Stargazer
Asset Management

What to focus on in Global Macro for the week of July 13th, 2020

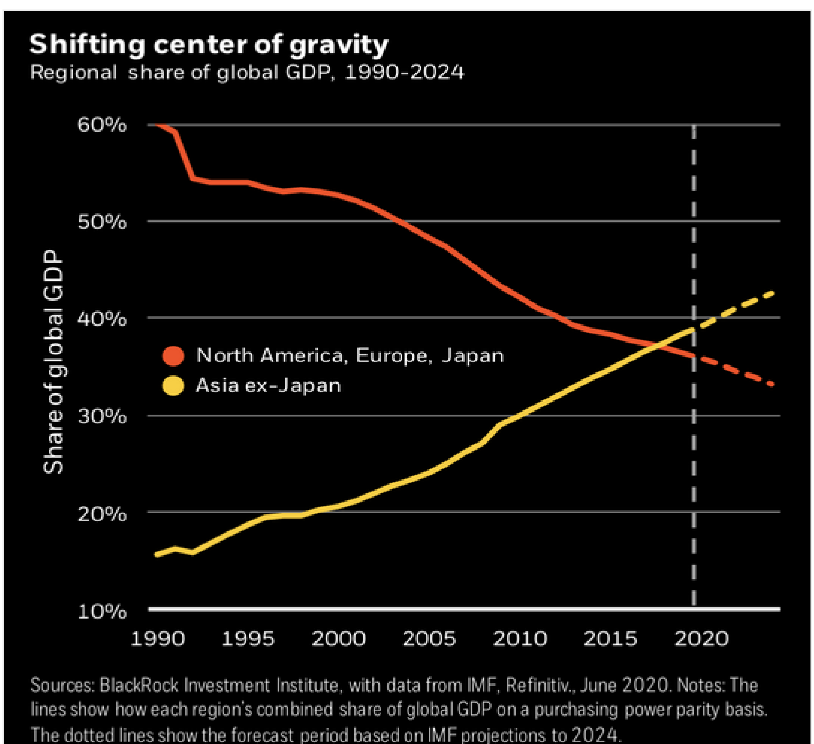
Macro Themes on the Radar:

Biden

On Friday, Biden made an economic policy speech in Scranton, Pennsylvania. As one would expect he hit on healthcare, gun control, the middle class and education. However, it was his focus on rebuilding the US manufacturing base and internal supply chains that was most interesting. While he pledged to reverse many of the Trump tax cuts for the wealthy and corporations (and double the capital gains tax) he also focused on his "Build Back Better" plan (blue BBB vs. red MAGA hats to follow?). He placed "Made in America" center stage and plans R&D spending and Federal government procurement programs to jumpstart manufacturing. The play for moderate blue-collar Trump supporters is on. The speech was designed to appeal to the "middle" and to calm growing concerns that the more progressive elements of the party (the likes of Sanders, Warren and the "Squad") have demanded and received a big say in his proposed policy mix. Achieving the right balance here will be a bit of a high-wire act for him in the coming months

It is interesting to see that both the Democrats and Republicans are focused on domestic manufacturing and access to strategically important products.

I would guess the reality of this chart is starting to hit home…



Sources: BlackRock Investment Institute, with data from IMF, Refinitiv., June 2020. Notes: The lines show how each region's combined share of global GDP on a purchasing power parity basis. The dotted lines show the forecast period based on IMF projections to 2024.

Will markets start to price the tax cut roll backs? Or, will the potential doubling of the capital gains tax lead to a bout of profit taking in equities? We are now inside 80 trading days until the election…

EU Recovery Fund

There has been talk in the German media that a compromise proposed by Germany seems to be acceptable to most member nations. It seems that the Netherlands was threatening a veto, so this would be a big deal if correct. The German proposal would require a qualified majority vote in the EcoFin to disburse funds. A majority would require 15 of the 27 votes. Merkel also believes that attaching some economic reform requirements could help ensure the votes, although Spain and Italy have already expressed their strong opposition to this. In the end, it appears that the Dutch PM Mark Rutte is the one who will need to be convinced. So far, it seems his main concerns are around the voting procedure for disbursements rather than the size of the fund or its makeup of loans vs. grants. If that is the sticking point, the German proposal may start them on the path to compromise and a deal.

