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Asset Management

What to focus on in Global Macro for the week of January 18th, 2021

Macro Themes on the Radar:

Fed

Last week was an interesting one for the Fed. The Atlanta Fed's Bostic had caught market participants by surprise when he indicated that the Fed may reduce QE and raise rates earlier than expected, if the stronger than consensus growth outlook he anticipates plays out. However, Powell and Clarida pushed back on the idea of a reduction in stimulus anytime in the near future. Powell, during his very open discussion with a Princeton moderator, indicated that the economy remains very far from achieving the Fed's goals. He also drove home that they would follow through on their "New Framework" and that by definition if they are to be credible in their goal of 2% average inflation, they will have to let inflation run hot for sometime given that it has now been below 2% for an extended period. The days of preempting higher expected inflation because of labor market tightness are over. Instead, a tight labor market is being actively sought out (as a remedy for inequality) and only when average inflation threatens to run away to the topside will they tighten monetary policy.

The Clarida speech is well worth reading. *"Regarding our maximum-employment mandate - an important evolution in our new framework is that the Committee now defines maximum employment as the highest level of employment that does not generate sustained pressures that put the price-stability mandate at risk... Indeed, in our September and subsequent FOMC statements, we indicated that we expect it will be appropriate to keep the federal funds rate in the current 0 to 25 basis point target range until inflation has reached 2 percent (on an annual basis) and labor market conditions have reached levels consistent with the Committee's assessment of maximum employment. In our new framework, when in a business cycle expansion labor market indicators return to a range that, in the Committee's judgment, is broadly consistent with its maximum-employment mandate, it will be data on inflation itself that policy will react to, but going forward, policy will not tighten solely because the unemployment rate has fallen below any particular econometric estimate of its long-run natural level."* ... NAIRU is out, PCE inflation is in.

As long as PCE inflation doesn't threaten to run away they will keep policy loose. How they actually react to higher inflation will be very interesting to see. How the bond markets react (or are allowed to react) will be critically important for financial assets. Markets are eventually going to test them on this.

With lots of pent up demand, high savings and supply chain issues, we could see a quick jump in inflation when economies do finally fully reopen. The Fed and the ECB are already talking about that potential inflation whipsaw and the fact that they intend to look through it. Will the markets be able to do the same?

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Biden Plan

The new administration's first spending initiative was unvailed last week. The American Rescue Plan includes the following:

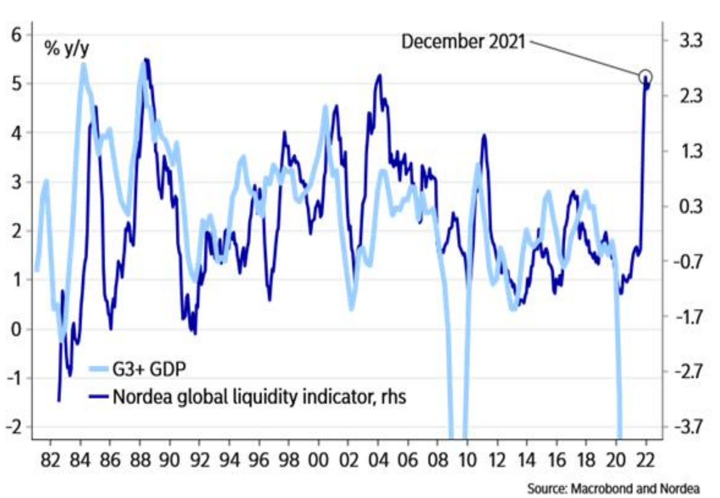
- Direct payments of $1,400 to most Americans, bringing the total relief to $2,000, including December's $600 payments
- Increasing the federal, per-week unemployment benefit to $400 and extending it through the end of September
- Increasing the federal minimum wage to $15 per hour
- Extending the eviction and foreclosure moratoriums until the end of September
- $350 billion in state and local government aid
- $170 billion for K-12 schools and institutions of higher education
- $50 billion toward Covid-19 testing
- $20 billion toward a national vaccine program in partnership with states, localities and tribes
- Making the Child Tax Credit fully refundable for the year and increasing the credit to $3,000 per child ($3,600 if under 6)

Expect a second and broader economic recovery plan to be presented to a joint session of Congress in February. That one will detail infrustructure spending plans and the approach to fighting climate change. It will also seemingly include plans for tax hikes. The feeling had been that tax hikes were on the back burner for now.

Larry Summers in response to the $1.9T plan: "We are going to have to watch this economy very carefully, and I do think the conventional wisdom is underestimating the risks of hitting capacity," said Summers, a Harvard University professor and paid contributor to Bloomberg TV. "If we do anything approaching this, we are going to be managing the economy with the accelerator more on the floor that any time in peacetime history."

With the pumps already primed it could be another wild year in terms of macro data.

Chart 1. Super strong nominal growth this year as a lagged effect om stimulus from 2020



Here is a good representation of what the Street is expecting for 2021 … It will be interesting to see how many of these are spectacularly wrong.

Table 2: BofA 2021 macro forecasts

	2020	2021
Global GDP Growth (%)	-3.8%	5.3%
US GDP Growth (%)	-3.6%	4.6%
China GDP Growth (%)	2.0%	8.5%
US Inflation (%)	1.2%	2.2%
US 10-Year Treasury Rate (year-end)	0.90%	1.50%
Fed Funds (year-end)	13 bps	13 bps
Gold, $/oz	$1,950	$2,100
Oil (WTI), $/barrel	$44	$47

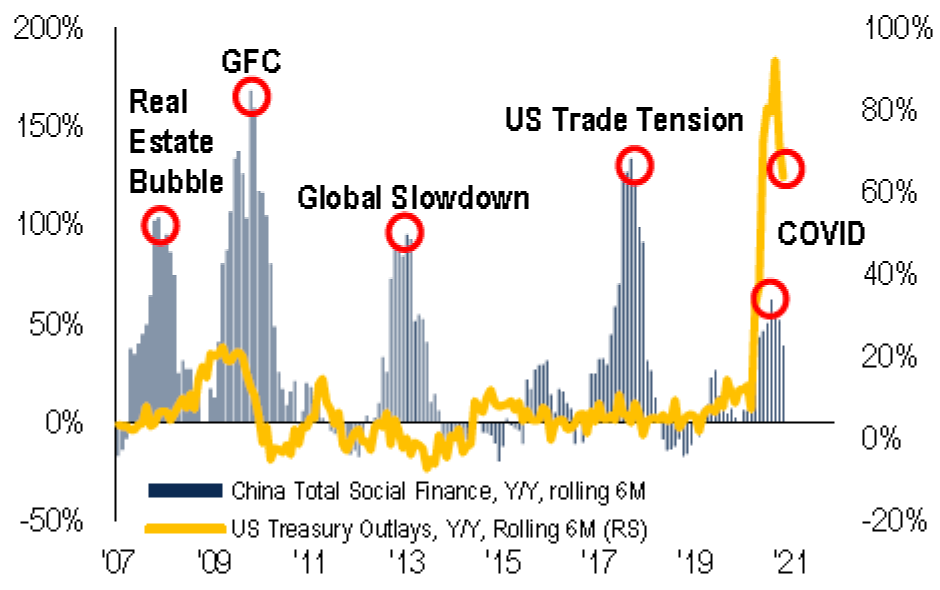
Source: BofA Global Research

China

Given China's ever growing global economic presence, I'll be paying close attention to what they are saying and doing this year.

While the US pushes on with monetary and fiscal stimulus, China seems to be slowly taking its foot off the gas. Aggregate credit availability seems to be peaking, but bear in mind this can have very lagged effects on global markets.

Chart 12: Role reversal: US splurging while Chinese credit slows



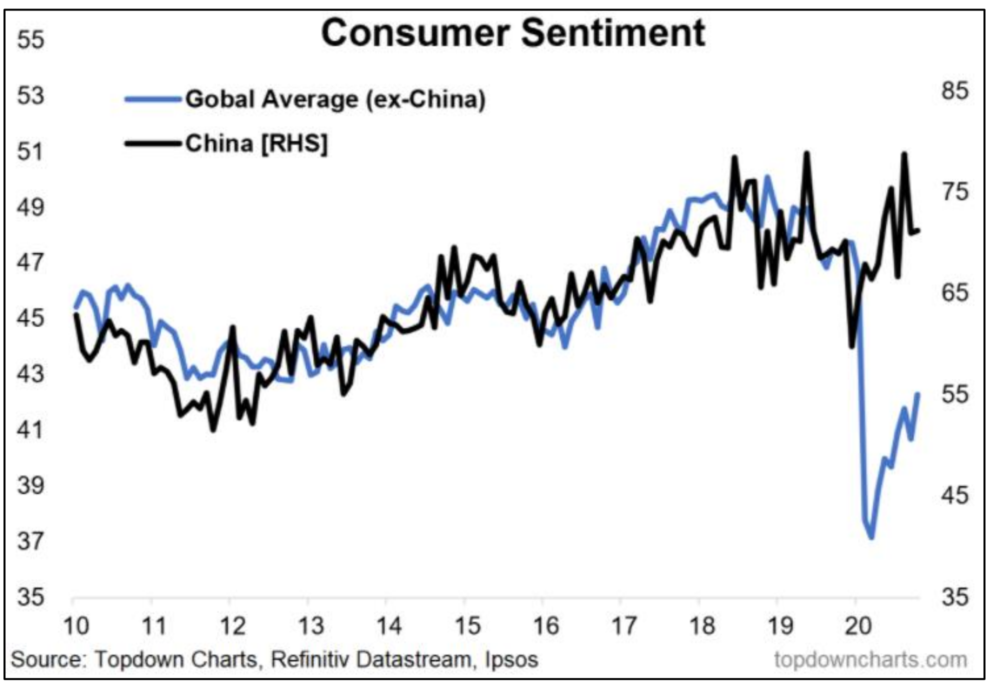
Source: BofA Global Investment Strategy, PBOC, US Treasury, Haver

For some time now the PBoC has expressed concern that excess liquidity being created by very expansive fiscal and monetary policies in developed economies could lead to asset bubbles and eventual financial crisis should they burst.

