What to focus on in Global Macro for the week of February 21st, 2022

Macro Themes on the Radar:

As expected, last week was all about ongoing Russia/Ukraine tensions. On Friday, things were looking dire, and expectations for war were running high. After Sunday's Macron/Putin call the French put out a statement that progress had been made and that assurances had been given by Putin. The only problem is that they had a similar exchange on February 8th that yielded nothing in the end. That time Macron offered nothing, this time he is offering a "new order of peace and security in Europe". In any case, it is interesting that the US is being totally sidelined in this French initiative.

From Russia Today (RT):

"Russian President Vladimir Putin and his French counterpart Emmanuel Macron have agreed to take urgent measures to halt escalation of conflict in eastern Ukraine, the Elysee Palace said in a statement.

During their Sunday phone conversation requested by Paris, the leaders agreed to resume work within the framework of the Normandy format, which consists of French, German, Russian, and Ukrainian leadership. It was also decided that a meeting of the trilateral contact group would be held "in the next few hours" in order to "obtain a commitment from all the stakeholders" to cease fire on the line of contact.

A meeting between French and Russian ministers of foreign affairs, Jean-Yves Le Drian and Sergey Lavrov, would take place "in the coming days," with diplomatic work due to intensify in general, Paris said. Russia's Foreign Ministry later told RT that the call is planned for Monday, since Le Drian was not immediately available.

According to the French presidency, it would involve all the stakeholders, i.e. the Europeans, allies, Russians, and Ukrainians, and would be poised, subject to conditions met, to make possible "a meeting at the highest level to define a new order of peace and security in Europe."

The Kremlin confirmed that "the two leaders agreed to maintain contact at various levels," but did not provide any specific details on such plans."

Geopolitics aside, last week saw a number of Fed speakers pushing back on the need/likelihood of a 50bp hike at the March meeting, while at the same time, sell-side economists and strategists were falling over themselves to roll out more-and-more aggressive hiking expectations. JPM made the news by calling for a hike at the next 9 consecutive FOMC meetings. I doubt that call will age well.

The Fed minutes were not very revealing, as there was no explicit discussion of when they might begin balance sheet runoff, or of the idea of a 50bp hike in March. Arguably, the minutes were a bit less hawkish than expectations, but remember that this meeting preceded the worse than expected inflation and wage data released since then, and as such, may not reflect current thinking. Recent Fed speakers have developed a real sense of urgency.

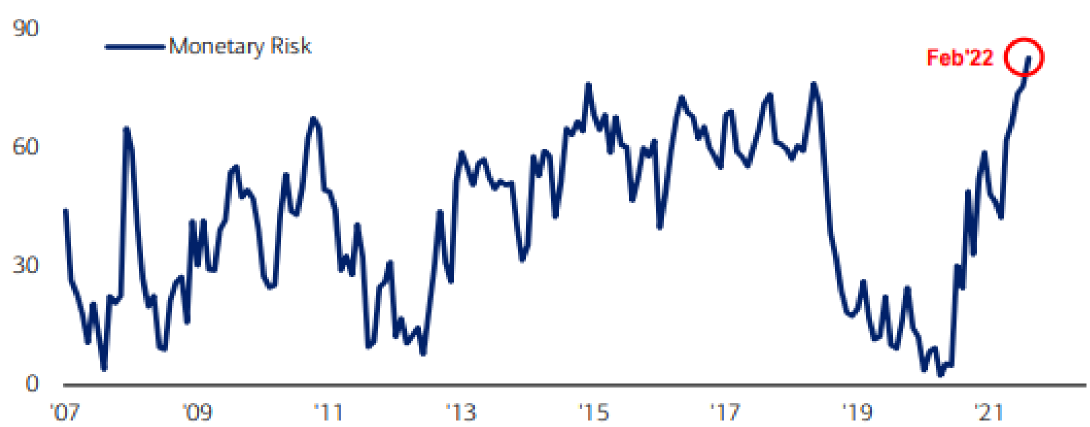
There are a lot of Fed hikes now priced by the markets. I would argue, probably too many. However, one big factor that remains unknown, is how aggressive the Fed will end up being with the balance sheet reductions.

In a somewhat out of character note on Friday, the now well-known Credit Suisse strategist Zoltan Pozsar summed up the Fed's problem well… *"how to curb inflation without a recession, in a socially just manner where the political goal is redistribution through preserving wage growth at the bottom and the monetary goal is curbing service inflation by deflating asset prices at the top end of the income distribution."*

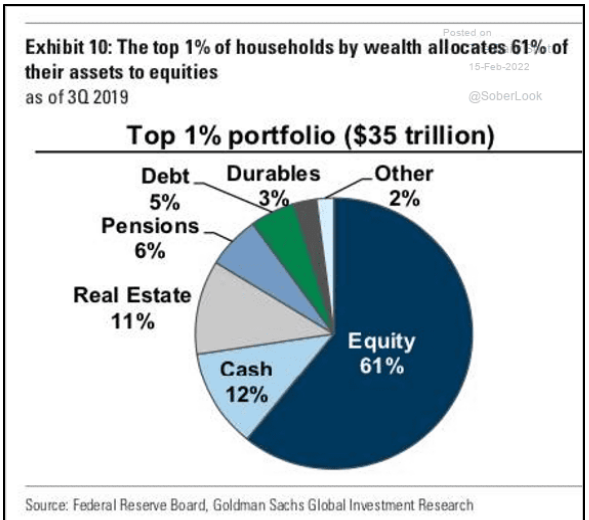
That potentially leaves them with a "socially just" version of their dual mandate. He goes on to argue that the logical step, given the above, is not only to engage in QT, but to go from passive QT to active QT. Given the vagaries around how any form of QT will play out, and that they have only done it once before (markets quickly became more volatile), that may be a bridge too far at this point. In fact, the Fed has expressly said that interest rates remain the main policy tool and that they would likely do QT in a measured and systematic way. My point, however, is not that the Fed is currently embracing the idea of upgrading QT as a policy tool, but rather, that the market continues to think about that possibility, and the need to be alert to even small moves in that direction as they could have quick and meaningful consequences for prices.

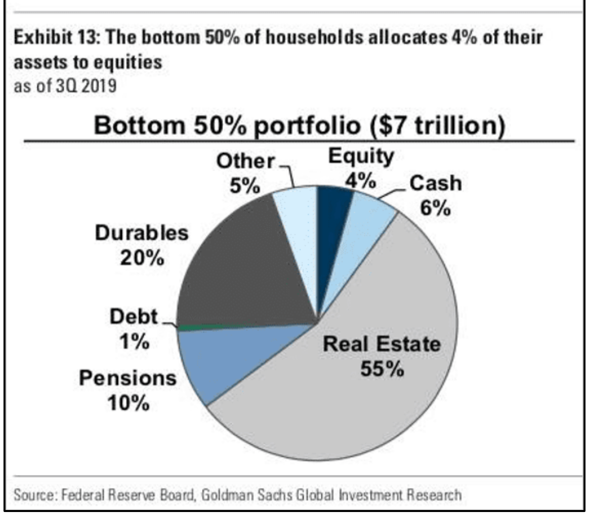
Investors are keenly aware that given the background of high inflation and high market valuations, the landing strip for a "soft-landing" by the Fed is very narrow.

Chart 11: Monetary risk now at the highest level ever
Net % that monetary risk to be above normal



Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH





One can see how the ability to minimize rate increases by deploying QT more aggressively could be enticing.

The wealth effect produced by rising and falling asset prices has always been a major consideration for Fed policy, but especially since the late '90's.

However, the wealth effect is generated by different asset classes, in different types of households.

