Stargazer
Asset Management

What to focus on in Global Macro for the week of August 31st, 2020

Macro Themes on the Radar:

Fed

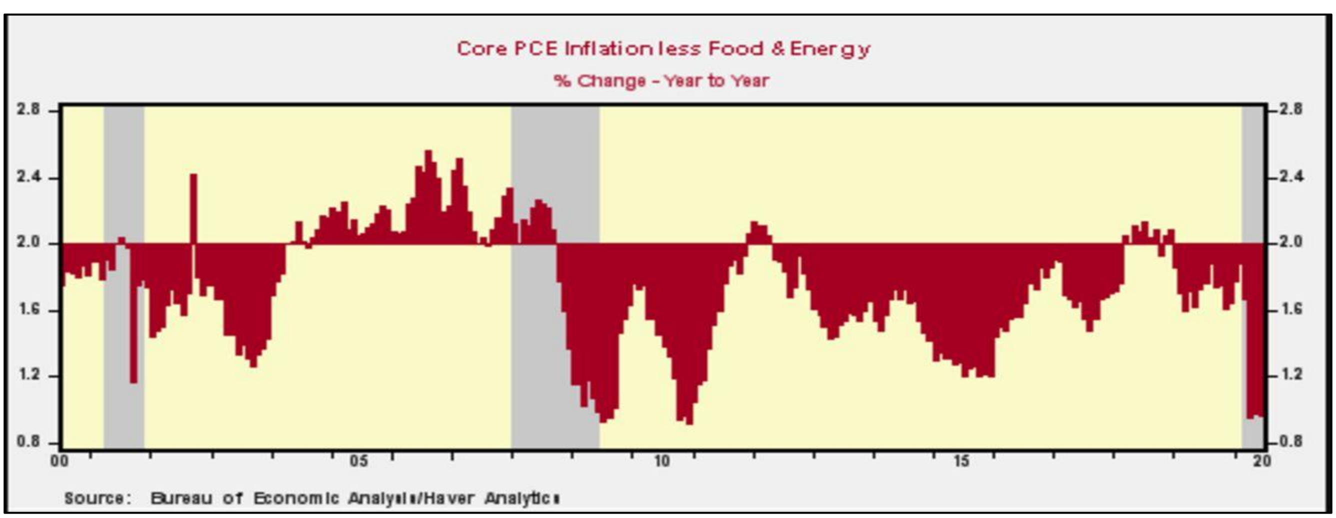
Last week's Powell speech delivered the move to average inflation targeting (AIT) that the markets had been anticipating. Having said that, he was light on details (I assume more to come) and offered no mechanical commitments. Soft AIT at this point.

"In seeking to achieve inflation that averages 2 percent over time, we are not tying ourselves to a particular mathematical formula that defines the average. Thus, our approach could be viewed as a flexible form of average inflation targeting".

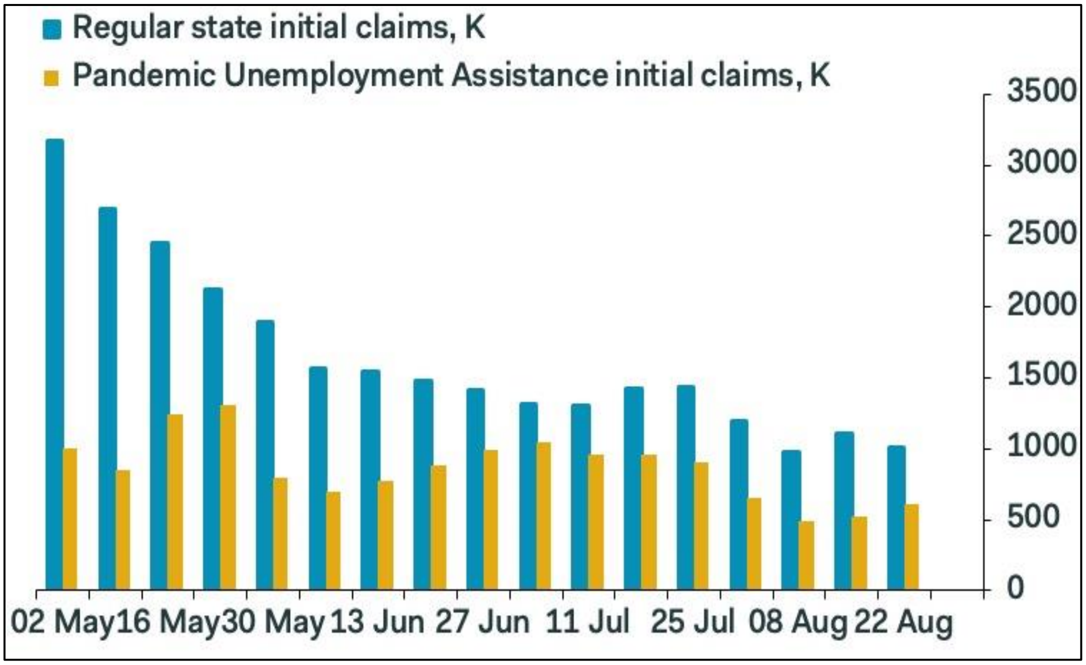
"In setting monetary policy, the Committee seeks over time to mitigate shortfalls of employment from the Committee's assessment of its maximum level and deviations of inflation from its longer-run goal."

