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What to focus on in Global Macro for the week of January 4th, 2020

Macro Themes on the Radar:

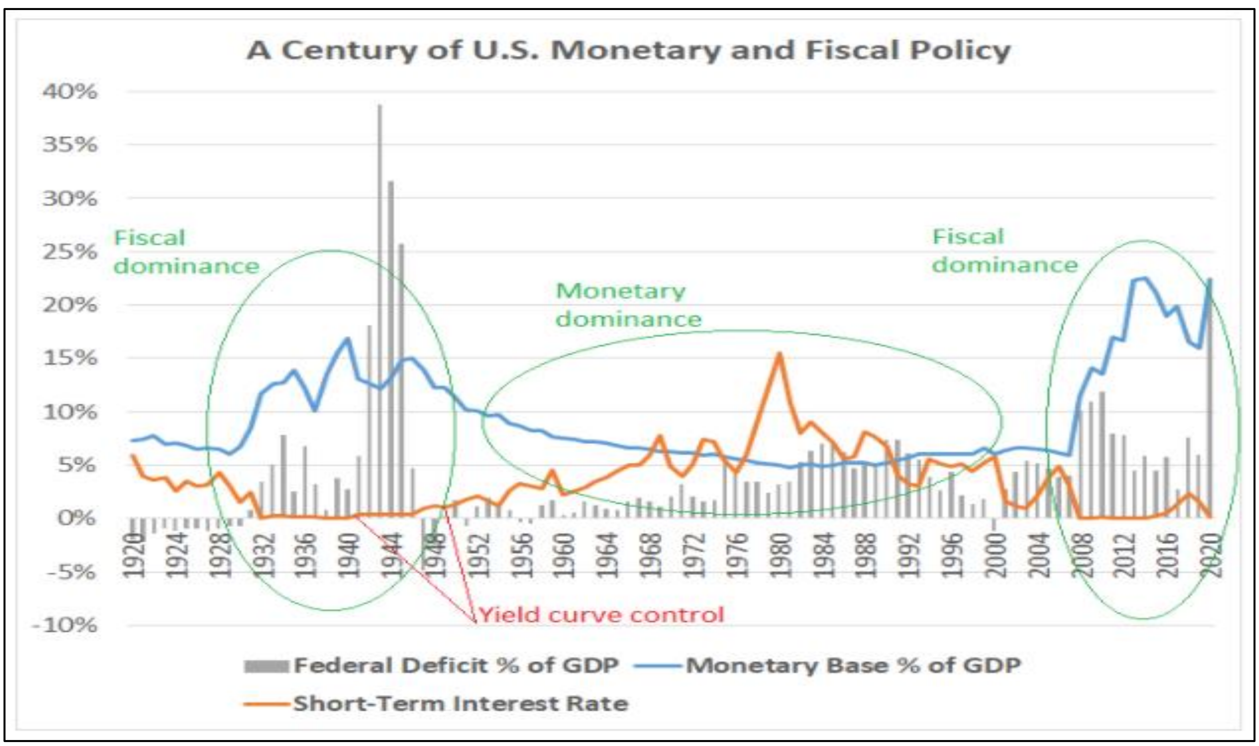
Last year was obviously extrordinary in so many ways; 2021 is likely to be as well.

The once in a 100-year pandemic has accelerated many technology driven trends and broken taboos for monetary and fiscal policy. There will be no going back anytime soon.

Debt levels globally have exploded and these high debt levels can only be dealt with via higher nominal growth or default. Default is not palatable. If possible governments will chose inflation rather than deflation.

There are lots of people trying to find historical analogs for the current situation. For obvious reasons the 1920's are a popular time period being proposed. As the 1918 pandemic and WW1 ended, a large stock of pent-up demand and technological progress was unleashed. A decade long party followed that drove economic, social and market trends.

While no analogy is perfect, I think the 40's are a better comparison. CB policies and fiscal spending are a better fit. Debt levels were exploding, due to the cost of WW2. COVID, equality/racial issues and the battle against climate change, leave the US feeling like it is on a war footing. I don't want to overbake the analogy in terms of the historical backdrop as it is obviously very different. However, the current debt, monetary and fiscal policy backdrops do have some strong parallels to that period. With interest rates at zero, fiscal policy takes over…



Souce: Lyn Alden

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Morgan Stanley expects central banks to remove well over $300 billion of securities on average from private markets every month in 2021. While that certainly represents a lot of continued QE for the forseeable future, and will undoubtedly support asset price inflation, it has in the past done little for actual goods and services inflation. However, 2020 has added some components to the previous monetary mix of low rates and QE. With increased fiscal spending, which is at least partially being monitized by central banks, and the policy of keeping interest rates and bond yields below the prevailing inflation rate, we are turning over a policy leaf that has arguable not been seen since the '40's. So far "flexible average inflation targeting" is a soft version of this, with an escape hatch. We will see how serious they are if and when bond yields start to rise, or if inflation prints pick up meaningfully.

Timing is everything, and how the economy and fiscal policy develops in the coming months will matter a lot for investors. Renewed economic weakness, higher taxes or gridlock in Washington will be deflationary on balance. The ability to push through aggressive fiscal spending will be inflationary. The mix and sequencing are important, but on balance policy makers desire will be to err on the side of an inflationary outcome.

Regarding gridlock, the outcome of the Georgia run-off on the fifth is obviously very important. It remains totally up in the air at the moment. Betting markets like PredictIt have a 60-65% chance that the Republicans retain control of the Senate, however several polls now show the two democratic challengers with a slim lead. If Biden faces a gridlocked Congress, it remains to be seen how quickly he will be able to pass the large infrastructure initiatives the administration is said to be preparing. Be ready for a series of executive orders either way. Also, expect Biden to look for other easy policy levers he can pull. As an example, here is an interesting article from Politico on a $40 billion Obama era energy loan program that could be used to further clean energy priorities.