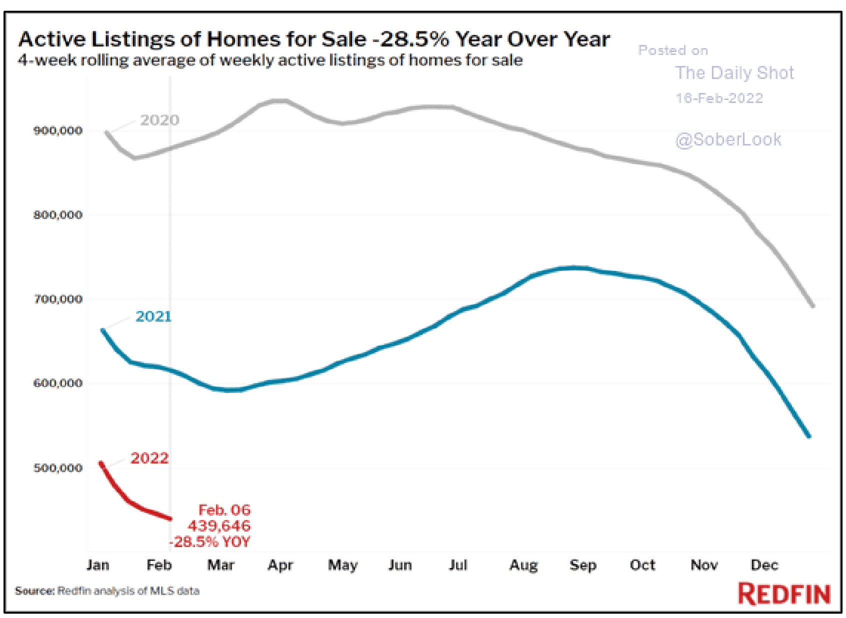
The wealthy have large exposure to equities, while the less well-off, have a much larger proportion of their wealth in real estate.

Since the March 2020 lows, both equities and real estate have had incredible runs. Good news for all households.

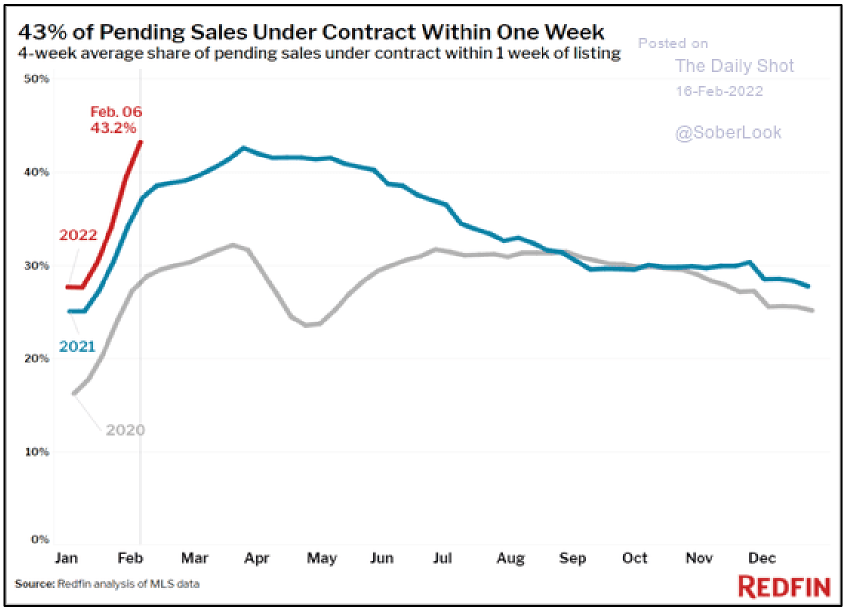
However, and this goes back to the socially acceptable outcomes, it might be easier to let some air out of equities than to ramp rates too much and deflate the real economy too quickly.

Real estate has certainly been hot.

Inventories are very low…

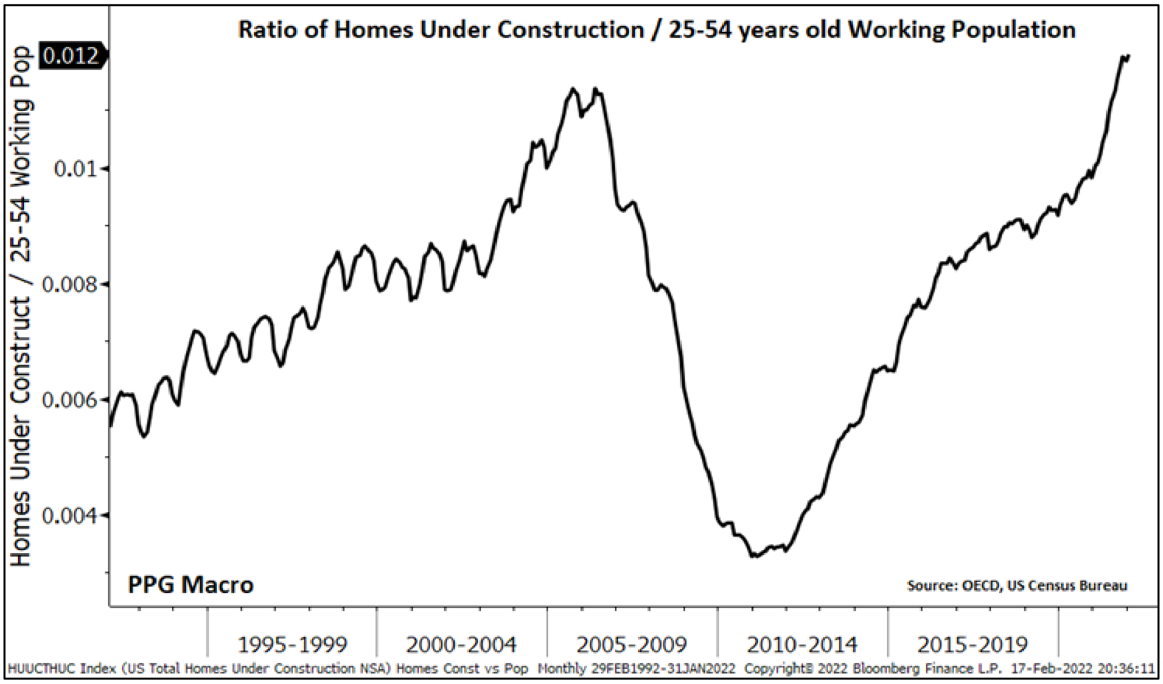


What there is for sale, is being bought up at a record pace.



Mortgage rates have seen a big jump since the start of the year.

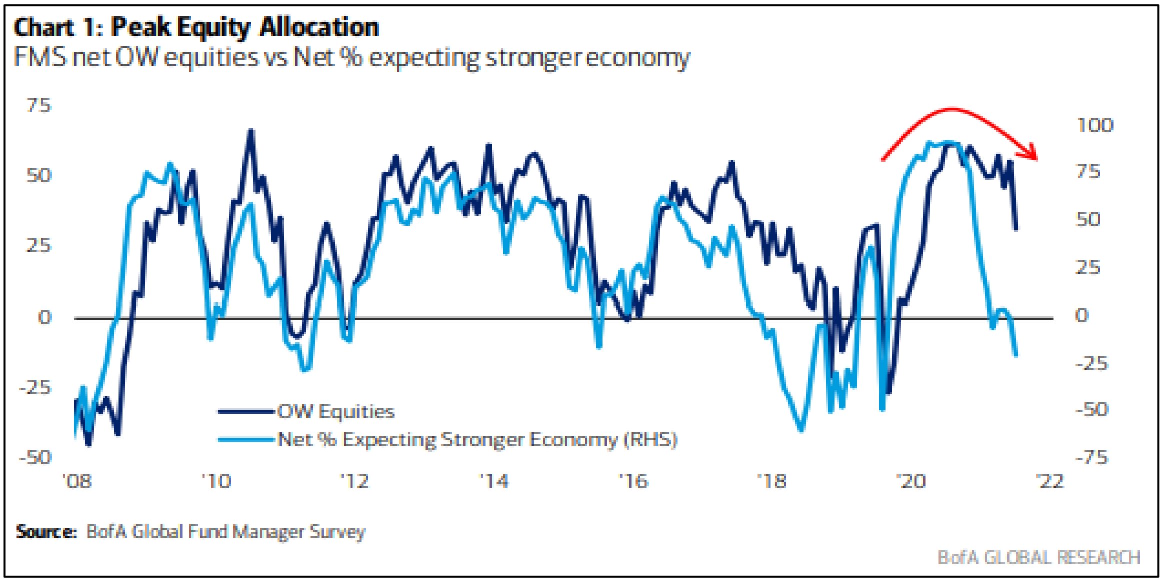
The combination of higher financing costs and a looming wave of supply should start to cool this market, at least in some areas.



