Stargazer
Asset Management

What to focus on in Global Macro for the week of January 25th, 2021

Macro Themes on the Radar:

Last week's ECB meeting…

Two main points came out of this meeting.

1) The ECB came across a bit more hawkish than expected, emphasizing that the Pandemic Emergency Purchase Programme (PEPP) might be adjusted in either direction.

"*If favourable financing conditions can be maintained with asset purchase flows that do not exhaust the envelope over the net purchase horizon of the PEPP, the envelope need not be used in full. Equally, the envelope can be recalibrated if required to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation.*"

I think this reflects the view that sovereign yields are low enough. They are happy for them to stay at these levels, but there is also a growing acknowledgement that when the pandemic lifts there is likely to be a surge of economic activity and a jump in inflation. Long end yields are likely to rise as a result. So, the focus is being shifted to preserving easy financial conditions. What exactly that means in terms of a reaction function is less clear. President Lagarde described financial conditions as being holistic, multifaceted and relating to all sectors. (If that helps) They start with government bond yields, but can include everything from corporate credit availability and spreads, to bank borrowing costs and bank deliver credit availability. They have purposefully muddied the waters here, leaving the market without a clear indicator to watch.

2) The reference to the EUR exchange rate was dropped from the statement but included in the introductory statement, downgrading its emphasis somewhat. Another slightly hawkish hat tip?

Overall, I was a bit surprised that they went down this road. It may be intended to give them greater flexibility and cover for when we do get that post vaccine economic pop.

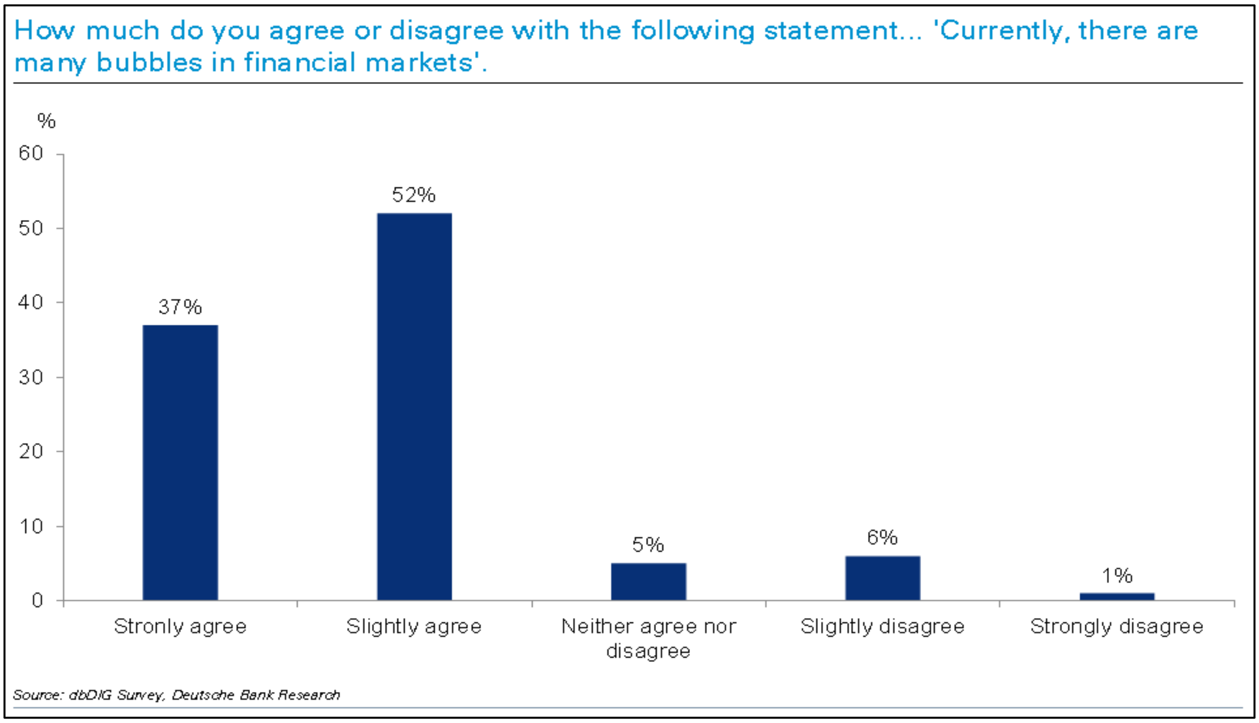
In the meanwhile, Europe is seeing continued vaccine rollout issues, Italian political instability and weakening economic data…

Fed this week…

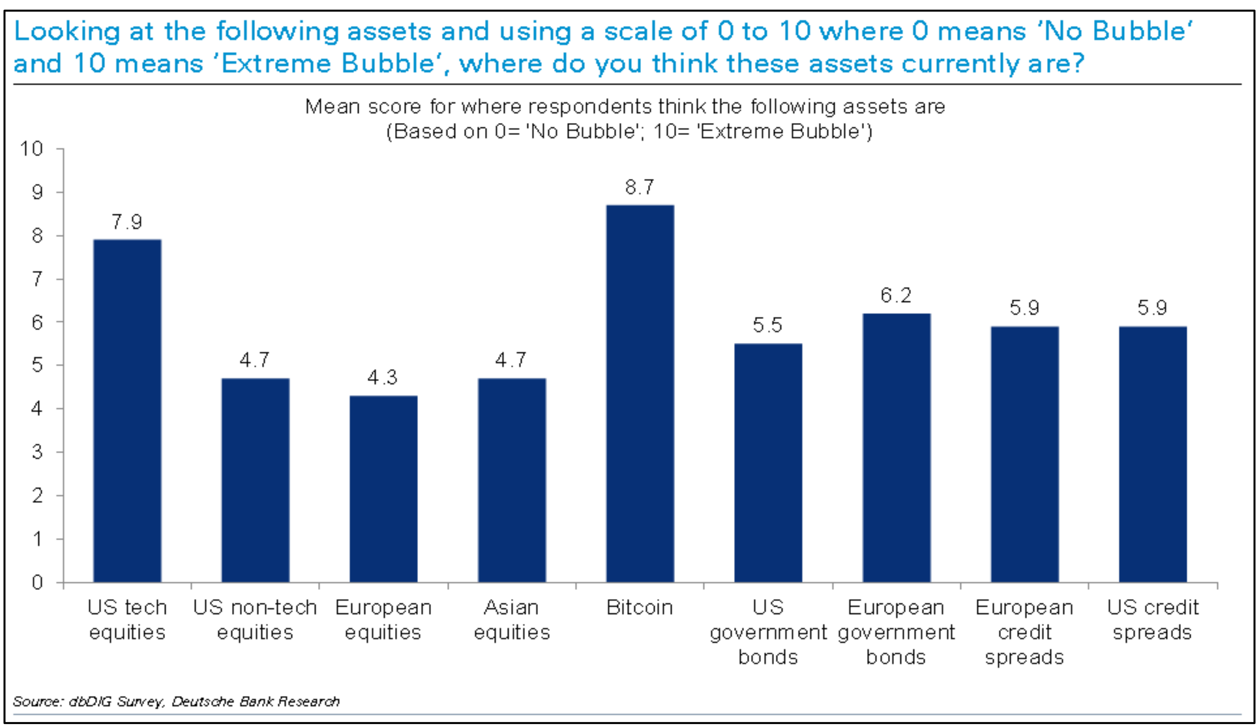
This Wednesday we have the Fed meeting. While I don't expect any changes in policy, it will be followed by a potentially interesting press conference. Expect the topics to include fiscal spending, flexible average inflation targeting, asset bubbles, debt sustainability, policy and inflation expectations. Doubt we get much we have not heard before, but look out for emphasis and pushback during the Q&A.

Bubble? I don't have any killer insights here but thought I would run you through what I am looking at.

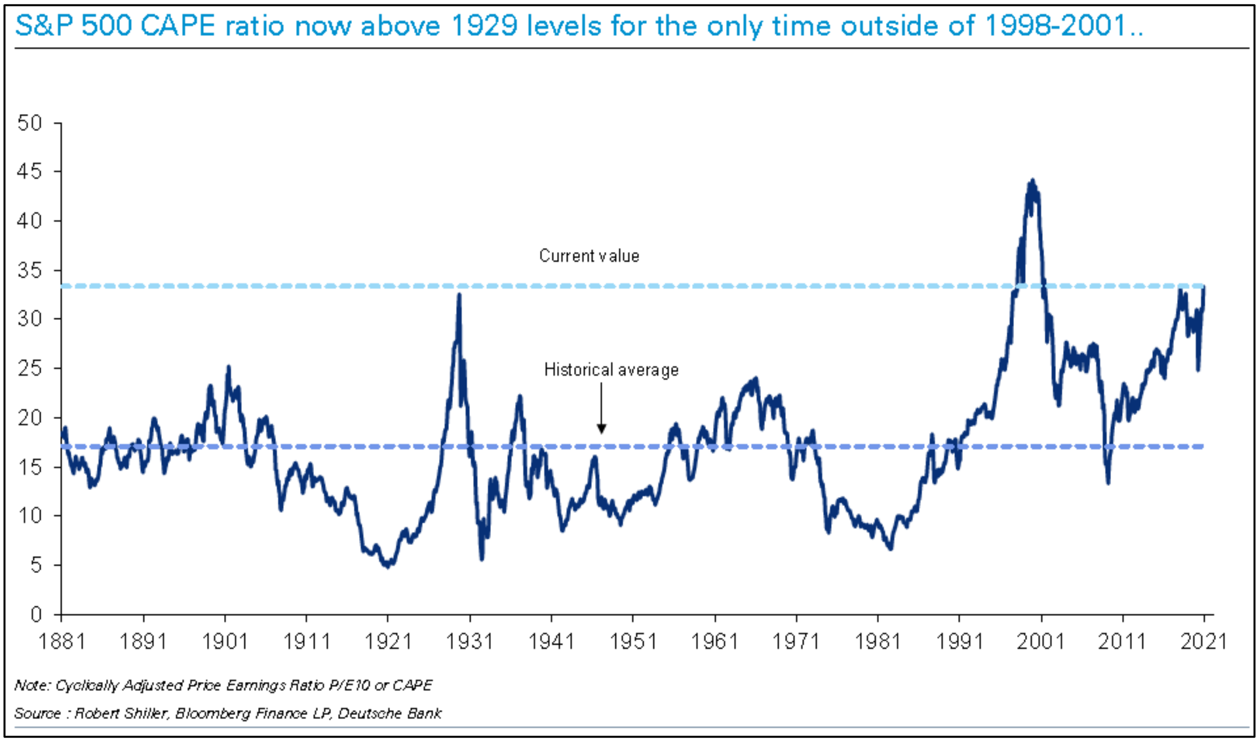
A recent survey from Deutsche Bank reveals that market participants increasingly feel that markets are getting bubbly.



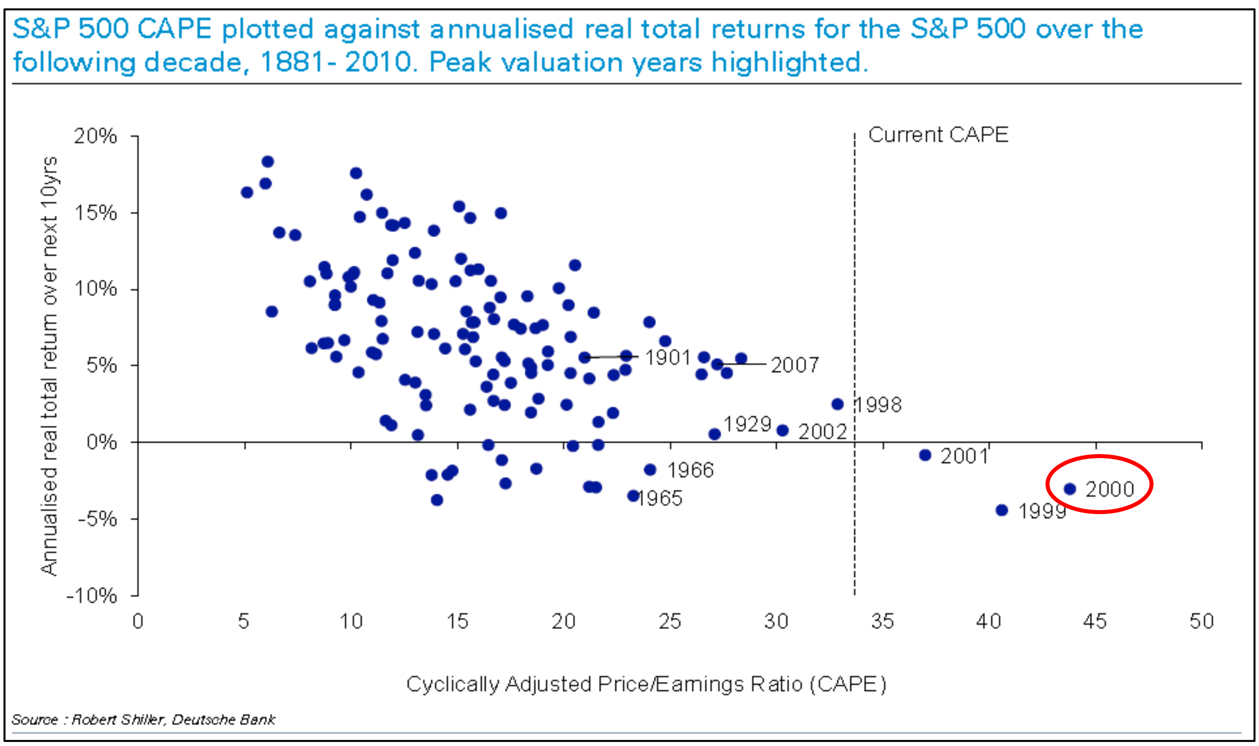
Interestingly, they are focused on US tech and things like Bitcoin and global bond markets, but less on global equity markets overall.



