Stargazer
Asset Management

What to focus on in Global Macro for the week of February 8st, 2021

Macro Themes on the Radar:

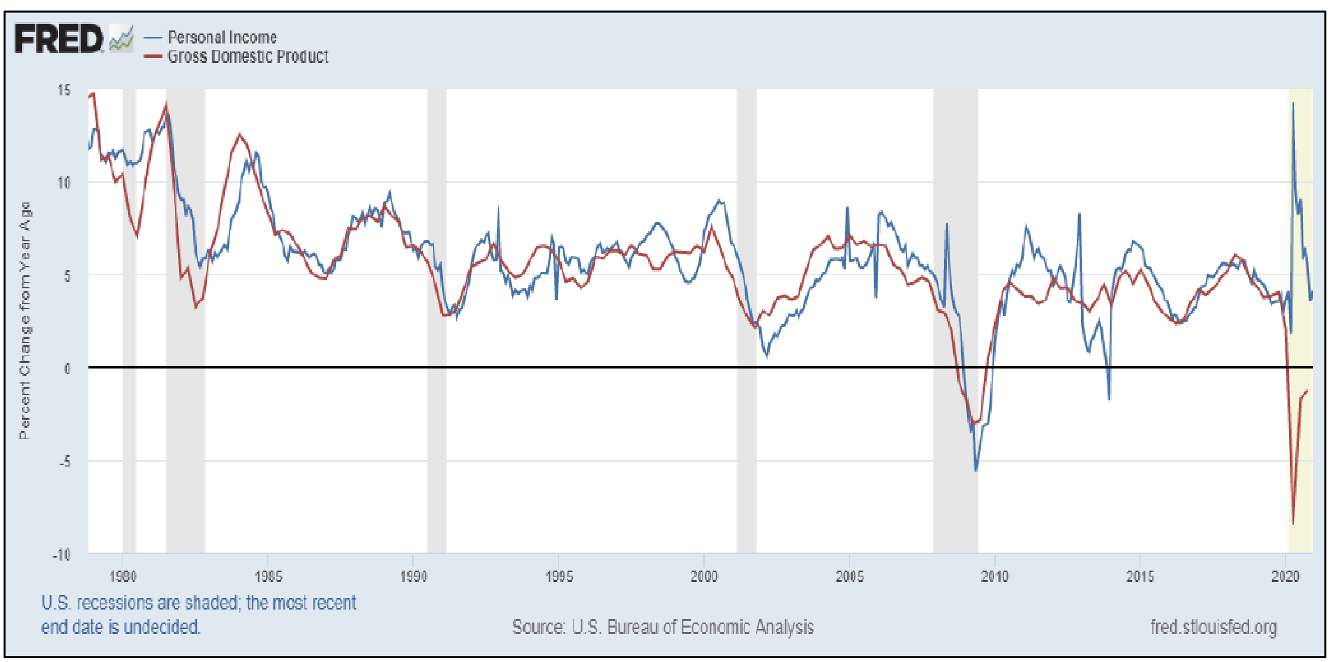
Inflation and Growth

In a recent Stanley Druckenmiller interview with GS, he summed up the current situation well. When asked about his outlook for markets, he said "Buckle up – I have been a CIO in one capacity or another since 1978, and this is the wildest cocktail I have ever seen in terms of trying to figure out a roadmap."

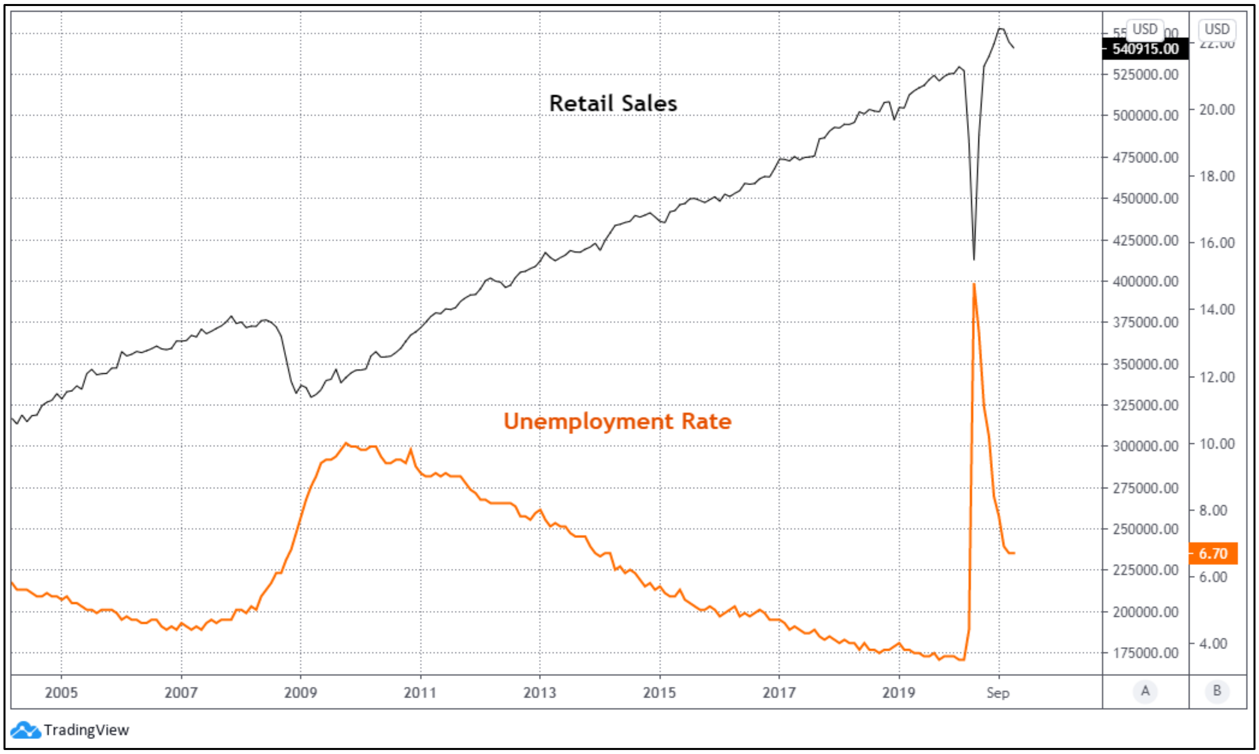
He went on to "frame" the current situation by pointing out the following:

- The downturn was 5x the average recession since WW2 in 25% of the time.
- Eleven million people unemployed while we had the largest increase in personal income in 20 years
- The Fed bought more Treasuries in 6-weeks than they did in 10-years under Yellen and Bernanke
- Corporate borrowing, which usually goes down during a recession (it fell $500 bln during the GFC) went up $400 bln this time.

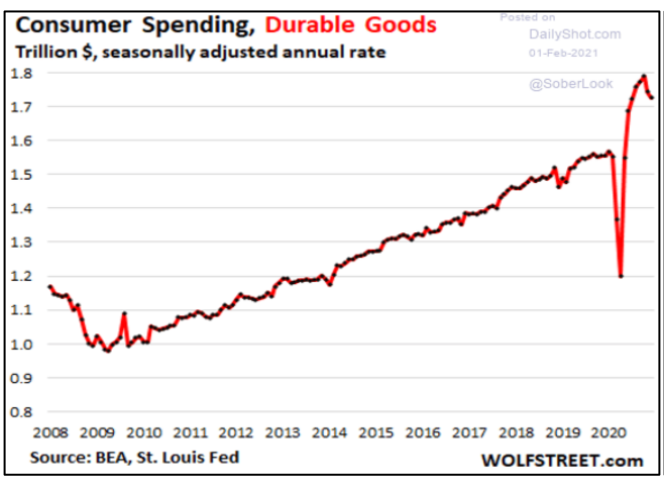
Personal Income and GDP

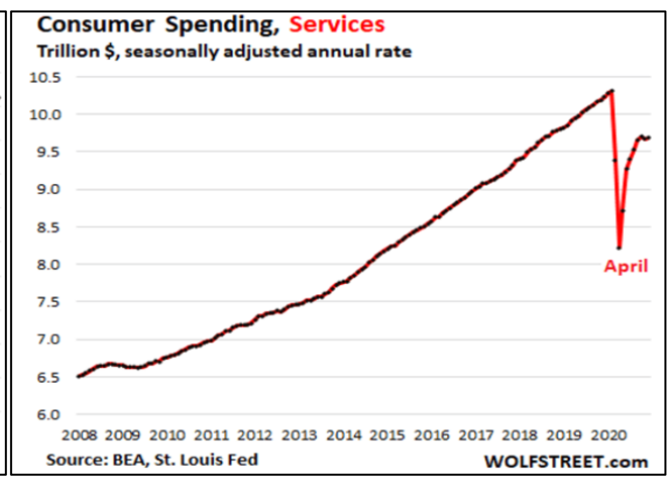


Here is the same effect expressed in a different way… of course the unprecedented government support has made all the difference this recession.



