Stargazer Asset Management

What to focus on in Global Macro for the week of October 19th, 2020

Macro Themes on the Radar:

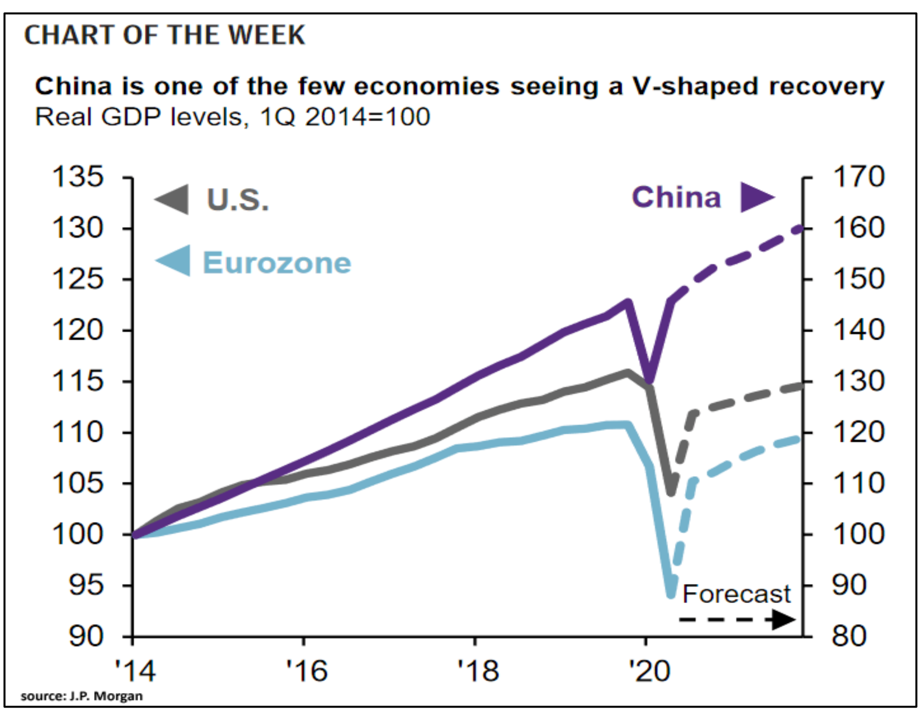
Fed

An FT article on Saturday highlights that financial stability is becoming a concern at the Fed.

"Senior Federal Reserve officials are calling for tougher financial regulation to prevent the US central bank's low interest-rate policies from giving rise to excessive risk-taking and asset bubbles in the markets." … "Eric Rosengren, president of the Federal Reserve Bank of Boston, told the Financial Times that the Fed lacked sufficient tools to "stop firms and households" from taking on "excessive leverage" and called for a "rethink" on "financial stability" issues in the US. "If you want to follow a monetary policy . . . that applies low interest rates for a long time, you want robust financial supervisory authority in order to be able to restrict the amount of excessive risk-taking occurring at the same time," he said. "[Otherwise] you're much more likely to get into a situation where the interest rates can be low for long but be counterproductive."

It is not clear what policies they could change or institute here. Nor are they likely to do anything anytime soon, but there is obviously some growing concern. There are various ways they can seek to reduce systemic leverage, but in reality, it is hard to pump up asset prices and not pump up asset prices at the same time.

China



For the most part China is rebounding from the COVID crisis better than most countries.

To what extent this is the product of China's first-in-first-out status is unclear. Certainly, the ability to minimize further waves of infection has been very helpful.

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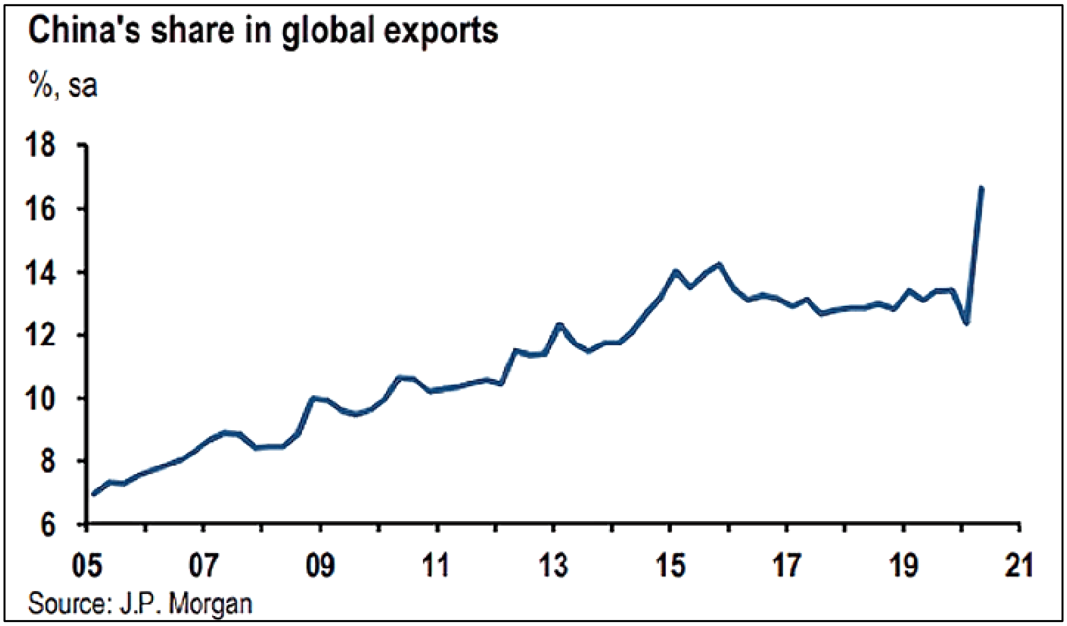
Trade has rebounded as well, with China recently posting its highest trade surplus with the US on record and global exports quickly surpassing pre pandemic levels.

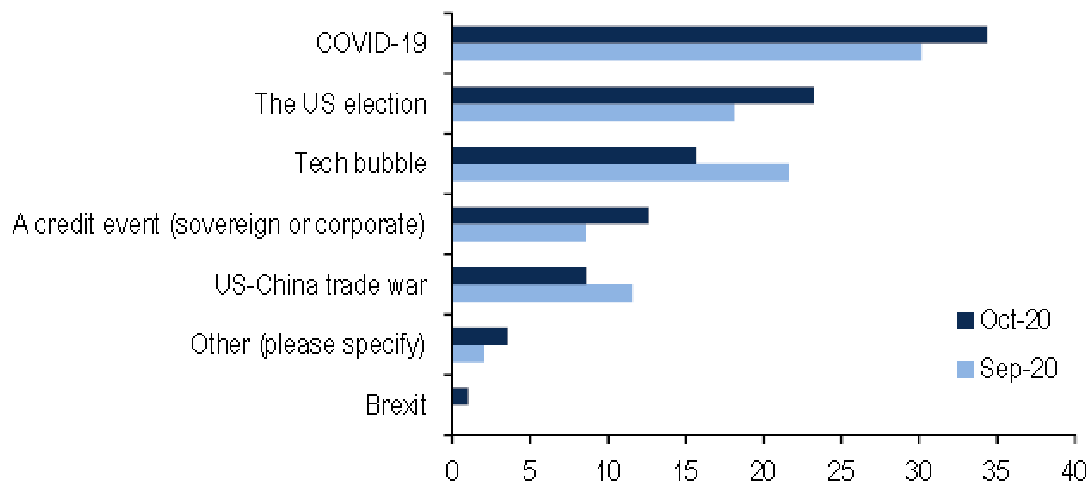


While the tech heavy CSI 300 is 40% off the March lows, total Chinese market cap is back to all-time highs. Second only to the US now globally.

What to Focus on Now:

Congressional stimulus negotiations continue and there was some good news over the weekend with Pelosi signaling that she was optimistic an agreement could be reached after a call with Mnuchin. That uncertainty aside, market participants continue to see the growing COVID resurgence and the potential for a contested election as the two largest near-term risks. The most recent Global Fund Managers Survey from BoA/ML confirms...

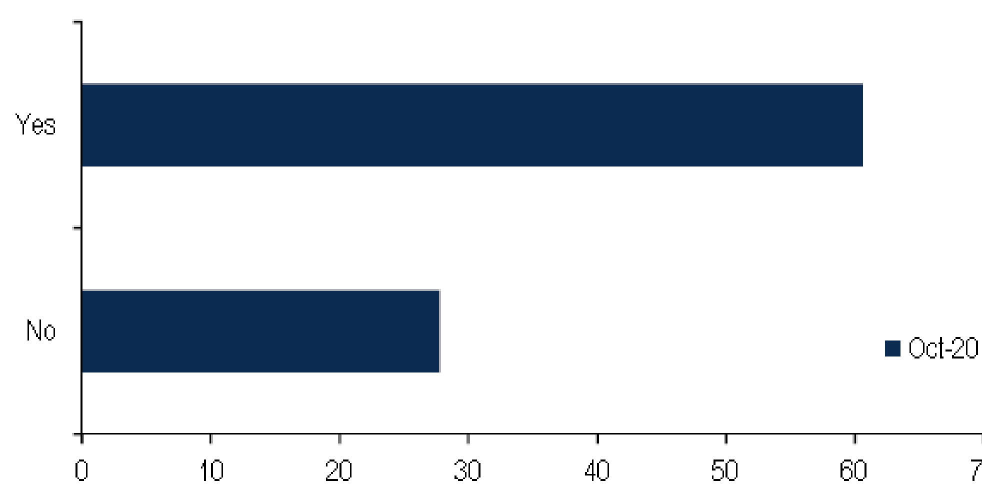
Exhibit 25: What do you consider the biggest "tail risk"?