What to Focus on Now:

What does it all mean for markets now? November and December ended up accounting for the bulk of 2020 performance. Historically, a Nov./Dec. rally of this magnitude has been bullish. However, the small sample size and unprecedented backdrop make for a big question mark.

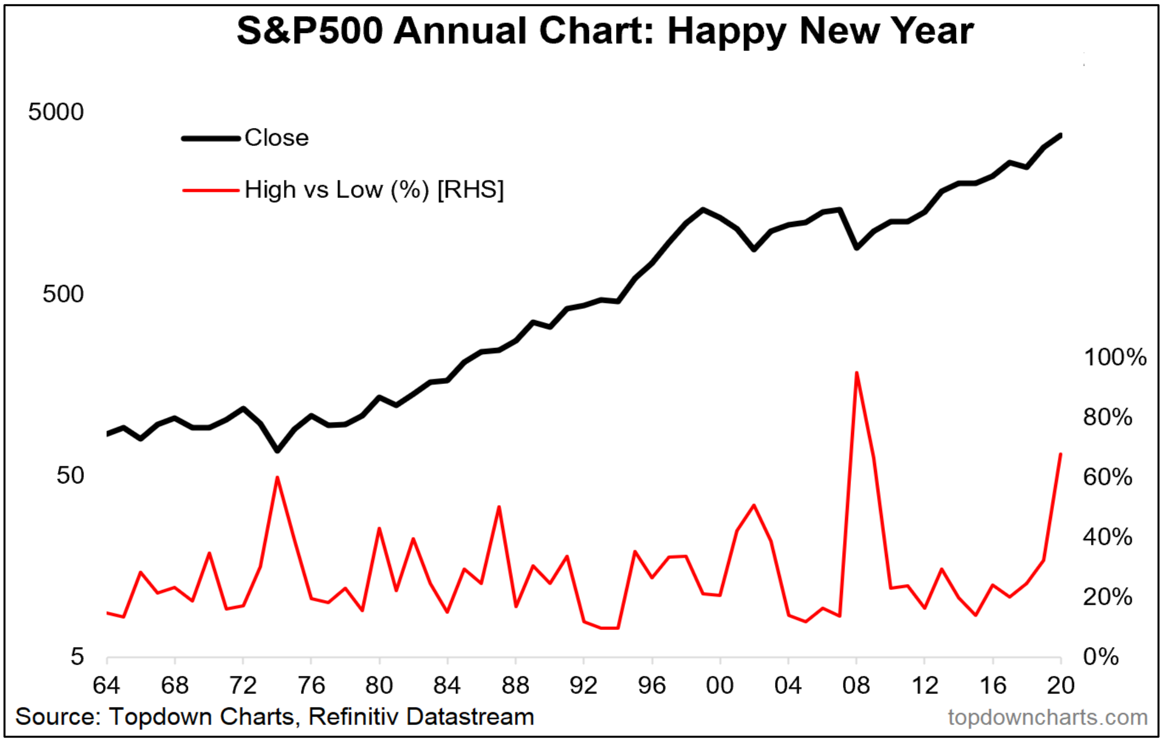
A Big End Of Year Rally Is Bullish

>10% S&P 500 Index Gains In November And December

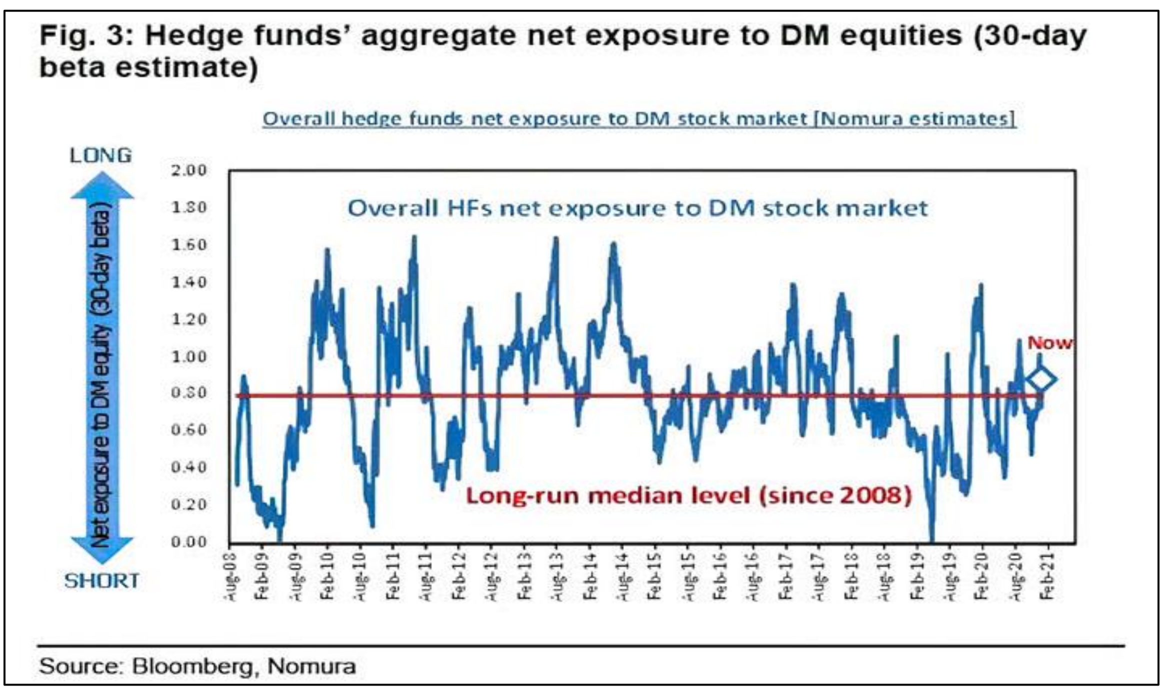
		S&P 500 Index Return	
Year	November/December Return	January Return	Following Year Return
1954	13.6%	1.8%	26.4%
1962	11.6%	4.9%	18.9%
1970	10.5%	4.2%	10.8%
1985	11.3%	0.2%	14.6%
1998	11.9%	4.1%	19.5%
2020	14.3%	?	?
	Average	3.0%	18.1%
	Median	4.1%	18.9%
	% Positive	100.0%	100.0%

Source: LPL Research, FactSet 12/30/20 (S&P 500 price as of noon ET)
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

We covered a lot of ground in 2020 as shown by this chart of percent range of intra-year closing high vs. low. Only 2008 beats it over the last 50+ years.



