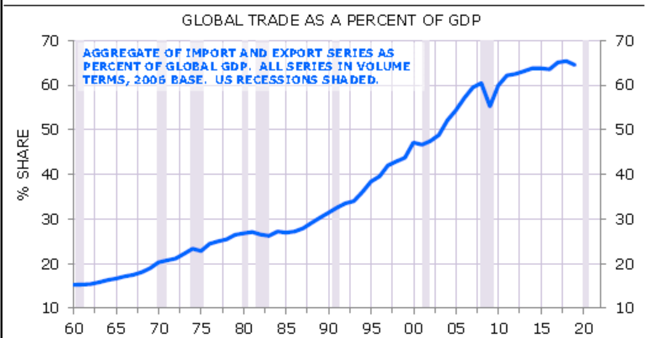
What to focus on in Global Macro for the week of August 17th, 2020

Macro Themes on the Radar:

With continued stress between the US and China and Xi pushing to increase the focus on internal consumption growth, it is worth contemplating what might follow. I'll explore this more in the coming weeks, but supply chain vulnerabilities exposed by COVID and already growing concern about blue collar jobs and wealth inequality in DM is having political and economic consequences for the global trade system. This tension is not likely to disappear whether Trump or Biden occupies the Oval Office, although the form it takes will differ. Going forward, the US and Europe may be increasingly willing to trade efficiency for resilience.

Exhibit 1

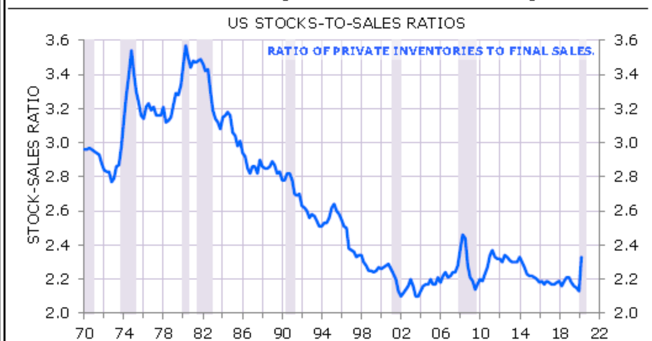
Peak trade?



Source: IMF, NBER; Minack Advisors

Exhibit 2

Just-in-time efficiency, but less resiliency



Source: BEA, NBER; Minack Advisors

High and rising government and consumer debt, deteriorating demographics and growing wealth inequality are being held together by low global rates. However, a meaningful and protracted shift away from globalization is likely to increase global political instability as economic ties are loosened between countries. It is also likely to be inflationary. Maybe not quite yet, but this is a big macro story to keep an eye on, with far reaching potential consequences.

What to Focus on Now:

The rebound in equities and retail sales, combined with a rising China credit impulse and higher inflation prints, is starting to weigh on bonds.

