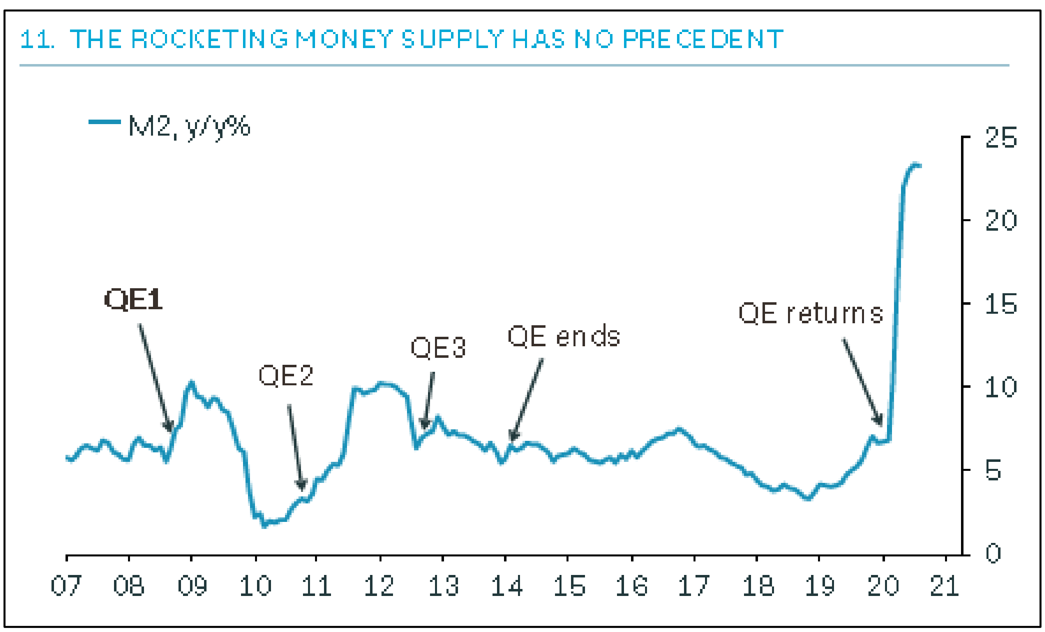
What to focus on in Global Macro for the week of October 12th, 2020

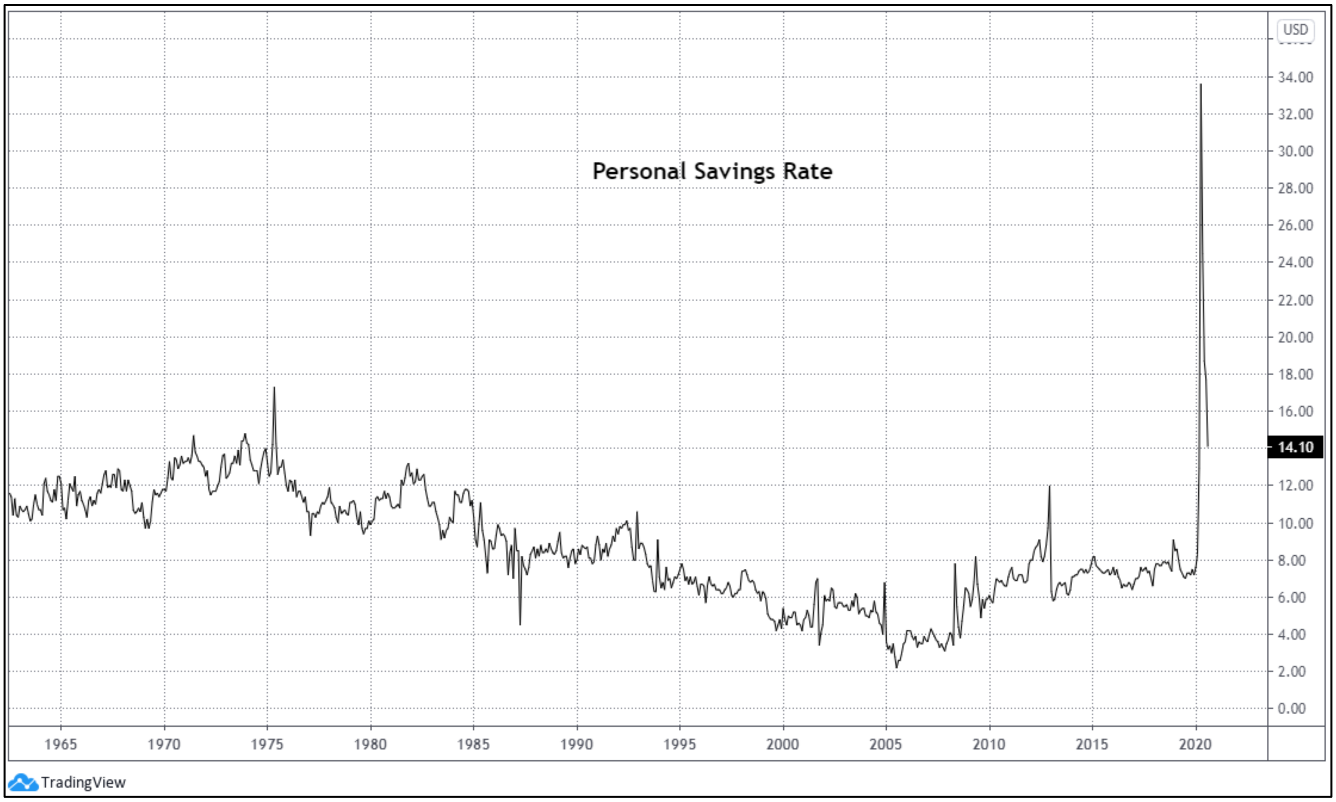
Macro Themes on the Radar:

The transfer of power from central banks to fiscal authorities continues. As with so many things, COVID has served to accelerate a trend already in place. As the transition progresses, economists and policy makers are becoming increasingly accepting of fiscal policies renewed role. We are inching towards a regime shift where fiscal policy isn't just used in the short-term to bridge consumption gaps, but also as a tool for achieving bigger picture goals. With monetary policy again at the zero bound, the primary remaining policy tool (QE) is increasingly seen as adding to wealth inequality as it largely bypasses Main Street in favor of financial assets. Fiscal policy, on the other hand, can be targeted to the real economy and focused on emerging policy priorities like decreasing inequality and ESG initiatives.