Source: BofA Global Fund Manager Survey

With the majority thinking that the probability of a contested election is high.

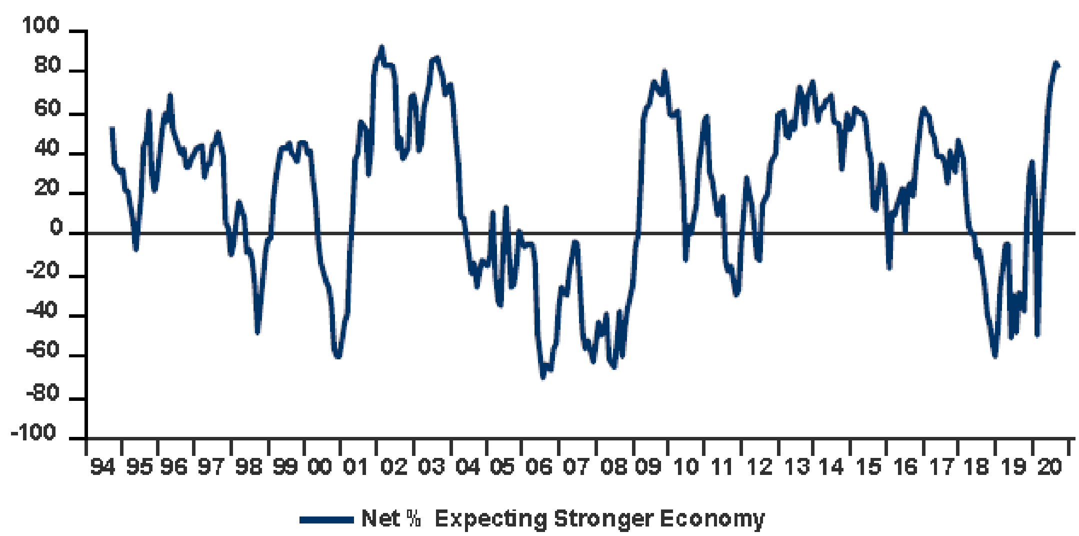
Exhibit 11: Do you think the US election outcome will be contested?



Source: BofA Global Fund Manager Survey

Overall, we have come a long way in terms of sentiment…

Exhibit 22: How do you think the global real economy will develop over the next 12 months?



Source: BofA Global Fund Manager Survey

A bit surprisingly so.

Exhibit 2: FMS recession expectations plummeted in October

Source: BofA Global Fund Manager Survey

Inflation expectations are also on the rise.

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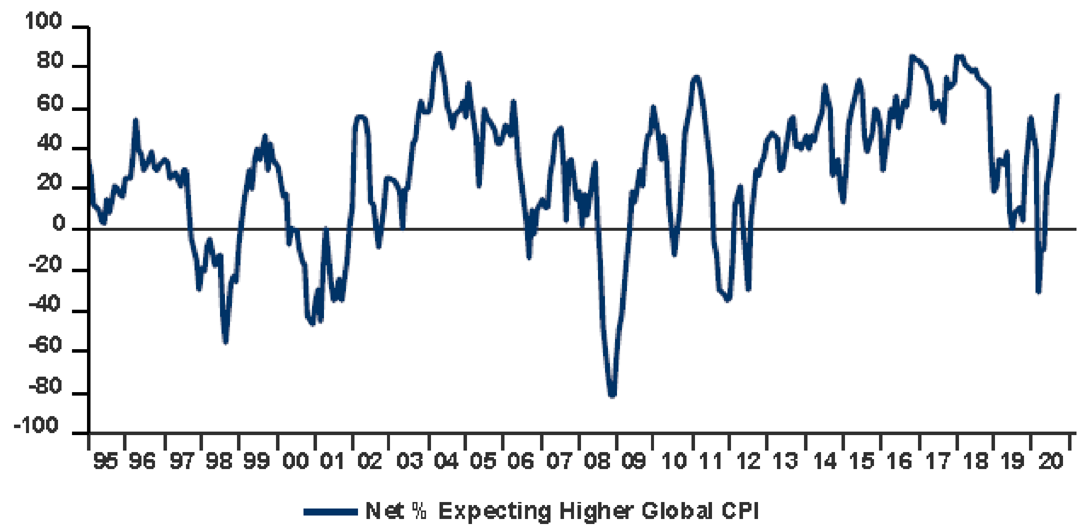
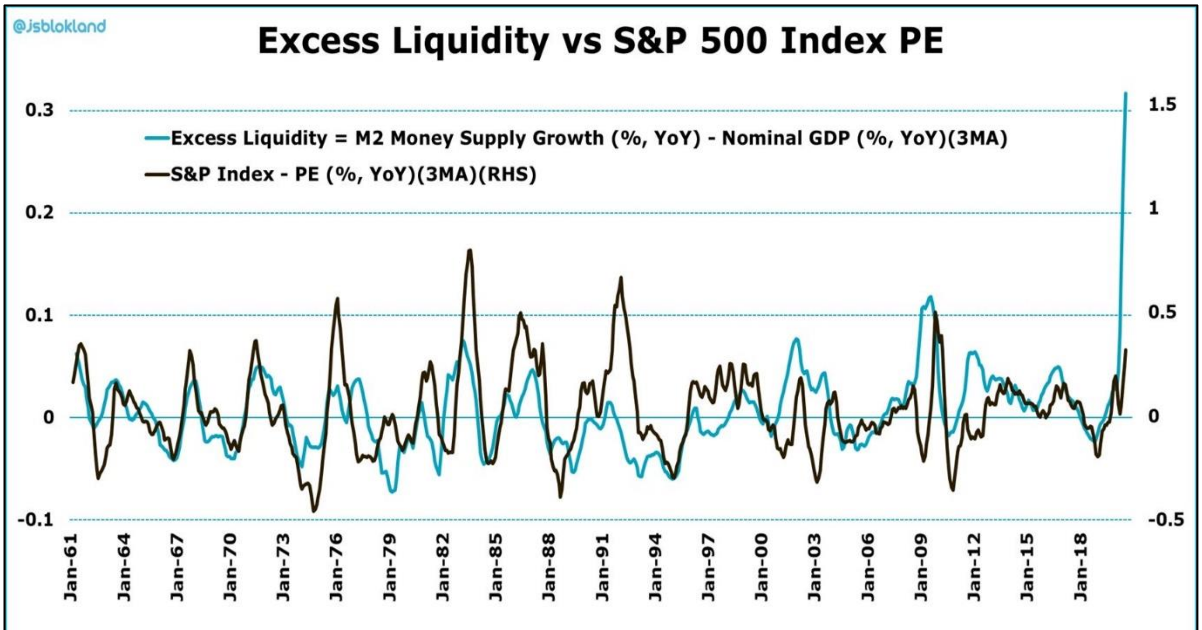
Exhibit 23: Inflation expectations



Source: BofA Global Fund Manager Survey.

The huge amounts of liquidity continue to support the markets.

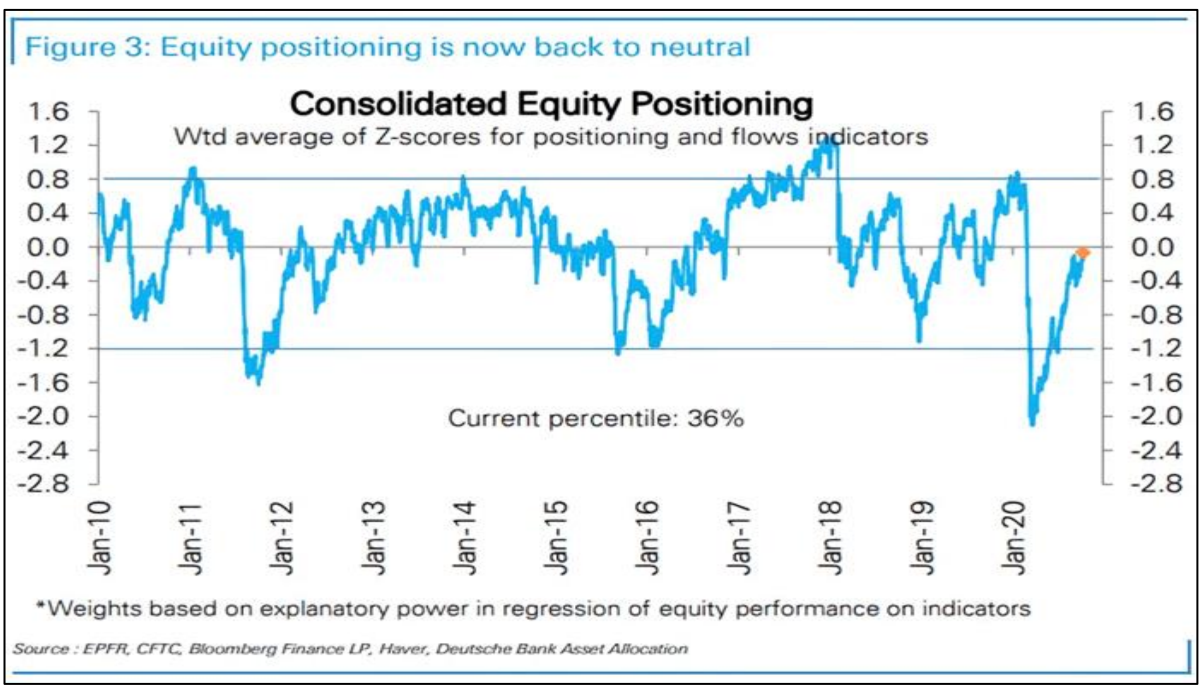


Source: Board of Governors of the Federal Reserve System, U.S. Bureau of Economic Analysis, FRED

