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What to focus on in Global Macro for the week of February 17th, 2020

Macro Themes on the Radar:

Fed

Jay Powell's Congressional testimony didn't hold any big surprises for the markets overall.

He was generally upbeat about the economy, indicating that the Fed sees "the U.S. economy in a very good place, performing well," and that "there is no reason why the expansion can't continue".

He expressed some concern about the trajectory of government debt at this point, especially in light of the low current rates and the limits that puts on the Fed's ability to lower rates further as a stimulative policy tool if/when that is necessary. Overall however, "there is nothing about this economy that is out of kilter or imbalanced," Powell said.

The coronavirus was mentioned...
"Some of the uncertainties around trade have diminished recently, but risks to the outlook remain. In particular, we are closely monitoring the emergence of the coronavirus, which could lead to disruptions in China that spill over to the rest of the global economy."

With regard to Climate Change, unlike Lagarde at the ECB, he continued to indicate that this topic, while important, doesn't fall under the Fed's mandate and should be addressed by other agencies of the government.

Global Growth

As I noted last week, the U.S. data has certainly held up well, actually surprising to the upside in recent weeks. Even Manufacturing PMI's have bounced. While we are certainly late cycle, there have been no clear signs that the broader economy is deteriorating. Importantly, the employment numbers have remained very resilient. The one forward looking employment component that is a little troubling is the continued decline in Job Openings.

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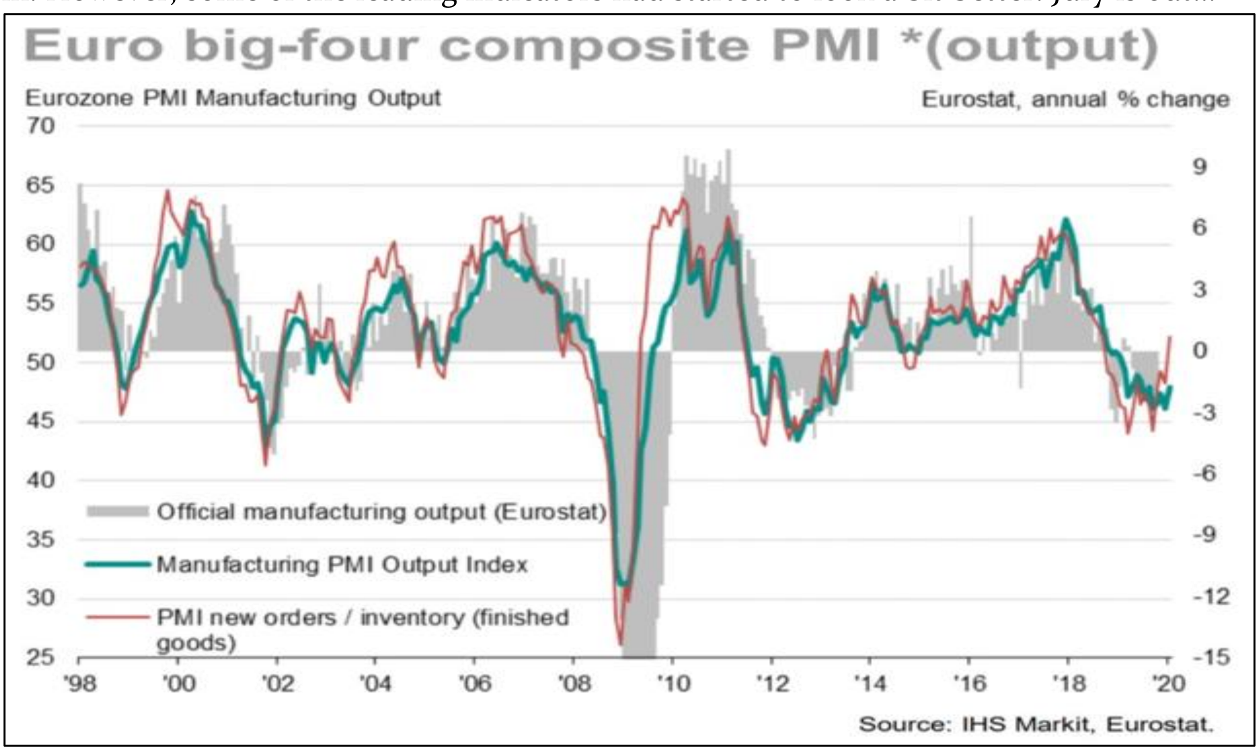
Europe has been much more mixed, with a fair number of disappointing numbers rolling in. However, some of the leading indicators had started to look a bit better. Jury is out…