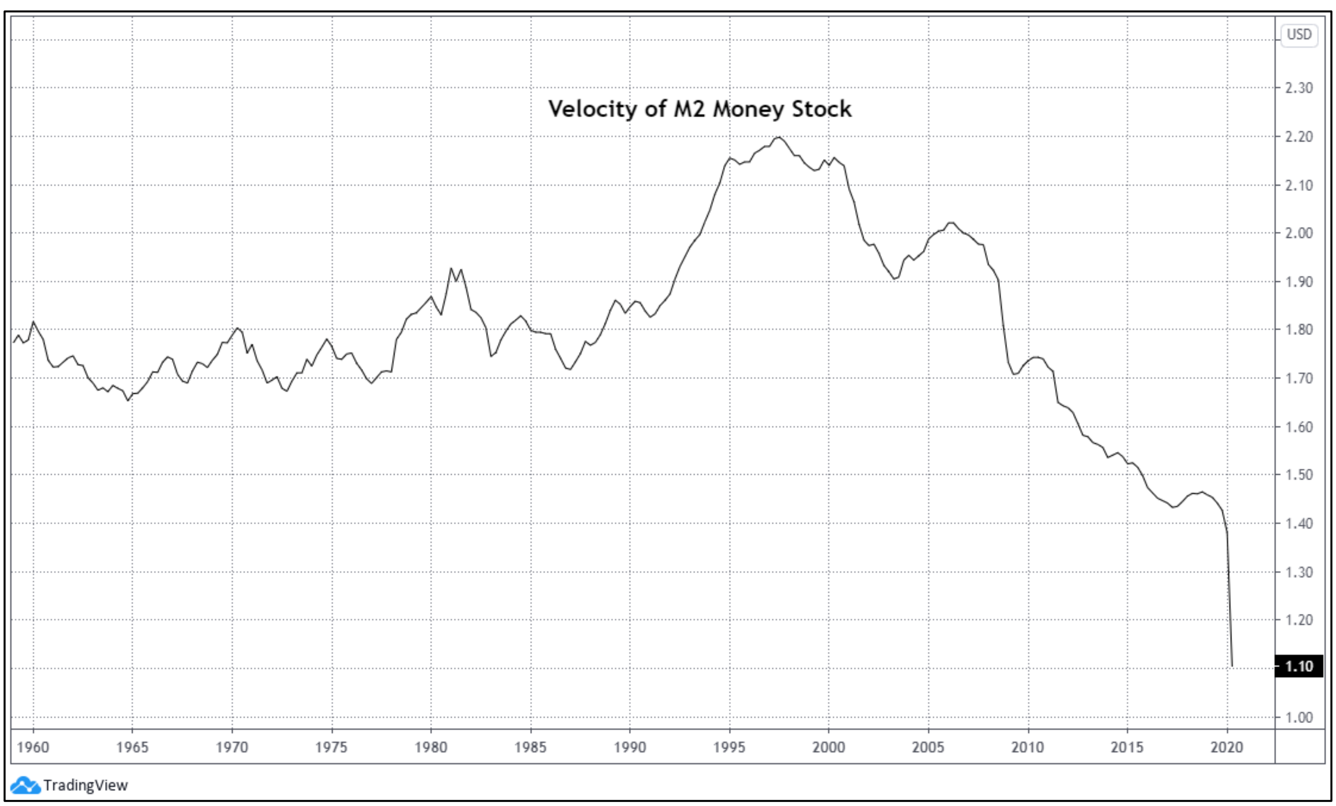
With concerns about future inflation and budget deficits having faded, and "bond market vigilantes" a distant memory, it has become increasingly appealing for monetary and fiscal authorities to work together. Far from fearing inflation, central banks are actively trying to foster its rebound. This makes it easy for them to not only encourage fiscal spending but to facilitate it by buying the newly issued bonds as part of their balance sheet expanding QE programs.

COVID, its impact on global economies and the policy actions that followed, have "spiked" everything from money supply to savings rates…