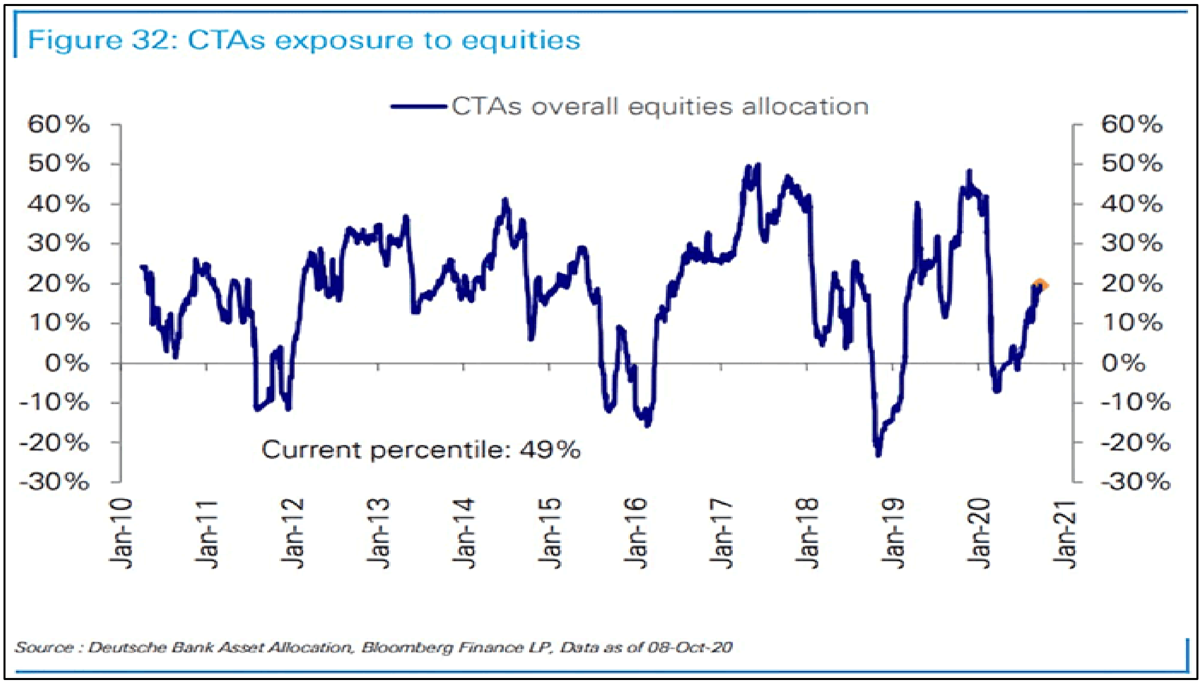
Equity exposure generally has been rising but is not at the extremes we have seen at previous price peaks. There are various ways to parse this, so I'll run through a few. They all tell a similar story, however.

Net of non-commercial futures contracts…

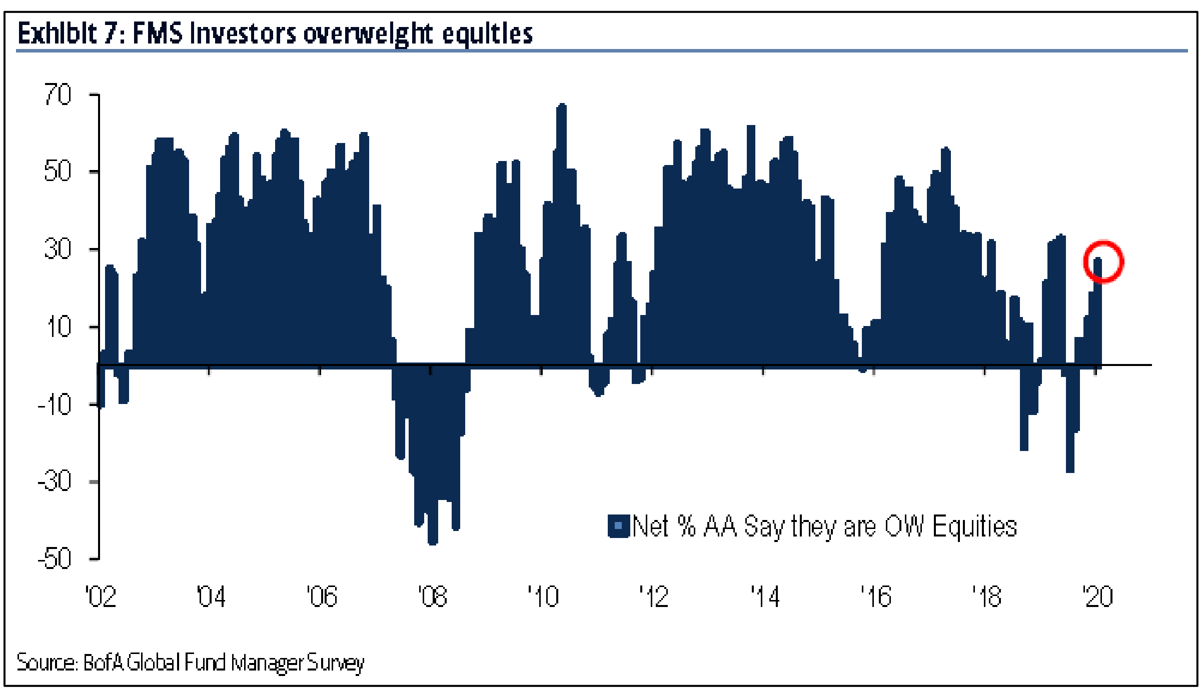
A more sophisticated approach…



Another version of the futures data…



and an institutional investor survey.