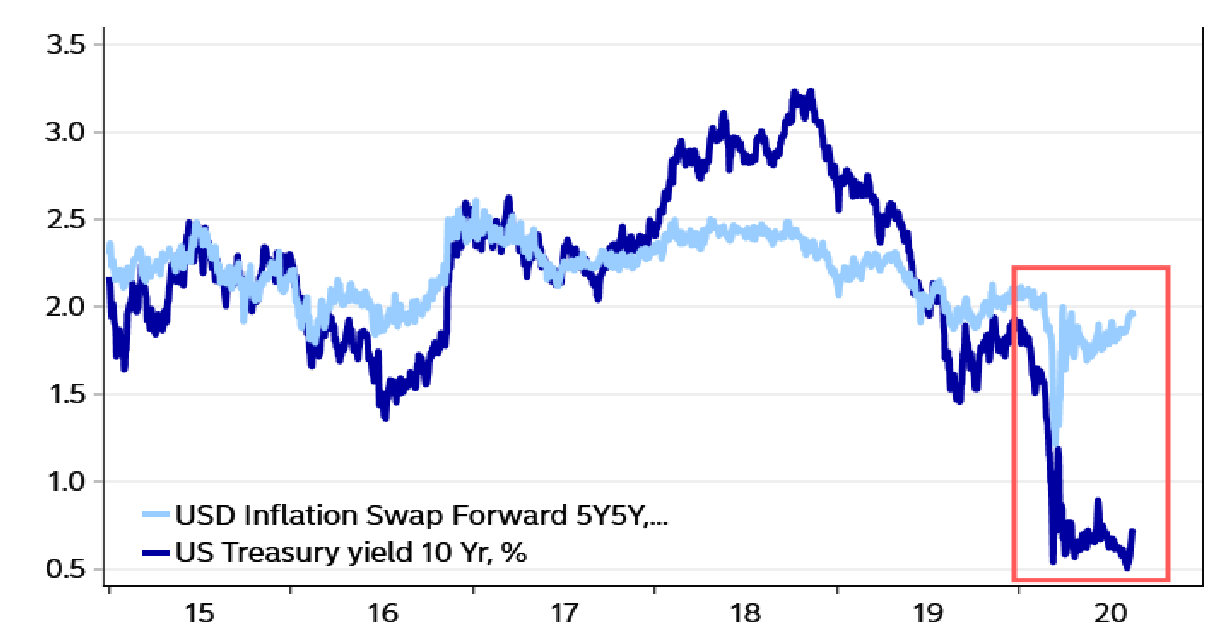
The V in stocks and other risk assets generally correlated to global growth, like AUD and Copper, have not had a meaningful impact on Treasury yields.

Nor has the bounce in Global Manufacturing PMI's made much of an impression… until now.

Over the last week +, US 30-year yields have popped over 25bps. Not a big deal if the move runs out of steam here, but potentially very impactful if it has legs.

For the last few months, NIRP in Europe and Japan, forward guidance in the US and the potential for a second wave and Yield Curve Control, have kept US yields from rising… What about the potential move to Average Inflation Targeting? Again, inflation expectations have recovered but yields have not.

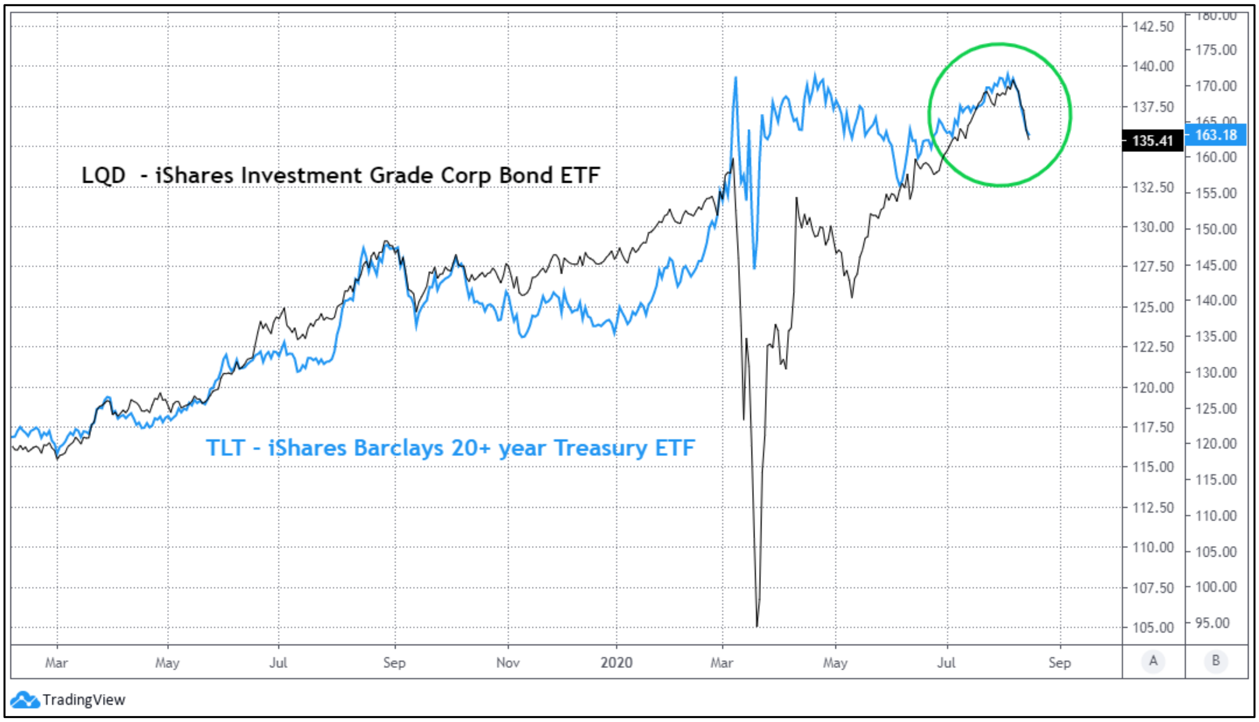
Chart 5. The average inflation targeting trade in one chart