Not surprisingly, people have been buying things not doing things.

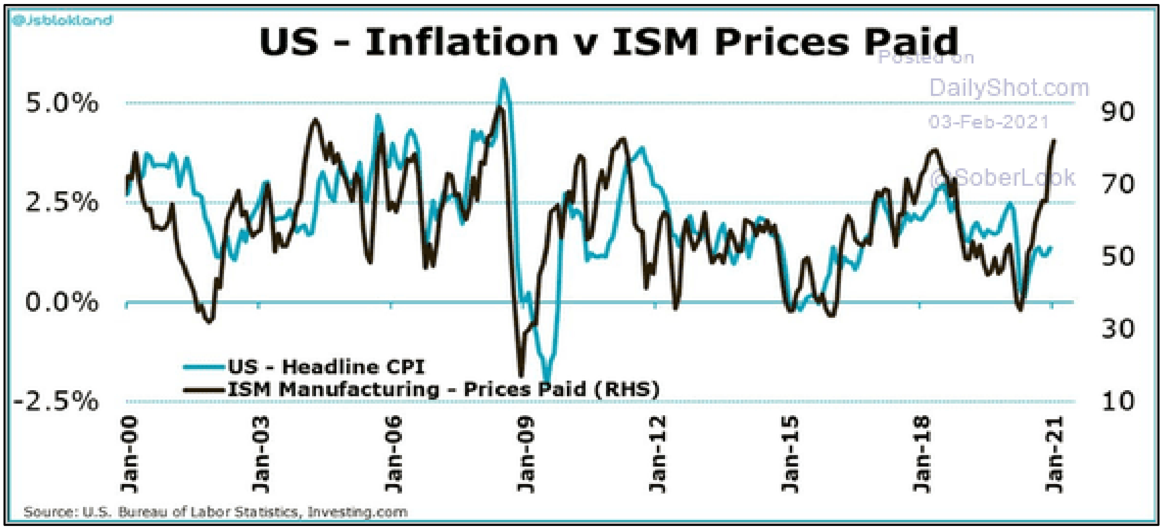




The markets expect that to change soon given the vaccines, and for the coming surge in economic activity to push inflation higher.

Lots of indicators (not to mention base effects) are already saying that higher inflation is baked in the cake.

Pricing pressure looks to be building…


@Jsblokland
US - Inflation v ISM Prices Paid
Posted on
DailyShot.com
03-Feb-2021
@SoberLook
5.0%
2.5%
0.0%
-2.5%
90
70
50
30
10
US - Headline CPI
ISM Manufacturing - Prices Paid (RHS)
Jan-00
Jan-03
Jan-06
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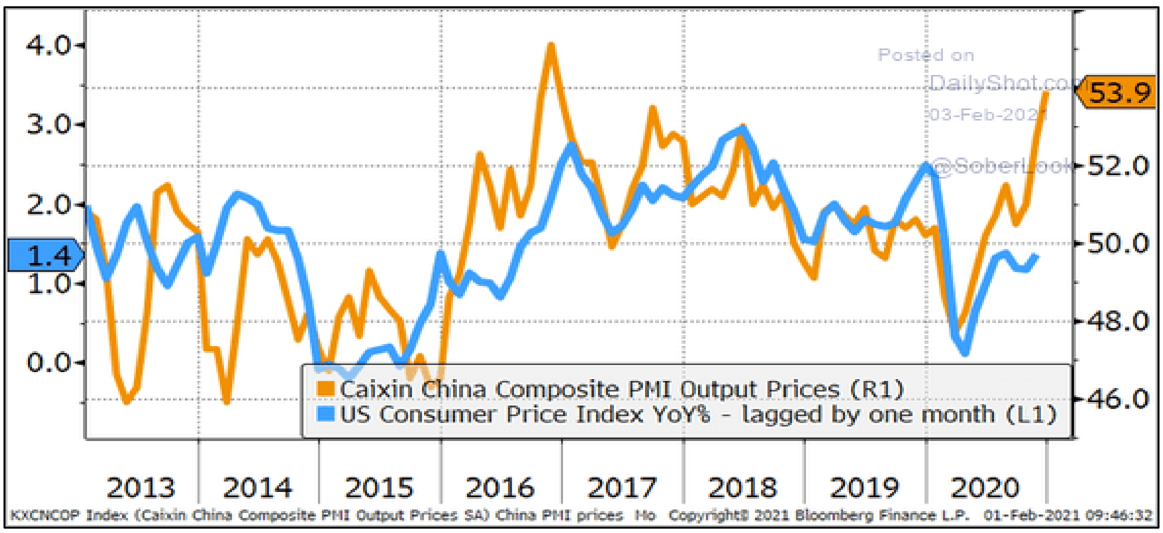
Jan-12
Jan-15
Jan-18
Jan-21
Source: U.S. Bureau of Labor Statistics, Investing.com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DailyShot.com
03-Feb-2021
@SoberLook
4.0
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Caixin China Composite PMI Output Prices (R1)
US Consumer Price Index YoY% - lagged by one month (L1)
2013
2014
2015
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2017
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2020
KXCNCOP Index (Caixin China Composite PMI Output Prices SA) China PMI prices Mo Copyright© 2021 Bloomberg Finance L.P. 01-Feb-2021 09:46:32

