What to focus on in Global Macro for the week of April 19th, 2021

Macro Themes on the Radar:

From a central bank perspective, next week will be focused on Thursday's ECB meeting. While no change in policy is expected, markets will be on the lookout for any shifts in the growth/inflation outlook and any hints on how they see financial conditions. The June meeting will be more interesting, as that is when they will assess how the current faster pace of bond buying is going, and how they should proceed. Many economists think they will slow the bond buying during the second half, as a recovery in Europe gathers steam. Recent comments from ECB members have highlighted that they are not against rising yields per se, but that they should not outpace the actual rebound. Last week, Lagarde also stated that she didn't think the recent shift in the Fed's framework would be carried over to other major central banks, citing the difference in mandates. This could make for some interesting divergences in CB policy as growth and inflation pick up. For many years the unified response across many central banks has suppressed FX volatility and growth differentiation.

In the meantime, we heard from a number of Fed officials last week, including Chairman Powell. They were united in their continued dovishness but clarified what the sequence of policy removal might look like when it starts. As in 2013-14, they will likely taper bond buying, then hold the balance sheet steady via reinvestment, and finally hike rates. Powell stated that the economy is now at an "inflection point", but that he thought interest rate hikes before 2022 were very unlikely. This is the first time we have had a specific calendar reference. Vice-Chair Clarida discussed a recent Fed paper that emphasized the "lower for longer" likelihood given the new framework. All in all, I was left with the feeling that tapering may come sooner than the market thinks but rate hikes may be slower.

On that point, the Fed's Bullard said that reaching the 75% vaccination level in the US would allow for the taper debate to start. Some analysts now think we could hit that level by June.

The combination of very easy financial conditions, an equity melt-up of sorts and very strong economic data, is going to keep markets focused on every word coming out of the Fed.

Deutsche Bank points out that the scale of the government packages we have already seen, and the still coming infrastructure bill, is drawing comparisons to the "New Deal" in the 1930's.

Here is what they have come up with, even before the infrastructure package.

Note how the quick action and the on/off nature of shutdowns have generated a much different outcome.

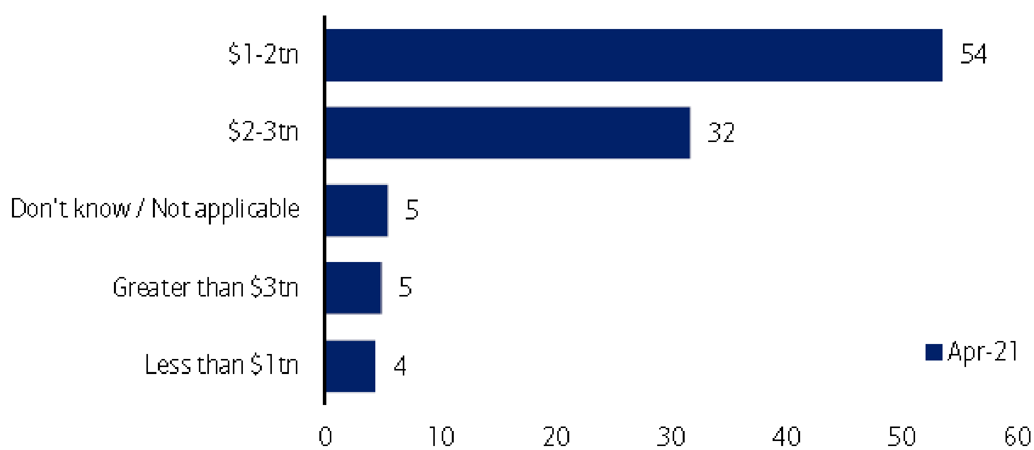
Figure 1: What was bigger? FDR's New Deal; The 2008 Recovery Act; and Trump 1&2 CARES/COVID plus Biden COVID

	New Deal	2008 Recovery Act	Trump 1& 2 CARES/COVID + Biden COVID 1
Total cost (USDbn - 2020 dollars)	788	1013	4100 (deficit impact less loan guarantee take-up)
Per capita cost (2020 dollars)	6311	3303	12400
Cost compared to nation's output	40% of 1929 output	5.7% of 2008 output	19% of 2020 output
Increase in federal debt (as a fraction of gross national product)	30.3% 1931 to 1939	32% 2008 to 2011	24% debt held by public 2019 to 2022
Negative output gap 1y after start of crisis	-30% of GDP	-5.5% of GDP	-3% of GDP
Equities 1 yr after crisis relative to peak	-37%	-30%	+22%

Source : Deutsche Bank; Federal Reserve of St.Louis

While it is likely to be a longer path, investors think that another $2Trl will eventually be passed.

Exhibit 16: FMS Investors expect roughly $1.9tn to be passed
What do you think will be the size of the U.S. infrastructure package?



Source: BofA Global Fund Manager Survey

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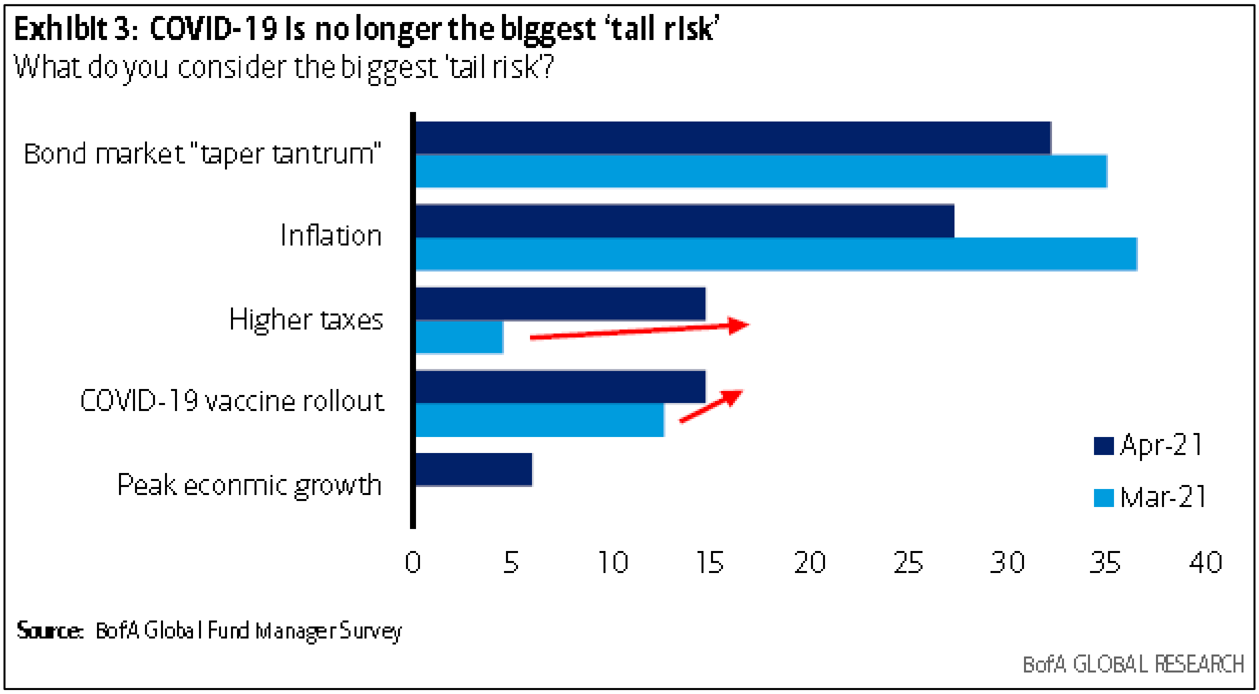
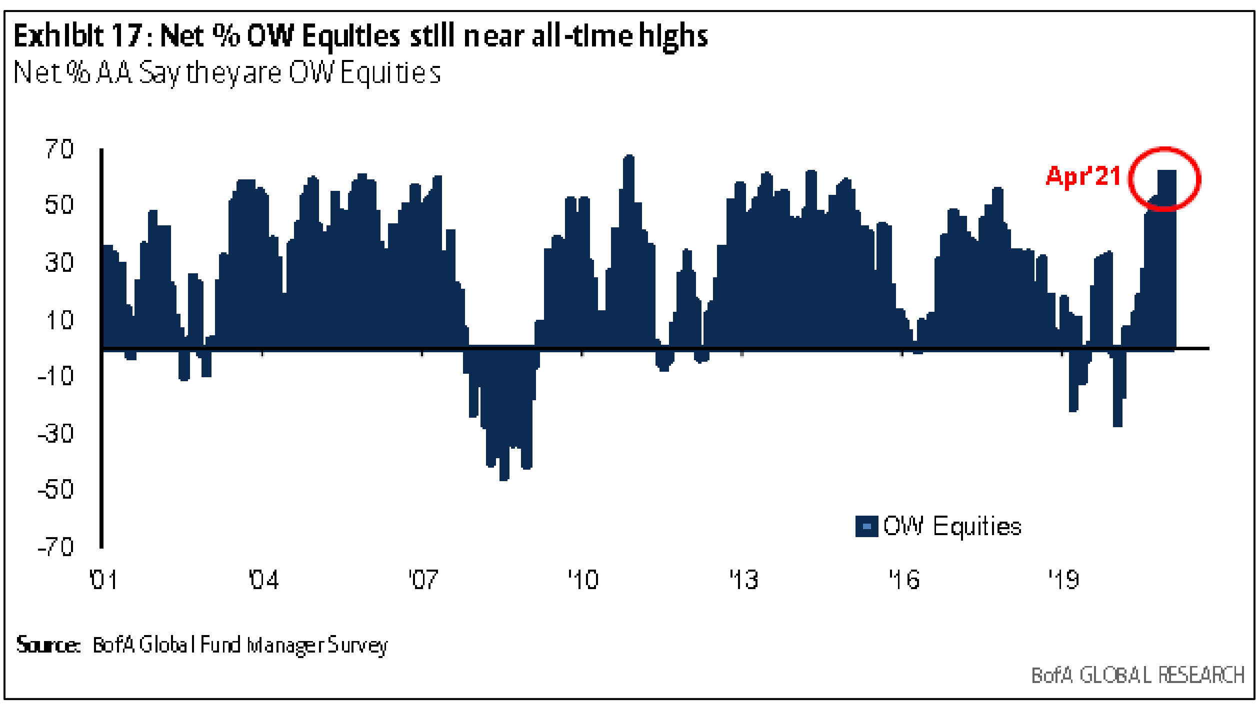
Stargazer
Asset Management