We know valuations are getting lofty again.

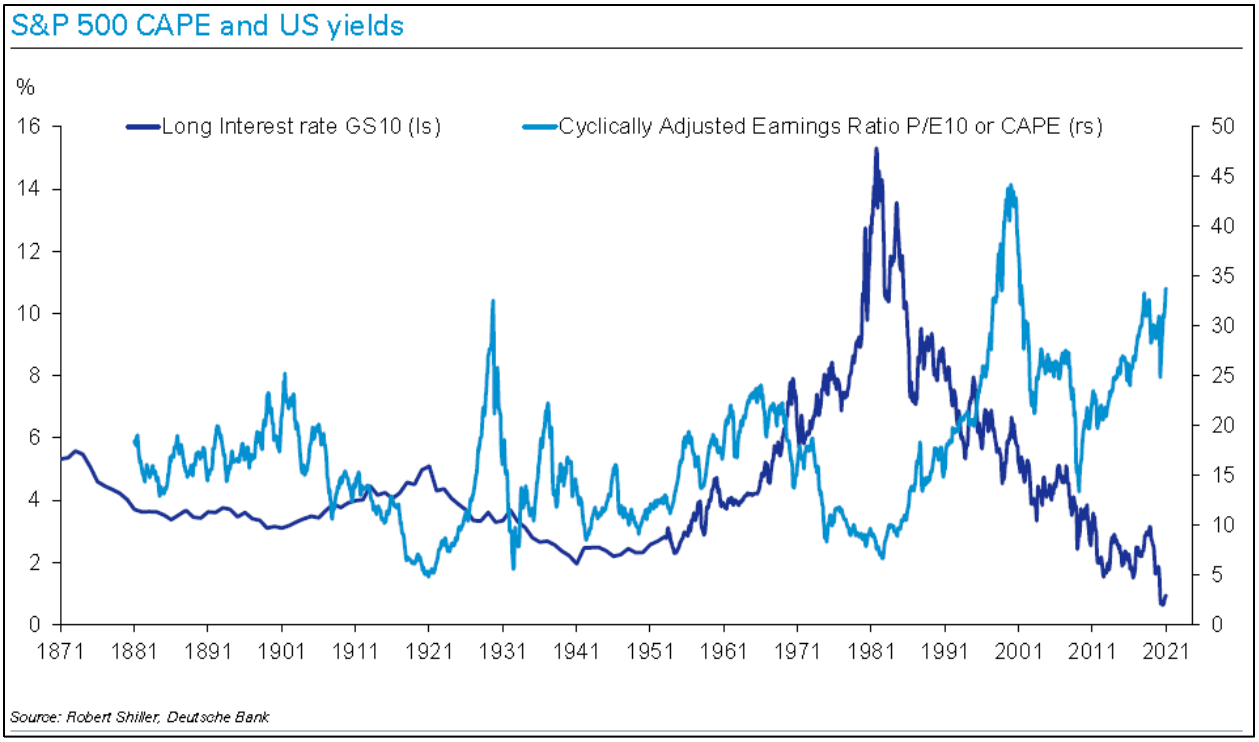


And that high valuations often mean lower returns going forward.

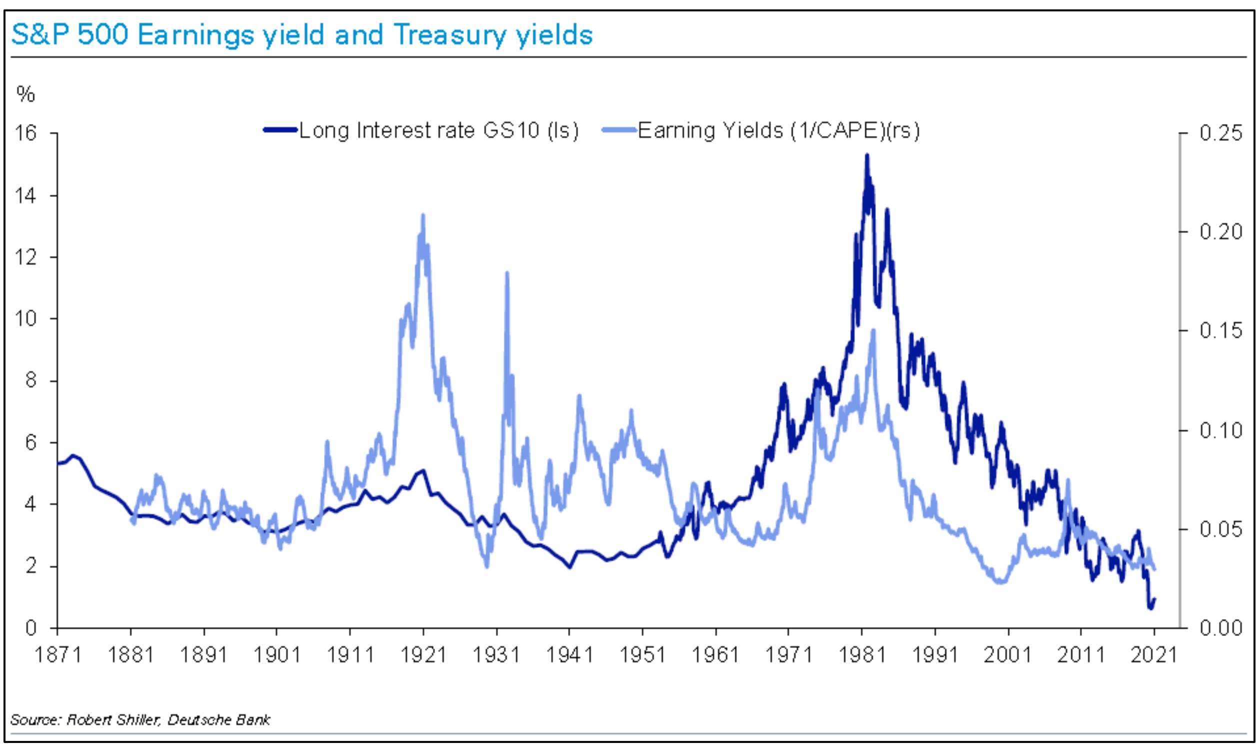


But lower yields tend to justify higher valuations.

Stargazer
Asset Management

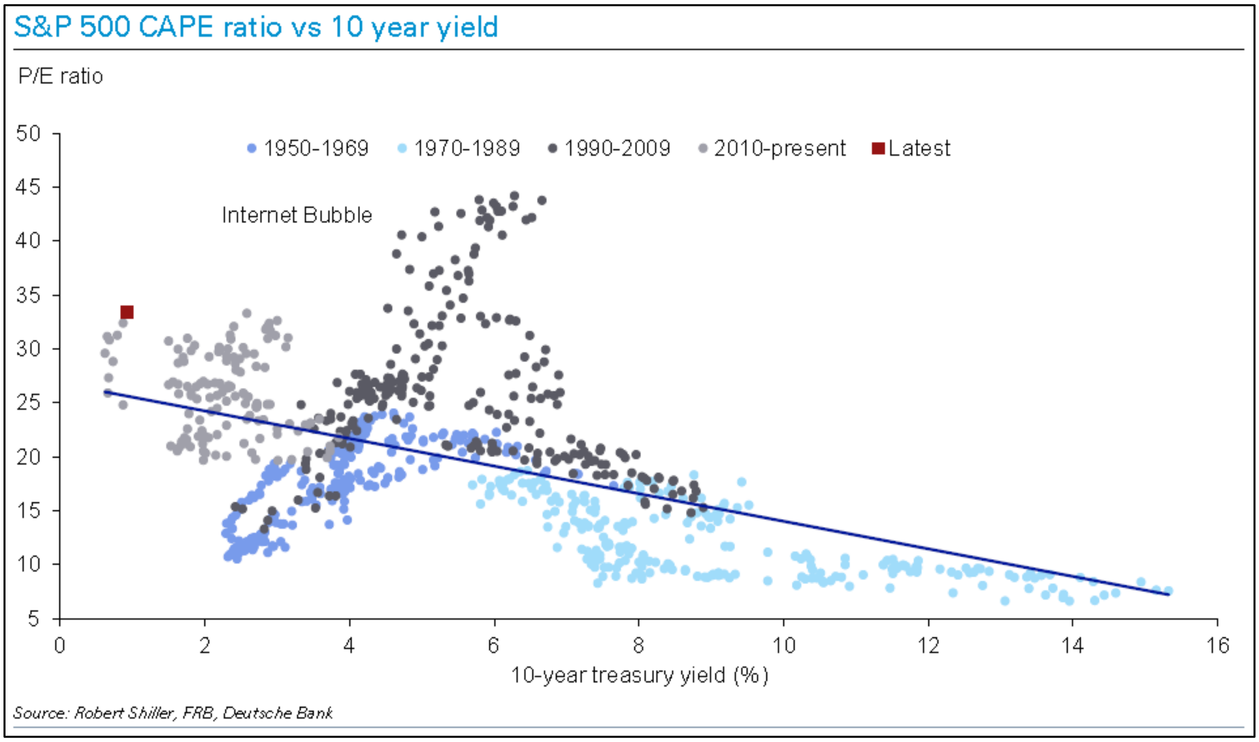


And by that measure at least stocks are actually not as expensive as they look.

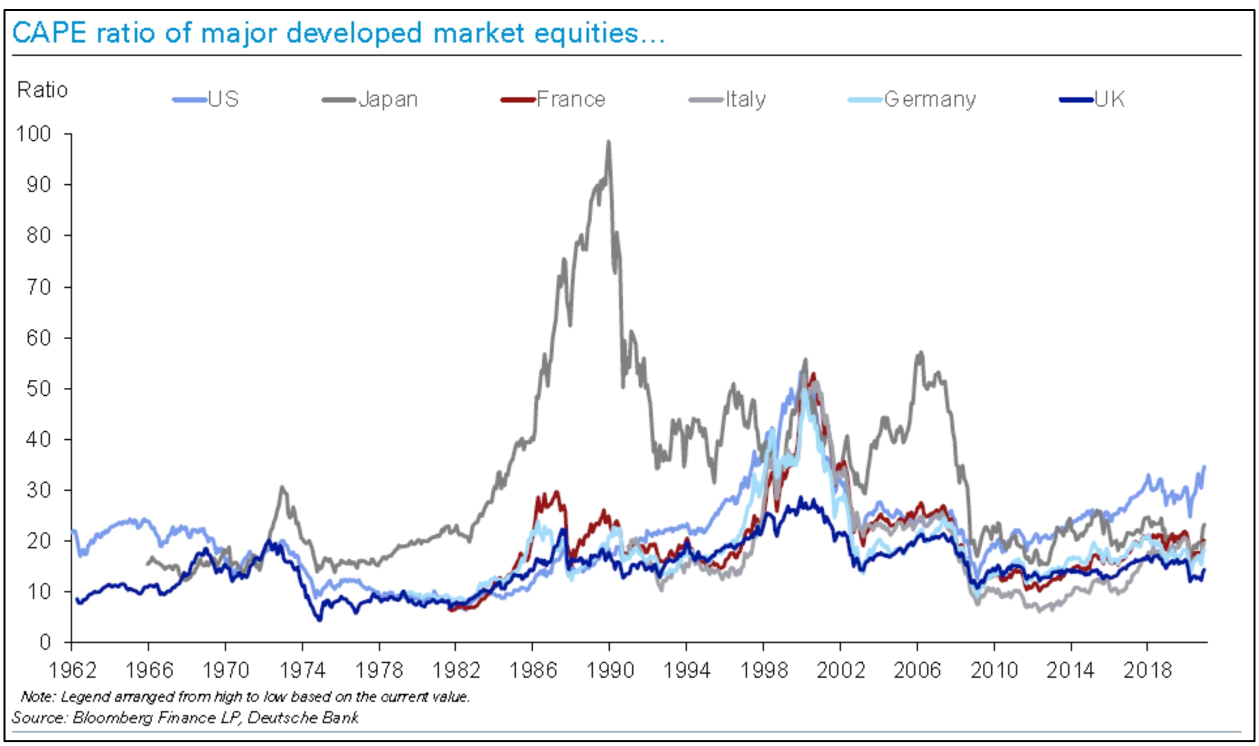


However, it still leaves us with the question of how high is too high.