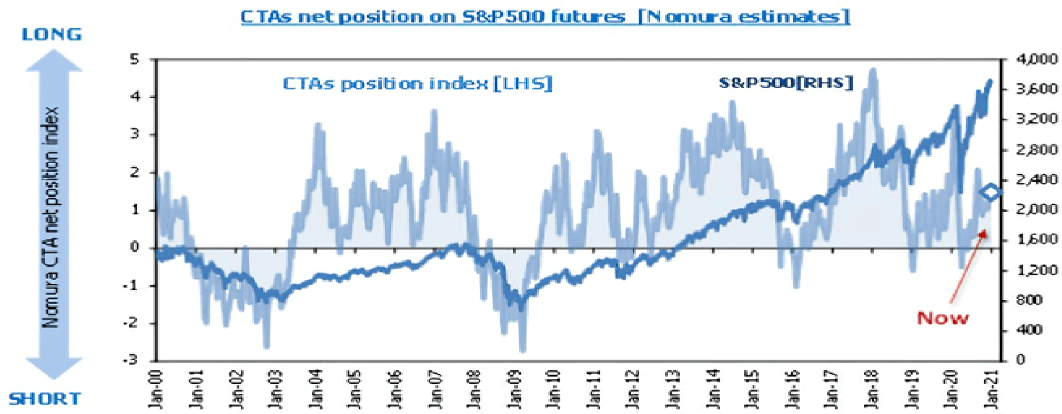
While retail and asset managers have plowed back into stocks after being big sellers on the plunge, Hedge Funds and CTA's are not yet at extremes.



Although at this point, with a lot of conflicting data, I'm having a hard time getting comfortable with what net positioning looks like.

Fig. 6: CTAs' net position in S&P 500 futures vs. the S&P 500 (since 2000)

CTAs have room in which to extend their net long position in S&P 500 futures



Source: Nomura

What does seem clear, is that on an historical bases, markets are not cheap.

Exhibit 10: The Stock Market's Excess Valuation heading into 2021

Source: BofA US Equity Strategy, Factset.

However, it has been a while since markets have cared about valuations. Instead, inputs like low global rates, TINA, FOMO, lots of liquidity, an expected jump in earnings/growth and strong price momentum have been the focus.

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Lots of thing like IPO's, SPACs, "disruptive" stocks, look bubbly, but it doesn't matter until it matters. Do we get an NDX repeat or is it more focused on clean energy and/or biotech "disruptors" this time?

Big price gains are still possible and the adage "when you see a bubble, buy it" seems to be playing out. However, the more expensive equities become, the more 10-year expected returns fall. So, this is a trading market and not a buy and hold market. As such, I think volatility will remain relatively high.

What can upset/accelerate the trend?

- Change in fiscal spending outlook
- Change in monetary policy outlook
- Whiff of accelerating deflation/inflation via USD/bond yields
- Geopolitics (expectation is that it calms down a lot)
- Continued momentum and new buyers needed, as valuations rise
- Some markets start to diverge, not just lead and lag. A "Tell" that something is up.

So far, I don't see much "news" in these, but watching.

