What to focus on in Global Macro for the week of November 16th, 2020

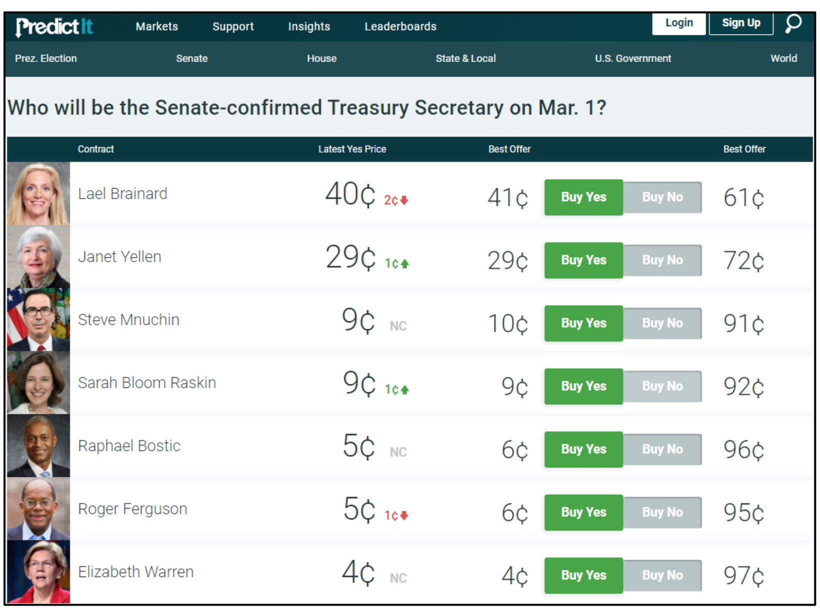
Macro Themes on the Radar:

Central Banks and the US Treasury Secretary

With the recent surge in COVID cases there is renewed focus on what the Fed and the ECB might do at their December meetings. If cases don't moderate, increased QE could be in the cards from the Fed, as well as more pressure on fiscal authorities to come up with another round of support for the economy. With the recent bout of curve steepening there is renewed talk that a nod toward implied yield curve control is possible. I think it is too soon for that and that a meaningful pop in the long end of treasury yields would have to come first.

The ECB's Lagarde has people thinking about some kind of yield curve control as well. However, with no single curve to target and German yields already very low, this would be more likely to come in the form of spread control, if at all. With yields in Spain and Italy way above those of Germany, some kind of spread targeting is possible down the road. This could be politically complicated and would be unlikely until well into next year, if at all.

In the meanwhile, back in DC, Biden's potential cabinet choices are being hotly debated. With the Fed at the zero bound on rates, there has been increasing cooperation between the Fed and the Treasury. With this "merging" by necessity, Biden's choice for Treasury Secretary will be especially important for markets. The Fed's Lael Brainard is seen to be the front runner by punters. Former Fed Chair Janet Yellen is a close second. Notice that five of the seven likely candidates are current or former Fed officials.



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Who will be the Senate-confirmed Treasury Secretary on Mar. 1?

Contract	Latest Yes Price		Best Offer			Best Offer
Lael Brainard	40¢	2¢ ▼	41¢	Buy Yes	Buy No	61¢
Janet Yellen	29¢	1¢ ▲	29¢	Buy Yes	Buy No	72¢
Steve Mnuchin	9¢	NC	10¢	Buy Yes	Buy No	91¢
Sarah Bloom Raskin	9¢	1¢ ▲	9¢	Buy Yes	Buy No	92¢
Raphael Bostic	5¢	NC	6¢	Buy Yes	Buy No	96¢
Roger Ferguson	5¢	1¢ ▼	6¢	Buy Yes	Buy No	95¢
Elizabeth Warren	4¢	NC	4¢	Buy Yes	Buy No	97¢