Interestingly, how much the view of biggest “tail risk” has shifted, with Fed policy, inflation, and higher taxes now front and center.



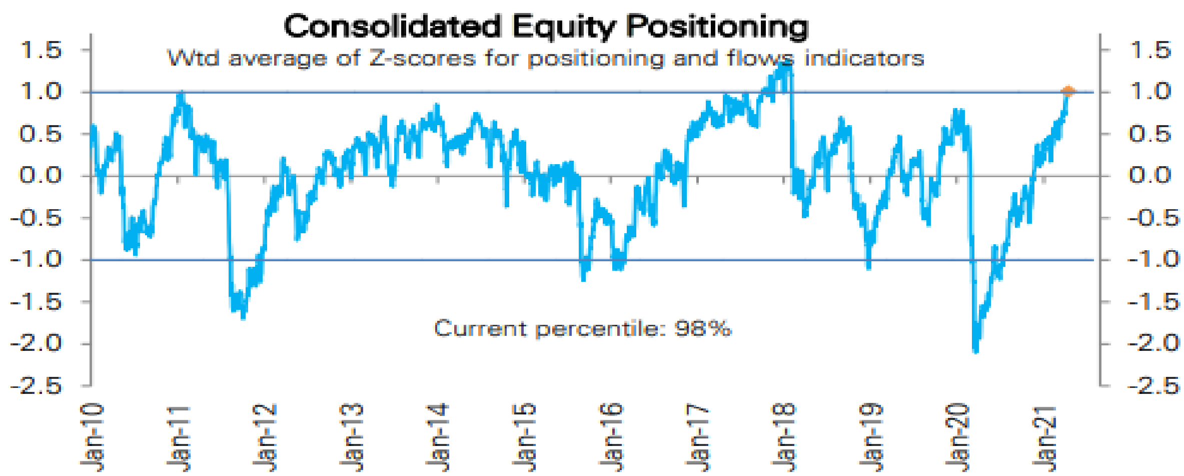
What to Focus on Now:

Equities – Given the price action, it should be no surprise that people are long.



We are slowly but surely getting back to the 2018 positioning levels.

Figure 18: Consolidated equity positioning[1]

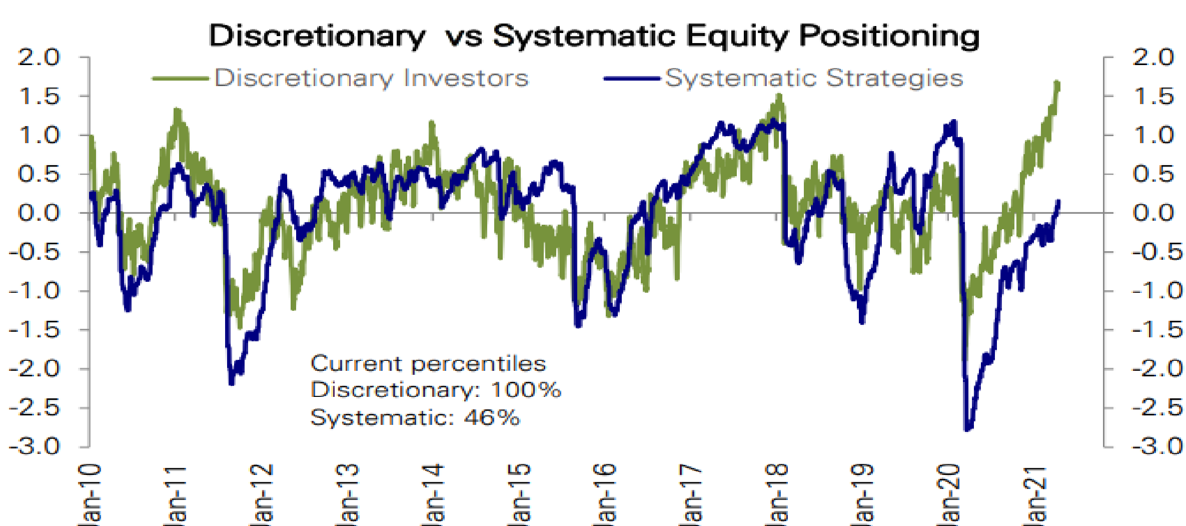


*Weights based on explanatory power in regression of equity performance on indicators

Source : EPFR, CFTC, Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation

Discretionary positioning is already there, but systematic positioning has been holding back the consolidated number.

Figure 5: There remains a notable divide between discretionary positioning at a new record high and systematic positioning at near median levels

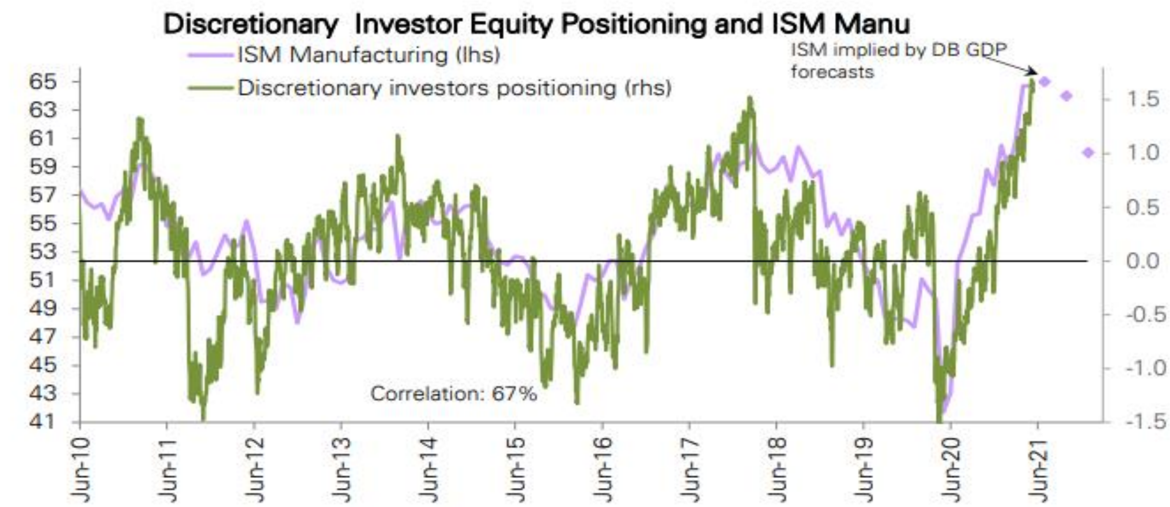


*Wtd average of Z-scores for positioning and flows indicators, weights based on explanatory power in regression of equity performance on indicators

Source : EPFR, CFTC, Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation

The relationship of discretionary positioning to the booming ISM Manufacturing data has been tight. However, ISM's are expected to peak in the coming months.