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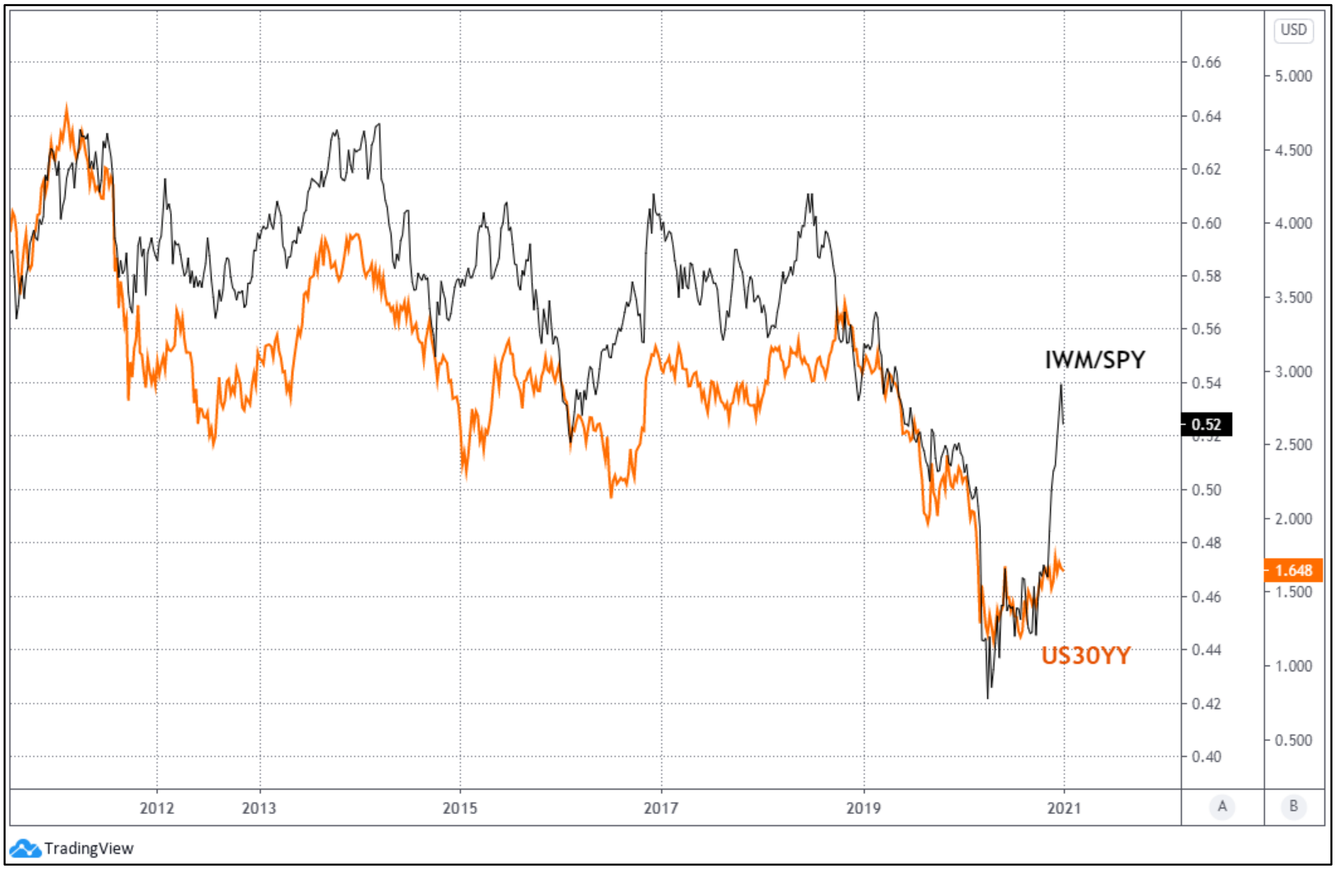
Other items to watch…

With the huge small cap outperformance in recent months, it is worth noting that they have broken away from directional relationship they have had with bond yield for the last decade. Bond yields arguably have more inputs than they used to, given the lower for longer rates promise from central banks and the implicit prospects for yield suppression. The Russell is pricing reflation, bonds are not. I think the Fed will be happy with that outcome.



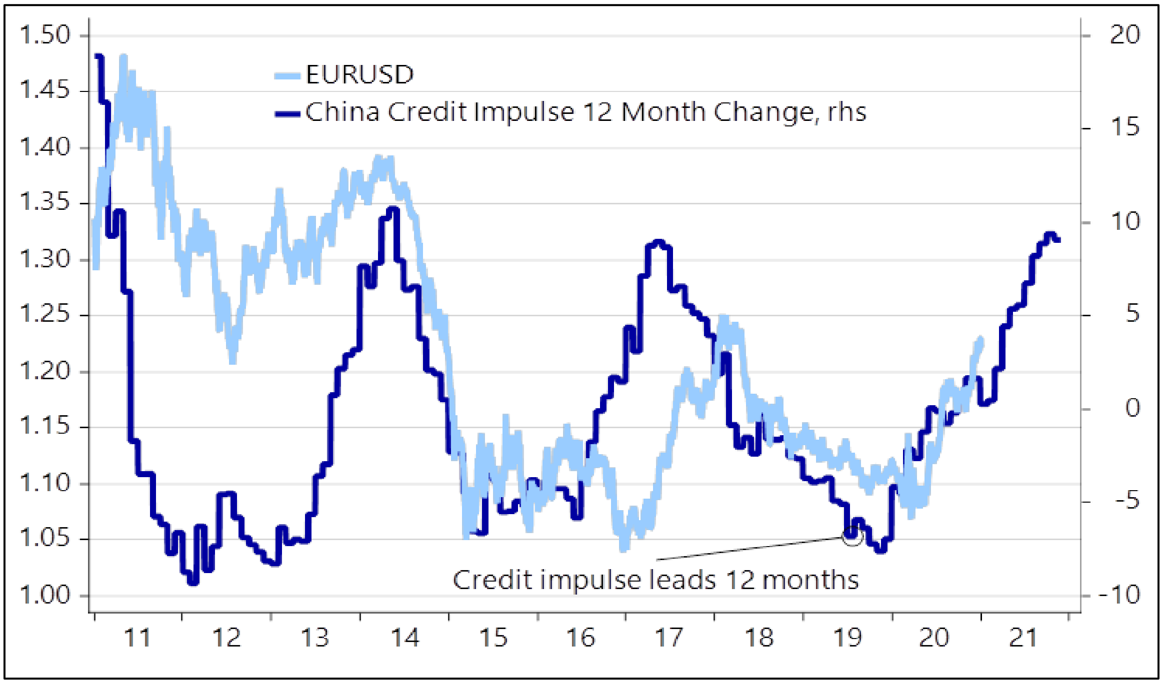
Chinese markets are also worth watching here. With plenty of tension in the final days of the Trump administration and forced delisting of some Chinese companies in the US possible, the price action in Chinese equities is worth a look. Are we seeing some government price support? Hopes of better relations with the Biden team? An expectation for EM growth acceleration and regional strength?

Either way we appear to be at big levels for Chinese stocks.