Underlying the difficult negotiations there remains a broader issue. There is a natural tension here between EU and Eurozone. Is this really a pandemic relief fund, or just a fiscal transfer mechanism being put into place? If in the end it is the Eurozone and not the single market that is under threat, a lot is being asked of EU members who are not in the currency union. We will see what their cost/benefit analysis demands at the end of the week when they meet.

As an aside … there was a surprise result in the vote for Eurogroup President last week. Spain's Nadia Calvino, who had the support of Germany, France, Italy and Spain (80% of Eurozone GDP) was passed over in favor of Ireland's Paschal Donohoe. The vote was 10-9. The point is that even with the support of Germany and France, margins are tight, and outcomes are uncertain.

<u>**What to Focus on Now:**</u>

Chinese Equities

Last Sunday, I pointed out the breakout in Chinese shares … they exploded right out of the gate as the week began. There seems to be clear government support for the move and while leverage and volumes have been rising, I think there is more room to the upside in the near-term.

Bond markets and currency markets continue to experience volatility suppressed by global rates that are very low and expected to remain there for a long time. Volatility (and price discovery) in credit markets, is also being removed by Central Bank buying. Global equities are on a shrinking list of asset classes that remain free to trade.

With bond yields and currencies less able to express expected growth differentials, global equity indices, both against each other and outright, have become more interesting than ever.

The shift from monetary policy to fiscal policy, as the marginal driver of markets, opens up many new lines along which national and regional differentiation can evolve.