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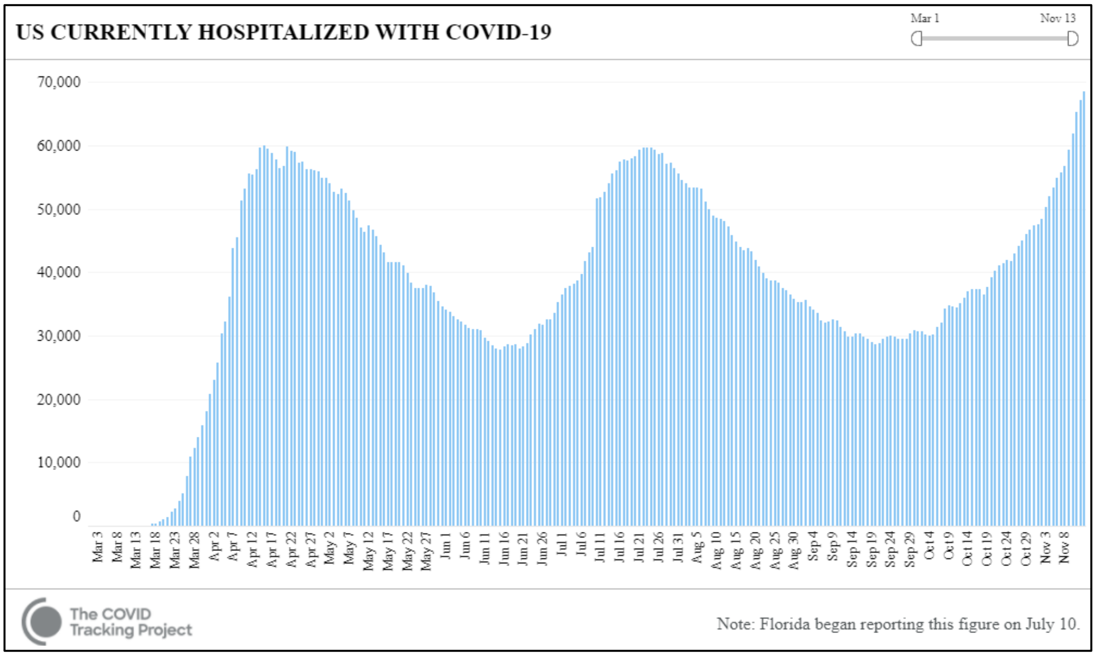
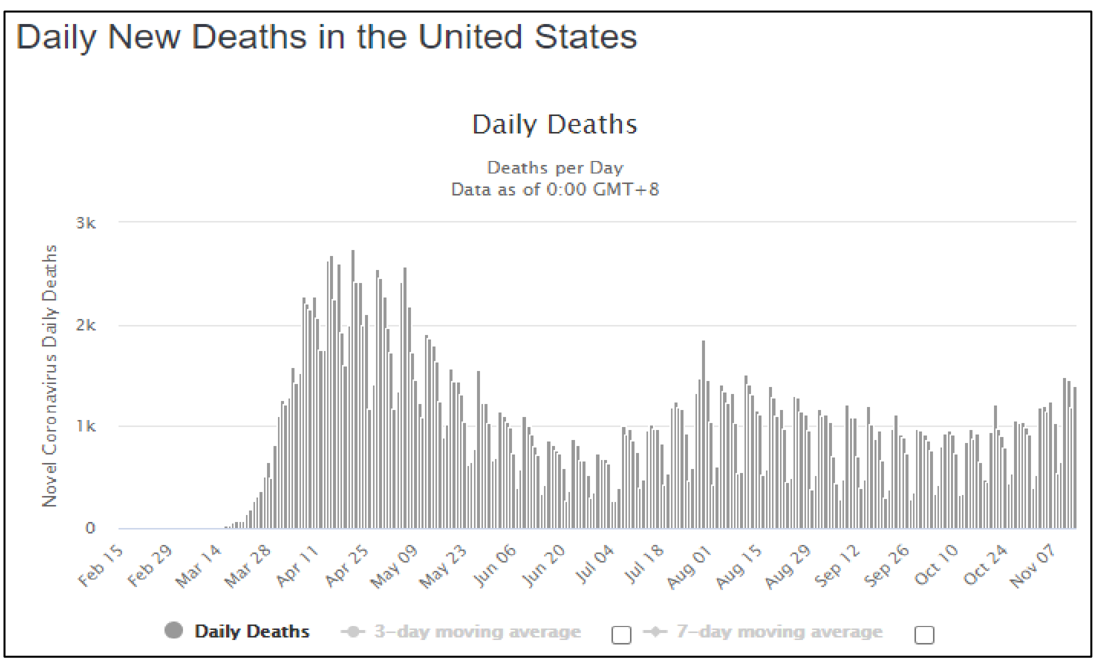
COVID and Markets

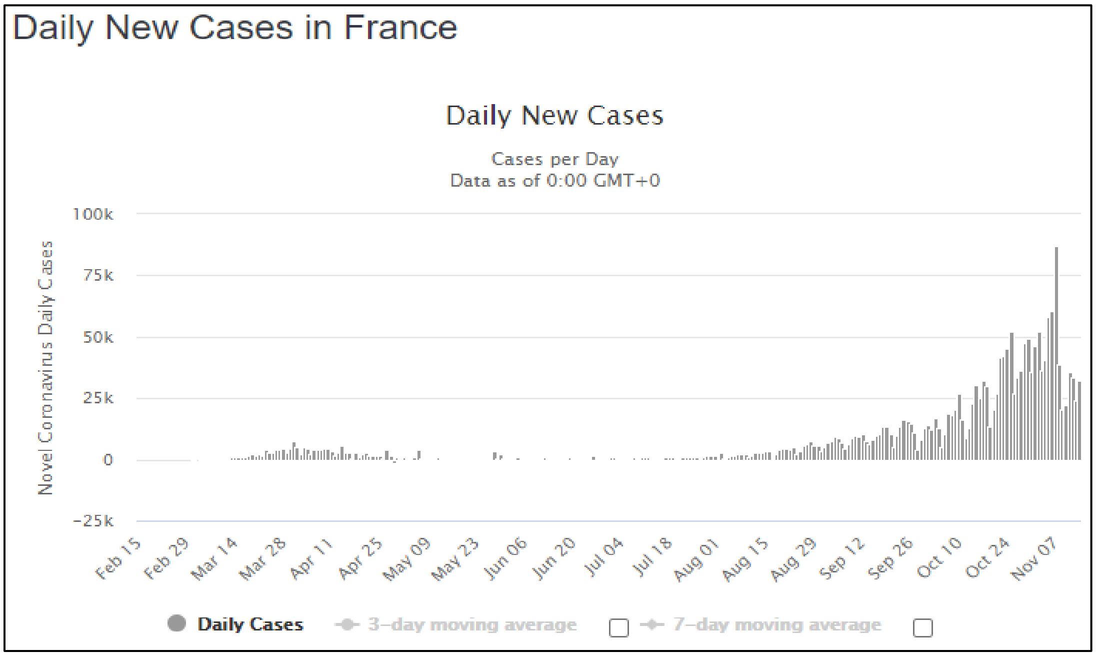
With hospitalizations hitting new highs for the pandemic during this third wave, both policy makers and markets are becoming increasingly nervous.



