raises the chance of a more pronounced reversal, or at a minimum, a pause. The end of day rally on Friday weakened the signal a bit on the margin but this is still well worth watching. For the S&P…

As well as the NDX and NASDAQ Comp…

And given the US big tech weighting even global indicies...



And even US Growth vs. Value... lets see if it has any staying power.



FX

The Dollar fall has stalled for the moment. Positioning has become very short dollars and the trend very overbought. A larger correction may require a bout of "risk-off" or a surprise out of the ECB on Thursday. Otherwise, while the USD can certainly strengthen on a position unwind, that probably results in a larger range, rather than a pronounced bout of dollar strength.

Bond Yields

If anything can rock the boat it would be a sudden back-up in bond yields. A sooner than expected vaccine and continued better than anticipated recovery could potentially generate that, but probably not yet.

They have gone to some pains to eliminate negitive Fed Funds from the potential policy mix. I think that removes one of the last remaining reasons to continue holding long duration bonds.

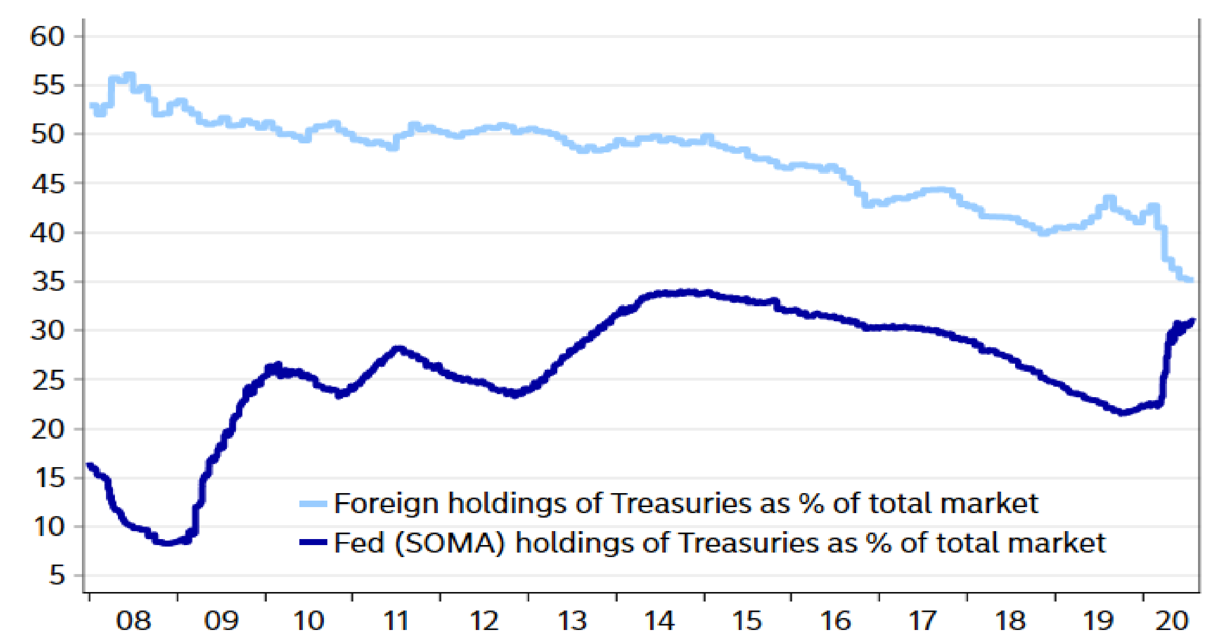
The Fed's vow to let inflation run hot doesn't amount to much without any inflation. If, or when it does appear I think the market will quickly test them. If it gets ugly, they could resort to yield curve control. That would be a big deal and they will be mindful of how bearish it is for the USD.

The sheer amount of US issuance may become a problem at some point. Yes, NIRP in Europe and Japan and the negative yielding global debt it has enabled, should provide a buyer of Treasuries.

Exhibit 27: Central banks have created $14tn of negatively yielding bonds

Source: BofA Global Markets, Bloomberg

However, Nordea Markets makes a good point. They highlight that total Fed holding of Treasuries was similar to the current levels (or higher) 2014/15/16 and much of '17 but 30-year bond yields were between 2.25% and 4%. Currently they are at 1.47%. Maybe they can rise…



Source: Macrobond and Nordea

Gold and Silver

So far, they have held up well despite some retracement in both the USD and yields. A big jump in yields or a pop in the USD would almost certainly trigger a deeper pullback.

My view has been that we develop a trading range as we unwind the extreme overbought condition.

So far, so good. I would look to add longer dated upside via options on a drop to 18500/1800, or if we sit here for another week or two. Silver has also held up well so far. Same plan, or sub 24.

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Important Macro Data Releases and Events for the Week

Monday 9/7/2020	**Labor Day Holiday**
	Leading Economic Index (Jul) Forecast: 84.6, Prior: 84.4
	Industrial Production s.a. MoM (Jul) Forecast: 4.8%, Prior: 8.9%
	GDP QoQ (Q2) Forecast: -8.1%, Prior: -7.8%
Tuesday 9/8/2020	GDP s.a QoQ (Q2) Forecast: -12.1%, Prior: -12.1%
	CPI YoY (Aug) Forecast: 2.4%, Prior: 2.7%
Wednesday 9/9/2020	BoC Interest Rate Decision and Statement / Current o/n rate 0.25%
Thursday 9/10/2020	ECB Interest Rate Decision / Current Deposit Rate -0.50%
	ECB Monetary Policy Statement and Press Conference
	Initial Jobless Claims Forecast: .925m, Prior: 1.106m
	Initial Jobless Claims 4-week ave. Forecast: - , Prior: 1.17575m
	Continuing Jobless Claims Forecast: 15m, Prior: 14.844m
	Eurogroup Meeting
	BoC Governor Macklem SPEECH
Friday 9/11/2020	Harmonized Index of Consumer Prices YoY (Aug) Forecast: -0.1%, Prior: -0.1%
	CPI MoM (Aug) Forecast: 0.3%, Prior: 0.6%

Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649

- CPI ex Food & Energy MoM (Aug) Forecast: 0.2%, Prior: 0.6%
- CPI YoY (Aug) Forecast: 1.2%, Prior: 1%
- CPI ex Food & Energy YoY (Aug) Forecast: 1.6%, Prior: 1.6%

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