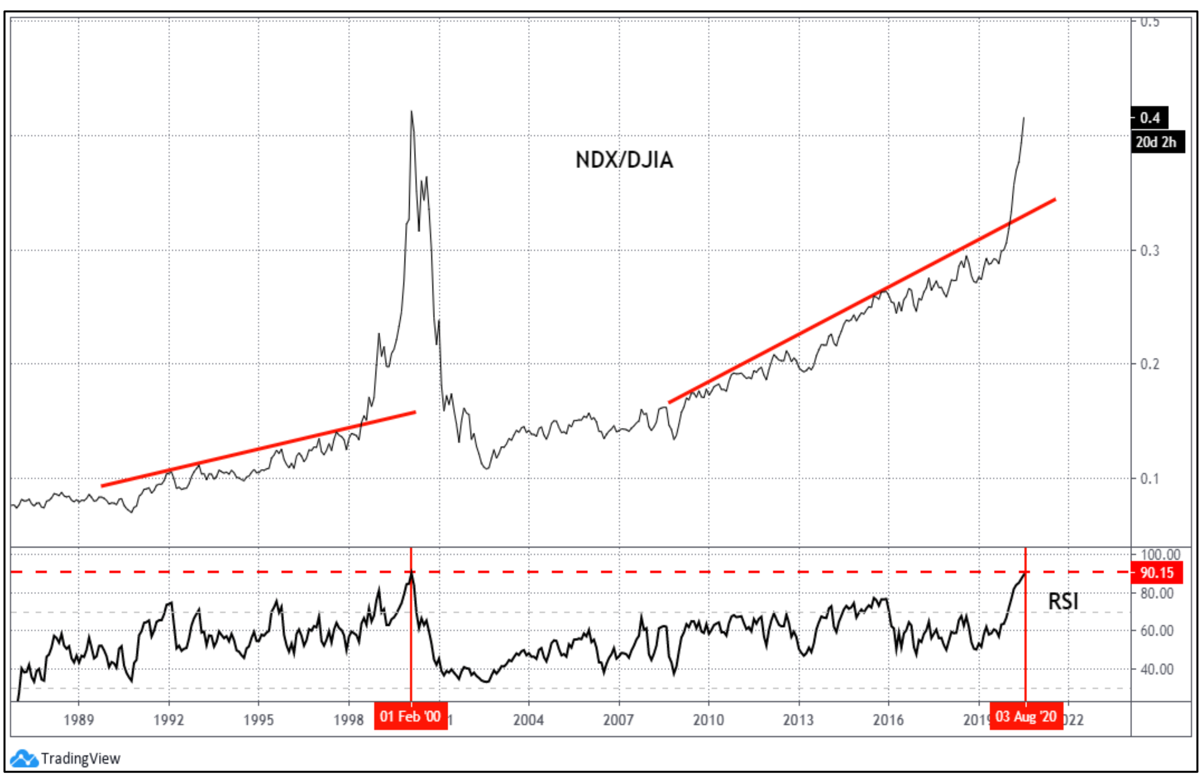
Big tech goes vertical

The outperformance of large US technology shares continues its '99 like sprint. Getting very over-bought now, but that only matters when momentum rolls.

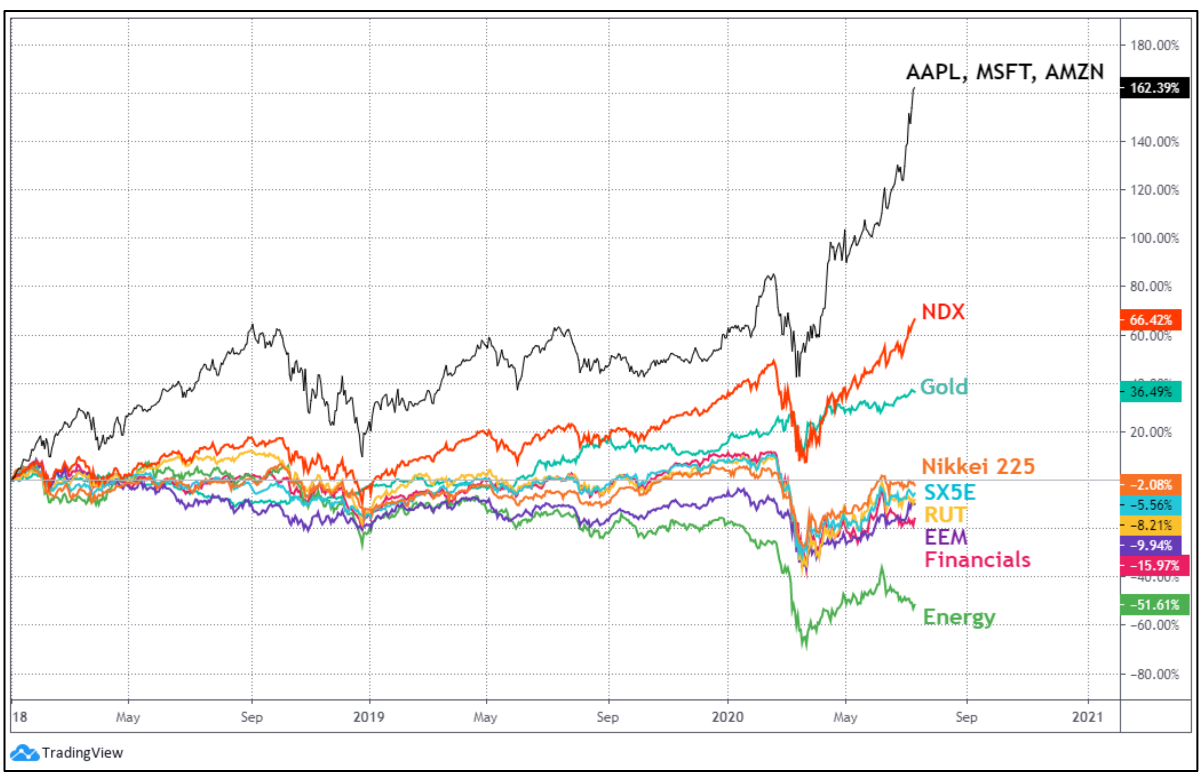
We are in the exponential phase…

Obviously, the backdrop is very different, but the price action is very similar…

The less big tech the index has, the more overdone the relationship looks via the RSI.



The dispersion since the beginning of 2018 has been remarkable: Growth + Defensive vs. Value + Cyclicals has continued to be the dominant theme.



