Stargazer
Asset Management

What to focus on in Global Macro for the week of August 10th, 2020

Macro Themes on the Radar:

Last week was full of political noise including the question of who Biden's VP choice would be. It also, saw another week go by during which Congress was unable to bridge the gap between the $1trl stimulus package in the Republican run Senate and the $3trl package already approved by the Democrat run House. On Saturday, Trump announced a series of executive orders and memorandums meant to bypass Congress. In reality however, these measures would take months to bring online and are still likely to be superseded by an eventual Congressional deal.

Through it all US stocks remained strong and found new highs last week.

We have reached new extremes for the size of equity market capitalization vs. the economy.

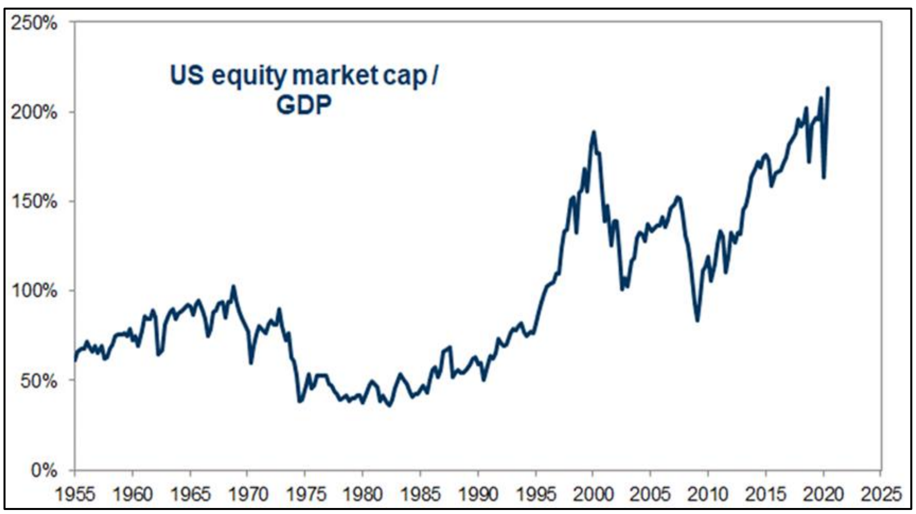
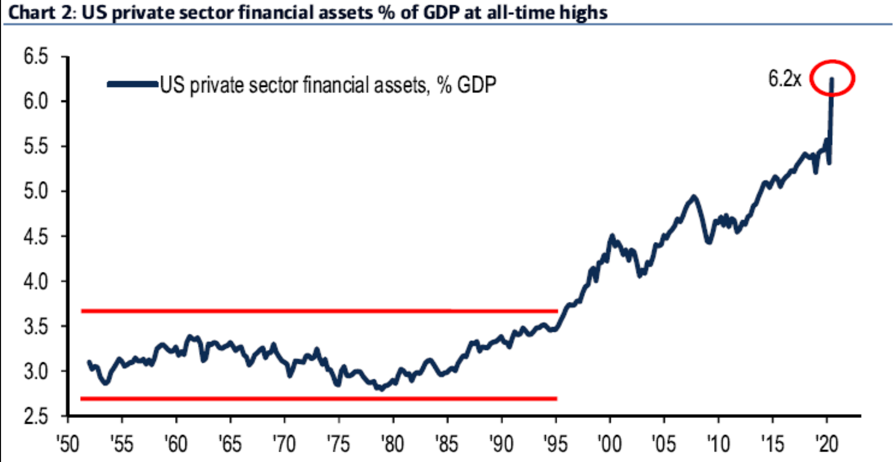


Chart 2: US private sector financial assets % of GDP at all-time highs



Source: BofA Global Investment Strategy, Federal Reserve Board, Q2 Private Sector Financial Assets estimated by regressing mutual fund AUM on Household financial assets and regressing institutional mutual fund AUM on Nonfinancial corporation financial assets

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These continue to be unprecedented times with lots of things to worry about. As BoA/ML pointed out last week … extremes everywhere.

