Stargazer Asset Management

What to focus on in Global Macro for the week of June 21st, 2021

Macro Themes on the Radar:

The Fed blinked

With inflation coming in way above their expectations in recent months, the Fed still thinks it is largely transitory but has also been forced to contemplate that some of the price rises could be sticky. As Powell said, *"shifts in demand can be large and rapid, and bottlenecks, hiring difficulties and other constraints could continue to limit how quickly supply can adjust -- raising the possibility that inflation could turn out to be higher and more persistent than we expect."*

The change in the inflation trajectory has been so large that they had to acknowledge it. At this point, everyone knows they brought forward expectations for rate lift-off and that they have started talking about tapering the asset purchases, so I'll keep it short. Given that both Powell, and subsequently Bullard, talked about discussing taper at future meetings (plural), September looks like the earliest we get the actual announcement. However, that wasn't really a surprise to the markets. If anything, it pushes it back slightly as many have been eyeing the August Jackson Hole meeting as a potential forum for the announcement. Was the move in the dots a surprise? It was, but it was also an acknowledgment, in my mind, that the forcast of no rate hikes until the end of 2023 was looking increasingly absurd. I think that the more hawkish tone, acknowledging a faster recovery this year and higher than expected inflation was also a hedge against getting better than expected employment numbers over the Summer on top of the already unexpectedly high inflation prints we have seen. The markets were increasingly being priced for a potentially irresponsibly dovish Fed; some of the air is now being released from that balloon.

Percent

Variable	Median[1]			
	2021	2022	2023	Longer run
Change in real GDP	7.0	3.3	2.4	1.8
March projection	6.5	3.3	2.2	1.8
Unemployment rate	4.5	3.8	3.5	4.0
March projection	4.5	3.9	3.5	4.0
PCE inflation	3.4	2.1	2.2	2.0
March projection	2.4	2.0	2.1	2.0
Core PCE inflation[4]	3.0	2.1	2.1	
March projection	2.2	2.0	2.1	

It is interesting to note that there were no big changes to the forecast other than the higher inflation surprises already baked in.

I guess to some extent that makes sense with an outcome-based framework.

It also leaves plenty of room for more hawkish surprises.

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After Powell, came the Bullard interview on CNBC. Rather than soften the hawkish message he repeated it, and that was more than markets could stomach.

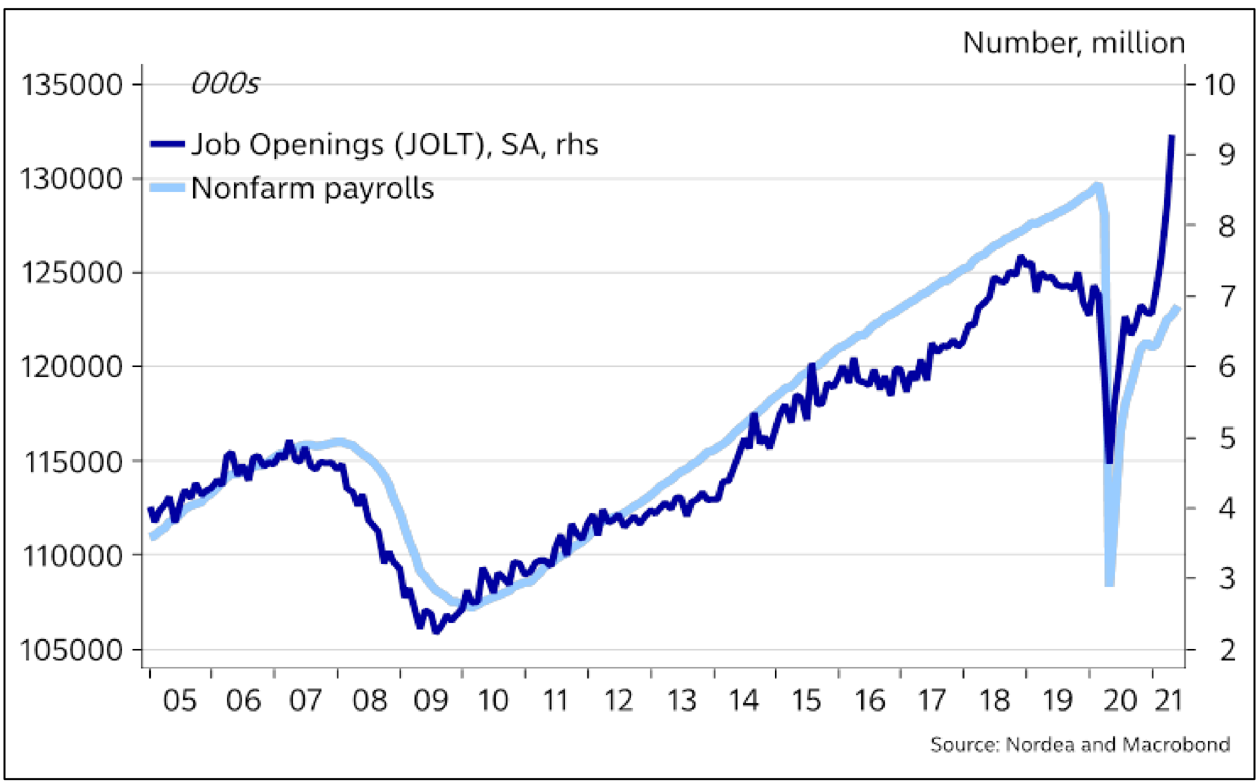
The more hawkish tone had big implications for the markets. Maybe they were exaggerated by the looming quarter and half-year end, and quadruple witching, but either way it was nasty.