Deaths, while of course lagging, have been steadily rising but are not yet back at previous peaks.

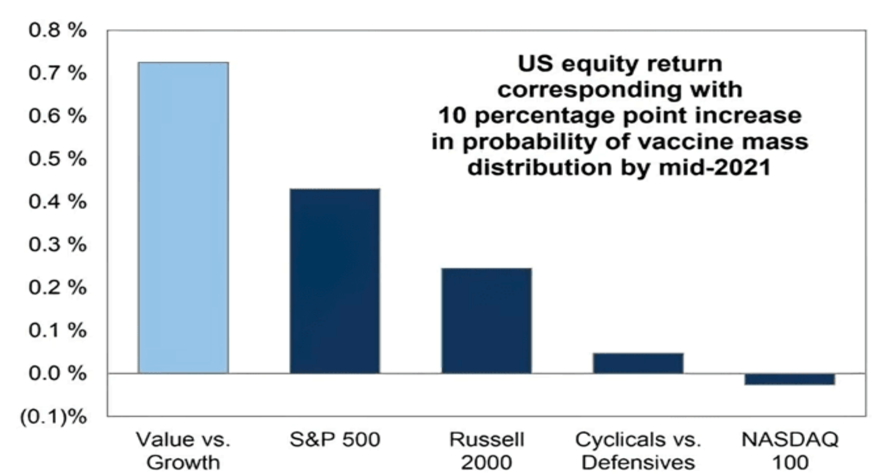


Europe, which again has been ahead of us in terms of the current wave, is now seeing signs of potentially peaking. Hopefully, the increased measures and caution will deliver similar results here in the coming weeks.



Coming on the heels of the Biden win, the vaccine announcement from Pfizer went off like a bomb in the markets. We saw rotation in equities in a few hours that would otherwise be expected to occur over weeks. A multiple sigma event that delivered the largest value outperformance day on record.

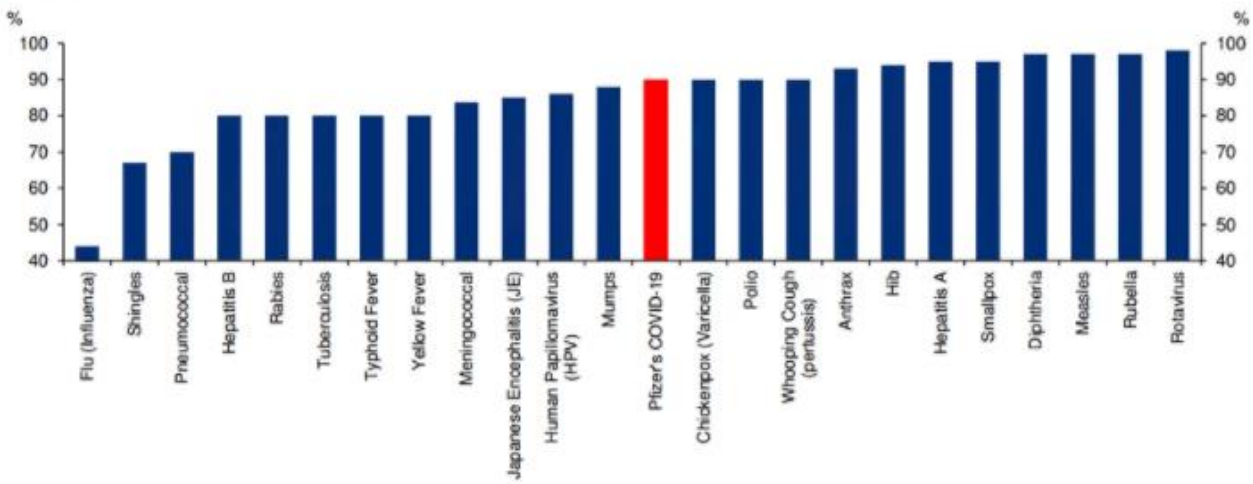
Exhibit 23: Value stocks have been particularly sensitive to vaccine expectations



Source: Goldman Sachs Global Investment Research

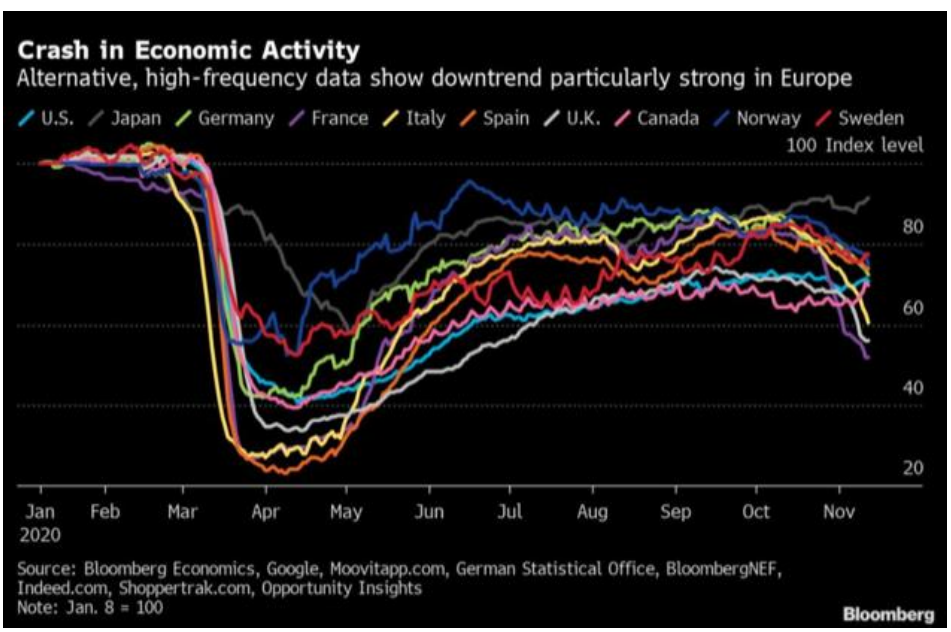
If current study results hold, this looks to be a big win in the ongoing battle against the virus. Potentially, we have more announcements to follow in the coming weeks as companies like Moderna and AstraZeneca report on their current trials.