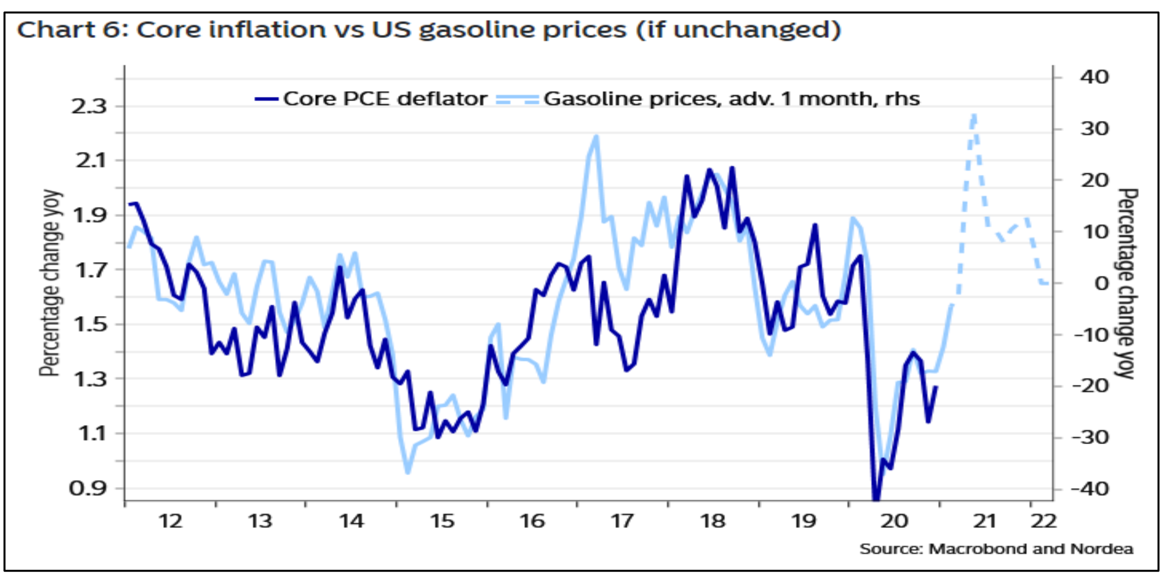
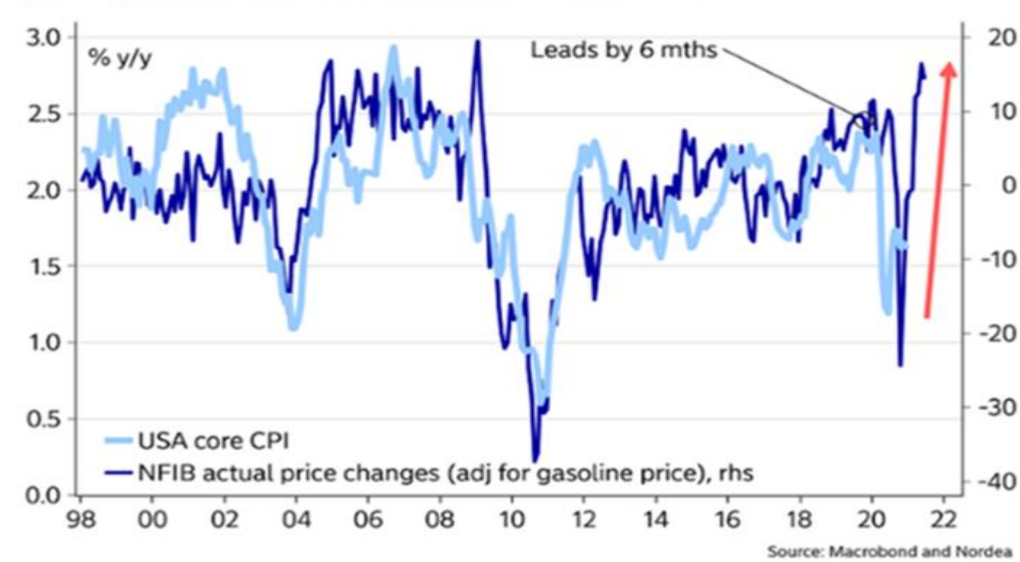


Chart 6: Core inflation vs US gasoline prices (if unchanged)
Core PCE deflator
Gasoline prices, adv. 1 month, rhs
Percentage change yoy
2.3
2.1
1.9
1.7
1.5
1.3
1.1
0.9
40
30
20
10
0
-10
-20
-30
-40
12
13
14
15
16
17
18
19
20
21
22
Source: Macrobond and Nordea

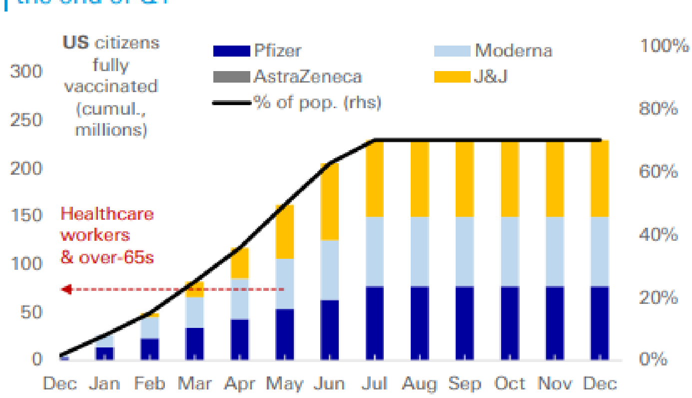
With lots more liquidity coming via both ongoing QE and more fiscal spending, and a likely powerful economic reopening, inflation could very well come in above what are already heightened market expectations. The Fed (and most CB's) have acknowledged this but have also promised to look through it as they think much of it will be transitory. Of course, they also have their new "frameworks" that include average inflation targeting, to legitimize. AIT talk is cheap when inflation is well below target. Things will get interesting when/if it starts to run above target. A lot will depend on how the Fed reacts when this occurs and if the markets buy it or challenge the Fed. Higher inflation will bring higher volatility in financial markets.

Chart 3. Inflation to run substantially above target in Q2?



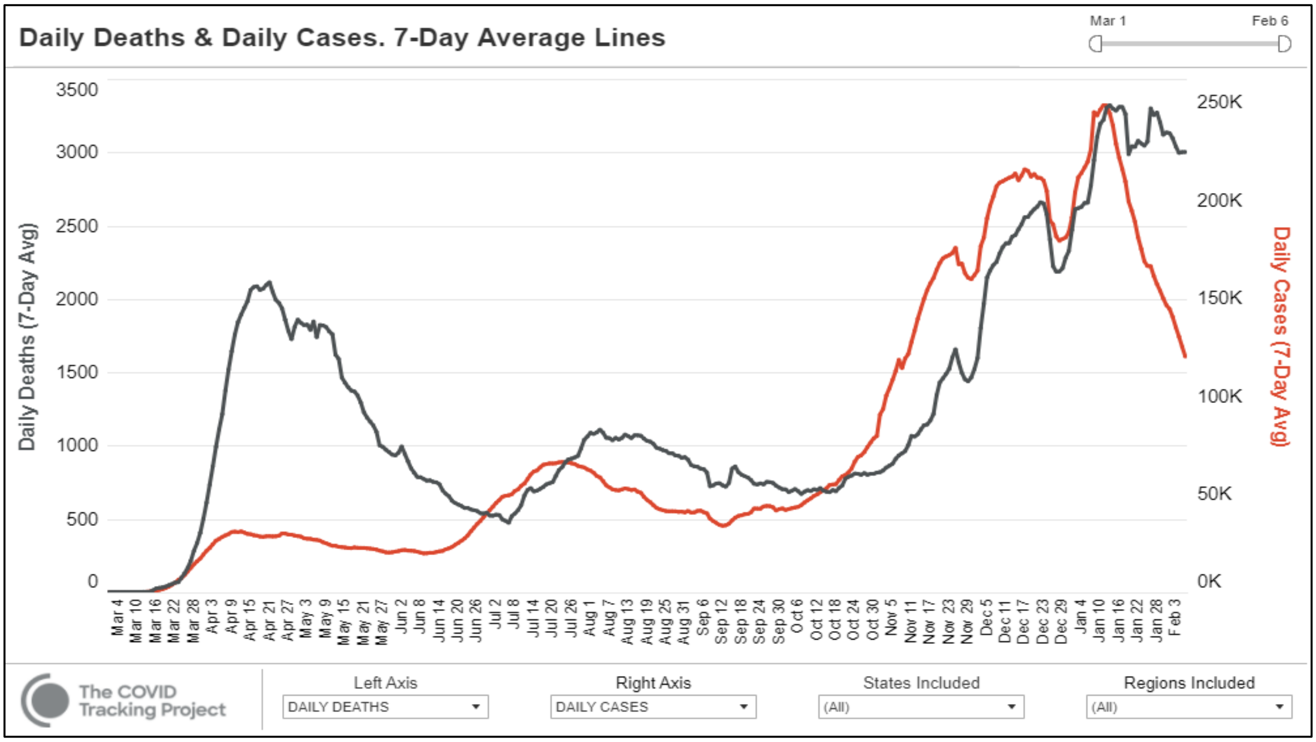
COVID – good news continues to build as the vaccine rollout progresses. Hospitalization rates should plunge as the most vulnerable are inoculated. Remember, 80% of hospitalizations come from the 20% of the population over the age of 70.