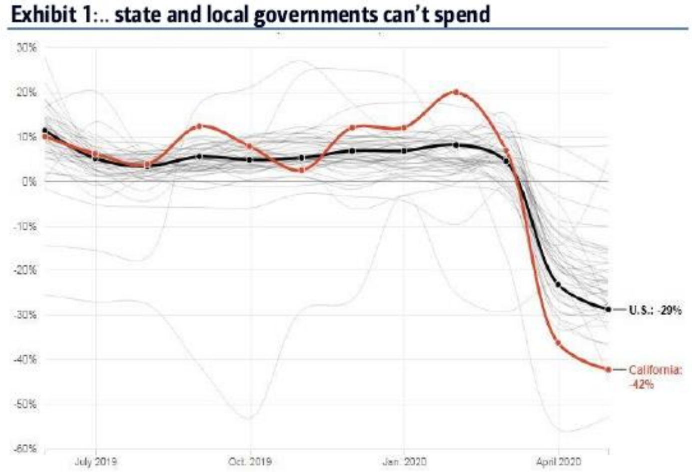
Chart 3: Banks won't lend...

Source: BofA Global Investment Strategy, Bloomberg

71% of bank loan officers reporting tighter lending standards in Q2… after the initial jump in lending as large corporations drew down on their revolving credit lines, lending has gone flat.

Not surprising in a recession but a headwind none the less.

Exhibit 1:... state and local governments can't spend



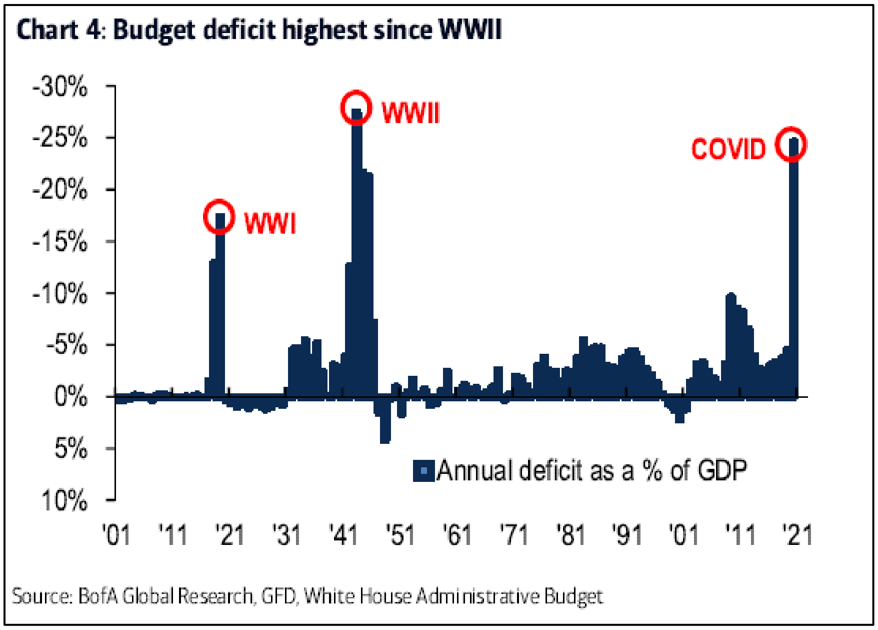
Source: Data and analysis from the Urban Institute's State and Local Finance Initiative, Daniel Wood/NPR

At the same time, state and local governments have been left with little ability to spend as tax revenues implode.

YoY tax revenues are down 37% in New York and 42% in California. Immense revenue shortfalls are looming.

The US government will eventually have to step in to support state and local governments, but the US budget deficit is now already expected to be at 25% of GDP. These are numbers only seen during WWI and WWII.