Figure 1: Effectiveness of vaccines



Note: As the flu vaccine effectiveness varies significantly over time, we averaged the last 10 years. For the other vaccines, we took the most recent published data.
Source : CDC, NCBI, WHO, NHS, Deutsche Bank

However, investors are now faced with a tough decision. The longer-term prospects for an end to COVID have quickly improved, while the short-term risks to the economy from the current outbreak have dramatically increased. The current virus resurgence has quickly slowed activity in Europe. The US is bound to follow to some degree.

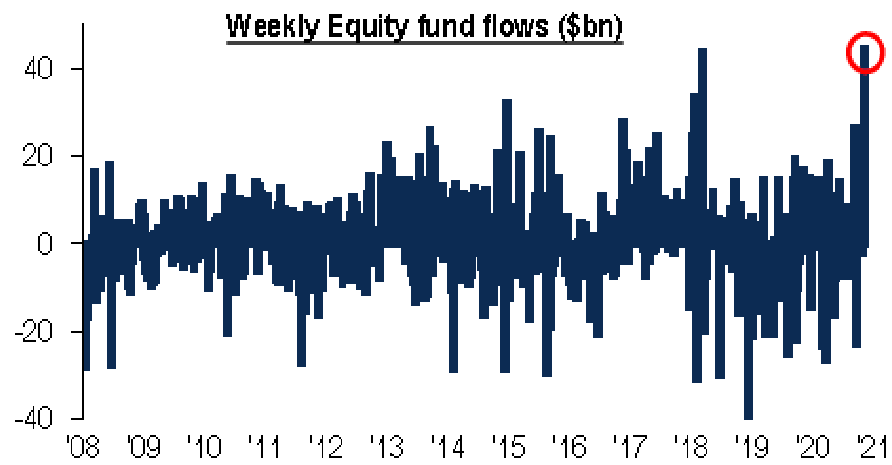


At this point the two unexpected outcomes would be: 1) the current wave is much worse than expected and lasts longer. 2) other vaccine announcements come close on the heals of Pfizer and due to pre-approval production, we suddenly have a lot more vaccine availability in the near-term than expected. It is 2020 so don't discount the tail outcomes.

Last week, flows and performance certainly seem to indicate that markets are optimistic that the double whammy of receding political uncertainty and light at the end of the COVID tunnel are enough to look through the near-term fog.

The result was a massive inflow into global equities last week, amounting to $44.5bln.

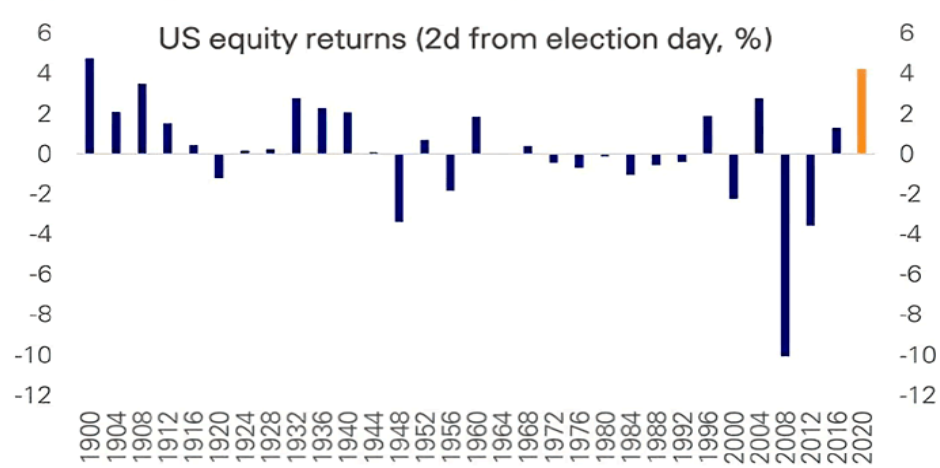
Chart 4: Largest week ever of global equity Inflows



Source: BofA Global Investment Strategy, EPFR

Which helped generate the largest 2-day post US election pop since… well pretty much ever.