Figure 1: The US could vaccinate 25% of the population by the end of Q1

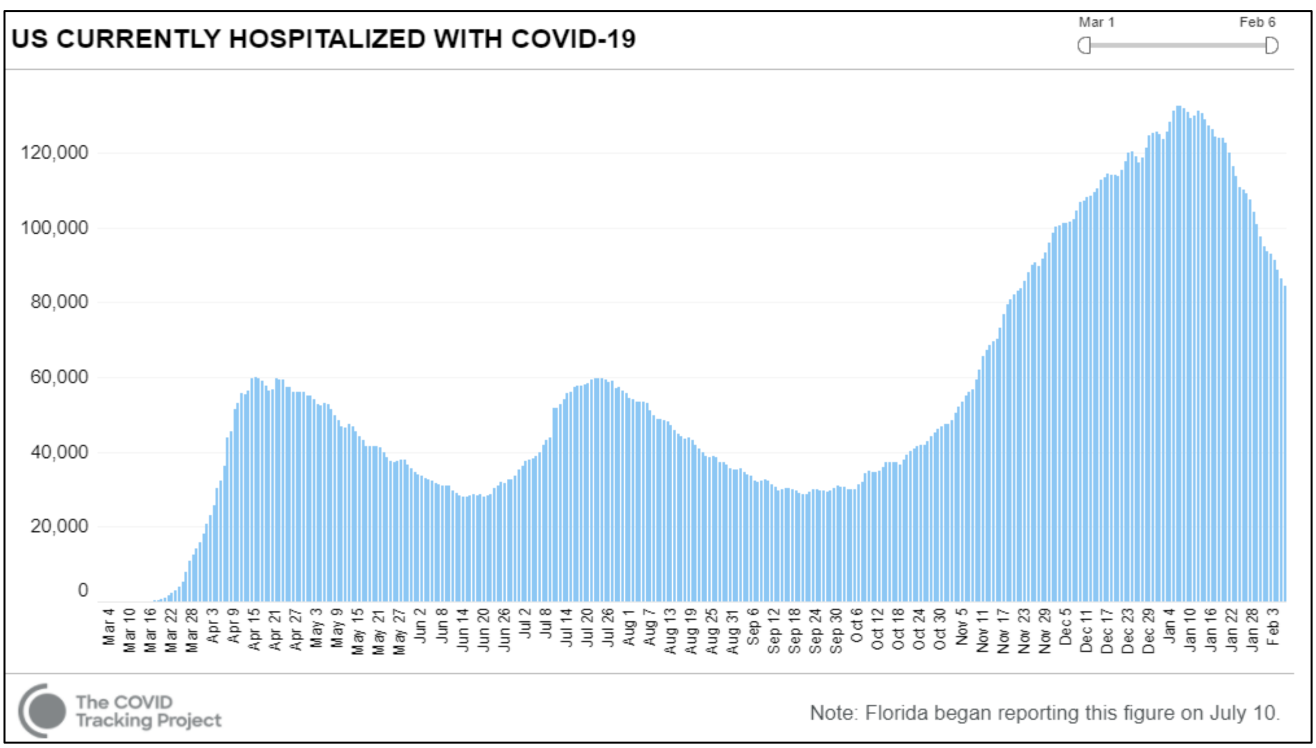


Source : Deutsche Bank

Despite the appearance of more easily spread variants, daily cases are now down 50% off the peak…



and hospitalizations continue to drop.

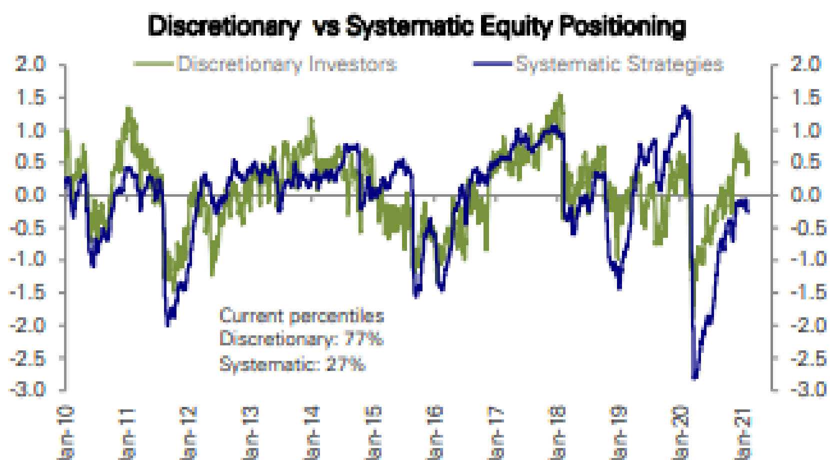


What to Focus on Now:

Flows and Positioning

While discretionary investors have piled into equity longs, systematic investors are still underweight, as the VIX has remained stubbornly high. Bulls say they will eventually be forced in.

Figure 18: Discretionary vs Systematic strategies divide²

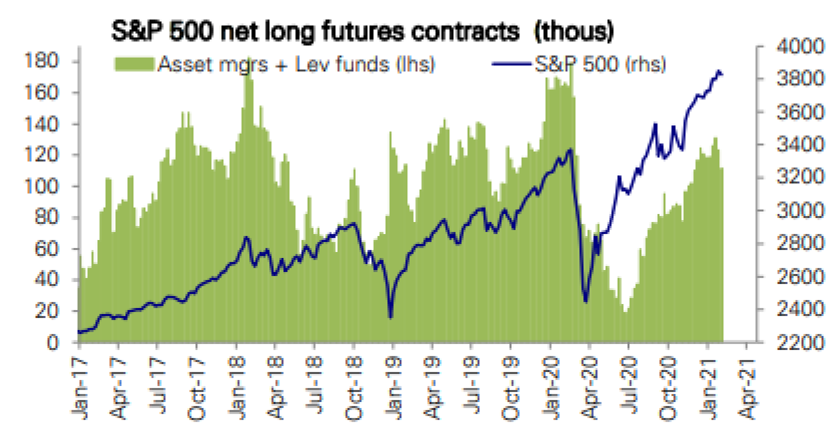


*Wtd average of Z-scores for positioning and flows indicators, weights based on explanatory power in regression of equity performance on indicators

Source : EPFR, CFTC, Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation

Positioning in futures is high, but not yet as extreme as we have seen at other times in recent years.

Figure 76: S&P 500 futures positioning

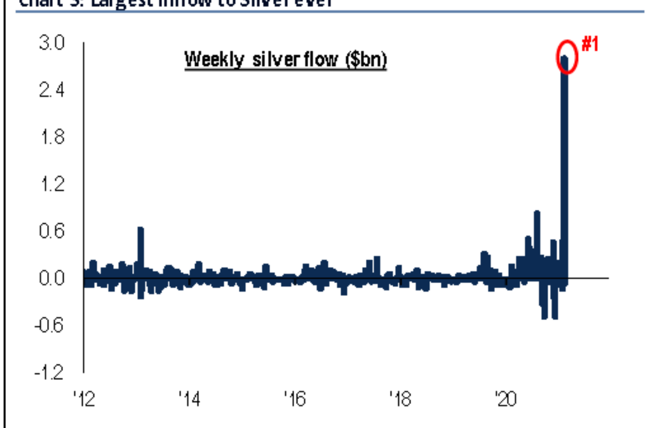


Positioning data as of 02 Feb 2021

Source : Deutsche Bank Asset Allocation, CFTC, Haver

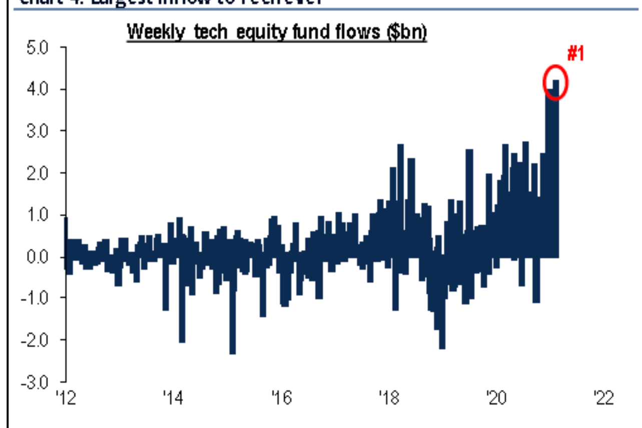
Last week saw continued large inflows into various assets classes and sectors. There is still money to be put to work it seems.