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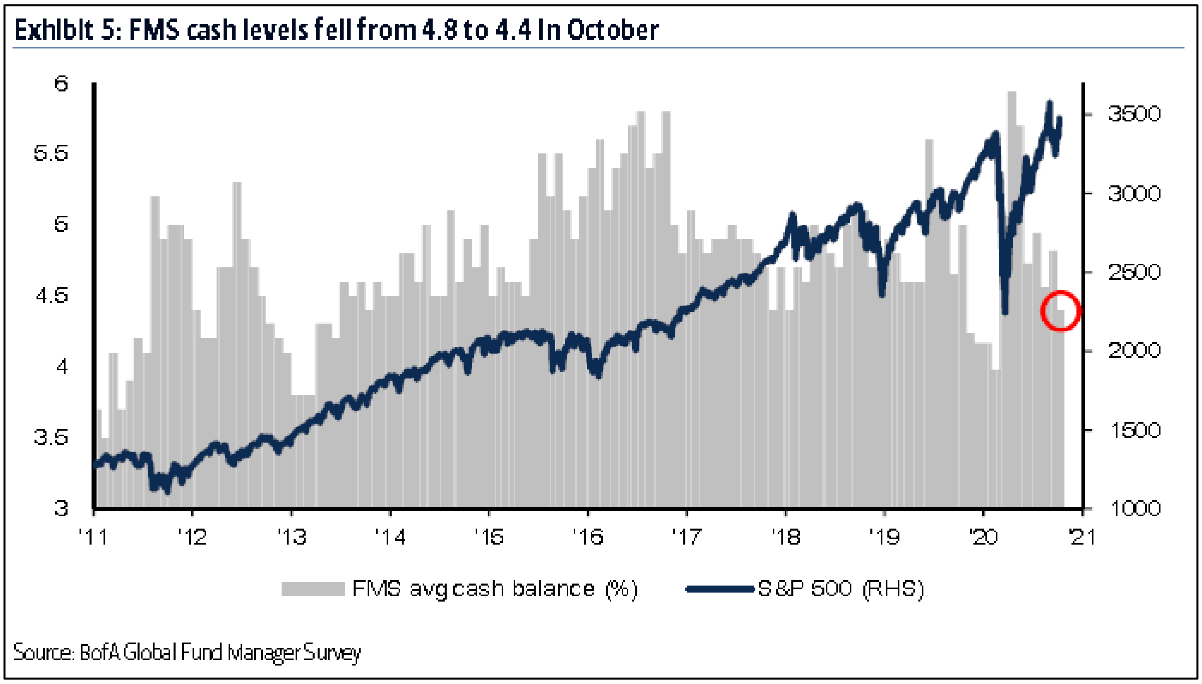
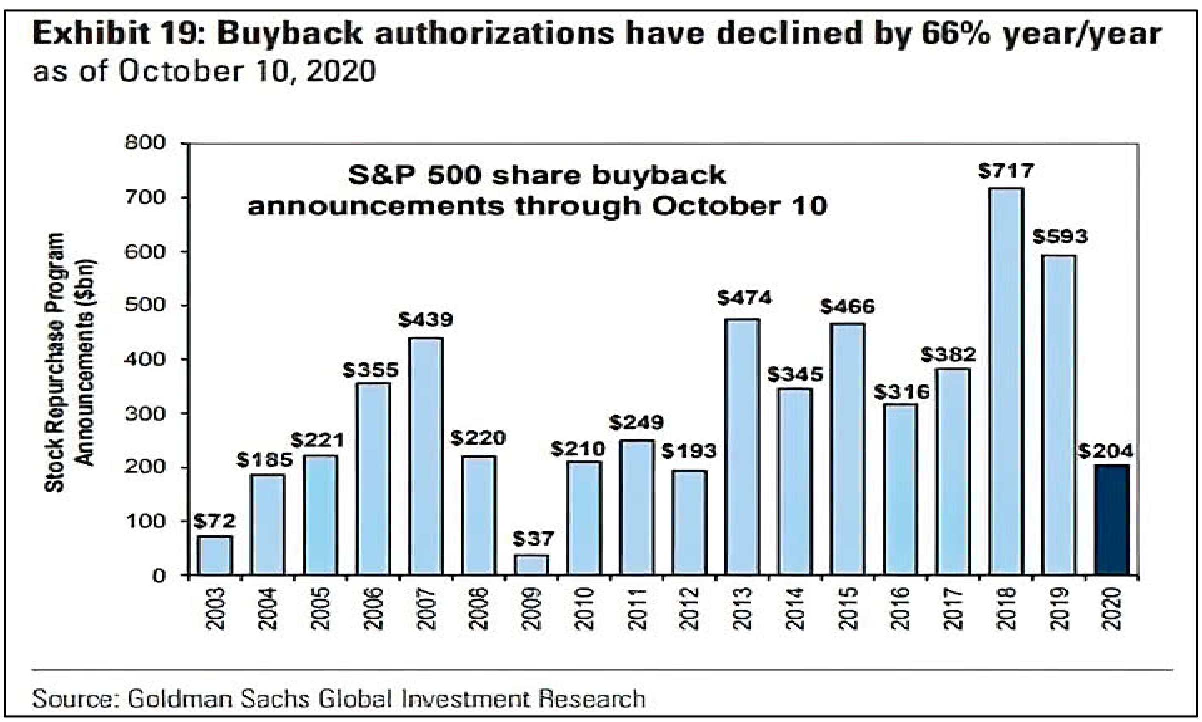
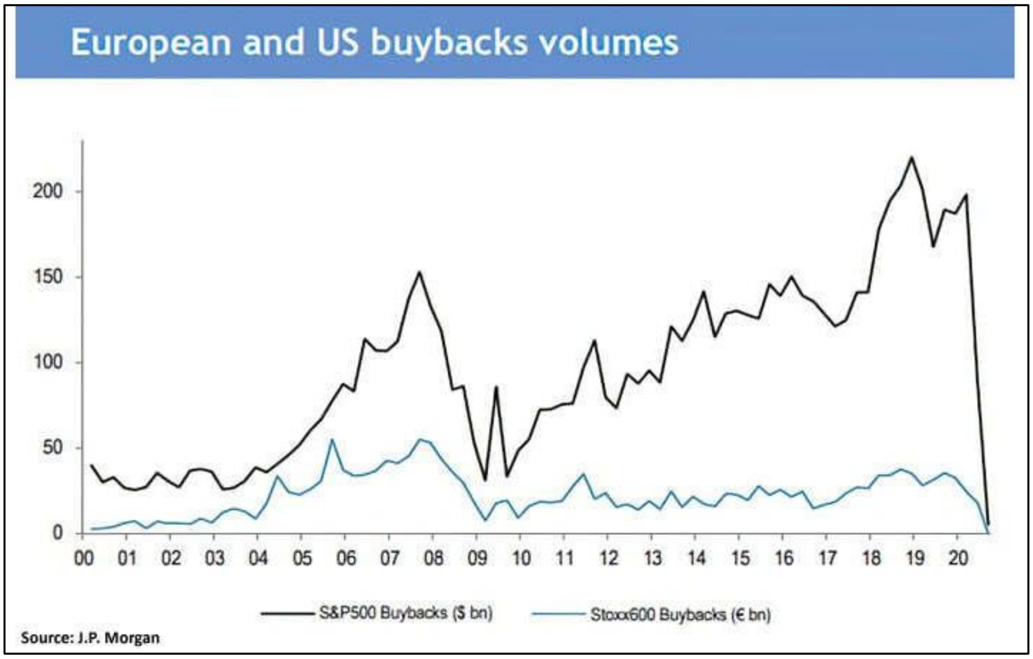
Cash levels of institutional investors have been falling but are not yet below the 4% mark where it has been historically worth considering.



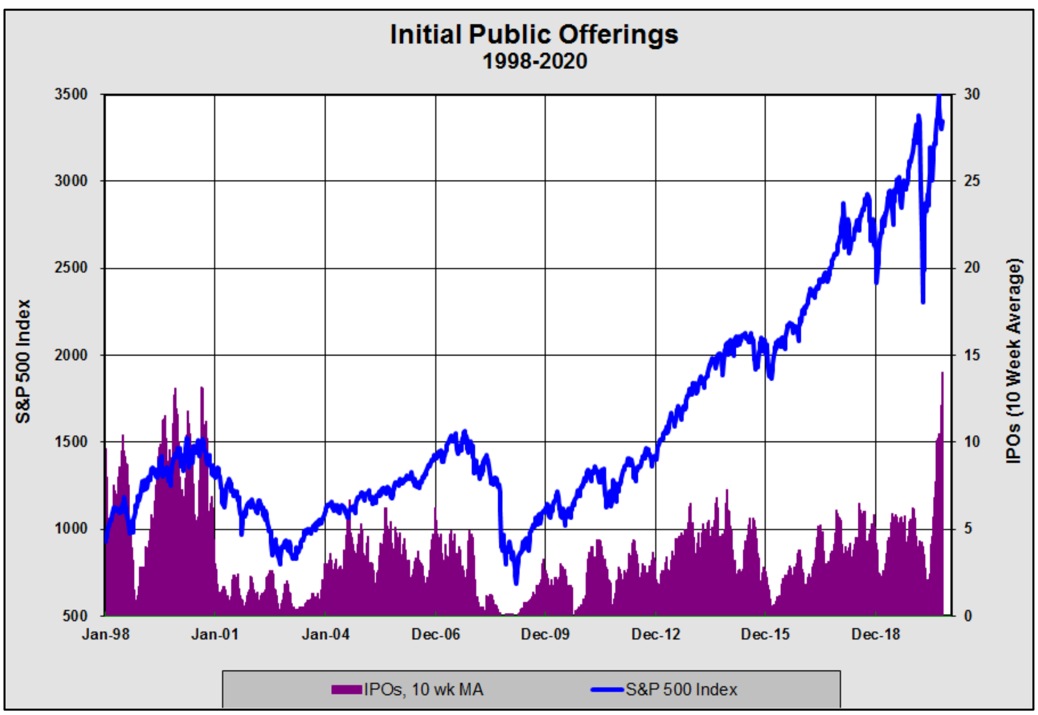
At the same time, buybacks have slowed dramatically this year. Not surprisingly, COVID has brought a big change to both the announced and actual buybacks we have seen vs. recent years.



Again, not surprisingly, corporations have been reticent to spend scarce capital repurchasing stocks.



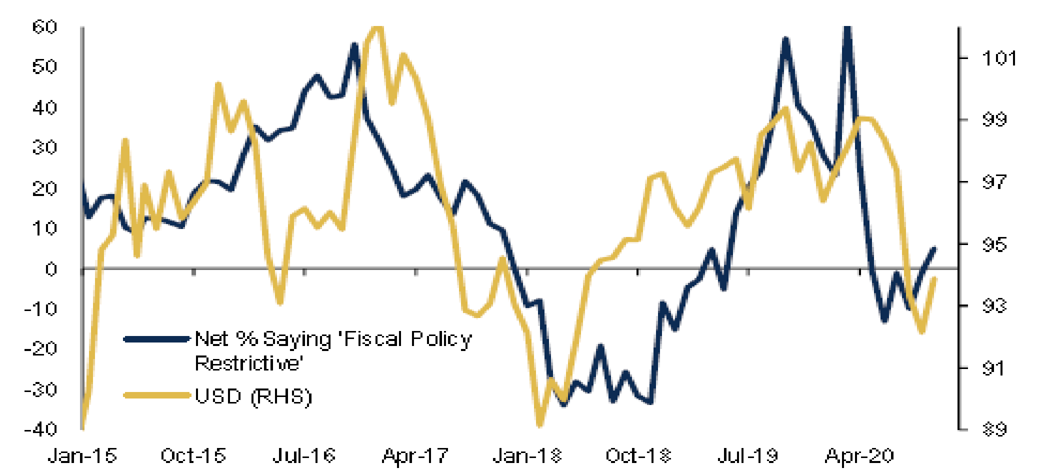
Instead, they have been issuing at a record pace. Unlike during other years, the scarcity of shares argument is hard to make these days. At least from the supply side.