Figure 2: Largest 2-day post US election equity bounce since 1900



Note: Returns calculated using DJIA prior to 1932 and using S&P 500 since
Source :Bloomberg Finance LP, Deutsche Bank Asset Allocation

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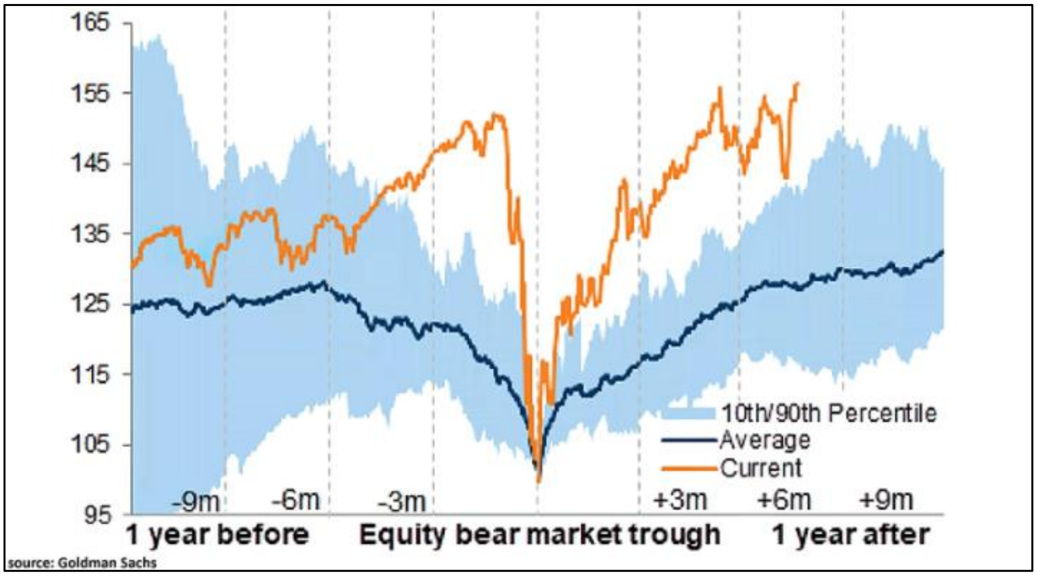
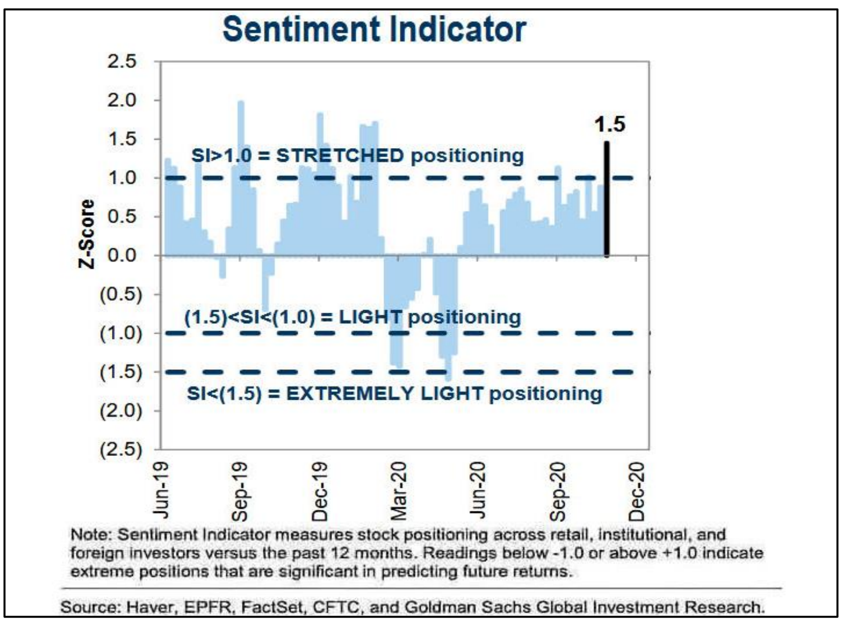
2020 continues to add to the list of biggest this or that ever… and there are still 6 weeks to go.

Here is an illustration of what a “normal” bear market and recovery look like vs. current.



Extremes continue to pop up.

With the recent rally, sentiment is now again very bullish as you might expect.



Of course, big cap technology has until now led global equity markets. If last week finally kicked off the start of the big rotation, there is plenty of room to go.

Chart 7: Five largest stocks = one fifth of the S&P 500

Source: BofA Research Investment Committee, Bloomberg

Asset prices are already expensive overall, which I think supports the idea of buying those that are beaten down and would benefit the most from a turn towards better global growth and recovery.

Chart 7: Global (equity + bond) total returns relative to GDP hit a new high this month

Source: BofA Global Research, ICE Data Indices LLC, Bloomberg, IMF. Total return for GFIM index rebalanced to 100 as of 01/01/98.Total return index net of dividends for MXWD index rebalanced as of 01/01/98.

Valuations are high but hard to trade on in real-time. Is this enough? Does everything need to get to the 100th %ile? No way to know, but volatility should remain high.

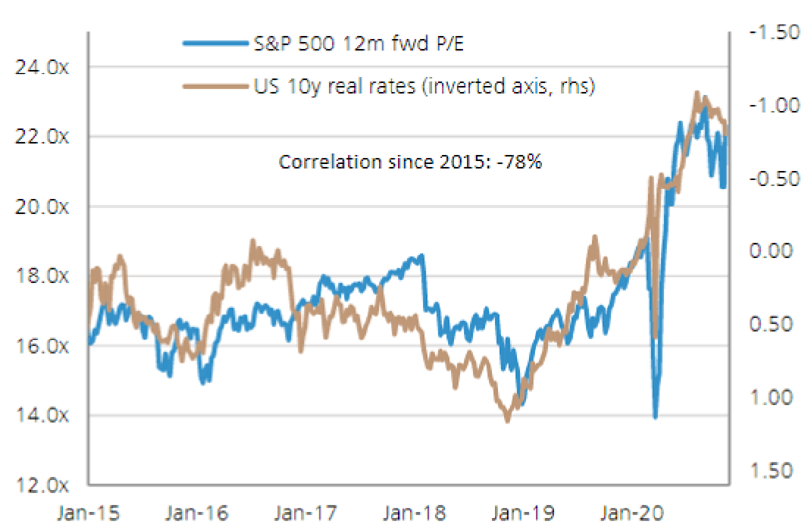
Exhibit 10: S&P 500 valuation versus history
As of November 9, 2020