The pandemic didn't change the existing trends, if anything it accelerated them.

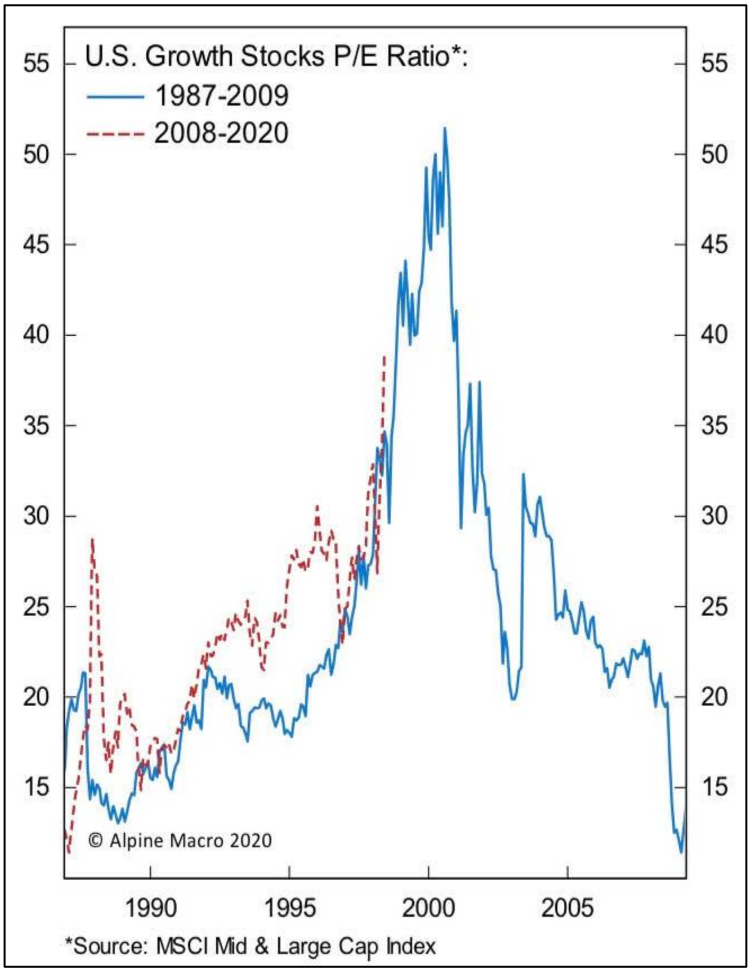
The liquidity had to go someplace, and investors just added to what they had. With a high correlation of equity prices to CB balance sheet expansion (95% in the near-term), the largest companies have done the best and are the most expensive.

S&P 500 Median Results Through July 3, 2020

Company Size	Market Cap	P/E	P/S	P/FCF	P/B	YTD Returns
Top 10	$848.5 billion	31.4	6.3	33.2	6.3	9.6%
Top 50	$198.7 billion	28.7	4.6	23.3	5.5	2.4%
51-100	$77.6 billion	26.0	3.8	25.0	5.3	-5.7%
101-150	$49.5 billion	22.9	3.9	23.6	4.1	-1.9%
151-200	$30.5 billion	26.4	3.0	23.5	4.1	-6.7%
201-250	$24.6 billion	24.4	2.6	20.0	3.2	-9.3%
251-300	$20.2 billion	23.2	2.6	21.8	3.3	-5.5%
301-350	$14.9 billion	23.9	2.8	22.8	2.5	-8.5%
351-400	$11.8 billion	22.1	1.8	18.4	3.0	-17.6%
401-450	$8.9 billion	13.3	1.4	12.8	1.9	-22.6%
451-505	$5.1 billion	13.9	0.8	10.0	1.2	-38.5%
S&P 500	$21.8 billion	22.8	2.4	20.4	3.0	-11.0%

Souce: Ycharts

Seen another way… the capitalization weighted NASDAQ 100 vs. an equally weighted version.



Earnings multiples are also starting to look like they are following the '99 path.

However, this time these are solid companies. They are in fact the realization of what the '99 dream was all about.