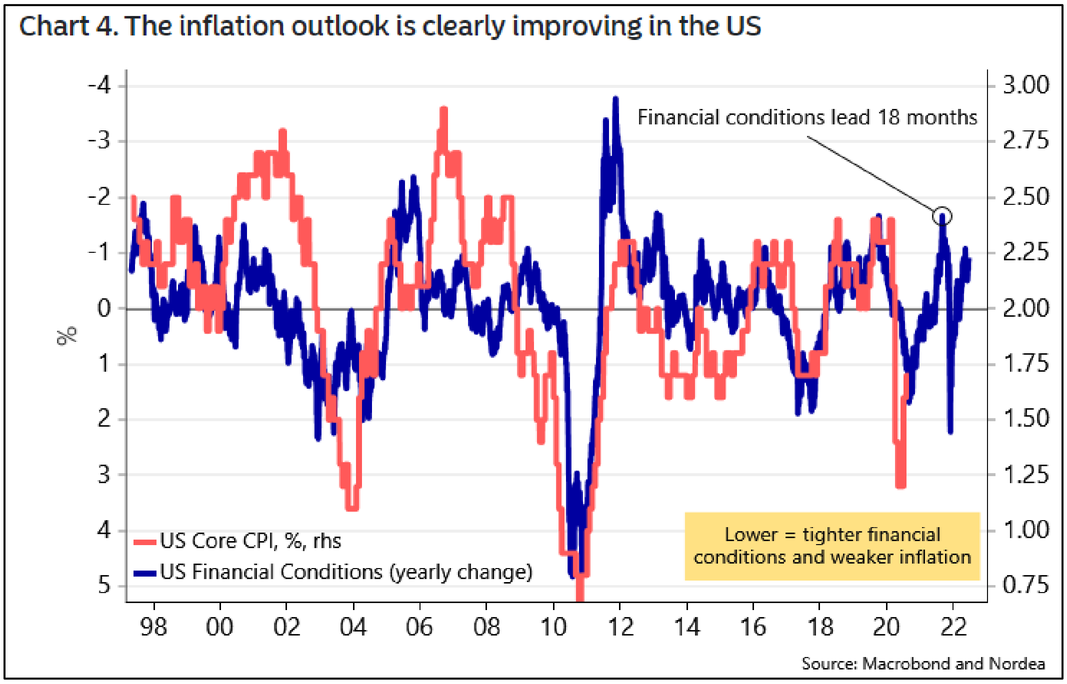




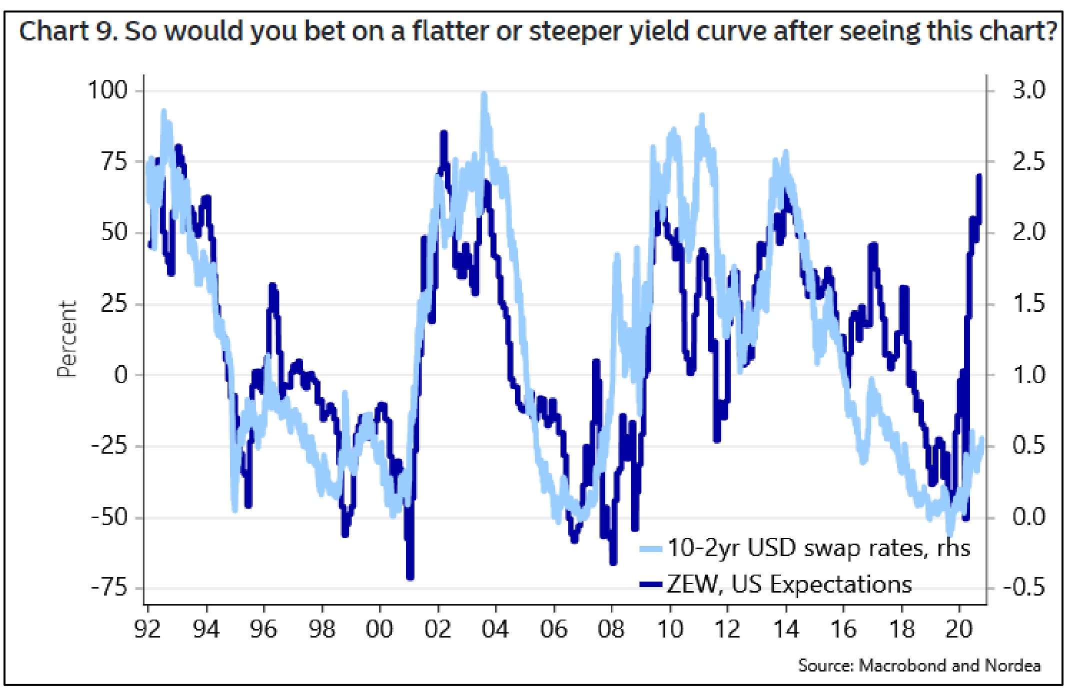
At the same time, at least for now, the velocity of money plunged as spending stopped.



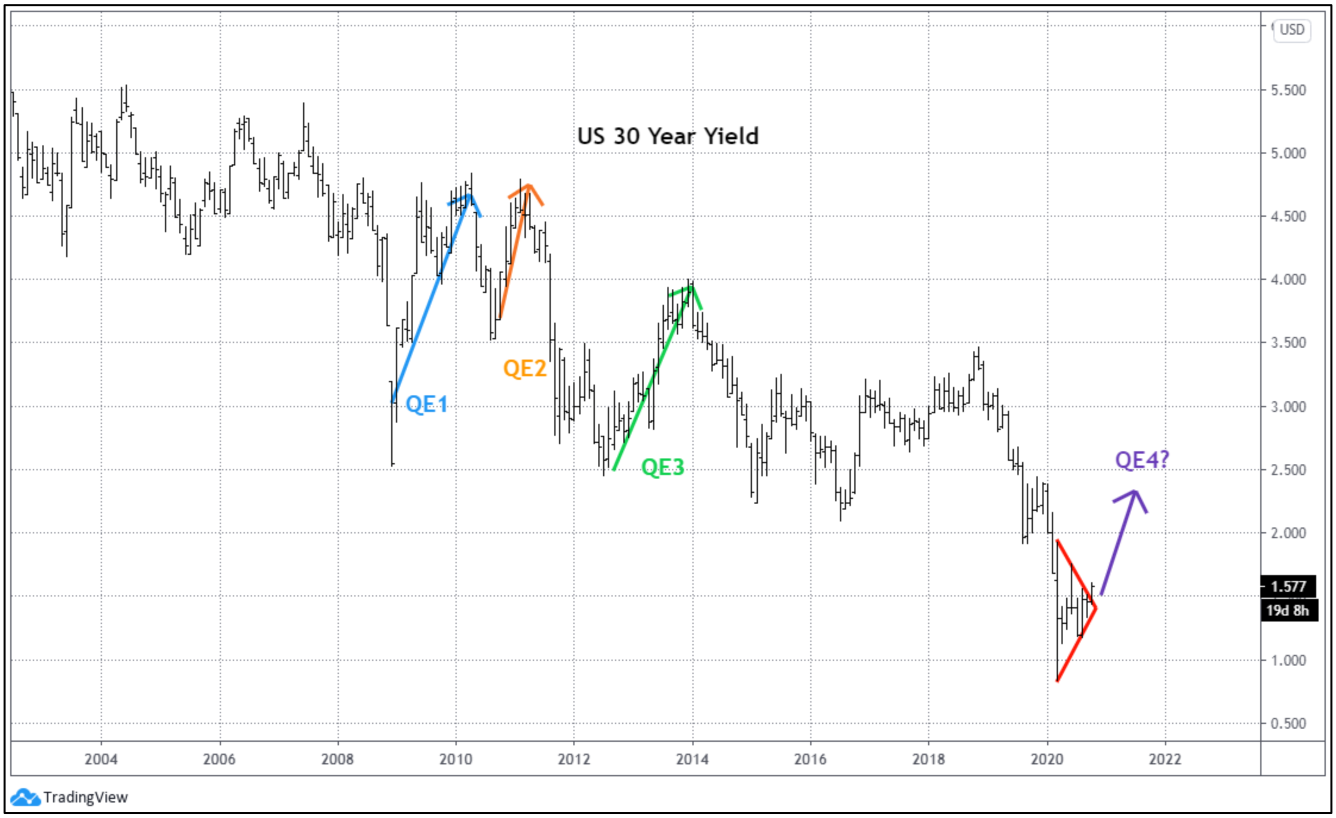
The question is, what happens once the economy normalizes? Does the huge jump in the number of dollars in the system start to quickly generate inflationary traction, once velocity again picks up and savings rates fall? (Nordea notes that nearly 20% of all USD in existence were created in 2020) If so, the Fed could of course reverse policy, except that they have "promised" not to for the foreseeable future.