Source: Macrobond and Nordea

Stargazer Asset Management

With the Fed buying both Treasuries and Corporate bonds, the spread compression already in place means that we are just trading on yields for the moment.



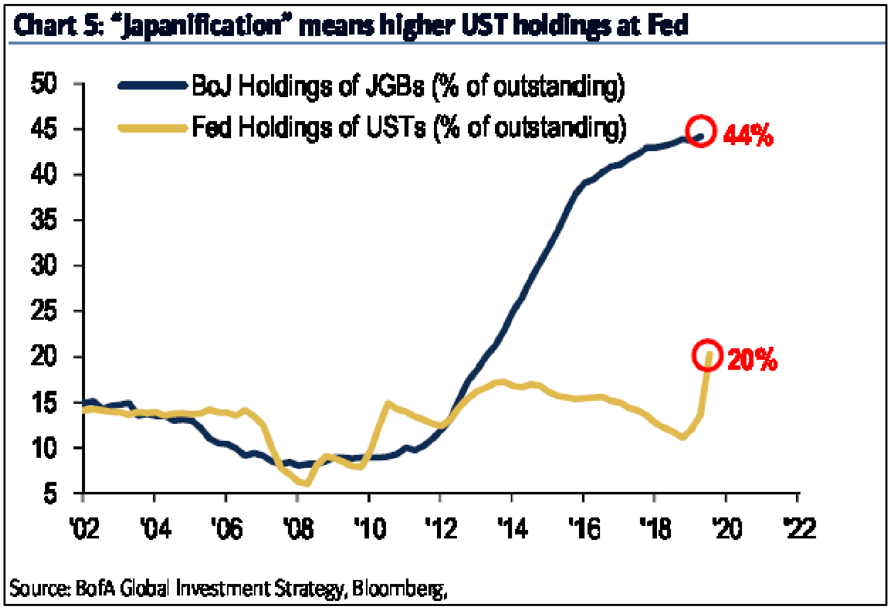
We now face a big IF. <u>If yields continue to rise what will the Fed do?</u> How they react to a potential rise in yields will have big consequences for markets.

Option #1 Do they just let yields rise while continuing with their plan (formal or informal) to let inflation "run hot"? This could open the door to an accident in Treasury yields where you get a large jump. It would also have the effect of tightening financial conditions immediately via higher yields, and a potential retrace higher in the dollar. Corporate bond prices could fall via yields or wider credit spreads. Stocks could fall too as the discount factor is adjusted. However, markets would sort it out and this would be the "free market" way.

Option #2 These days CB's have not been in the mood to let markets sort it out, and that is where Yield Curve Control comes in. Do they see the need, or have the guts, to do it? It would be crossing the Rubicon (again) for the Fed. The nuclear option of course would be formal inflation targeting <u>AND</u> YCC.

In either case, the first step is that bond markets selloff and yields rise. If that happens, things could quickly get messy and realized volatility should pick up across asset classes. If yields don't rise, it is back to the status quo.

BoA/ML argues that Europe and the US are facing economic Japanification and that as a result the Fed will continue to buy large amounts of Treasuries for a long time to come.