In some ways they have become the "Gold" of the equity markets. The only question is how much are they worth and why would investors decide to unwind. We have to be vigilant for signs that the party is winding down.

During the mad rush in '99 the VIX ranged between 20 and 30 as realized volatility remained high.

Again, with so many other asset classes sidelined by one form or another of government intervention, it may pay to find ways to be long gamma in various equity indices.

FX

The dollar is still on everyone's mind. Will it start to meaningfully weaken vs. its major trading partners or are we stuck in a range?

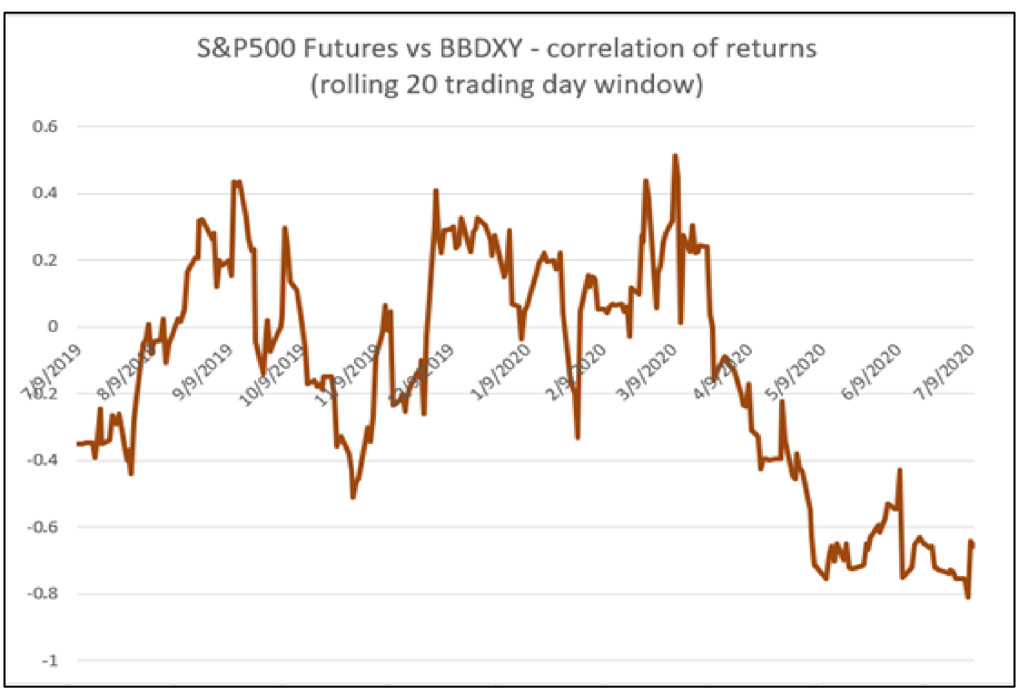
The EUR is an important part of this puzzle. Bullish EUR arguments rest on the following: 1) a persistent current account surplus 2) hopes for a meaningful move towards debt mutualization via the pending EU Recovery Fund and 3) the idea that Europe has in some ways weathered the COVID Pandemic better than the US has.

These arguments, in the end, all rely on a resurgence of relative growth in GDP and earnings. Fundamentally, I would say the jury is still out on that one. Technically we are still stuck in a range. A meaningful price break would indicate that perhaps the above fundamental view is starting to get some traction.

NIRP and a sense of suspicion about the sustainability of the Eurozone project is holding back the EUR for the moment. A breakthrough this week on the EU Recovery Fund would help…

In the meantime, it's been obvious that the dollar has been moving with equities (actually negatively correlated). Although when I looked at it, I was amazed by how tight the relationship has actually been.

Here is another way of looking at the S&P vs. USD correlation from BNY/Mellon



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Bigger picture…

More broadly, I think it is easy to underestimate the effect that NIRP in Europe has had on the trade weighted indices and on things like the DXY.

Yes, the GFC hit Europe hard. However, it was the cumulative effect of a lose of confidence in the eurozone project, brought on by the debt crisis in 2011, and quickly followed by the move to negative interest rates by the ECB in 2014, that has been a big contributor to EUR weakness and as a result USD strength.