By focusing on average inflation over time they can, in theory, let the economy run hotter for longer, allowing unemployment to come down further than the previous methodology would have allowed. The dual mandate of 2% inflation and maximum employment has been shifted in favour of employment, at least for now. It is reflective of the expectation that we can return to the pre-COVID economy, in which unemployment and inflation where low simultaneously. If inflation runs higher than expected, this policy buys them more time to get unemployment down.

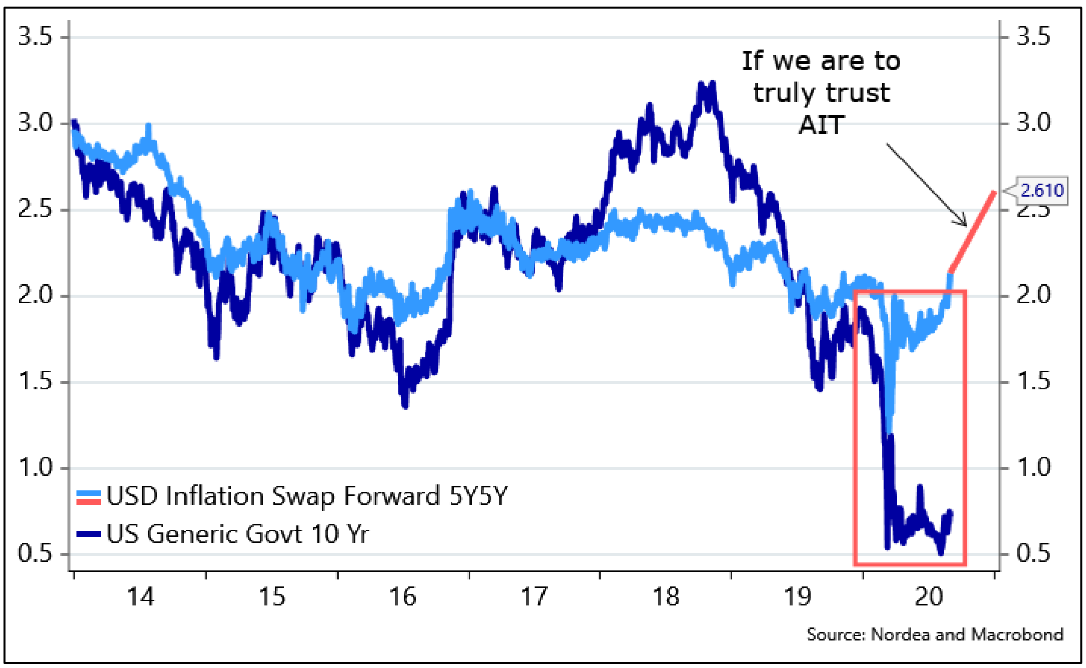
They are trying to convey that somewhat higher inflation is to be expected going forward. If it doesn't materialize, the policy shift will become moot. If it does, things will get interesting as Fed credibility meets market expectations.



For the moment inflation remains low. While post lockdowns the unemployment claims have fallen, recently the progress has slowed. They have their work cut out for them.



For now, watch 5y5y forward breakevens and US long bond yields for how the market is voting.



We have plenty of Fed speakers this week including the Vice Chair Richard Clarida at 9am on Monday. He will be speaking on this topic - ***The Federal Reserve's New Monetary Policy***

Framework at the Peterson Institute for International Economics, Washington, D.C. [(livestream)]() Expect further headlines.

It will be interesting to see if this shift by the Fed puts pressure on the ECB to also do something along the lines of AIT. In theory, the pressure would be exerted via a rising EUR. I seriously doubt it. The rally in the EUR has still been relatively minor, and while it could become painful if it extends, it also gives some needed renewed credibility to the eurozone project. Also, given their current inflation levels and the single mandate (not to mention German fear of inflation) it would be hard to convey credibly.

