Stargazer Asset Management

What to focus on in Global Macro for the week of September 27th, 2021

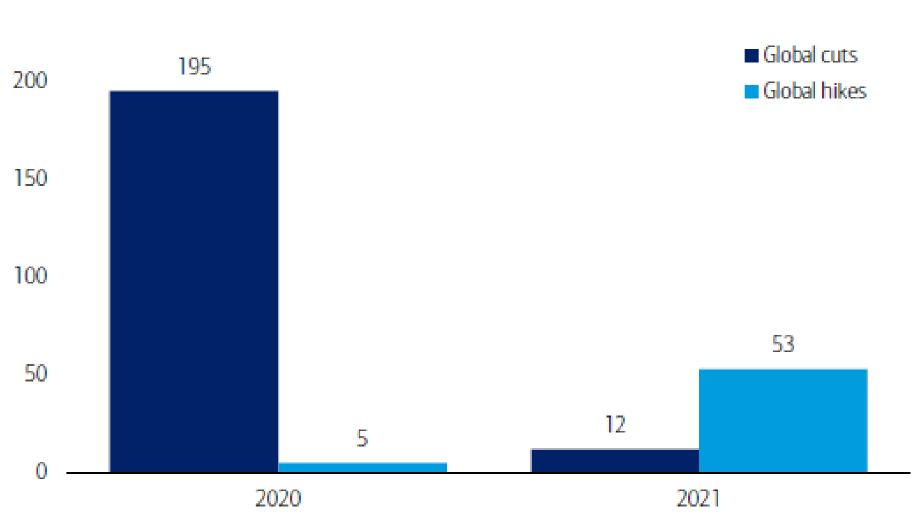
Macro Themes on the Radar:

Central Banks - Last week's Fed meeting was a bit more hawkish in tone and content. As the dots indicated, members continue to migrate towards 2022 for the first hike. It also brought news that Powell expects the taper, which is likely to begin in November, to be completed by the middle of next year, a quicker pace than many had expected. The market is now pricing a mid/late 2022 lift-off. At least for the next couple of months, the Fed is now not likely to deliver any further market moving news, given that they won't start hiking until QE ends. The market will now have to price further rate moves based on its own expectations.

The mix of downgraded growth and upgraded inflation, both in the US and abroad, makes this a very tricky environment. Stagflation is being mentioned much more frequently in recent weeks. So far, the market has continued to believe that this is a high debt low global yield world where US terminal rates remain low i.e., front end rates are not likely to get above 2.5% this cycle. This is illustrated by a yield curve that is no longer able to steepen (Thursday's and Friday's bounce aside). The Fed thinks that by the end of 2024… three years+ from now, the funds rate will only be at 1.8%. Big picture that is still very dovish stuff given that real interest rates will still be negative.

Globally, stimulus is already being withdrawn, as more central banks start to lift rates and rate hike expectations are being brought forward. Tapering is underway or about to start at the ECB, BoE, BoC, RBA, and now, of course, the Fed.

Chart 15: Central banks beginning to normalize
Global rate cuts vs hikes



Source: BofA Global Investment Strategy, Bloomberg, IMF
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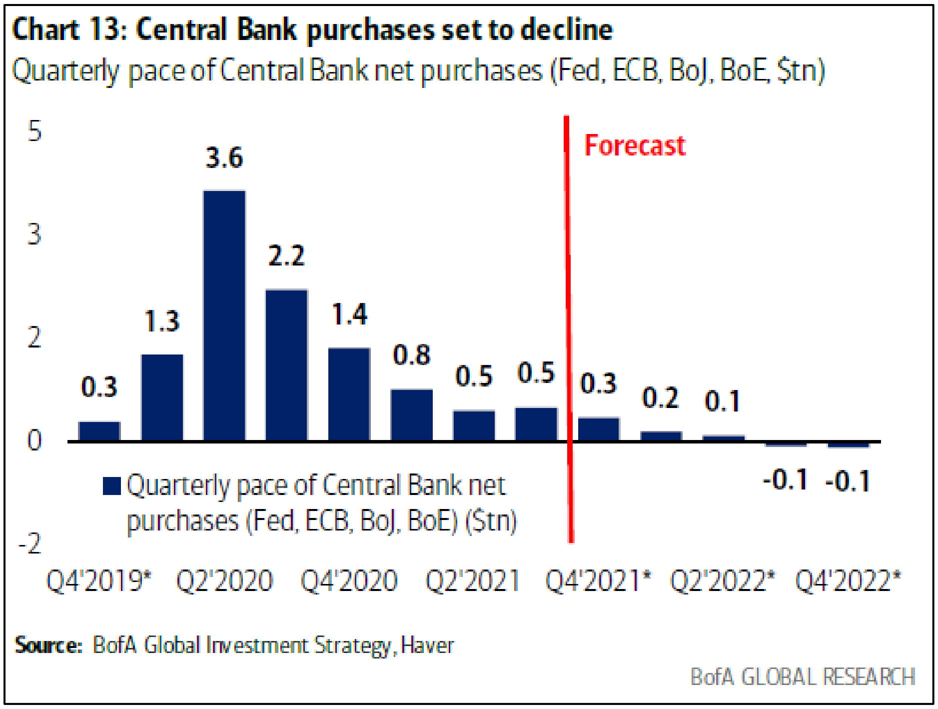


Consumer

With inflation jumping in recent months but yields staying low and the yield curve in fact flattening, the market has been buying into the transitory inflation argument. Partially, because of substantial expected demand destruction from the supply shock that is causing inflation.

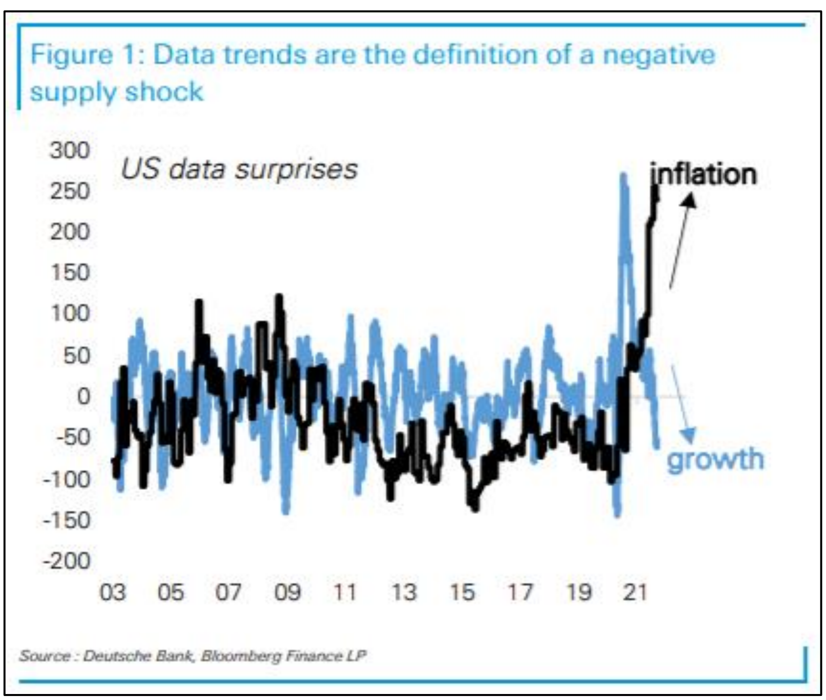


Figure 4: The consumer seems extremely sensitive to price rises, ie demand curve is very flat

Source : Deutsche Bank, Bloomberg Finance LP

DB Research makes an interesting point on this… *"current market pricing is fully in line with a supply side shock with very strong demand destruction effects. A low r*, as we have been arguing (terminal fed funds rate) is likely to prevail as post-COVID only flattens consumer demand curves further. We continue to believe that it is the behavior of the consumer, including the desired level of precautionary savings as well as the response to the unfolding supply shock that is the most important macro variable for the market this year and beyond."*

Will this be the right thing for markets to continue pricing?

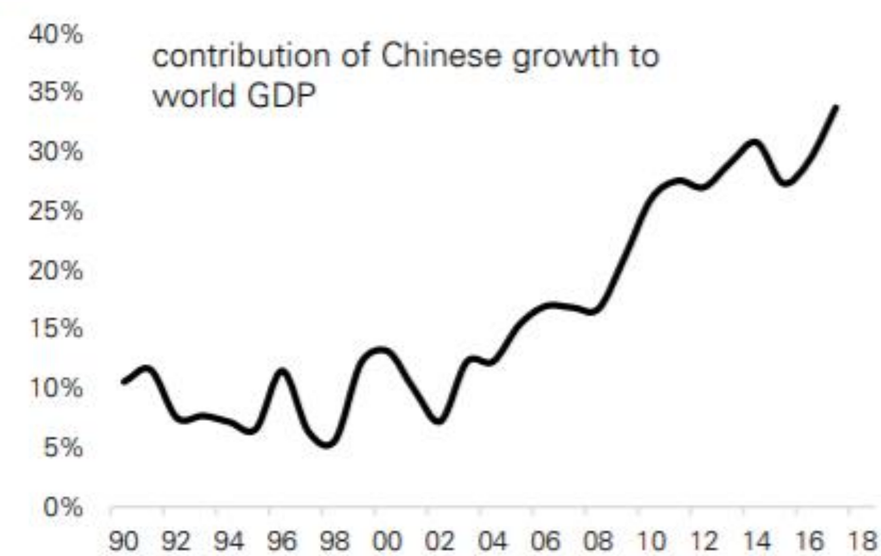
The Fed has been able to look through the inflation jump because of its supply shock origins. For as long as most of us have been investing, inflation has been correlated with growth (demand). That is an easy type inflation to curb. Even relatively conservative rate hikes can bring both back down as the Fed shoots for the "soft landing" of previous cycles. Now, however, if lower supply rather than higher demand is the issue, life is much more complicated for CB's. Hiking rates hurts the growth side but doesn't help the supply problem. You can see why the Fed would rather not react to a supply shock if they can avoid it. Consumer savings and their propensity to spend it, combined with a shift to chasing higher prices rather than recoiling from them will be key going forward.

The mix of demand and supply inputs is different country to country and that is making for increasingly divergent global CB policies, as some countries hike rates while a few are again easing them.

China

There is a constant flow of China related headlines these days, as new domestic policies continue to be rolled out, the highly leveraged real estate sector teeters, regulators ban all crypto activities, and incursions into Taiwanese airspace continue. The credit impulse remains a worry for global growth and as economic data weakens, it is hard to decipher to what extent that is being driven by COVID policies vs. government policies vs. now self-enforcing economic behavior. Either way, China has become such a big driver of global growth that we had better keep paying attention.

Figure 1: What happens without the turbocharge?



Source :

One company like Evergrande can be easily ring-fenced and doesn't matter to China or the global economy in the end. However, if it is the tip of the iceberg for the whole Chinese real estate sector, then it potentially has big ramifications, given the leverage and overcapacity that is present in the sector.

Now add into the mix deteriorating Chinese and US/European relations, overlayed on the greatest supply chain in human history, during a global supply shock, and you really have some things to focus the mind.

German Elections

After 16 years of Merkel, there is political change coming to Germany. While the SPD's lead has narrowed in recent days, there is still a good chance that we will get a much broader, more left-leaning coalition, in the coming weeks. If the SPD holds, it will be the first time they win the popular vote in nearly 20 years, and will be the CDU's worst outcome, as the Greens take a more prominent position.

Why does it potentially matter for Global Macro? If the SPD prevails, it will likely mean looser fiscal policy for Germany and potentially Europe and would mean policies strongly supporting a European Green New Deal will follow. Both are potentially very supportive of a more durable inflationary backdrop in Europe. That would be something new.

What to Focus on Now:

The result of last week's various central bank meetings, and policy decisions, was that we got a big jump in global yields.

After months of consolidation, US 5-year yields hit new highs for the move, and levels not seen since early March 2020.

On Thursday and Friday, longer yields jumped too as hikes in the UK were brought forward.

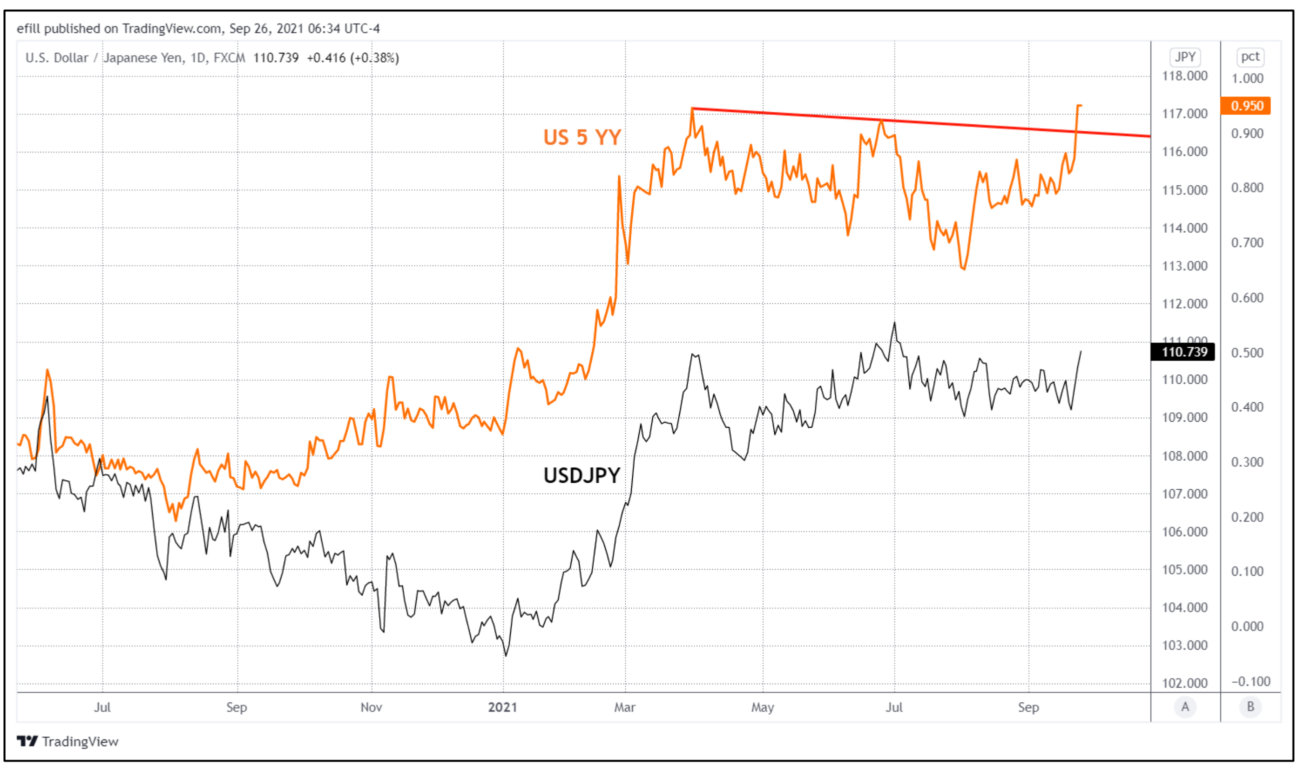
The result was that we took a break from the relentless curve flattening we had been seeing, and we actually got a few days of steepening

The US front-end got cracked post Fed. It will be interesting to see if we can crack the next level at 98.80 in the December 2023 Eurodollar futures.

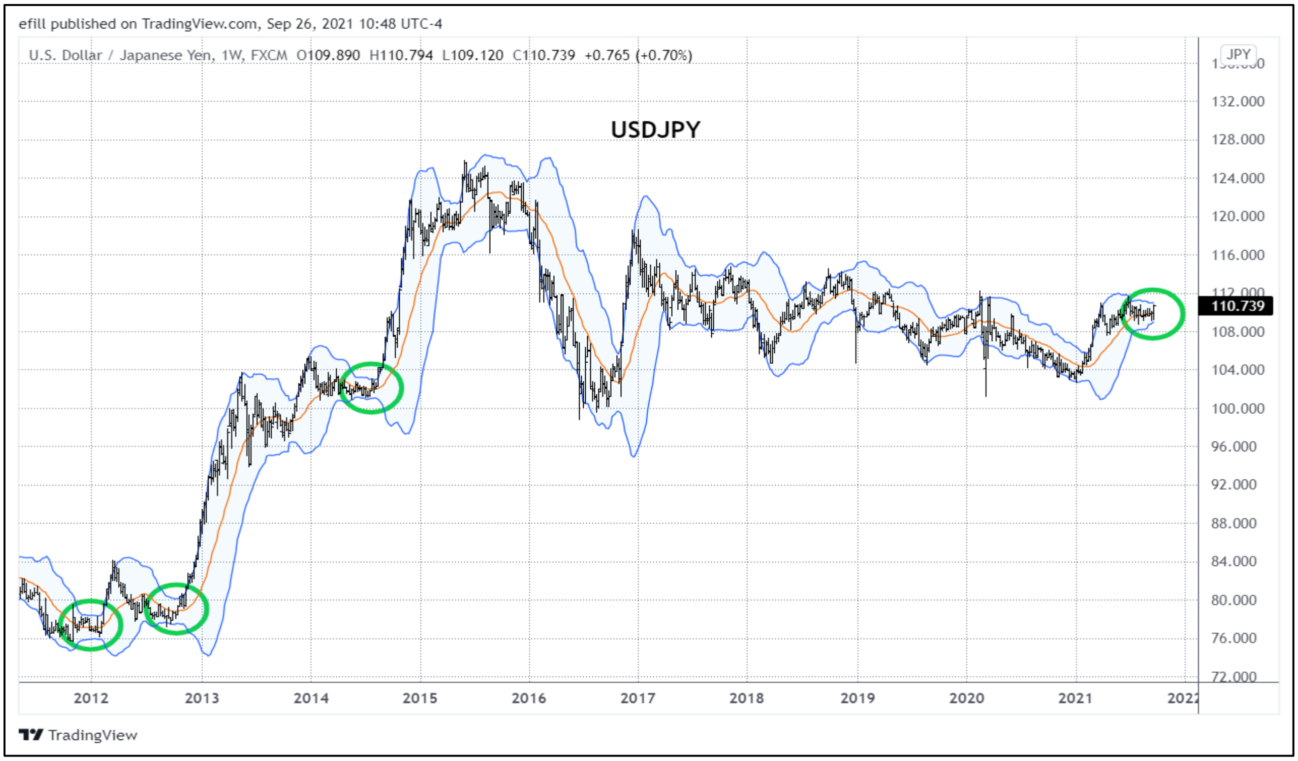
Interestingly Germany has had a big run higher in yields even preceding last week's global rise. Election expectations playing a role?

The dollar has continued to gyrate at the top end of the broader range. It seems conflicted with the risk recovery on one side and higher US yields and impending taper on the other.

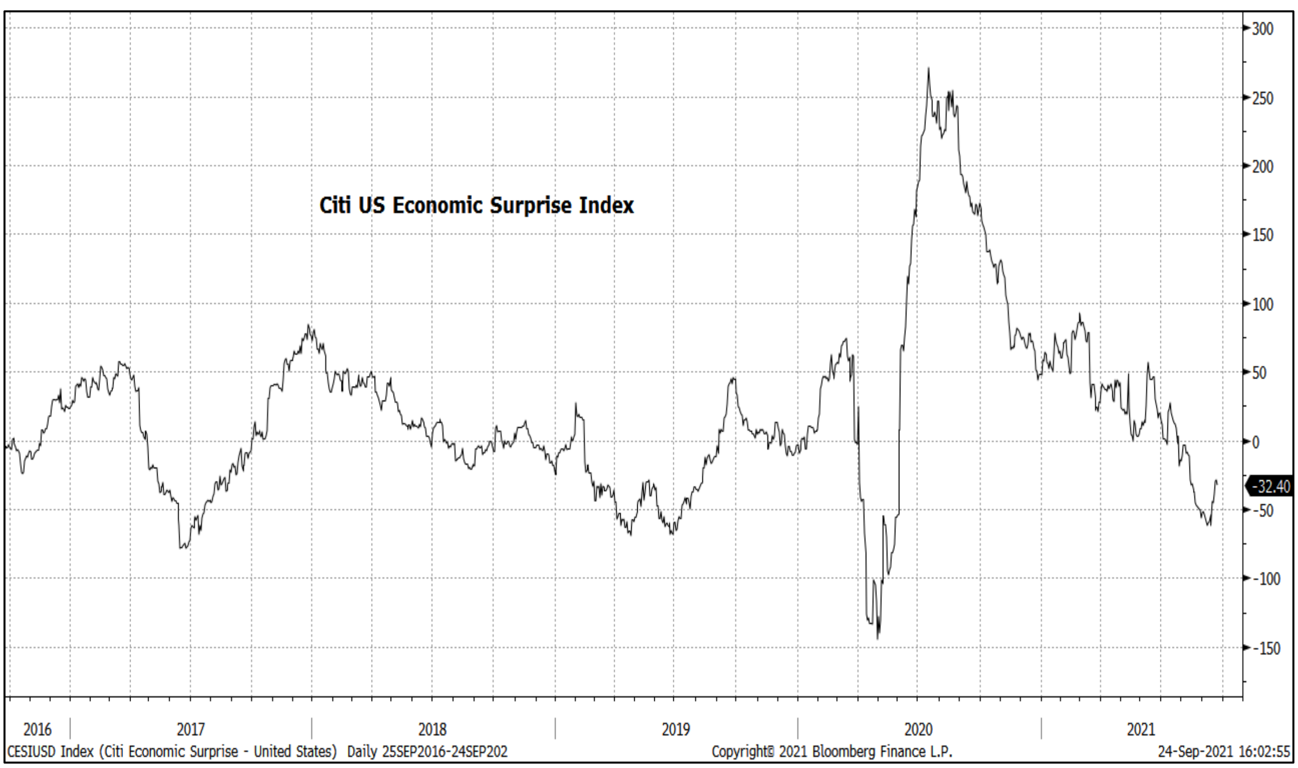
I continue to watch the negative yielders like CHF and JPY.



USDJPY remains very coiled with Bollinger Bands showing just how tight the ranges have been.



Let's see if US data can perk up on a relative basis in the coming weeks. That wouldn't hurt the dollar.



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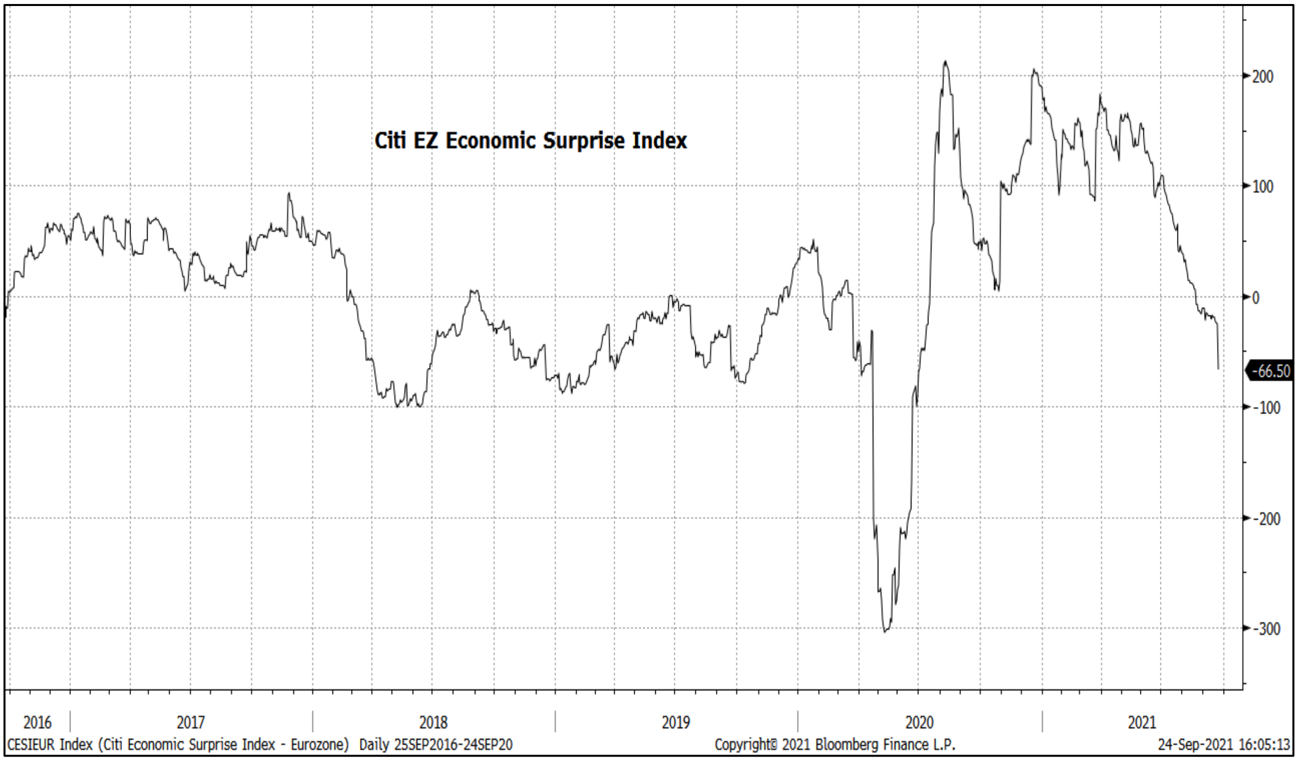
European PMIs disappointed last week.



On the equity front, we were watching our inflection points which got hit in the DJIA in the US.

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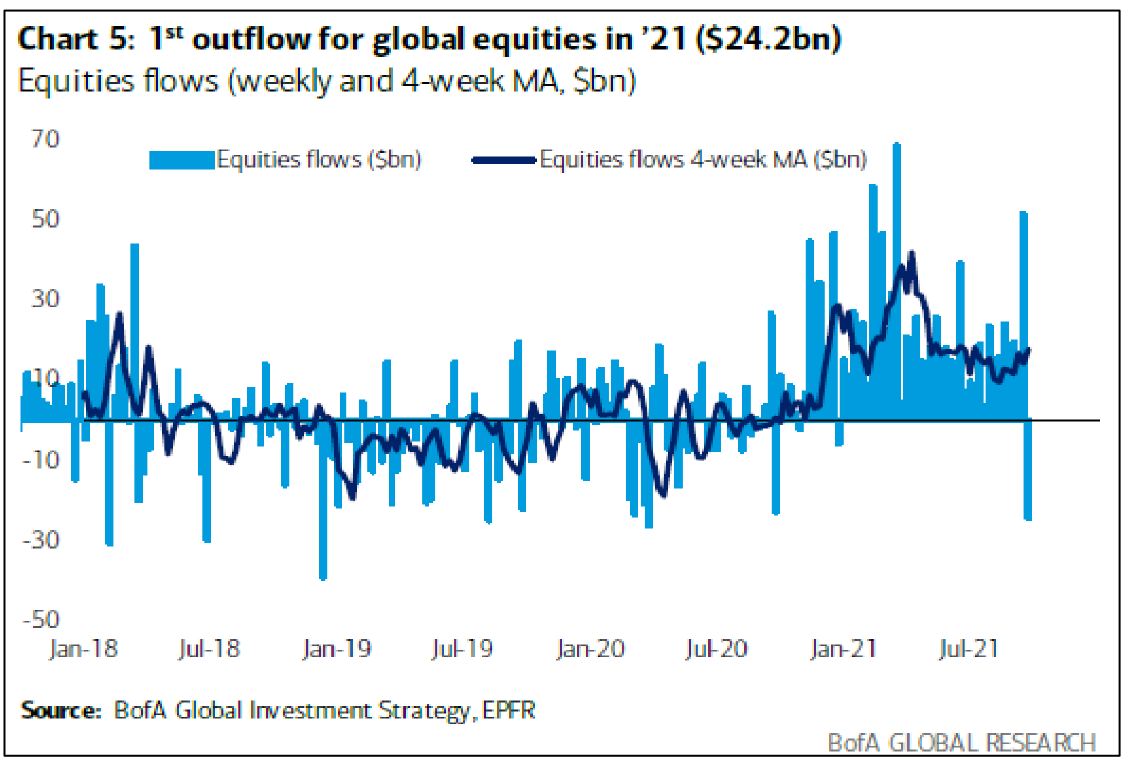
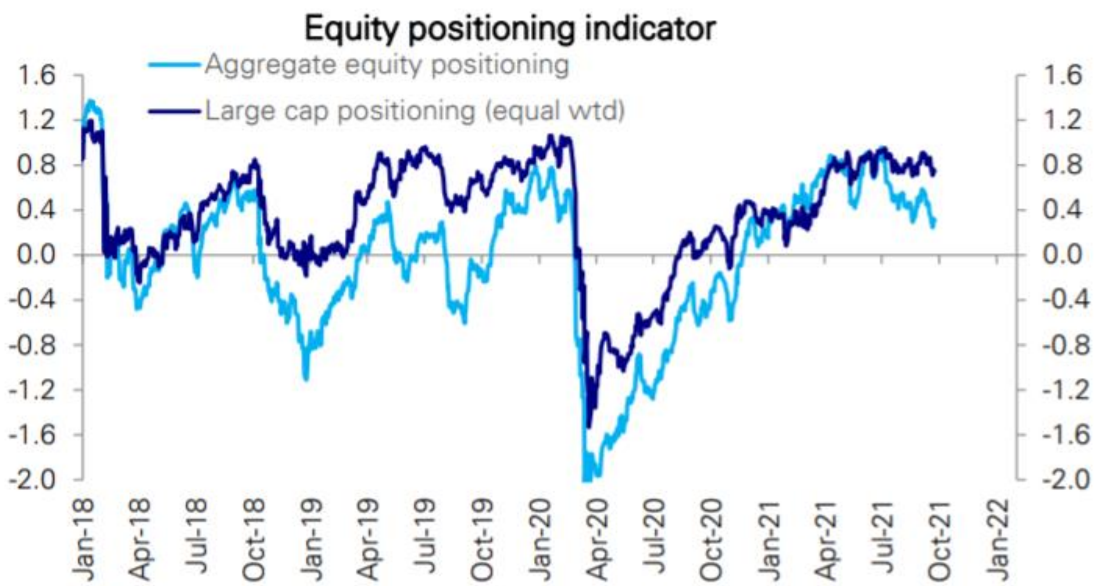
And in the German DAX. No other indices hit on the recent swoon. Inflection points tend to mean accelerative downside or a strong rebound. Obviously, last week generated B.

Despite all the buy the dip talk, last week generated some meaningful selling.



Overall, equity positioning has come off the highs, although US Large Cap remains the favorite.

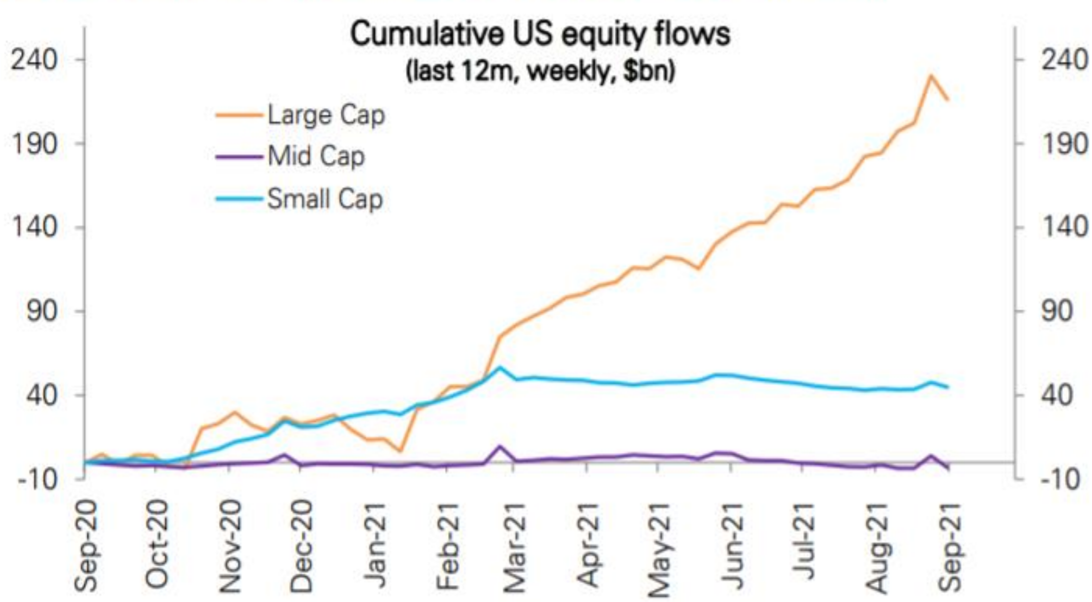
Figure 9:...with US large-cap positioning still on the higher end



Source : EPFR, CFTC, Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation

The next chart shouldn't be a surprise…

Figure 11: Inflows have benefited large cap US funds in particular

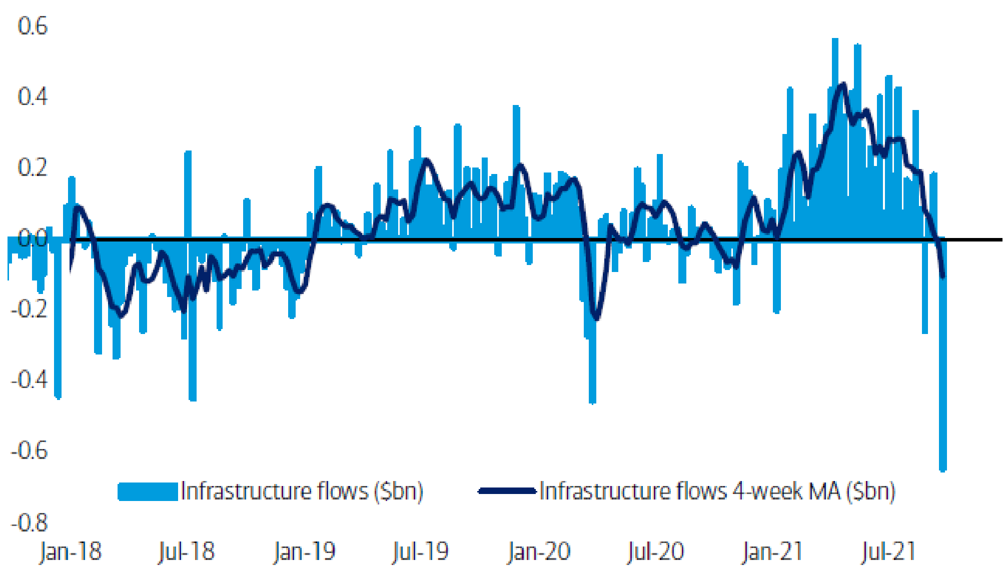


Source : EPFR, Haver, Deutsche Bank Asset Allocation

Worries around US infrastructure bill(s) continues.

Chart 2: 2nd biggest outflow ever from infrastructure funds

Infrastructure flows (weekly and 4-week MA, $bn)



Source: BofA Global Investment Strategy, EPFR

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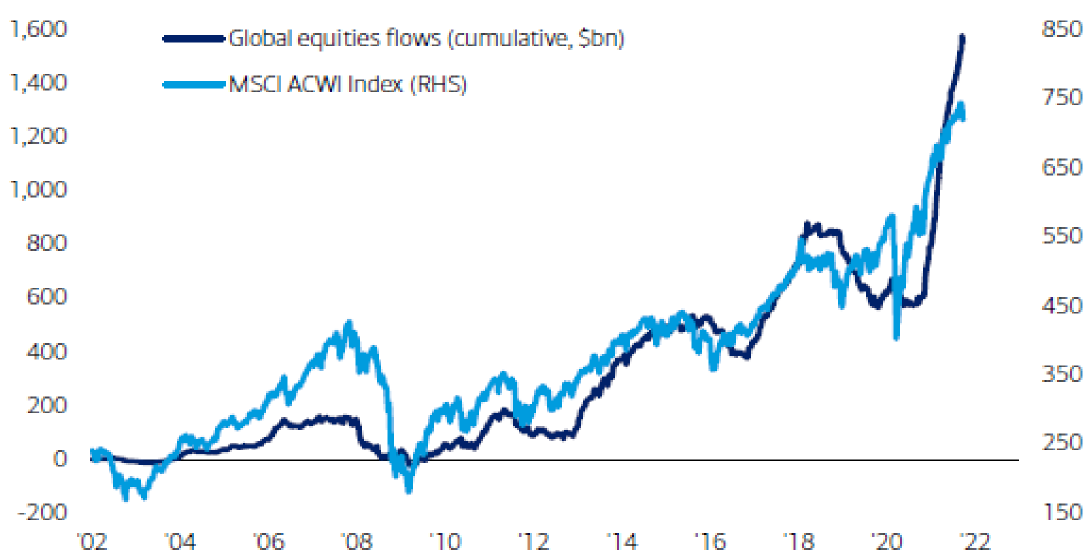
BoA reports that since 2002, flows have had a 93% correlation to price. Price is lagging. Is that bullish or bearish?

Chart 7: Equity flows up >90% vs ACWI up 12% in 2021

Cumulative global equities flows vs MSCI ACWI Index



Source: BofA Global Investment Strategy, EPFR, Bloomberg

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Today's German election will be followed up this week with the looming US government funding deadline, and potentially some action on the infrastructure bill. We have Fed Chair Powell and ECB President Lagarde speaking this week, as well as a number of other central bankers. It will be interesting to see what they have to say about last week's move in yields and interest rate hike expectations.

Important Macro Data Releases and Events for the Week

Monday 9/27/2021	Durable Goods (Aug)
	BoJ Monetary Policy Minutes
Tuesday 9/28/2021	Gfk Consumer Confidence Survey (Oct)
	Housing Price Index (Jul)
	Consumer Confidence (Sep)
Wednesday 9/29/2021	Consumer, Industrial and Business Confidence (Sep)
	Pending Home Sales (Aug)
	Non-Manufacturing PMI (Sep)
	NBS Manufacturing PMI (Sep)
Thursday 9/30/2021	CPI and Core YoY (Sep)
	Harmonized Index of Consumer Prices YoY (Sep)
	Initial Jobless Claims
	GDP Annualized (Q2)
	GDP Price Index (Q2)

	Chicago Purchasing Managers Index (Sep)
	Caixin Manufacturing PMI (Sep)
Friday 10/1/2021	Retail Sales
	Markit final PMI's across Europe (Sep)
	Personal Income and Spending
	Core PCE (Aug)
	Markit Manufacturing PMI (Sep)
	ISM Manufacturing PMI (Sep)