As the South China Morning Post reports:

Responding to questions about the potential impact on China of Biden's proposed aid package, Chen Yulu, deputy governor of the PBOC, said on Friday that the central bank must stay vigilant as it aims to "strictly prevent and control external financial risks". And he went on to outline what he said were three main risks facing the global economy. "One [external risk] is the departure from the fundamentals of the real economy in the international financial market, with increasing volatility. The second [risk] is that, with loose global liquidity, the direction of cross-border [capital] flows is increasingly volatile," Chen said at a media briefing, referencing speculative "hot money" – short-term investments in financial products that can move out of the country rapidly. "Third, the pandemic has had an unprecedented impact on the economy, and the debt risk of low-income countries will rise further, which may further affect the progress of the global economic recovery."

With China having bounced back the quickest, and the only major nation showing growth last year, it isn't surprising that they are worried about over baking the stimulus cake.



COVID

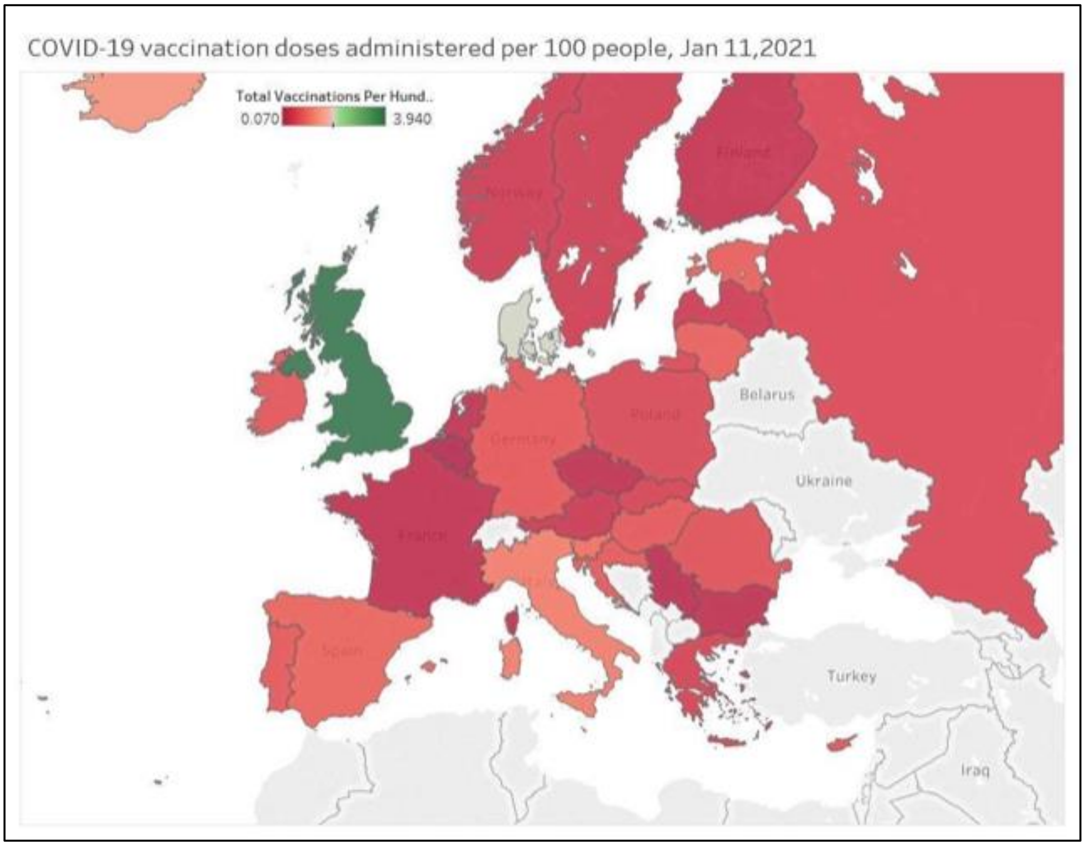
Three quick slides to have a look at.

The first two are from Deutsche Bank re vaccine rollout...