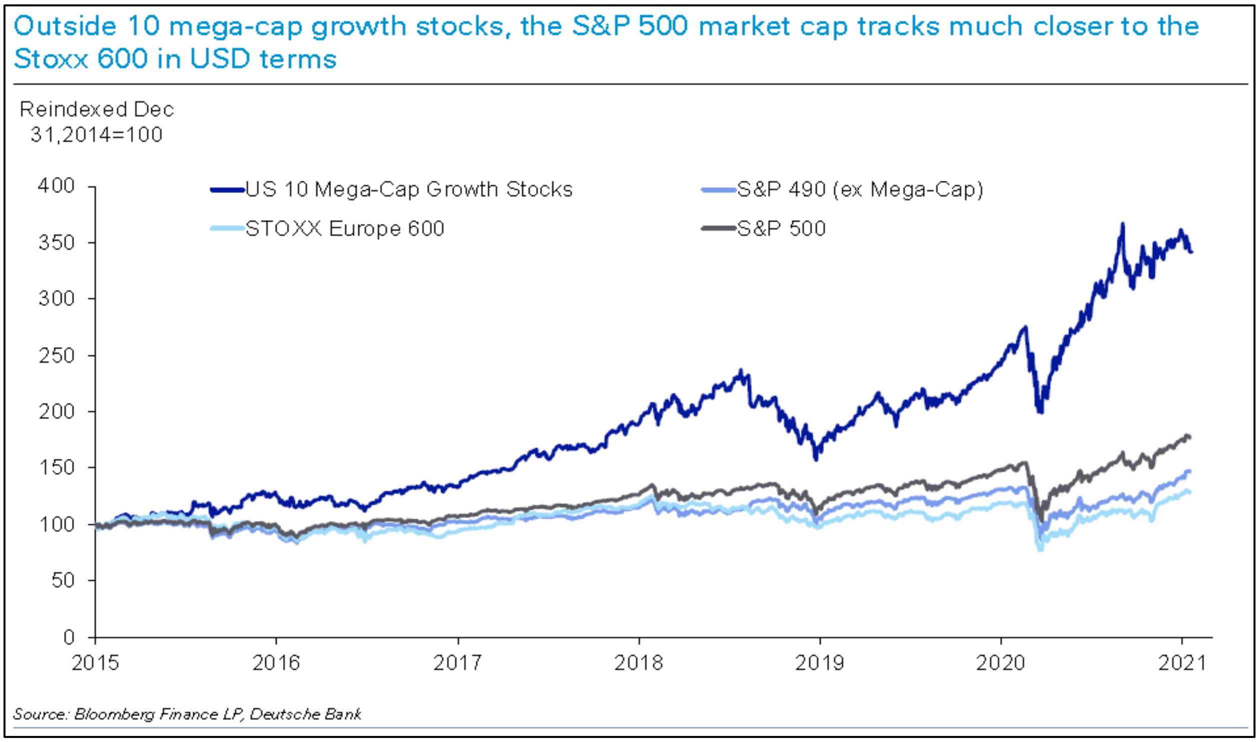
Stargazer Asset Management



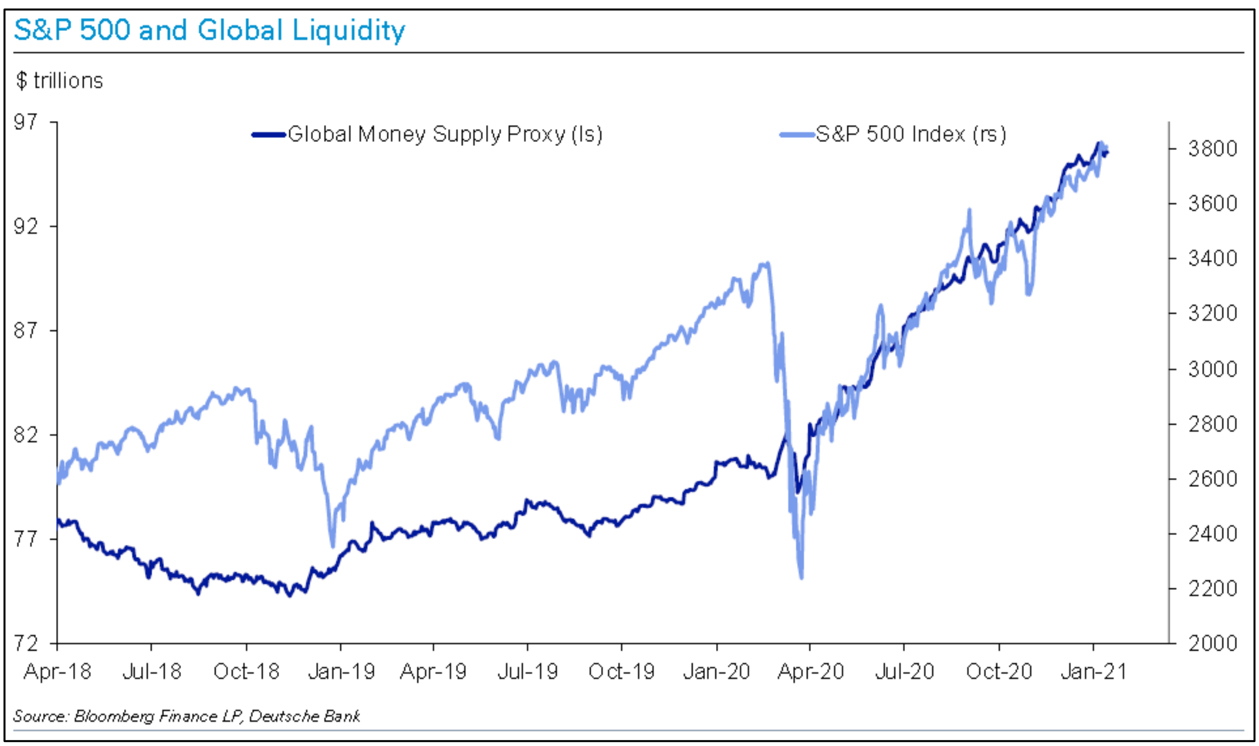
International developed markets equities are much cheaper than the US, thanks to US tech and the multi-year pull of those growth stocks in a relatively low global growth environment.



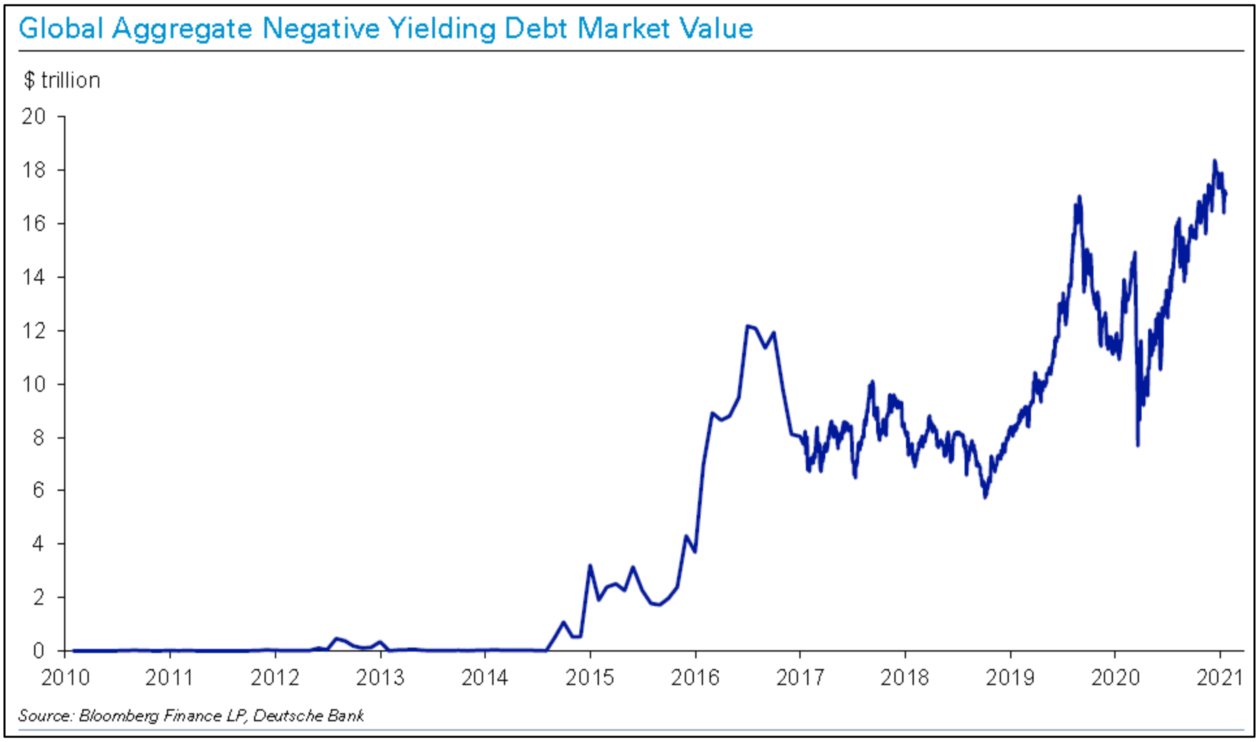
As noted previously, if you take US big tech out, US performance hasn't been so different from that of Europe over the last few years.



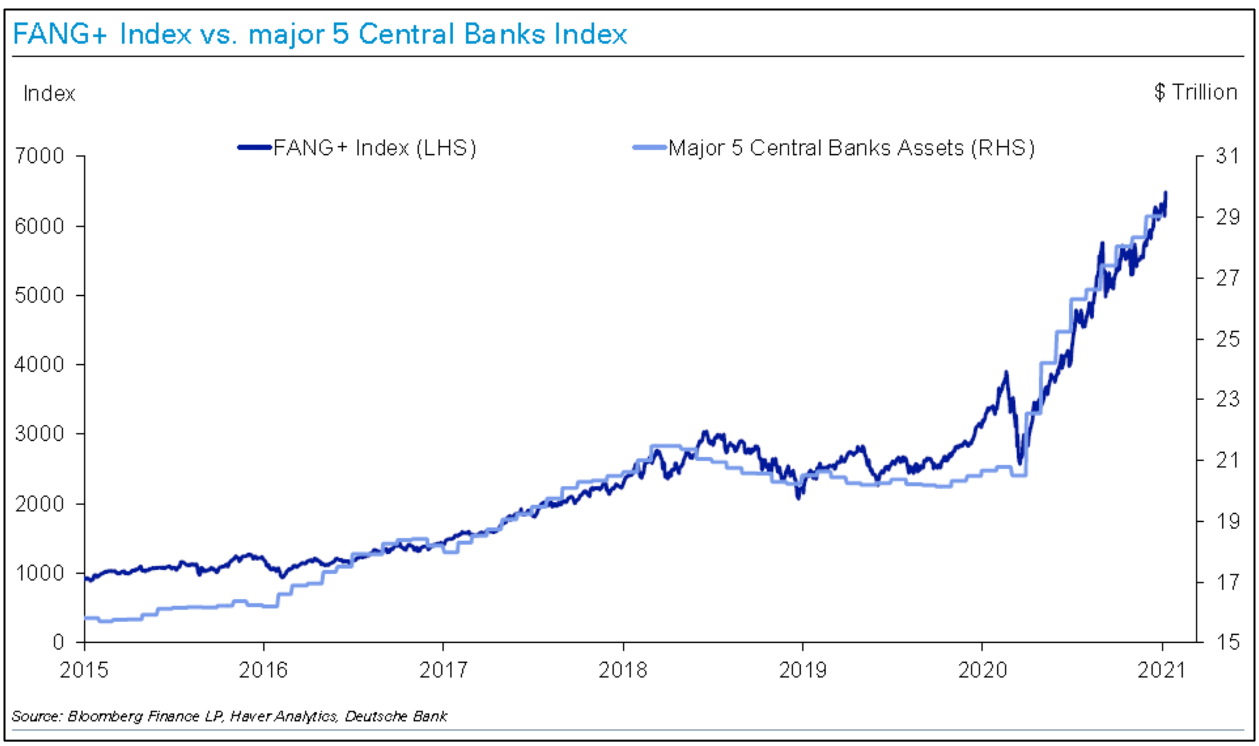
There is little doubt that CB, and now fiscal liquidity have been a huge driver, especially since last March.



At the same time, zero and negative interest rate policies have kept bond markets in line (and then some).