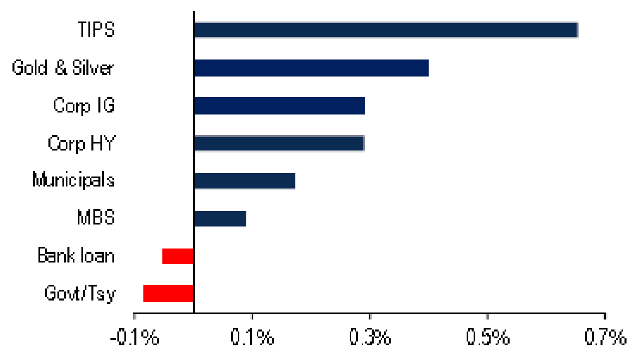
<u>What to Focus on Now:</u>

Stocks have been relentless. As per BoA/ML, if we see 3630 on the S&P by Election Day it will be the greatest rally of all time in both speed and magnitude. Tech is still doing the heavy lifting and for the first time ever the market cap of the US tech sector now exceeds that of Europe (incl. UK and Switzerland).

In theory at least, the shift in Fed policy should encourage investors to look at inflation vs. deflation assets. TIPS, Europe, Asia and value should be of interest.

We are seeing some of those flows as money continues to move into TIPS and commodities.

Chart 10: Weekly FICC flows as % AUM



Source: EPFR Global

Table 4: Global asset class flows, $mn

	Wk % AUM	YTD	YTD %AUM
Equities	0.0%	-42,204	-0.3%
ETFs	0.1%	117,277	2.3%
LO	-0.1%	-159,313	-2.1%
Bonds	0.3%	196,453	3.0%
Commodities	0.4%	73,875	22.6%
Money-market	-0.1%	1,109,927	18.3%

* week of 8/26/2020: Source: BofA Global Investment Strategy, EPFR Global

However, as I noted last week, despite flows into EM and Europe, the performance has continued to disappoint vs. the US so far.

And, despite the continued enthusiasm for US tech stocks, institutional investors continue to be fairly cautious about US equities more generally.

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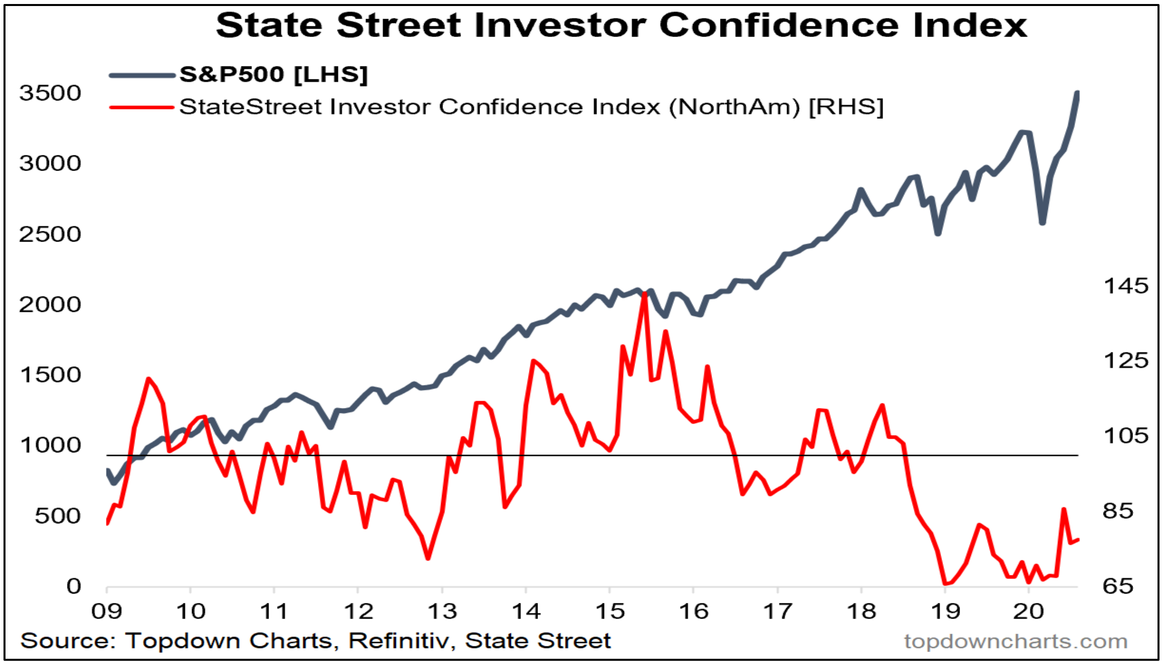
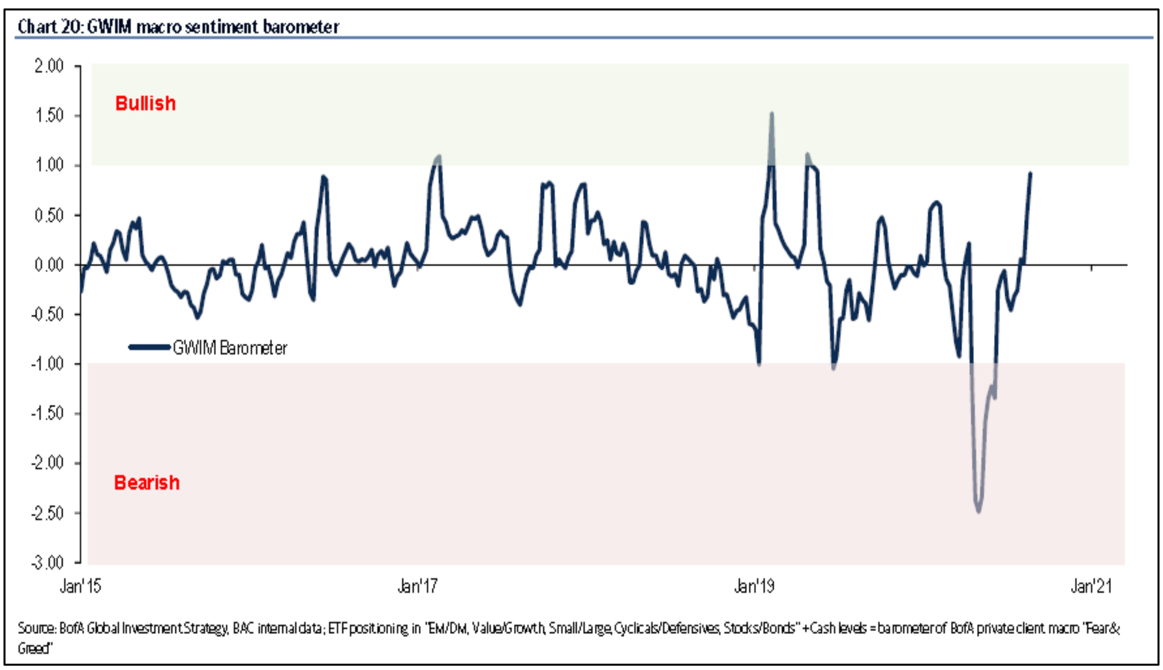