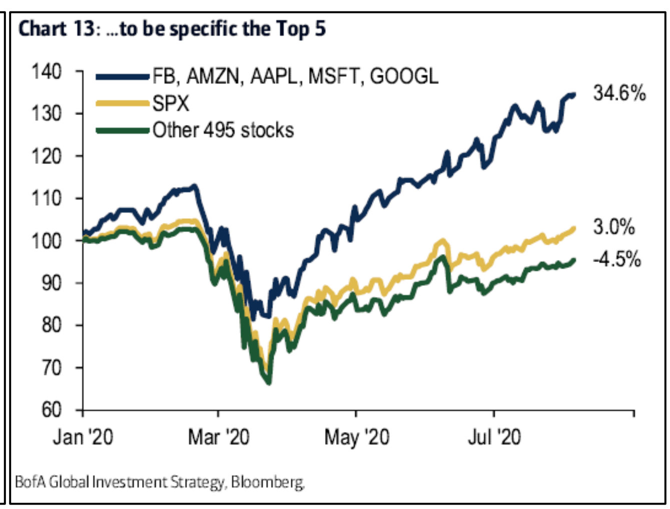
However, as long as bond markets don't care, there are no negative consequences. With bond vigilantes long dead, and no crowding out since the Fed is buying corporate bonds and mortgages, it is a brave new world.



For now, we are stable at slightly insane, since the Fed is willing to finance US debt and deficits.

Zero rates and massive liquidity provisions, combined with huge fiscal spending into a recessionary economy, has motivated investors to place their bets.

As discussed, those bets have been on US big technology. Extreme inputs have resulted in extreme results.

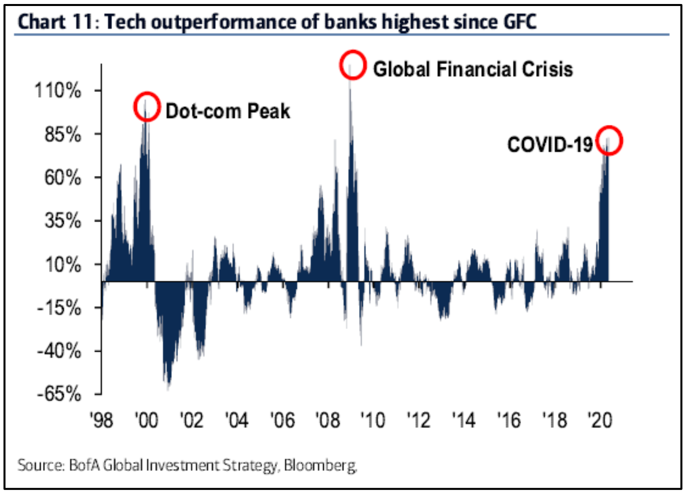


On the other side, there have certainly been some real losers in terms of relative performance.

The financials / banks have felt the other side of the COVID perfect storm.

Low interest rates, a relatively flat curve and a recessionary backdrop have been a bad combination for this sector.

When you look at tech vs. banks it is no surprise that again we find ourselves at an extreme.



The thing about extreme moves, is that while they can go a long way from "normal" they don't tend to sit at the top tick for long, so it is worth playing the tails.

It is time to be on the lookout for signs that the situation currently priced, is ready to change.