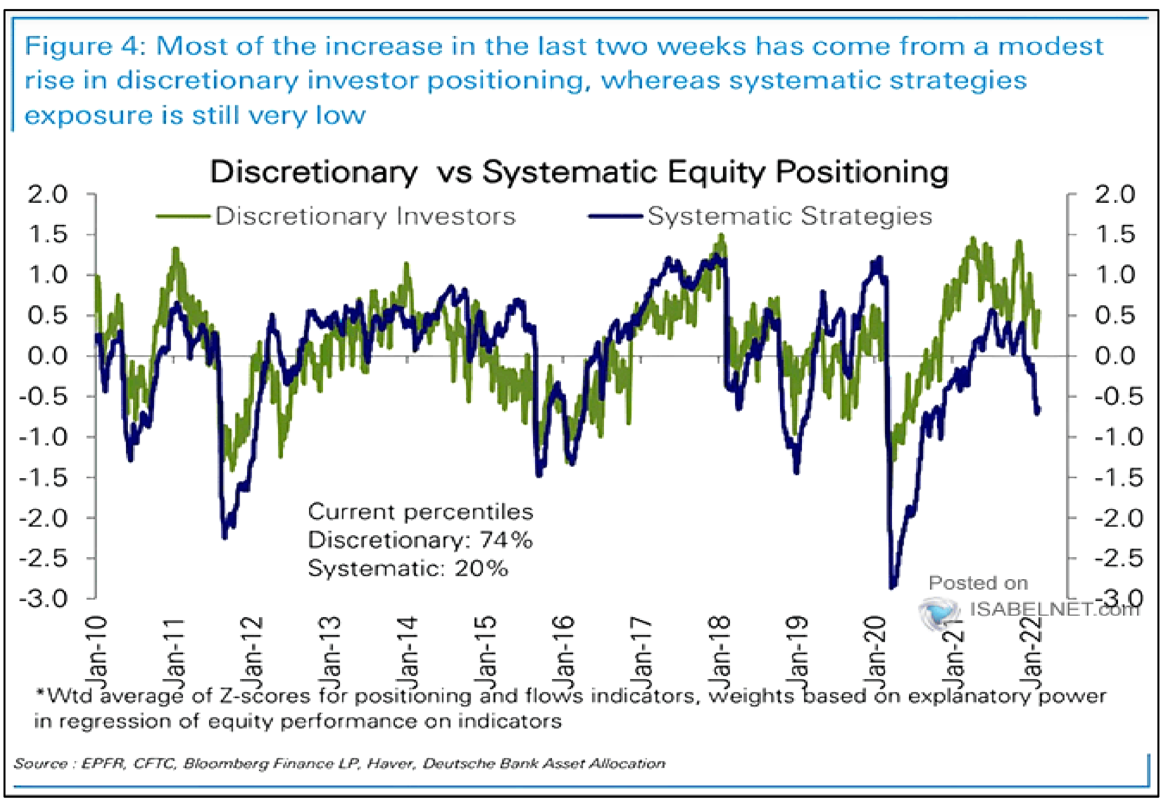
<u>**What to Focus on Now:**</u>

Equities – Did the pandemic bring forward growth and earnings that will now be hard to repeat? Add to that, rising cost pressures and signs of slowing growth momentum?

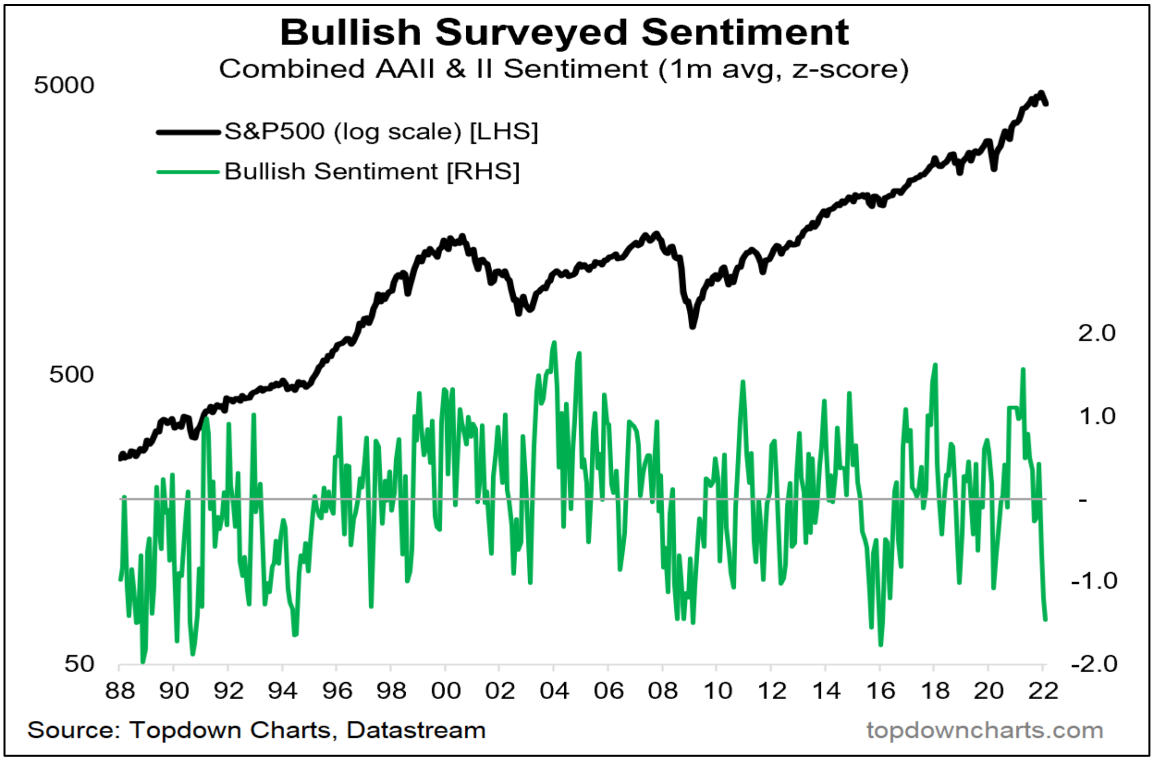
Economic growth expectations have been falling, helping investors to justify reducing equity exposure.



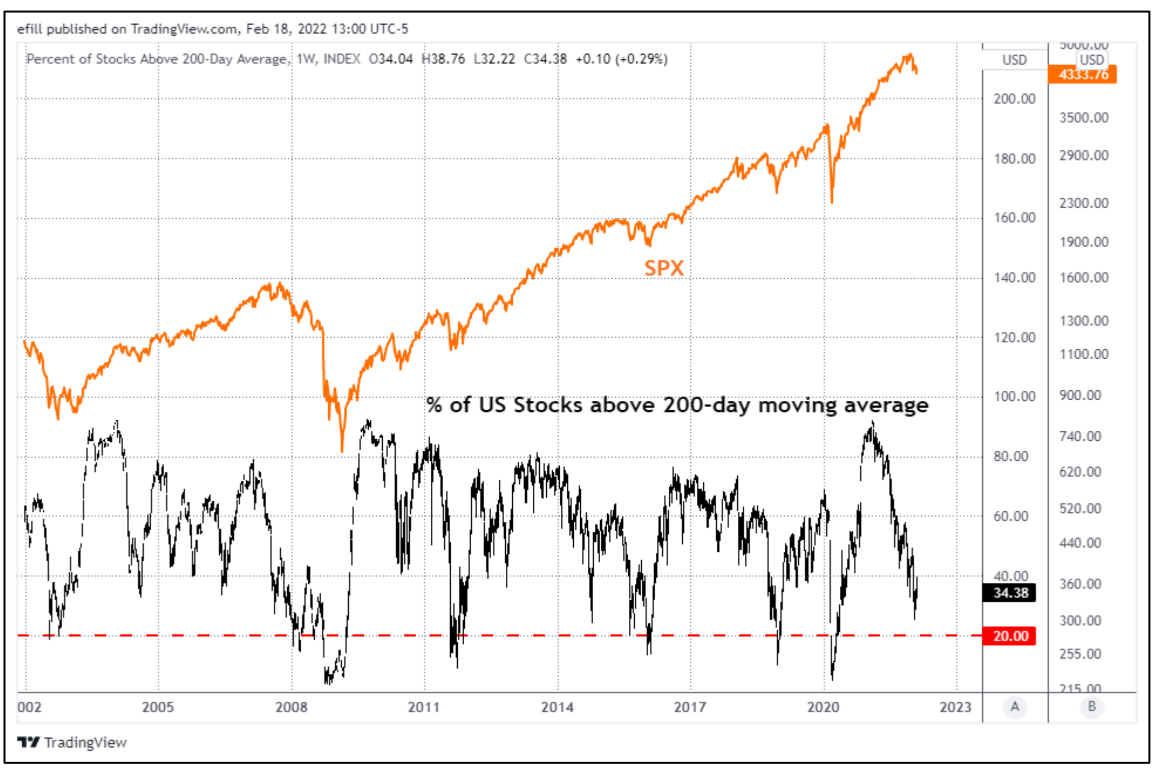
Both discretionary and systematic positioning is now well off the highs.