	Aggregate index	
Valuation metric	**Current**	**Historical %ile**
US market cap / GDP	239 %	**100 %**
EV / sales	3.0 x	**100**
EV / EBITDA	15.9 x	**100**
Forward P/E	22.3 x	**96**
Cash flow yield (CFO)	6.1 %	**93**
Price / book	3.9 x	**92**
Cyclically adjusted P/E (CAPE)	29.0 x	**91**
Free cash flow yield	3.8 %	**60**
Yield gap vs. IG	273 bp	**46**
Yield gap vs. 10-year UST	381 bp	**37**
Median metric		**92 %**

Source: FactSet, Standard and Poor's, Goldman Sachs Global Investment Research

If we do get further large equity market gains from here, they may become self-limiting as they become increasingly likely to provoke higher taxes, higher inflation and potentially higher yields.

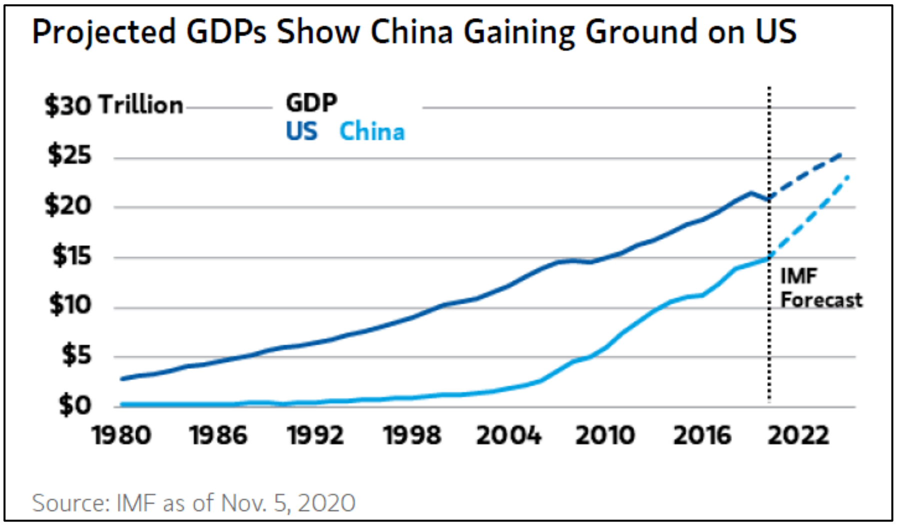
Figure 11: US 10y real yields and S&P 500 12m fwd P/E