Chart 3: Largest Inflow to Silver ever



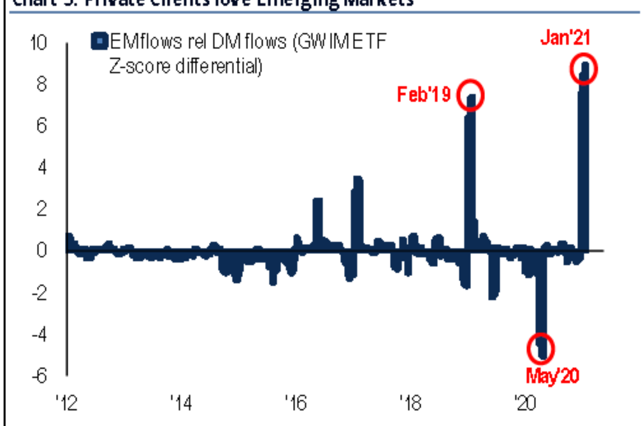
Source: BofA Global Investment Strategy, EPFR Global

Chart 4: Largest Inflow to Tech ever



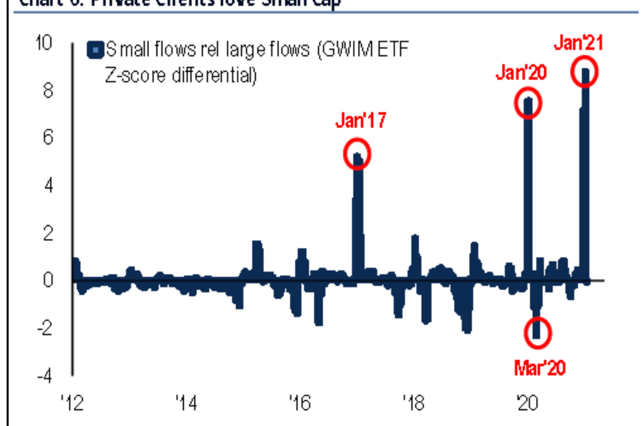
Source: BofA Global Investment Strategy, EPFR Global

Chart 5: Private Clients love Emerging Markets



Source: BofA Global Investment Strategy, BAC Data

Chart 6: Private Clients love Small Cap



Source: BofA Global Investment Strategy, BAC Data

Two weeks ago, we saw some initial cracks in equities as the meme stock debacle caused some pain for long/short investors and led to de-grossing and higher volatility.

It didn't last long. The outside weeks we saw in many indices quickly came out last week as money poured back into stocks.

With the potential for a quicker than expected improvement in the COVID situation, and the increased likelihood that much of the Biden plan will be quickly pushed through via reconciliation, markets are thinking a short-term melt-up is still in the cards.

The Treasuries quarterly refunding report also caught the markets attention last week. The report included a significant downwards revision of the issuance targets. This is thought to be a sign that they will finally be running down the Treasury General Account (TGA) going forward. Starting at the currently very high balance that is north of $1.5 Trl, this could result in a meaningful jump in USD liquidity.

Markets have been anticipating this kind of TGA run-off for a while and we have even seen prior hints of it from the Treasury, but so far, they didn't play out. Analysts think that this time could be different. Let's see. If it does come to pass commercial banks will see a big inflow of liquidity.

Chart 2. The TGA will likely fall to sub $500bn levels by summer

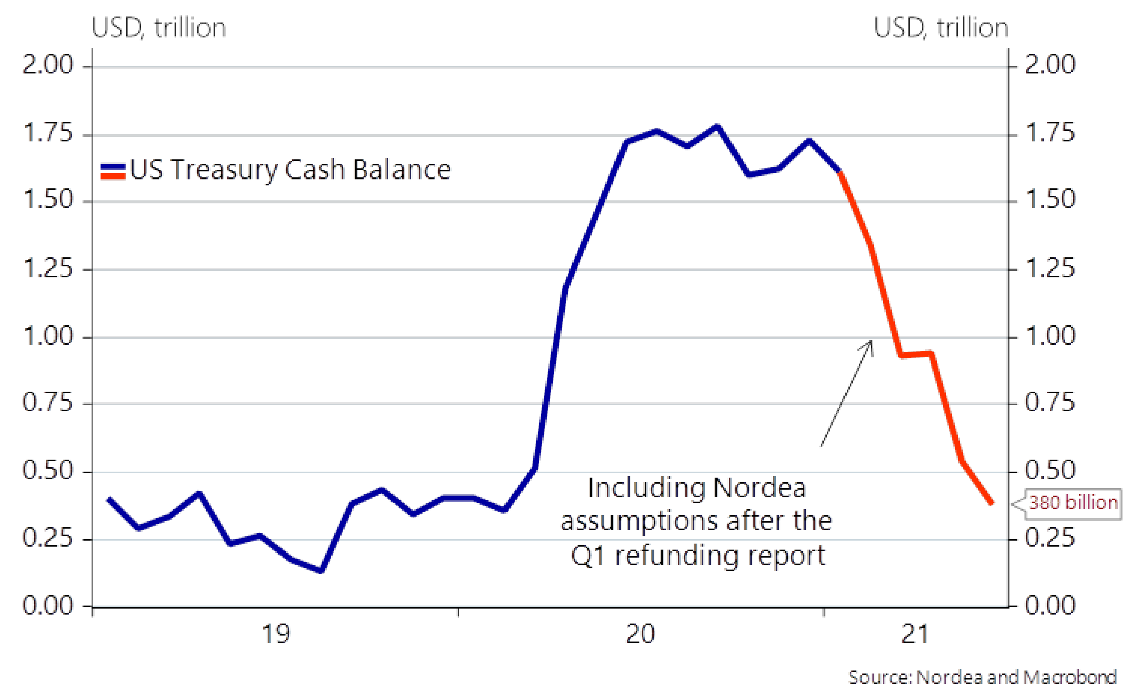
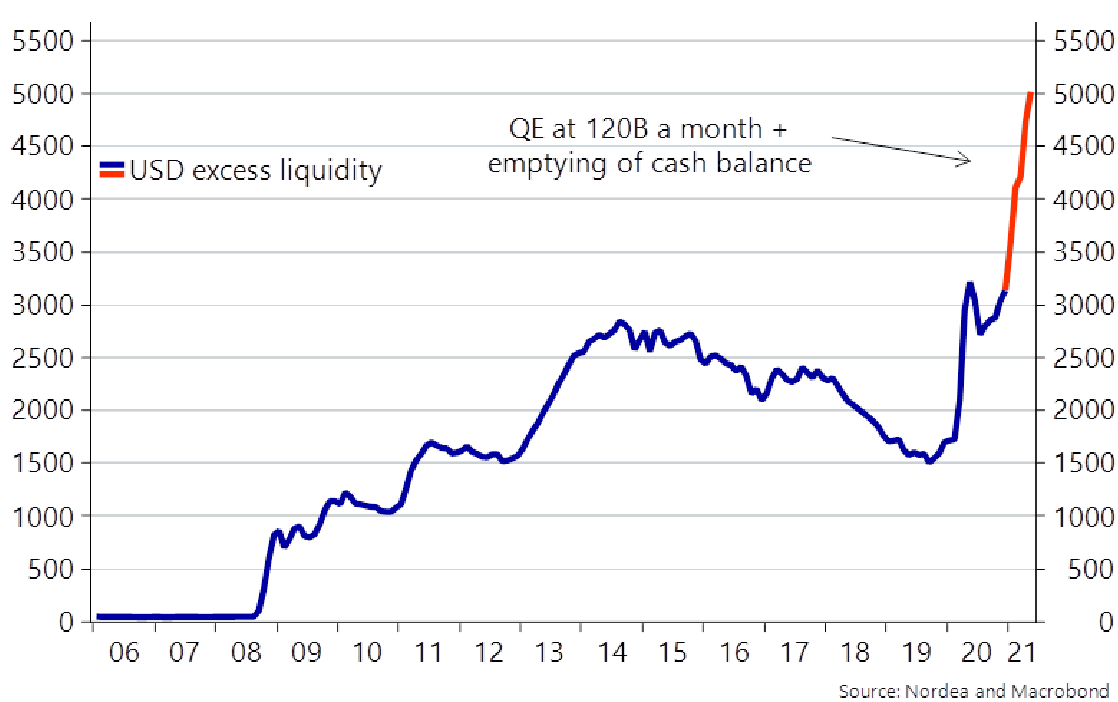
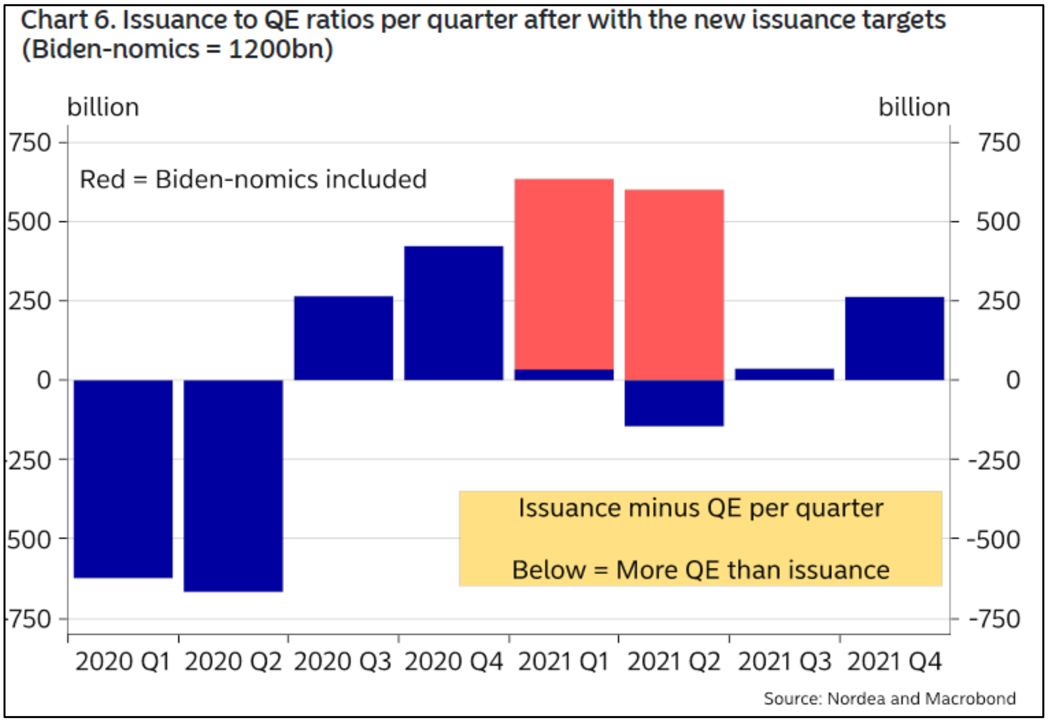