The big flattener drove price action. With front-end yields jumping and long-end yields falling, the impact was felt across asset classes. The biggest positionings with the most direct link to the rates move were hit the hardest. There may well be more unwinds to come next week.

Further out, I am watching two things carefully:

With some States now ending the extra unemployment payments early, and the entire program due to end in September, do we get an increasingly powerful rebound in employment?

This chart is now well worn but still powerful… Either we get a strong rebound in labor market participation or else we need a big surge in wage growth to fill the job openings gap. Both scenarios sound potentially hawkish for the Fed going forward.



This next chart is an interesting one as well, and could also be titled “retail sales artificially high” I suppose. This has been a rare recession where retail sales went up, as government payments and a lack of “experiences” to spend money on conspired to concentrate spending and boost savings.

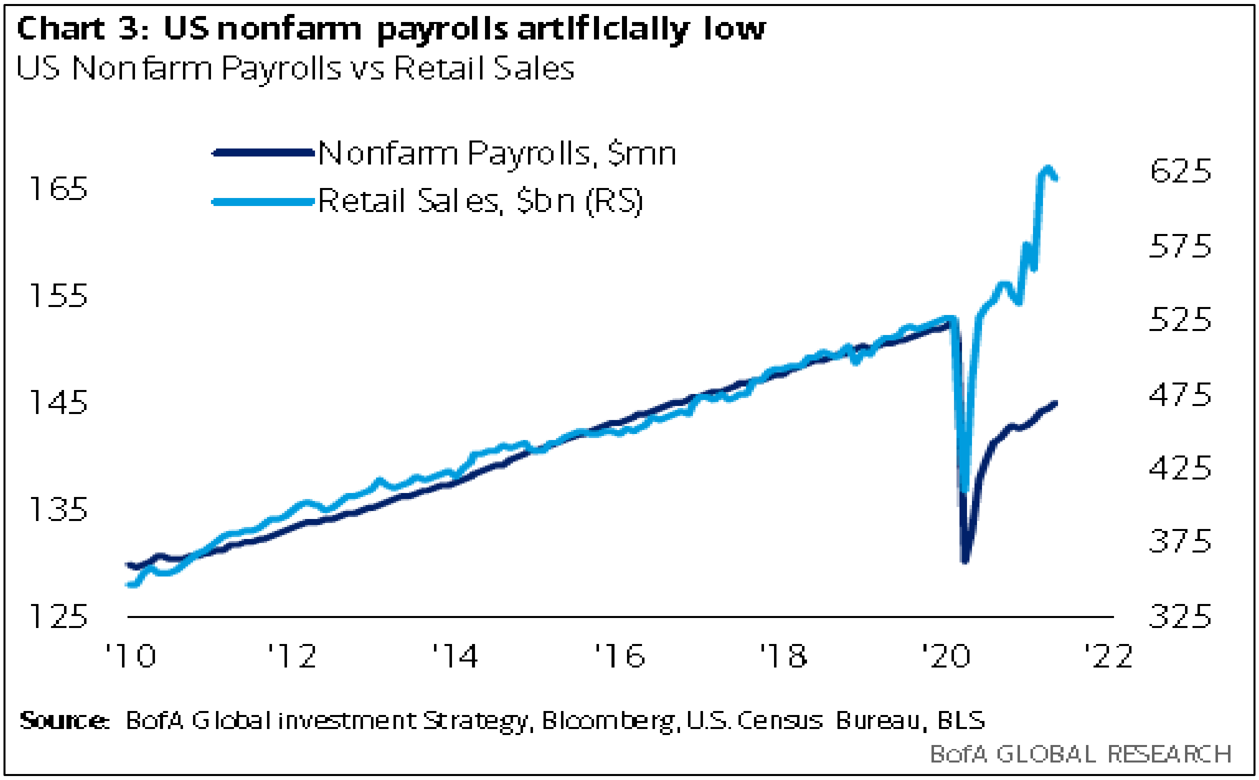


Chart 3: US nonfarm payrolls artificially low
US Nonfarm Payrolls vs Retail Sales
Source: BofA Global investment Strategy, Bloomberg, U.S. Census Bureau, BLS

One of the biggest questions going forward is to what extent consumers will spend the increased saving they have accumulated. Some research says that after pandemics and large shocks, households have historically tended to be more risk-averse and continue to hoard their cash. This question of excess savings vs. consumption is a big one for markets and the Fed. It is at the heart of the debate around r*, the real neutral rate. The higher the propensity of consumers to save, the lower the r*, and the lower the steady state of growth. A low r* would mean that when the Fed does hike it won't be able to hike much before it runs into a slowing economy.