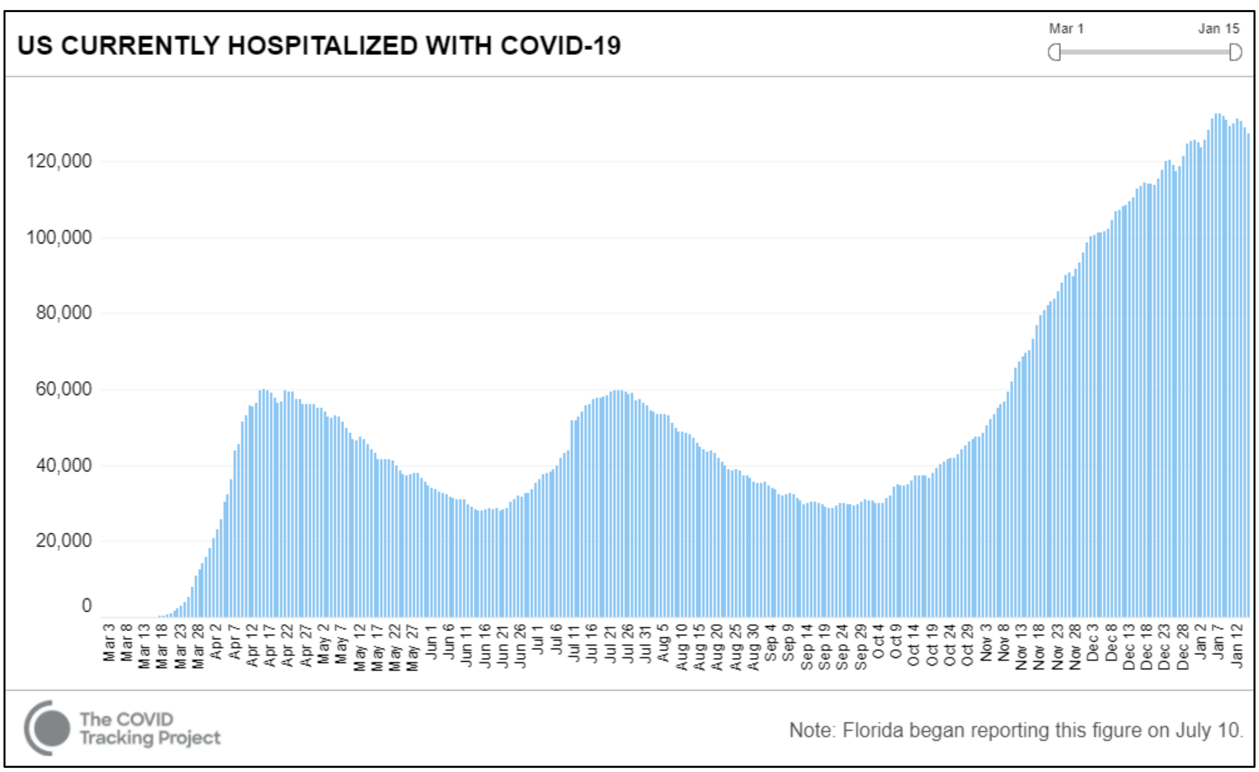
COVID-19 vaccination as % of population

Country	Total vaccinations	Total people vaccinated	Total vaccination as % of pop	7 day Δ (Total vaccinations)	7 day Δ (Total people vaccinated)	Total vaccination as % pop in last 7 days	Latest data as on
Israel	2,160,361	1,991,749	24.96	469,518	300,911	5.42	1/14/2021
United Arab Emirates	1,527,833	1,277,833	15.45	640,136	-	6.47	1/14/2021
Bahrain	109,566	109,566	6.44	37,327	37,327	2.19	1/14/2021
United Kingdom	3,356,229	2,918,252	5.02	-	-	-	1/13/2021
United States	11,148,991	11,148,991	3.37	5,229,573	5,229,573	1.58	1/14/2021
Denmark	129,170	129,170	2.23	40,759	40,759	0.70	1/13/2021
Italy	972,099	972,099	1.61	546,779	546,779	0.90	1/14/2021
Ireland	77,303	77,303	1.57	-	-	-	1/13/2021
Spain	676,186	676,186	1.45	468,863	468,863	1.00	1/14/2021
Iceland	4,875	4,875	1.43	-	-	-	12/30/2020
Slovenia	29,561	29,561	1.42	17,296	17,296	0.83	1/13/2021
Lithuania	31,524	31,524	1.16	17,722	17,722	0.65	1/13/2021
Estonia	14,879	14,879	1.12	8,247	8,247	0.62	1/14/2021
Canada	419,209	419,209	1.11	235,519	235,519	0.62	1/13/2021
Russia	1,500,000	1,500,000	1.03	-	-	-	1/11/2021
Germany	842,455	842,455	1.01	412,267	412,267	0.49	1/13/2021
Hungary	96,101	96,101	0.99	64,601	64,601	0.67	1/13/2021
Poland	369,212	369,212	0.98	208,853	208,853	0.55	1/13/2021
Croatia	38,000	38,000	0.93	17,397	17,397	0.42	1/14/2021
Romania	167,612	167,612	0.87	91,212	91,212	0.47	1/14/2021
Austria	74,100	74,100	0.82	59,005	59,005	0.66	1/14/2021
Sweden	79,466	79,466	0.78	48,337	48,337	0.48	1/10/2021
Slovakia	42,096	42,096	0.77	22,369	22,369	0.41	1/14/2021
Switzerland	66,000	66,000	0.76	-	-	-	1/14/2021
Latvia	13,129	13,129	0.70	7,702	7,702	0.41	1/14/2021
China	10,000,000	10,000,000	0.70	-	-	-	1/13/2021
Portugal	70,000	70,000	0.69	-	-	-	1/8/2021
Greece	70,698	70,698	0.68	44,692	44,692	0.43	1/14/2021
Czechia	70,680	70,680	0.66	50,762	50,762	0.47	1/13/2021
Norway	33,611	33,611	0.62	19,549	19,549	0.36	1/13/2021
Finland	33,033	33,033	0.60	24,878	24,878	0.45	1/14/2021
Belgium	68,968	68,968	0.59	64,288	64,288	0.55	1/14/2021
Saudi Arabia	178,337	178,337	0.51	-	-	-	1/11/2021
Cyprus	6,035	6,035	0.50	-	-	-	1/10/2021
France	318,216	318,216	0.49	273,216	273,216	0.42	1/14/2021
Luxembourg	2,871	2,871	0.46	-	-	-	1/13/2021
Oman	22,749	22,749	0.45	8,744	8,744	0.17	1/13/2021
Argentina	166,833	166,833	0.37	-	-	-	1/13/2021
Turkey	286,806	286,806	0.34	-	-	-	1/15/2021
Malta	1,400	1,400	0.32	-	-	-	1/3/2021
Netherlands	47,000	47,000	0.27	41,000	41,000	0.24	1/13/2021
Bulgaria	17,686	17,686	0.25	6,569	6,569	0.09	1/14/2021
Costa Rica	9,751	9,751	0.19	-	-	-	1/8/2021
Mexico	192,567	192,567	0.15	139,382	139,382	0.11	1/13/2021
Singapore	6,200	6,200	0.11	-	-	-	1/12/2021
Kuwait	2,500	2,500	0.06	-	-	-	12/28/2020
Chile	10,699	10,699	0.06	-	-	-	1/6/2021

A lot of variability within Europe…



Some hope that hospitalizations are peaking… maybe.



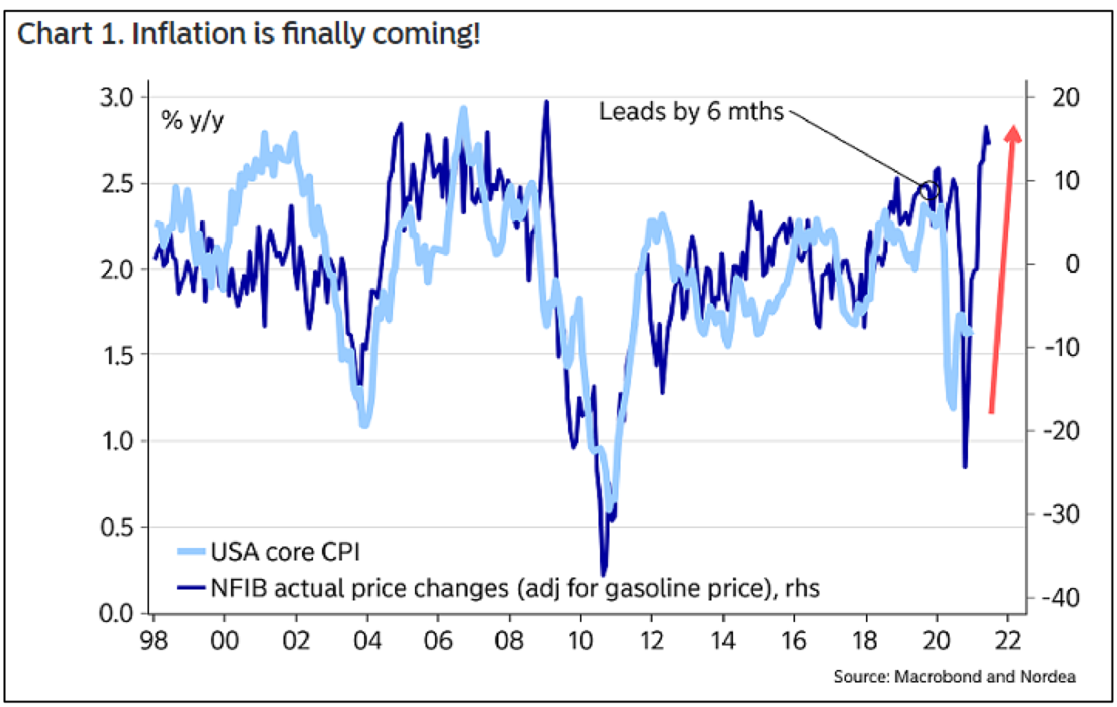
What to Focus on Now:

USD - The dollar had a good week and that makes two in a row. The set-up is very similar to Aug/Sep of last year. I would expect a bit more USD strength this coming week.

Let's see if the ECB says anything specific about the EUR. While there has been a lot of talk about extreme short USD positioning, the majority of that seems to be vs. EUR, so further unwind there is very possible. I would guess it is a buy on the first stab sub 1.2000.

Bonds – A pop in yields stalls as equities soften and USD jumps.

Given that equities are expensive, the continued fiscal expansion and the Feds "new framework" this might be the market that matters the most. There are lots of reasons to think we will see a jump in inflation this year. If it happens it could be a big source of volatility. Here are a few charts that support an inflation pop.



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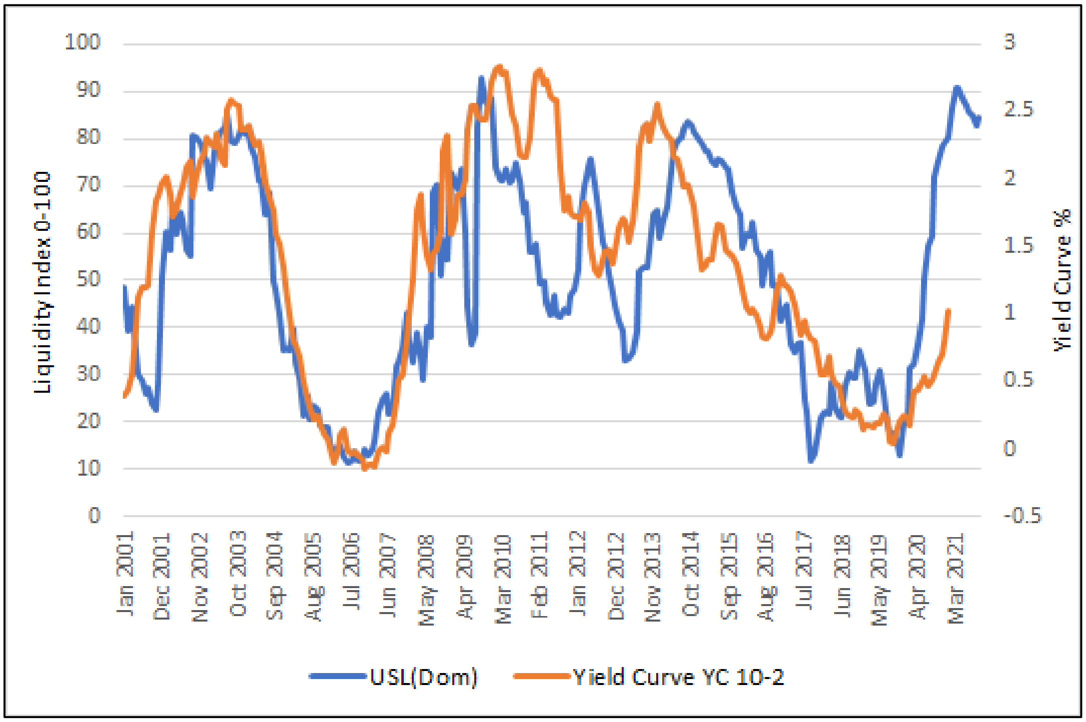
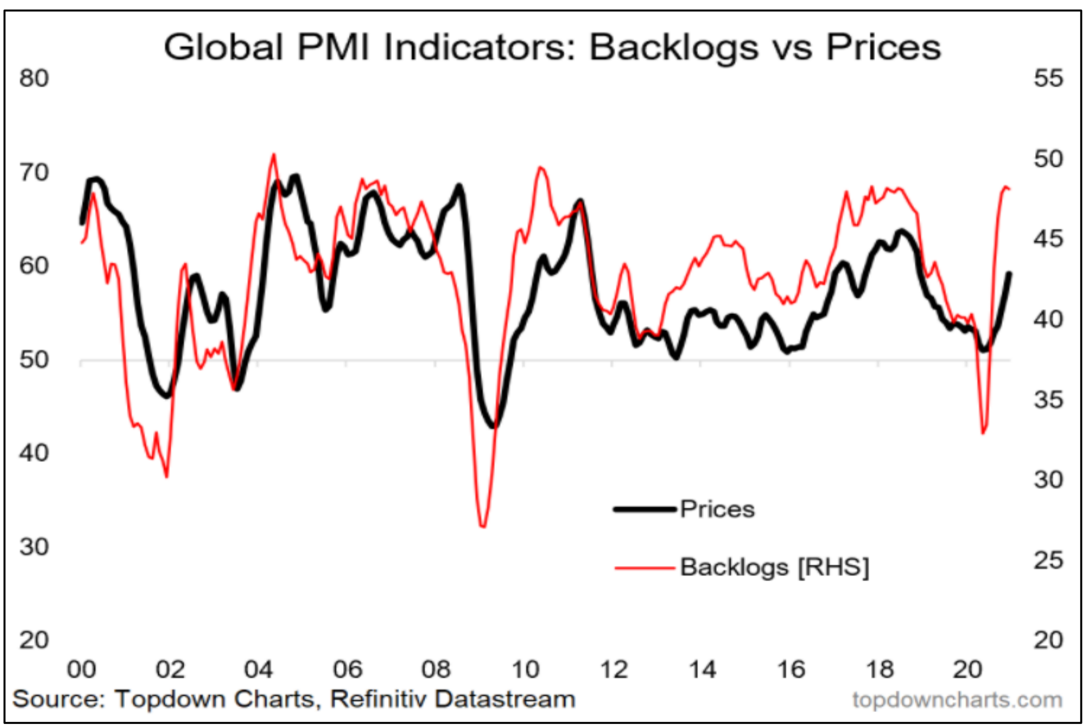
Lots of liquidity should mean steeper yield curve and higher inflation expectations.