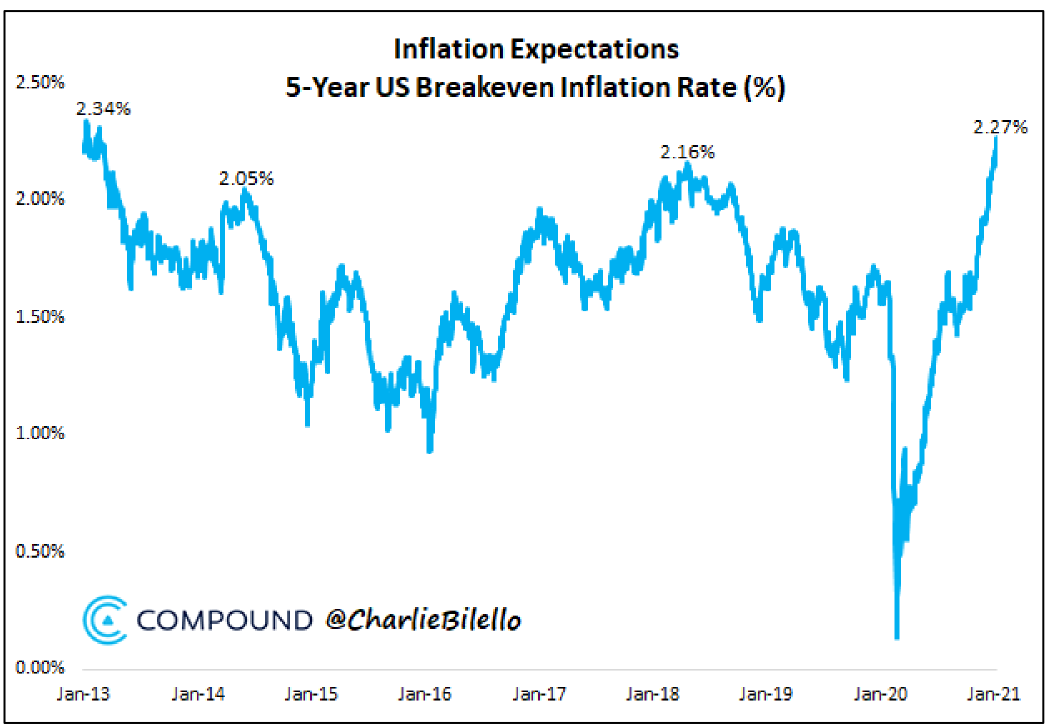
Chart 3. Excess liquidity to increase by a whopping 1.6-1.8trn $



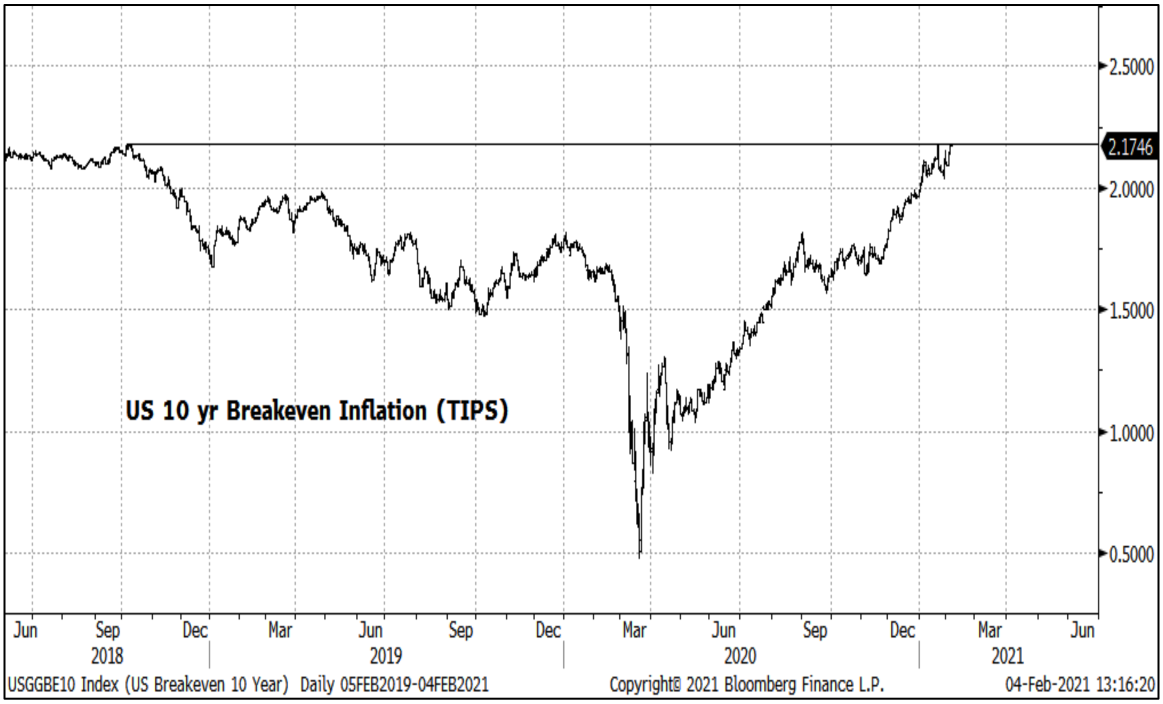
Spending down the TGA would take down the amount of net issuance of Treasuries expected (net of QE purchases). However, with the Biden plan it is still potentially a big number.