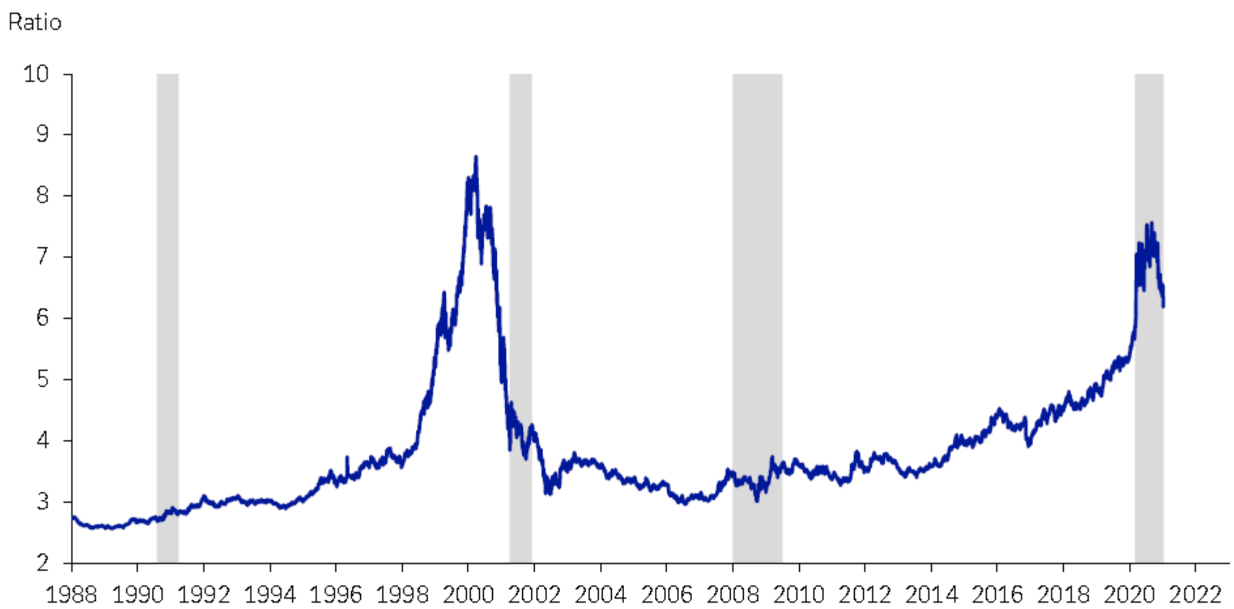


CB policy has tended to have a strong correlation with the big tech growth names. Low growth and low inflation have kept CB's easy and crowded in investors.



The US election has brought a big and sudden rotation as reflation and growth expectations zoom. Very different from what ended the largest prior period of tech outperformance in 2000.

NASDAQ Composite to Russell 2000 ratio



Source: WSJ, Haver Analytics,, Deutsche Bank

The question is, can you have a benign rotation of meaningful magnitude without rocking the boat? The more expensive equities are in aggregate, the more fragile they become to unexpected outcomes.

S&P 500 valuations...

Current percentile of S&P 500 valuation metrics

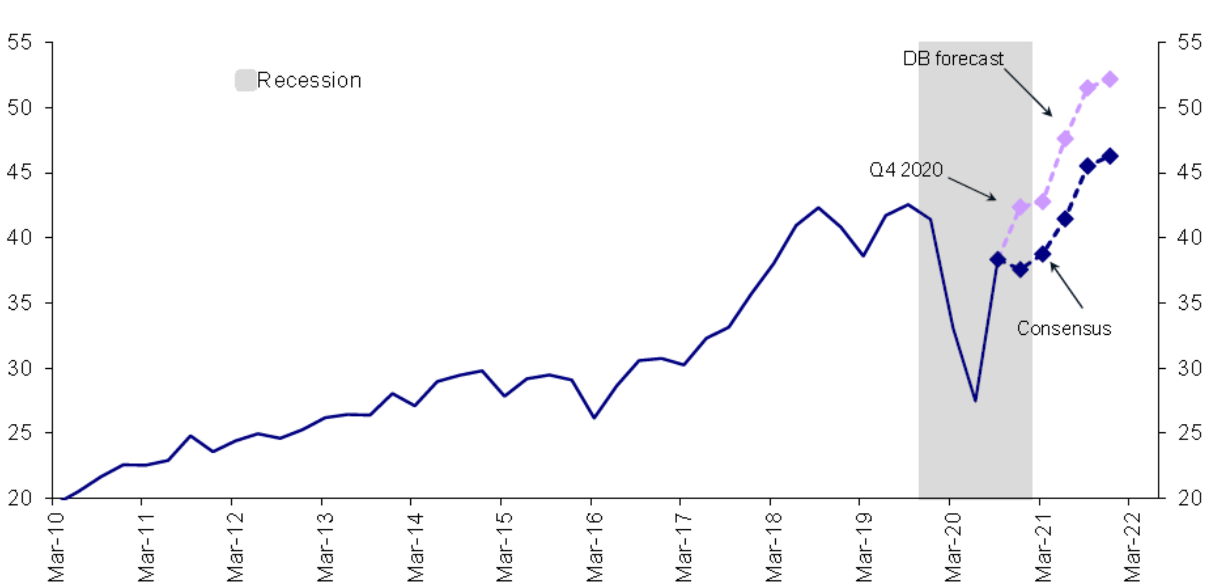
	Ex Tech bubble	Whole sample
LTM PE[1]	99.8	97.5
Price to trend EPS[1]	99.4	93.6
NTM PE[2]	100.0	95.7
EV/EBIT[3]	100.0	100.0
EV/EBITDA[3]	100.0	100.0
EV/EOCF[3]	100.0	98.1

1. since 1935; 2. since 1988; 3. since 1966

Source: DB Asset Allocation, Deutsche Bank

The good news, and this is clearly already part of the narrative, is that EPS are expected to jump as economies and consumer service sector in particular, reopen.

S&P 500 Quarterly EPS ($ per share)

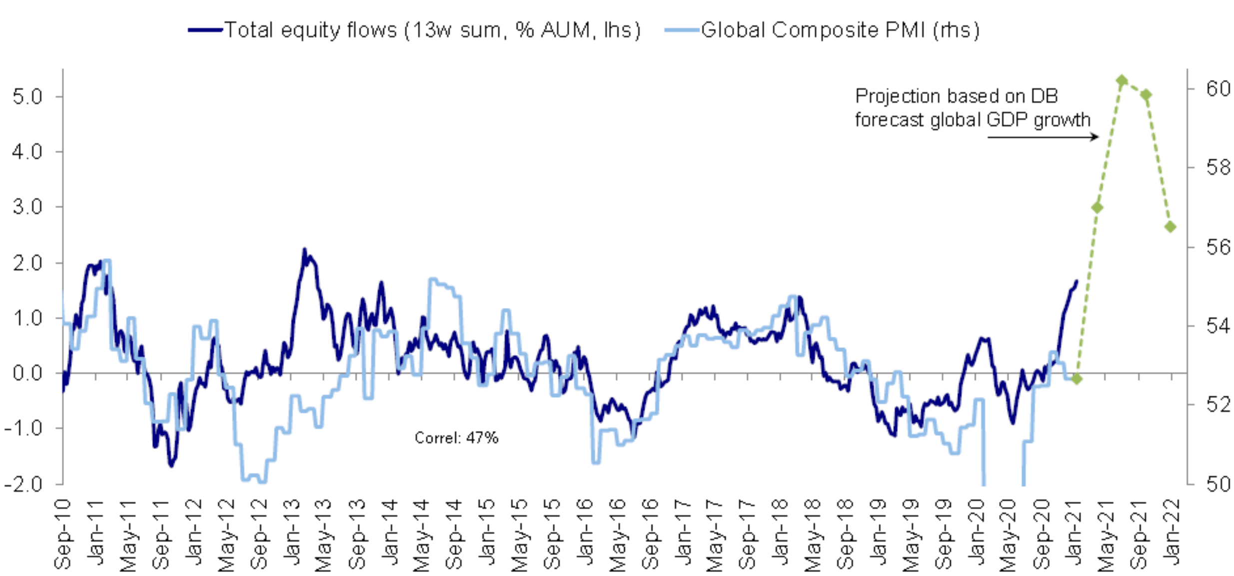


*Consensus Q4 earnings assumes cos yet to report meet estimates

Source: DB Asset Allocation, Deutsche Bank

A jump in global growth has historically been accompanied by even larger equity inflows.

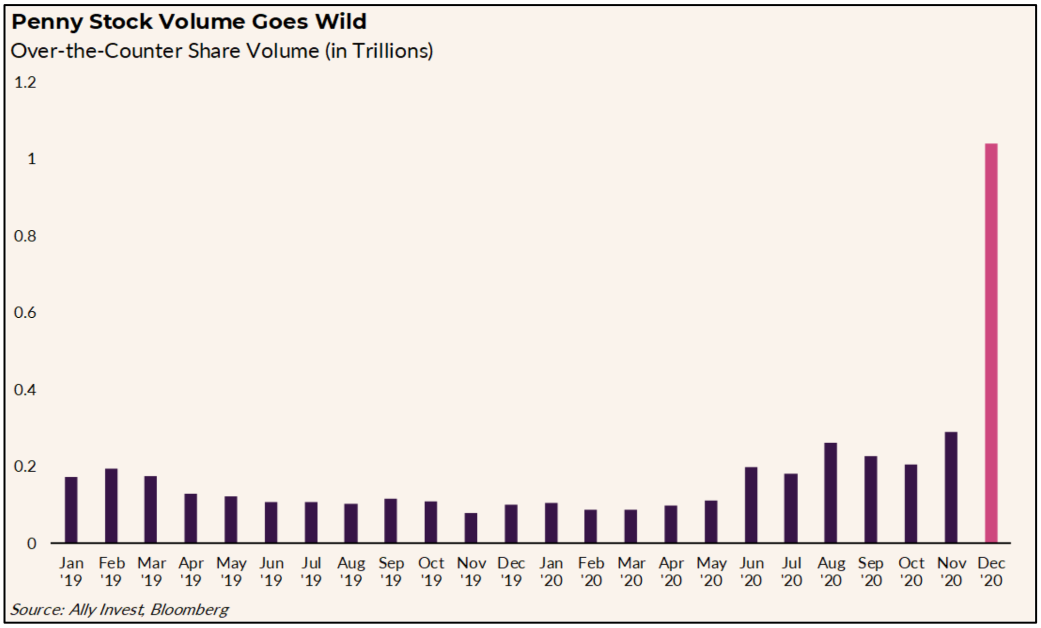
Total equity fund flows vs Global Composite PMI



Source: EPFR Global, Markit, Haver, DB Asset Allocation, Deutsche Bank

Again, it is a matter of how much has already been priced and what portion of potential flows have already been exhausted. As we get more expensive, we become less stable… in both directions.

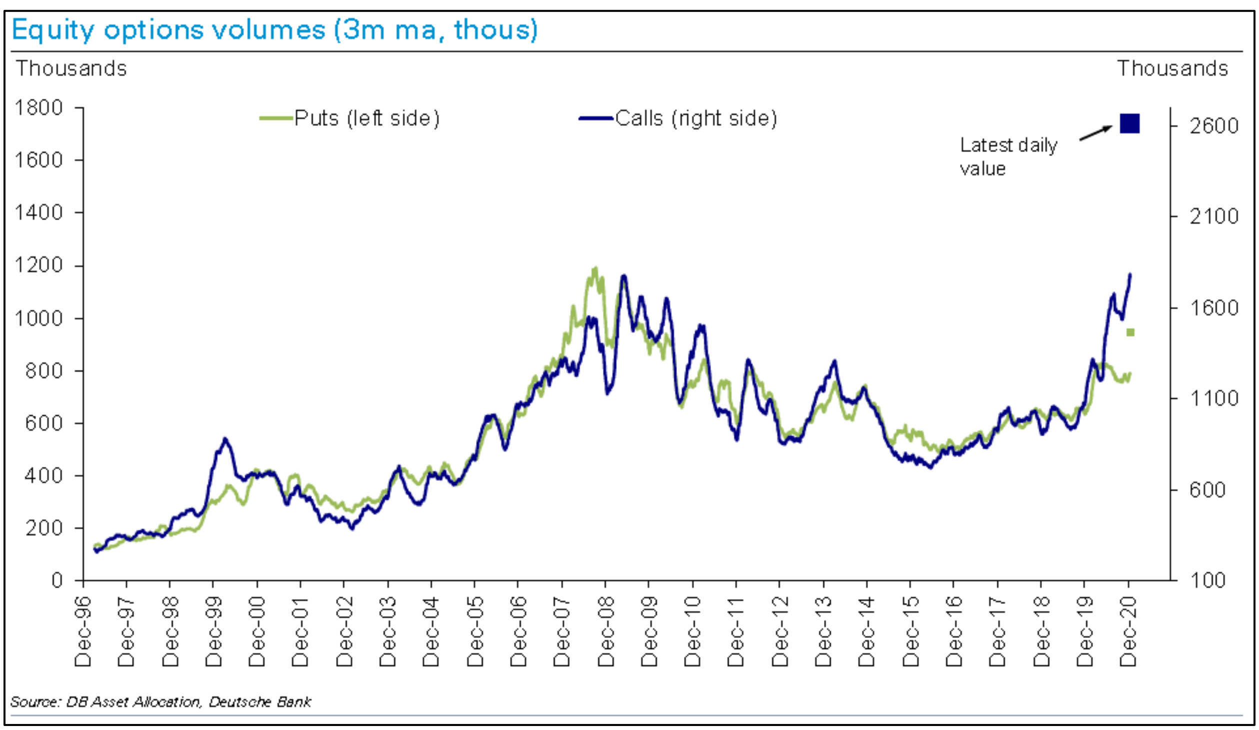
Most recently retail has been back with a vengeance and we are seeing it in everything from call buying (I look at that next) to penny stocks.