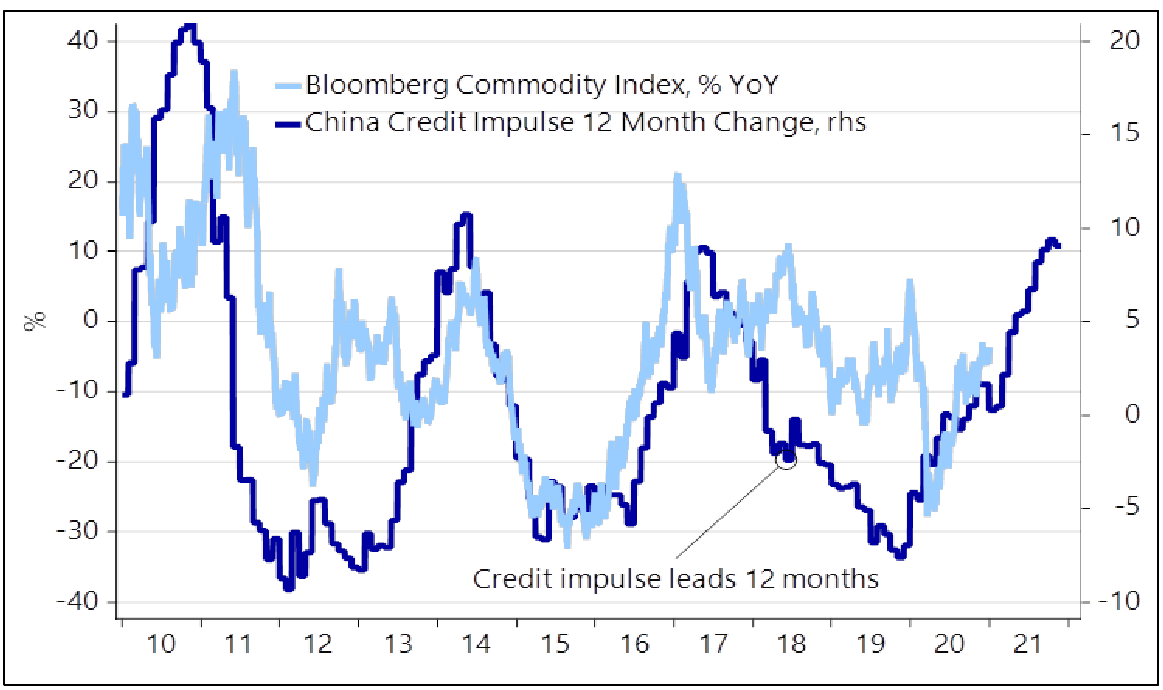
Chinese tech has been strong for a while, now the broader indices are threatening a break higher.

HK stocks having a look at a three-year downtrend from the 2018 global growth highs.

The China Credit Impulse has shown powerful growth. It reflects Total Social Financing (a measure of aggregate credit growth) vs. nominal GDP. With China closing in on the US in terms of GDP, their credit cycle has taken on increased importance for the global economy. Some analysts now expect the rate of change to fall substantially in 2021. However, it tends to be a leading indicator, so for now it should remain supportive to a lower USD...



Commodities...