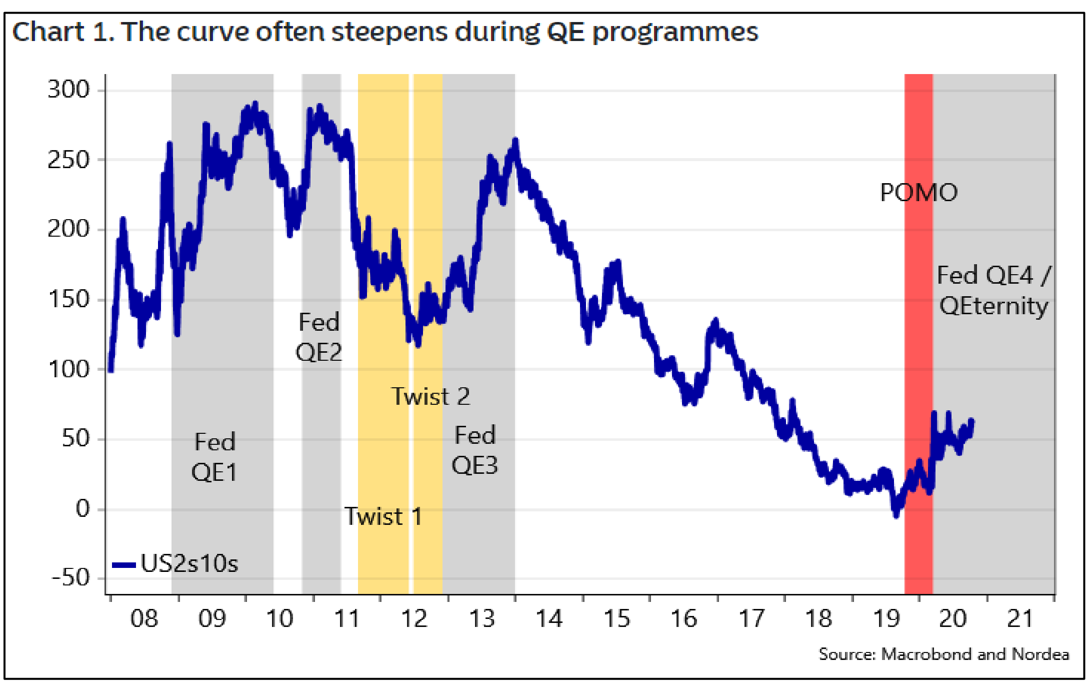
Normally, one would expect higher long-end yields and a steeper curve to follow.



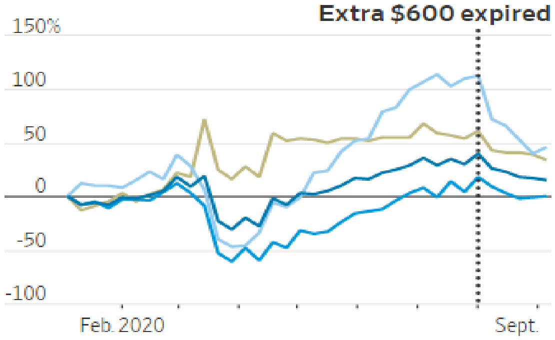
QE alone has historically meant higher long end yields as it has allowed the market to price reflation.



And a steeper curve...



Granted, COVID is different, as we have seen in all the charts. The unknowns are many, including how long before normalcy returns, and given the looming election, what the handoff to fiscal policy will look like in the coming months.



Note: Unemployment-insurance recipients are those who received benefits via direct deposit between July 15 and July 31
Source: Cardify.ai

In the near-term add the uncertainty around the timing of the next stimulus bill, the US political circus and the resurgence of the virus both in the US and globally.

Fiscal support is still needed, and I have little doubt that another round will be supplied.

As the northern hemisphere heads into winter expect the service businesses to remain under plenty of pressure.

It will be important to observe how the yield curve acts going forward. Continued steepening will eventually bring its own challenges and could result in Fed extending the duration of their bond purchases, even Yield Curve Control. After all, take away globalization and add ESG and we should eventually have some inflation to show for it. However, a failure to even attempt steepening will mean more stimulus to follow. The next six months are likely to bring continued volatility for markets as the economic, political, fiscal and monetary drivers remain in flux.

Europe

The ECB has now made it clear they will be following the same path as the Fed in terms of average inflation targeting. Although given the current inflation prints the point continues to be moot.

They also will not be letting up on QE and are likely to announce an addition to the PEPP program. The EUR rally continues to be seen as unhelpful to the transmission of monetary policy but they don't have many options for dealing with it.

Lagarde has continued to push for more fiscal spending as the monetary toolbox is looking sadly empty. If they follow the Bank of Japan playbook, they will be eyeing equity buying. Although I can only image the political firestorm that would ignite.

China

Unlike their European and American counterparts, the PBOC is reluctant to follow the policy of unlimited QE, and zero or even negative rates.

In an article published on Saturday by China Finance magazine, the central bank head Yi Gang wrote that "Implementing a normal monetary policy, i.e. a positive interest rate and a rising yield curve, is good to provide incentives for market entities and promote sustainable development of the economy and society" … "We need to maintain reasonable liquidity, money supply and aggregated financing, but must say no to a flood of money at the same time. Instead, we should target growth near potential productivity and avoid economic fluctuations."… "In the long run, it will inflate debt and asset bubbles, distort economic structures, influence income distribution and increase systematic [financial] risk."