Supply chain disruptions and backlogs.



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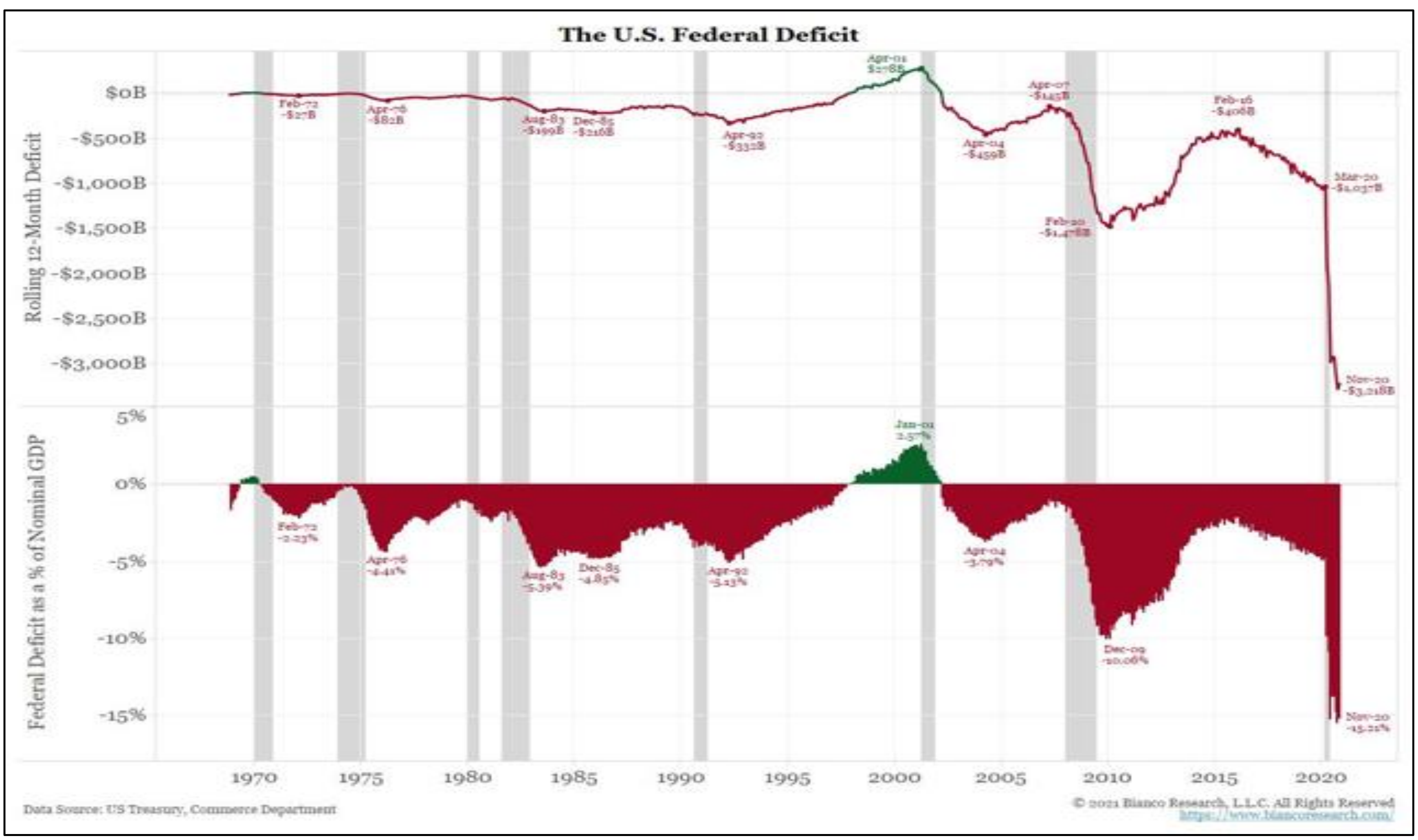
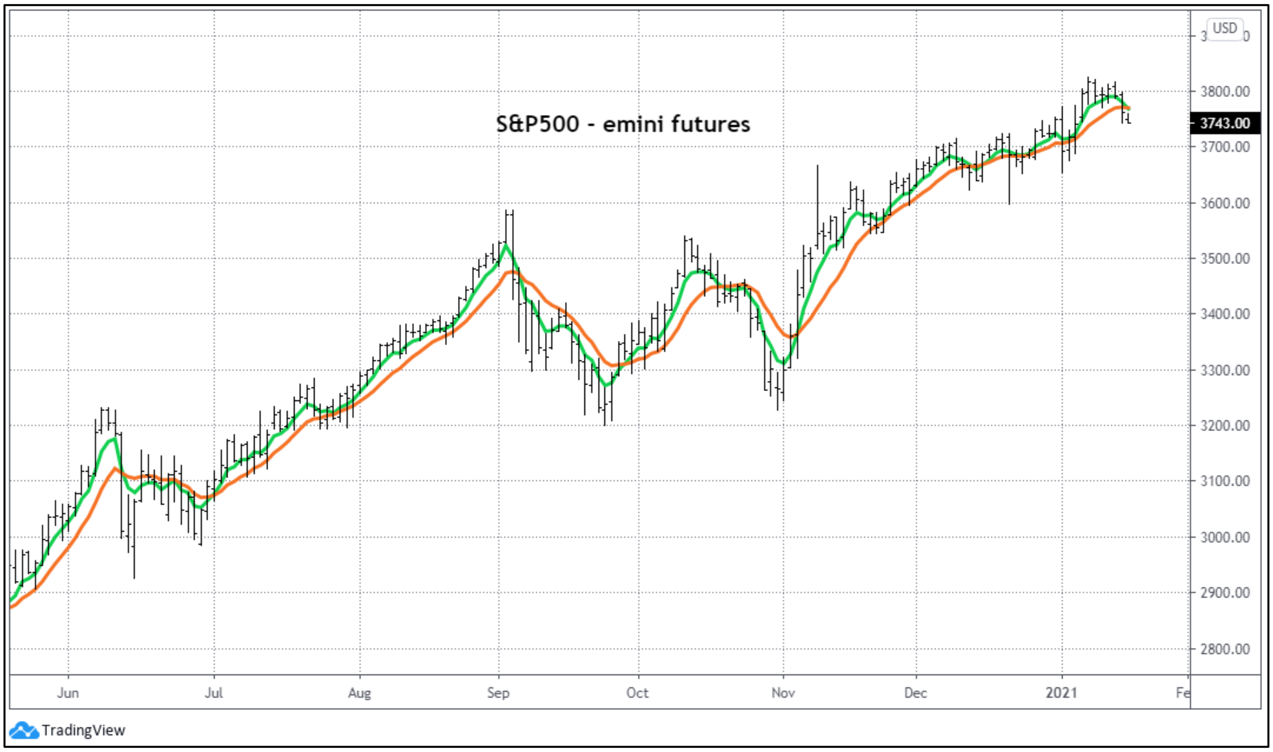
During Powell's Princeton discussion last week, he emphasized that we are a long way from having a debt level that is unsustainable. Especially given that rates are so low. However, with another $5T in spending potentially coming down the pike (between the two recovery plans) the Fed will increasingly be buying a smaller portion of new issuance. Will it matter for markets? With an inflation pop it might…



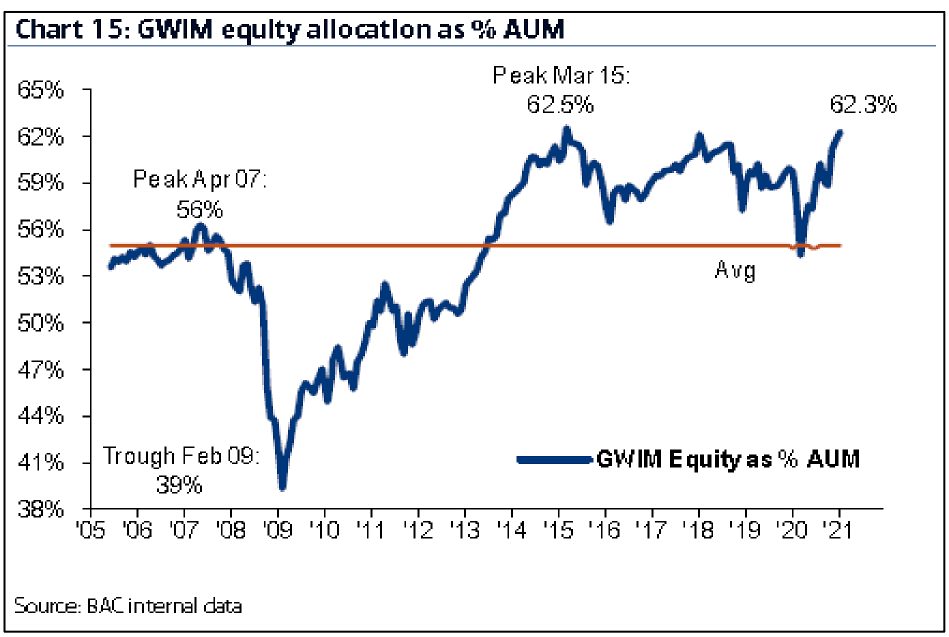
Equities

Stocks came off the boil last week on weaker than expected economic numbers. Short-term momentum is in danger of rolling.