Sentiment has become increasingly bearish.

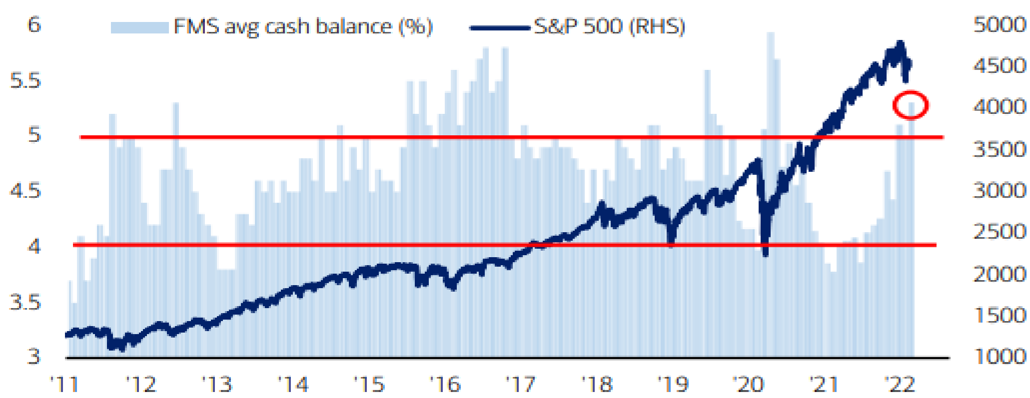


While the % of stocks above their 200-day moving average is approaching the washout-zone, the final bit often results in the ugliest price action.



While retail has continued to buy stocks, institutional investors have been raising cash.

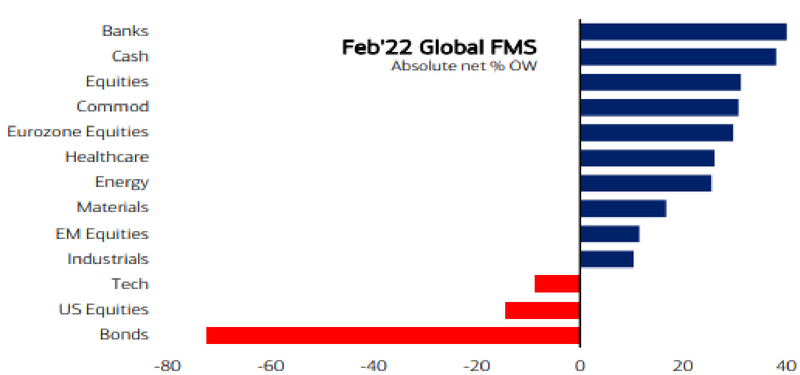
Chart 13: FMS cash levels up to 5.3 in February
FMS average cash balance, %



Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

Inflation and interest rate fears are clearly visible in the positioning.

Chart 14: FMS investors are bullish cyclicals and cash…
Absolute net % OW

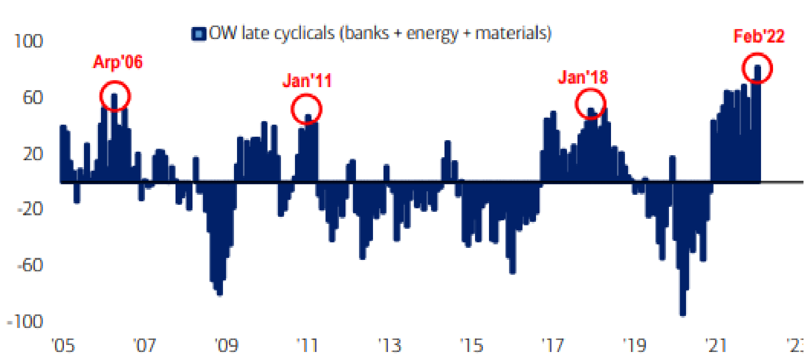


Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

This chart shows FMS absolute investor positioning (net %).

Investors are very long banks, cash, equities, commodities and EU while they shun bonds, the US, and tech.

Chart 24: Highest allocation to late cyclicals ever
Net % OW late cyclicals (banks + energy + materials)

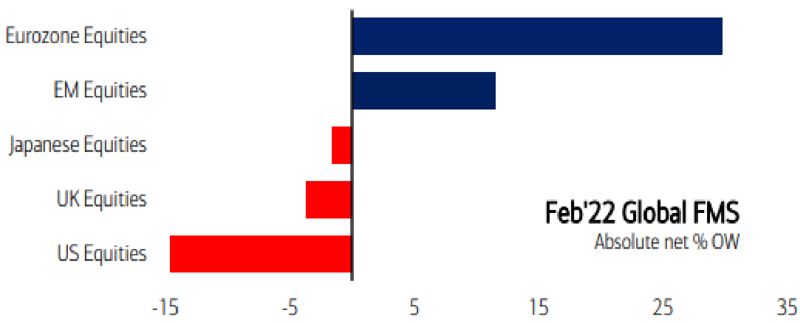


Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

…with the net OW to cyclicals (banks + energy + materials) at its highest level ever.

In terms of global equities, Europe has been a big beneficiary of flows as a value proposition vs. expensive US big tech.

Chart 18: FMS most bullish on EU and most bearish on US
Net % OW in regional equities



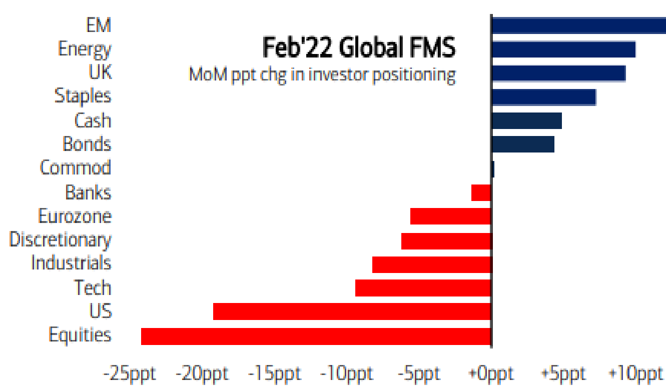
Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

This chart shows FMS absolute investor positioning (net %) for regional equities.

- Bullish: EU (net 30%), EM (net 11%)
- Bearish: US (net -15%)

Month-on-month flows show a growing taste for EM, despite rising global rates.

Chart 16: ...big rotation to cash, UK & EM, energy from equities, US stocks, tech & industrials
MoM ppt change in investor positioning

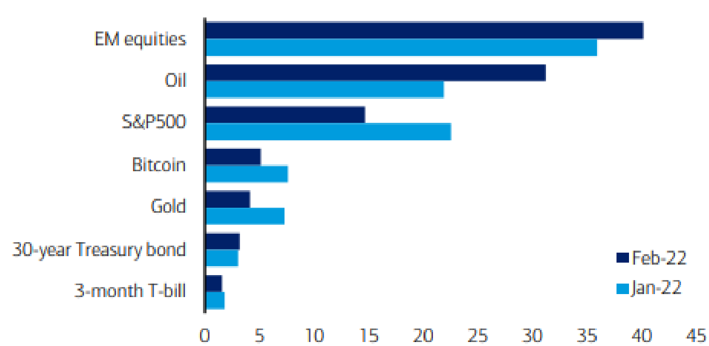


Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

This chart shows FMS investor MoM changes in investor asset allocation.

Investors have gotten more cyclical (i.e. EM, energy, UK) while at the same time cut exposure to equities (particularly the US), tech and industrials.