Last week's Fed hawkishness led to lower long-end yields. That is very unusual given that they are not even close to starting the hiking cycle. This has people thinking about how low the real neutral rate actually is… this is going to be a hot topic if the flattening continues.

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

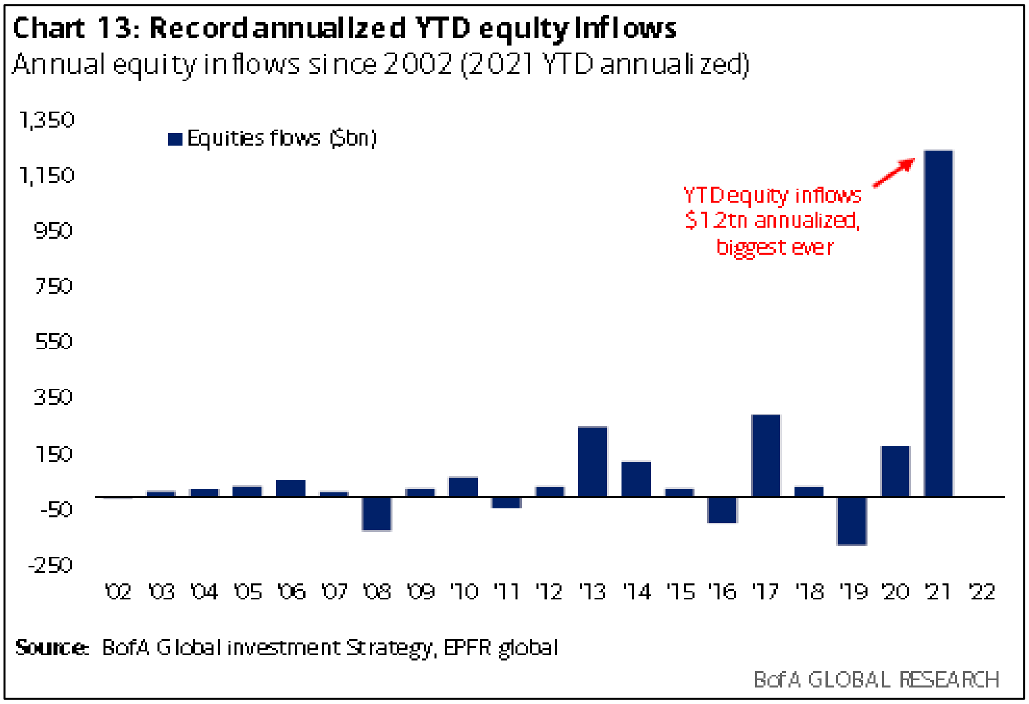
Equities

Heavily positioned trades and themes had a hard time last week as they got flushed.

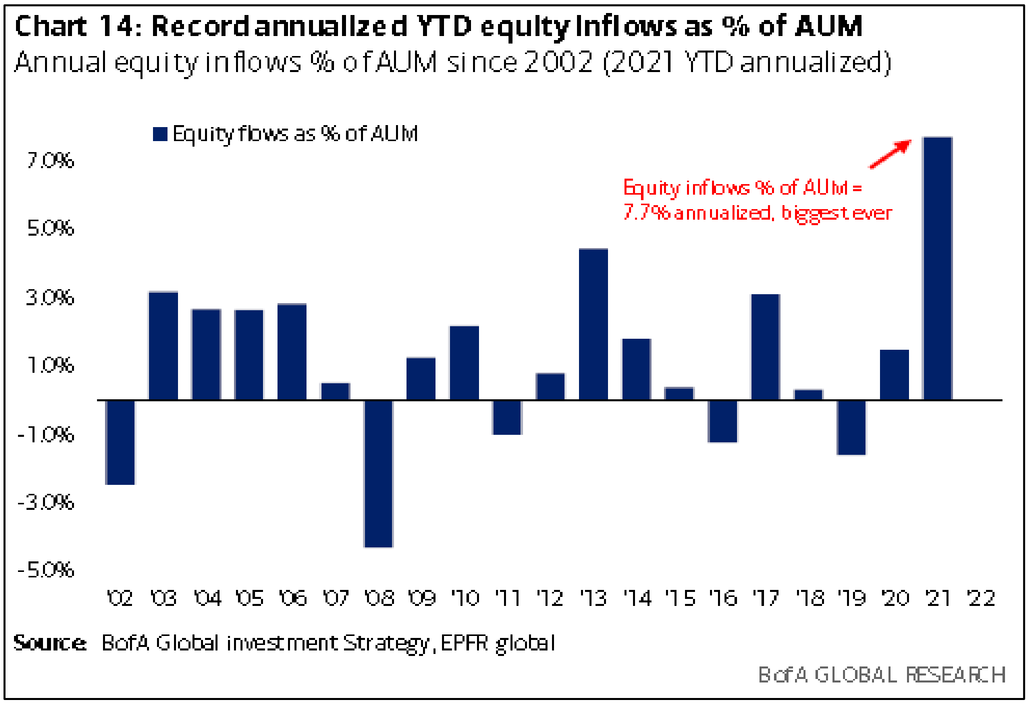
Recent outperformers and most inflation trades took it on the chin. The nasty price action did some damage as we ended the weak breaking some big uptrends and with a number of weekly reversals in various indices.