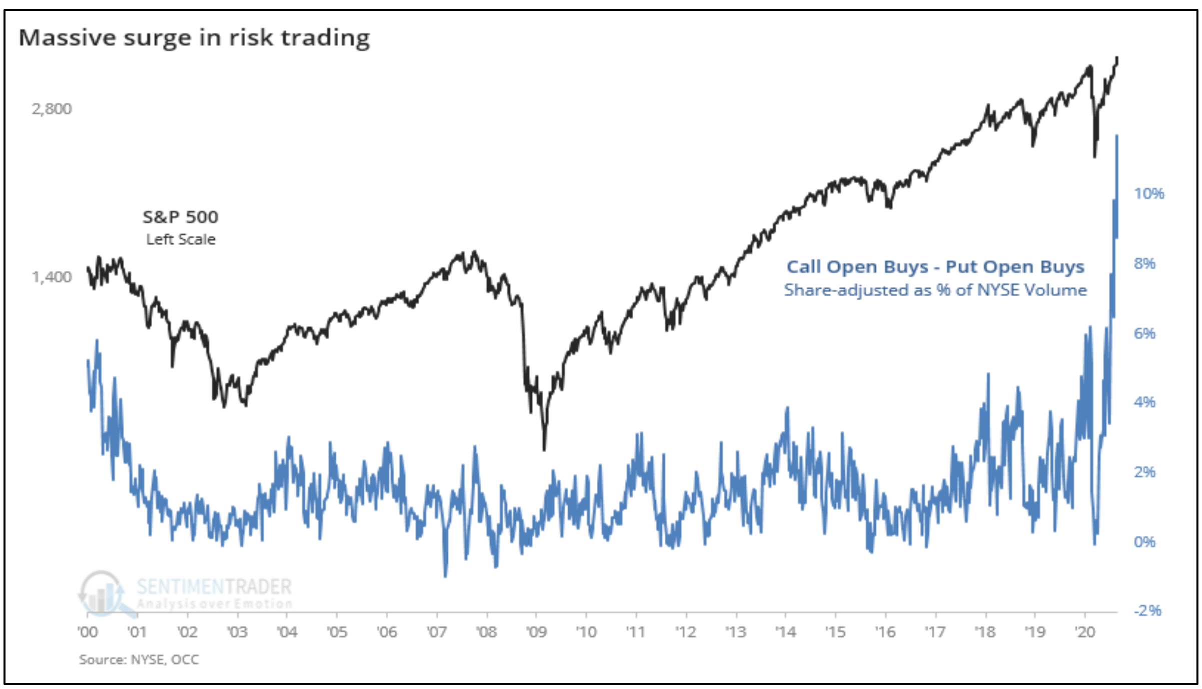
Despite their view that the macro economic situation is improving.



Worries about high multiples and economic disconnects seems to be combining with a strong fear of missing out. While they have not been pouring money into stocks, they are looking for exposure via call options.

Call option volumes are high…

And historically in favor of calls.