FX

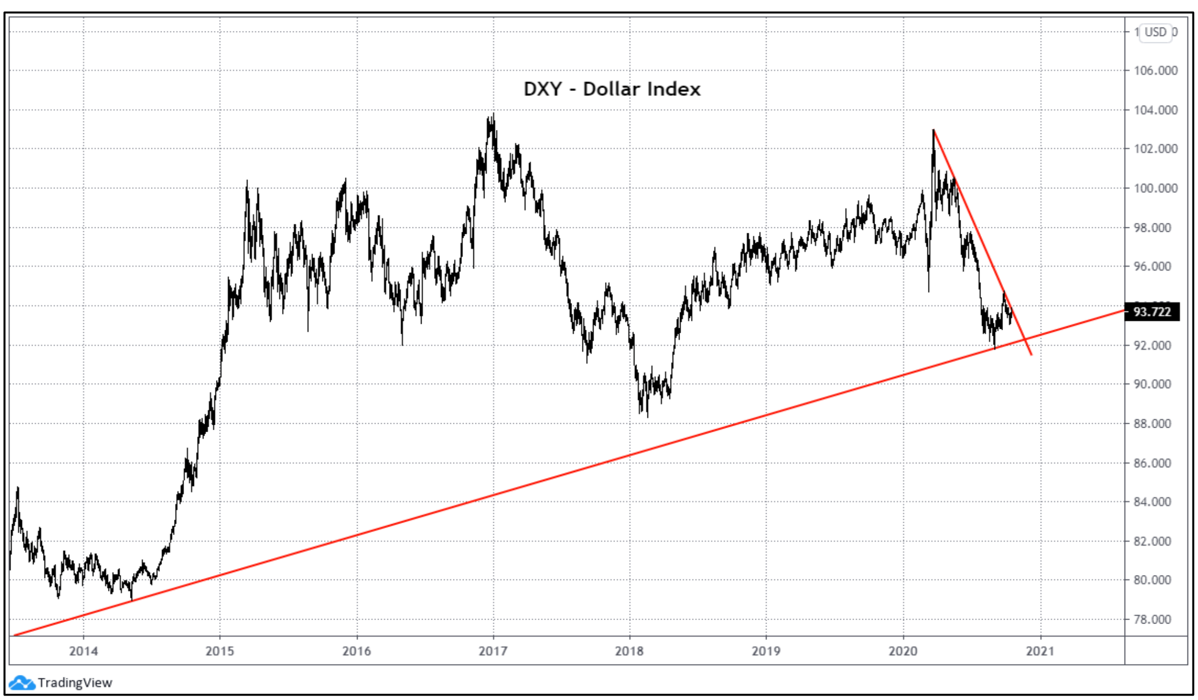
Not surprisingly, the USD and sentiment regarding tightness of US fiscal policy have been correlated. With the USD as the global reserve currency, and the US government the ultimate grantor of global liquidity as a result, the feedback loops created by dollar strength and dollar weakness are always critical to markets.

Chart 7: Need for fiscal stimulus and US dollar

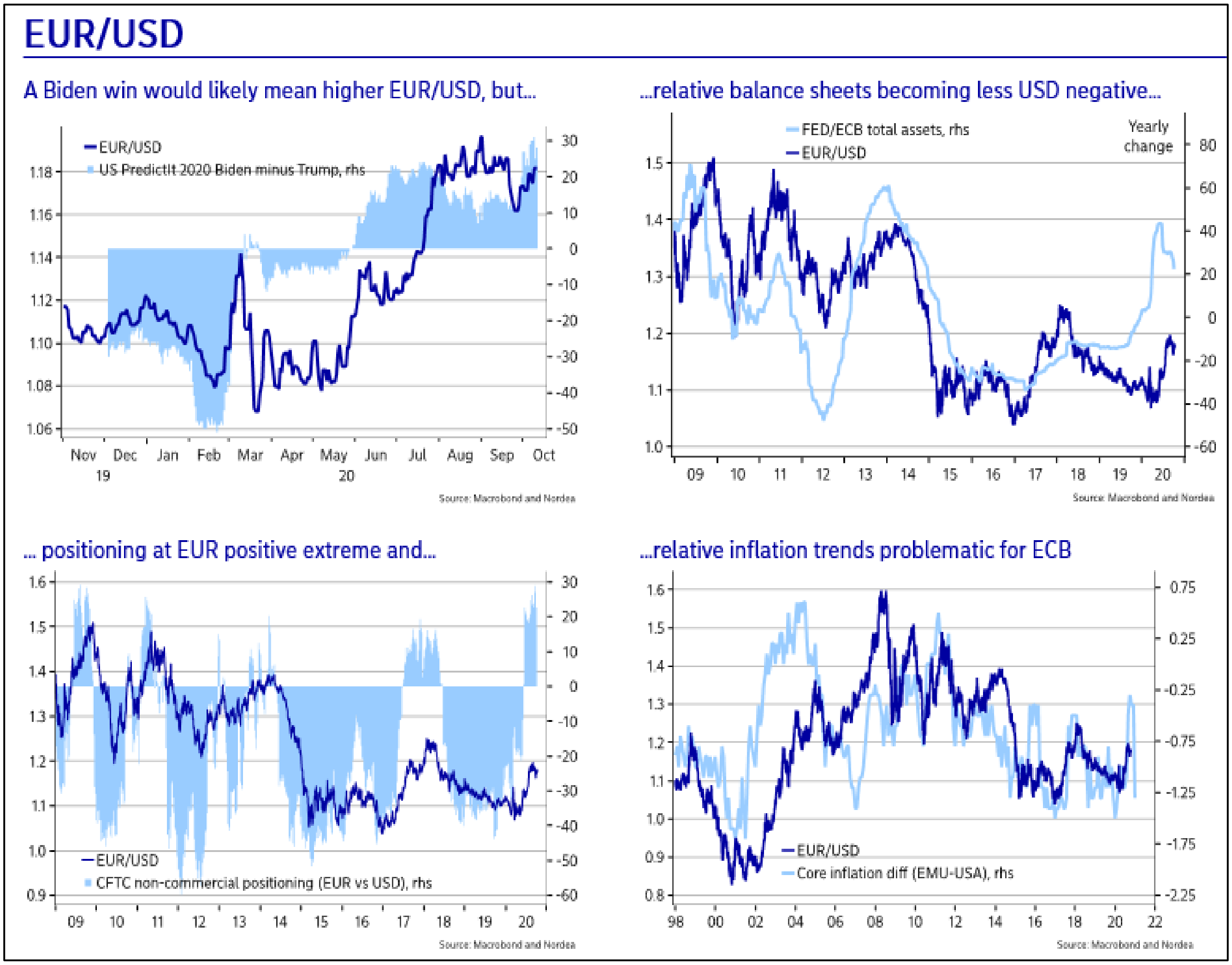


Source: BofA Global Fund Manager Survey, Bloomberg

For weeks now the dollar has been caught holding above a long-term uptrend but below the shorter-term down trend.



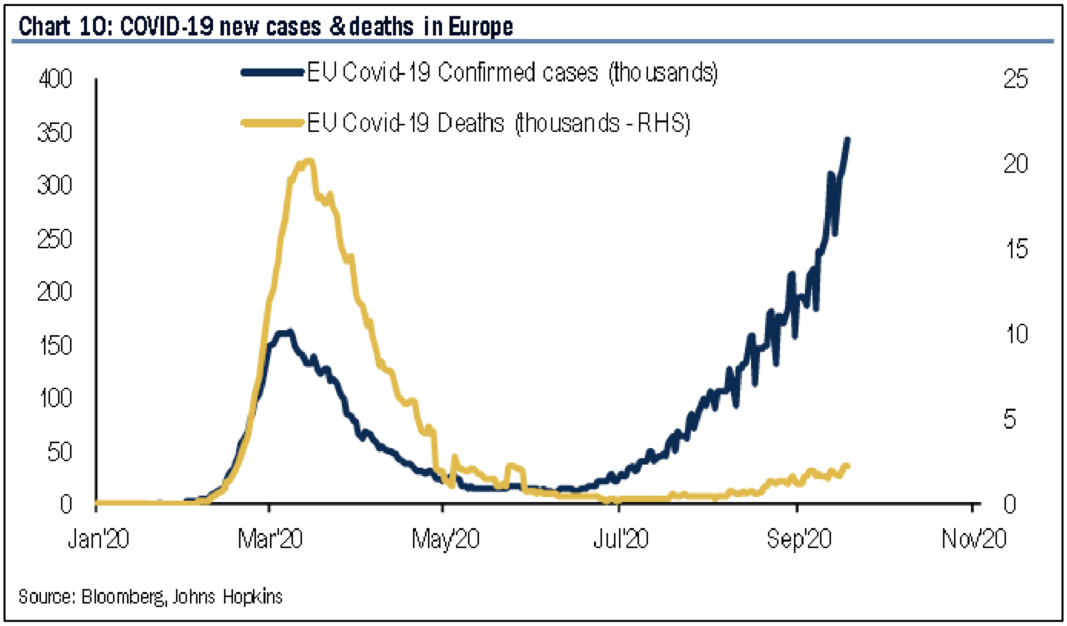
For the moment, the consensus dollar down view could continue to be challenged. Yes, both Biden and Trump are likely to mean further fiscal spending, with the market betting that Biden will deliver more. However, as Nordea illustrates nicely in the below graphic, relative balance sheet trends, positioning and relative inflation trends will likely be an issue in the near-term.