YTD equity flows have been dramatic, and all that positioning makes the price action extra twitchy.

In nominal terms, annualized…



and in % of AUM.

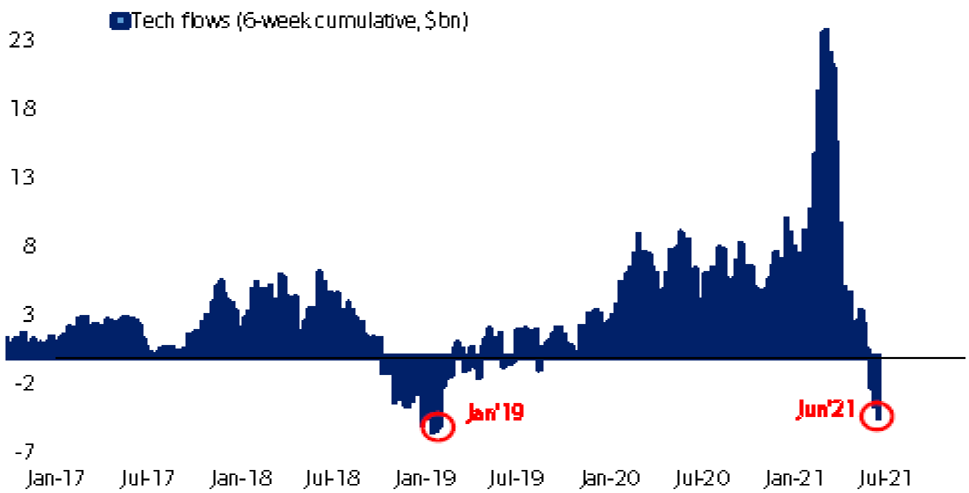


Industrials, which had been particularly strong recently and had become very overbought, saw a big break.

Financials had a tough week as well as the curve flattened.

Flows have been coming out of tech growth stocks as value and small caps were seen as more reflective of the narrative and with less duration.

Chart 12: Largest 6-week tech outflows since Jan'19
6-week cumulative flows to tech stocks ($bn)



Source: BofA Global Investment Strategy, EPFR global

BofA GLOBAL RESEARCH

However, this week's curve flattener caused the NASDAQ to break higher vs. the Russell. Looks like there is more to come…