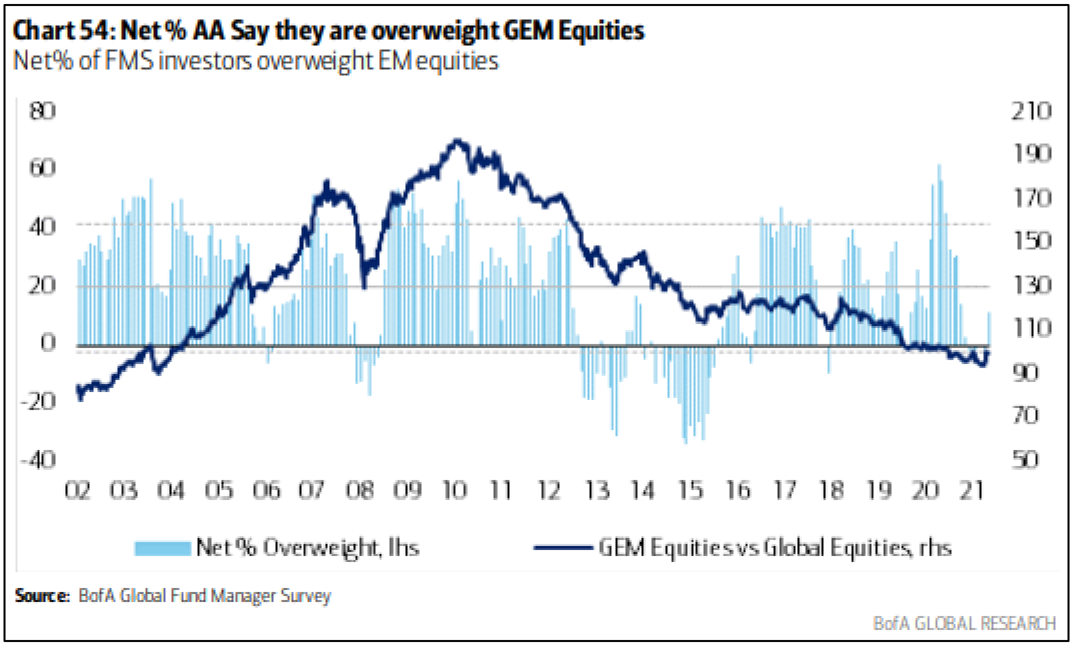
Chart 28: FMS investors expect EM to outperform in 2022
Which of the following assets will produce the best returns in 2022?



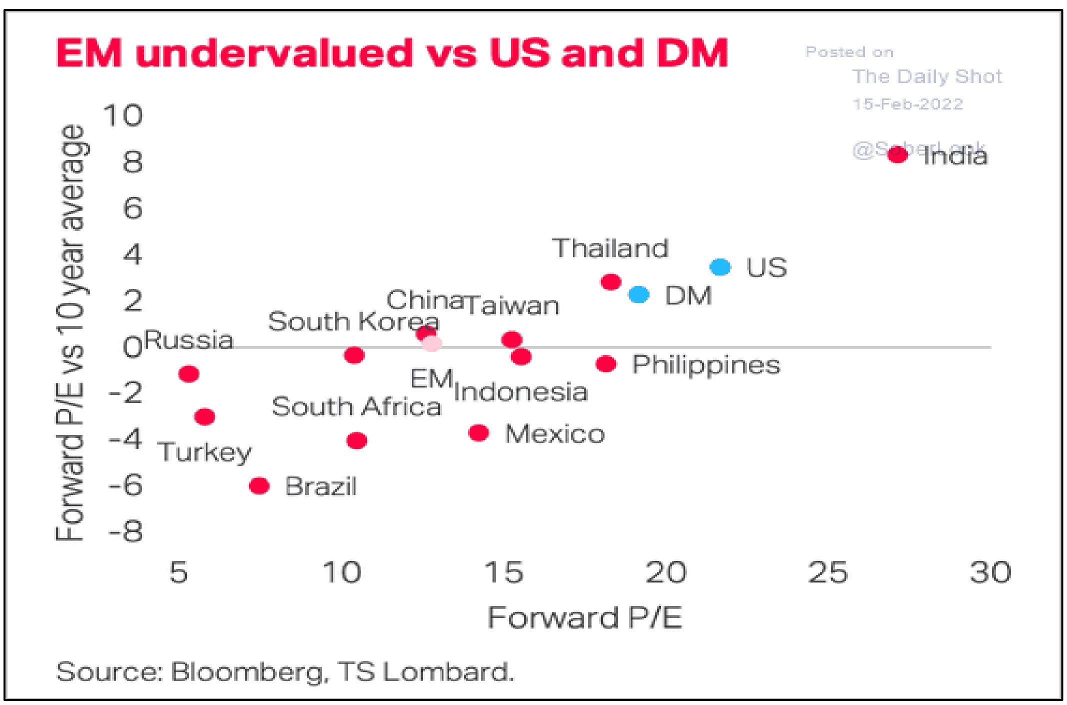
Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

40% of FMS investors think EM equities will produce the best returns in 2022 but only 5% think 30-year Treasury bonds and 3-month T-bills will outperform.

Total positioning remains relatively low in EM, despite the recent flows.



The argument for relative value, also remains. Especially, in countries like Brazil, South Africa, and South Korea. A weaker USD would be very helpful.



Going forward, if we are entering a period of higher inflation and reduced US big tech dominance, cross asset returns may look more like the 2000-2010 period, than the period since then.

Here are the three top performing asset classes for those periods by year.

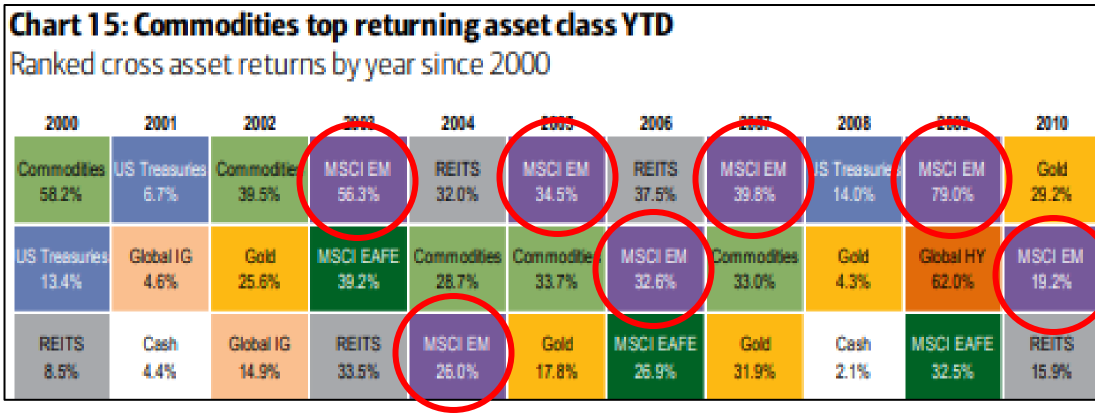


Chart 15: Commodities top returning asset class YTD

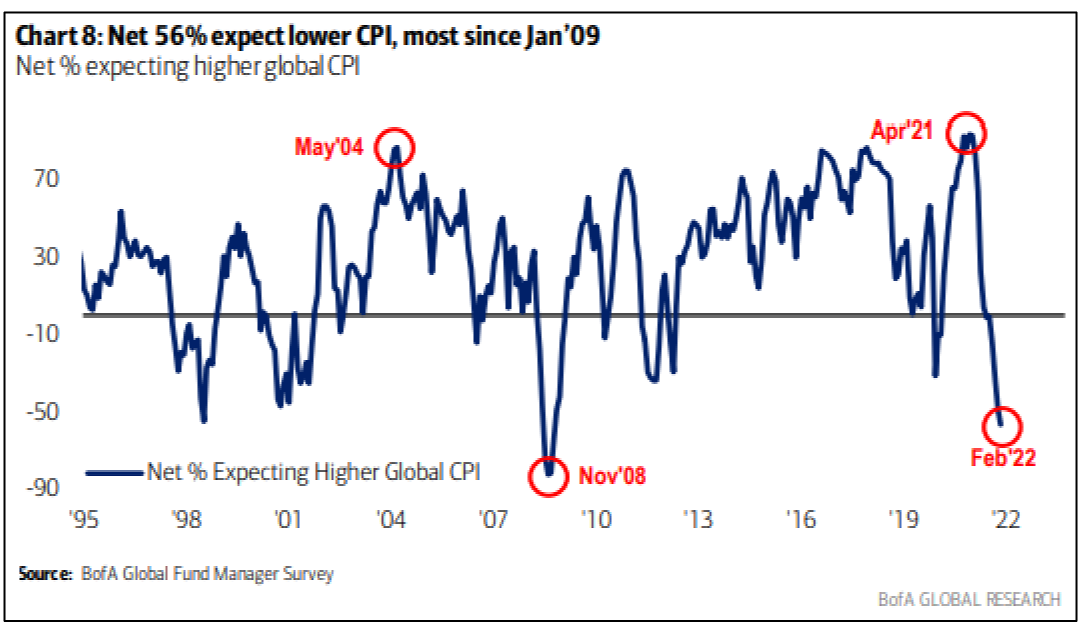
Ranked cross asset returns by year since 2000