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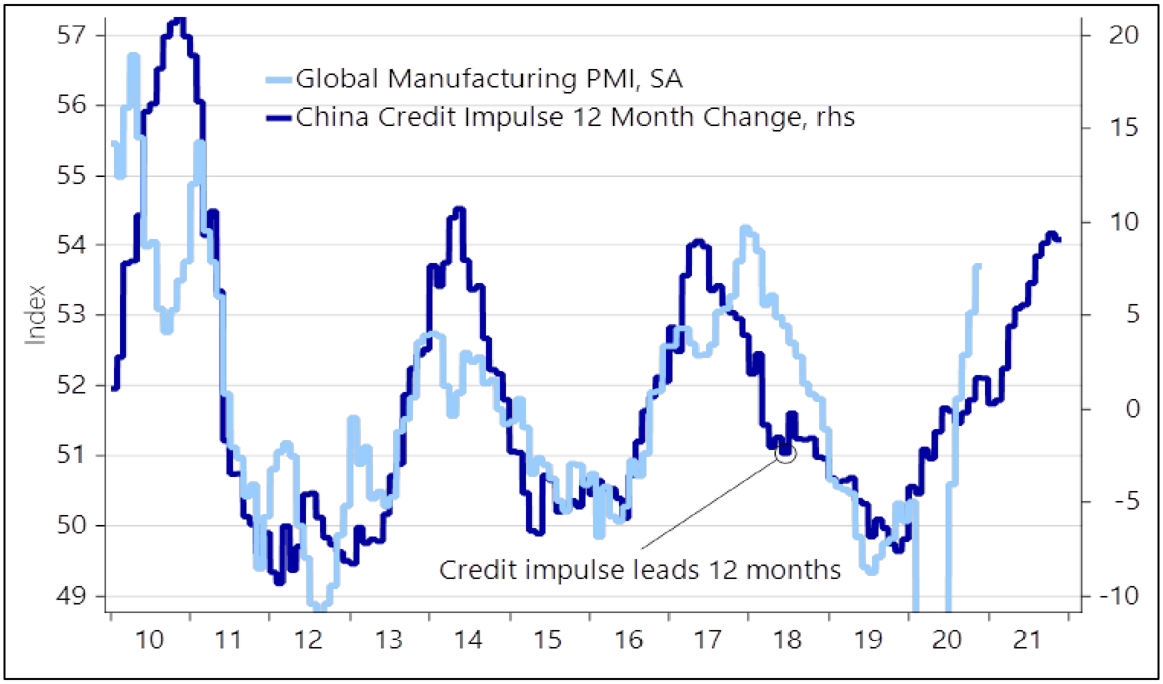
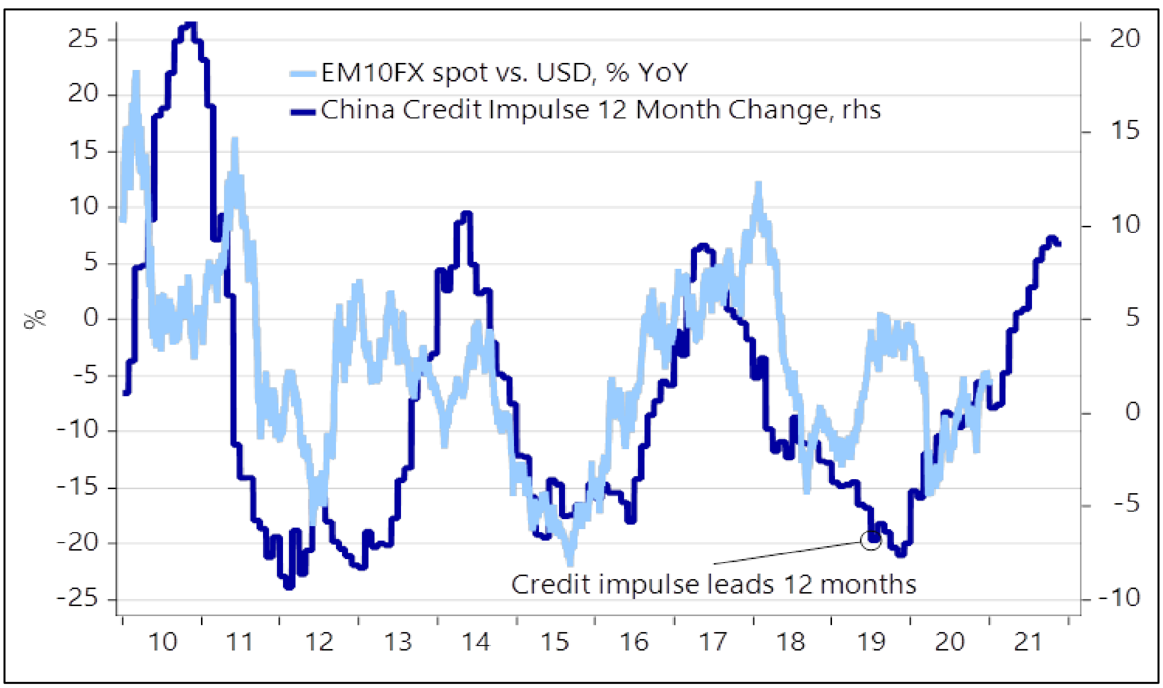
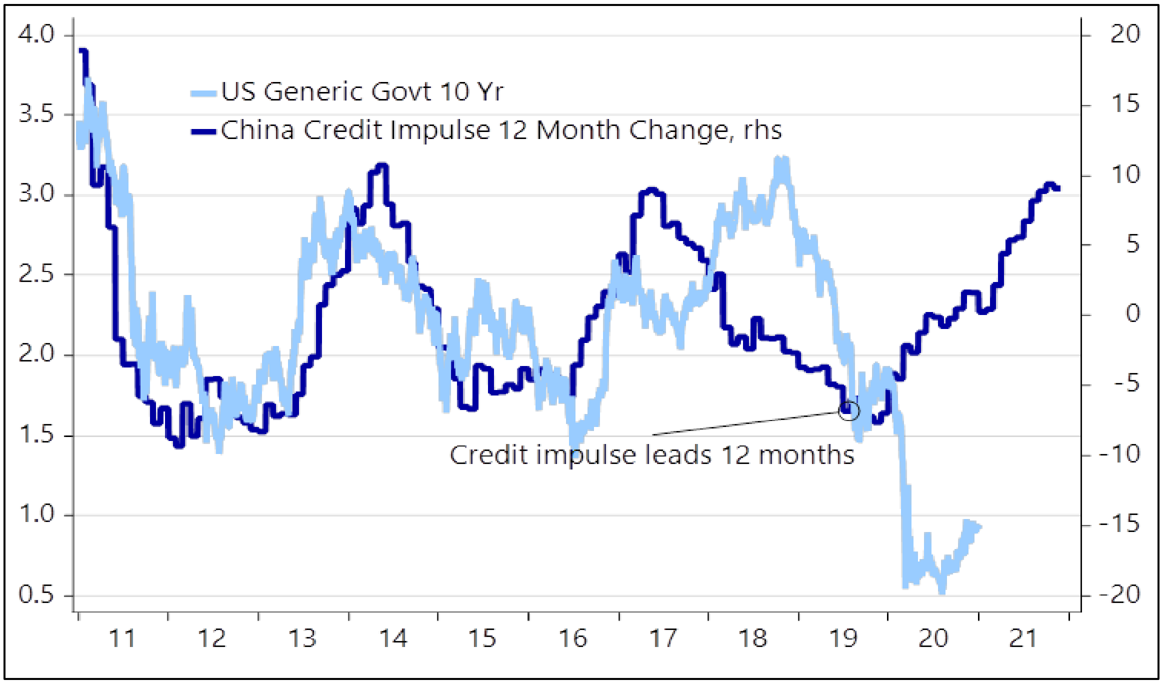
PMI's



and EM FX which tends to go in the same direction as EM equities.



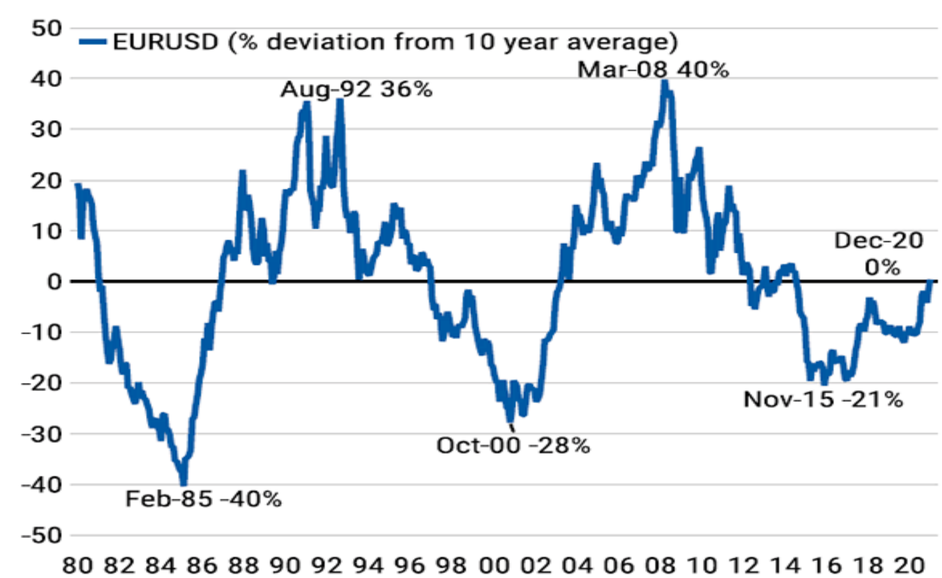
Again, US Treasury yields are the outlier so far for the reasons discussed.