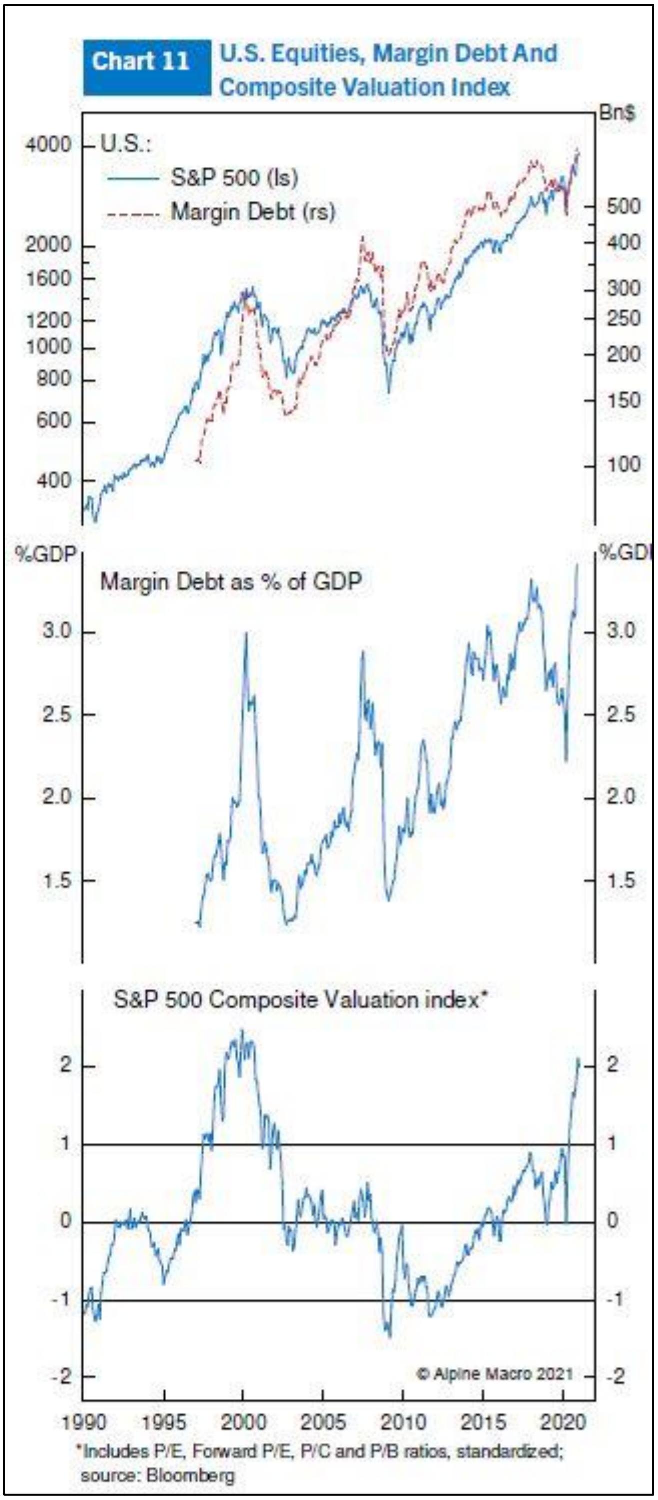


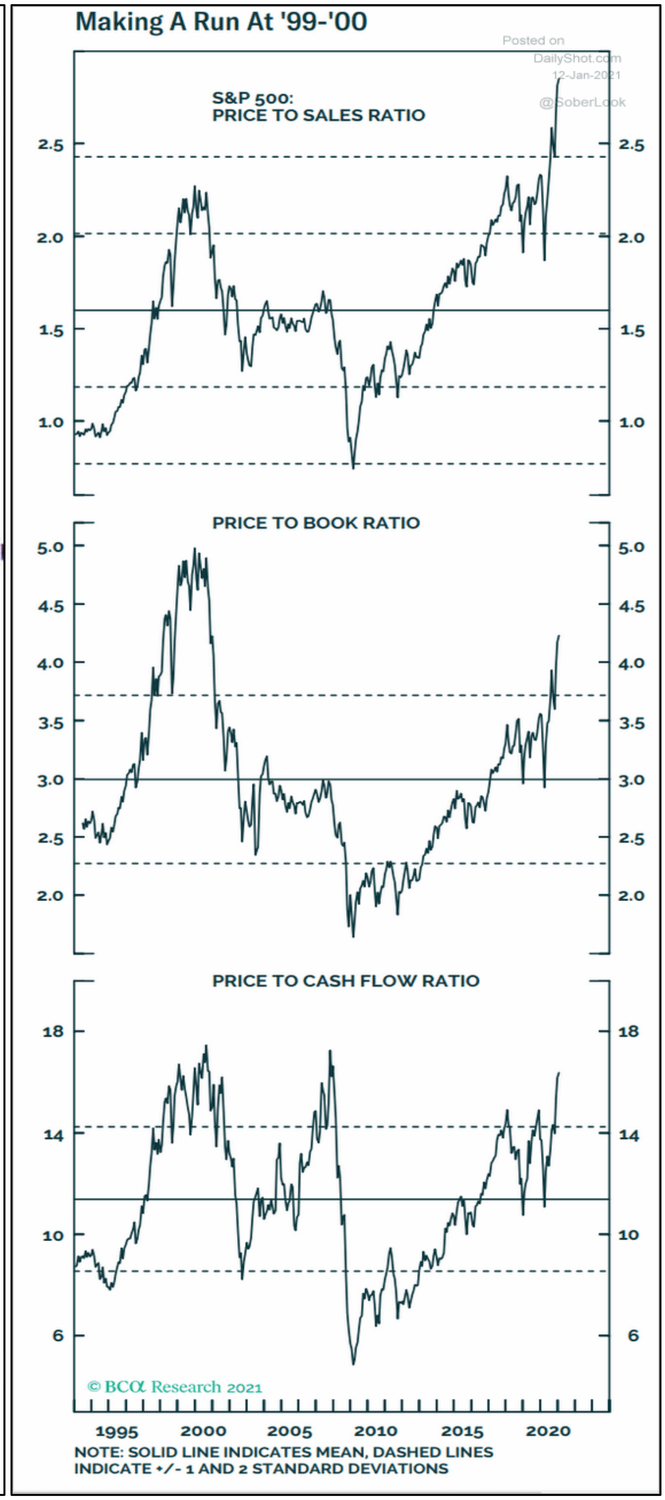
The post pandemic growth expectations are now increasingly priced in. Sentiment and positioning can no longer be seen as a tailwind. Volatility should increase as instability builds.

BoA private clients back near max historical equity allocation.

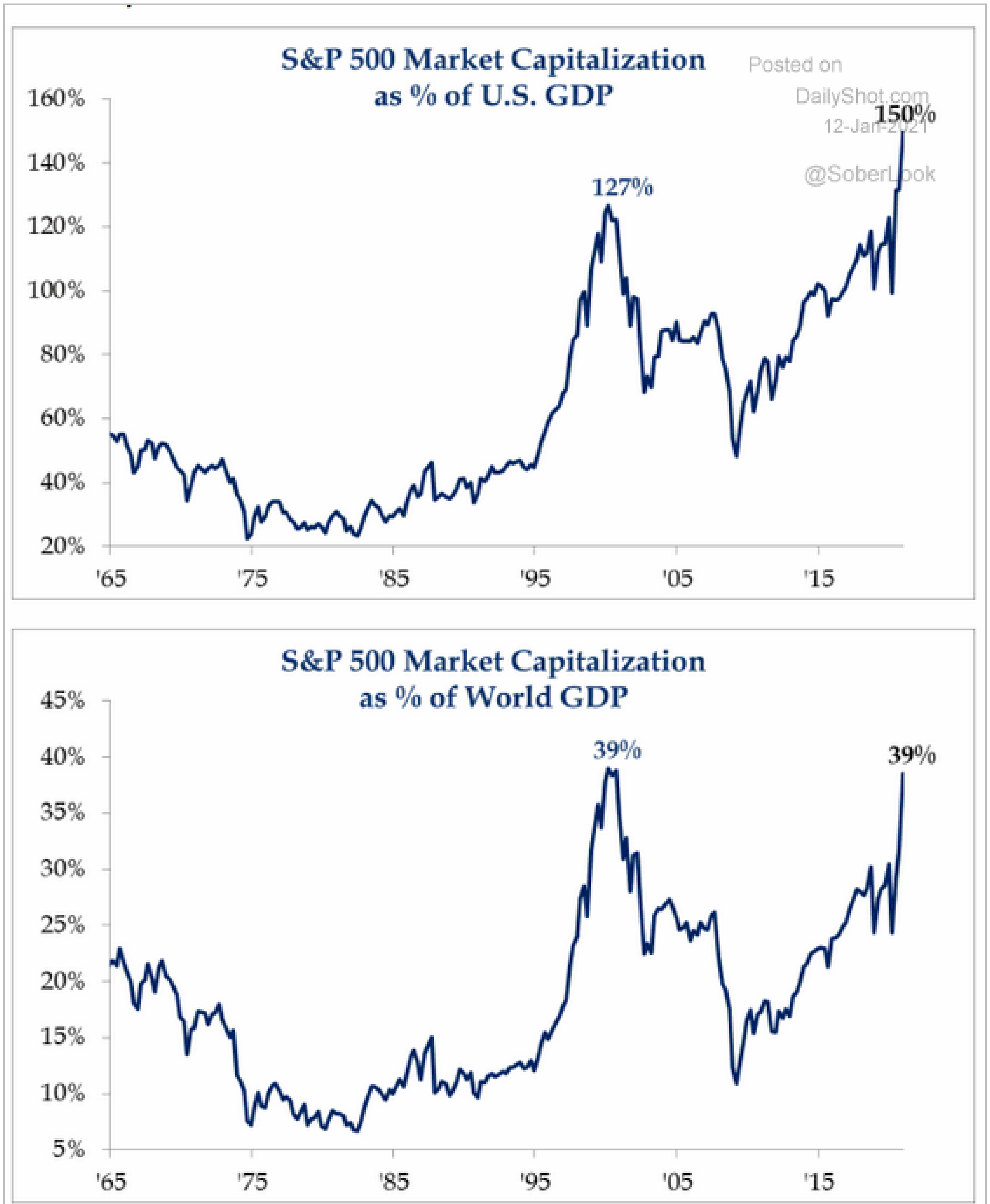


Here are various valuation measures that illustrate where we are vs. the 2000 extremes.