I'm still watching for signs that the global "value" trade is starting to kick in. EM, Asia, Europe and US value in general still hasn't been able to turn the corner on a relative basis. Despite the price action underwhelming, they need to be watched as the risk/reward is there.

While EM can be expressed in a number of ways, the greater China heavy EEM is still not able to outshine the S&P.

China itself has been coiling after taking out the early Jan 2020 highs.

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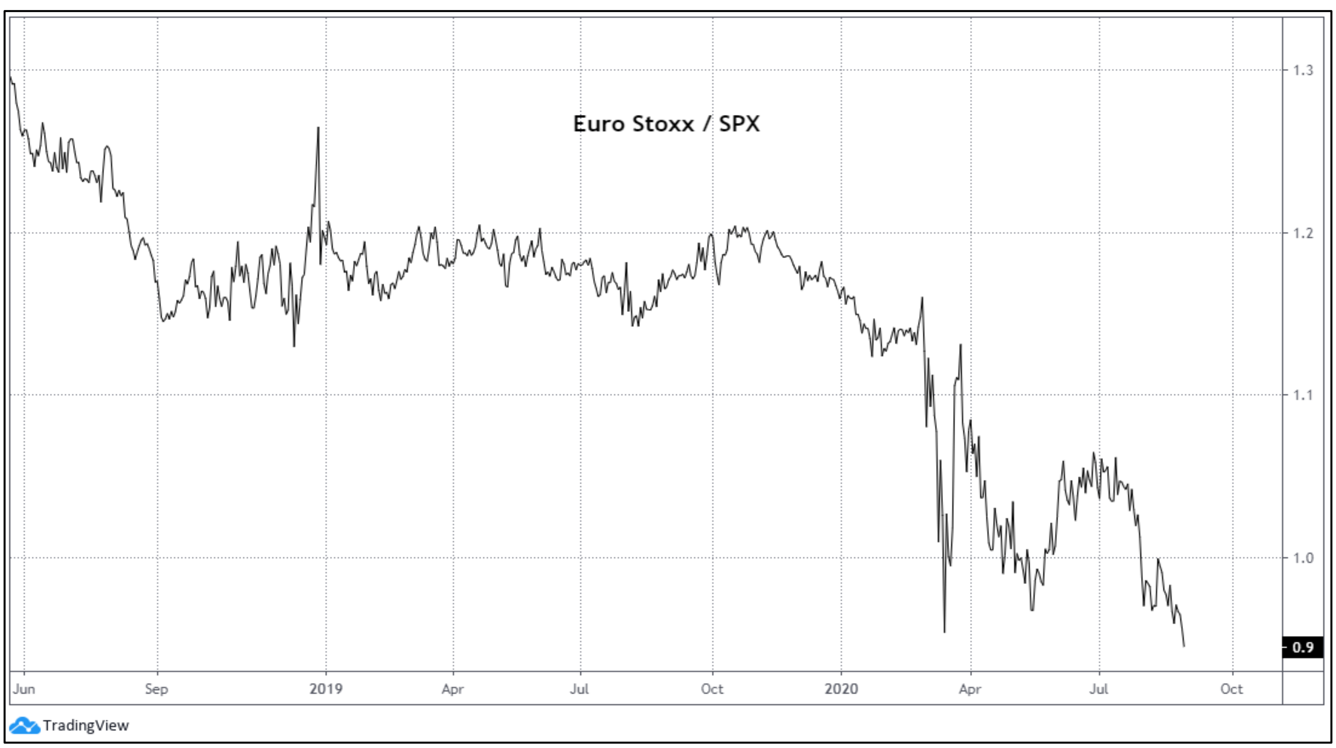
The more tech heavy CSI 300 is trying to resume the up move. Recent China data and the looming Ant Group IPO is fanning the flames.