Despite all the trade issues and political back and forth, the currency is appreciating, industry has bounced back relatively well, and their net trade position remains strong.

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

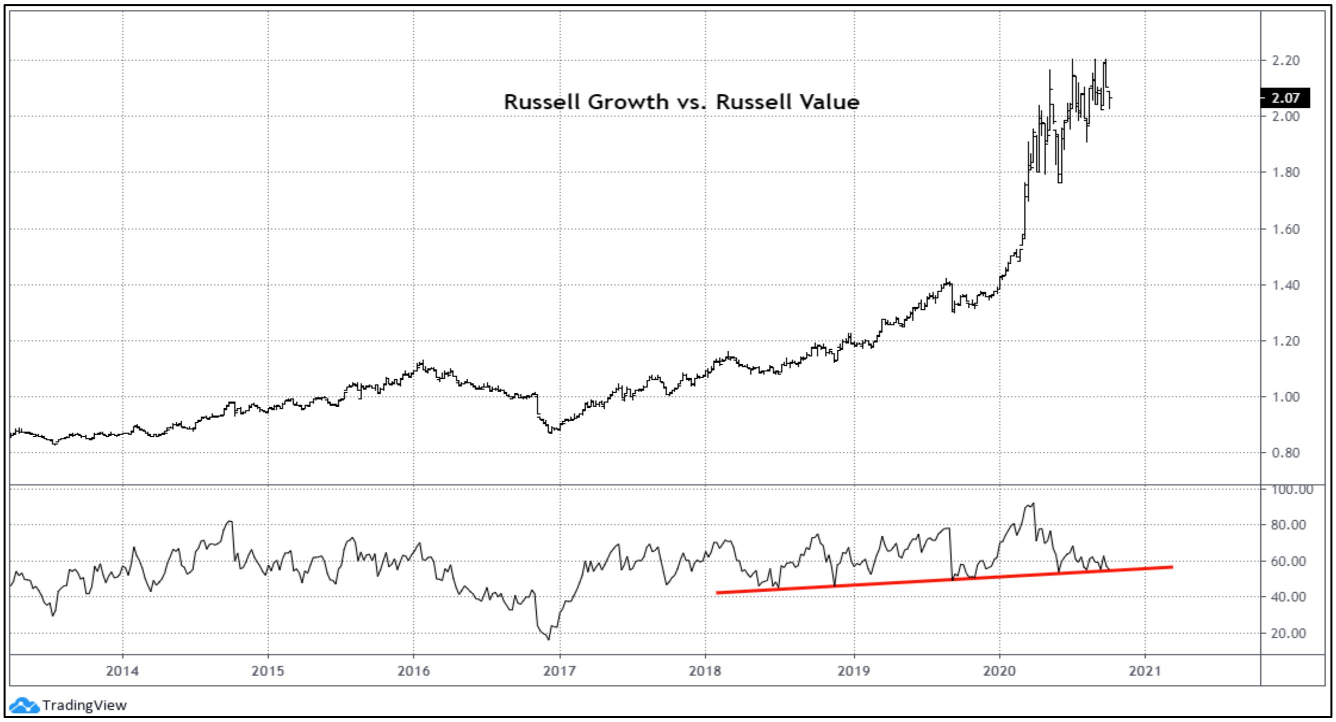
As discussed above, the continuation of the recent steepening and the breakout in long-end yields is worth keeping an eye on.

If so, it should have a supportive effect and the recent strength in financials and on the latest attempt to get Value to finally shine vs. Growth stocks.

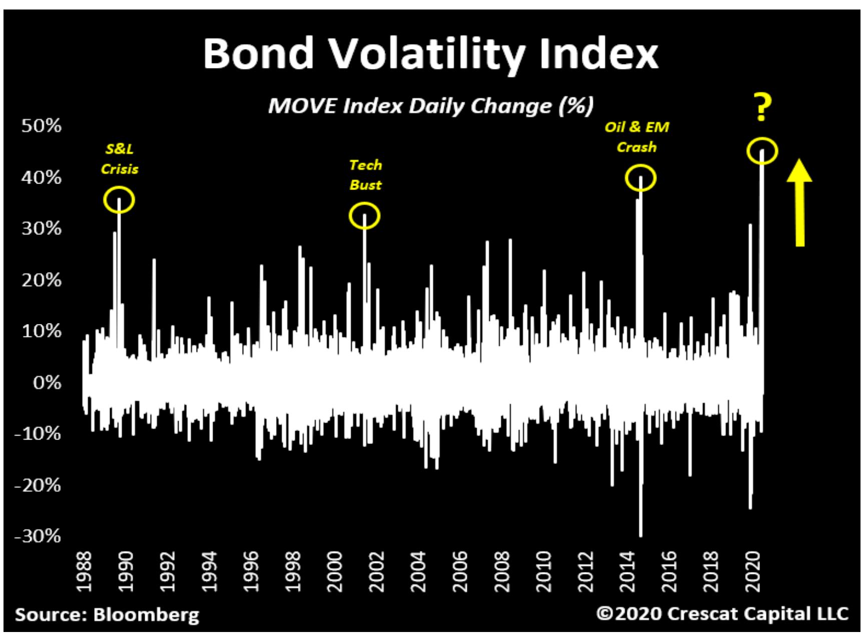
Keep going or run out of steam like in June?

The Russell is trying to break higher vs. the S&P. Third time the charm?

Generally, the value trade does look interesting (again). The question is can we reach escape velocity? Arguably the set-up now is better than during the last few attempts. Higher yields would certainly help.



While yields have jumped a bit in the long end, and I am sympathetic to another leg up in yields, there has been a lot of talk about the accompanying sudden jump in the MOVE Index which measures bond market volatility.



However, I would note that this is a measure of U.S. interest rate volatility that tracks the movement in U.S. Treasury yield volatility implied by current prices of one-month over-the-counter options on 2-year, 5-year, 10-year and 30-year Treasuries.