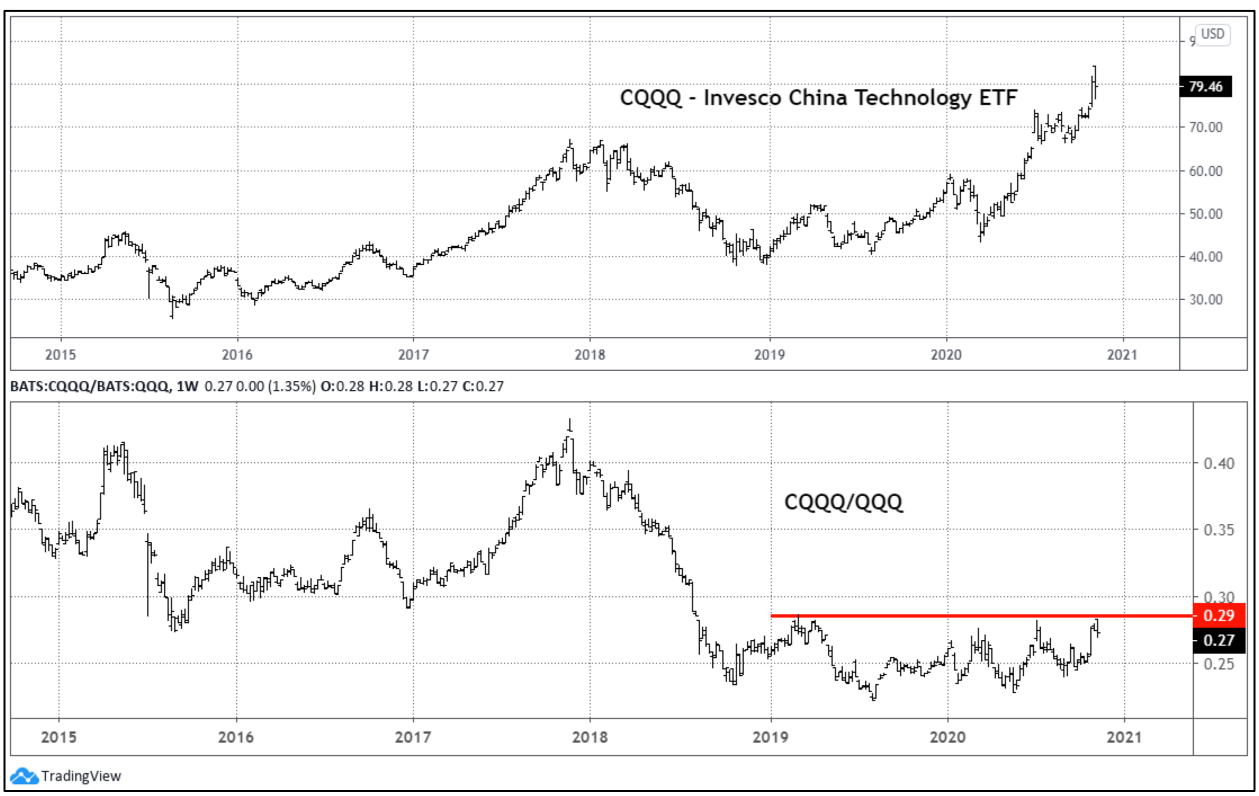
Source: Datastream, Bloomberg, UBS

China

Bridgewater's Dalio continues to bet on China's growing economic influence. There is little doubt that the trend toward economic power convergence has been part of the building stress in US/China relations.



Chinese equities have been rallying, and as in the US, have been led by technology. So far however, they have not been outperforming their US counterparts in the bigger picture.



While absolute performance gets the headlines, relative performance informs the asset allocation decisions. As a result, these charts are worth keeping an eye on.

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

US

Last election brought the hope of tax cuts and market friendly policies. This time, it is the potential for a vaccine and an end to the virus, more fiscal stimulus and lowered political tensions.

Back in 2016 the rebound in "value" vs. "growth" only lasted for a couple of months and was relatively small.

This time, the setup is arguably much better as we threaten a reversal from very rich relative performance.

The price action has been violent, and it has been hard to hold onto positions in the relative trades. Let's see where we are in the charts.

The "growth" vs. "value" trend has cracked. Whether the reversal takes on momentum will depend on whether markets can continue to look through the current virus resurgence or not.

The break in favor of the Russell looks more durable vs. the S&P.

The Russel vs. NDX moves this week have been huge, but barely look noticeable vs. the powerful trend we have seen.

Banks have been holding up well, but higher bond yields have been the driver.

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The dominance of big cap tech names has been doing most of the heavy lifting for the US market. Global equities ex-US have had a poor three years by comparison. However, last week's sudden lift and potential breakout are worth noting.

Europe - Last week brought some stunning European equity market performance. Even on a relative basis. Let's see if after some back and fill of the price action, it keeps going.

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Long suffering Spain had a big jump, but probably needs a rest even if this is the start of a new run higher. RSI readings like this usually yield at least a pause before we push on.

On a relative basis Spain is trying to bottom vs. the US as well, but still has some work to do.

Same story for Italy. If European growth ever does get off its back Italy and Spain have a lot of upside.

Japan – Big pop through all the resistance. Short-term overdone and expect some back and fill.

FX - With three and a half months of back and forth now, it is starting to smell like we could get a break soon. Again, it is back to the interplay between COVID resurgence and it's expected effects on growth now vs. going forward. Prices are sitting at big long-term levels. EM looks better vs. USD than DM.

Gold

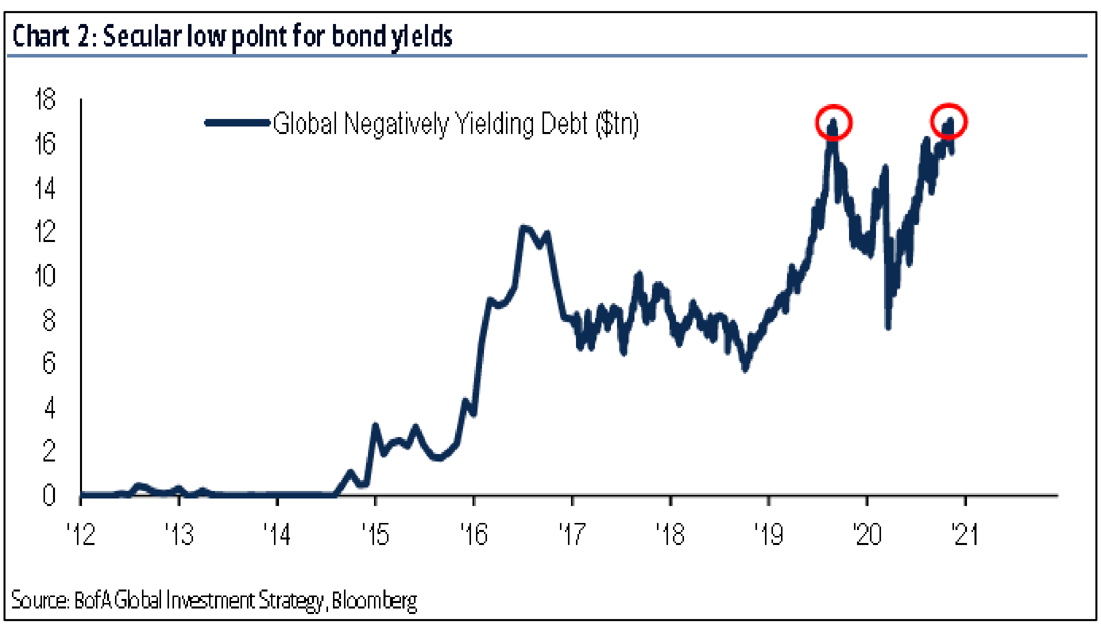
It was a wild week for Gold too as the break above 1935 failed when the vaccine news hit, and bond yields jumped. The subsequent move back down in bond yields and a bit of softening in the USD, didn't help all that much. Further softening of the USD should provide support, but with global stocks now in demand, it has tough competition.