The above charts reflect a lot of consensus views. While that doesn't mean they are necessarily wrong, a reversal is worth watching out for as I wouldn't be surprised if markets start to shorten the lead time.

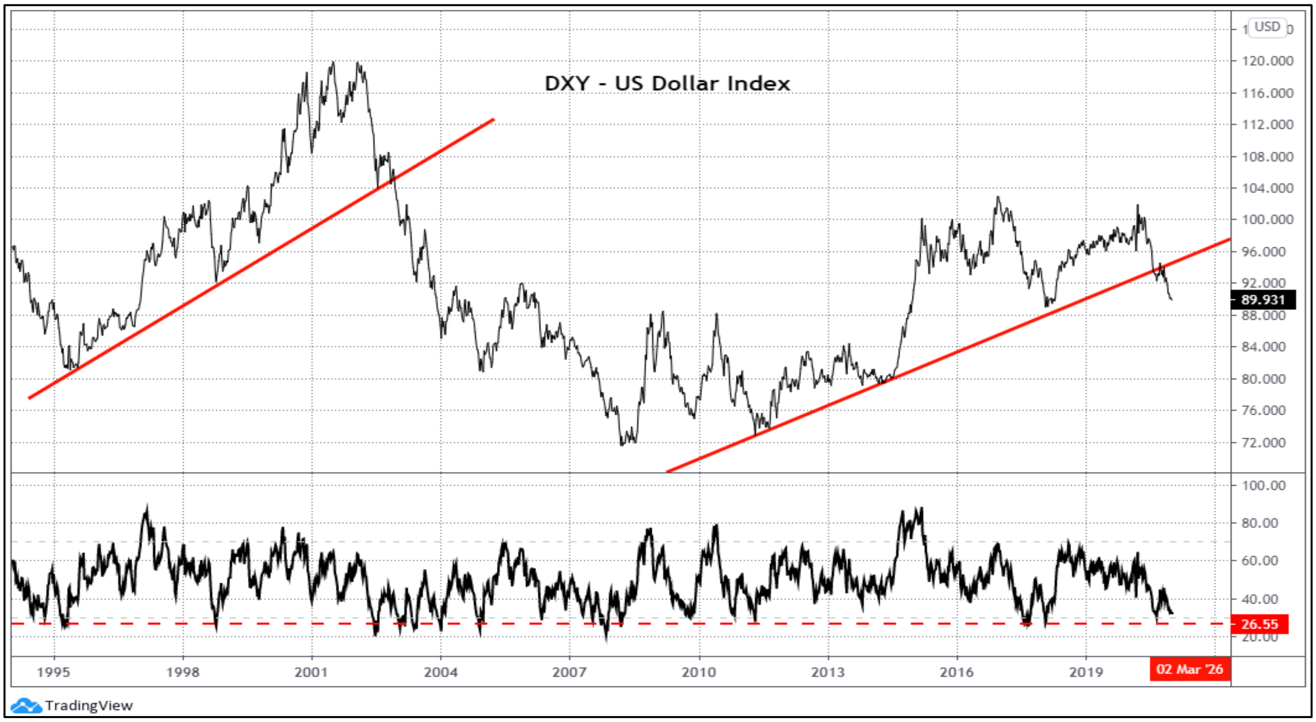
FX – So far, the dollar remains under pressure. Will these cycles hold? If so, we have more to run.

Exhibit 29: EUR/USD at the long-term average in an appreciating leg of the cycle



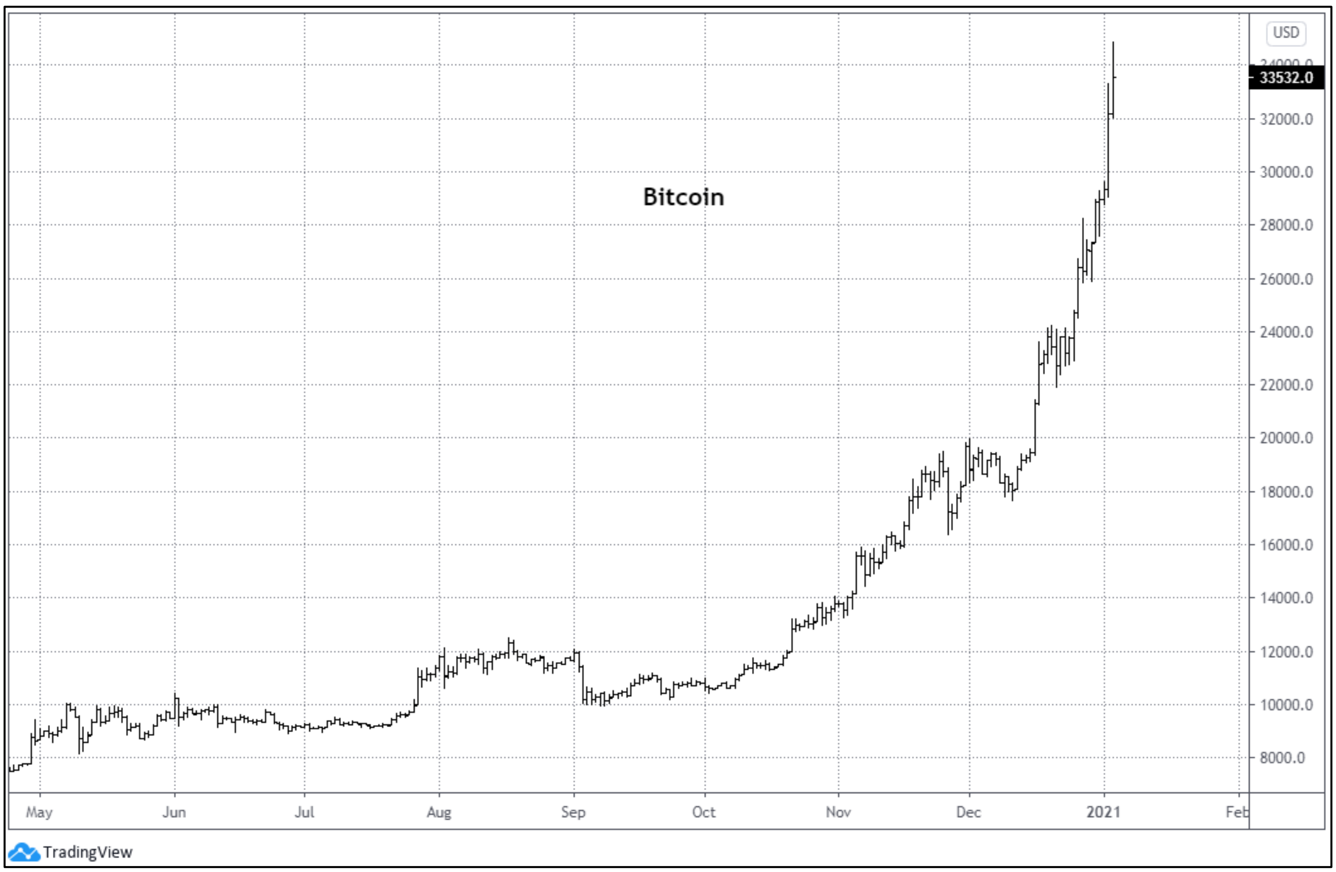
Source: Macrobond, Morgan Stanley Research

The dollar is getting oversold but isn't yet at historical extremes. I would expect some back and fill, but not a large retracement yet, unless we have a surprise catalyst.



US 30-year yields are coiled with the market looking for higher yields. Something is going to break.

Last week VanEck filed papers with the SEC as they take their turn attempting to get a Bitcoin tracking ETF approved. So far, the 4 or 5 other attempts have been blocked for various reasons including transparency, liquidity and volatility concerns. Maybe this time. While I think this has been a factor in the run-up over the last few days, maybe the most interesting point regarding the price action is that so far there has been no let-up in "animal spirits". Worth watching as a general market "tell'?



Important Macro Data Releases and Events for the Week

Monday
01/04/2020

- Sunday Night - Caixin Manufacturing PMI (Dec) Forecast: 54.9, Prior: 54.9
- Markit Manufacturing PMI's (Dec) for Europe - expected to be unch or slightly better
- OPEC Meeting
- Markit Manufacturing PMI (Dec) Forecast: -, Prior: 56.5

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Tuesday
01/05/2020

- Retail Sales YoY (Nov) Forecast: 3.9%, Prior: 8.2%
- Unemployment Change (Dec) Forecast: +10k, Prior: -39k
- ISM Manufacturing Employment Index (Dec) Forecast: 50.7, Prior: 48.4
- ISM Manufacturing PMI (Dec) Forecast: 56.5, Prior: 57.5
- ISM Manufacturing Prices Paid (Dec) Forecast: 62.1, Prior: 65.4
- ISM Manufacturing New Orders Index (Dec) Forecast: 74.8, Prior: 65.1
- Fed's Williams SPEECH

Wednesday
01/06/2020

- Markit Service PMI's (Dec) for Europe - expected to be unch or slightly better
- Harmonized Index of Consumer Prices MoM (Dec) Forecast: -0.6%, Prior: -0.7%
- ADP Employment Change (Dec) Forecast: 159k, Prior: 307k
- Markit Services PMI(Dec) Forecast: 55.3, Prior: 55.3
- Markit PMI Composite (Dec) Forecast: 55.7, Prior: 55.7
- Factory Orders MoM (Nov) Forecast: 0.7%, Prior: 1%
- **FOMC Minutes**

Thursday
01/07/2020

- Economic Bulletin
- Retail Sales YoY (Nov) Forecast: 1.2%, Prior: 4.3%
- CPI YoY (Dec) Forecast: -0.2%, Prior: -0.3%
- Business Climate (Dec) Forecast-, Prior: -0.63
- Initial Jobless Claims Forecast: 795k, Prior: 787k
- Initial Jobless Claims 4-week ave. Forecast: - , Prior: 836.75k

- Continuing Jobless Claims Forecast: -, Prior: 5.219m
- Trade Balance (Dec) Forecast: $-64.2bln, Prior: $-63.1bln
- ISM Services (Dec) Forecast: 54.5, Prior: 55.9

Friday
01/08/2020

- Leading Economic Index (Nov) Forecast: -, Prior: 94.3
- Industrial Production s.a. (MoM)(Nov) Forecast:0.7%, Prior: 3.2%
- Unemployment Rate (Nov) Forecast: 8.5%, Prior: 8.4%
- Nonfarm Payrolls (Dec) Forecast: 100k, Prior: 245k
- Unemployment Rate (Dec) Forecast: 6.8%, Prior: 6.7%