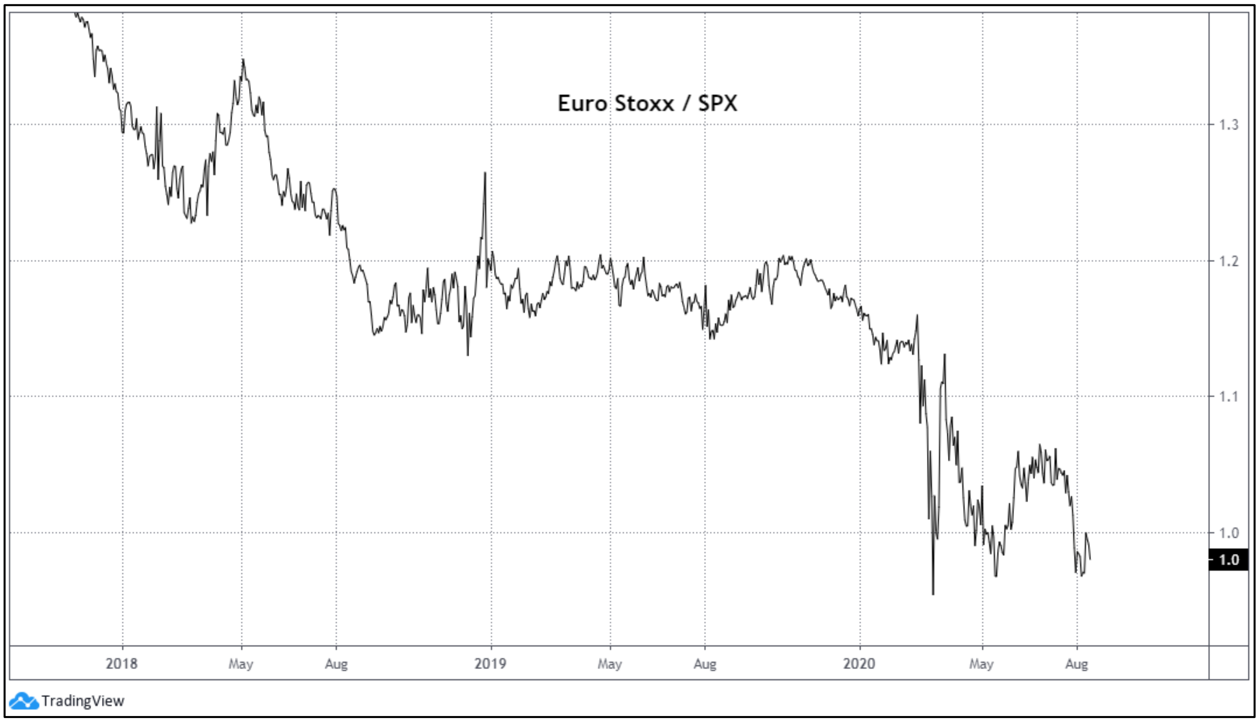


Interestingly, Japan's experiment with YCC has yielded unspectacular results, but the JPY is also not the global reserve currency. That matters.

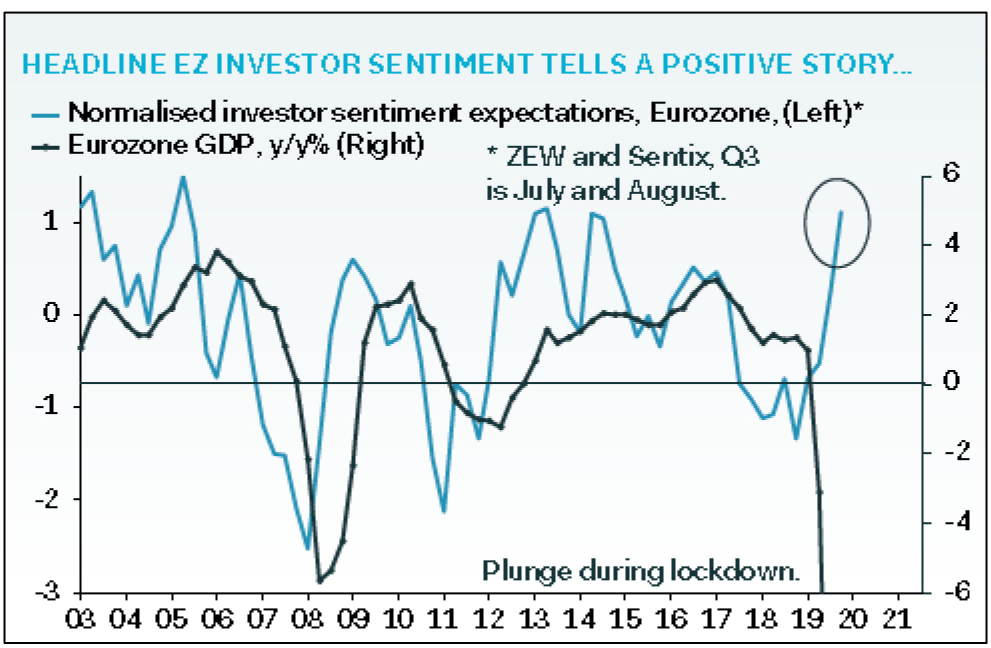
In a year of extraordinary market moves, with unprecedented events feeling almost common place, I think it is ok and maybe even essential to have some imagination and play the tails. What if a few months from now inflation is higher and unemployment is lower than anyone currently thinks possible? Can we steepen the front of the curve as well?