Figure 9: In keeping with historical behavior, the rise in discretionary positioning has been in line with that in the ISMs



*Wtd avg Z-score across indicators; weights based on explanatory power in regression w/equity perf

Source : ISM, EPFR, CFTC, Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation

While, until recently, stubbornly high volatility has held back the systematic exposure.

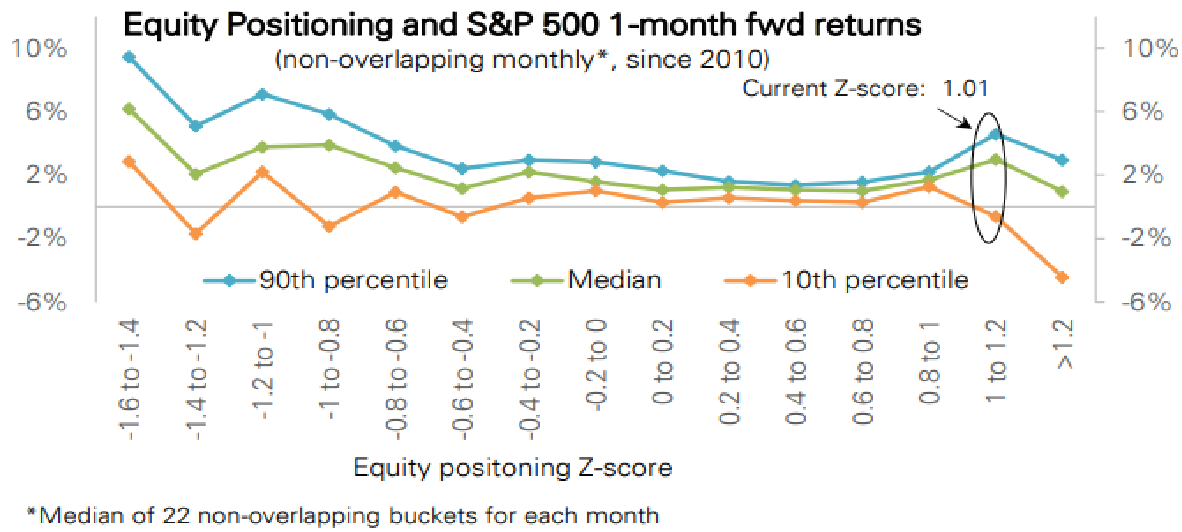
Figure 8: The recent leg up in systematic strategies exposure has followed the decline in equity volatility

*Wtd avg Z-score across indicators; weights based on explanatory power in regression w/equity perf

Source : Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation

It is interesting to note that higher positioning tends to bring a wider distribution of returns and more downside risk.

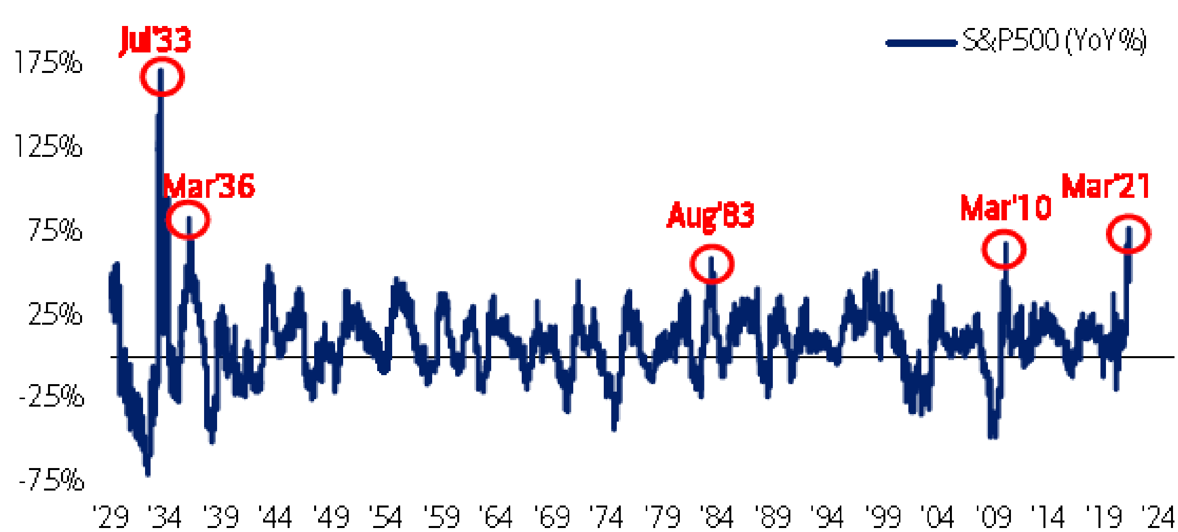
Figure 17: Elevated positioning tends to see a wider distribution of 1-month forward returns and increased skew to the downside



Source : EPFR, CFTC, Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation

This run-up off last year's March lows has been one for the record books.

Chart 2: 76% jump in US stock prices YoY from Mar'20 lows = 3rd largest jump in 100 years
US stock prices in YoY terms back to 1928



Source: BofA Global Investment Strategy, Bloomberg

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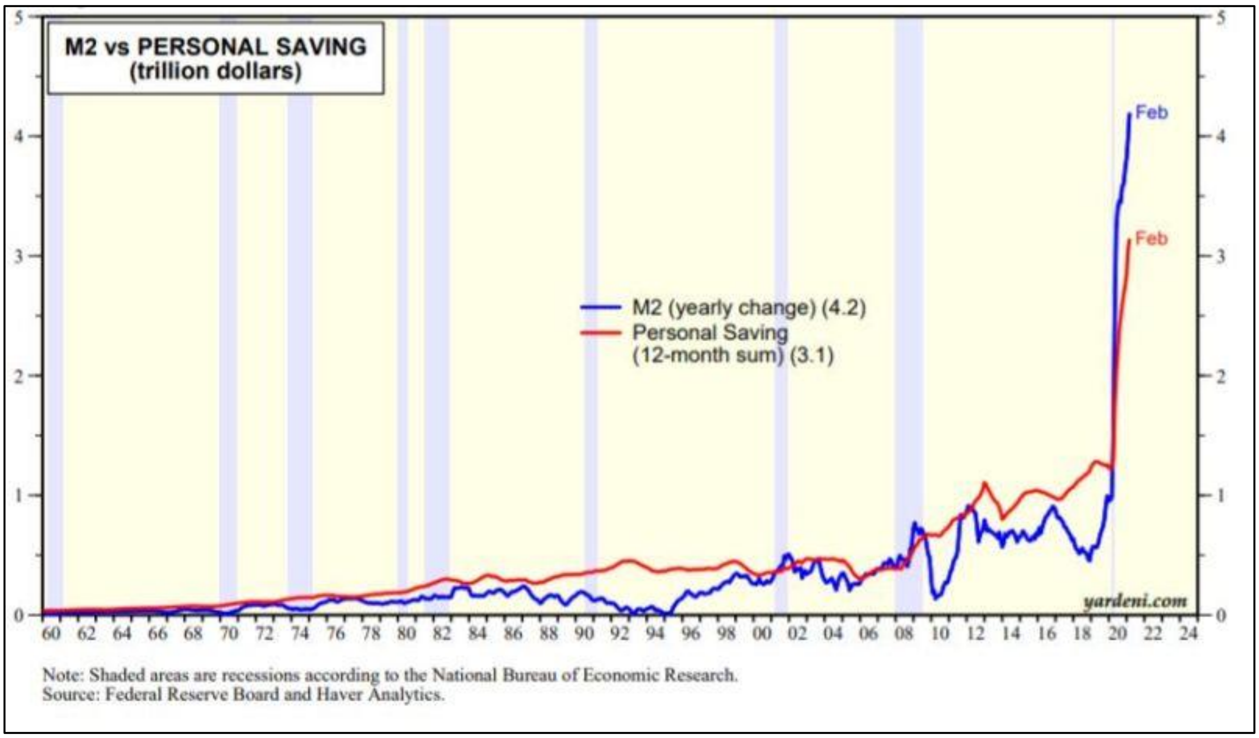
Of course, so has nearly every aspect of the COVID outbreak, including the suddenness of the lockdowns and the size of the government response, and resulting powerful snap-back.