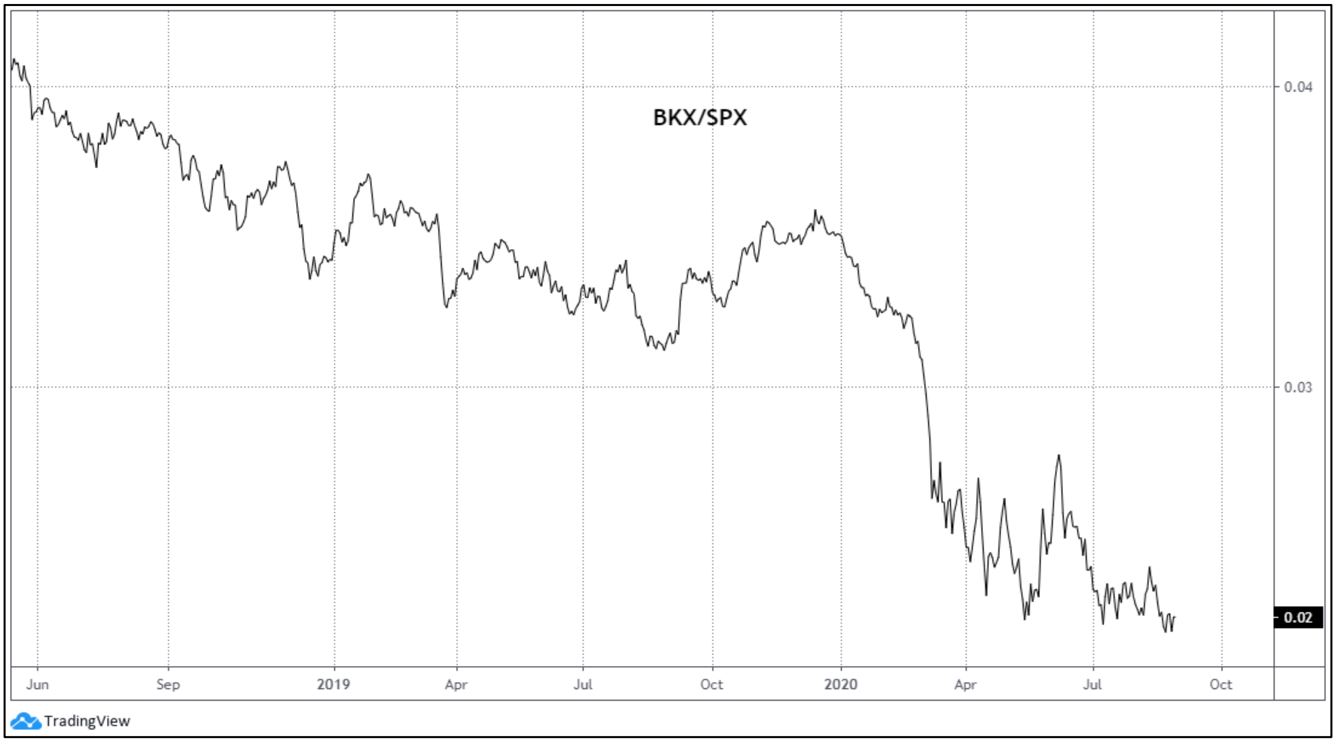
In the meantime, European relative performance is making new lows…



Partially thanks to last week's news of the resignation of Prime Minister Shinzo Abe for health reasons, the Nikkei isn't doing much better.

Overall, the US has remained the leaders as the rest of the world continues to underperform US tech.

US Banks are sitting at the lows in terms of relative performance.



More generally, "value" continues to be no match for "growth". Attempts to bottom have persistently failed.

Bonds

What happens next in the long end of the curve will be important. With NIRP in Europe and Japan and the promise of near zero rates in the US, potentially for years to come, the front end of the curve looks solid. Potentially the back end could see a pop in yields if people are positioned the wrong way and the potential for a more inflationary outcome is re-rated.

A small pop in yields so far as AIT and higher inflation expectations have been getting priced. Above 1.60% yield and it would get more interesting.

FX

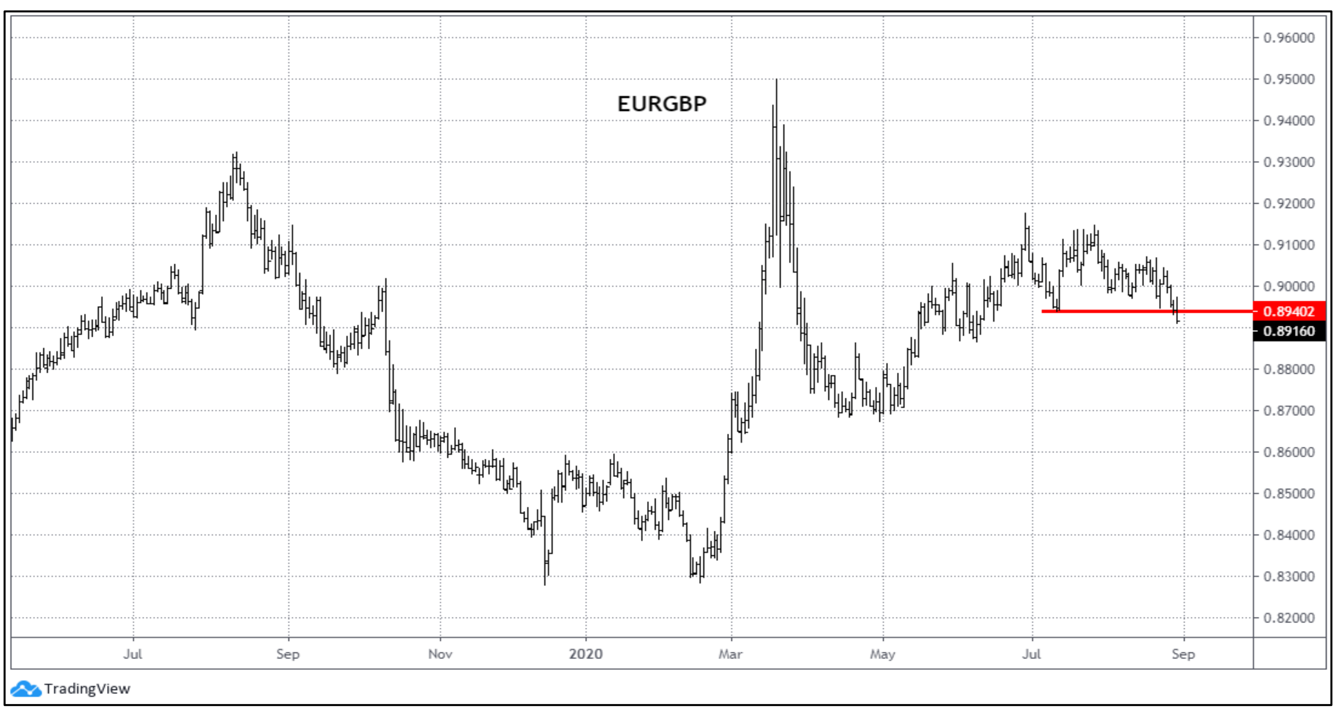
The last few days (post-Powell) have seen renewed USD weakness. Currencies like the EUR and CHF are back near their highs vs. the dollar while other currencies like GBP, AUD, NZD and CAD have broken those highs and pushed on.