What to Focus on Now:

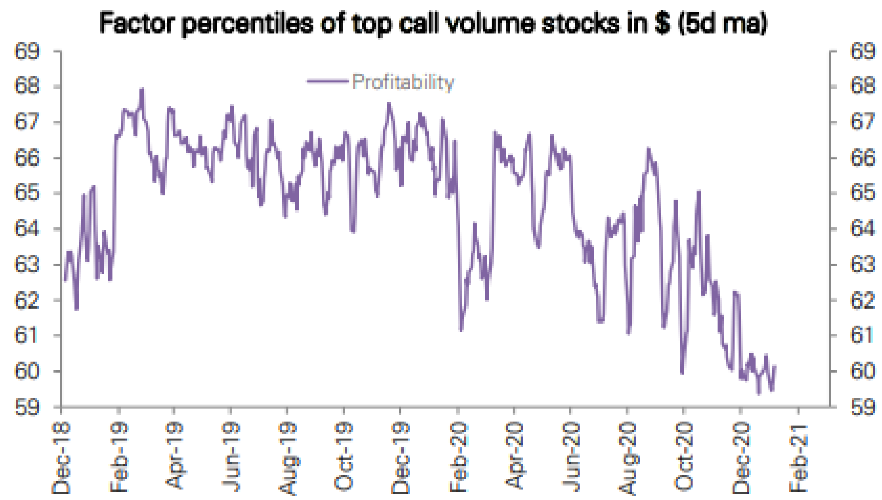
All that call option buying…

Retail continues to splurge on equity call options.



The calll buying which started in FAANG stocks is now moving into more speculative stuff…

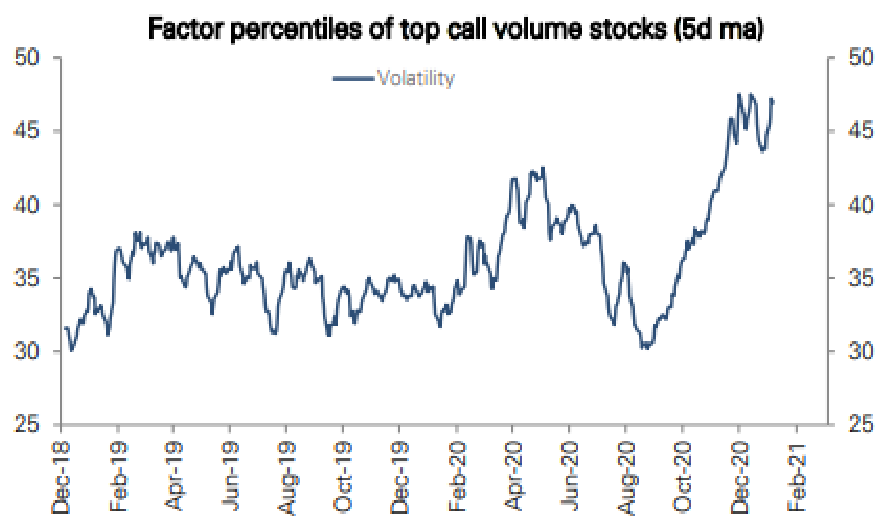
Figure 7: High call volume stocks have been moving towards those with lower profitability …



Source :OCC, Axioma, Deutsche Bank Asset Allocation

And into stocks with higher volatility.

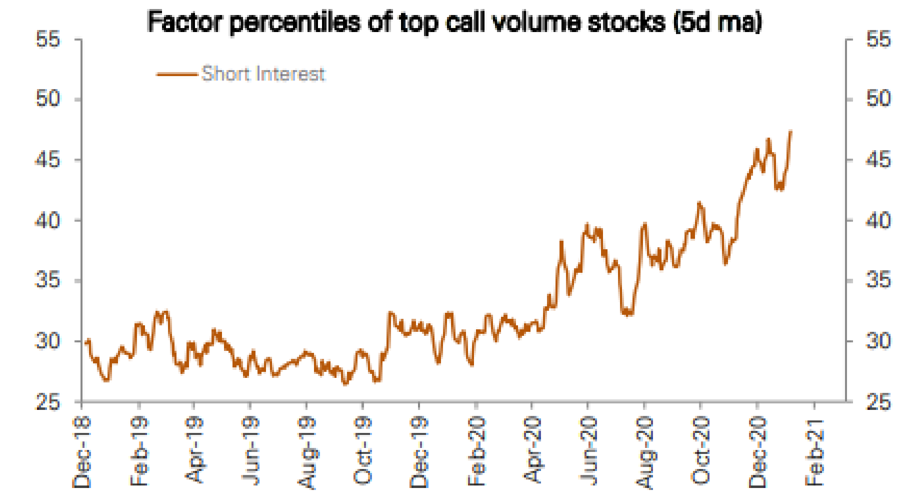
Figure 8: … and higher volatility



Source : OCC, Axioma, Deutsche Bank Asset Allocation

The call buying has also been moving into the underperformers that consequentially have had higher short interest.

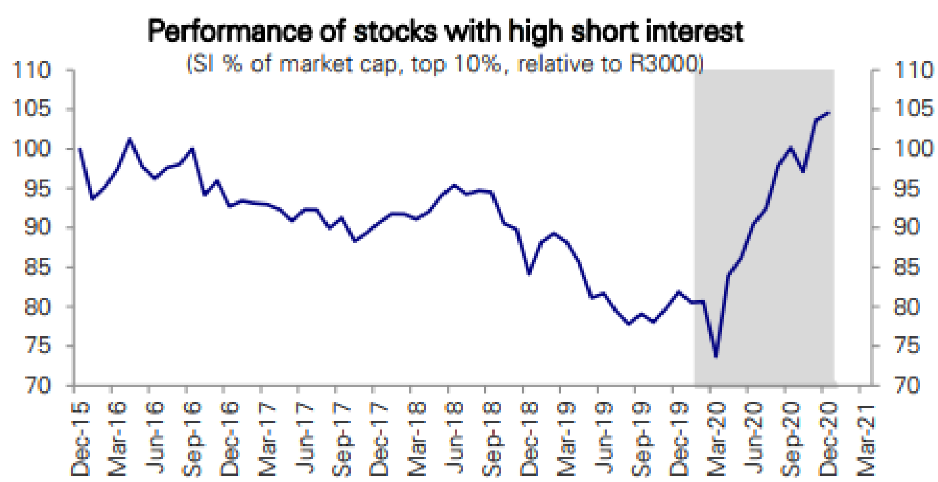
Figure 13: Stocks with higher short interest have also seen rising call volumes, whether measured in dollar terms ...



Source : OCC, Axioma, Compustat, Deutsche Bank Asset Allocation

Initiating a bit of a short squeeze.

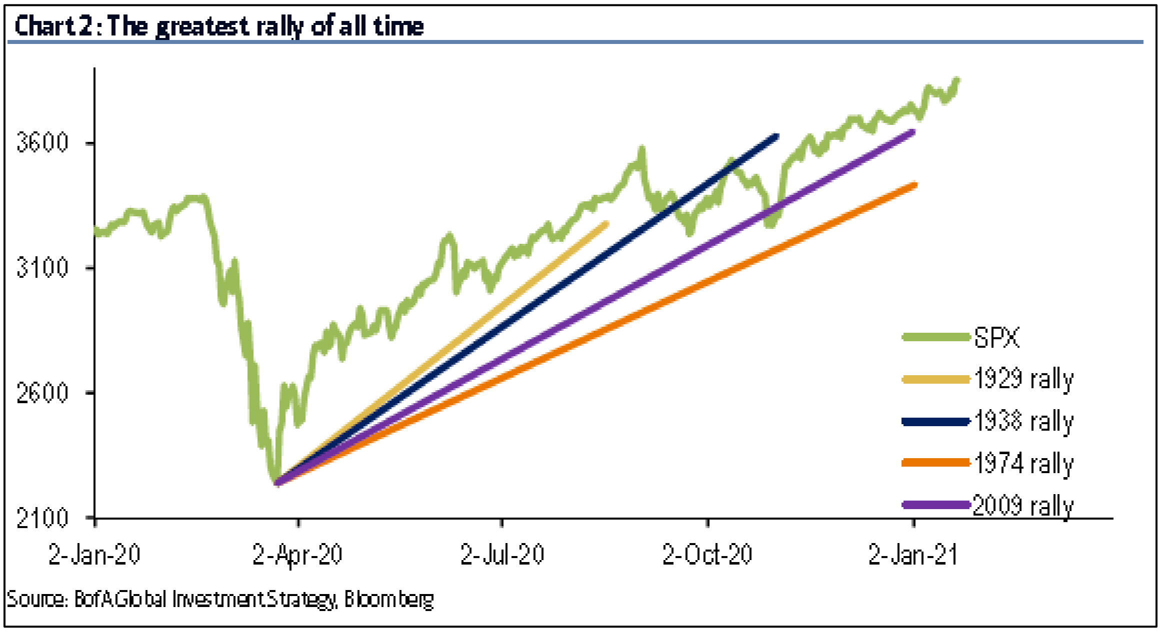
Figure 15: Stocks with high short interest in turn have been massively outperforming since April



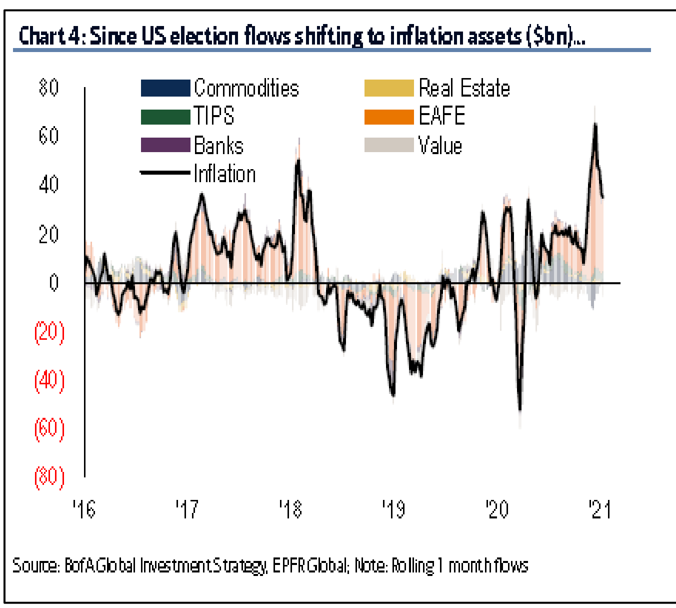
Sector absolute, monthly rebalance

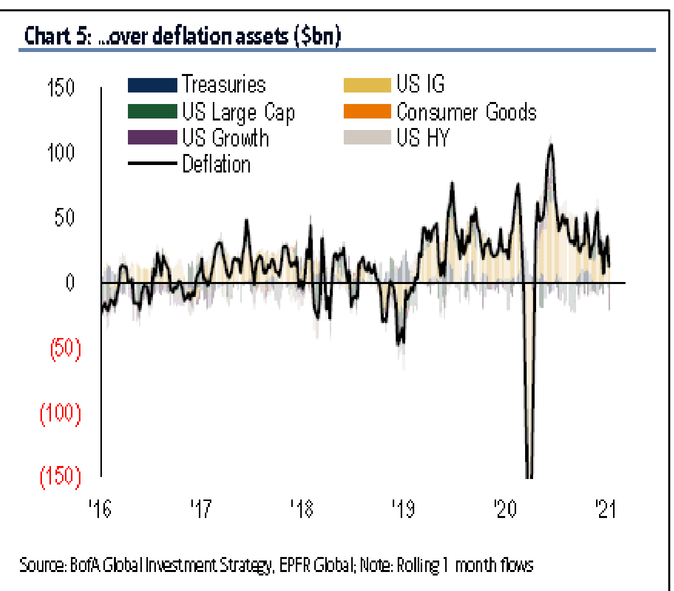
Source : Compustat, Deutsche Bank Asset Allocation

The past 12 weeks have seen the largest inflow to stocks ever, sparked by unprecedented fiscal and monetary stimulus and light at the end of the virus tunnel via a widely distributed vaccine. This in turn has delivered the most recent leg of what is now one of the strongest rallies ever.



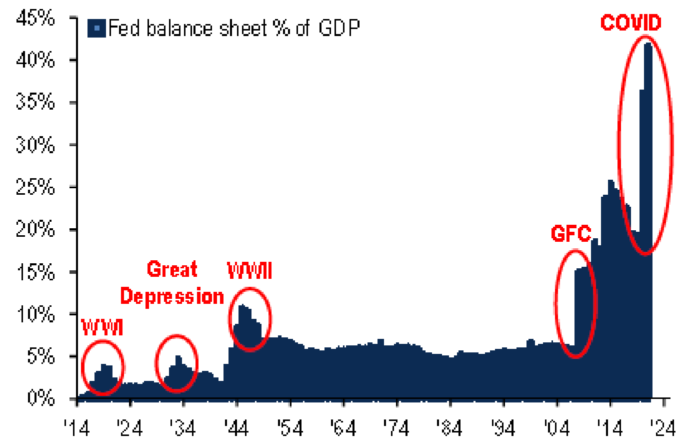
The election really put the fuel on the fire. (Russell, Energy, Industrials, Materials, EM, etc.)