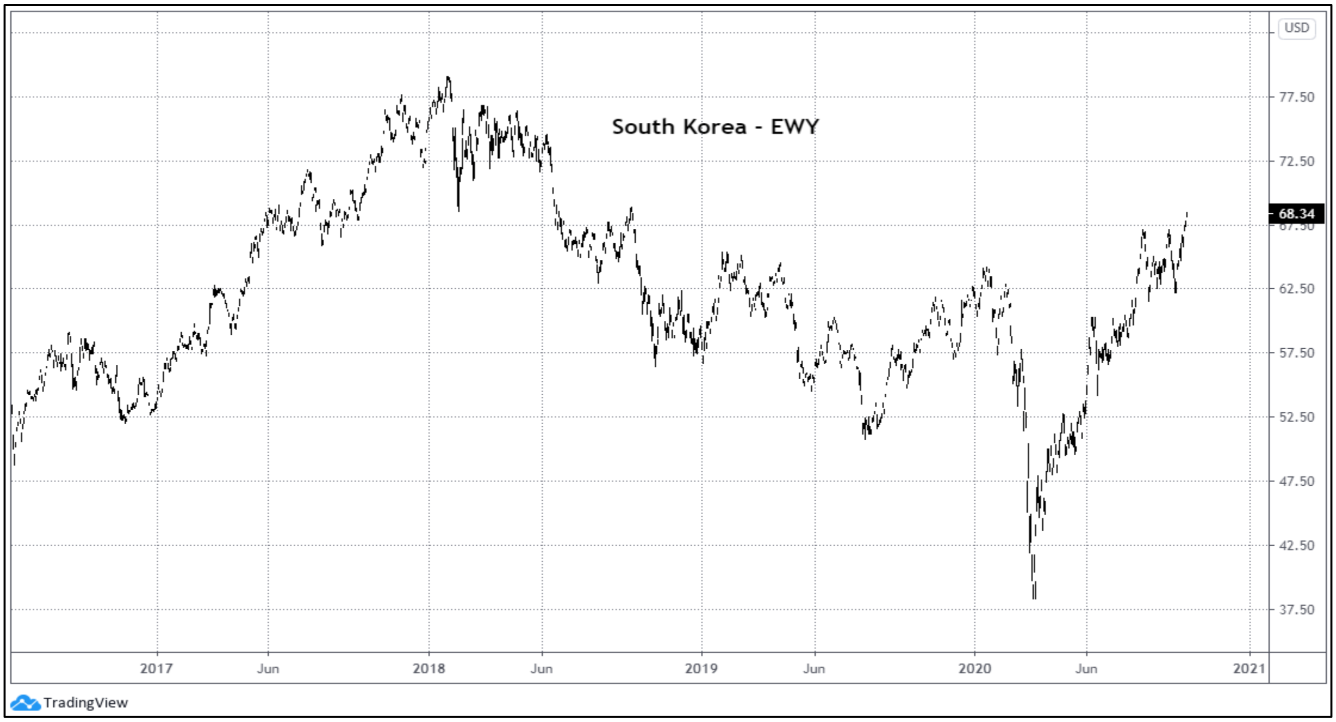
At least part of the jump in implied volatility is the recent inclusion of the election date in the rolling one-month window. Rather than the expectation of a breakout in bond yields it reflects continued election uncertainty.

EM

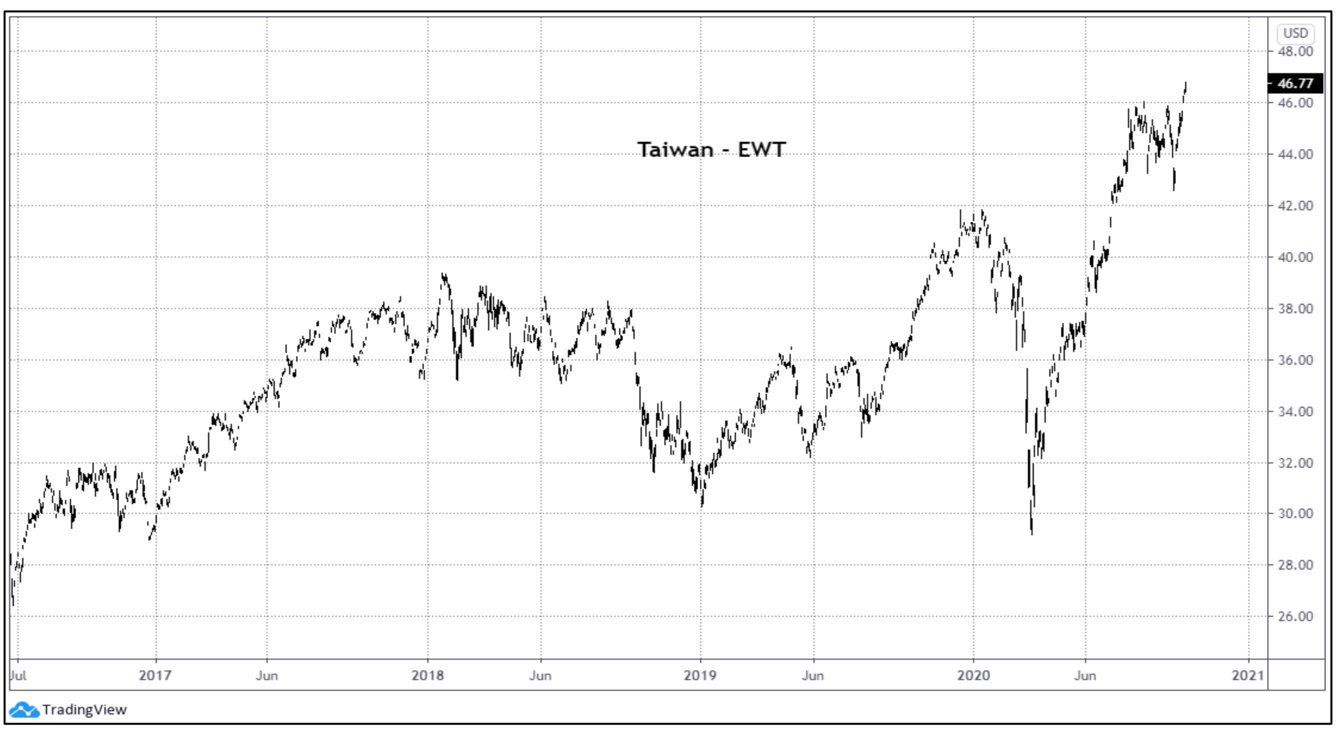
With the weaker USD in recent days EM equities have been perking up. The greater China heavy EEM is back near this year's highs.