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Commodities 58.2%	US Treasuries 6.7%	Commodities 39.5%	MSCI EM 56.3%	REITS 32.0%	MSCI EM 34.5%	REITS 37.5%	MSCI EM 39.8%	US Treasuries 14.0%	MSCI EM 79.0%	Gold 29.2%
US Treasuries 13.4%	Global IG 4.6%	Gold 25.6%	MSCI EAFE 39.2%	Commodities 28.7%	Commodities 33.7%	MSCI EM 32.6%	Commodities 33.0%	Gold 4.3%	Global HY 62.0%	MSCI EM 19.2%
REITS 8.5%	Cash 4.4%	Global IG 14.9%	REITS 33.5%	MSCI EM 26.0%	Gold 17.8%	MSCI EAFE 26.9%	Gold 31.9%	Cash 2.1%	MSCI EAFE 32.5%	REITS 15.9%

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
US Treasuries 9.8%	REITS 23.8%	S&P 500 32.4%	S&P 500 13.7%	S&P 500 1.4%	Commodities 17.5%	MSCI EM 37.8%	Cash 1.8%	S&P 500 31.5%	Gold 24.8%	Commodities 46.3%
Gold 8.9%	Global HY 19.3%	MSCI EAFE 23.3%	REITS 11.7%	US Treasuries 0.8%	Global HY 14.8%	MSCI EAFE 25.9%	US Treasuries 0.8%	REITS 27.4%	S&P 500 16.3%	REITS 33.2%
Global IG 4.5%	MSCI EM 18.6%	Global HY 8.0%	US Treasuries 6.0%	Cash 0.1%	S&P 500 12.0%	S&P 500 22.0%	Gold -1.9%	MSCI EAFE 22.8%	MSCI EM 15.8%	S&P 500 26.9%

Fixed Income - Peak inflation fear?

Investor expectations on inflation have swung the other way, as front-loaded hikes combine with the expectation of near-term base effects kicking in.



Flows have continued out of credit and TIPS, and into low duration bank loans.

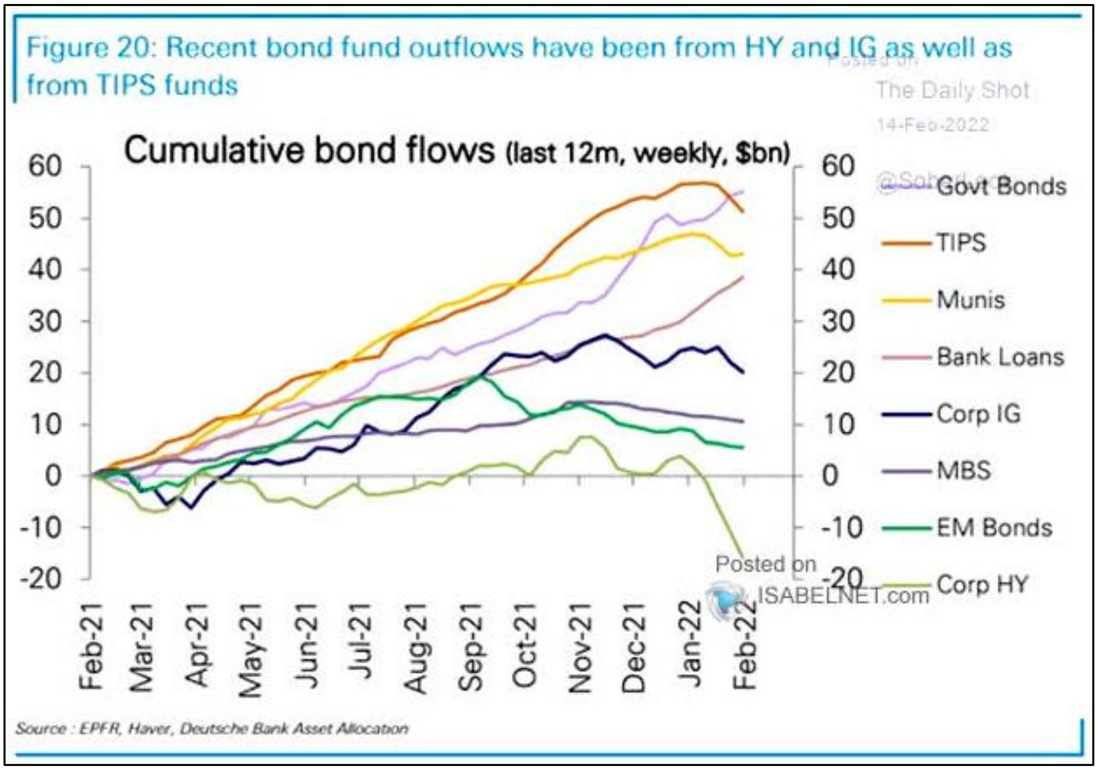


Figure 20: Recent bond fund outflows have been from HY and IG as well as from TIPS funds

Source : EPFR, Haver, Deutsche Bank Asset Allocation

Interestingly, higher Treasury yields are starting to attract flows.

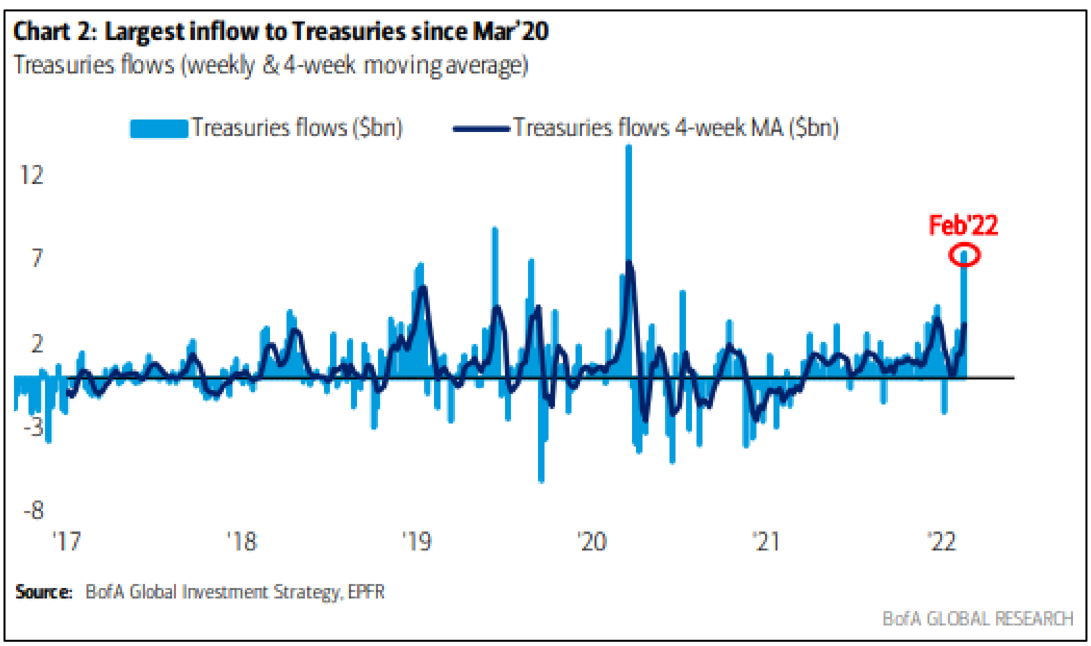
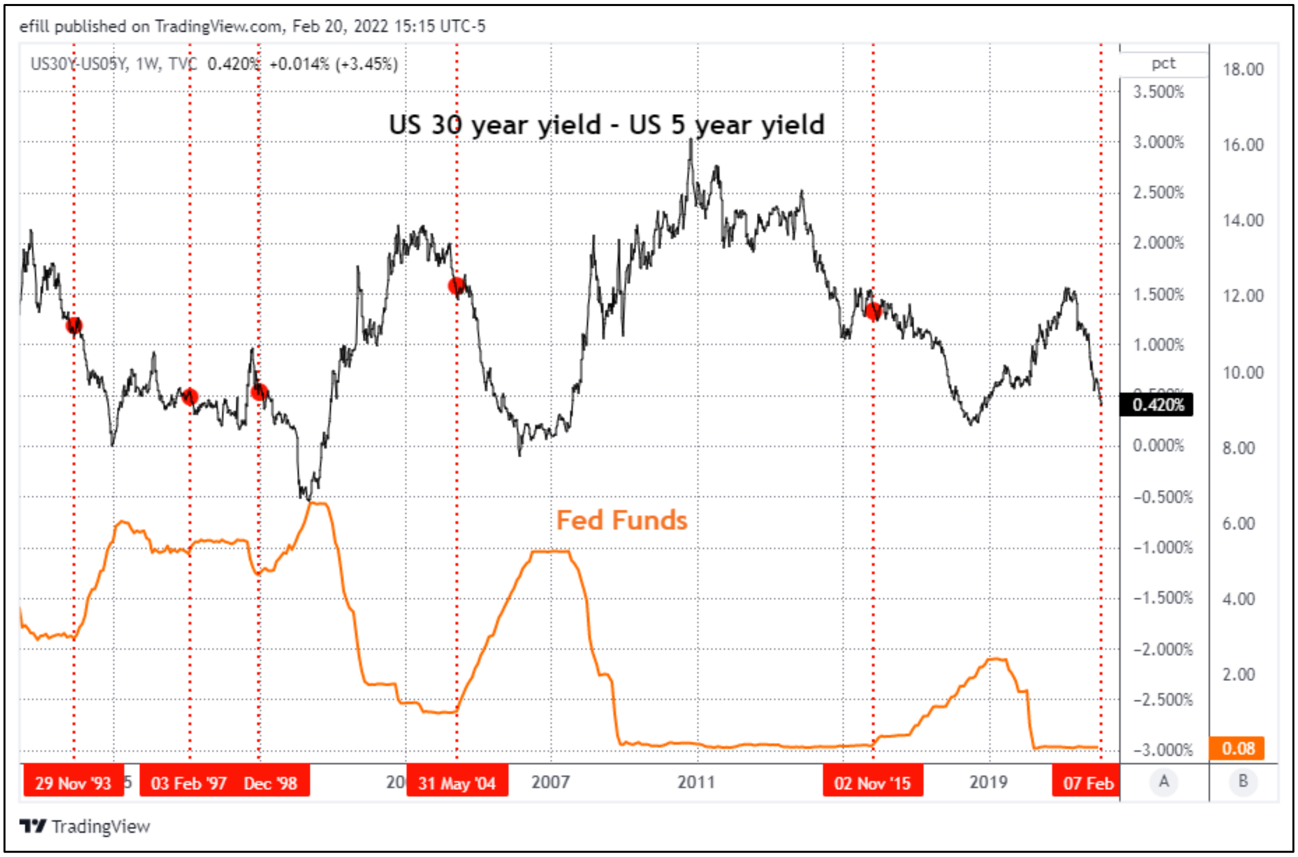