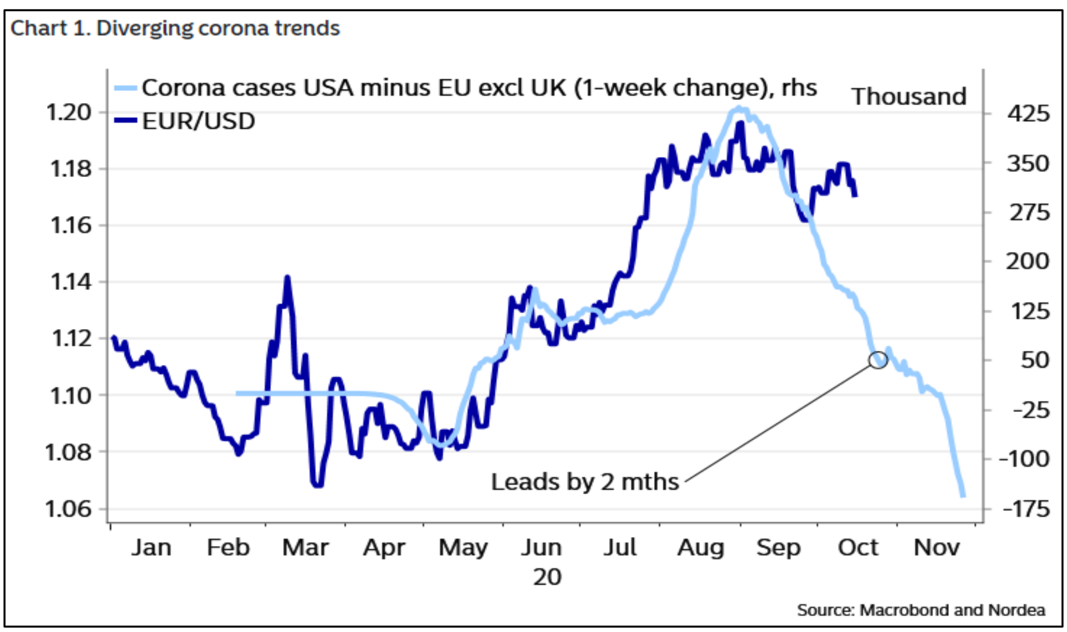
The growth and inflation outlook for Europe is looking especially challenged by the continued resurgence of COVID in Europe.

While a similar situation is unfolding in the US, it had been assumed that Europe had largely beaten back the virus and was set to see better growth and inflation numbers.

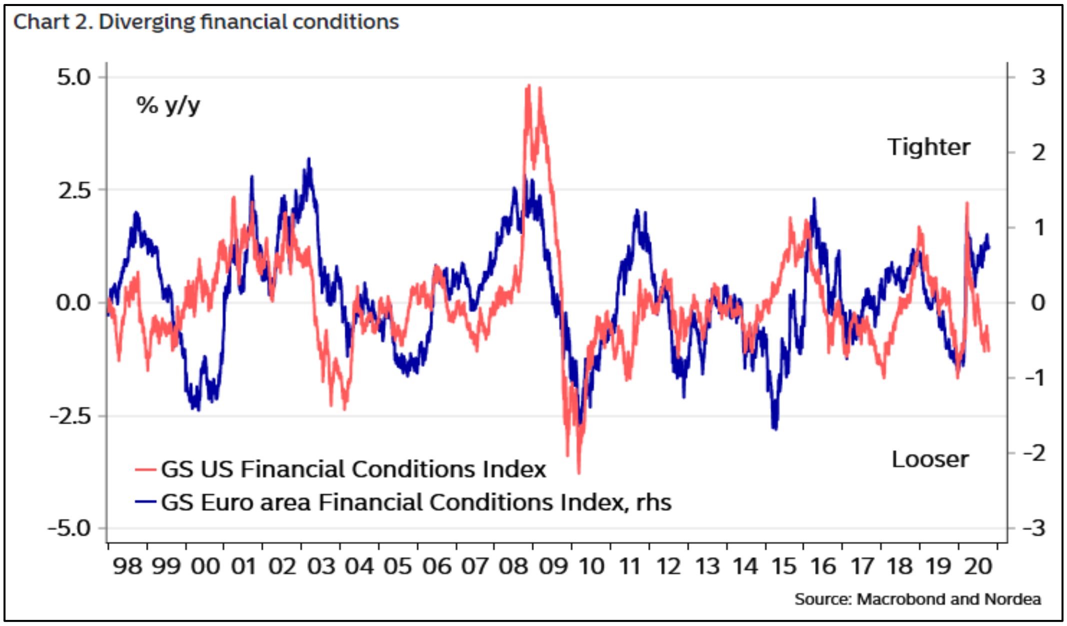
Now with Europe actually looking relatively worse in terms of current trends, the hope for economic recovery is being pushed back.



Will that, combined with the other factors, spell near-term difficulty for the Euro? The passing of a large next round of US fiscal stimulus soon would likely help counteract any potential near-term USD strength. For now, markets are having a hard time deciding what comes next.



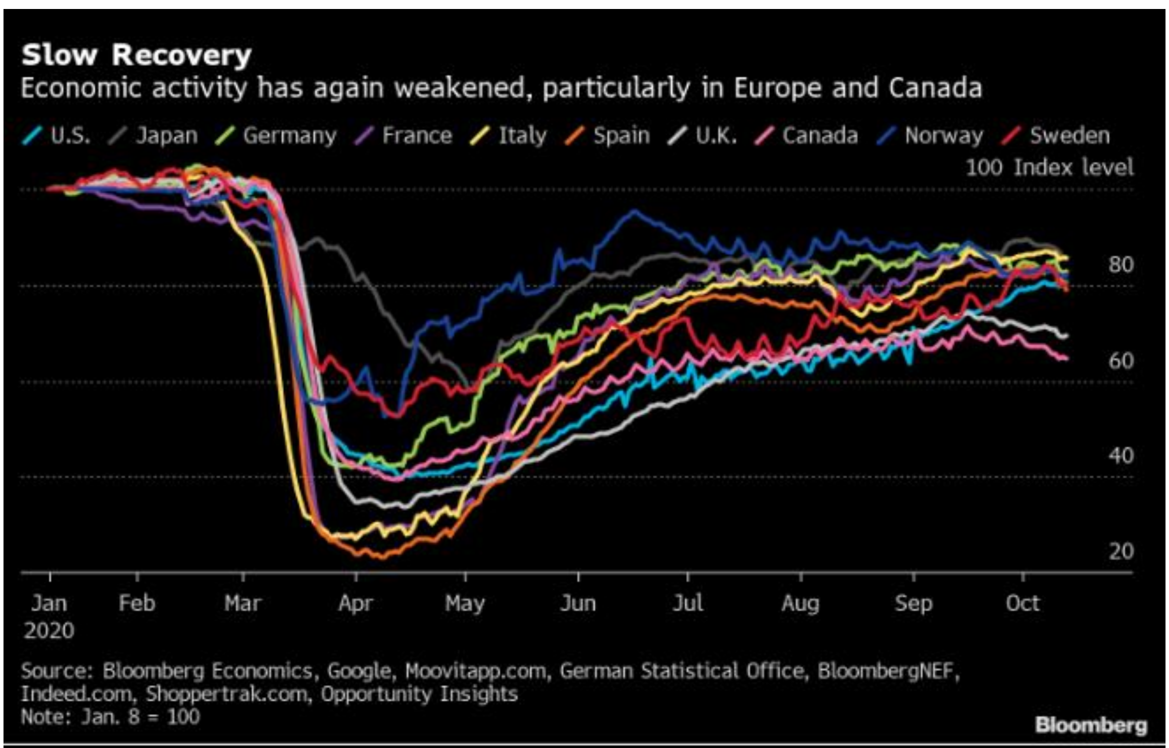
Relative financial conditions in the US vs. Europe are a headwind at this point as well for relative growth outcomes.



Again, it will be important what the relative responses are to the resurgence of the virus. Insufficient fiscal support could quickly lead to a decline in disposable income and a retrenchment of what have been surprisingly strong retail sales globally.