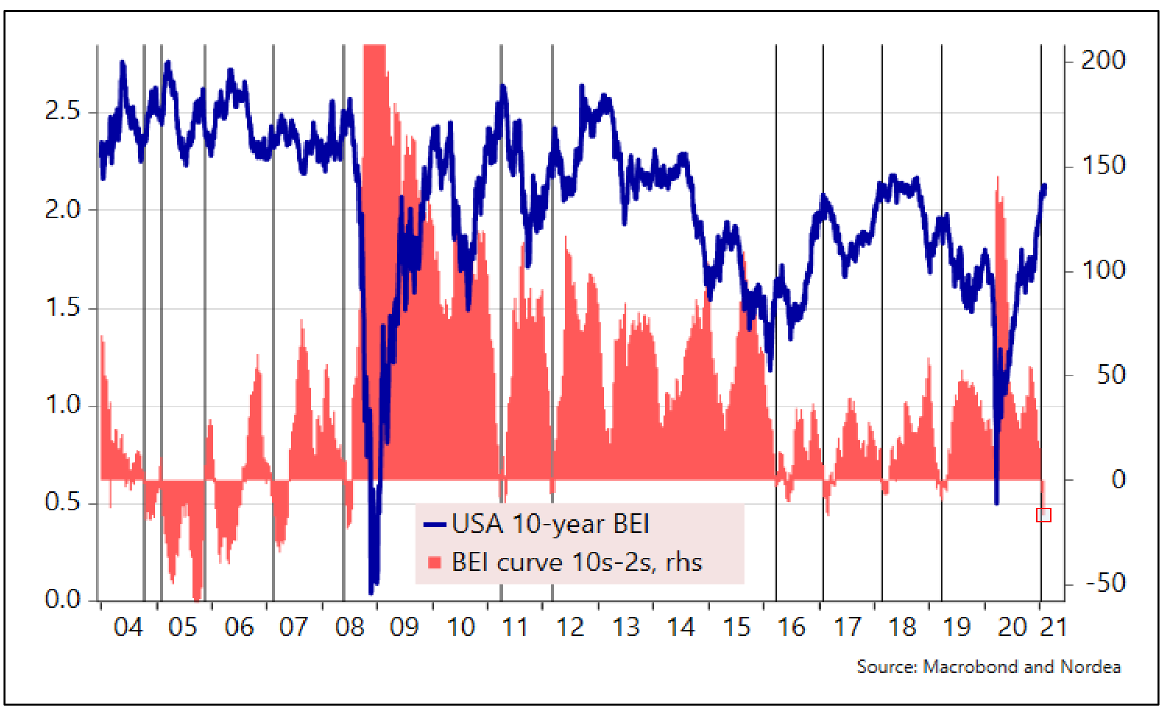
In the meantime, inflation expectations via breakevens have continued to rise… 5 year



And 10 year… now back above 2% that we last saw in 2018.



Although Nordea points out that the current BEI curve inversion has tended to occur close to the end of a run higher in inflation expectations. However, the current "wild cocktail" makes historical charts more problematic.



With inflation expectations zooming, yields have been lifting. 10-year swap yield are trying to push into pre-COVID zone, above 1.25.

The US yield curve continues to steepen…

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As long end yields rise…

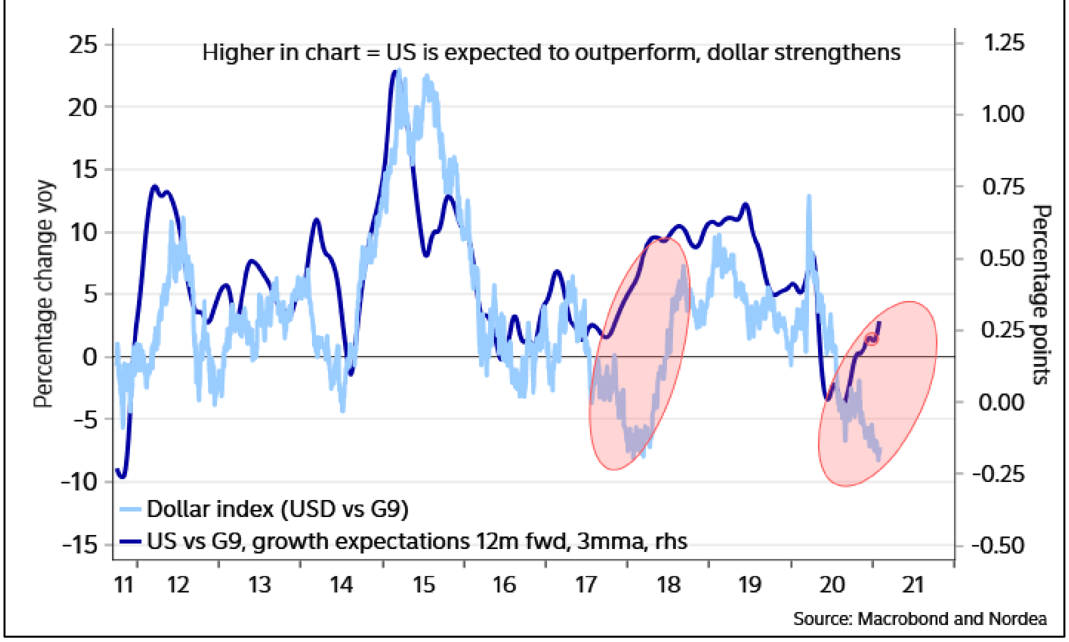
At what level would rising yields become disruptive for markets? Given that a further rise would likely be the result of better growth and higher inflation numbers, at first they can go hand in hand with risk-on. The speed of a yield jump will be important, and of course how the Fed reacts to it. Long end yields can continue to slowly rise, but you will know it is showtime if the front-end starts to price a sooner than expected first hike from the Fed. Grinding bond prices will be the best backdrop for risk. Big moves will quickly create volatility across markets.

FX – Last Summer and into early Fall was flat out bad for the dollar. Now things have become increasingly complicated as competing narratives emerge. They go something like this…

1) Relative liquidity provision is the driver and the US has been pouring on liquidity via QE, fiscal spending and zero rates. This will continue and fiscal spending is about to get taken up another notch. M2 is through the roof and for the global reserve currency, that matters. Twin deficits will sink the dollar. Global reflation means dollar down.
2) Potential growth and forward-looking monetary policy differentiation are the drivers now. More stimulus, especially fiscal, means more upside for US growth and yields. The dollar should strengthen as the US outperforms. Europe is way behind the US in vaccinations and that will hold back relative performance. European yields are experiencing de-facto yield curve control via negative rates for years to come.

Here is one that illustrates the dollar bullish view based on relative growth.

Chart 2: Relative growth look supportive of the USD



I'm thinking differentiation is the likely driver now. Some currencies will lead and others lag. Interest rate differentials will matter, but so will global growth and positioning. The dollar up story assumes that the US resumes its role as global growth leader in a low growth world. Dollar down assumes that global growth has a bit of a boom as COVID is eventually put behind us, maybe sooner than expected. The EUR broke down then reversed on Friday… in limbo for now.

With conflicting narratives, I find myself increasingly watching the price action.

Crosses like EURGBP and GBPCHF look interesting and speak to differentiation.