Some of the old relationships between the DXY (EUR heavy) and instruments like EEM have broken down as a result. EEM has far outperformed what might have previously been expected as a result.

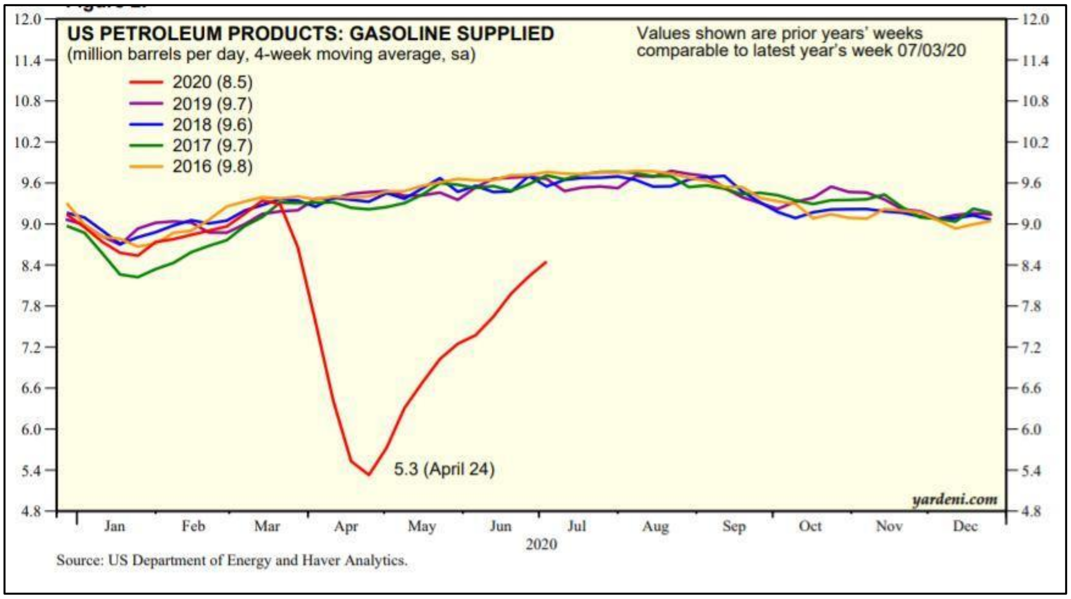
Add to this the fact that EEM has a meaningful weighting in technology, telecom and healthcare, which have of course outperformed in recent years.

Eco Data

Houses and automobiles have been in high demand.