Technicals for Gold are now a mess, and while there are potentially big fundamental triggers (like YCC and large fiscal spending) they are down the road.

The very tight relationship between Tech and Gold in a very low (negative) real rate environment is worth thinking about.

Basically, they are both being treated like perpetual zero yield bonds. Higher global bond yields would likely break this correlation.

But for now, the continued existence of things like $17Trl in global negative yielding debt are holding it in place.



Metals and Mining stocks are looking interesting here. With the additional industrial metals exposure, they are starting to break higher. Both on an absolute and relative basis.

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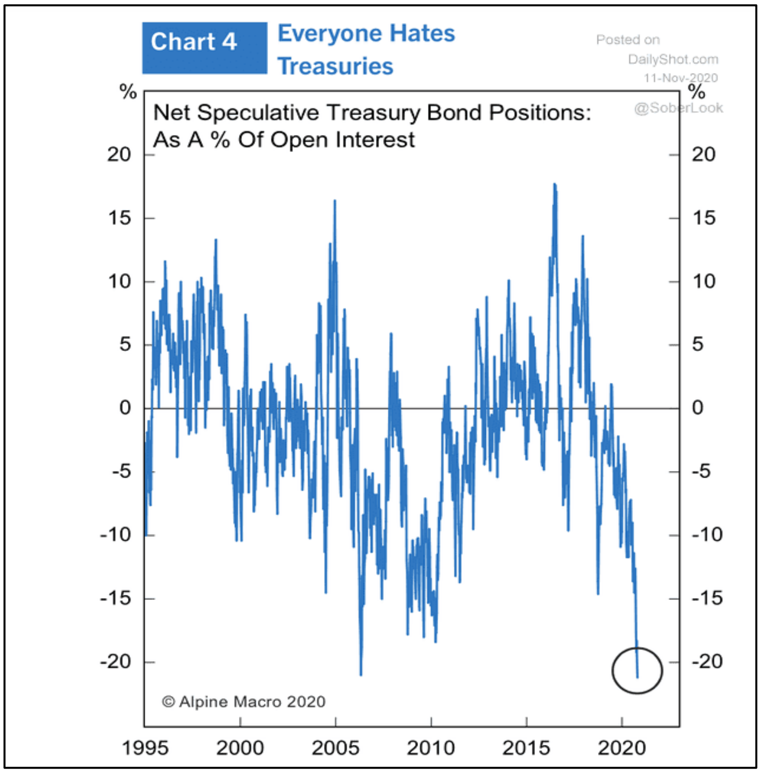
Bonds

We are at a big level for bond yields here. An early vaccine and the prospects for more stimulus and better growth are again weighed against near-term damage to the economy from the current COVID wave. The 2016 election was a catalyst… will 2020 be one as well?

Lots of reasons for bond yields not to rise. Positioning is cited as a headwind and looks extreme. Although some of this is likely to be via relative bets on other issuers and maturities, so it may be overstated.



Another reason is that the Fed doesn't want long yields to rise and at some point, will put its foot down. Yes, that is likely but could be a sequencing thing, i.e. they have to rise further before policy makers take a stand. As it looks now, they will increasingly be buying less of the total issuance. All the more reason to potentially step up QE if they can justify it.

Table 1: Treasury supply now much greater than Fed purchases

	Net Treasury Supply ($bn)	Fed Treasury Purchases ($bn)
3Q '20	504	233
4Q '20	625	237
1Q '21	597	240
2Q '21	618	240
3Q '21	572	240
4Q '21	584	240

Source: BofA Global Research, Federal Reserve

Still, even with all of the above, additional positive vaccine news could rock the boat in bonds. That in turn would further support the equity rotation story.

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Important Macro Data Releases and Events for the Week

Monday 11/16/2020	(Sunday Night) Retail Sales YoY (Oct) Forecast: 5%, Prior: 3.3%
	RBA Governor Lowe SPEECH
	Fed's Clarida SPEECH
Tuesday 11/17/2020	Retail Sales MoM (Oct) Forecast: 0.5%, Prior: 1.9%
	Retail Sales Control Group (Oct) Forecast: 0.5%, Prior: 1.4%
	BOE's Governor Bailey SPEECH
	Industrial Production MoM (Oct) Forecast: 1%, Prior: -0.6%
	Fed's Williams SPEECH
Wednesday 11/18/2020	CPI - Core YoY (Oct) Forecast: 0.2%, Prior: 0.2%
	CPI - Core MoM (Oct) Forecast: 0.2%, Prior: 0.1%
Thursday 11/19/2020	Philadelphia Fed Manufacturing Survey (Nov) Forecast: 24. Prior: 32.3
	Initial Jobless Claims Forecast: 707k, Prior: 709k
	Initial Jobless Claims 4-week ave. Forecast: - , Prior: 755.25k
	Continuing Jobless Claims Forecast: -, Prior: 6.786m
	Existing Home Sales MoM (Oct) Forecast: 6.45m, Prior: 6.54m
	G20 Meeting
	PBOC Interest Rate Decision

Friday 11/20/2020		German Buba President Weidman SPEECH
		Consumer Confidence (Nov) Forecast: -17.6, Prior: -15.5
		G20 Meeting

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