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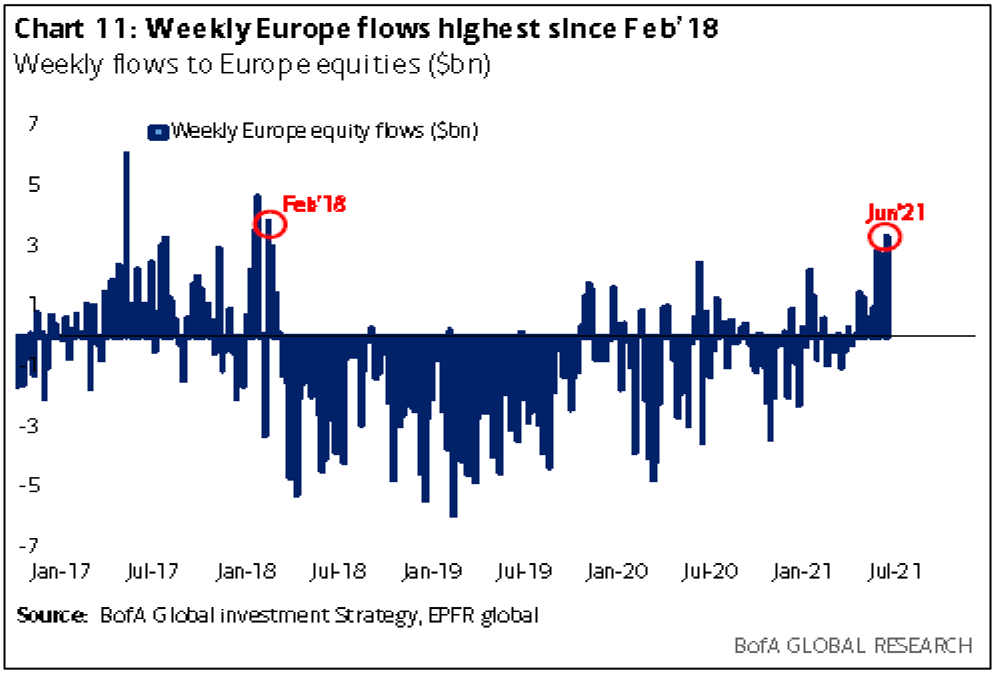
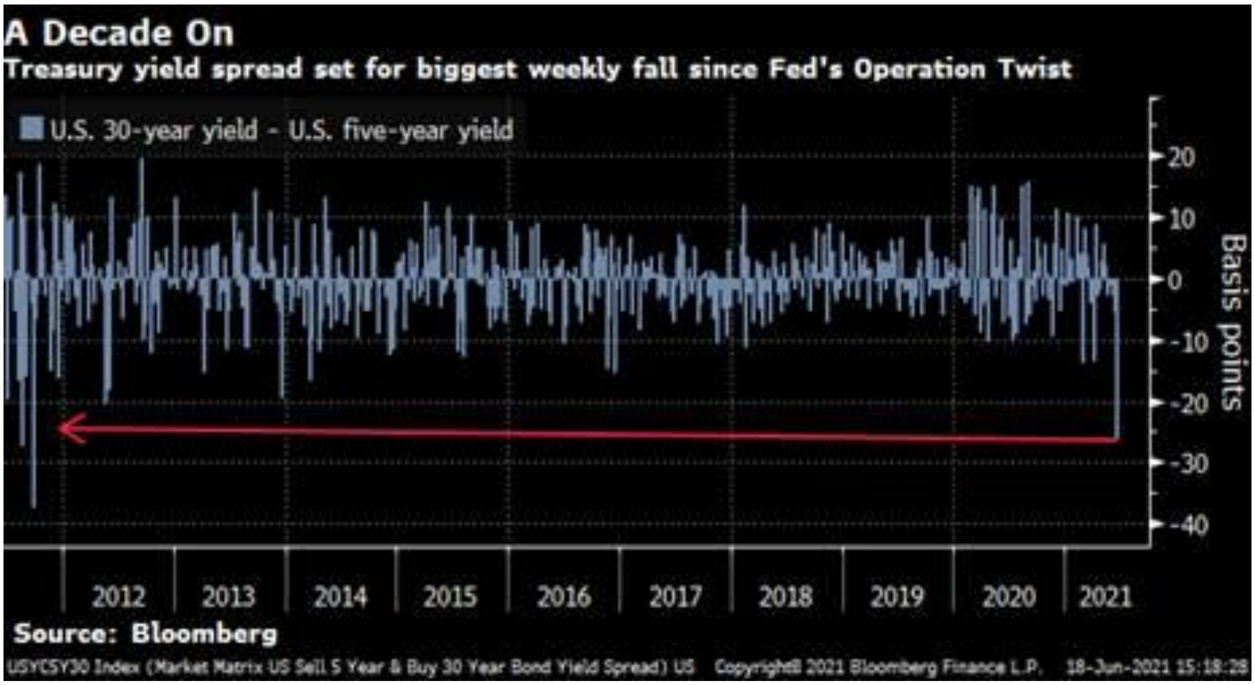
Europe has been the beneficiary of inflows and with positioning now higher than it has been for a while, didn't escape the late week carnage either.



So far, EM has held up relatively well as the drop in bond yields has partially canceled out the rising dollar. We will see if the USD move continues, if so, it will be a problem for EM.

Bonds

The unusual flattening of the yield curve at this point in the cycle has been dramatic.