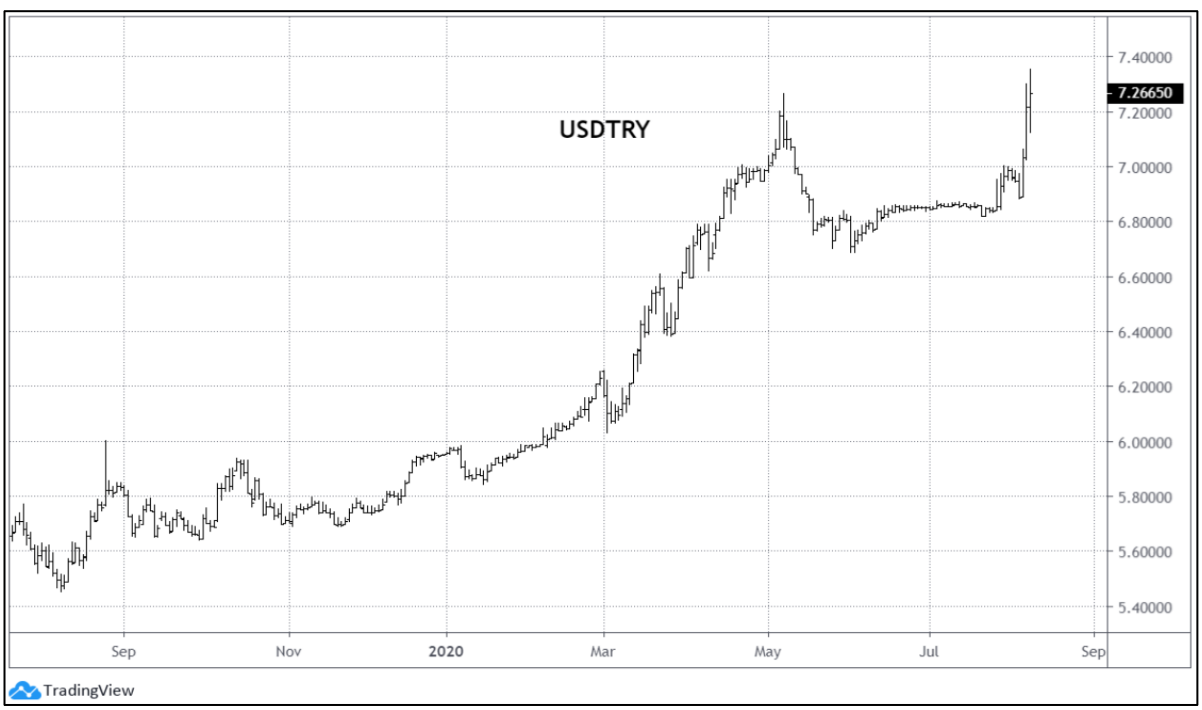
Extreme moves make for an opportunity rich environment, but you need to be very tactical and vigilant to monetize it. You also need to have imagination because "crazy" moves are currently commonplace and tail events are realizing.

What to Focus on Now:

FX - I'm still thinking that the USD selling needs a rest and potentially a retracement here.

As mentioned last week, the move higher in the EUR also looks like it still needs a rest to me. We spent last week trying to push it to new highs only to get knocked back down on Friday.

While developed market currencies held in well overall vs. the dollar last week, some EM pairs like USDTRY made the news, as the Turkish Lira hit new lows against the USD.



While the dollar wasn't back at its highs against any of the other EM currencies, the last week or two has certainly seen an uptick in the USD vs. a diverse set of EM currencies.

USD vs. South Africa

And USD vs. Brazil … maybe some EM contagion starting to come through.

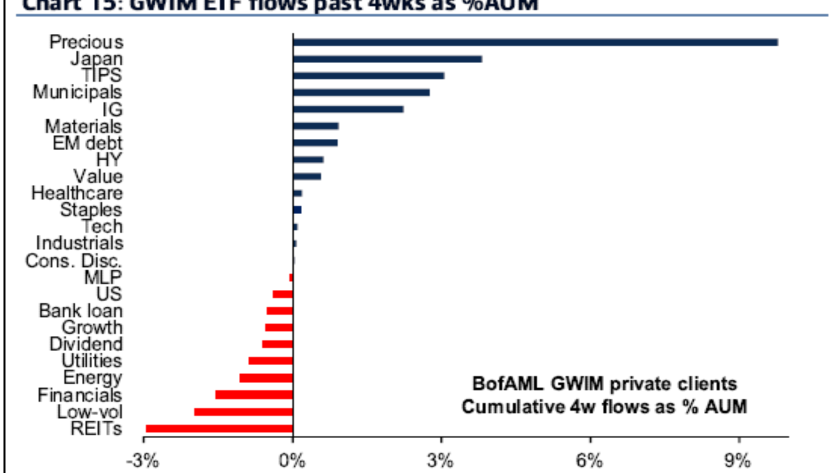
Another short-term warning sign for a bit of USD strength could be the recent weakness in Copper. Should that continue, it could drag down commodity currencies like the AUD.

At this point I'm still an overall USD bear but think that at a minimum we need a pause.

Gold & Silver

The flows have been huge as precious metals have pushed on. They remain over bought, and if the USD pauses, Gold and Silver could settle into a range or retrace for a bit. However, I still think that after some back and forth, silver could see the mid to high 40's.