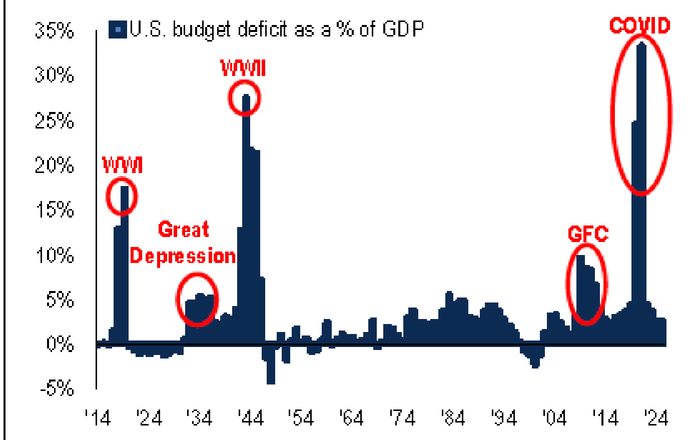
Understandably so, given the monetary and fiscal expectations for the next six +months.

Chart 9: Fed balance sheet to hit 42% of GDP...



Source: BofA Global Research, GFD, Haver

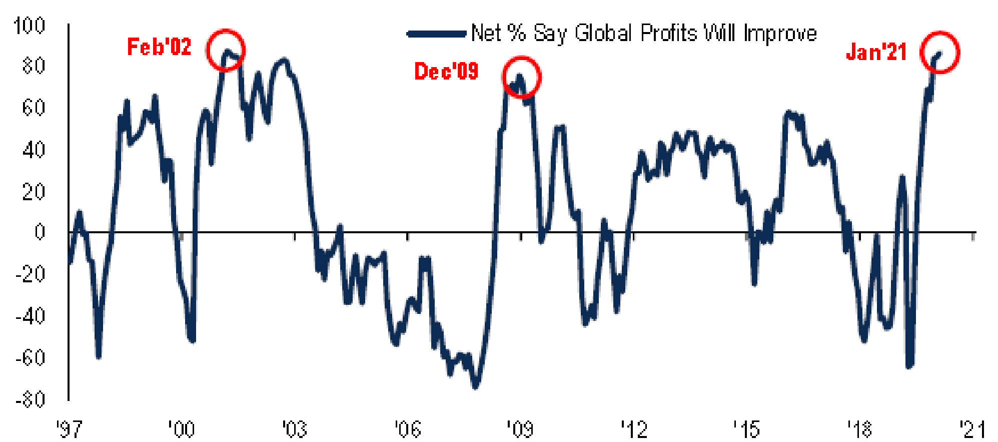
Chart 10: ...& US budget deficit to hit 33% of GDP in 2021



Source BofA Global Investment Strategy, GFD, Haver, White House

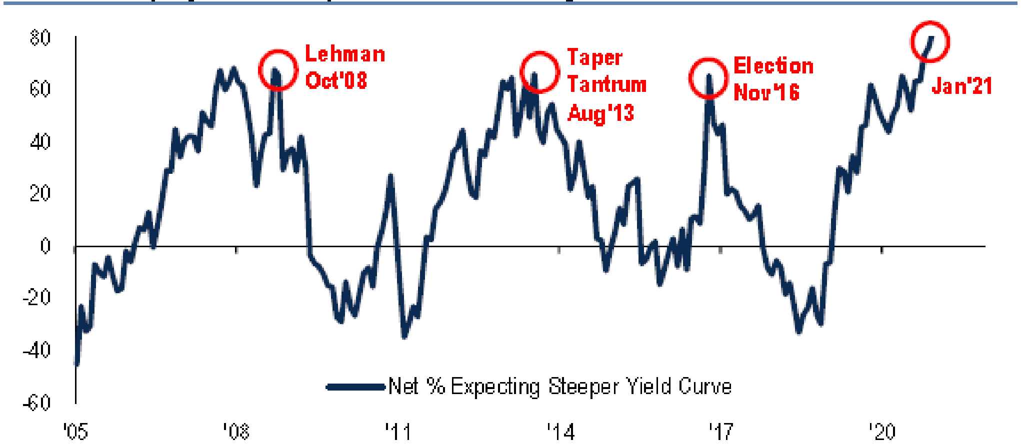
Those expectations have led to strong consensus of views by market participants. A short list via BoA.

Exhibit 1: FMS profit expectation highest since Feb'02



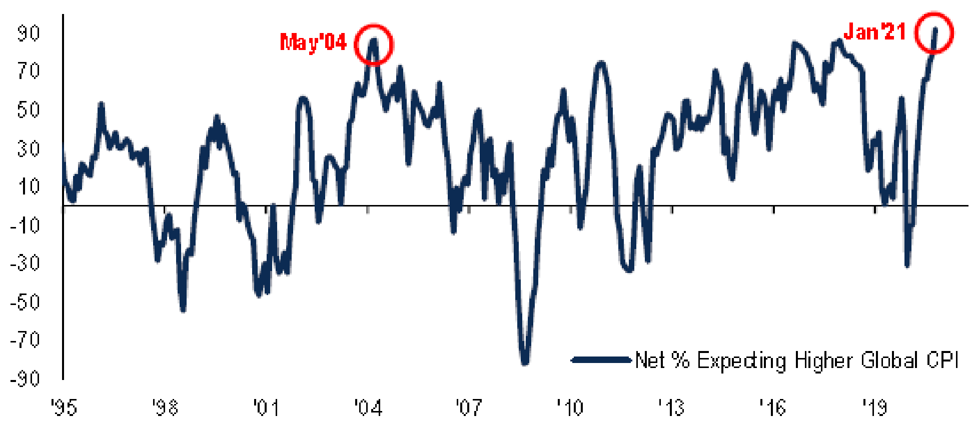
Source: BofA Global Fund Manager Survey

Exhibit 3: Steeper yield curve expectations at all-time high



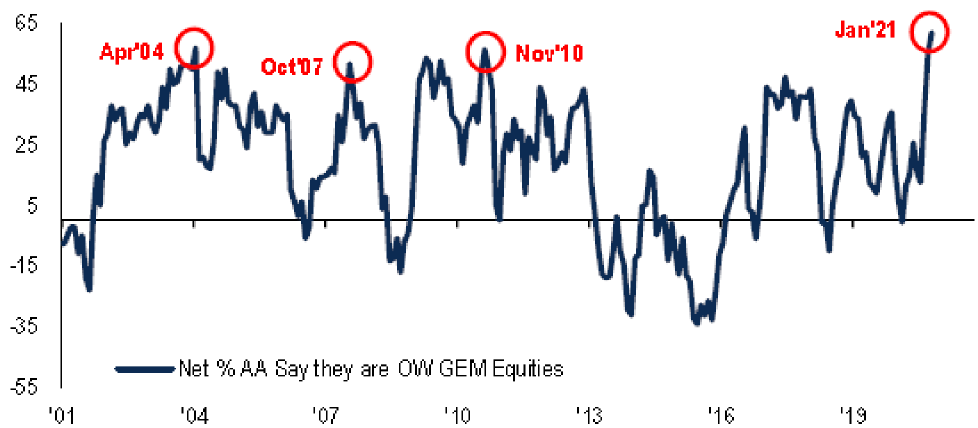
Source: BofA Global Fund Manager Survey

Exhibit 4: Inflation expectations at an all-time high



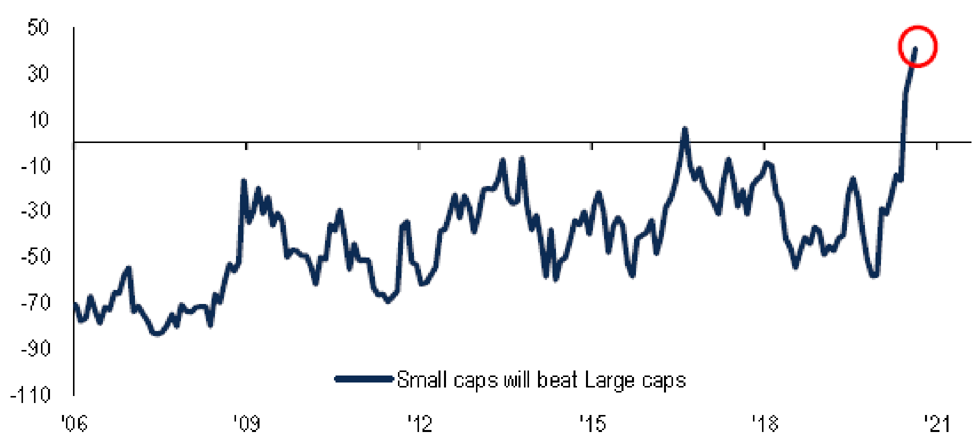
Source: BofA Global Fund Manager Survey

Exhibit 9: Asset allocation to EM at all-time high



Source: BofA Global Fund Manager Survey

Exhibit 12: Net % Think Small Cap will Outperform Large Caps

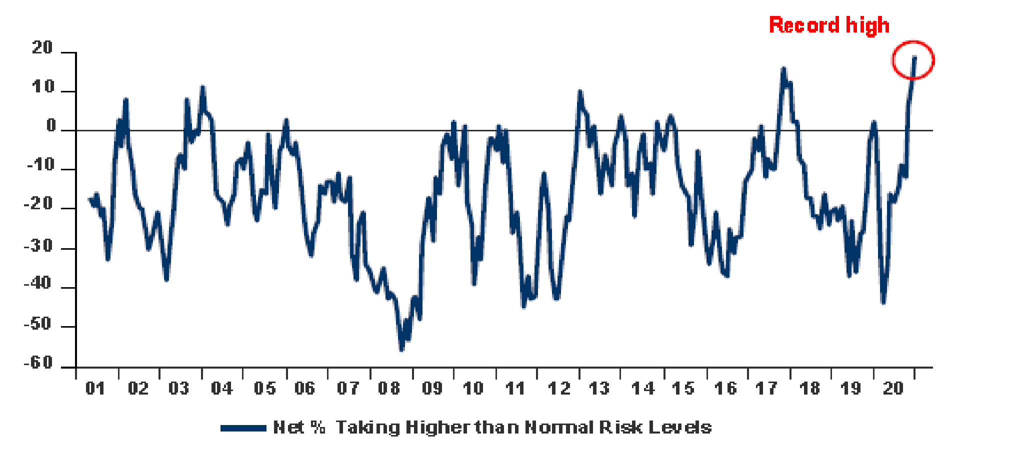


Source: BofA Global Fund Manager Survey

Exhibit 25: How do you think the global real economy will develop over the next 12 months?

Source: BofA Global Fund Manager Survey

Exhibit 30: What level of risk do you think you're currently taking in your investment?



Source: BofA Global Fund Manager Survey

However, the Goldilocks scenario of above trend growth and below trend inflation expectations might be peaking…

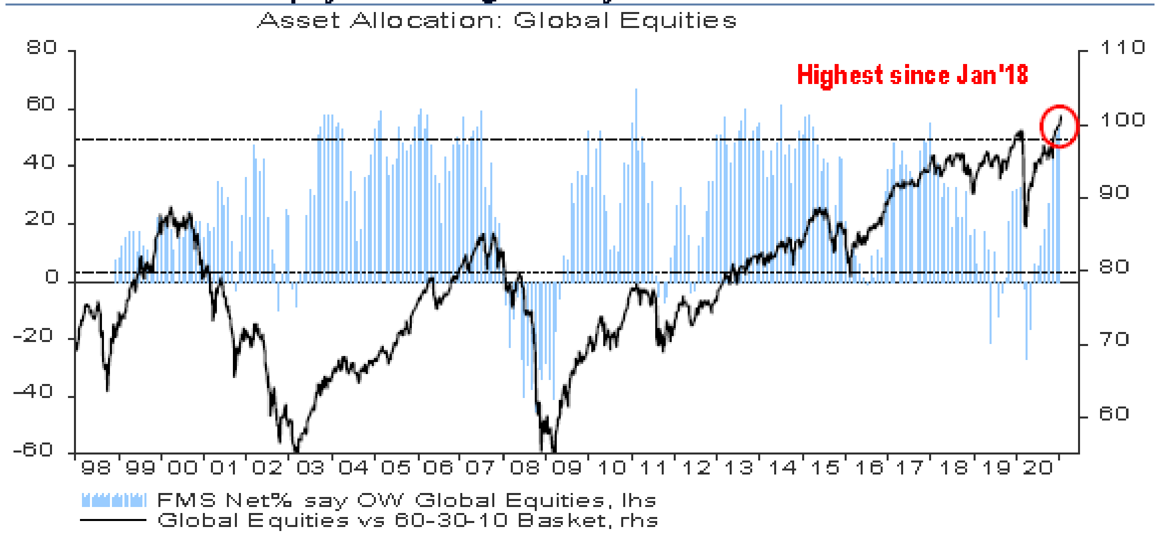
Exhibit 5: Jan FMS shows Goldilocks consensus has peaked

Source: BofA Global Fund Manager Survey

Now when you look carefully at the dates of previous extremes in the above charts, it leaves you with a problem. Namely, that those extremes tend to occur either as economies and markets are coming out of a slump OR after an extended rally when expectations, and as a result positioning, are most vulnerable. Which will it turn out to be? In this case we have been exiting a slump AND rocketing to new highs.

In terms of equity positioning, it has certainly bounced back from the massive liquidation during Feb./Mar. of last year.