Europe

European equities have continued to underperform on a relative basis, despite agreement on the EU Recovery Fund.



This is despite investor sentiment picking up…



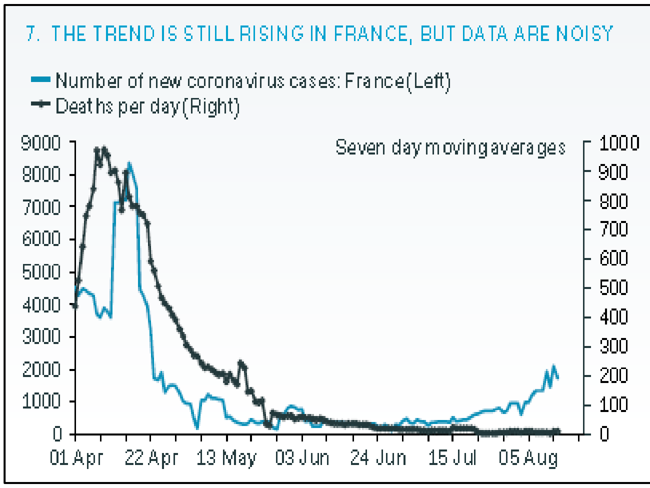
Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649

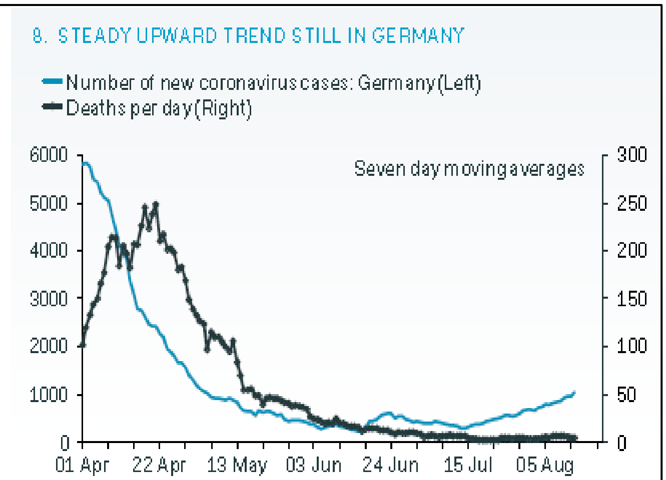
Stargazer
Asset Management

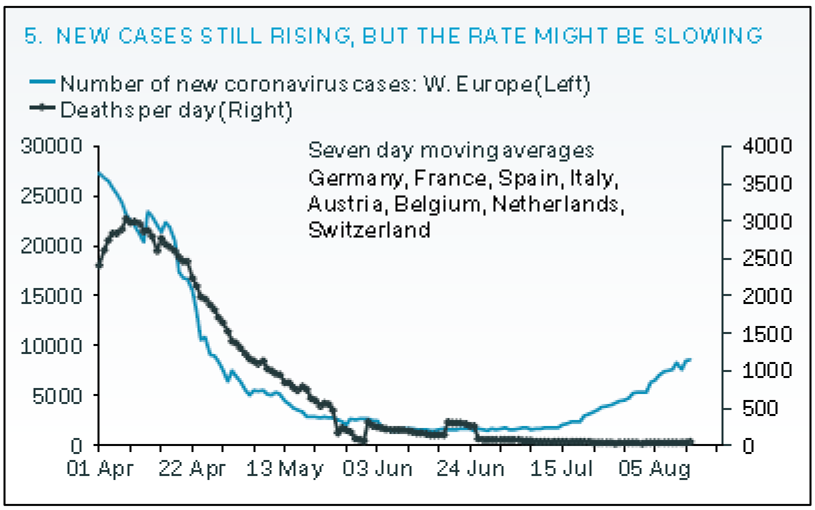
Industrial production is picking up too, but is still well off pre COVID levels.