Chart 2: Largest inflow to Treasuries since Mar'20

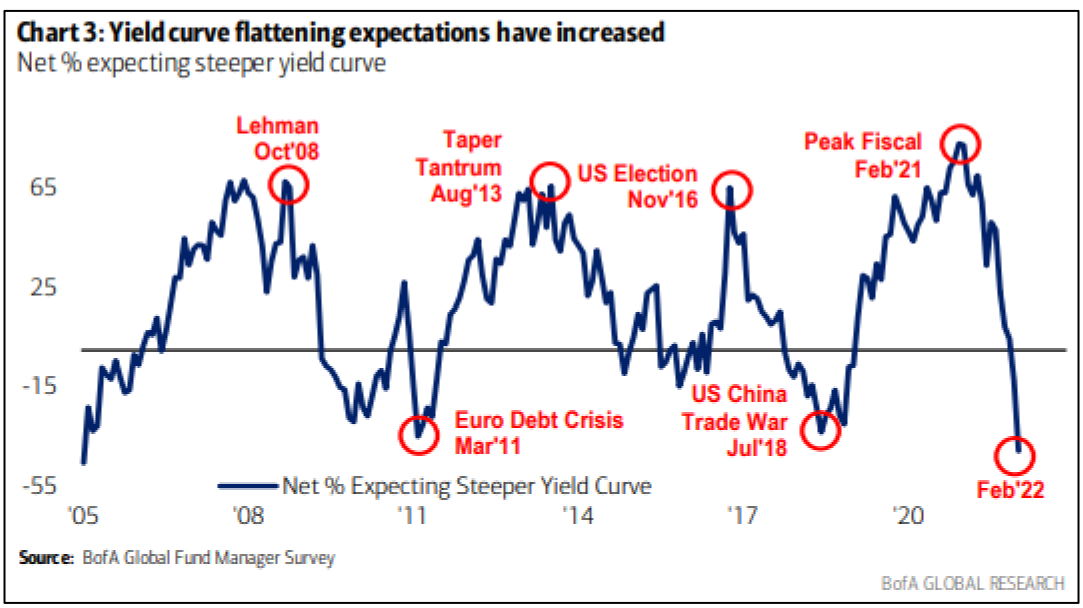
Treasuries flows (weekly & 4-week moving average)

Source: BofA Global Investment Strategy, EPFR

The curve has continued to flatten…

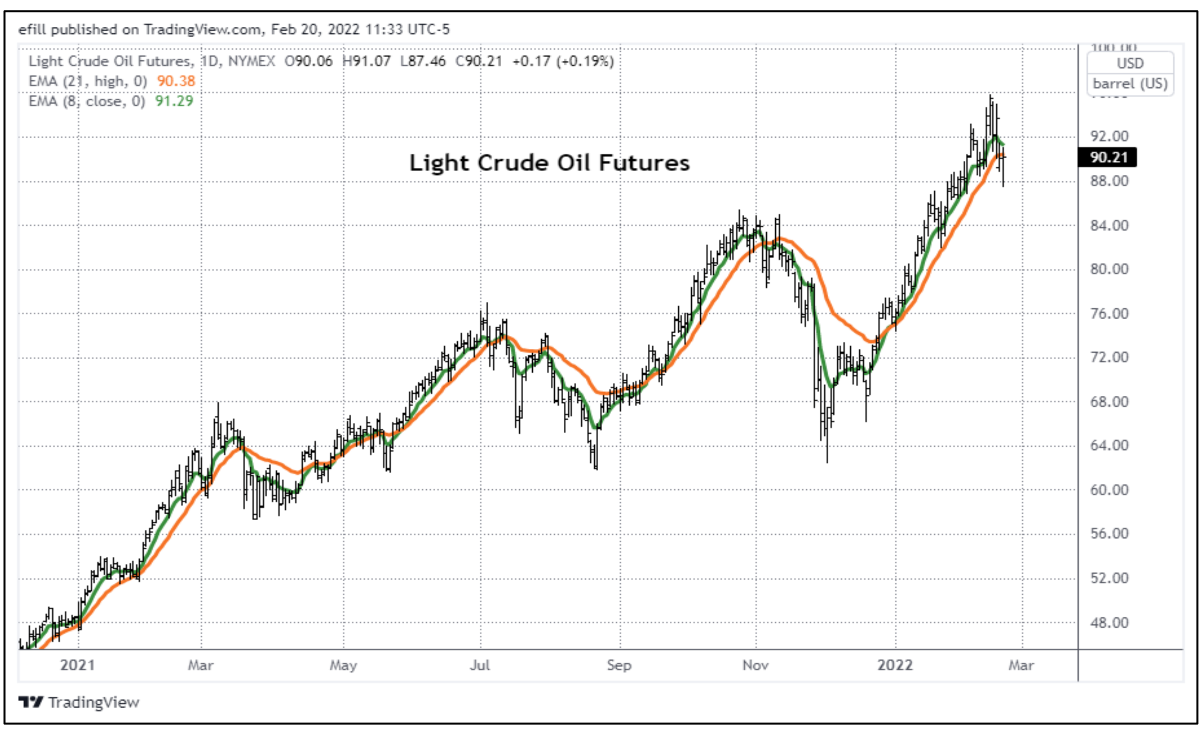


However, expectations are now becoming extreme.



FX – While EM FX has held up very well as a result of recent flows, DM has been caught between competing interest rate expectations and geopolitics.

Commodities – Thanks to the Ukraine situation, oil has seen new highs, although momentum is now starting to falter as the market awaits a resolution, one way or the other.