Chart 15: GWIM ETF flows past 4wks as %AUM

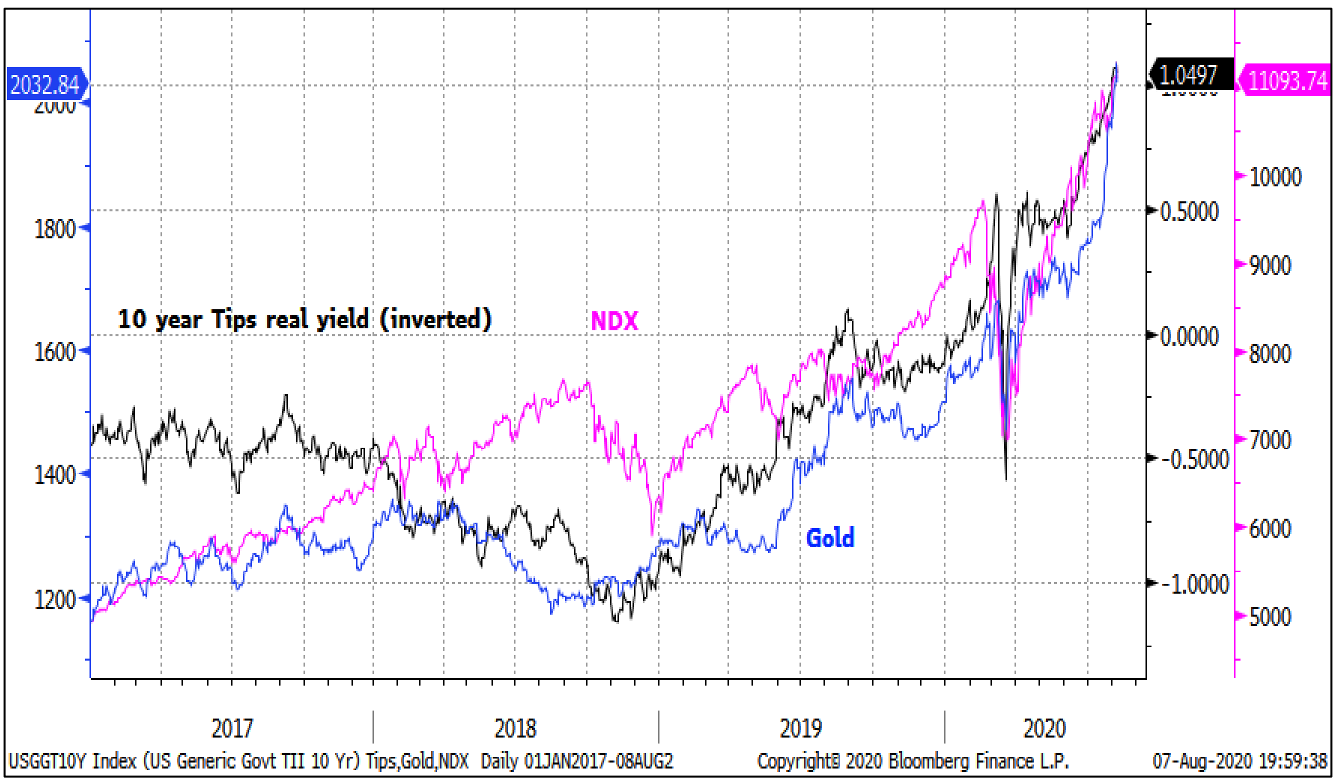


Source: BAC internal data

The debate rages over whether Gold is a good substitute for Bonds given the low yields and risk of inflation.

I share the view that bonds are not a great hedge against anything at these levels. However, at least in the short-term, I do worry that the same forces have been pushing up Gold and FAANG stocks, and that what goes up together can also go down together. I would rather view Gold as a separate trade than a passive Bond replacement.