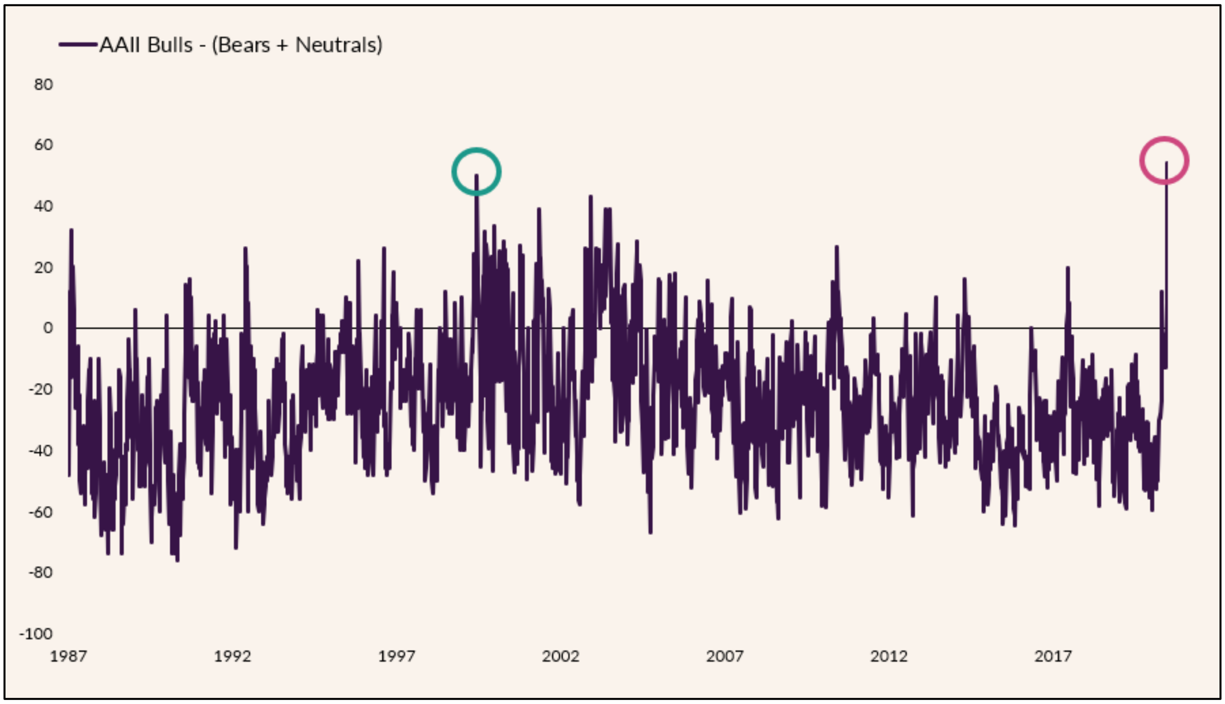
Market Capitalization vs. GDP is now also at new highs. Again, could of course go higher, but it is important to know where we are.



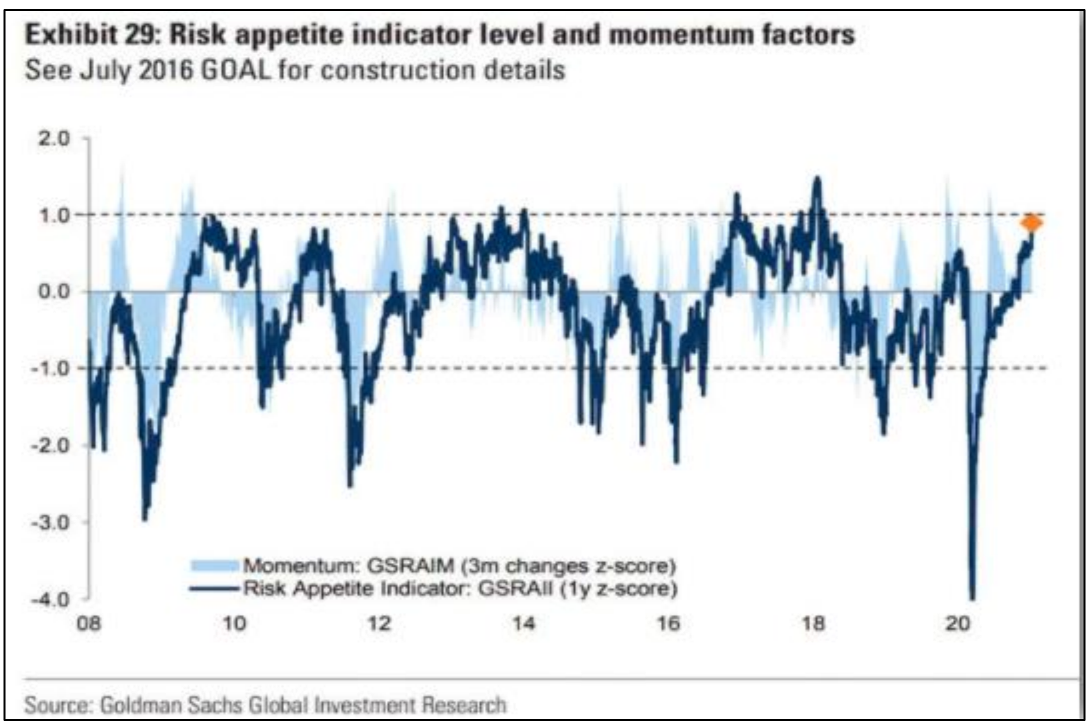
Strategas Securities, LLC – Investment Strategy

Of course, it helps that US and global GDP went down and stocks went up.

Investor sentiment surveys have gone from very bearish to very bullish.



As has risk appetite.

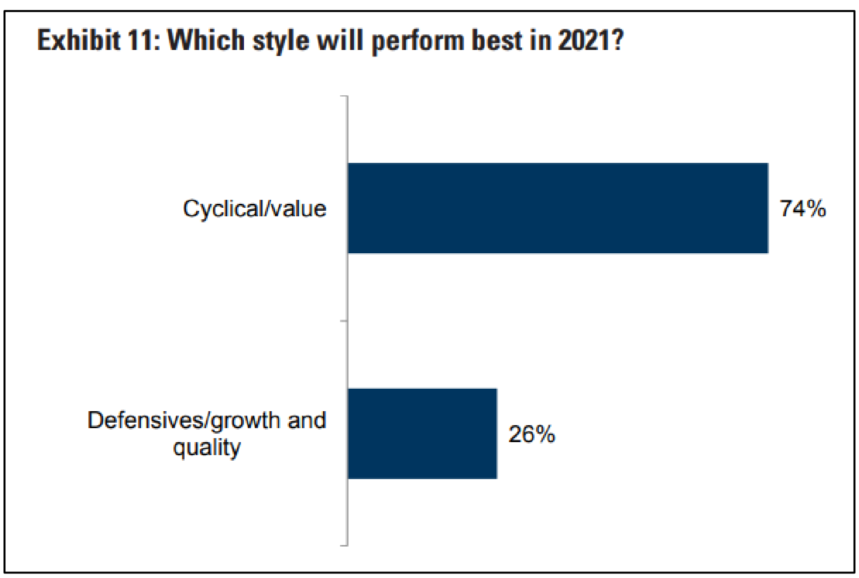


<u>Taken together, these valuation and sentiment charts do not create the backdrop for a low volatility environment.</u>