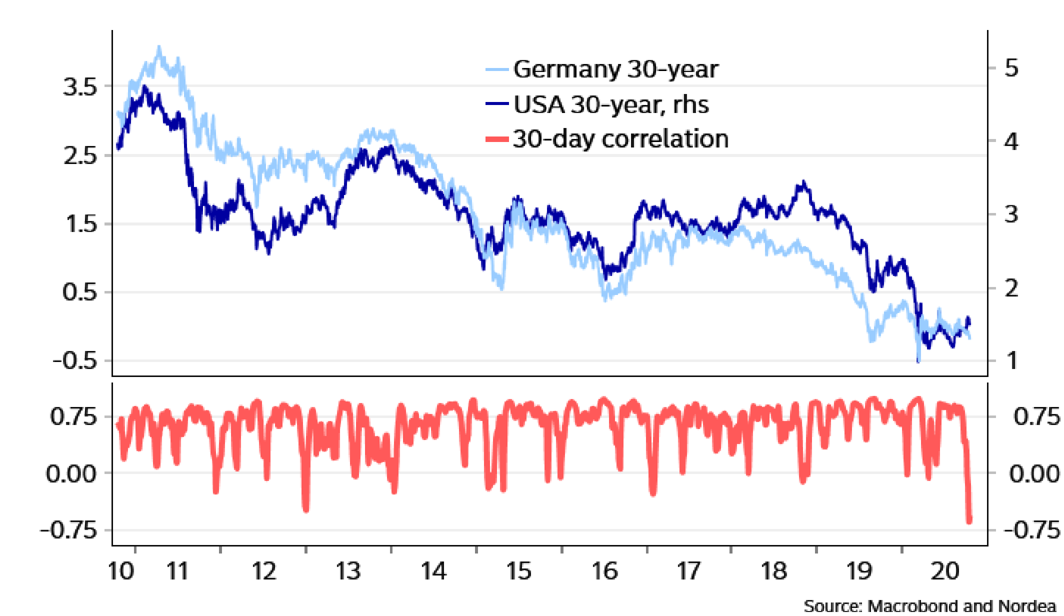
Bonds

With the post lockdown bounce losing some steam, bonds yields have not been able to rally.

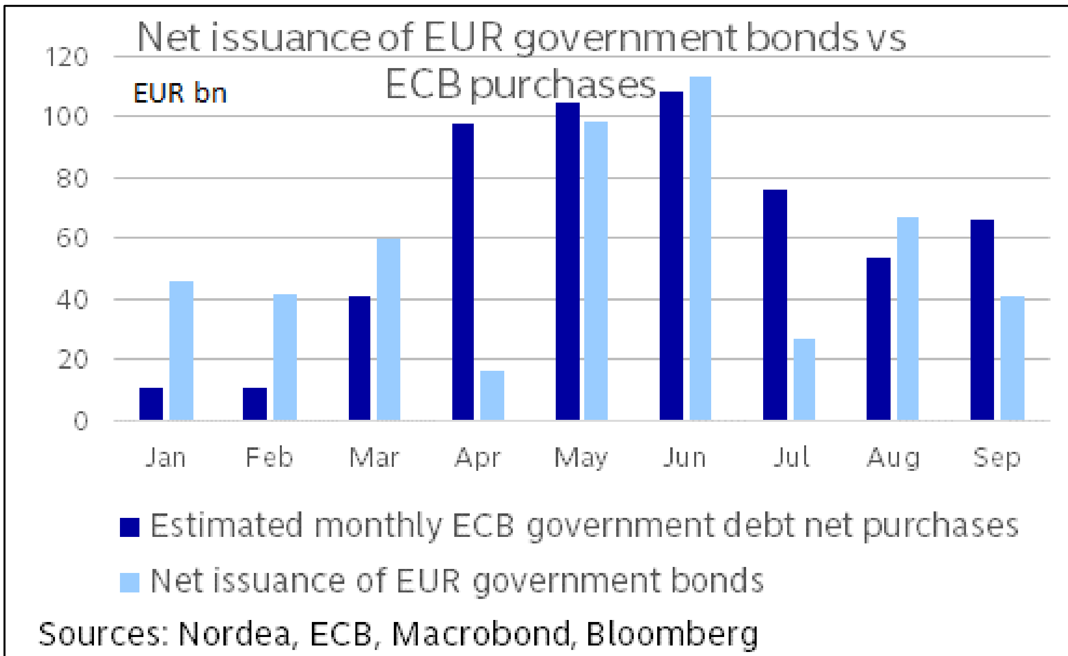


The recently worsening COVID trends, fears about the US election and Brexit, have been pushing down on long end yields again. Europe, starting from a weaker place is seeing bond yields fall more quickly. That disconnect probably can't last very long, one way or the other.

Chart 7. Diverging long bond yield trends



Despite all the fiscal spending, QE has continued to mop up most or all the new bond issuance. This has been the case in both the US and in Europe.



With global sovereign indebtedness continuing to rise, the ability to keep the demand/supply situation in balance is critical. As the stack of plates gets taller, it also gets more unstable. There is a growing potential that central banks move some of their purchases out the curve in a new round of "operation twist". Or, if volatility picks up, institute yield curve control. So far, with still low inflation and the ability to continue soaking up supply, it hasn't been necessary.

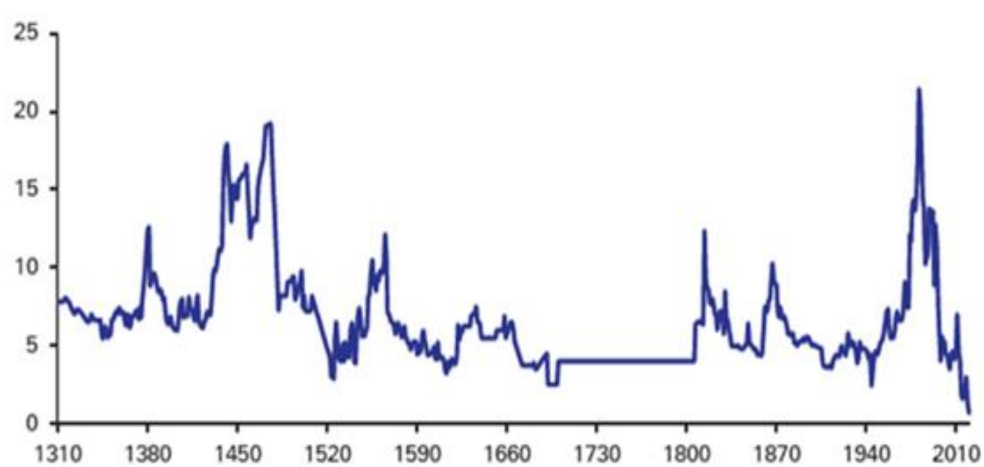
Table 2: Countries with fiscal debt/GDP >100

The 100 Club Countries with Sovereign Debt/GDP> 100%	
Japan	266
Italy	162
Singapore	131
USA	131
Spain	123
France	119
Belgium	118
Canada	115
UK	108
Brazil	101

Source: IMF

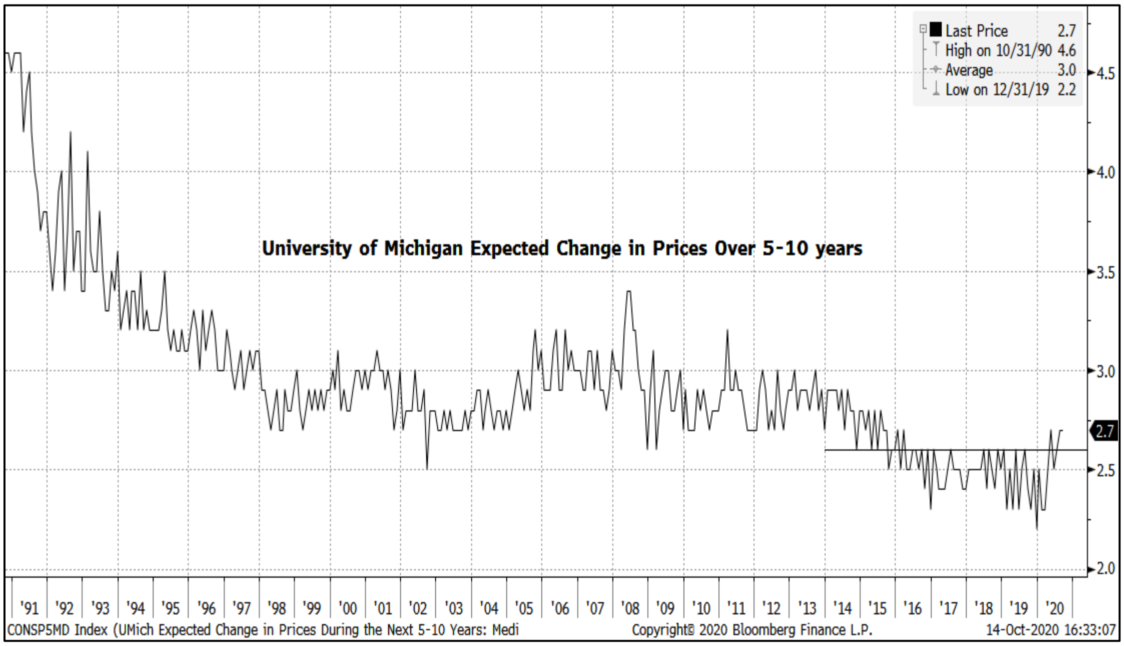
It is amazing what a determined central bank can do with its balance sheet. In prior crises of this magnitude we would be more likely be approaching 20+% than zero in Italian 10-year bonds. Can they keep it here? For now, the credit issue is being subsumed by Germany & Co. Unless that is called into question, inflation will need to return.