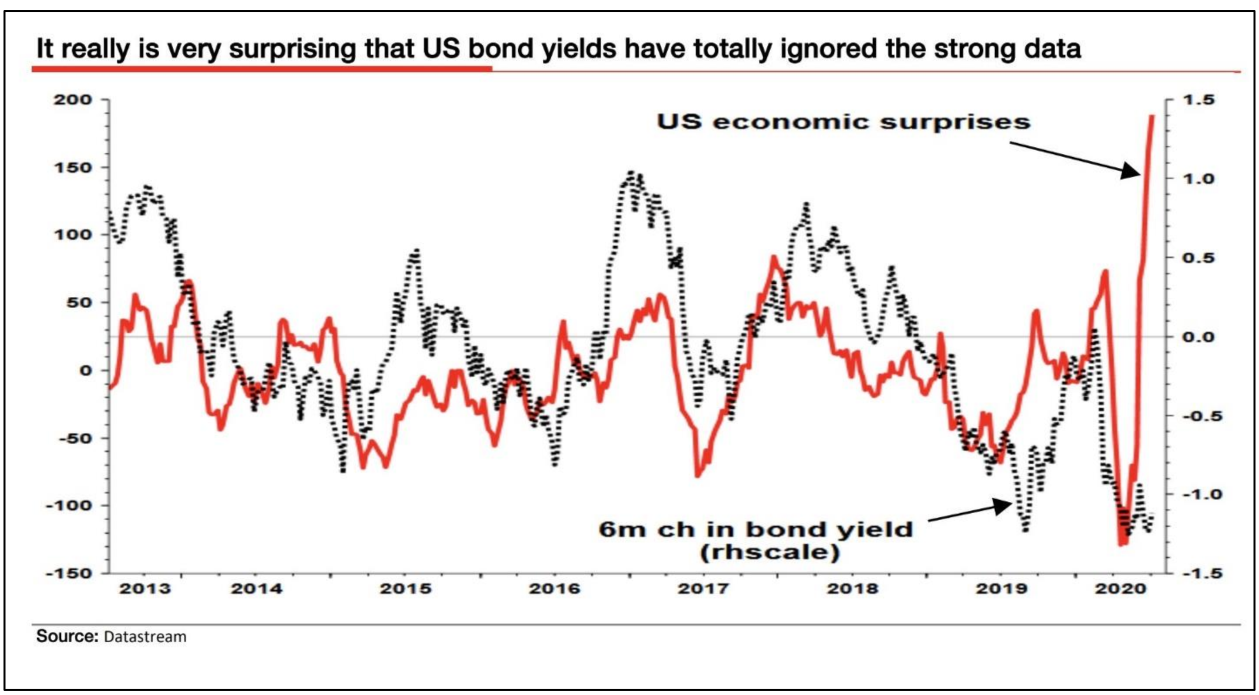
The fear of being stuck in a city without an escape is almost certainly playing a role on the housing side. With very low mortgage rates and high equity valuations, are people also making an asset allocation decision / inflation hedge?

Cars are in demand (and so is gas) as people decide driving is better than public transportation and no one is going away on vacation.



With re-openings, the traditional US data has been good and beating expectations. As discussed, the higher frequency data however has looked a bit softer recently as the virus has spiked in the South and the West.

Either way bonds have barely reacted… so far, forward guidance at home, and NIRP overseas, is doing the trick.



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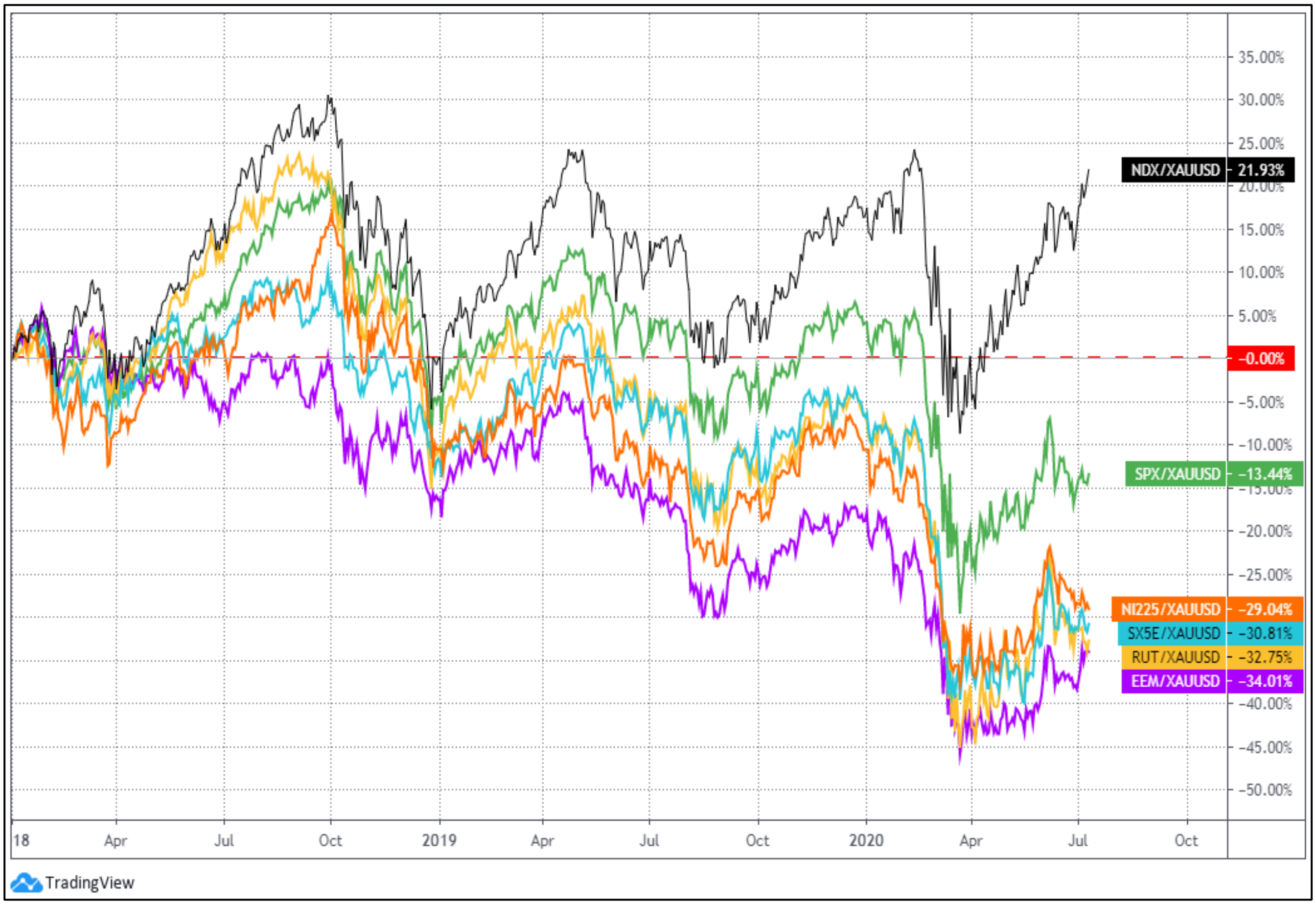
Gold