On an absolute basis European stocks have also not been able to achieve escape velocity over the last 4-5 weeks. Germany and France have been doing the best.

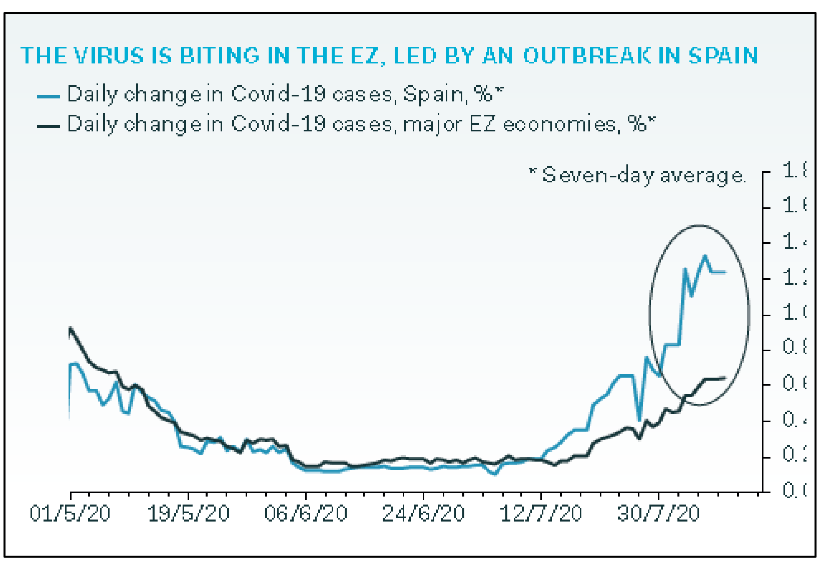
COVID has been rebounding over the last month in Europe and that has almost certainly been part of the problem. (Pantheon Macro source of following charts)