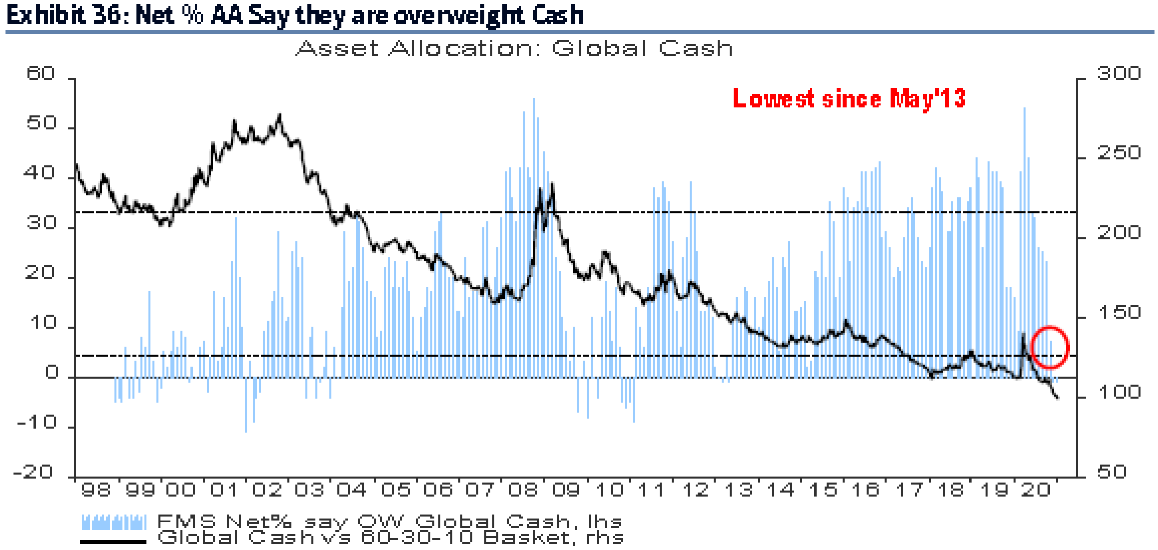
Exhibit 11: FMS Global equity allocation highest in 2-years



Source: BofA Global Fund Manager Survey

While investor cash levels have fallen.

Exhibit 36: Net % AA Say they are overweight Cash

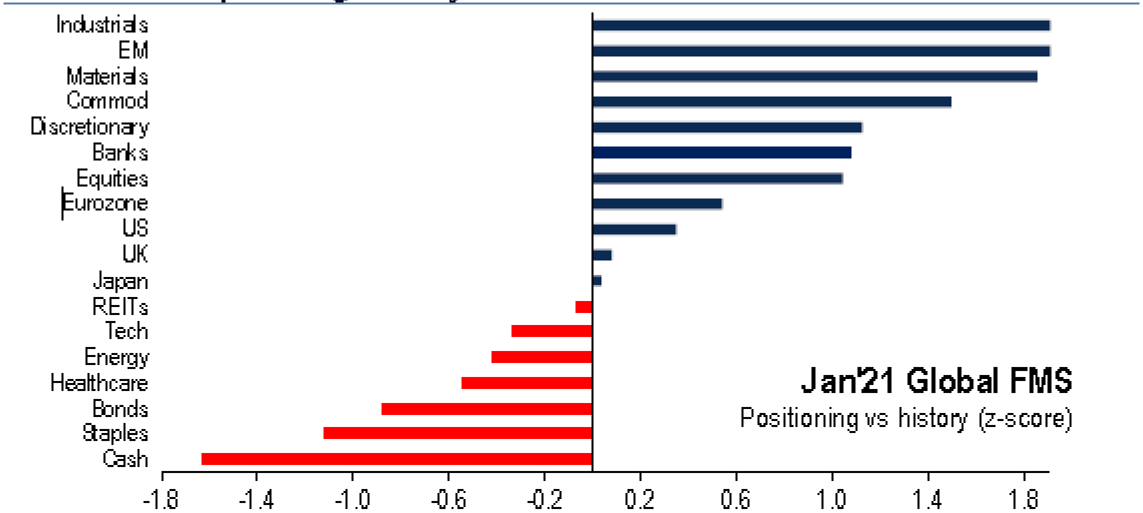


Source: BofA Global Fund Manager Survey

Putting all the above together, I'm left watching for tells and thinking about ways to own some volatility vs. my equity longs.

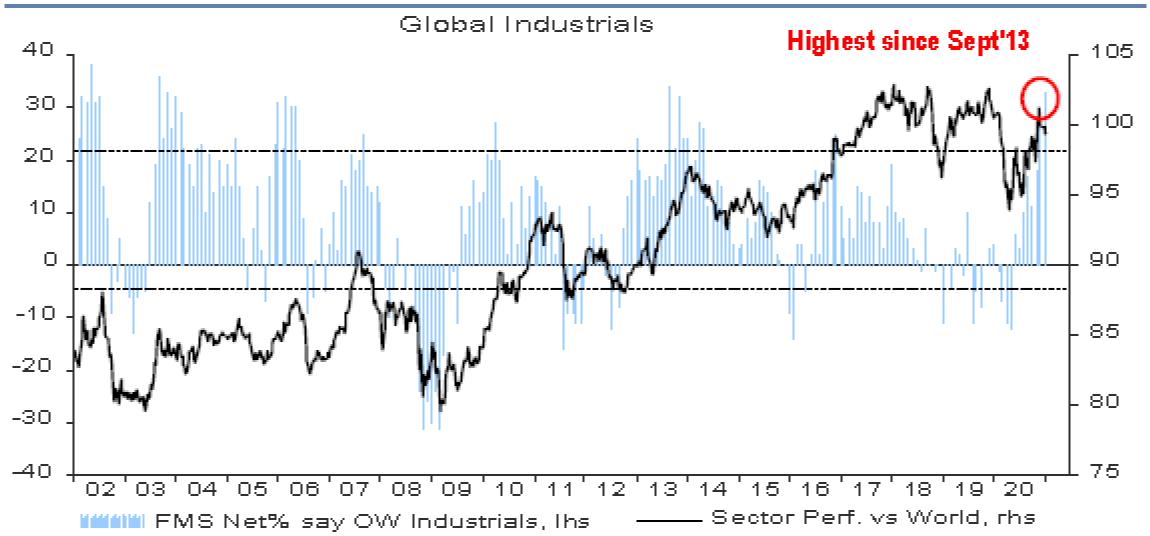
Industrials and EM, not surprisingly, are now favorite longs given the reflation and growth expectations.

Chart 1: BofA FMS positioning vs history



Source: BofA Global Fund Manager Survey

Exhibit 52: Global Industrials

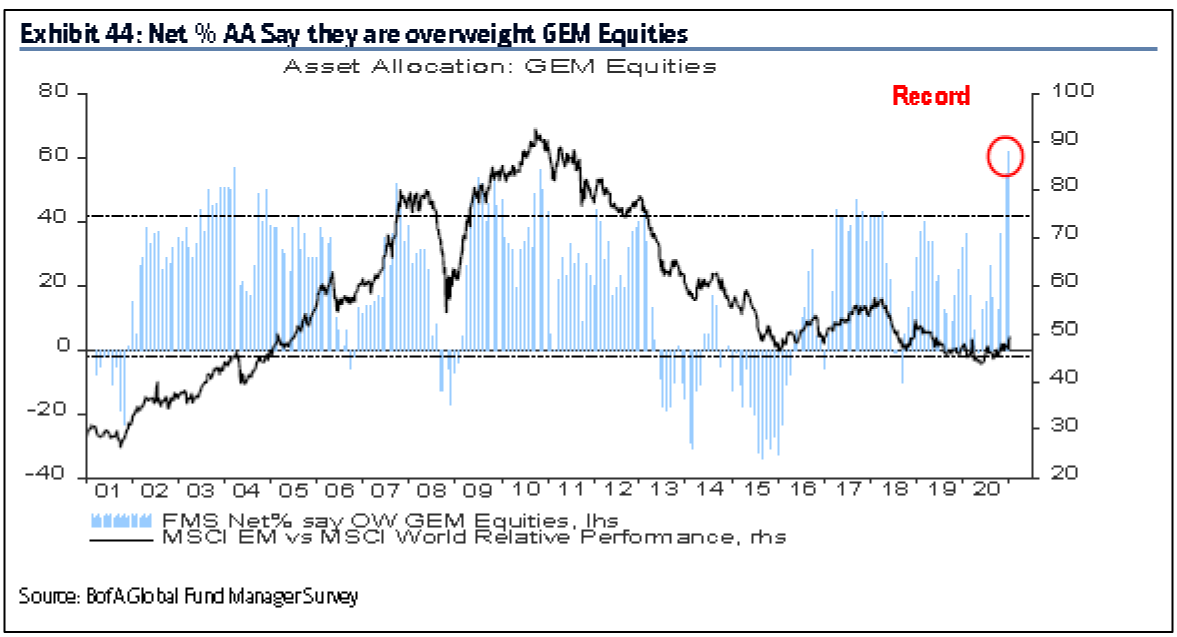


Source: BofA Global Fund Manager Survey

However, having outperformed into late November, Industrials are now starting to underperform the market as a whole. While not a clear tell, and maybe it just gives way to different rotation, the price action is something to watch.

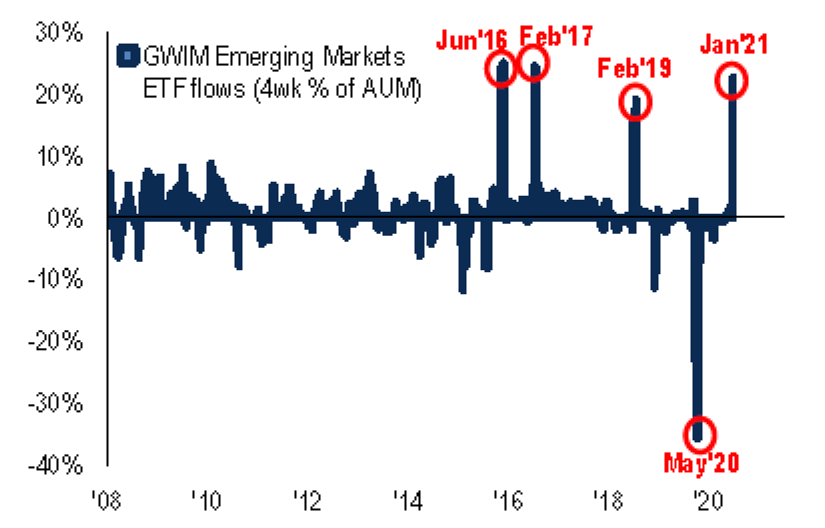
EM has seen very large inflows (from asset managers) as the poster child for a falling USD, higher inflation and global growth expectations.

While EM has started to outperform it hasn't yet done so on a grand scale.



Recent EM inflows from retail have been impressive as well…

Chart 6: Private client ETF inflows to EM...