As Chinese equities have recovered…

As have those in its sphere of influence…



These have been the haves…



vs. the have nots…

Some of the worst performers were especially hard hit by COVID and/or had idiosyncratic political and economic issues.

Even for those there are some signs of life now… Mexico's currency and equity market has been doing better recently.

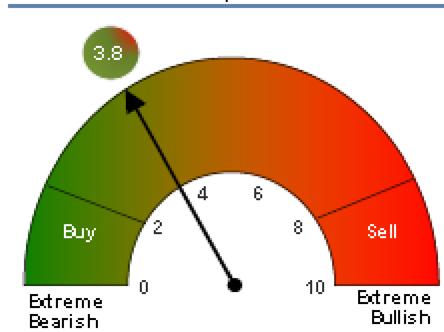
With equities globally holding in here and potentially re-accelerating, there could be further upside as some of the looming uncertainty is removed in the coming weeks. We have climbed the wall of worry thanks to ample liquidity and a lack of alternatives but flows and positioning have not indicated that everyone is fully invested.

Table 4: Net fund flows to global equities, $mn

	Wk % AUM	YTD
Total Equities	**0.0%**	**-21,295**
long-only funds	0.0%	-175,134
ETFs	0.1%	153,998
Total EM	**0.1%**	**-50,605**
Brazil	-0.4%	-61
Russia	-1.9%	-630
India	0.0%	-7,136
China	0.1%	479
Total DM	**0.0%**	**29,310**
US	0.0%	-46,468
Europe	0.0%	-32,551
Japan	0.1%	34,446
International	0.2%	70,122

Total Equities = Total EM + Total DM
Source: EPFR Global

Chart 1: BofA Bull & Bear Indicator



There is still the potential for reluctant investors to be forced back in as the fear of missing out becomes unbearable…

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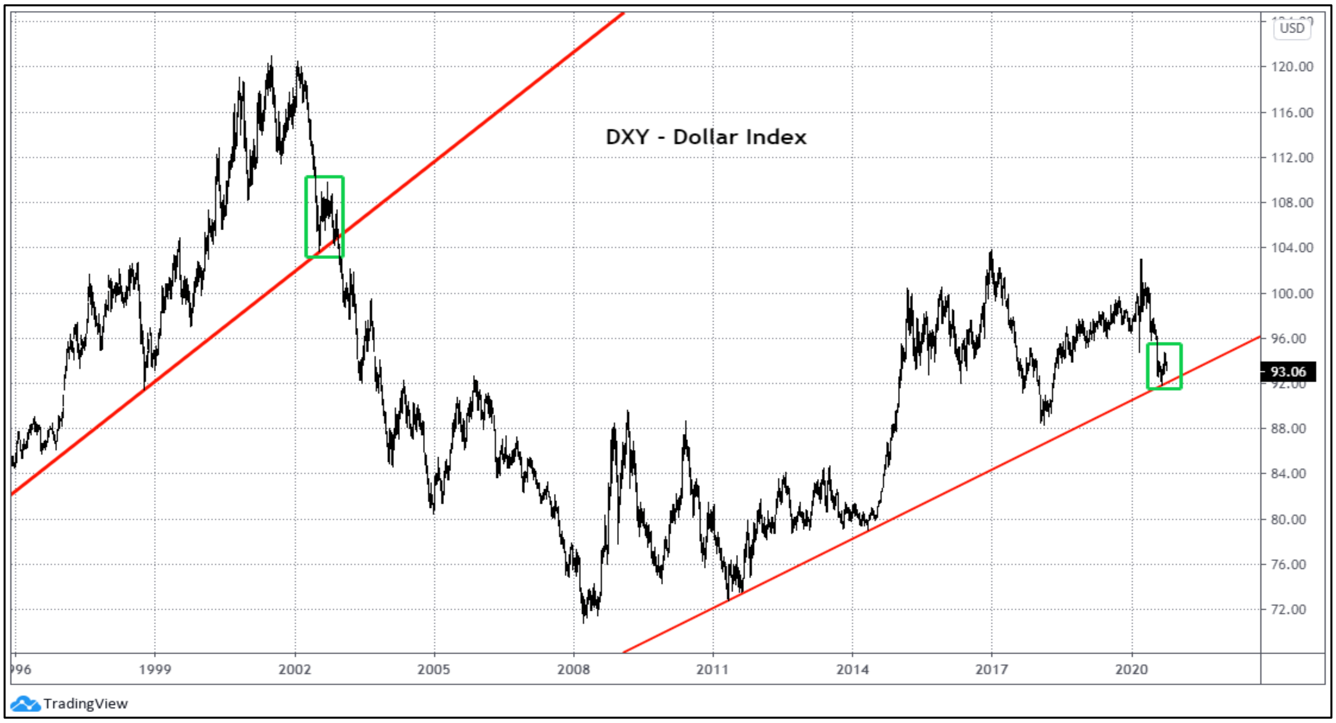
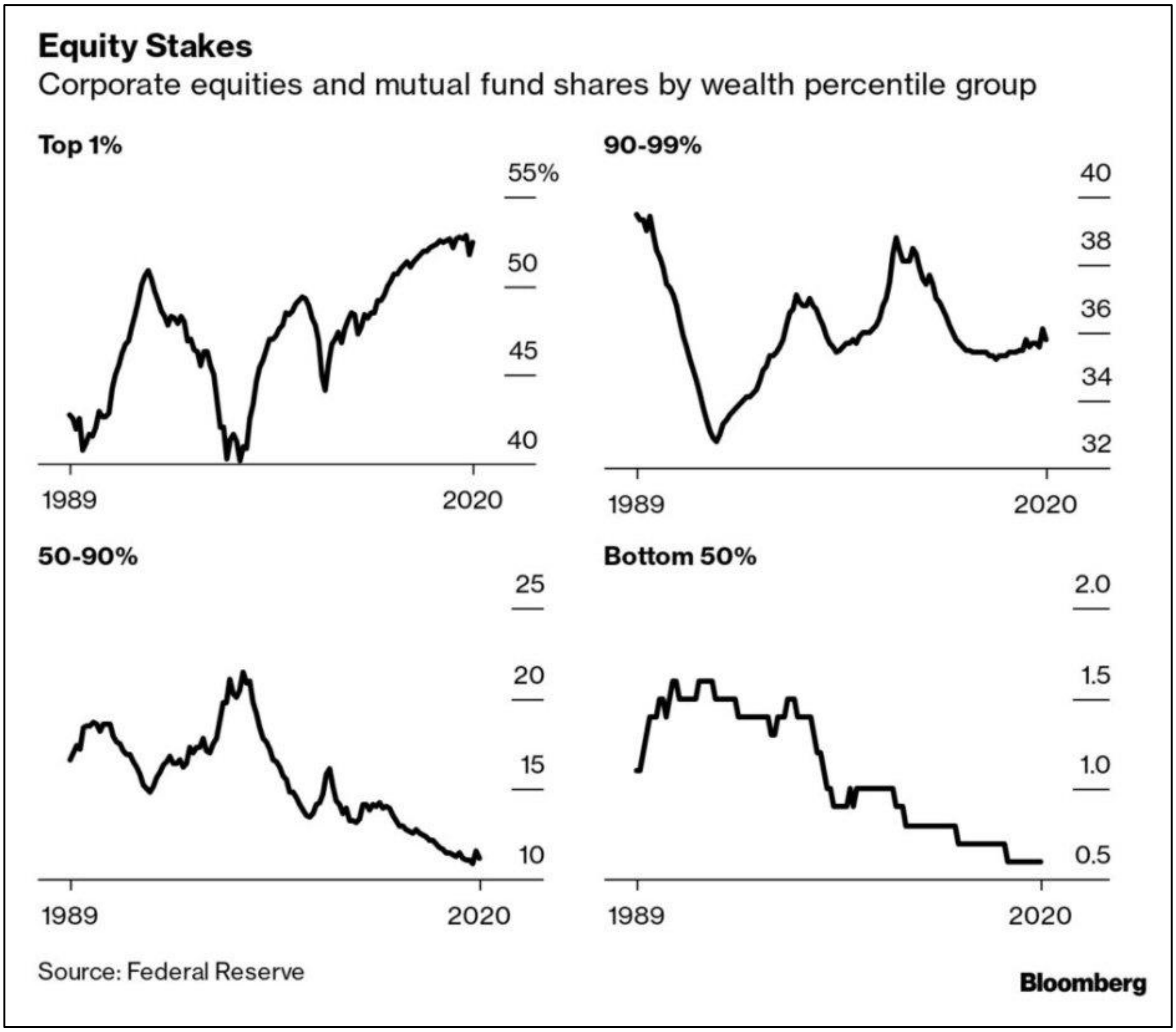
Gold & FX