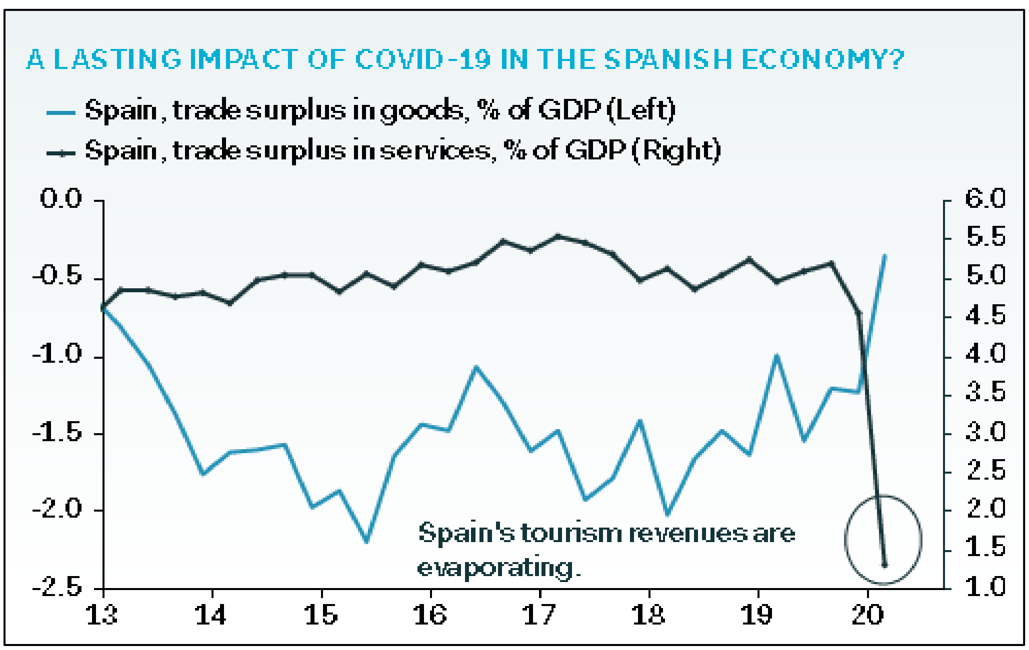


Thankfully death rates have remained low even as the number of cases has risen. Spain has been ugly however… and Spanish equities have reflected it.



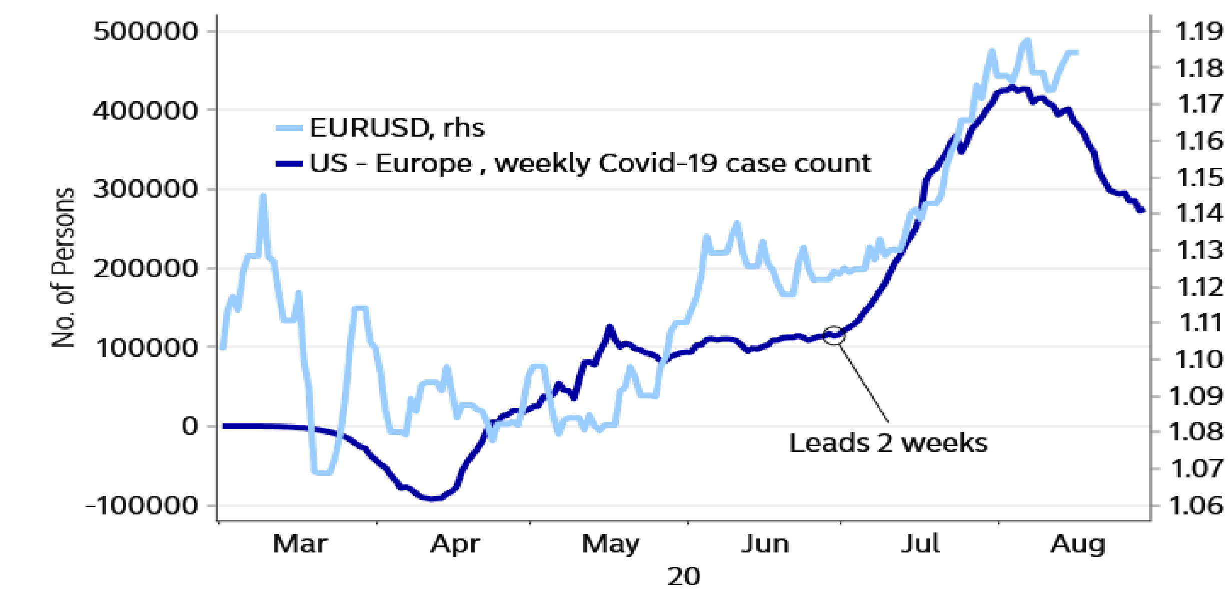
Unlike the economic powerhouses in Europe, Spain has meaningful exposure to tourism.

And the resurgence of COVID has hurt, preventing a real recovery.



While the US cases have been surging as well, the relative advantage that Europe had has eroded a bit with the latest bump in cases. It remains an open question as to whether that will take the shine off the EUR, at least in the near-term. However, without rising death tolls there is little chance of more draconian shutdowns being reinstated broadly across the continent.

Chart 8. EUR/USD momentum to wane due to a change in relative Covid-19 momentum?



Source: Macrobond and Nordea

Currencies

USD positioning remains very bearish from an historical perspective. So far, that has only meant sideways price action rather than a more pronounced retracement to punish shorts.

Stargazer Asset Management

While most currencies have been quiet over the last two weeks, precious metals have seen some wild swings.

Gold ran out of steam from very extended levels as bond yields jumped. Could be time for some sideways. Again, what yields do from here and how the Fed reacts will be important.

The most bullish scenario for Silver would require that we settle into a range for a bit before another big leg higher. Initiated by YCC and inflation targeting from the Fed?