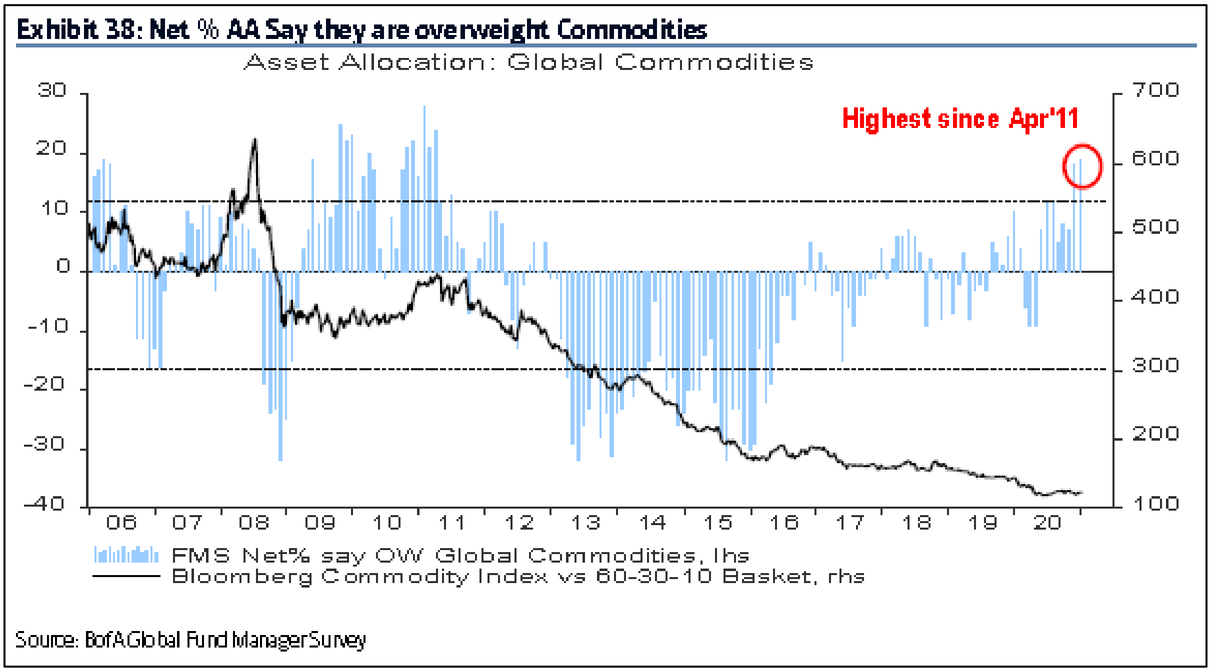


Source: BofA Global Investment Strategy, BAC Internal Data

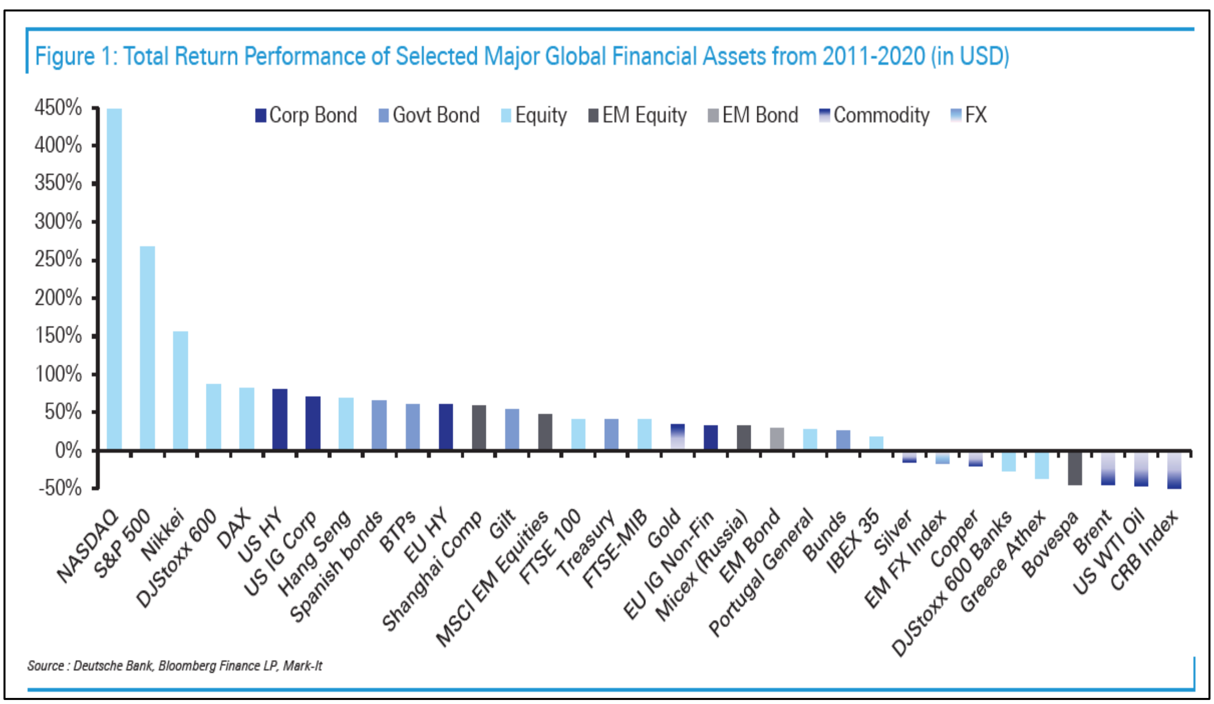
However, extreme inflows don't have a good record of predicting tops in EM it seems. Here are the above dates overlayed on EEM. EM is another one that looks and feels very stretched, but making new highs after so much sideways in a huge range certainly has the potential for eventually extending higher.

Commodities

In theme with the reflation story, positioning in commodities has risen as well.

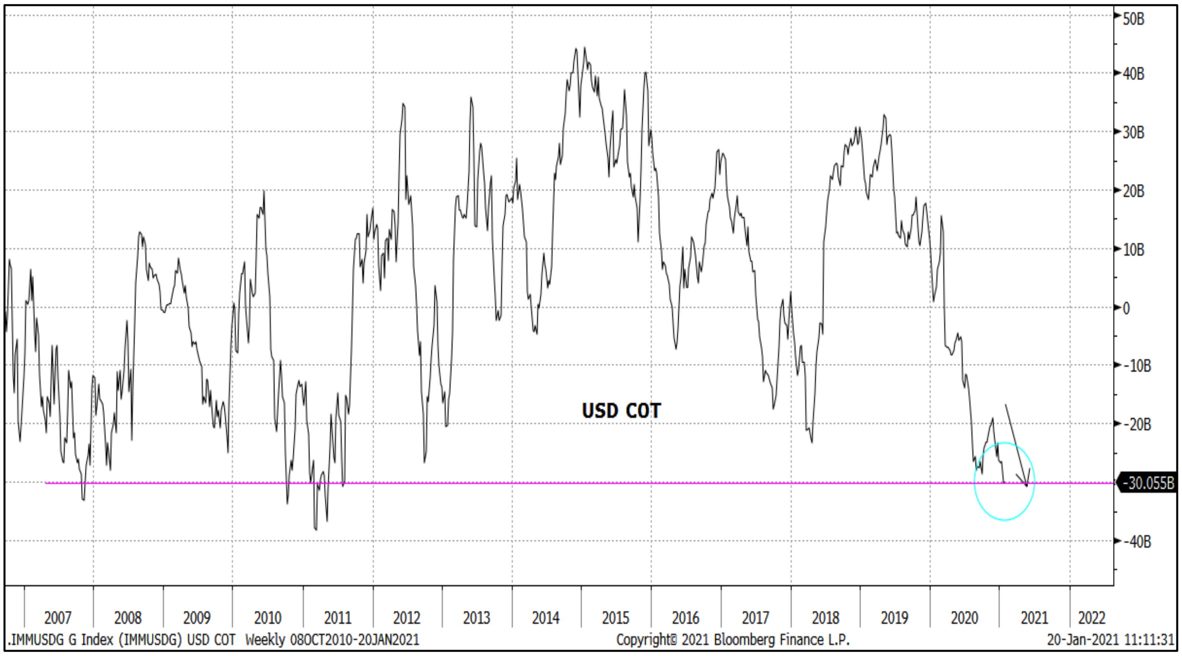


If the reflation story turns into a real inflation cycle, then the winners and losers for the last decade on this chart are may end up switching positions during this decade.

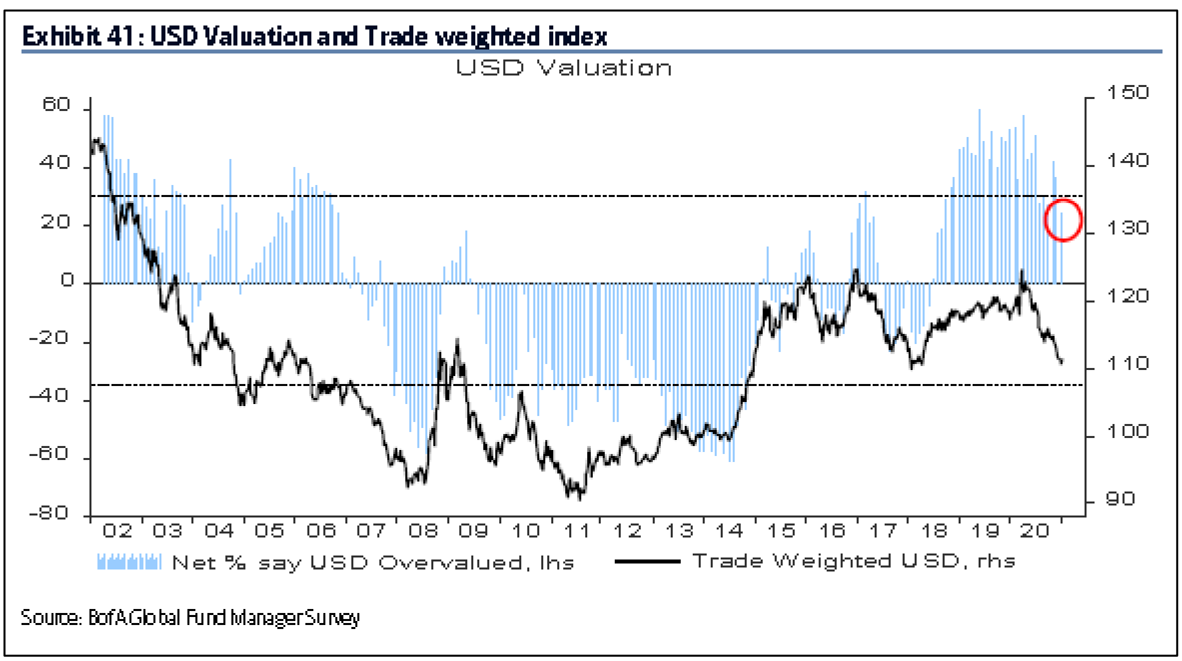


Currencies

Investors remain short USD… and in fact have been adding into recent strength…



as they continue to think it is overvalued.



I can't say I have a strong view of the current price action. FX has been frustrating for the last few months and despite all the talk, the USD is only 2% from where it was back in August. It has been a sideshow vs. what has been going on in equities.

Putting it all together, markets are expensive, there are lots of extremes in sentiment and positioning, the reflation narrative has been fully embraced and there are lots of bubbly signs. However, sometimes everyone is right, at least for a while.

Shocks or tells that could challenge the consensus view:

- Stronger and quicker growth and inflation than expected, that forces up interest rates in a disorderly manner
- Congressional gridlock that undermines what has been priced for the "blue wave"
- Bad virus news via mutations that have higher mortality or vaccine resistance
- Credit spread widening (hard to justify Fed buying now)
- Stronger USD particularly vs. EM

Fed meeting this week. Other than that, vaccine good news/bad news and the likelihood of Biden being able to implement large fiscal plans should be main drivers.

Important Macro Data Releases and Events for the Week

Monday
01/25/2021

- IFO - Business Climate (Jan) Forecast: 92, Prior: 92.1
- IFO - Current Climate Assessment (Jan) Forecast: 90.7, Prior: 91.3
- IFO - Expectations (Jan) Forecast: 93.2, Prior: 92.8

Tuesday
01/26/2021

- Housing Prices Index MoM (Nov) Forecast: -, Prior: 1.5%
- S&P/Case-Shiller Home Price Indices YoY (Nov) Forecast: 6.9%, Prior: 7.9%
- Consumer Confidence (Jan)

Wednesday
01/27/2021

- Leading Economic Index (Nov) Forecast: 96.6, Prior: 96.6
- Gfk Consumer Confidence Survey (Feb) Forecast: -7.8, Prior: -7.3
- Durable Goods Orders (and related numbers) (Dec) Forecast: 1%, Prior: 1%
- **Fed Interest Rate Decision, Monetary Policy Statement and Press Conf.**

Stargazer Asset Management

Thursday 01/28/2021		Consumer Confidence (Jan) Forcast: -15.5, Prior: -15.5
		Business Climate (Jan) Forecast: -, Prior: -0.41
		Harmonized Index of Consumer Prices YoY (Jan) Forecast: 0.5%, Prior: -0.7%
		Personal Consumption Expenditures Prices QoQ (Q4) Forecast: -, Prior: 3.7%
		Core PCE QoQ (Q4) Forecast: 1.5%, Prior: 3.4%
		Initial Jobless Claims Forecast: 875k, Prior: 900k
		Initial Jobless Claims 4-week ave. Forecast: -, Prior: 848k
		Continuing Jobless Claims Forecast: -, Prior: 5.054m
		GDP Annualized (Q4) Forecast: 3.9%, Prior: 33.4%
		New Home Sales MoM (Dec) Forecast: 0.855M, Prior: 0.841M
Friday 01/29/2021		GDP QoQ (Q4) Forecast: 0%, Prior: 8.5%
		Core PCE Price Index MoM (Dec) Forecast: 0.1%, Prior: 0%
		Core PCE Price Index YoY (Dec) Forecast: 1.3%, Prior: 1.4%
		Personal Spending (Dec) Forecast: -0.4%, Prior: 0.4
		Personal Income (Dec) Forecast: 0.1%, Prior: -1.1%
		Chicago PMI (Jan) Forecast: 58, Prior: 58.7
		Michigan Consumer Sentiment Index (Jan) Forecast: 79.2, Prior: 79.2
		Pending Home Sales YoY (Dec) Forecast: -, Prior: 16.4%
Saturday 01/30/2021		Non-Manufacturing PMI (Jan) Forecast: -, Prior: 55.7
		NBS Manufacturing PMI (Jan) Forecast: -, Prior: 51.9

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

Disclaimer

This document and its contents are confidential to the person(s) to whom it is delivered and should not be copied or distributed, in whole or in part, or its contents disclosed by such person(s) to any other person. Any party receiving and/or reviewing this material, in consideration therefore, agrees not to circumvent the business proposals explicitly or implicitly contained herein in any manner, directly or indirectly. Further, any recipient hereof agrees to maintain all information received in the strictest confidence and shall not disclose to any third parties any information material to the opportunity contained herein and, upon review hereof, agrees that any unauthorized disclosure by any party will result in irreparable damage for which monetary damages would be difficult or impossible to accurately determine. Recipients recognize, and hereby agree, that the proprietary information disclosed herein represents confidential and valuable proprietary information and, therefore, will not, without express prior written consent, disclose such information to any person, company, entity or other third party, unless so doing would contravene governing law or regulations. This document is an outline of matters for discussion only.

This document does not constitute and should not be interpreted as advice, including legal, tax or accounting advice. This presentation includes statements that represent opinions, estimates and forecasts, which may not be realized. We believe the information provided herein is reliable, as of the date hereof, but do not warrant accuracy or completeness. In preparing these materials, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources.

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