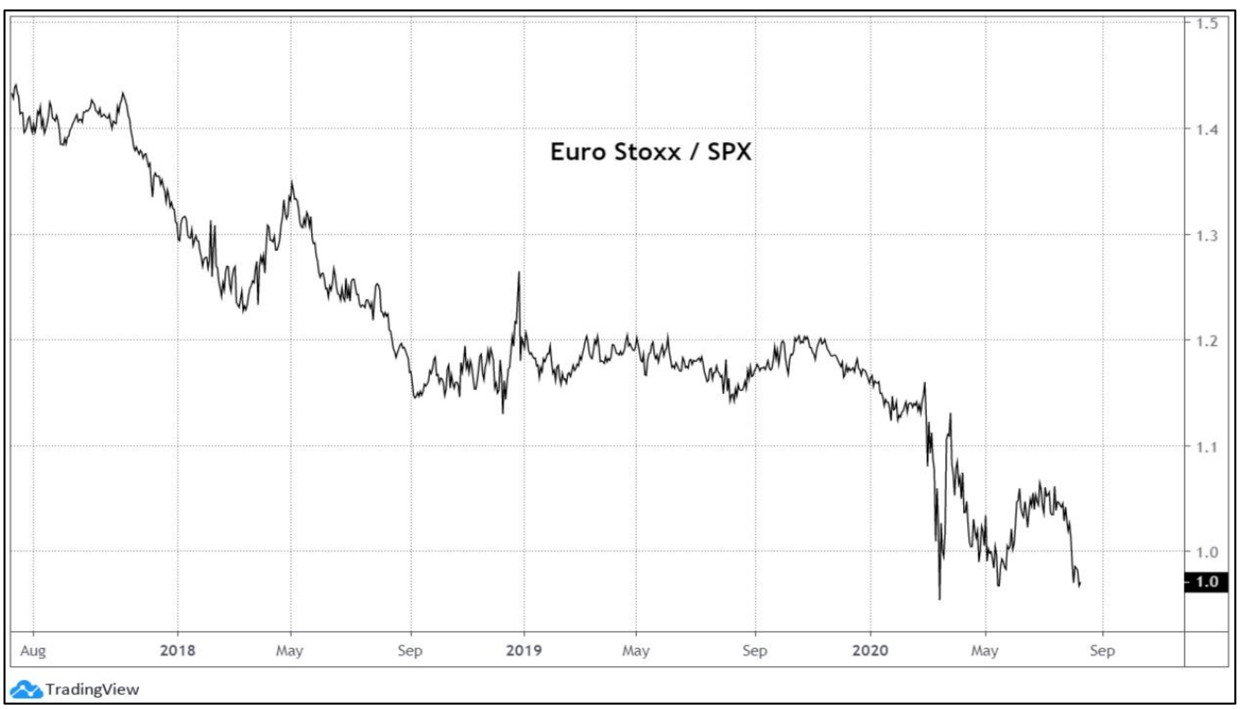
This chart shows the NDX, Gold and real yields (inverted). At least for now, the Fed seems committed to keeping real yields down, although further acceleration of the move might be difficult from here. You will need lower treasury yields or higher inflation expectations (they have already returned to pre-COVID levels). Yield Curve Control by the Fed could do it, but we might need to see a protest from the bond market before getting them to engage more formally.