For the week…

Talk of Pelosi bringing back the House early to deal with the Postal Service/Election issues and potentially to take another crack at the stimulus deal.

Also, keep an eye on what is going on in **Belarus**.

Tomorrow organizers are threatening another round of large protests against President Lukashenko.

The hotly contested election result in which he claims to have received 80% of the votes, is suspected by many of being rigged. The EU is threatening sanctions as a result of violent crackdowns in which two protesters have been killed and thousands are being detained. The All-National Strike will continue tomorrow. Demands include the release of all political prisoners, the removal of Lukashenko and free elections. <u>The real concern, and what could move markets, is that Russia will take this opportunity to intercede militarily.</u>

Important Macro Data Releases and Events for the Week

Monday 8/17/2020

- Eurogroup Meeting

Tuesday 8/18/2020

- EcoFin Meeting
- Fed's Brainard SPEECH
- Building Permits MoM (Jul) Forecast: 1.29m, Prior: 1.258m
- Housing Starts MoM (Jul) Forecast: 1.169m, Prior: 1.186m
- Merchandise Trade Balance Total (Jul) Forecast: JPY -77.6b, Prior: JPY-268.8b

Wednesday 8/19/2020

- CPI MoM (Jul) Forecast: -0.3%, Prior: 0,3%
- CPI Core YoY (Jul) Forecast: 1.2%, Prior: 1.2%
- CPI Core MoM (Jul) Forecast: 0.3%, Prior: -0.2%
- CPI Core YoY (Jul) Forecast: -, Prior: 1.1%
- **FOMC Minutes**

Thursday 8/20/2020

- PPI MoM (Jul) Forecast: -, Prior: 0%
- Gfk Consumer Confidence Survey Forecast: -, Prior: -0.3
- ECB Monetary Policy Meeting Accounts

Initial Jobless Claims Forecast: -, Prior: 963k

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 1.25275m

Continuing Jobless Claims Forecast: -, Prior: 15.486m

Philadelphia Fed Manufacturing Survey (Aug) Forecast: 21, Prior: 24.1

BoC's Beaudry SPEECH

National CPI data

Friday
8/21/2020

Markit Manufacturing PMI (Aug) Forecast: 52.5, Prior: 51

Markit Service PMI (Aug) Forecast: 55.6, Prior: 55.6

Markit Composite PMI (Aug) Forecast: -, Prior: 55.3

Markit Manufacturing PMI (Aug) Forecast: 53, Prior: 51.8

Markit Service PMI (Aug) Forecast: 54, Prior: 54.7

Markit Composite PMI (Aug) Forecast: 54.7, Prior: 54.9

Markit Manufacturing PMI (Aug) Forecast: 51.5, Prior: 50.9

Markit Service PMI (Aug) Forecast: -, Prior: 50

Markit Composite PMI (Aug) Forecast: -, Prior: 50.3

Existing Home Sales MoM (Jul) Forecast: 5.1m, Prior: 4.72m

Stargazer Asset Management

Disclaimer

This document and its contents are confidential to the person(s) to whom it is delivered and should not be copied or distributed, in whole or in part, or its contents disclosed by such person(s) to any other person. Any party receiving and/or reviewing this material, in consideration therefore, agrees not to circumvent the business proposals explicitly or implicitly contained herein in any manner, directly or indirectly. Further, any recipient hereof agrees to maintain all information received in the strictest confidence and shall not disclose to any third parties any information material to the opportunity contained herein and, upon review hereof, agrees that any unauthorized disclosure by any party will result in irreparable damage for which monetary damages would be difficult or impossible to accurately determine. Recipients recognize, and hereby agree, that the proprietary information disclosed herein represents confidential and valuable proprietary information and, therefore, will not, without express prior written consent, disclose such information to any person, company, entity or other third party, unless so doing would contravene governing law or regulations. This document is an outline of matters for discussion only.

This document does not constitute and should not be interpreted as advice, including legal, tax or accounting advice. This presentation includes statements that represent opinions, estimates and forecasts, which may not be realized. We believe the information provided herein is reliable, as of the date hereof, but do not warrant accuracy or completeness. In preparing these materials, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources.