Stargazer Asset Management

What to focus on in Global Macro for the week of October 5th, 2020

Macro Themes on the Radar:

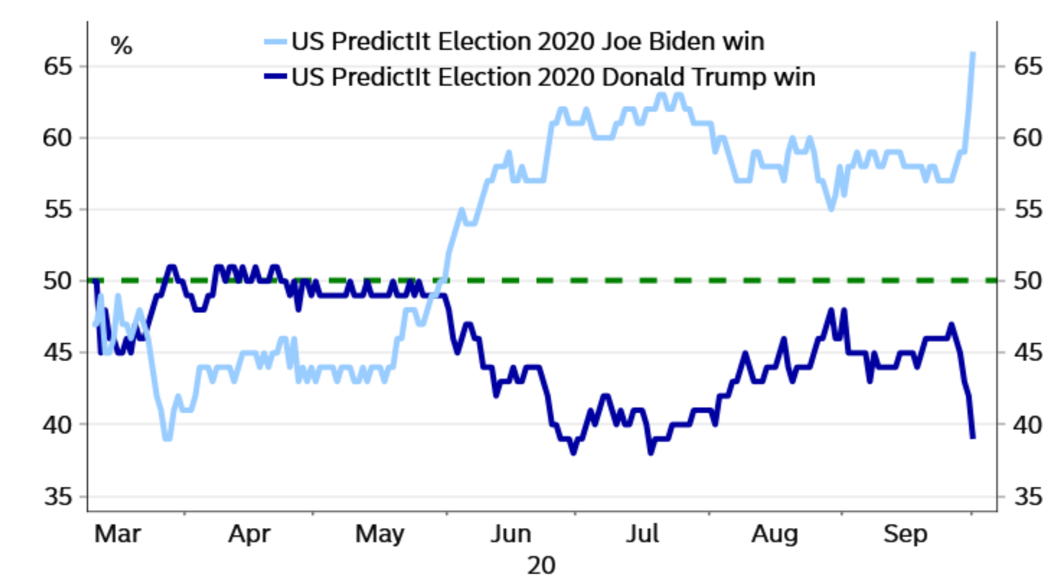
US

2020 continues to amaze with its ability to churn out the unexpected and extraordinary. Last week we had the first Presidential debate (being anything but Presidential), followed by Trump's positive COVID test result and a trip to the hospital. Going forward we still have the potential for stimulus IV. Apparently, Mnuchin and Pelosi spoke with Powell on Thursday during a private call regarding how much help municipalities and local governments will need. The point is they are still talking. Then of course there is the election itself, with all its potential for an extended vote count and contested outcome. Maybe we can round out the year with an alien invasion…

With all the headlines and partisan bickering, between the parties and in the media, it is hard to not get caught up in the noise. However, clarity is coming, and we need to focus on what matters to markets.

The latest polls suggest that Biden is pulling further into the lead … betting markets agree. Of course, there is lots of water yet to go under the bridge, but Biden is increasingly being priced in.

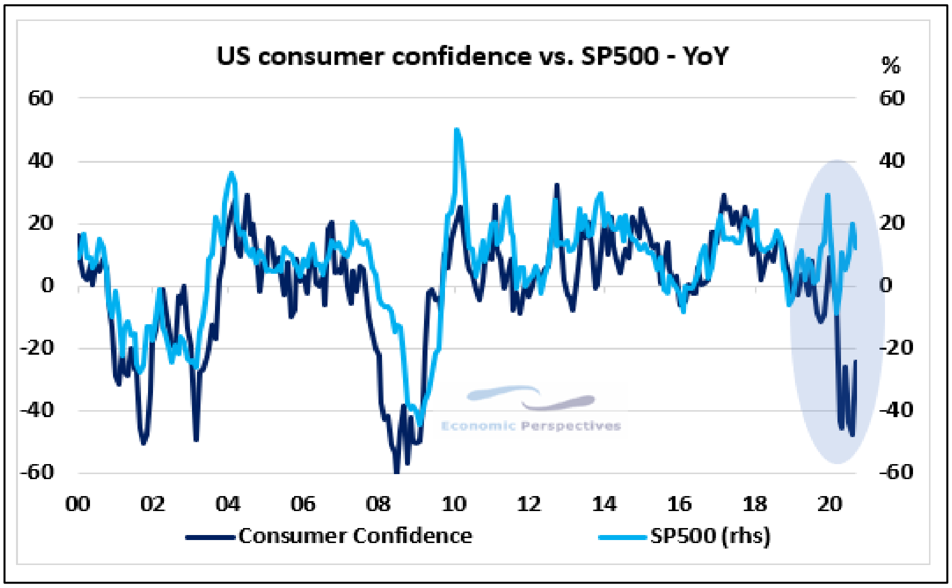
Chart 2. US election betting probabilities



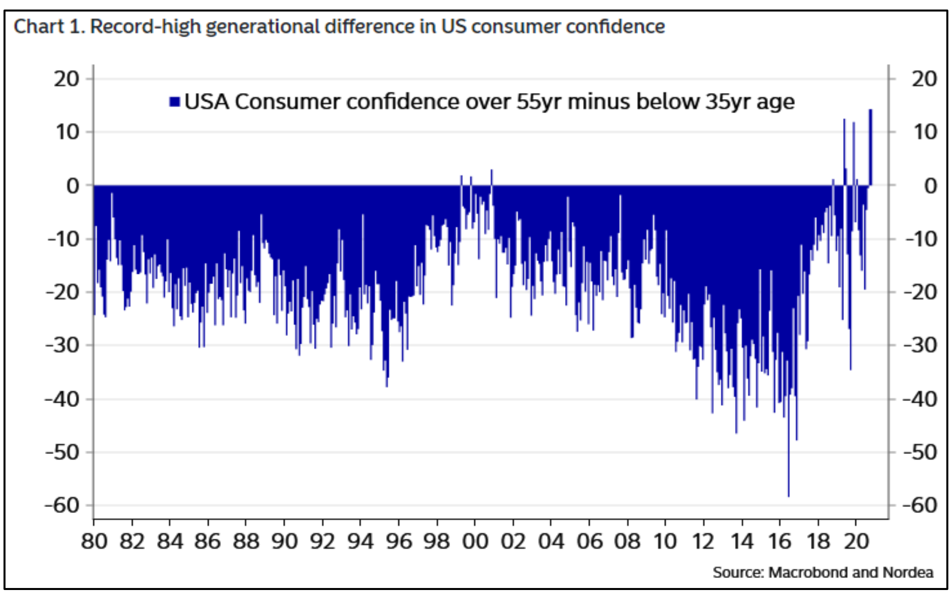
Source: Macrobond and Nordea

Less priced, but potentially more important for markets, will be the outcome in the Senate. A Blue Wave could bring a much more sweeping policy shift than currently expected and as a result, much bigger consequences for markets. In particular, the ability to reduce or eliminate the lower tax rate for capital gains could be impactful. The goal of reducing income and wealth disparity via redistributive tax policy, could push up inflation expectations as money is moved from those who invest to those who spend. With the policy baton now shifted from the central bankers to politicians, expect fiscal policy to continue to be the dominant driver. Efforts will be made to narrow the gap between the performance of financial markets and the real economy.

COVID has only served to highlight the divide…



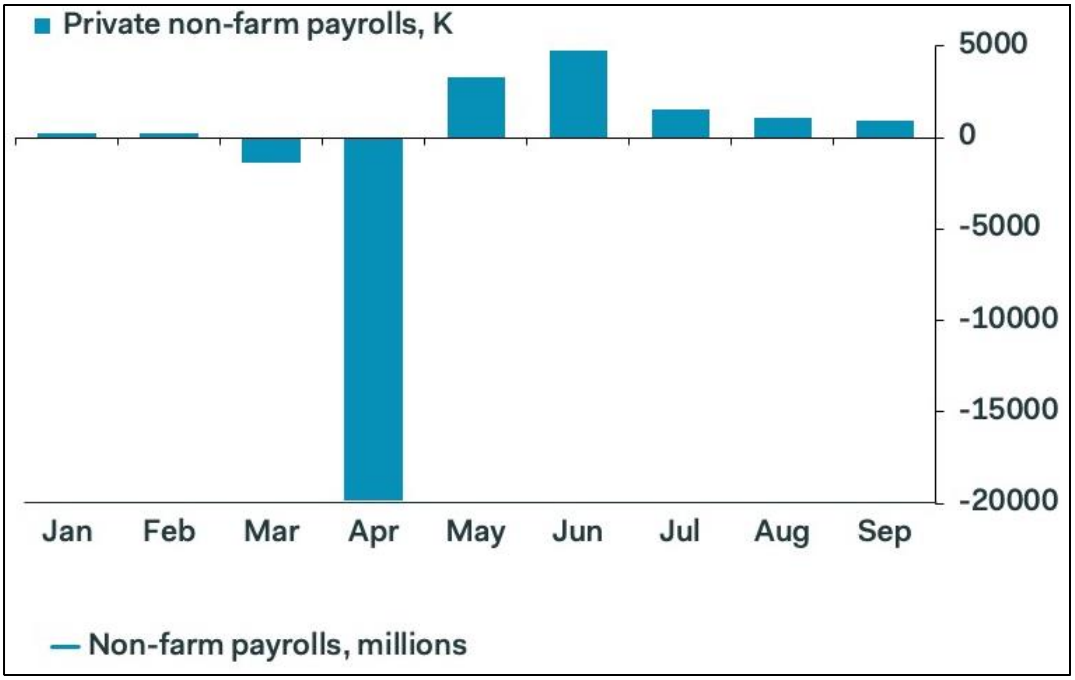
Maybe because there will be an old guy in the White House either way, the young are especially concerned. Not great for the American dream…



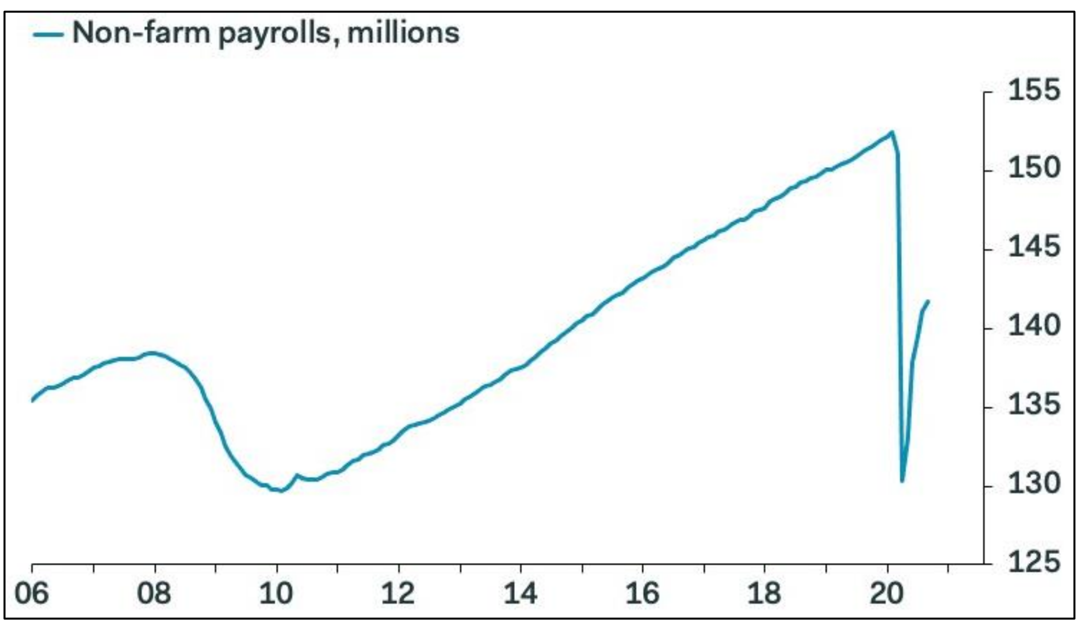
No doubt the employment story is part of the problem. Younger workers, often in service industries, have been disproportionately affected by COVID.

To make thing worse, the initial bounce in employment post lockdowns is slowing as the virus drags on.

The momentum in private payrolls is slowing…

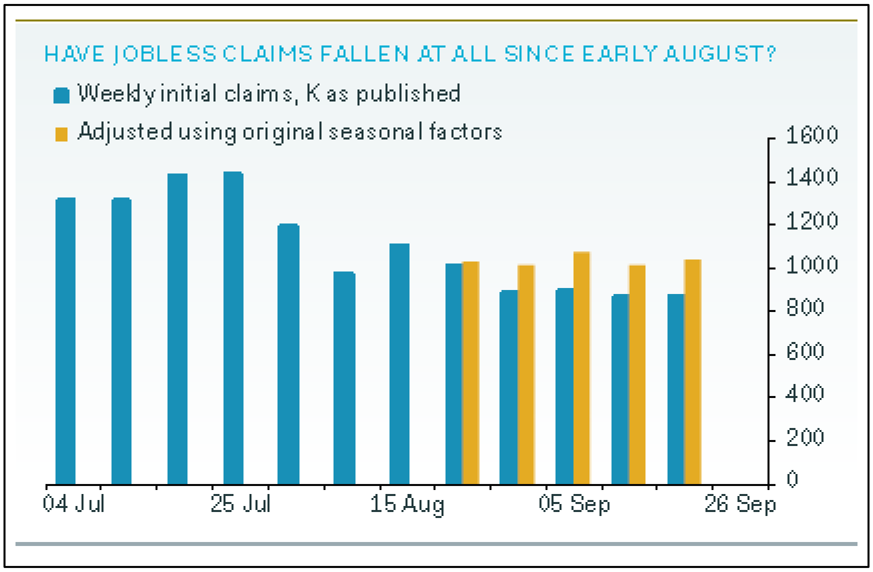


And only about half the jobs lost due to pandemic have so far been recovered.



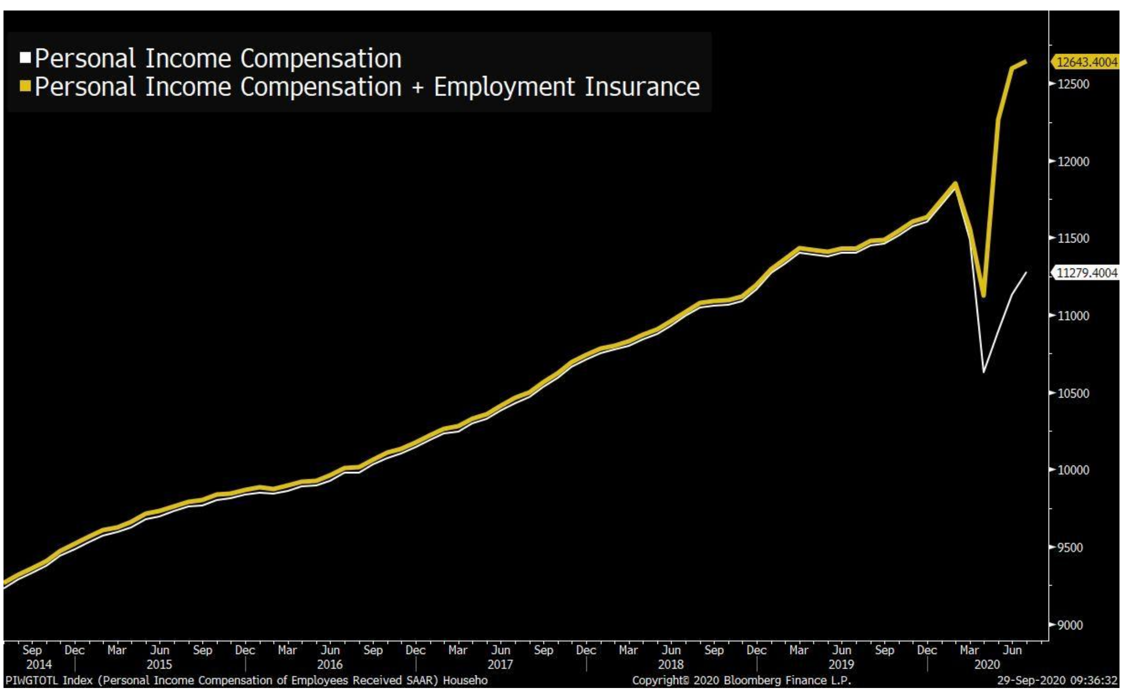
Source for both above charts: Pantheon Macro

Recent weekly unemployment claims have stopped making much headway…



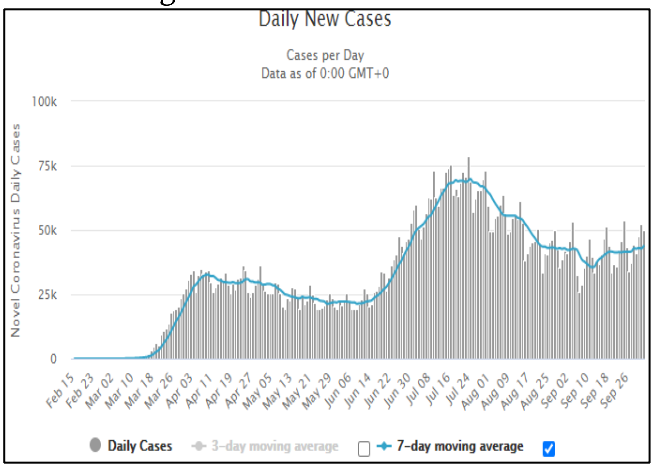
Source: Pantheon Macro

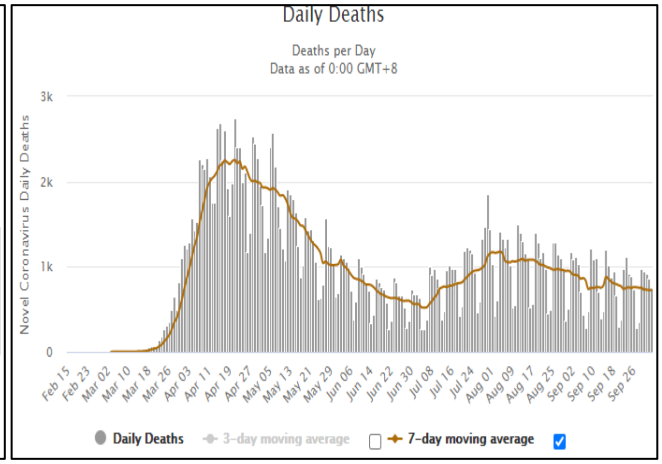
The boost to unemployment benefits has so far more than offset the fall in income. A huge help to retail sales.



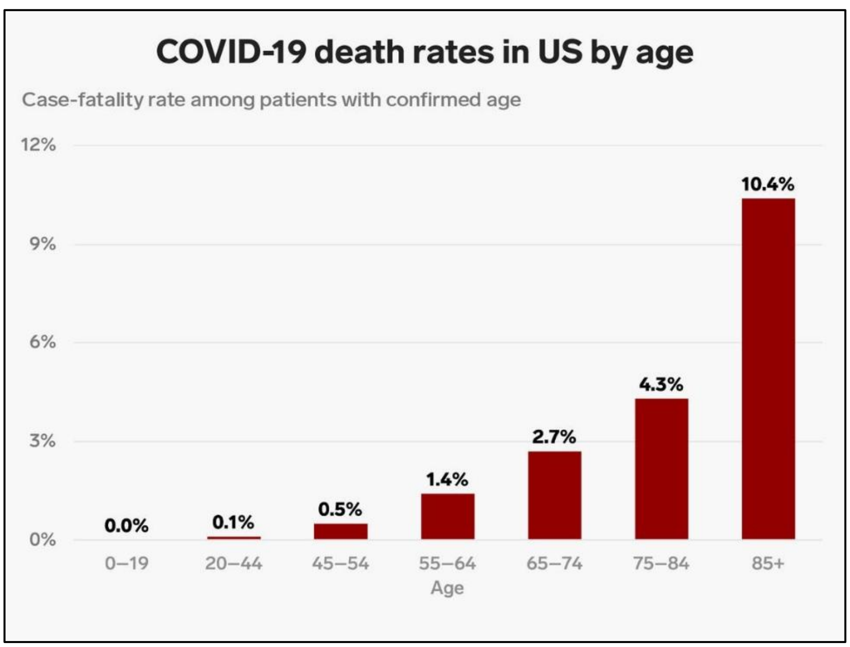
With the number of cases again rising and a vaccine still some way off, we should get the next stimulus bill soon or markets could force their hand.

The good news on the virus remains that deaths are now much lower than in April although new cases are higher.





Better theraputics and an understanding of who the most vulnerable are is helping. Most new cases are in the less vulnerable younger age brackets.



ECB

The ECB has also been going through a policy review and it seems they will follow the Fed in embracing some kind of average inflation targeting around a symmetric 2% inflation target. Prior to this they have been focused on having inflation run at just under 2%. They will also increasingly focus on core inflation.

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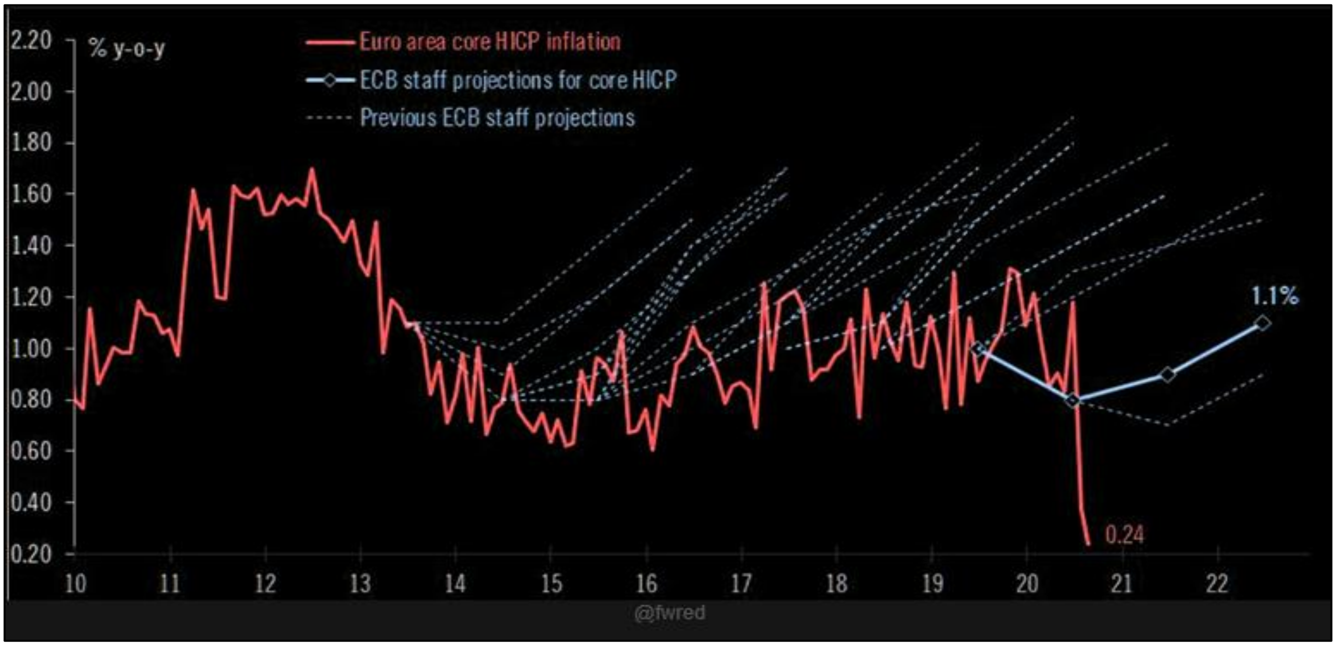
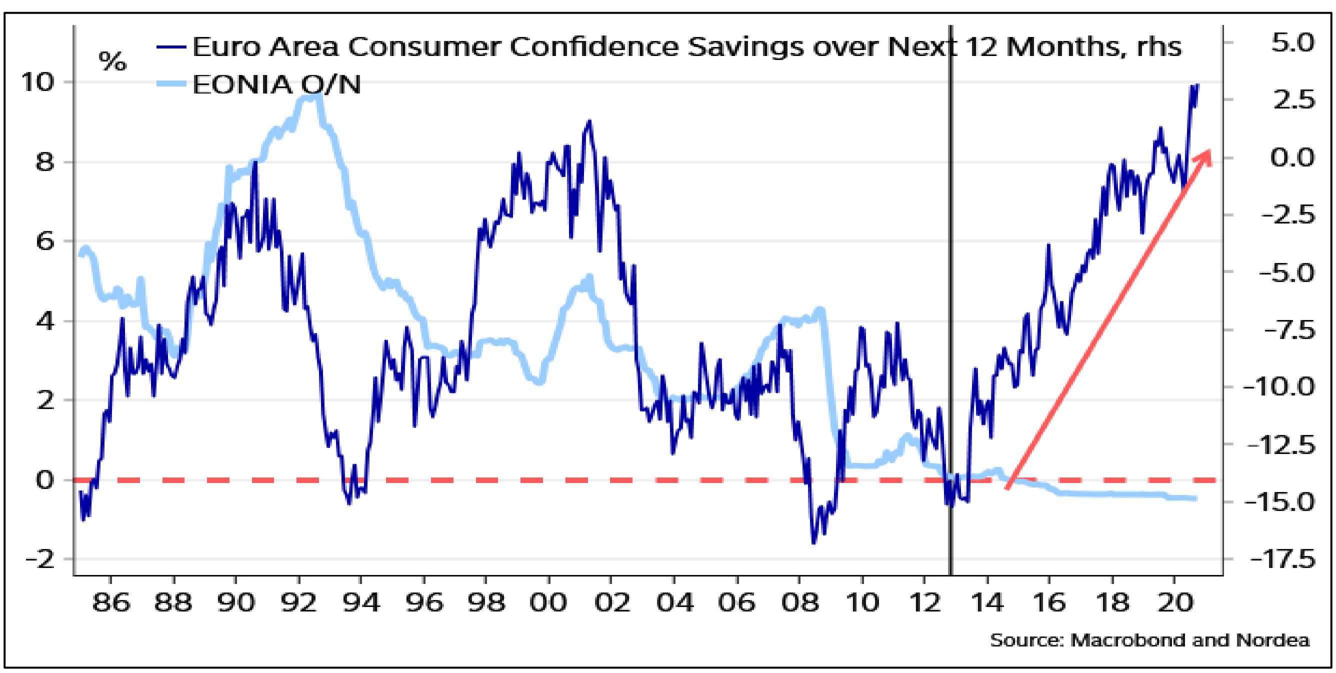
So far, their efforts to stoke inflation via negative front-end rates and QE have not brought the expected results … even pandemic aside.



I think there is very little appetite for further rate cuts at this point. It has become increasingly clear that NIRP doesn't work and may in fact be counterproductive. Not only does it mess with the business model of the banks, but it seems to encourage increased savings rather than increased borrowing and consumption. As rates approached zero and then went negative, plans to increase savings steadily increased.



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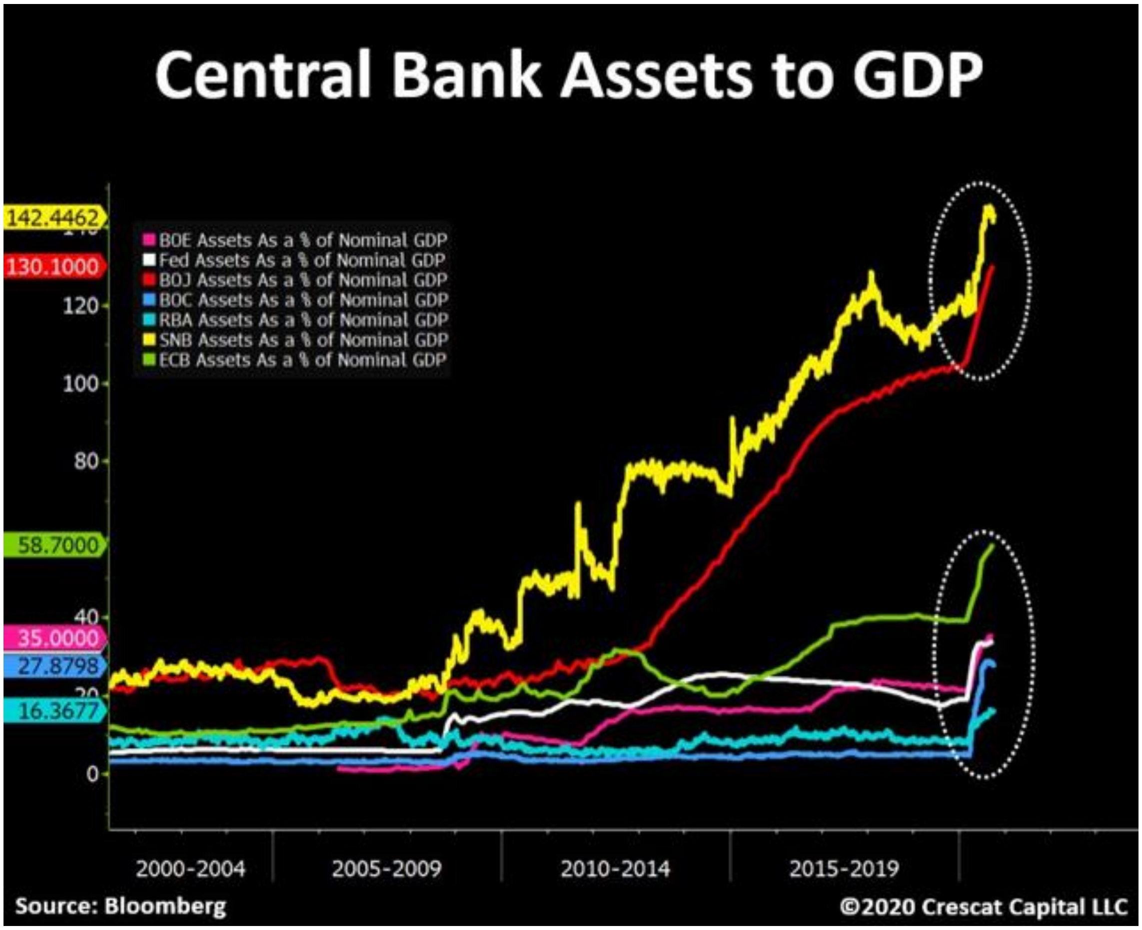
Instead of cutting rates further, more QE is likely. Don't be surprised to see an increase under cover of the PEPP program in December. It increasingly looks like everyone will follow the Swiss National Bank and the Bank of Japan.



Does QE do much other than allow governments to self-finance and maybe push up asset prices? CB certainly think it does.

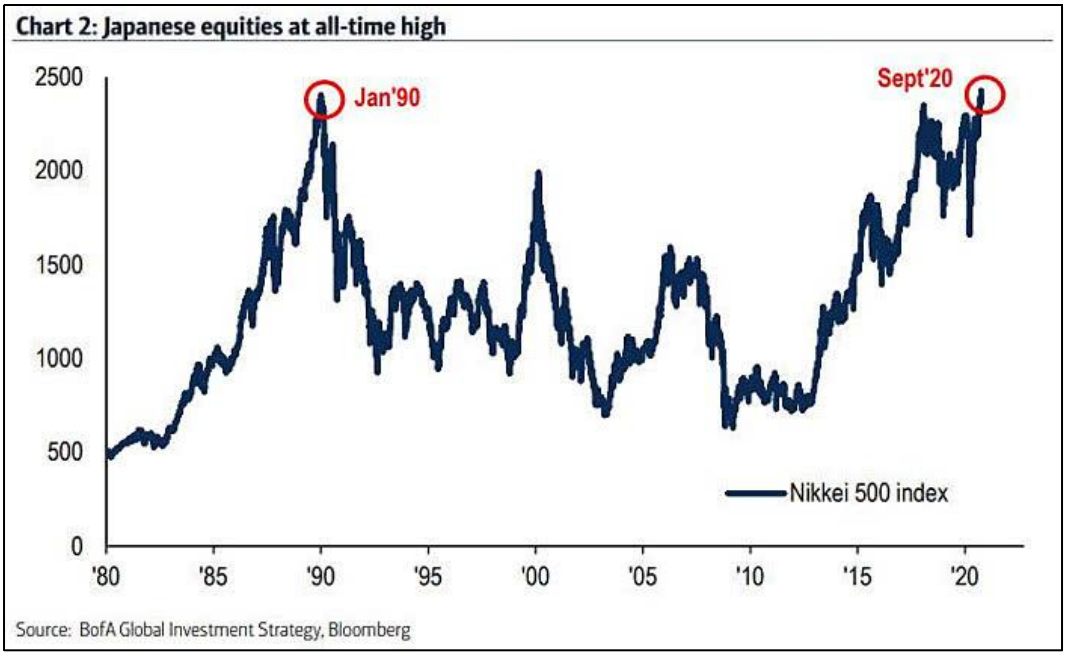
A recent study by the National Bureau of Economic Research found that…

"Central banks sometimes evaluate their own policies. To assess the inherent conflict of interest, we compare the research findings of central bank researchers and academic economists regarding the macroeconomic effects of quantitative easing (QE). We find that central bank papers report larger effects of QE on output and inflation. Central bankers are also more likely to report significant effects of QE on output and to use more positive language in the abstract. Central bankers who report larger QE effects on output experience more favorable career outcomes. A survey of central banks reveals substantial involvement of bank management in research production."

While the study was relatively small, and I am sure open to all kinds of critical review, I can't say I am shocked.

What to Focus on Now:

A recent BoA/ML chart pointed out that Japan's Nikkei 500 (new economy index) had just reached new highs. With the new Prime Minister Suga coming in it is worth reviewing where we are. I thought I would try and provide some perspective. While the new economy stock index is back to the highs of 30 years ago…



that is not the case for the more widely followed (and more industrial) Nikkei 225 index. That is still 40% off the '89 high … Eventually the a break of 24,500 will open the door to new highs.

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On a relative basis, the Nikkei has been quitley outperforming Euro Stoxx since 2002.

Vs. the US, performance has been net flat since early 2013. There is the potential that we are forming a long-term low here. This is worth watching if Nikkei outperformance picks up.

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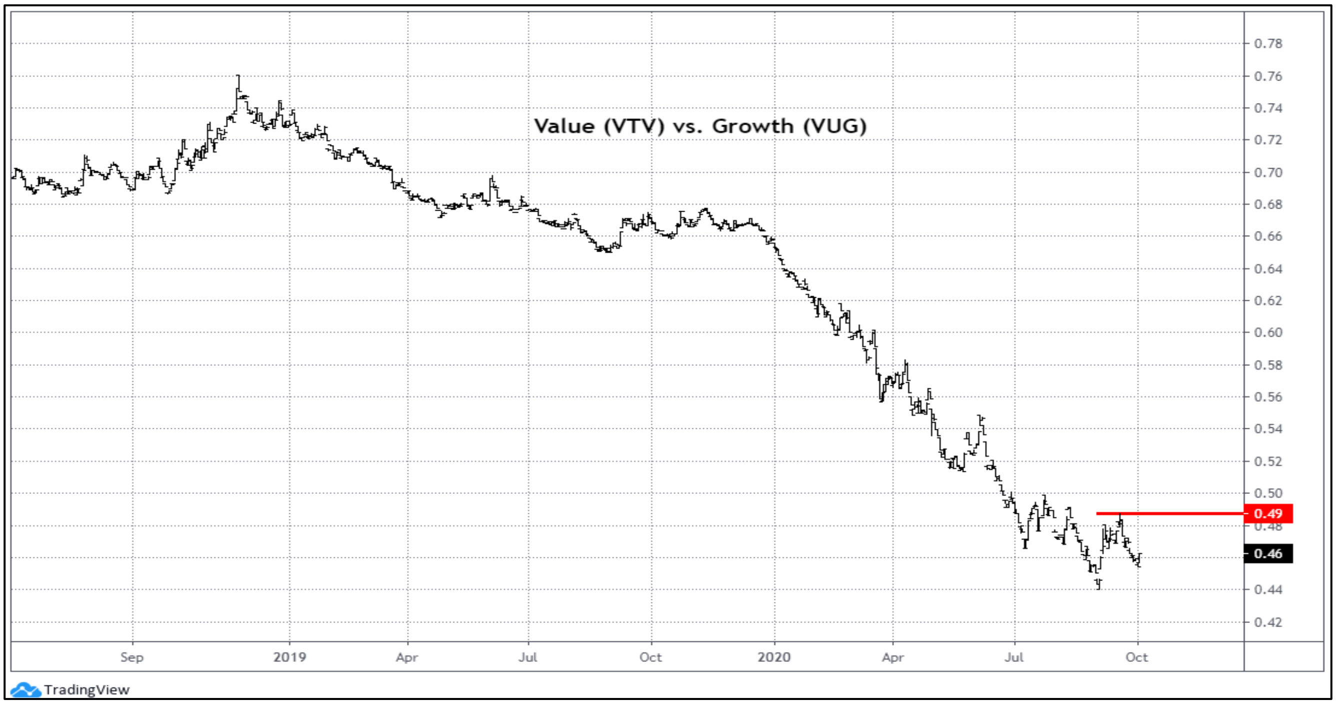
US Markets

Friday brought weaker equity prices led by growth and tech on one hand and outperformance by value and small caps on the other. This dance has been going on for a while now as the market tries to rotate.



On a relative basis, the mid-September highs are worth watching as a signal that the shift is real.

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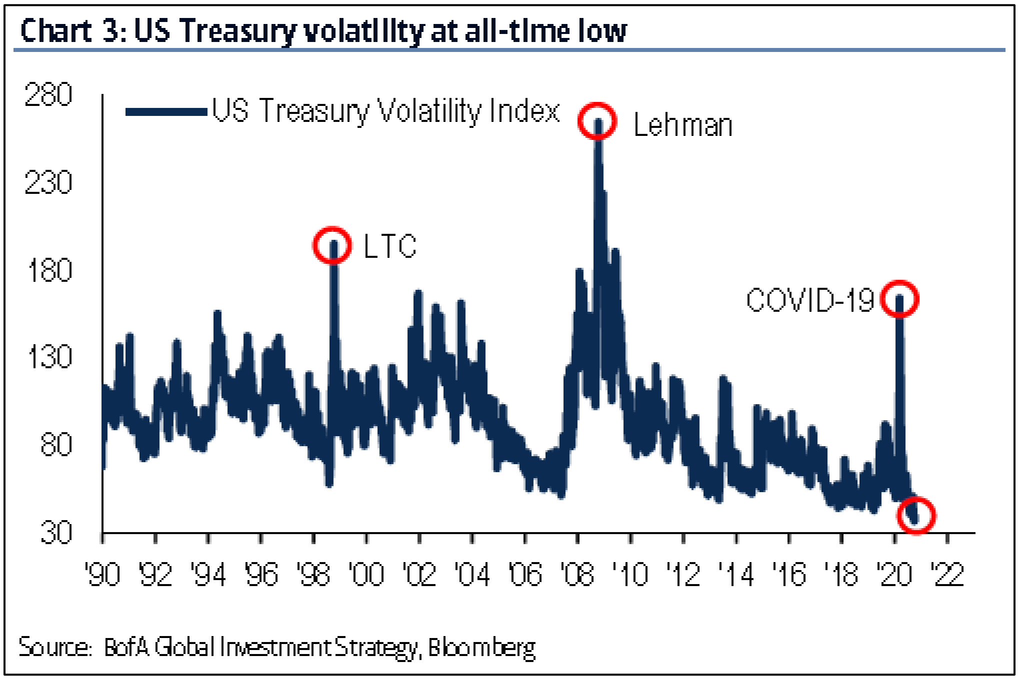
Even Financials found a little love as they continue to try and put in a bottom in relative performance. Friday was one of those rare days where long end of the US yields actually moved a bit and bonds went down with stocks.

A break of the recent range would certainly help.

Given the Fed's AIT plans, the very low volatility in Treasuries and the potential for a Blue Wave, it is worth watching the long end of the curve out of the corner of your eye.



If we start to crack above 1.25% in 5's vs 30's it could signal another leg in a steeper curve.

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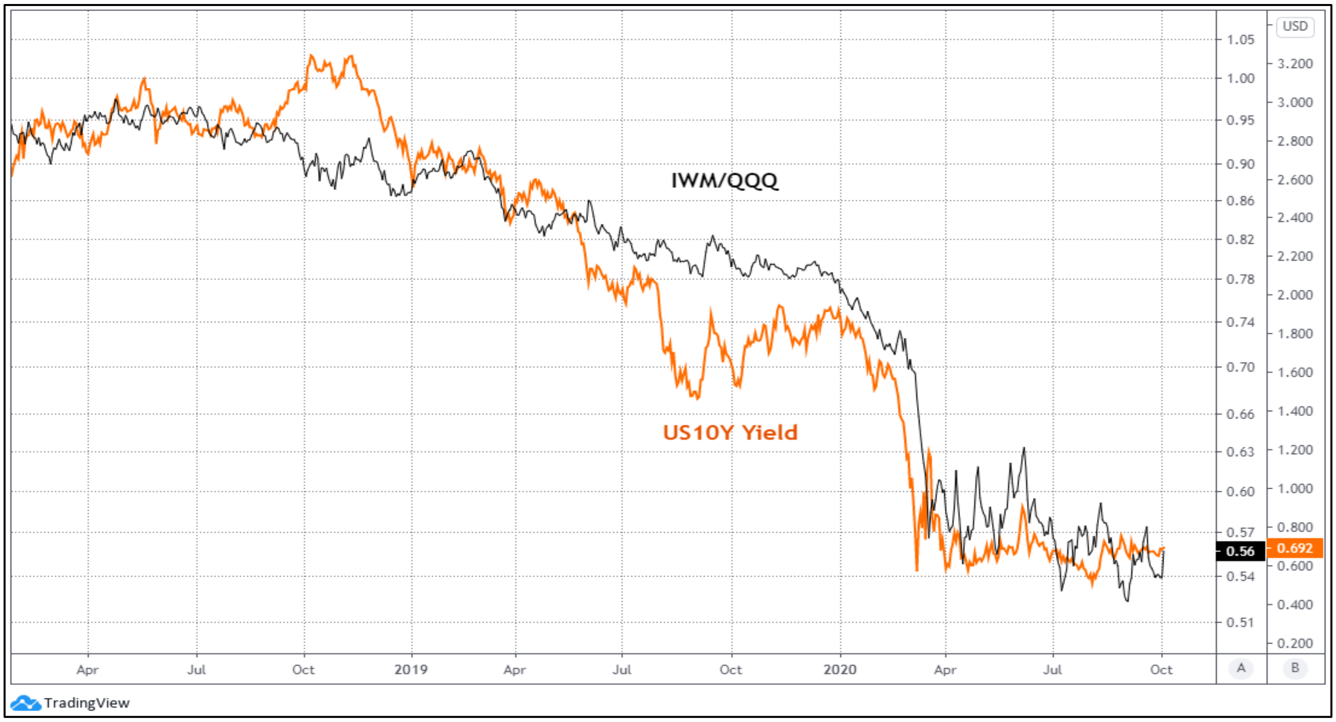
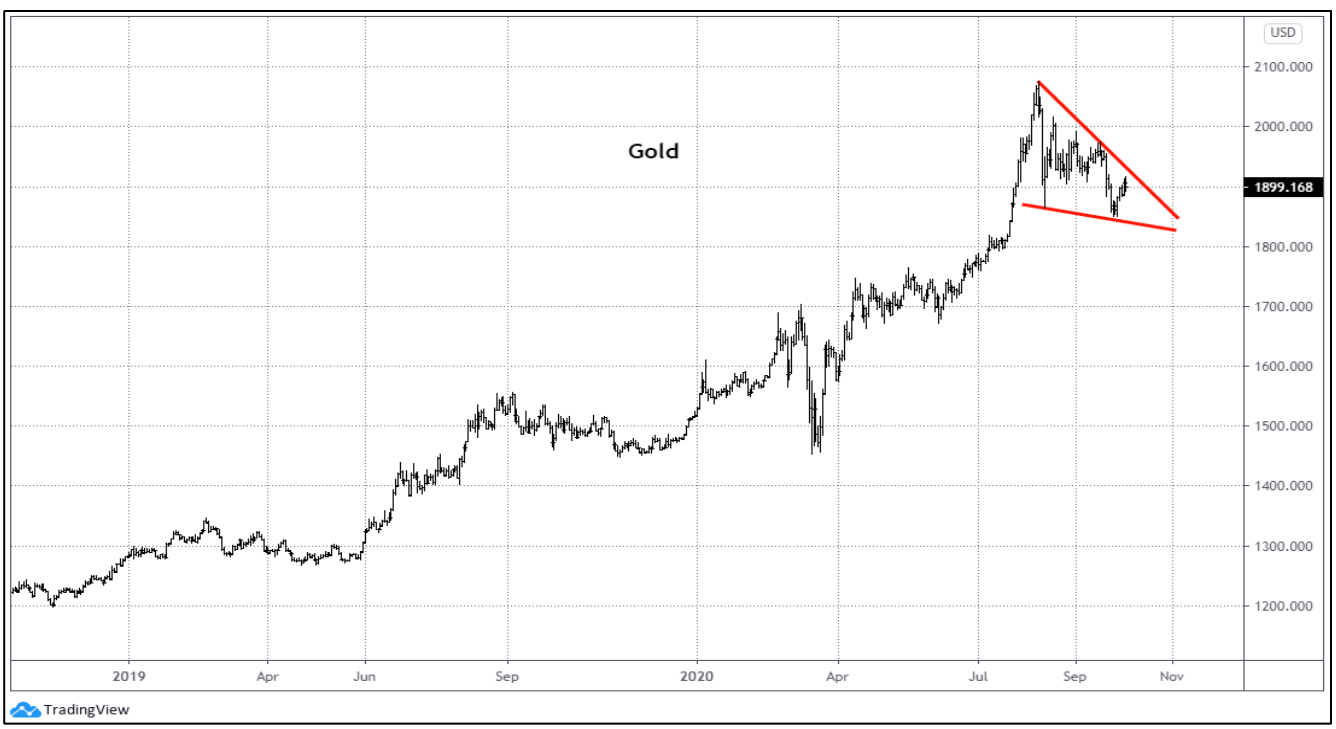
Higher long end yields would likely help reinforce the rotation in US equities.



However, it could be counterproductive for Gold unless it is accompanied by USD weakness.



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FX

With Brexit negotiations coming to a head, I still think there is potential for a GBP rally. A resolution, almost any, will mean an undervalued British Pound could have some meaningful upside. Career risk of a sudden catastrophic outcome is keeping investors out. When that passes, a 10% appreciation can follow.

Hedging and Downside Protection

With bonds increasingly challenged as effective hedges for an equity portfolio, advisors and investors are looking for alternatives. Some strategists are viewing preferred stocks and high yield bonds as potential replacements. However, with the correlation they have to equities and yields, this makes little sense. Increasingly, I expect purely passive positions to become challenging for investors to hold on to. Buy high, sell low will get expensive as higher correlations mean that they are forced to panic out of and then back into the market. The solution is more active management and smaller constant overall exposure while diversifying across asset classes and strategies. Here is an article in the WSJ that touches on some of this. While tactical opportunities can help diversify the portfolio, they can also be used as risk management tools. Our equity tail-risk strategy can be applied to many global equity indices and can provide effective protection against large equity selloffs. It can be employed as an overlay on an existing portfolio, or as part of a holistic strategy that provides equity exposure while seeking to protect the downside.

Important Macro Data Releases and Events for the Week

Monday
10/5/2020

- Eurogroup Meeting (Brexit will be on the front burner)
- Markit PMI's across Europe
- Retail Sales YoY (Aug) Forecast: 0.6%, Prior: 0.4%
- Markit Service PMI (Sep) Forecast: 54.6, Prior: 54.6
- Markit PMI Composite (Sep) Forecast: 54.4, Prior: 54.4
- ISM Services New Orders Index (Sep) Forecast: 44.7, Prior: 56.8
- ISM Service PMI (Sep) Forecast: 56, Prior: 56.9
- ISM Service Employment Index (Sep) Forecast: 58.1, Prior: 47.9
- ISM Service Prices Paid (Sep) Forecast: 61.1, Prior: 64.2

Tuesday 10/6/2020		RBA Interest Rate Decision and Statement - Current 0.25%
		Factory Orders s.a. MoM (Aug) Forecasts: 5%, Prior: 2.8%
		EcoFin Meeting
		Trade Balance (Aug) Forecast: $-64.4B, Prior: $-63.6B
		Fed's Chair Powell SPEECH
Wednesday 10/7/2020		Leading Economic Index (Aug) Forecast: 89.4, Prior: 86.9
		Industrial Production s.a. MoM (Aug) Forecast: -, Prior: 1.2%
		EBC's Lagarde SPEECH
		FOMC Minutes
		Fed's Williams SPEECH
Thursday 10/8/2020		Trade Balance s.a. (Aug) Forecast: 16B, Prior: 18B
		SNB Chai Jordan SPEECH
		ECB's Mersch SPEECH
		ECB's Monetary Policy Meeting Accounts
		Initial Jobless Claims Forecast: - , Prior: 837m
		Initial Jobless Claims 4-week ave. Forecast: - , Prior: 867.25m
		Continuing Claims Forecast: - , Prior: 11.767m
		BoC's Governor Macklem SPEECH

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