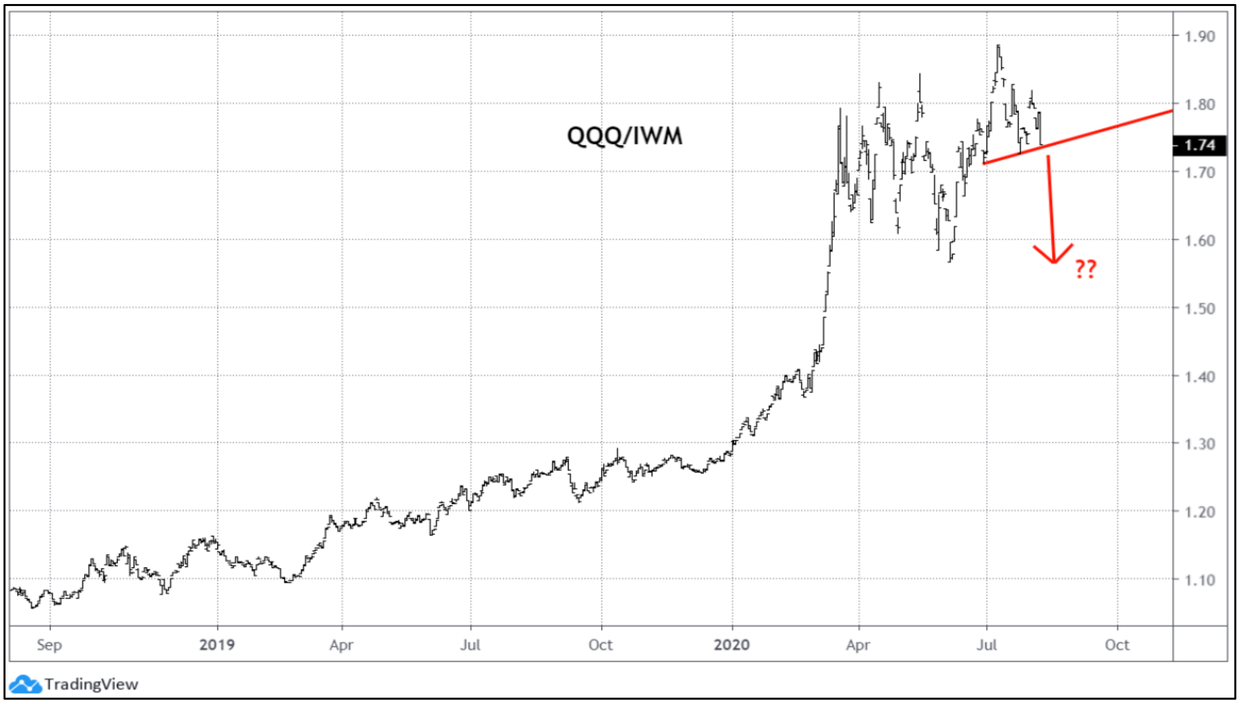
Equity Indices and Sectors

Europe managed a small bounce last week after breaking lower the previous week. Not very impressive yet and still no sign of outperformance on a relative basis. Overall, we really have not seen any sign that the global growth vs. value trade is turning yet.