There are certainly lots of sentiment and positioning indicators flashing red, but we are still likely to get a number of months with very solid growth data. Given massive liquidity, pent-up demand, and continued data surprises, there is potential for a further melt-up. To borrow a formula from economist Ed Yardeni: MMT + TINA + FOMO (my addition) = MAMU (mother of all melt-ups).

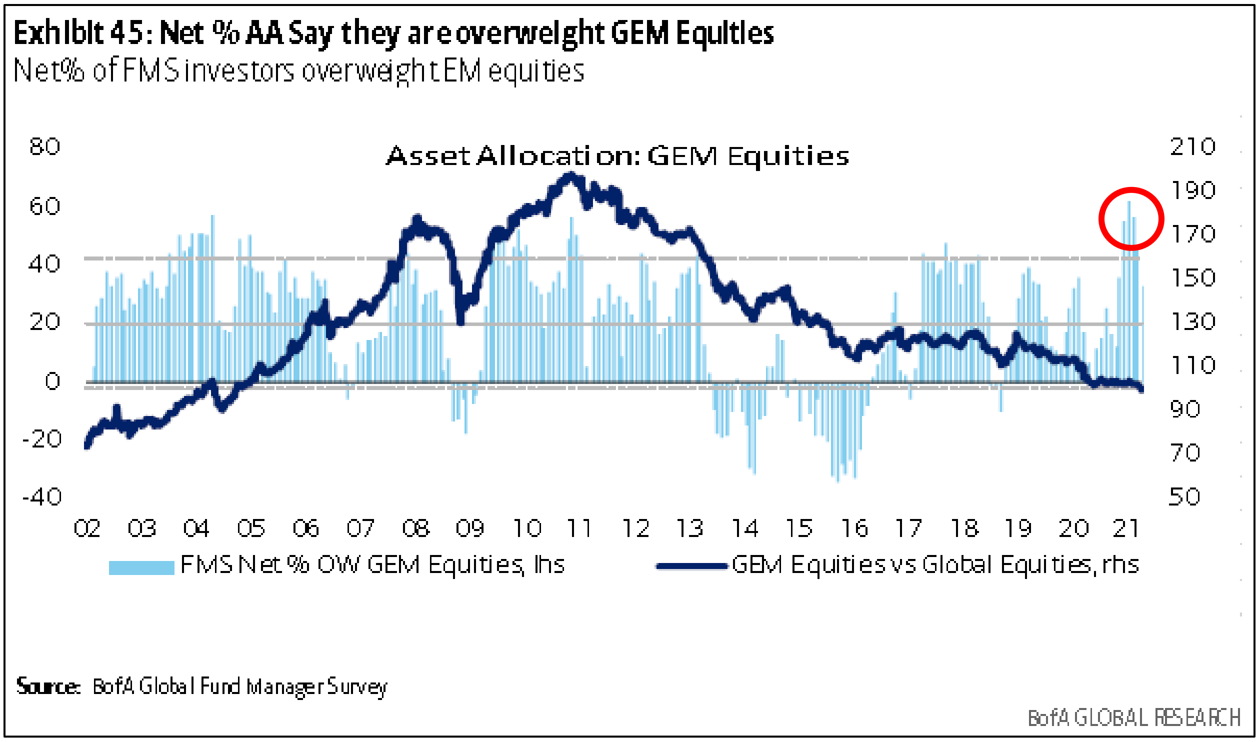
This was before the recent $1400 payment…



The powerful flow into equities combined with a shifting relative growth environment, COVID waves, vaccine news, and dollar and bond moves, has made for continued frantic rotation and un-rotation.

Some of the real highfliers of a few months ago, have taken big hits, as capital moves to other areas. Clean Energy and Biotech have been casualties, as have many of the stocks held in some of the very popular "innovation" ETFs.

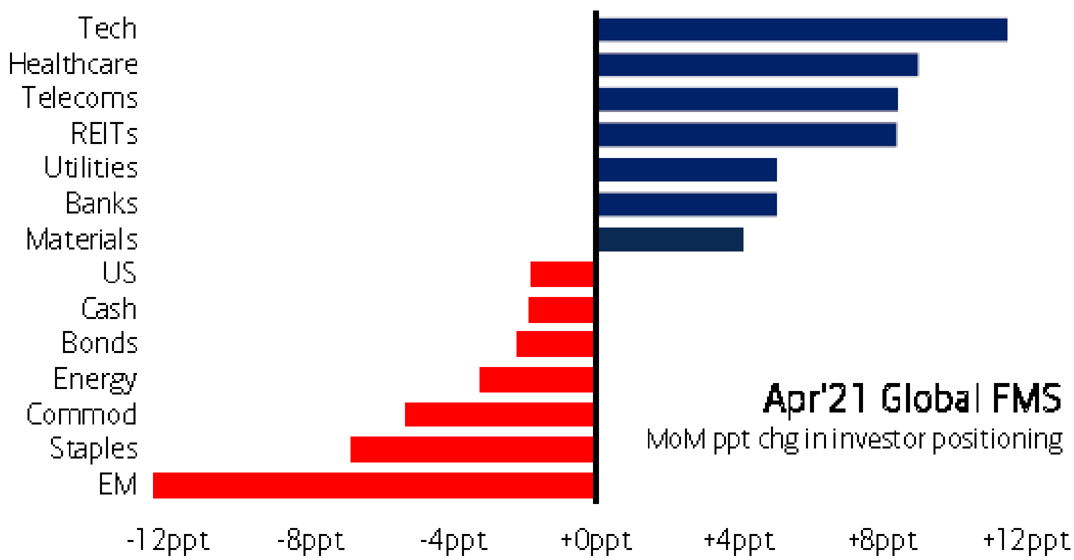
EM is another one that got taken down a notch recently, as greater China has underperformed, just as positioning got max long.



Giving back a big chunk of the 7+ months of EM outperformance we had seen.

The flows show the rotation back out of EM and into Tech…

Exhibit 2: ...but investors are back into tech and out of EM this month
Month on Month change in FMS investor positioning



Source: BofA Global Fund Manager Survey

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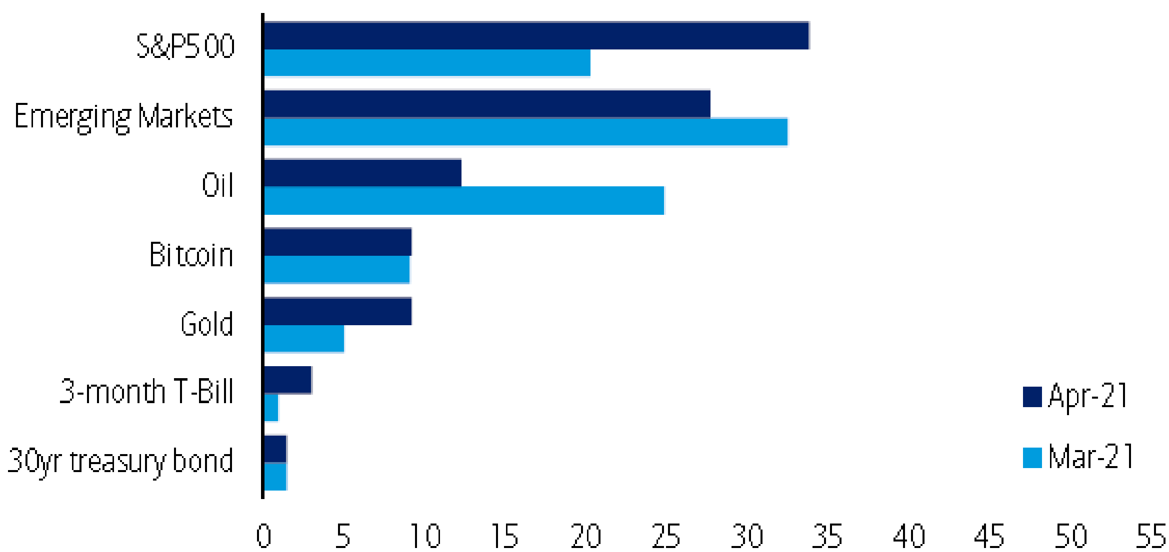
Now, after the price move, investors again think the S&P will outperform EM this year.

Exhibit 14: Investors now think S&P500 will outperform EM in 2021
What asset class do you think will outperform in 2021?



Source: BofA Global Fund Manager Survey

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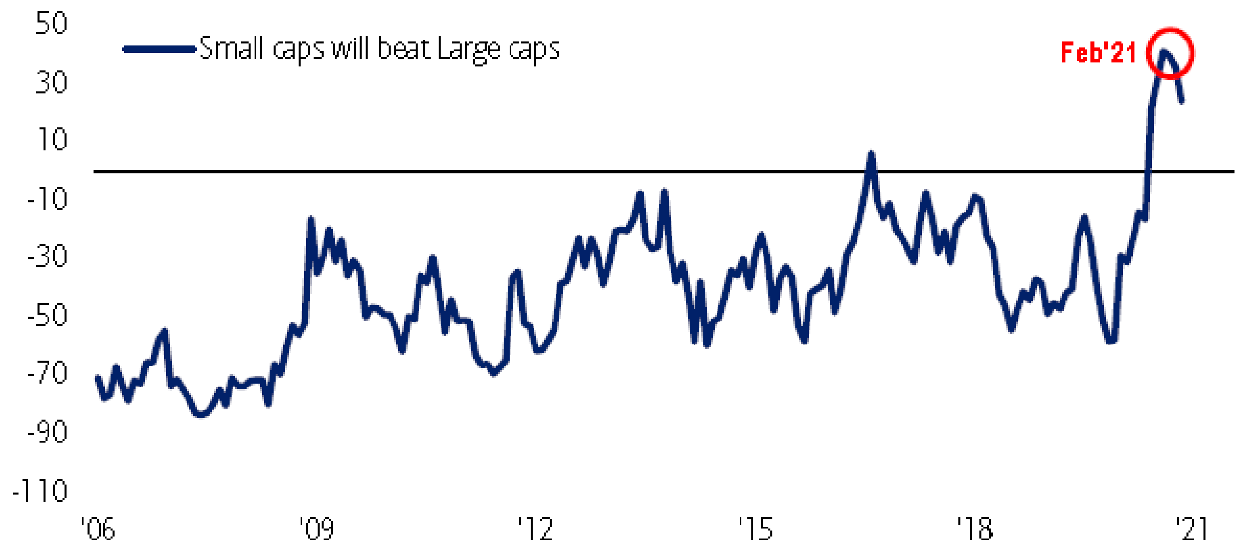
With the recent Russell underperformance, after a great run, sentiment is starting to weaken.

Exhibit 22: Net % think small cap will outperform large cap has fallen in recent months
Net % Think Small caps will Outperform Large Caps



Source: BofA Global Fund Manager Survey

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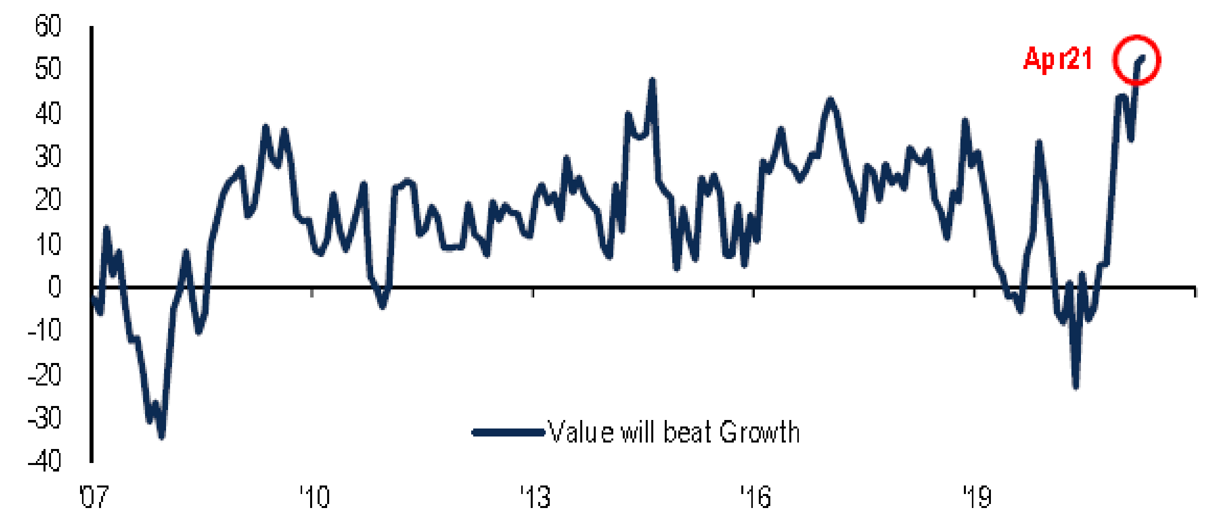
However, value is still seen as a clear winner over growth, at the moment. Fast moving markets!

Exhibit 23: Record net % think value will outperform growth
Net % Think Value will Outperform Growth



Source: BofA Global Fund Manager Survey

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In the meanwhile, Europe has pushed on after breaking the long-standing top of its range.

DB continues to make the case that there is a lot of pent-up demand in Europe about to be released… with durable goods the driver.

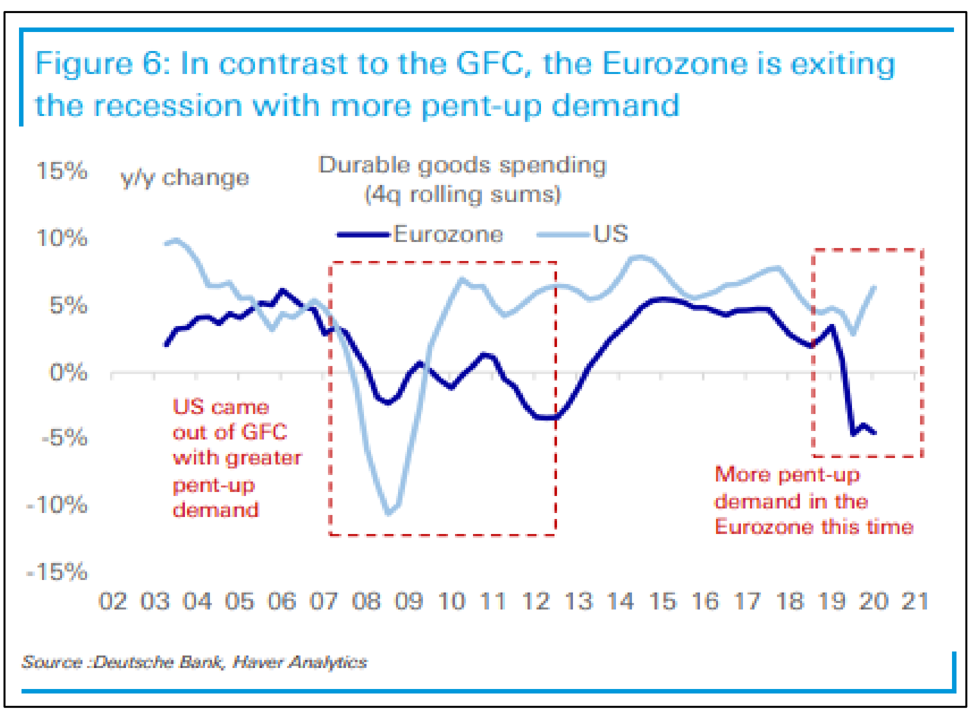


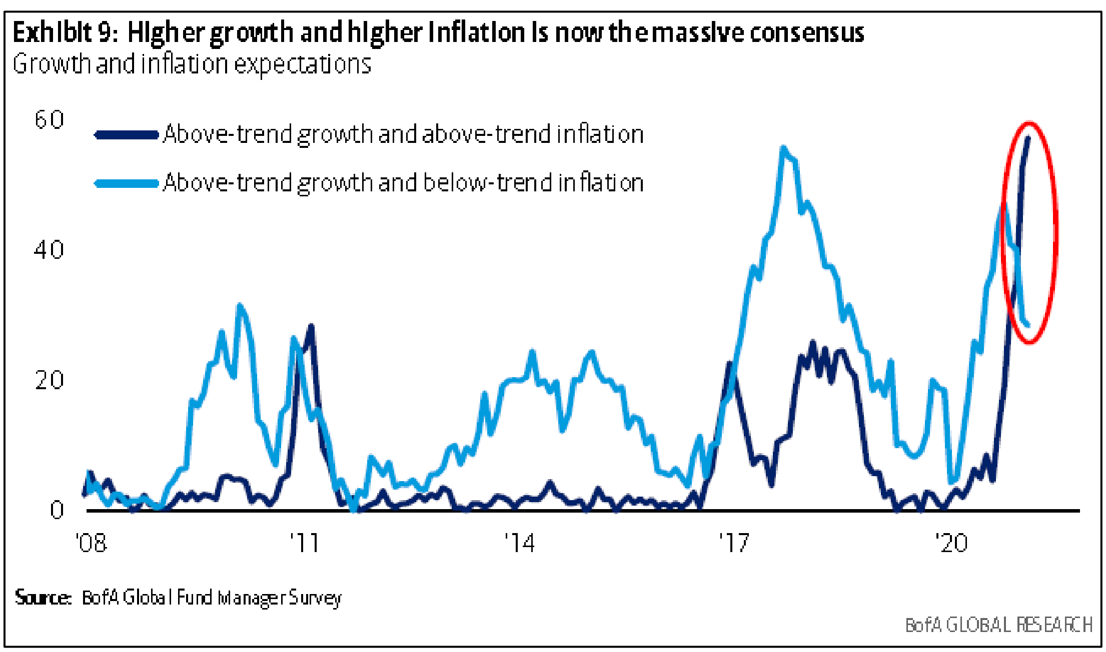
Figure 6: In contrast to the GFC, the Eurozone is exiting the recession with more pent-up demand

Bonds

Last week there were lots of strong data, and plenty of issuance, but bond markets didn't care. In fact, the $24bln in 30-year bonds, saw very strong demand at the auction.

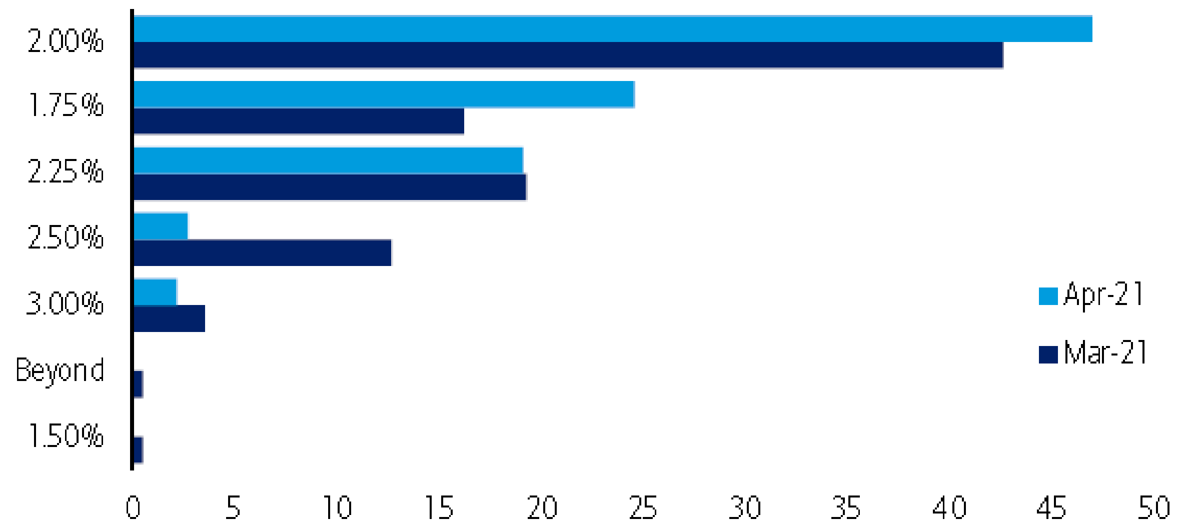
The expectation by markets, is that the next V-shaped recovery we see will be in inflation and labor markets.

With expectations so high, it takes a big data beat to surprise people now.



A lot of market participants have been thinking that as we approach 2% in 10-year yields they could be attractive, either because they will rock the boat for equities…

Exhibit 12: 2.1% on the 10-year Treasury could be the level of reckoning for stocks
What level on the 10-year Treasury yield will cause a +10% correction in stocks?



Source: BofA Global Fund Manager Survey

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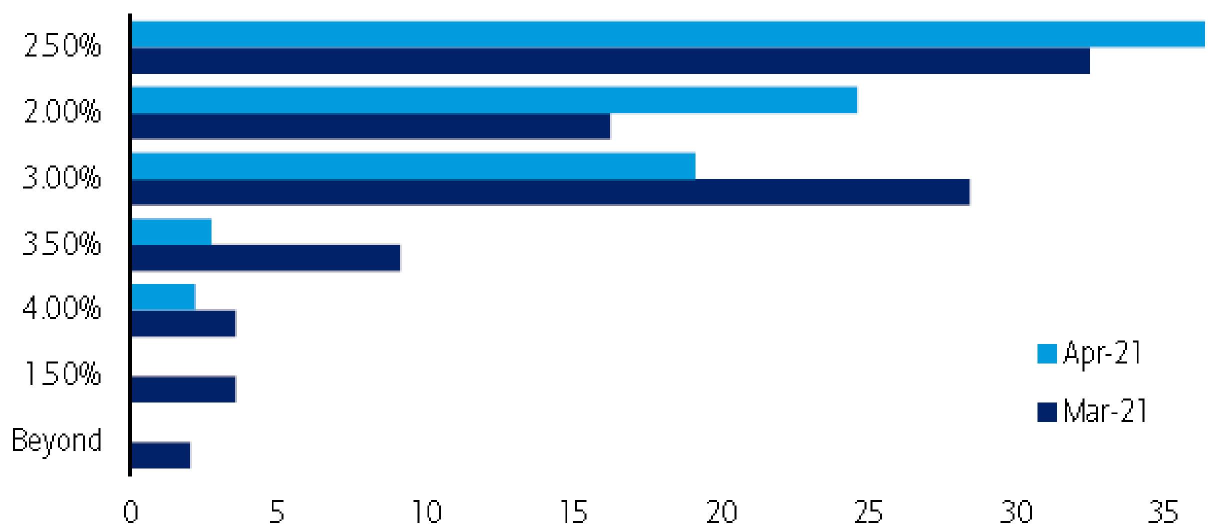
or just on a relative basis.

Exhibit 13: 2.3% on the 10-year Treasury makes bonds attractive rel to stocks
What level on the 10-year Treasury makes bonds attractive relative to stocks?



Source: BofA Global Fund Manager Survey

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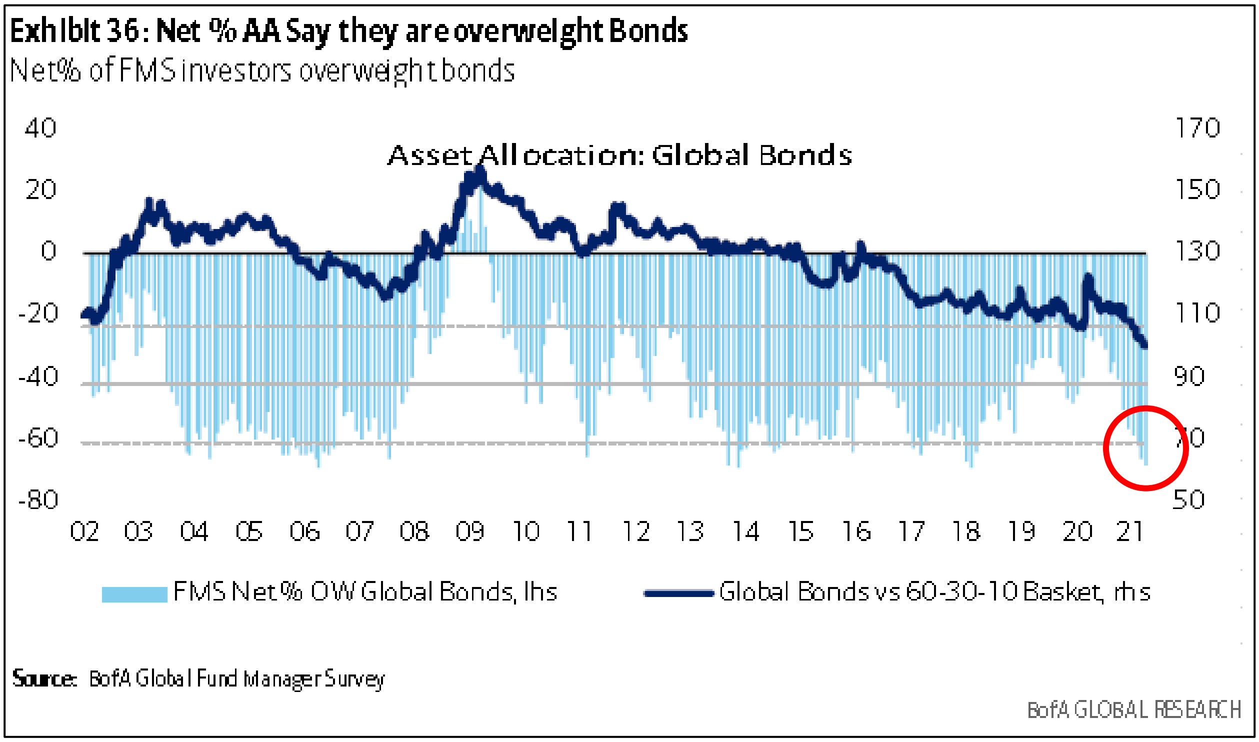
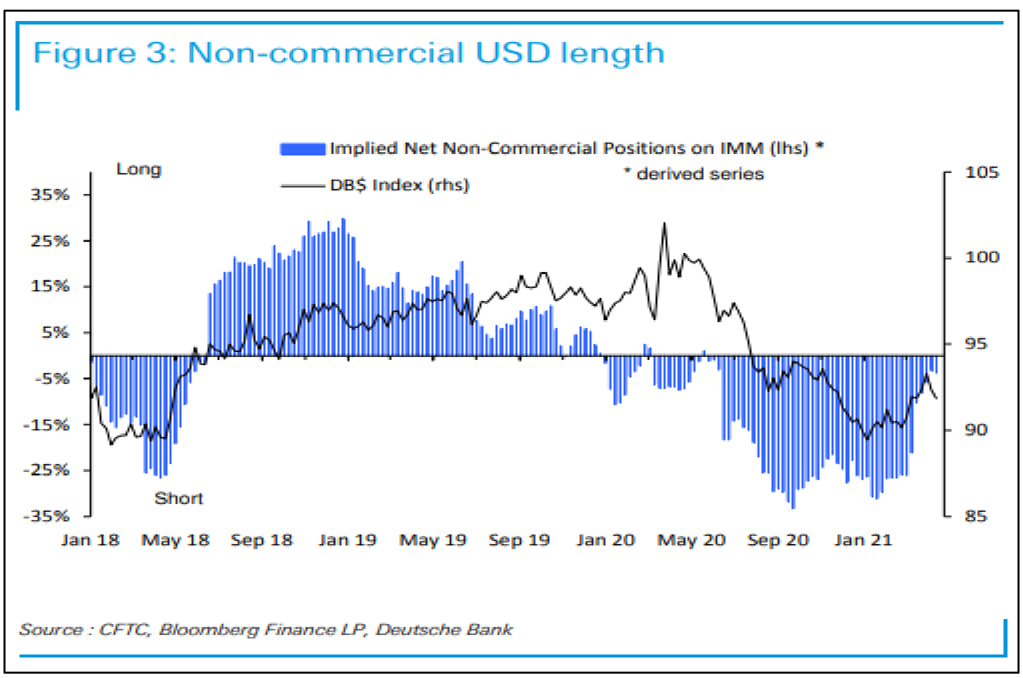
We got close to 1.80%, and it seems that given the positioning, which is solidly the other way, that was enough. At least in the US, a time and price correction is playing out, and some shorts have been squeezed.



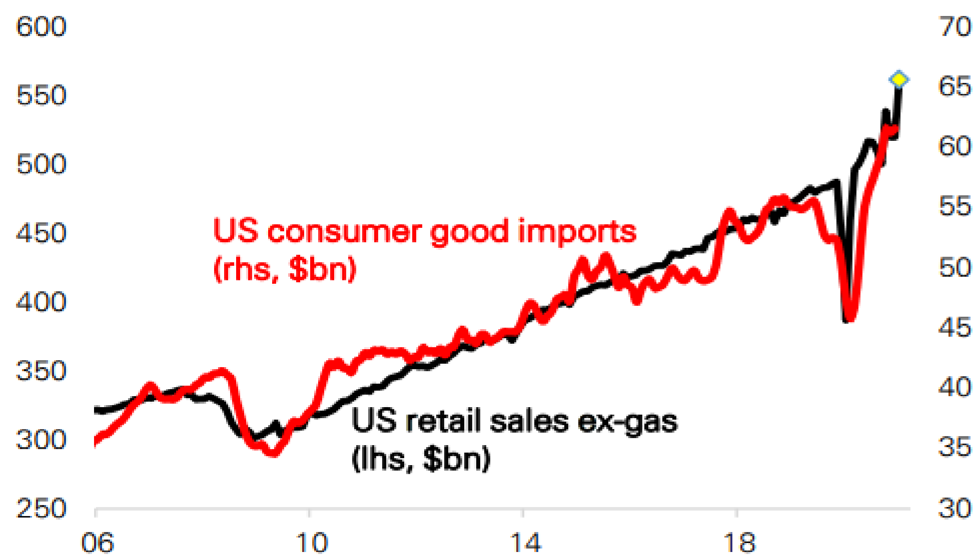
FX

The very oversold conditions we had seen in the USD, have largely been unwound.



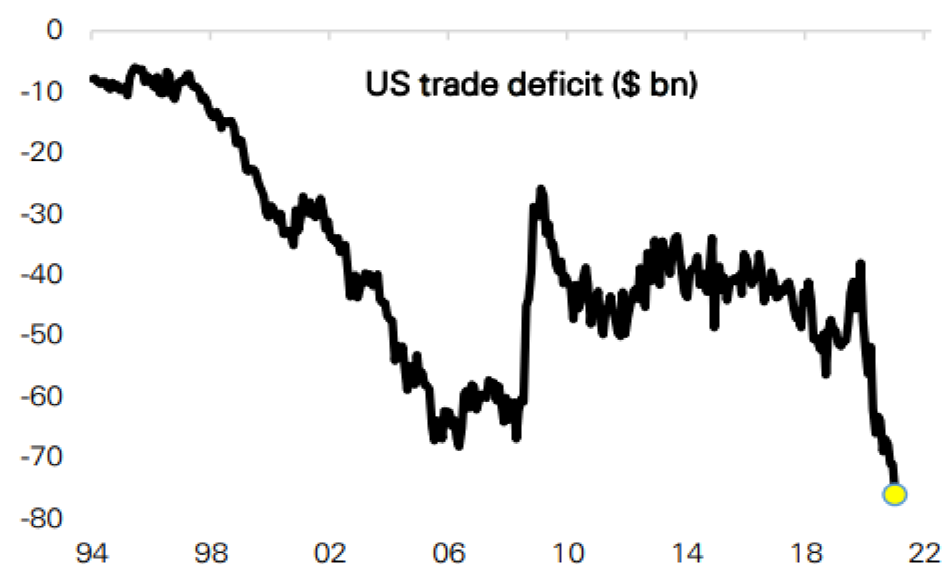
The central case for the dollar bears remains intact. A dovish Fed and a deteriorating external account as consumers re-engage.

Figure 1: More spending = bigger imports



Source : Deutsche Bank, Bloomberg Finance

Figure 2: Trade accounts deteriorating sharply



Source : Deutsche Bank, Bloomberg Finance

However, how the global relative growth picture plays out, will also be key for FX.

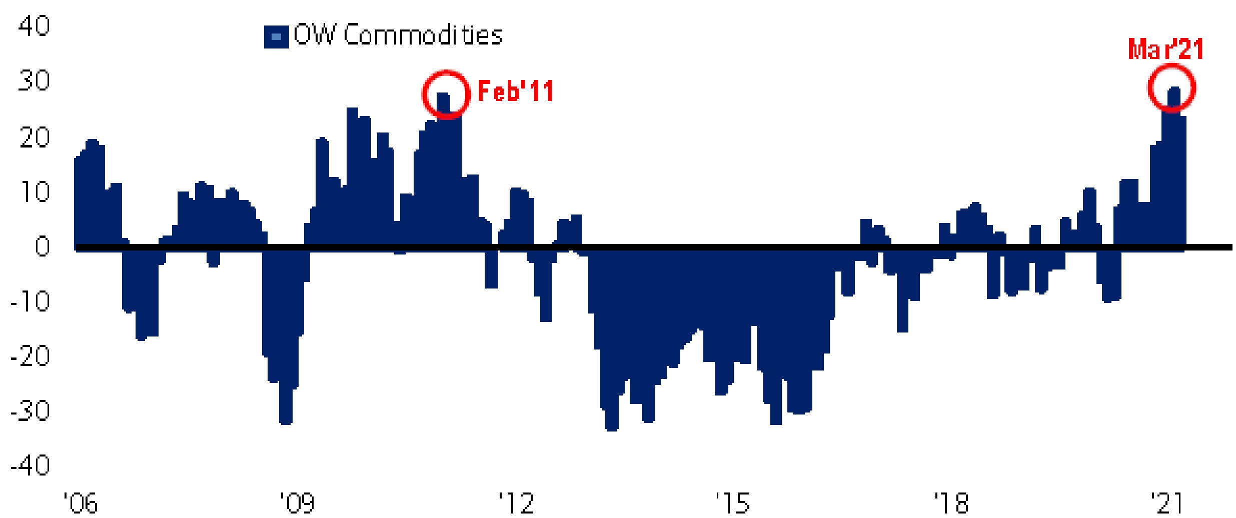
Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649

For the EUR and the DXY, I find myself lacking conviction in the near term. There is currently a lot of differentiation in FX, as a result, I'm looking at crosses on an individual basis, rather than using a simple USD up/down template.

Commodities – While there has been a good amount of commodity related positioning, it doesn't feel like, in the big picture, it is very extreme. Yes, vs. recent years it has certainly jumped, but we have largely been in a commodity bear market for many years, so total allocations are still likely very low.

Exhibit 18: FMS Global commodity allocation has rolled over

Net % AA Say they are Commodities



Source: BofA Global Fund Manager Survey

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Because there is such differentiation between commodities, and the heavy traditional weighting of oil in most of the commodity indices, it is very hard to get a real top-down view of the asset class.

Grains and lumber have been hot, but they have their own stories.

There is lots of talk about copper being the new oil because of the global switch towards electric vehicles.

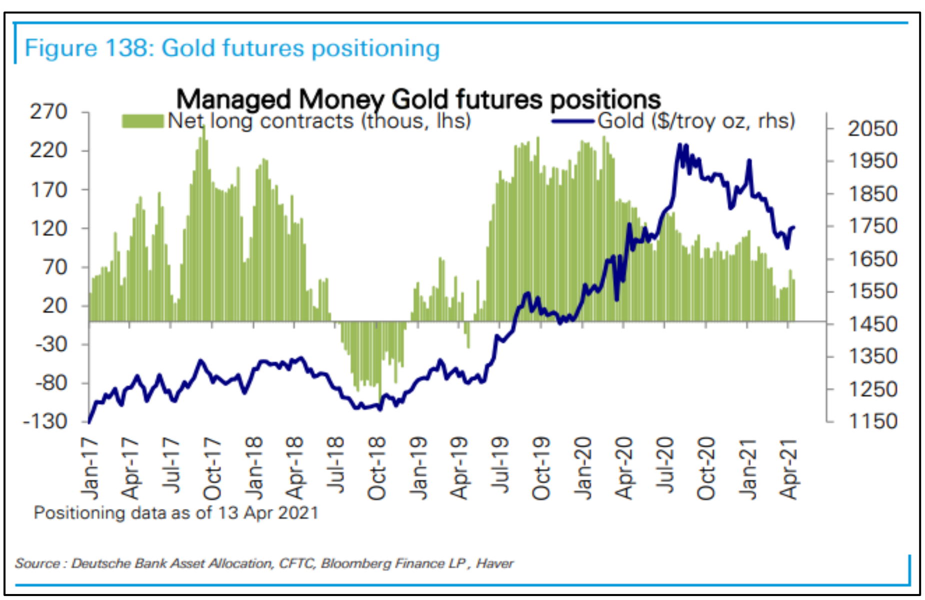
If the markets look to gain real and lasting exposure to commodities as an asset class, however, I would note the difficulty of sitting with long positions in the underlying commodity, given storage costs etc.

It seems to me, that from a sector allocation perspective, commodity related companies are the way to go, rather than physical.

Stargazer Asset Management

While equities like FCX have had a big move off the lows, it is worth having a look at them on a longer-term relative basis. However, when we get away from idiosyncratic drivers of individual commodities, the dollar really matters. The effect of periods of dollar weakness and strength can be very substantial on performance.

With the downward pressure off bonds and some renewed USD weakness at the end of last week, even things like Gold have perked up. Positioning is much reduced.



Gold has held so far, so let's see how it develops…

The miners held too.

Next week markets will continue to monitor the path of the pandemic and progress on vaccinations. Earnings reports continue, and we have the ECB on Thursday and global April flash PMI's on Friday.

Important Macro Data Releases and Events for the Week

Monday
4/19/2021

- PBoC Interest Rate Decision
- RBA Meeting Minutes

Tuesday
4/20/2021

- Claimant Count Change and Unemployment Rate
- ECB Lending Survey

Wednesday
4/21/2021

- CPI and PPI (Mar)
- BoE's Governor Bailey SPEECH
- 10-y Bund Auction
- CPI (Mar)
- BoC Interest Rate Decision and Monetary Policy Report

Thursday
4/22/2021

- **ECB Interest Rate Decision, Policy Statement and Press Conference**
- Initial Jobless Claims Forecast: -, Prior: 576k
- Initial Jobless Claims 4-week average Forecast: -, Prior: -
- Continuing Jobless Claims -, Prior: -
- Consumer Confidence (Apr) Forecast: -10.9, Prior: -10.8

Friday
4/23/2021

Retail Sales (Various)

Markit Manufacturing and Service PMI's across Europe

Markit Manufacturing PMI (Apr) Forecast: 59.3, Prior: 59.1

Markit Service PMI (Apr) Forecast: 61.5, Prior: 60.4

Markit PMI Composite (Apr) Forecast: -, Prior: 59.7

New Home Sales MoM (Mar) Forecast: 0.88M, Prior: 0.775M

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Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649