I had thought we would get a few more weeks of range-bound trading as we digest the previous price move, but maybe not.

So far, the biggest effect of Powell's announcement has been on the USD. With the Fed's Clarida speaking early in the week, followed by a number of other Fed speakers and employment numbers on Friday, it could be an interesting week when all is said and done.

If the USD keeps going it will have knock on effects across markets. In some ways, that would be the best reaction for the Fed's inflation plan as it would drive a potential positive feedback loop for them.

Last week I had mentioned the EURGBP cross. It cracked support on Friday. Maybe they are starting to price a better Brexit/Trade deal.



If so, the relative under positioning in GBP and UK equities could make for an interesting trade.

Gold and Silver

As expected, given how overbought it had gotten, Gold has been range-trading over the last couple of weeks. More sideways to come or ready for another leg higher?

After the initial plunge a few weeks ago on rising bond yields, Silver has held in very well. I was hoping to re-buy on a dip to 23 but that might be too aggressive. Either way I think mid-40's is possible by Q1 of next year.

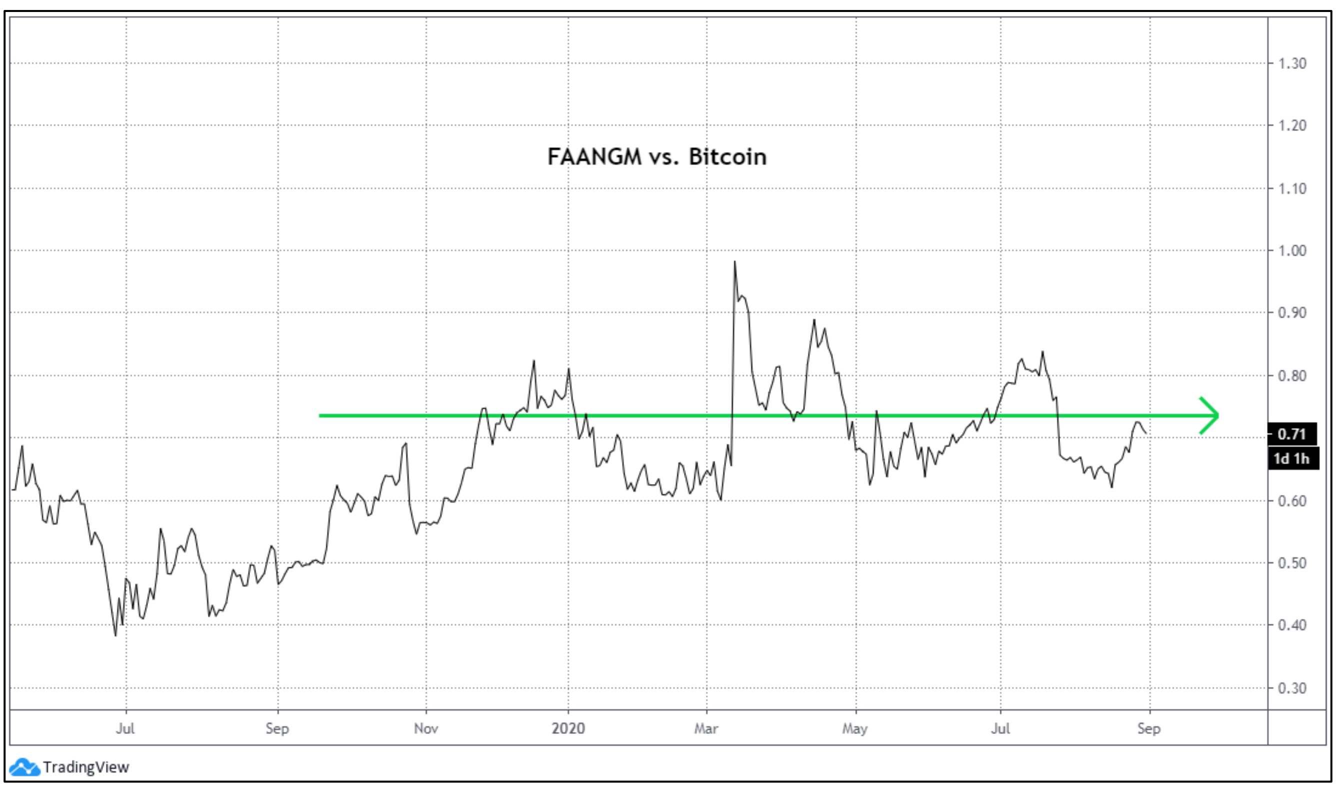
Again, what happens to bond yields and the USD will be very important for precious metals. If they can transition from a relationship with real yields driven by lower Treasury yields, to one driven by rising inflation expectations, they can push on.