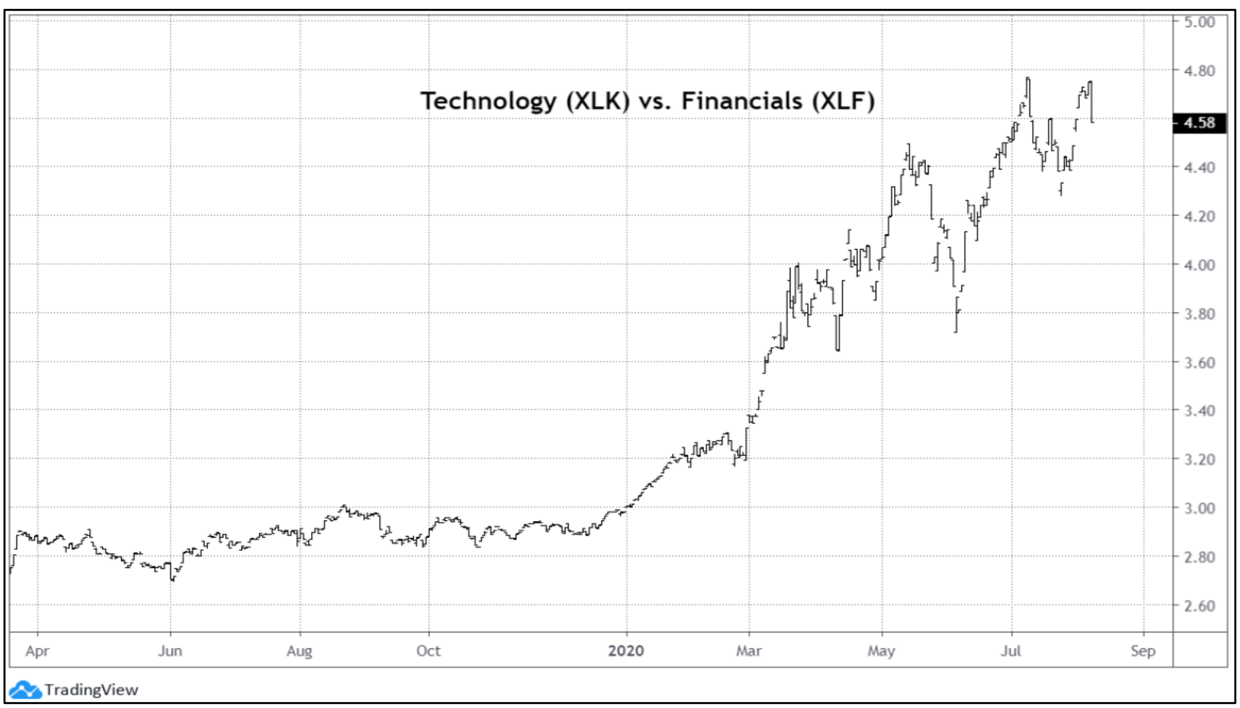
No sign of outperformance yet…



In the US things are a bit more interesting… after trying to again outperform for much of last week, the NDX gave it all up on Friday relative to the Russell. I think there remains a good chance that a top is forming, and we get a period of NDX underperformance. Again, as per the above discussion about extremes this could be an important development…



A big shift on Friday was the outperformance of the financials/banks. Again, this could get interesting as we are at such an extreme vs. the NDX and its big tech drivers. It is early to make the call, but this is worth watching. The implications are potentially bullish for the broader economy.



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Here NDX vs a broader and equally weighted bank ETF … let's see if we get more evidence of a turn.

Here is NDX vs. Berkshire Hathaway with its meaningful exposure to financials. Cracking… and that was before the weekend earnings release.

Important Macro Data Releases and Events for the Week

Monday 8/10/2020	Watch for stimulus Bill news otherwise slow news day
Tuesday 8/11/2020	ZEW Survey - Economic Sentiment (Aug) Forecast: 59.9, Prior: 59.6
	ZEW Survey - Current Situation (Aug) Forecast: -69.5, Prior: -80.9
	ZEW Survey - Economic Sentiment (Aug) Forecast: 58, Prior: 59.3
	NFIB Business Optimism Index (Jul) Forecast: 105.9, Prior: 100.6
	PPI Index ex-Food & Energy Forecast: 0.3%, prior: 0.1%
Wednesday 8/12/2020	GDP QoQ (Q2) Forecast: -20.2%, Prior: -2.2%
	CPI ex-Food & Energy MoM (Jul) Forecast: 0.2%, Prior: 0.2%
	CPI ex-Food & Energy YoY (Jul) Forecast: 1.2%, Prior: 1.2%
	Monthly Budget Statement (Jul) Forecast: -, Prior: $-864bln
	Employment Change s.a. (Jul) Forecast: 40k, Prior: 210.8k
	Unemployment Rate s.a. (Jul) Forecast: 7.8%, Prior: 7.4%
Thursday 8/13/2020	Harmonized Index of Consumer Prices MoM (Jul) Forecast: 0%, Prior: 0%'
	Initial Jobless Claims Forecast: -, Prior: 1.186m
	Initial Jobless Claims 4-week ave. Forecast: -, Prior: 1.33775m
	Continuing Jobless Claims Forecast: -, Prior: 16.107m
	NBS Press Conference
	Industrial Production YoY (Jul) Forecast: 4.7%, Prior: 4.8%

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	China	Retail Sales YoY (Jul) Forecast: 0.2%, Prior: -1.8%
Friday 8/14/2020	EU	GDP s.a. QoQ (Q2) Forecast: -12.1%, Prior: -12.1%
	EU	GDP s.a. YoY (Q2) Forecast: -15%, Prior: -15%
	US	Retail Sales MoM (Jul) Forecast: 1.7%, Prior: 7.5%
	US	Retail Sales ex-Auto MoM (Jul) Forecast: 1.4%, Prior: 7.3%
	US	Retail Sales Control Group MoM (Jul) Forecast: -, Prior: 5.6%
	US	Nonfarm Productivity (Q2) Forecast: -, Prior: -0.9%
	US	Unit Labor Costs (Q2) Forecast: -, Prior: 5.1%
	US	Industrial Production MoM (Jul) Forecast: 3.3%, Prior: 5.4%
	US	Michigan Consumer Sentiment Index (Aug) Forecast: 71.5, Prior: 72.5