Figure 1: Italian 10yr yield since 1310 (%)



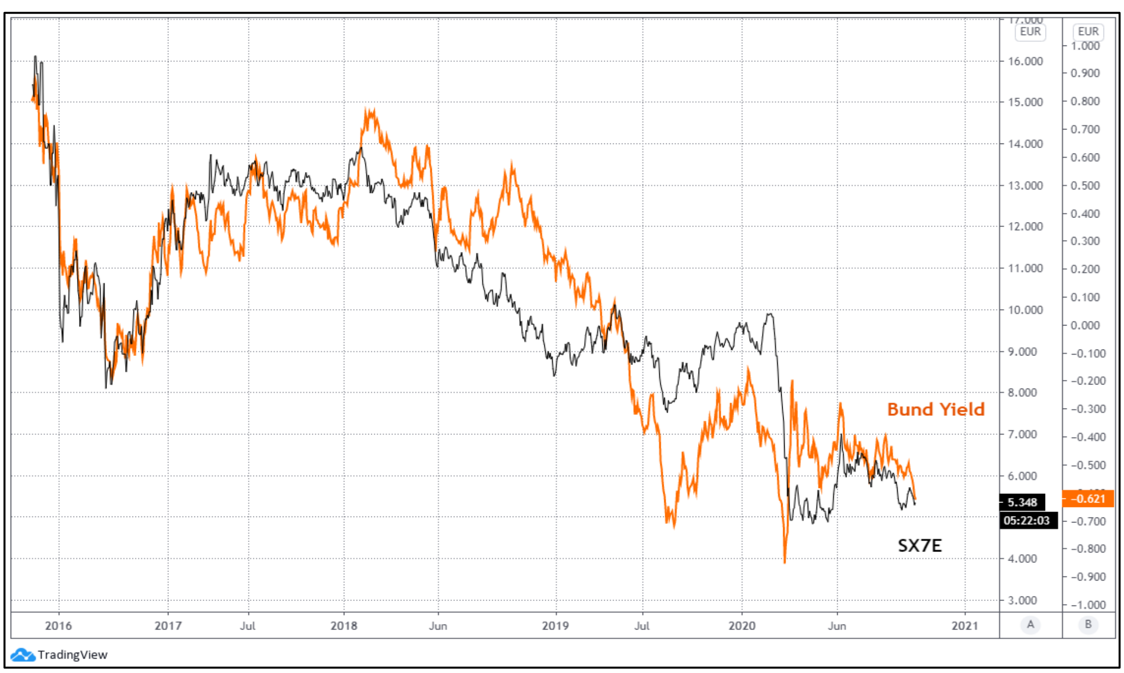
Source : GFD, Bloomberg Finance LP, Deutsche Bank, Market Watch

Inflation expectations are ticking up in the US but only just. To really get them going we will need another leg higher in growth expectations or a lot more fiscal spending, that then in turn gets you the former.



In Europe, with a banking system hobbled by negative rates, one of the pipes for getting money into the economy is constricted. That leaves government spending.

German 10-year yields vs. Banking Index (SX7E)



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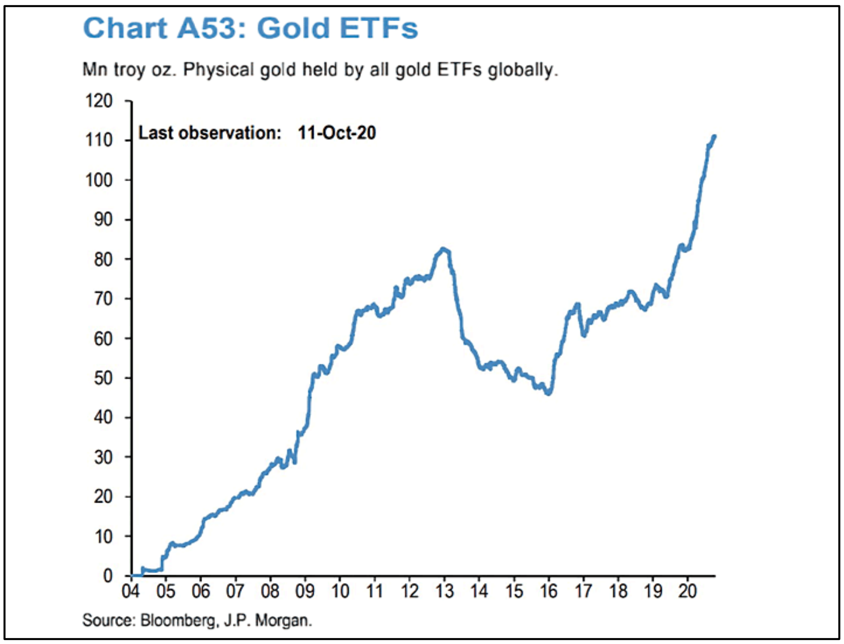
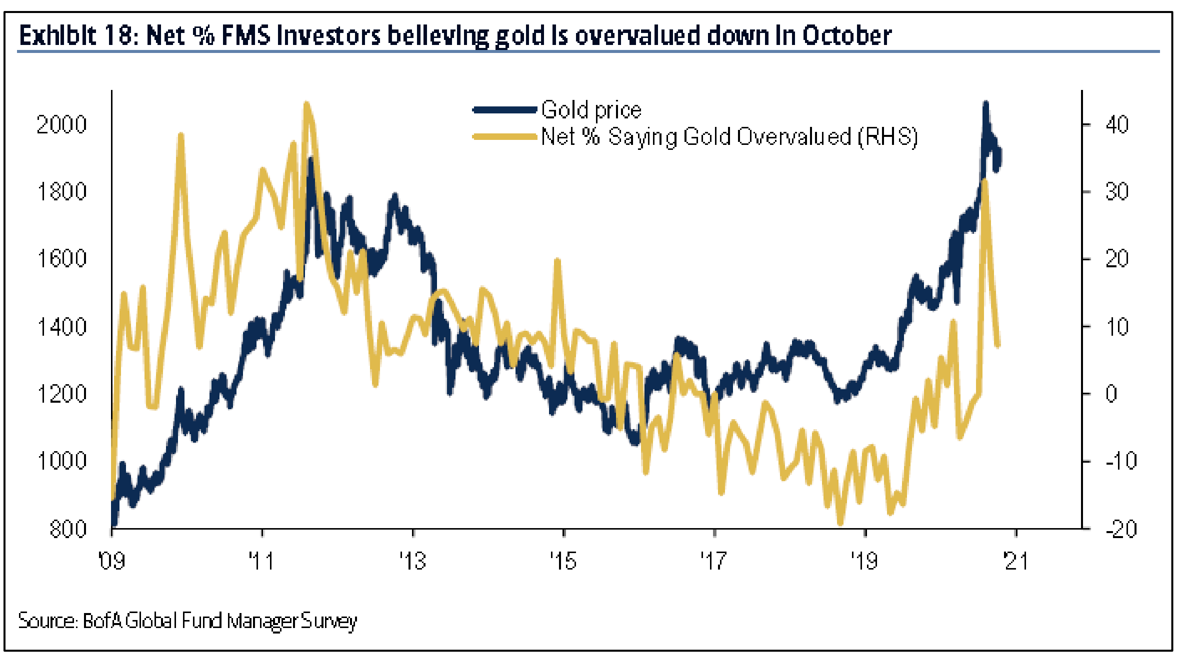
Gold

With danger of higher bond yields (leading to higher real yields) seemingly averted for the moment, Gold has its eye on the dollar. With lots of potential uncertainty likely to be removed in the coming weeks we are approaching decision time.

So far, even with continued flows into Gold, the price has not been able to break the gravitational pull of yields and the USD. The good news is that the number of investors who feel it is overvalued is now falling.





Again, lots of CB speakers this week… also a new round of PMI's.

Important Macro Data Releases and Events for the Week

Monday 10/19/2020	GDP numbers for Q3
	Industrial Production YoY (Sep) Forecast: 5.8%, Prior: 5.6%
	Retail Sales YoY (Sep) Forecast: 1.8%, Prior: 0.5%
	ECB's De Guindos, Mersch, Lane and Lagarde SPEECHS
	Fed's Chair Powell SPEECH
	Fed's Williams SPEECH
	German Buba President Weidmann SPEECH
Tuesday 10/20/2020	RBA Meeting Minutes
	PBoC Interest Rate Decision
	Building Permits MoM (Sep) Forecast: 1.5M, Prior: 1.476M
	Housing Starts MoM (Sep) Forecast: 1.451M, Prior: 1.416M
	Fed's Quarles SPEECH
Wednesday 10/21/2020	ECB's Lagarde, Lane and De Guindos SPEECHES
	Fed's Brainard and Mester SPEECHS
	CPI Core YoY (Sep) Forecast: 0.7%, Prior: 0.8%
	Retail Sales MoM (Aug) Forecast: -, Prior: 1.1%
	Fed's Beige Book Report

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Thursday
10/22/2020

- Gfk Consumer Confidence Survey (Nov) Forecast: -2.5, Prior: -1.6
- Initial Jobless Claims Forecast: -, Prior: 898k
- Initial Jobless Claims 4-week ave. Forecast: - , Prior: 866k
- Continuing Jobless Claims Forecast: -, Prior: 10.018m
- Existing Home Sales MoM (Sep) Forecast: 6.16m, Prior: 6m
- Consumer Confidence (Oct) Forecast: -15, Prior: -13.9
- Presidential Debate

Friday
10/23/2020

- Markit Manufacturing and Service PMI's for UK, France, Germany and EU
- Markit Manufacturing PMI (Oct) Forecast: 53.3, Prior: 53.2
- Markit Service PMI (Oct) Forecast: 54.5, Prior: 54.6
- Markit PMI Composite (Oct) Forecast: -, Prior: 54.3

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