Relative Performance

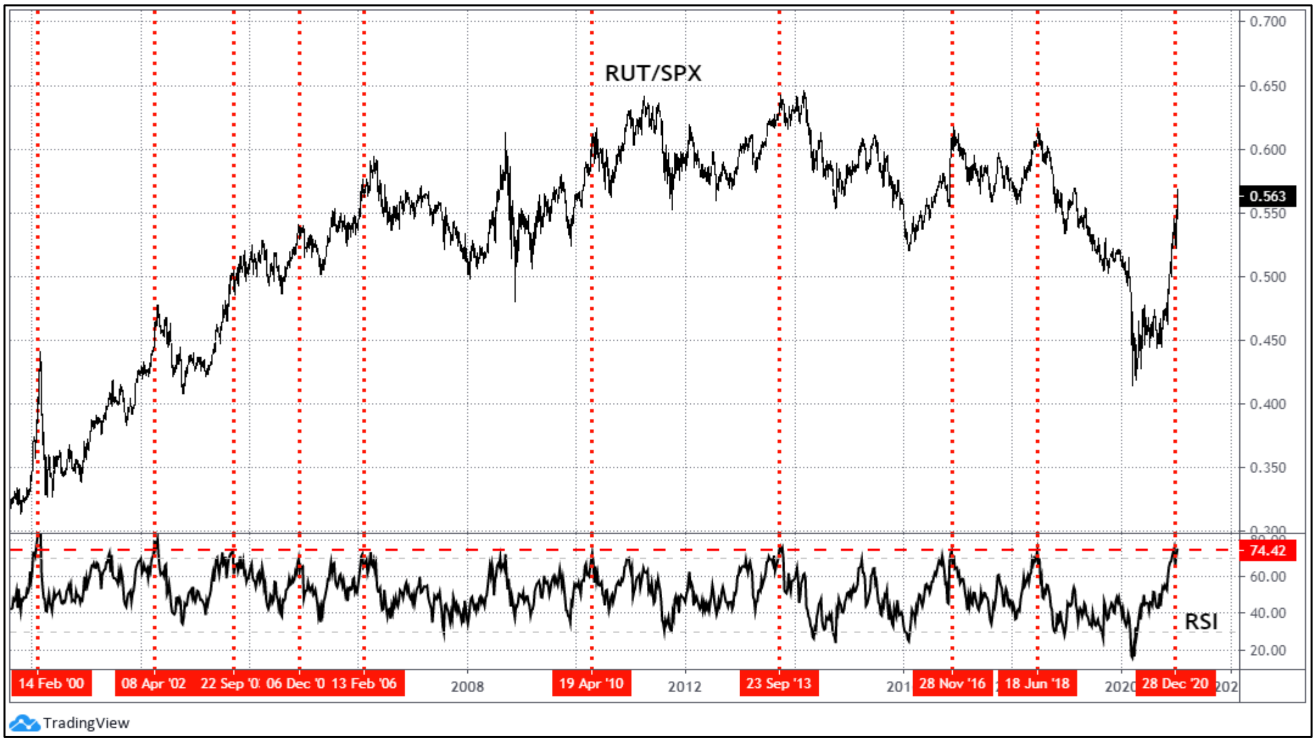
Only now is “growth” really on the edge of breaking down vs. “value” stocks.

Of course that it is not a new idea that investors are expecting value to outperform this year.

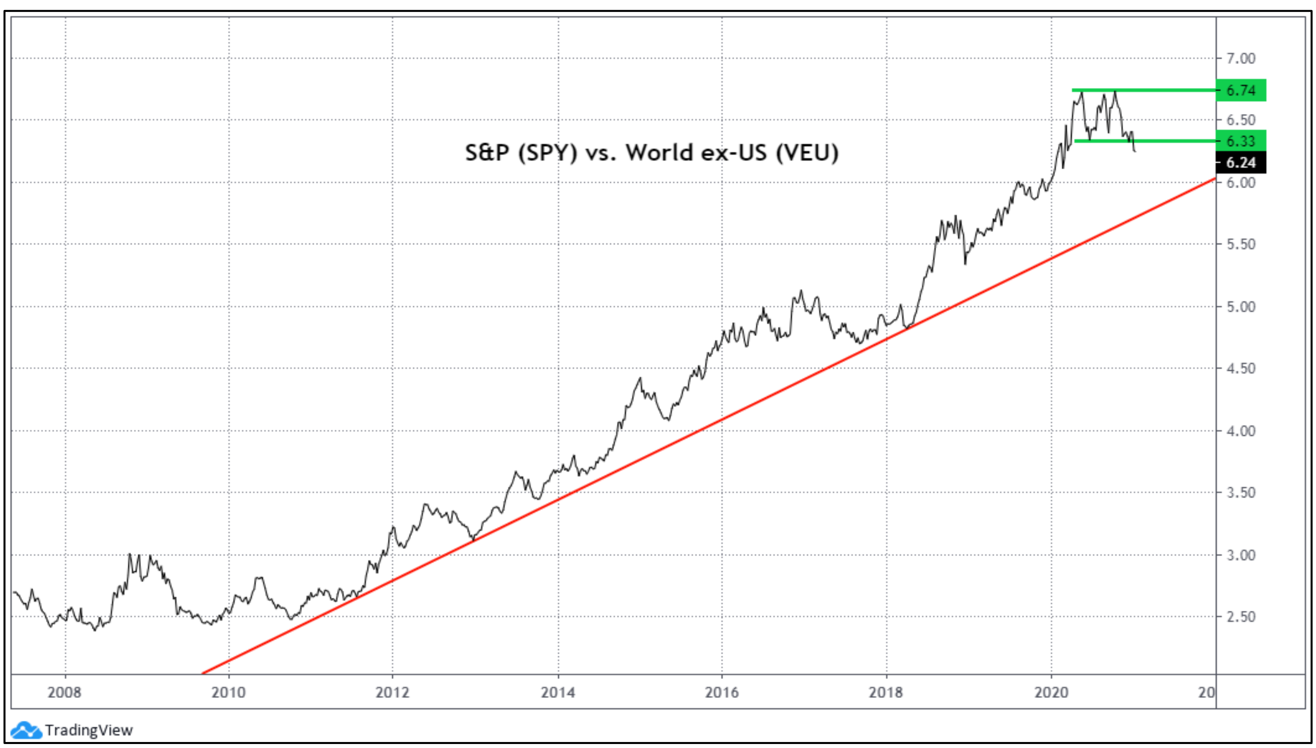


Source: GS survey

Over the last few months (since it broke out in early Nov.) the Russell outperformance has been THE rotation story. However, at this point that outperformace is due to take a break.



The US has outperformed for the last decade thanks to US big cap tech, but there are signs that the trend is due for a rest, or even a reversal.



Many international markets such as Emerging Markets and even Europe to some extent, have seen large and powerful rallies off the March lows. EM finally taking out its 2007 price highs.

However, for US investors what really matters is their performance relative to US equities. Here the relative performance has also perked up. EM has been outperforming and looks to be breaking higher now on a relative basis. The fate of the dollar will be a very important input here however.

Europe is another one I am watching. While we have seen a big pop back from the March lows, we are still stuck in the middle of what has been a volatile range now lasting 20+ years.

Relative performance here has not been nearly as good as vs. EM, but is also showing potential signs of bottoming.

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Since the breakout noted in the weekly back in November, Japanese stocks have been zooming. Amazingly, 30+ years later the Nikkei is still 27% below its '89 highs.

On a relative basis, this is perhaps the most interesting market as a long-term bottom looks to be forming vs. the US which could result in a protracted period of outperformance.

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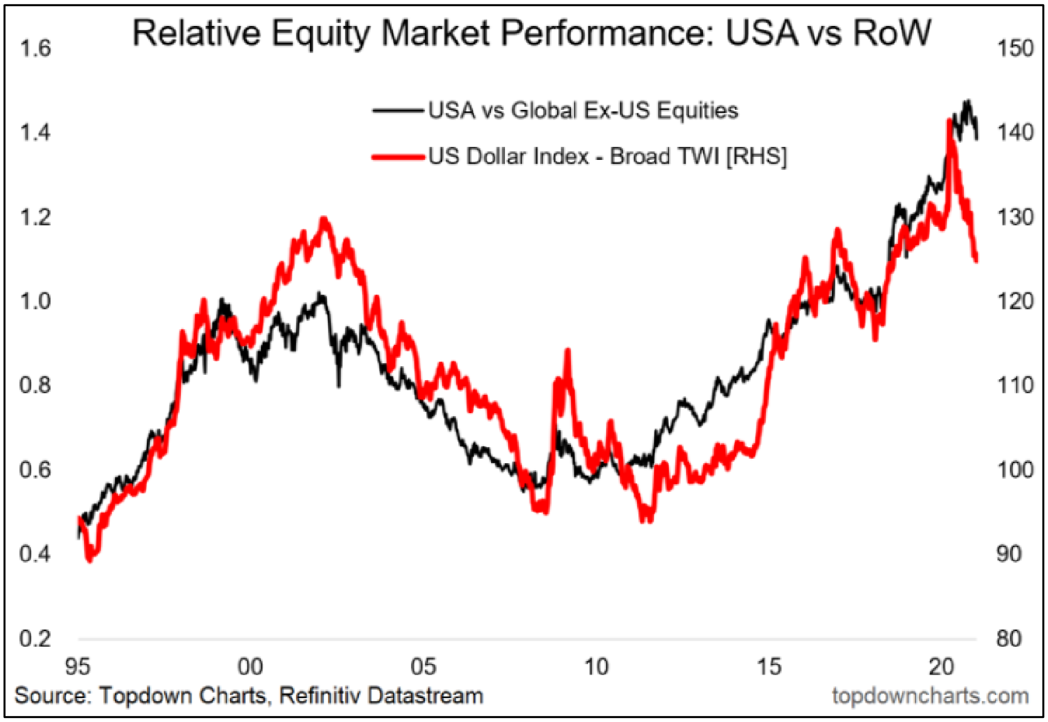
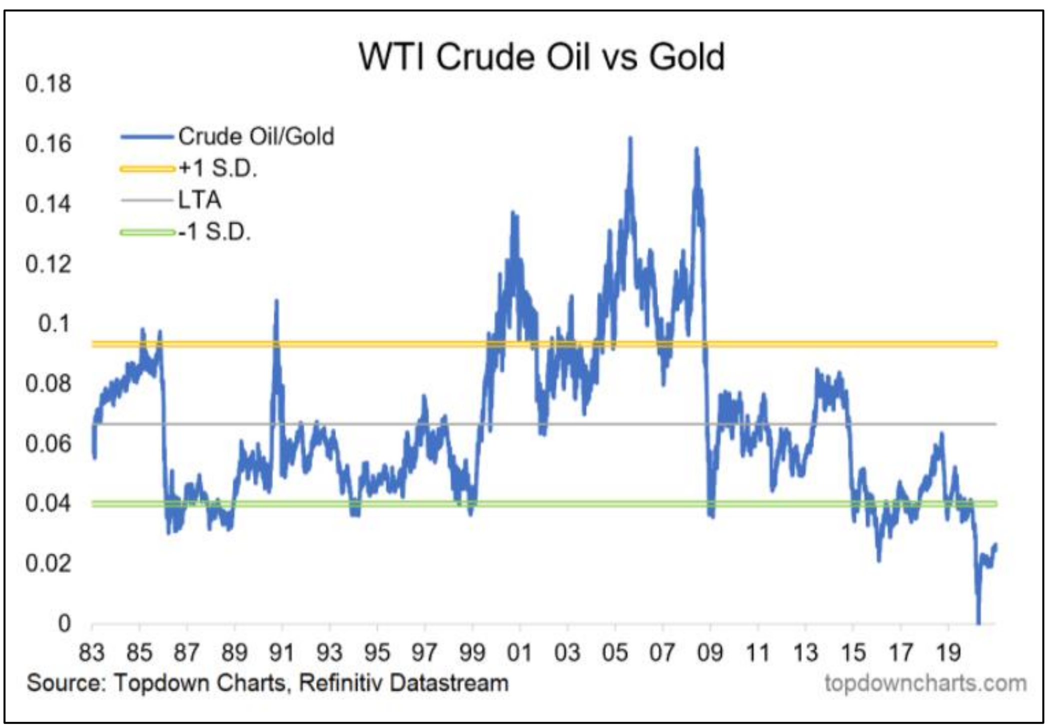
Historically dollar weakness has meant better performance for non-US equities.

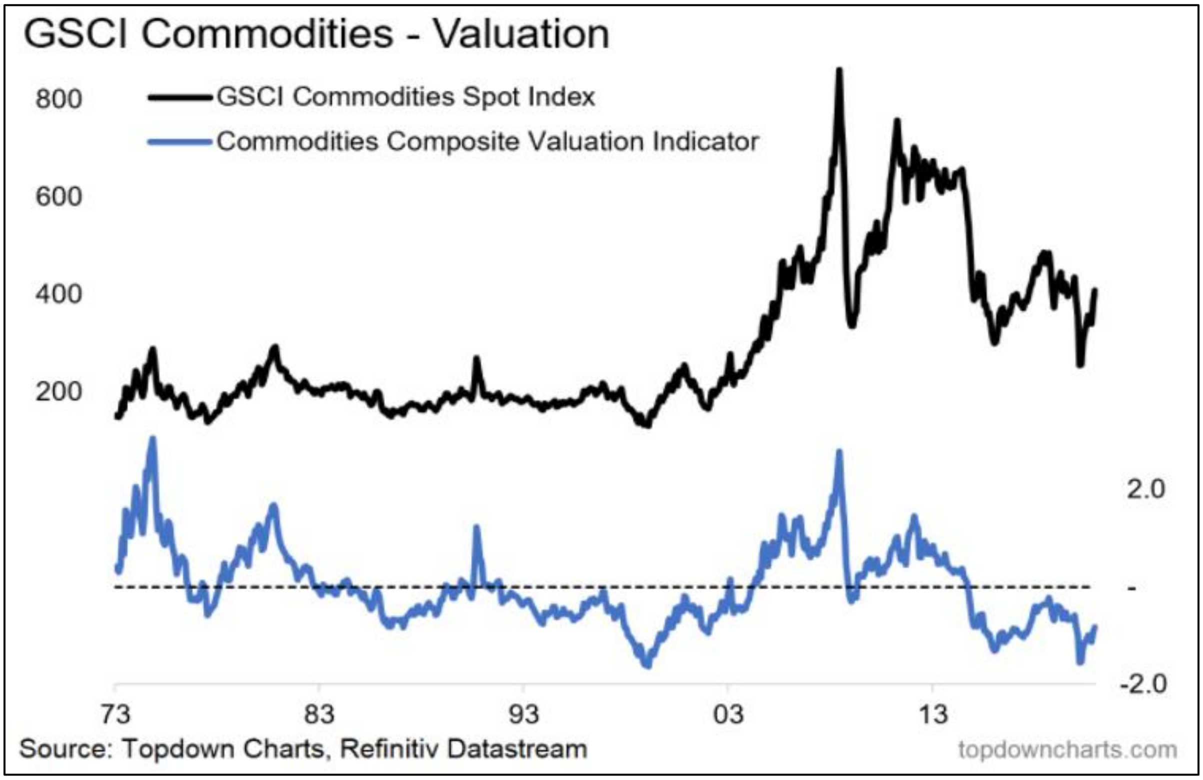


Commodities

Part of the problem for Gold has been that in an environment where growth is expected, industrial non-safe haven commodities are more appealing.



Overall, if reflation is real, commodities are cheap. Although, you need to remember that many of the commodity indices are heavily influenced by their oil allocation.



Cheap vs. equities as well. Although again, you need to keep it in perspective in a world of bytes with an impending big spend on clean energy. Still real inflation will take this down, potentially a lot.

El-Erian's view…

About 10 days ago Mohamed El-Erian did an interview with a Swiss paper. I hadn't gotten around to reading it until yesterday, but when I did it struck me how forceful he was in his views. Usually he is much more mild-mannered.

It is worth a read. Here are a few zingers…

"When you are an institutional investor and you put a lot of money in an investment, you ask yourself always one final question after you go through the fundamentals, the valuations and everything else: Who is going to buy after me? If the buyer after you is someone with a printing press in the basement, who has a willingness to use it, doesn't care about valuation and isn't buying to make money, that is incredibly reassuring."

"There was no doubt that two central banks in particular, the Federal Reserve and the European Central Bank, are going to provide ample and predictable injections of liquidity, and that they are going to be continuous buyers with no limit to how much they can buy and at what price. That is the reason why we've seen prices going from one record high to another despite completely changing narratives. Forget about the «great reopening», the «Trump trade» and all this other stuff."

"People have a relative mindset. It's like in this story where dad comes home and declares to his family that he just bought a dog for $30.000. Of course, the family is stunned. But he declares: «It's one of the best deals ever, the cat was selling for $50.000». When you have a relative mindset, things get totally disconnected. Just take Greece: People are buying Greek bonds at negative yields. Why? Because they say it's a yield pick-up relative to German bonds. Liquidity encourages a relative mindset; you start really mispricing things. Then, one day, you ask yourself a different question: Is a negative yield compensating me for credit risk in Greece? Of course, it's not. But we never know when the relative mindset changes to an absolute mindset."

This past week we had another "Roaring 20's" cover…

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Biden Administration takes the reigns on Wednesday. Expect a quick and determined start to the first 100 days. Lots of CB interest rate and policy meeting next week. Expect near-term economic downgrades due to virus but no further meaningful easing.

Important Macro Data Releases and Events for the Week

Monday
1/18/2021

- GDP YoY (Jan) Forecast: 6.1%, Prior: 4.9% (Number out Sunday night US)
- Retail Sales YoY (Dec) Forecast: 5.5%, Prior: 5% (Number out Sunday night US)
- **U.S. Markets Closed**
- Eurogroup Meeting

Tuesday
1/19/21

- EcoFin Meeting
- ECB Lending Survey
- Harmonized Index of Consumer Prices YoY (Dec) Forecast: -0.7%, Prior: -0.7%
- ZEW Survey - Current Situation (Jan) Forecast: -68, Prior: -66.5
- ZEW Survey - Economic Sentiment (Jan) Forecast: 60, Prior: 55
- BoE's Haldane Speech
- **PBoC Interest Rate Decision Forecast: 3.85%, Prior: 3.85%**

Wednesday
1/20/21

- PPI MoM (Dec) Forecast: 0.3%, Prior: 0.2%
- CPI Core YoY (Dec) Forecast: 0.2%, Prior: 0.2%
- BoC CPI Core YoY (Dec) Forecast: 1.2%, Prior: 1.5%
- BoC Interest Rate Decision, Statement and Press Conference
- Foreign Investment in Japan Stocks (Jan) ...This could be an interesting one
- Employment Change and Unemployment Rate

	BoJ Interest Rate Decision, Monetary Policy Statement and Press Conference
Thursday 1/21/21	**ECB Interest Rate Decision, Policy Statement and Press Conference**
	Consumer Confidence (Jan) Forecast: -15, Prior: -13.9
	Building Permits MoM (Dec) Forecast: 1.61M, Prior: 1.635M
	Housing Starts MoM (Dec) Forecast: 1.562M, Prior: 1.547M
	Philadelphia Fed Manufacturing Survey (Jan) Forecast: 12, Prior: 11.1
	Initial Jobless Claims Forecast: 860k, Prior: 965k
	Initial Jobless Claims 4-week ave. Forecast: -, Prior: 834.25k
	Continuing Claims Forecast: -, Prior: 5.271M
	National CPI ex Food and Energy (Dec) Forecast: -, Prior: -0.3%
Friday 1/22/21	Markit Flash PMI's (Jan) - Across Europe
	Markit Manufacturing PMI (Jan) Forecast: 56.5, Prior: 57.1
	Markit Service PMI (Jan) Forecast: 54, Prior: 54.8
	Markit PMI Composite (Jan) Forecast: -, Prior: 55.3

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