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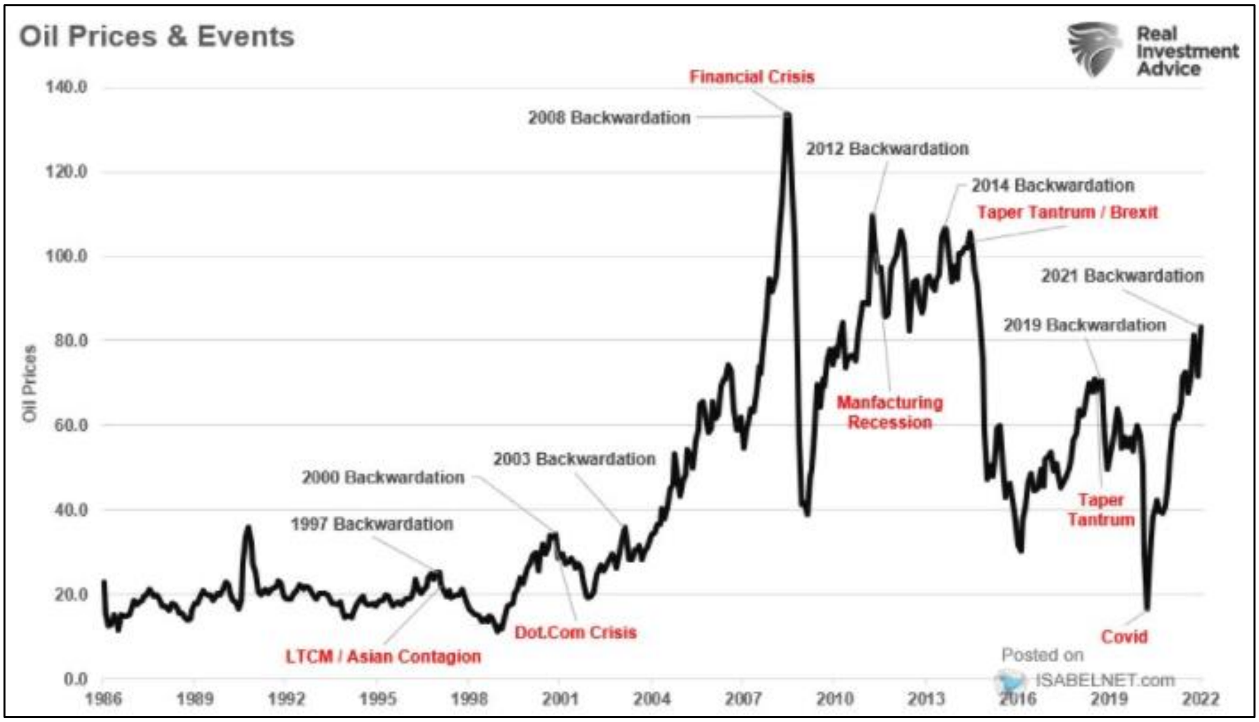
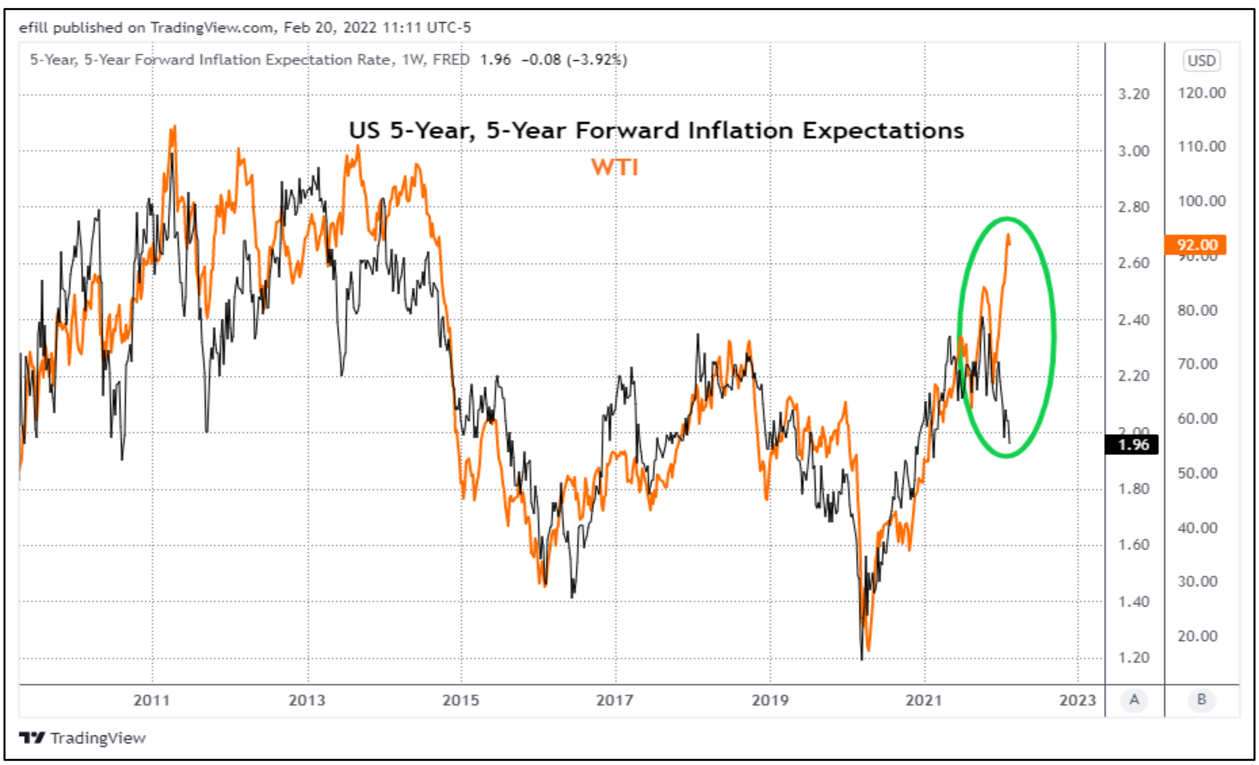
This kind of an oil move does tend to at least coincide with "things" breaking. We will see if it does this time as well.



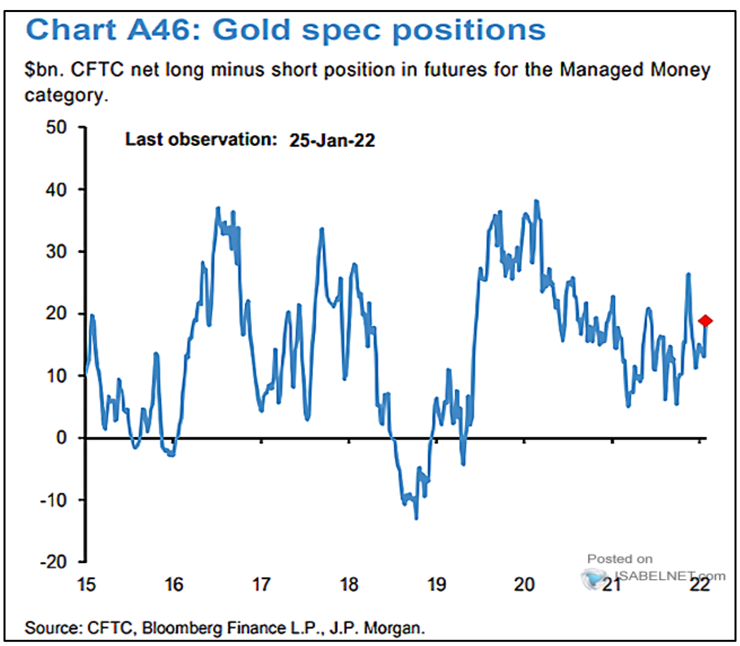
Is that what the 5-year, 5-year forward inflation expectations vs. oil are telling us?



Gold and Silver

Gold and Silver

Gold has begun to shine over the last two weeks. Largely, this seems to be due to geopolitical concerns. The fact that silver, which generally outperforms, has this time underperformed, would tend to support that idea. Silver is both a precious and an industrial metal, to a greater extent than gold is.



The technical breakout is meaningful if it can be sustained, and positioning is still far from extreme, indicating plenty of room for new flows.

We will see how gold weathers a resolution to the Ukraine saga and if any reduction in interest rate hike expectations and/or a weaker USD can replace the tailwind from geopolitics, once that fades.

For now, the inverse correlation to real yields has cracked.

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Important Macro Data Releases and Events for the Week

Monday 2/21/2022	PBoC Interest Rate Decision (20:15 ET Sunday) Markit PMIs (prel.) (Feb) across Europe
Tuesday 2/22/2022	Housing Prices Index and Case-Shiller Home Price Index (Dec)
Wednesday 2/23/2022	BoE Monetary Policy Report Gfk Consumer Confidence Survey (Mar)
Thursday 2/24/2022	Chicago Fed National Activity Index (Jan) GDP Annualized (Q4) Initial Jobless Claims Initial Jobless Claims 4-week average Continuing Jobless Claims PCE and Core PCE QoQ (Q4) New Home Sales MoM (Jan)
Friday 2/25/2022	Durable Goods Orders (Series) (Jan) Core PCE Price Index MoM and YoY (Jan) Personal Income and Spending Michigan Consumer Sentiment Index (Feb) Pending Home Sales (Jan)

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