Bitcoin and the FAANGM

At the risk of being told I just don't understand bitcoin (I really don't) it strikes me that some of the same factors are driving the price action.

- A way to protect purchasing power / Something the government can't print
- Technology and innovation that is changing the world
- Has a limited supply (for the equities the supply has actually been falling)
- Uncertainty around what the maximum valuation might be

Just something to ponder. Funnily enough...



September could be an interesting month… besides the scheduled events we have more congressional wrangling over the next stimulus round and the approaching need for a continuing resolution (CR).

Sept 4th Payroll (Aug)

Sept 6th Hong Kong elections

Sept 10th ECB meeting

Sept 16th FOMC meeting

Sept 17th BoJ & BoE meetings

Sept 29th 1st Presidential debate

Important Macro Data Releases and Events for the Week

Monday 8/31/2020

- Non-Manufacturing PMI (Aug) Forecast: 52.1, Prior: 54.2
- NBS Manufacturing PMI (Aug) Forecast: 48.7, Prior: 51.1
- Harmonized Index of Consumer Prices (Aug) Forecast: 0.4%, Prior: 0%
- **Fed's Clarida SPEECH**

Tuesday 9/1/2020

- RBA Interest Rate Decision and Statement / Currently 0.25%
- Markit Manufacturing PMI's for a number of European countries
- Unemployment Rate (Aug) Forecast: 6.5%
- Unemployment Change (Aug) Forecast: 43k
- CPI - Core YoY (Aug) Forecast: 1%, Prior: 1.2%
- CPI YoY (Aug) Forecast: 0.2%, Prior: 0.4%
- **Fed's Brainard SPEECH**

Wednesday 9/2/2020

- Retail Sales YoY (Jul) Forecast: 3%, Prior: 5.9%

ADP Employment Change (Aug) Forecast: -, Prior: 167k

Factory Orders MoM (Jul) Forecast: 5%, Prior: 6.2%

Fed's Williams SPEECH

Fed's Mester SPEECH

Fed's Beige Book REPORT

Thursday
9/3/2020

Caixin Services PMI (Aug) Forecast: 50.4, Prior:54.1

Markit Service and Composite PMI's for a number of European countries

Retail Sales YoY (Jul) Forecast: -0.5%, Prior: 1.3%

Initial Jobless Claims Forecast: -, Prior: 1.006k

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 1.068m

Continuing Jobless Claims Forecast: -, Prior: 14.535m

Trade Balance (Jul) Forecast: $-52.3b, Prior: $-50.7b

Markit Service PMI (Aug) Forecast: 54.8, Prior: 54.8

Markit PMI Composite (Aug) Forecast: 54.7, Prior: 54.7

ISM Service New Orders Index (Aug) Forecast: 56.5, Prior: 67.7

ISM Service PMI (Aug) Forecast: 57.1, Prior: 58.1

ISM Service Employment Index (Aug) Forecast: Forecast: 31.9, Prior: 42.1

ISM Service Prices Paid (Aug) Forecast: 61.7, Prior: 57.6

BoE's Governor Bailey SPEECH

Friday
9/4/2020

Factory Orders s.a. MoM (Jul) Forecast: 21.1%, Prior: 27.9%

Nonfarm Payrolls (Aug) Forecast: 1550k, Prior: 1763k

Unemployment Rate (Aug) Forecast: 9.9%, Prior: 10.2%

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Net Change in Employment (Aug) Forecast: 400k, Prior: 418.5k

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