When looking at how Gold has done vs. some of the global equity indices, it is interesting to note that on a price only basis (no dividends), only the NASDAQ 100 has outperformed it.

Last two and a half years…



Next Week…

With earnings rolling in this week it could get volatile. According to FactSet, the S&P is expected to report a decline in earnings of -44.6% for the second quarter. However, there isn't much guidance out there so surprises could abound. Buckle up.

Important Macro Data Releases and Events for the Week

Monday 7/13/2020 — Fed's Williams SPEECH

Monthly Budget Statement (Jun) Forecast: -, Prior: $-399bln

Tuesday
7/14/2020

Trade Data: Imports, Exports and Trade Balance

Harmonized Index of Consumer Prices Forecast: 0.8%, Prior: 0.8%

ECB Bank Lending Survey

ZEW Survey - Economic Sentiment (Jul) Forecast: 78.1, Prior: 58.6%

ZEW Survey - Current Situation (Jul) Forecast: -64, Prior: -83.1%

ZEW Survey - Economic Sentiment Forecast: 60, Prior: 63.4%

CPI ex-food and energy MoM (Jun) Forecast: 0.1%, Prior: -0.1%

CPI ex-food and energy YoY (Jun) Forecast: 1.1%, Prior: 1.2%

Wednesday
7/15/2020

BoJ Monetary Policy Statement and Interest Rate Decision

Industrial Production MoM (Jun) Forecast: 4.3%, Prior: 1.4%

BoC Monetary Policy Statement and Interest Rate Decision

Fed's Beige Book

Thursday
7/16/2020

GDP QoQ Forecast: 10.4% vs. -9.8%, YoY Forecast: 2.5% vs. -6.8%

ECB Monetary Policy Statement and Interest Rate Decision

Retail Sales / Various Releases

Initial Jobless Claims Forecast: 1.25m, Prior: 1.314m

Initial Jobless Claims 4-week ave. Forecast: -, Prior: 1.437m

Continuing Jobless Claims Forecast: -, Prior: 18.62m

Friday
7/17/2020

EU Leaders Special Summit

Building Permits MoM (Jun) Forecast: 1.28m, Prior: 1.216m

Housing Starts MoM (Jun) Forecast: 1.15m, Prior: 0.974m

Michigan Consumer Sentiment Index (Jul) Forecast: 79.1, Prior: 78.1

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