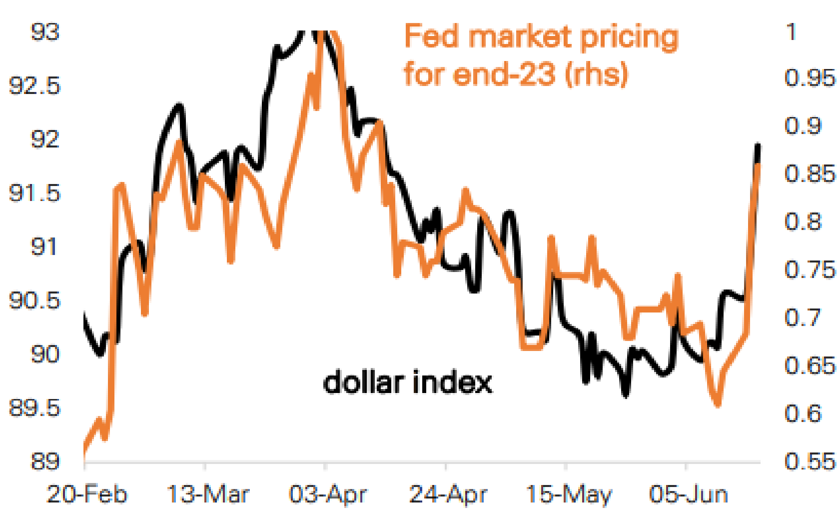


Nominal 30-year yields broke down in their own right.

This price action and how it interacts with the USD will be key to watch next week. We have a number of US Treasury sales that will be interesting to see: $60bn in 2Y, $61bn in 5Y, $62bn in 7Y.

FX

Figure 1: Dollar showing its expected responsiveness to front-end rates



Source : Deutsche Bank, Bloomberg Finance LP

The big rally in the USD looks consistent with the jump in front-end real rates.

For the moment at least it is the adjustment in relative tightening expectations rather than long end yields that continues to drive the USD.

Well, that and positioning, which was meaningfully short USD vs. DM.

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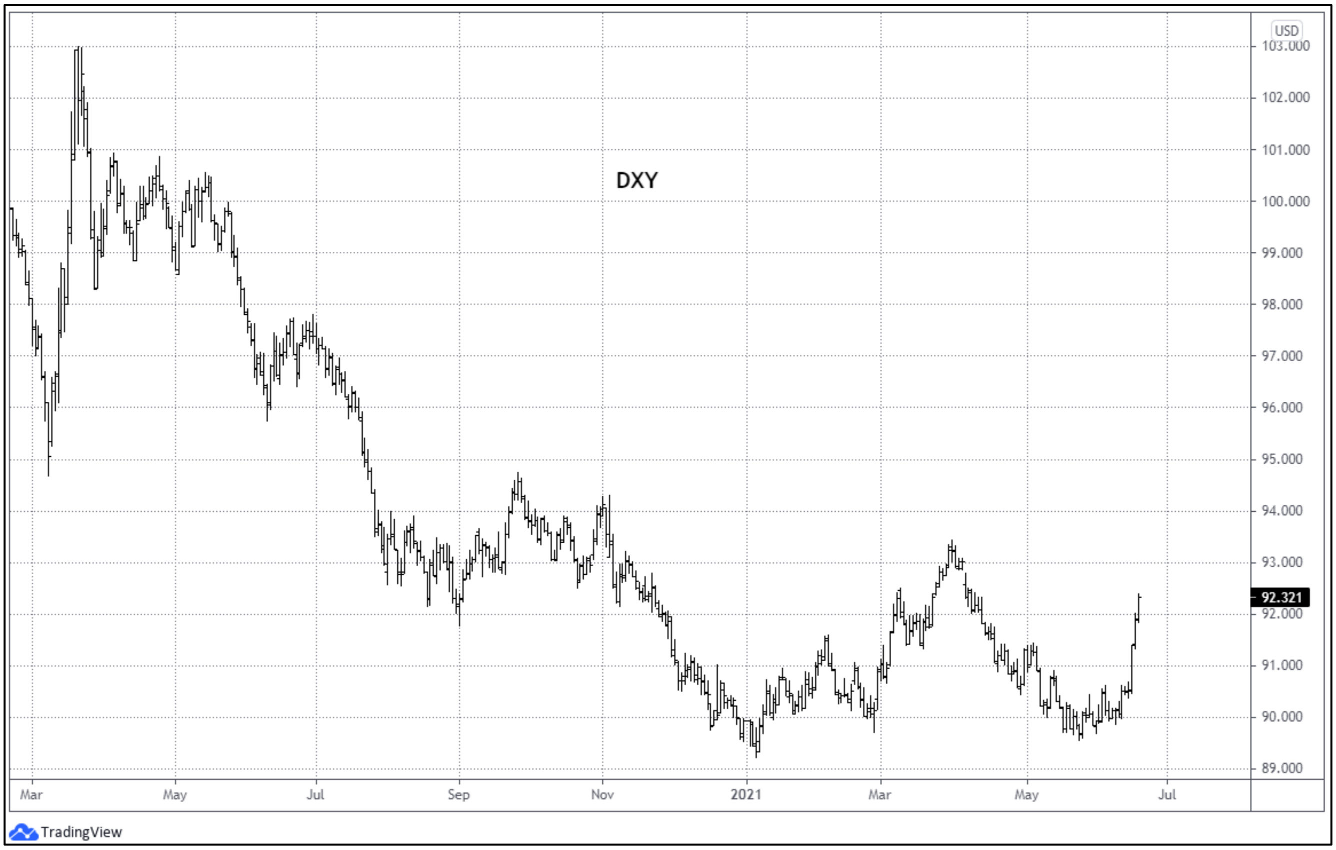
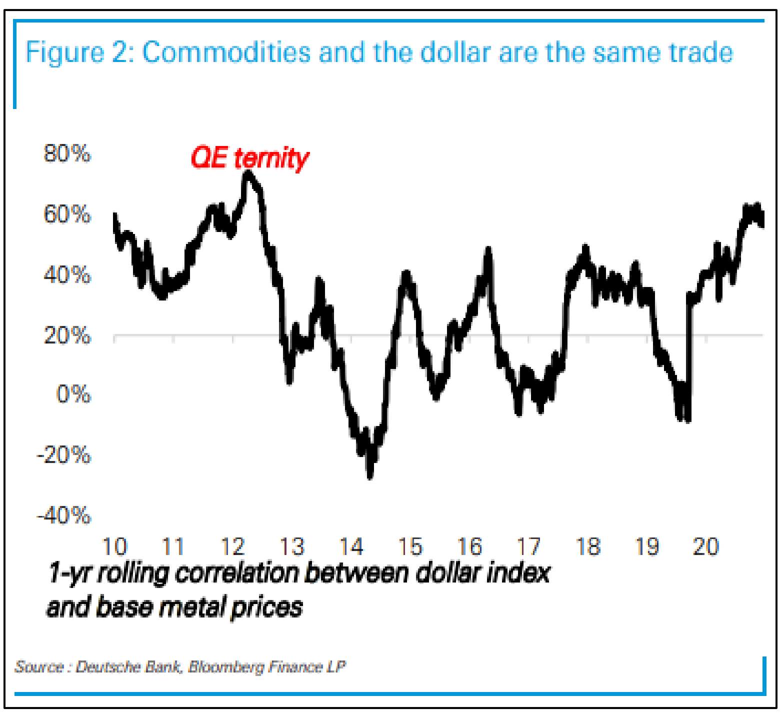


Commodities



We have seen broadening weakness in commodities as they have recently stalled after big rallies. Lumber for example is now already 50% off its highs. Softs and industrial metals have come of the boil as well.

With a shift in the dollar, it is always worth remembering the virtuous and vicious cycles that the dollar and commodities tend to experience as they feed off each other's price action. This goes to highlight the leveraged power the Fed can have over inflation via the USD/Commodity channel.

Copper, which had stalled recently broke down last week. More USD strength will not help.

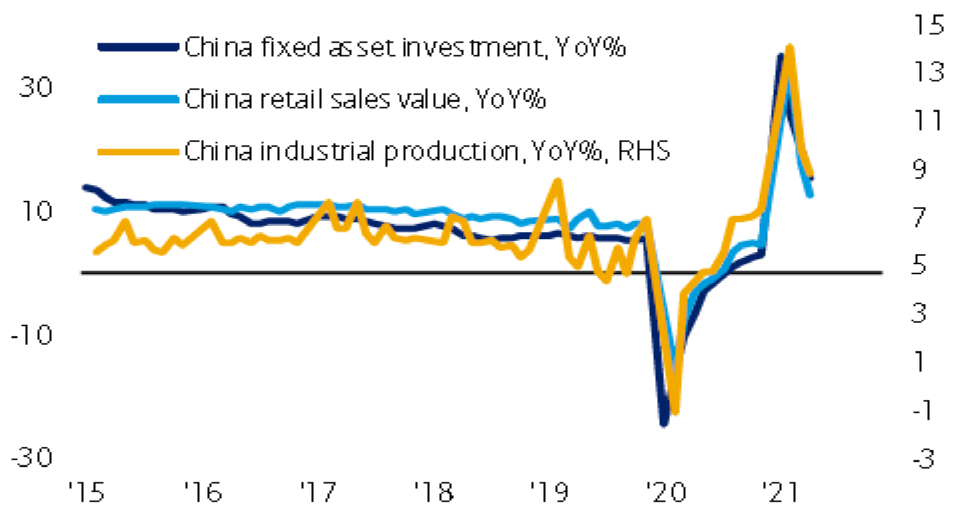
Gold had a very tough week as higher front-end yields and a rising USD took it back through the 1840 level and triggered a deluge of stops.

In the other column…

Need to keep an eye on China's growth given its sway on global GDP.