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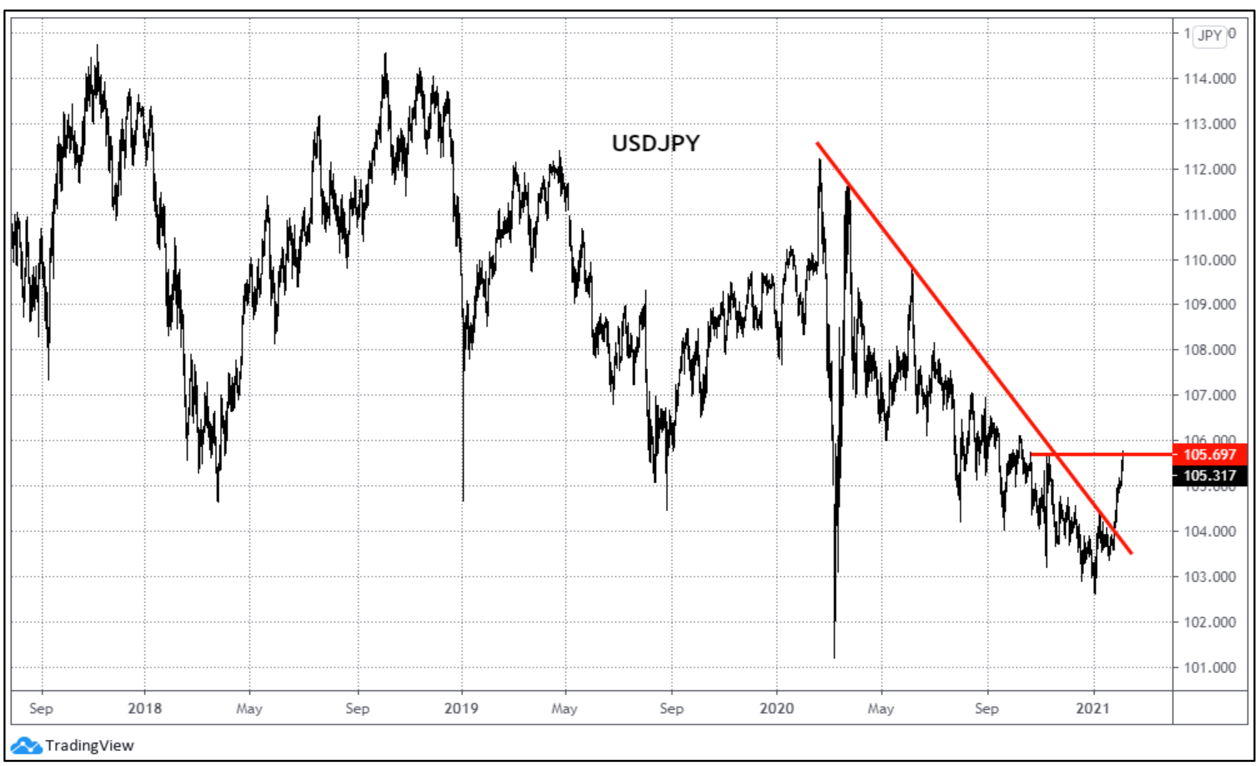
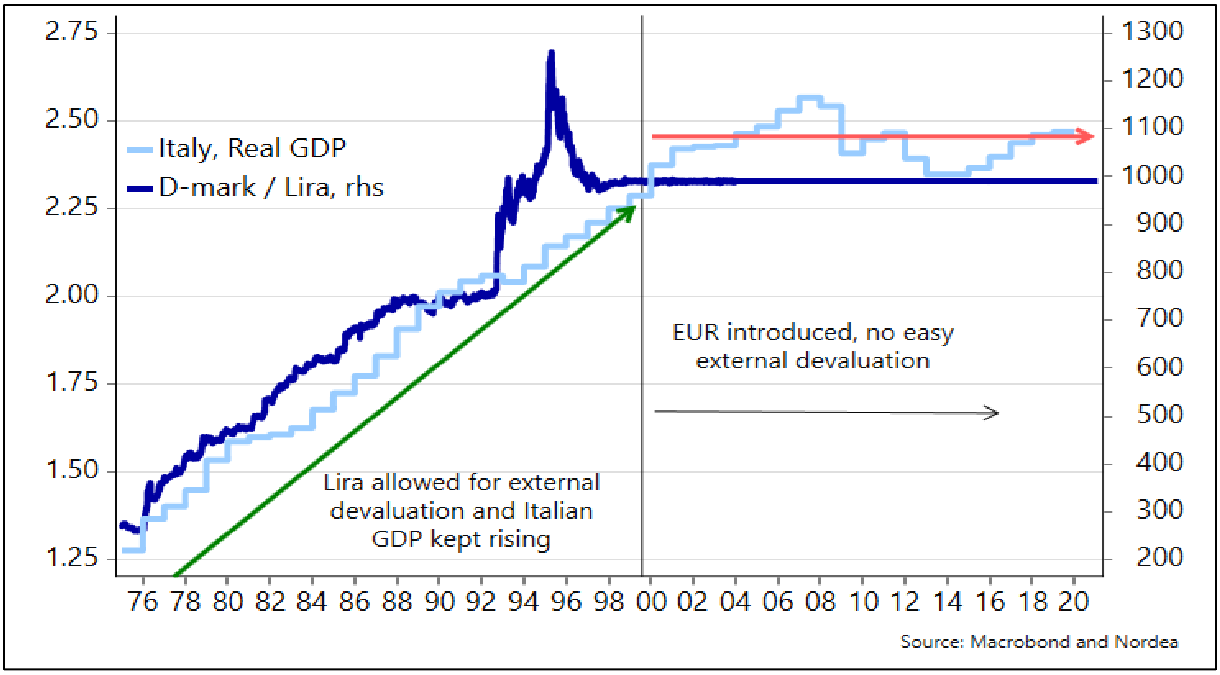
Some of the Yen crosses also look interesting. GBPJPY recently took out some big levels.

Although probably a bit extended here, USDJPY looks like it could have further upside after a rest/retrace.



Italy – Former ECB President Mario Draghi looks set to take the helm in Italy as PM. With an economy that saw -8.9% GDP last year he has his work cut out for him. On the bright side, there is €200 bln in EU funding coming his way and he is probably the best choice for figuring out how to spend it. Given his high level of credibility in Europe and his deep network he should be able to work the system in Italy's favor. It is not clear, however, how he will get around one of Italy's biggest problems, the Euro. Still, the long-suffering Italy ETF is knocking on interesting levels.



And in the “sign of the times” column…

DOGECOIN spiked today after Snoop Dogg endorsed it. Elon Musk and Gene Simmons (of KISS) have been Tweeting about it too. This coin came to life during the Reddit meme stock rally of two weeks ago. It is the last man standing.

From the Coindesk site:

“Dogecoin emerged in 2013 as a joke. It was created by Jackson Palmer and Billy Markus to satirize the growth of altcoins by making the doge internet meme into a cryptocurrency. While it was birthed as a joke, it actually led to some practicality as it’s large supply and low price facilitated efficient micro-tipping content on social media. It is a derivative of Luckycoin which forked from Litecoin and uses a Scrypt algorithm. Dogecoin has 1 minute block intervals making it faster than other blockchains. <u>There is no cap to the supply of coins and thus the coin can inflate infinitely.”</u>

What is there to say…

Relatively slow data week coming up…

Important Macro Data Releases and Events for the Week

Monday 02/08/2021	Trade Balance (Jan) Forecast: -, Prior: $78.17 bln
Tuesday 02/09/2021	CPI and PPI for (Jan) CPI YoY Forecast: -0.1, PPI YoY Forecast: 0.4%
Wednesday 02/10/2021	Harmonized Index of Consumer Prices YoY (Jan) Forecast: 1.6%, Prior: 1.6%
	CPI Ex Food and Energy MoM (Jan) Forecast: 0.2%
	CPI Ex Food and Energy YoY (Jan) Forecast: 1.6%
	BoE's Governor Bailey SPEECH
Thursday 02/11/2021	Foreign Direct Investment YTD YoY (Jan) Forecast-, Prior: 6.2%
	Chinese New Year
	Initial Jobless Claims Forecast: 814k, Prior: 779k
	Initial Jobless Claims 4-week ave. Forecast: - , Prior: 848k
	Continuing Jobless Claims Forecast: -, Prior: 4.592m
Friday 02/12/2021	Industrial Production s.a. MoM (Dec) Forecast: -, Prior: 2.5%
	Michigan Consumer Sentiment Index (Feb) Forecast: 75.7, Prior: 79

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