With so many assets trading in tandem the link between equities, commodities and currencies has been strong. Gold has recently tried to reassert itself. It has held up well given the jump in long end yields and recent USD weakness has helped.

Overall, the EUR heavy DXY looks headed back to the bottom of its recent range and important support. A break of 91.75 would be noteworthy now. EM currency laggards have big potential if that happens.



Fun fact: In the US, the top 10% own 88% of the shares. In that context, Biden's proposed change with regard to how capital gains are taxed, is hardly surprising.



Lots of ECB speakers this week…

Also, Dallas Fed's Kaplan speaks on Wednesday … he has been increasingly critical of Fed policy. Although not likely to be able to influence policy he is a lone voice of dissention. For him financial stability is becoming an issue. On Thursday he said… ""I don't think it's healthy for the markets to be addicted, or too reliant, on Fed presence … it engenders fragilities." He sees no need to expand asset purchases further at this time and instead signaled support for winding down stimulus as soon as the COVID crisis eases.

Stargazer
Asset Management

Important Macro Data Releases and Events for the Week

Monday
10/12/2020

ECB's President Lagarde, Schnabel, DeGuindos and Panetta SPEECHES

BoE's Governor Bailey SPEECH

Tuesday
10/13/2020

Trade Balance Forecast: $59.98bln, Prior: $59.9bln

Harmonized Index of Consumer Prices YoY (Sep) Forecast: -0.4%, Prior: -0.4%

ZEW Survey - Economic Sentiment (Oct) Forecast: 70.5, Prior: 73.9

ZEW Survey - Current Situation (Oct) Forecast: -60, Prior: -66.2

ZEW Survey - Economic Sentiment (Oct) Forecast: 74, Prior: 77.4

CPI ex Food and Energy MoM (Sep) Forecast: 0.2%, Prior: 0.4%

CPI ex Food and Energy YoY (Sep) Forecast: -%, Prior: 1.7%

Wednesday
10/14/2020

ECB's President Lagarde SPEECH

Industrial Production s.a. MoM (Aug) Forecast: -, Prior: 4.1%

ECB's Mersch SPEECH

Fed's Kaplan SPEECH

ECB's Lane SPEECH

PPI ex Food and Energy YoY (Sep) Forecast: 0.3%, Prior: 0.6%

RBA's Governor Lowe SPEECH

Thursday
10/15/2020

European Council Meeting

Consumer Price Index YoY (Sep) Forecast:2.4%, Prior: 2.4%

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- Initial Jobless Claims Forecast: -, Prior: 840k
- Initial Jobless Claims 4-week ave. Forecast: - , Prior: 857k
- Continuing Jobless Claims Forecast: -, Prior: 10.976m
- Philadelphia Fed Manufacturing Survey (Ocy) Forecast: 15.5, Prior: 15
- BoC's Lane SPEECH

Friday 10/16/2020

- IMF Meeting
- European Council Meeting
- CPI YoY (Sep) Forecast: 0.2%, Prior: 0.2%
- Retail Sales Control Group (Sep) Forecast: 0.5%, Prior: 0.6%
- Retail Sales MoM (Sep) Forecast: 0.5%, Prior: 0.6%
- Industrial Production MoM (Sep) Forecast: 0.4%, Prior: 0.4%
- Michigan Consumer Sentiment Index (Oct) Forecast: 81, Prior: 80.4

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