Chart 7: China economy has slowed

Indicators of Chinese economic growth slowing



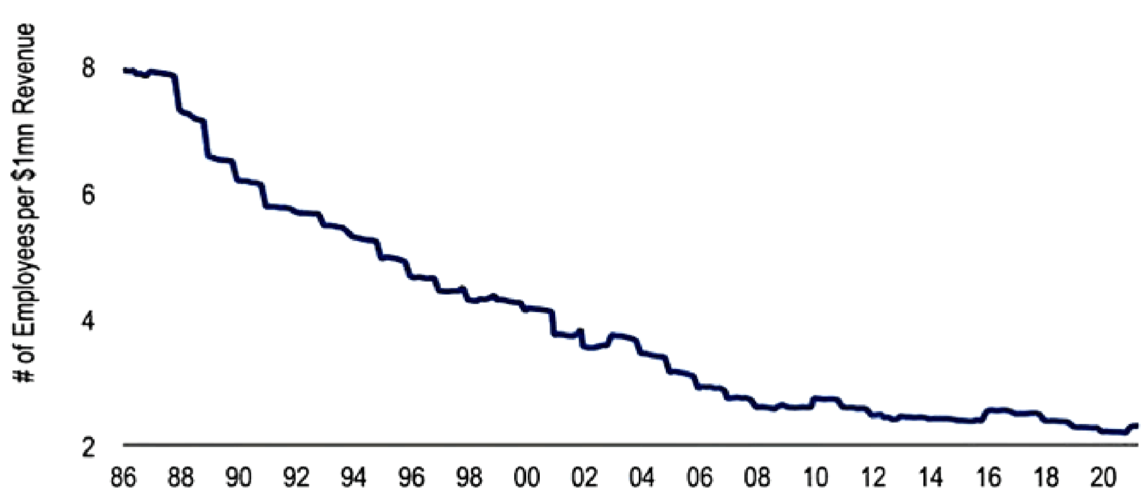
Source: BofA Global Investment Strategy, Bloomberg, National Bureau of Statistics of China

BofA GLOBAL RESEARCH

S&P500 Labor Intensity: According to BoA research - "In 1986, it took 8 employees to generate US$1 million in revenue. Today, the S&P 500 is 70% less labor intensive than it was in the 80s". There are probably numerous factors contributing here, including technology and outsourcing etc., but still interesting.

Exhibit 10: S&P 500 is 70% less labor intensive than it was in the 80s

S&P 500 total # of employees to total revenues ratio



Source: BofA Global Research

Stargazer
Asset Management

A much quieter week ahead now that the Fed is behind us. However, there are still some key events to watch out for, including the release of the flash PMIs on Wednesday, the Bank of England meeting on Thursday, and speeches by various central bankers including Fed Chair Powell and ECB President Lagarde.

Important Macro Data Releases and Events for the Week

Monday
6/21/2021

- PBoC Interest Rate Decision (Sunday Night ET)
- Chicago Fed National Activity Index (May) Forecast: -, Previous 0.24
- ECB's President Lagarde speech
- Fed's Williams speech

Tuesday
6/22/2021

- Consumer Confidence (Jun) Forecast: -2.9, Prior: -5.1
- ECB's Lane speech
- ECB's Schnabel speech
- **Fed's Chair Powell testifies**

Wednesday
6/23/2021

- **Markit Flash PMI's across Europe**
- ECB's De Guinos speech
- Retail Sales MoM (Apr) Forecast: -5.1%, Prior: 3.6%
- Fed's Bowman speech
- **Markit Manufacturing PMI (Jun) Forecast: 61.5, Prior: 62.1**
- **Markit Service PMI (Jun) Forecast: 70, Prior: 70.4**
- **Markit PMI Composite (Jun) Forecast: -, Prior: 68.7**
- ECB's President Lagarde speech
- Fed's Rosengren speech

European Council Meeting

Thursday
6/24/2021

BoJ's Governor Kuroda speech

IFO Surveys

BoE Interest Rate Decision and Monetary Policy Summary

Initial Jobless Claims Forecast: 380k, Prior: 412k

Initial Jobless Claims 4-week average Forecast: -, Prior: 395k

Continuing Jobless Claims -, Prior: 3.518M

Durable Goods Orders (May) Forecast: 1.9%, Prior: -1.3%

Nondefense Capital Goods Orders ex Aircraft (May) Forecast: -, Prior: 2.2%

GDP Annualized (Q1) Forecast: 6.4, Prior: 6.4

Core PCE Expenditures QoQ (Q1) Forecast: 2.5%, Prior: 2.5%

PCE Prices QoQ (Q1) Forecast: -, Prior: 3.7%

Fed's Williams speech

European Council Meeting

Friday
6/25/2021

Personal Income MoM (May) Forecast: -2%, -13.1%

Personal Spending MoM (May) Forecast: 0.4%, Prior: 0.5%

Core PCE - Price Index MoM (May) Forecast: 0.6%, Prior 0.7%

Core PCE - Price Index YoY (May) Forecast: 3.5%, Prior 3.1%

Michigan Consumer Sentiment Index (Jun) Forecast: 86.4, Prior: 86.4

Fed's Rosengren speech

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