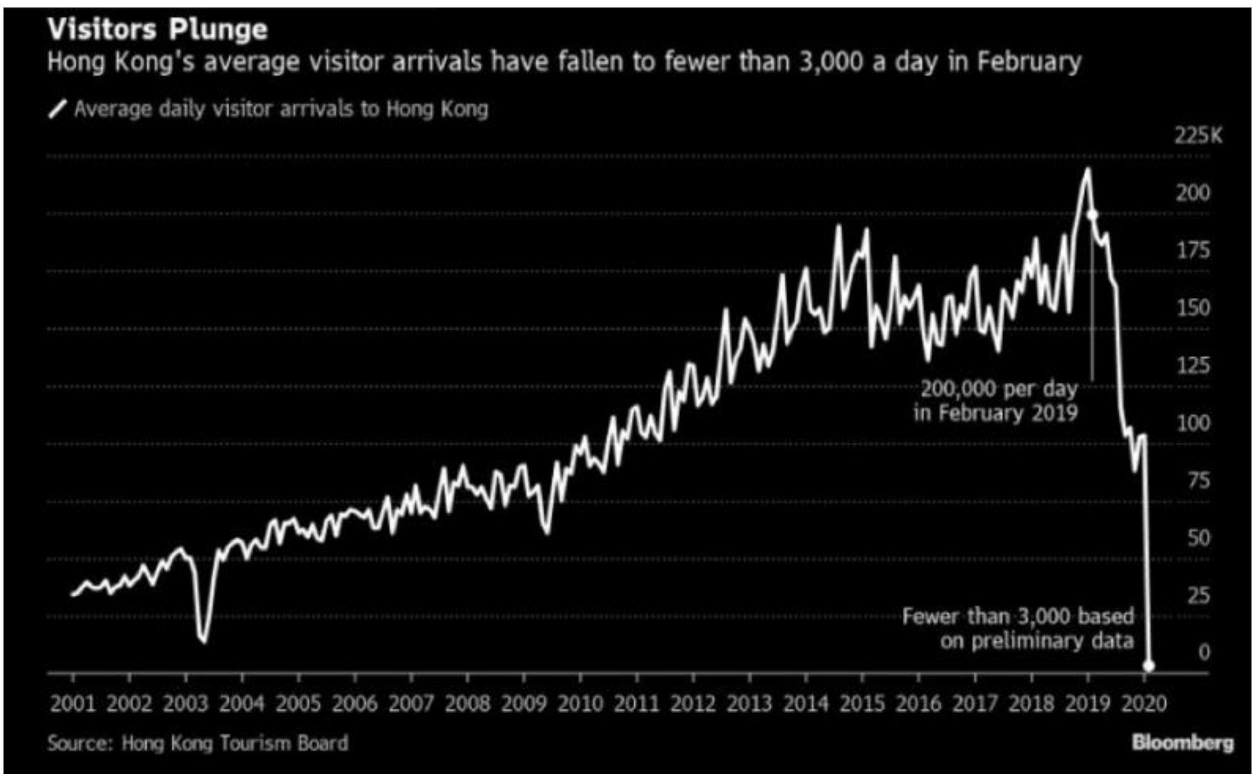
Asia had already been struggling as China growth was slowing and Japan was looking at a recession.

And then the coronavirus showed up…

So much now depends on how bad and widespread this outbreak becomes and how long it lasts. Markets are holding on to the SARS analog from 2003 and, should that fail, the backstop of Central Bank liquidity and Government fiscal spending. Further PBOC liquidity and rate cut support is expected and the market is now pricing a bit more than an additional rate cut by the Fed this year.

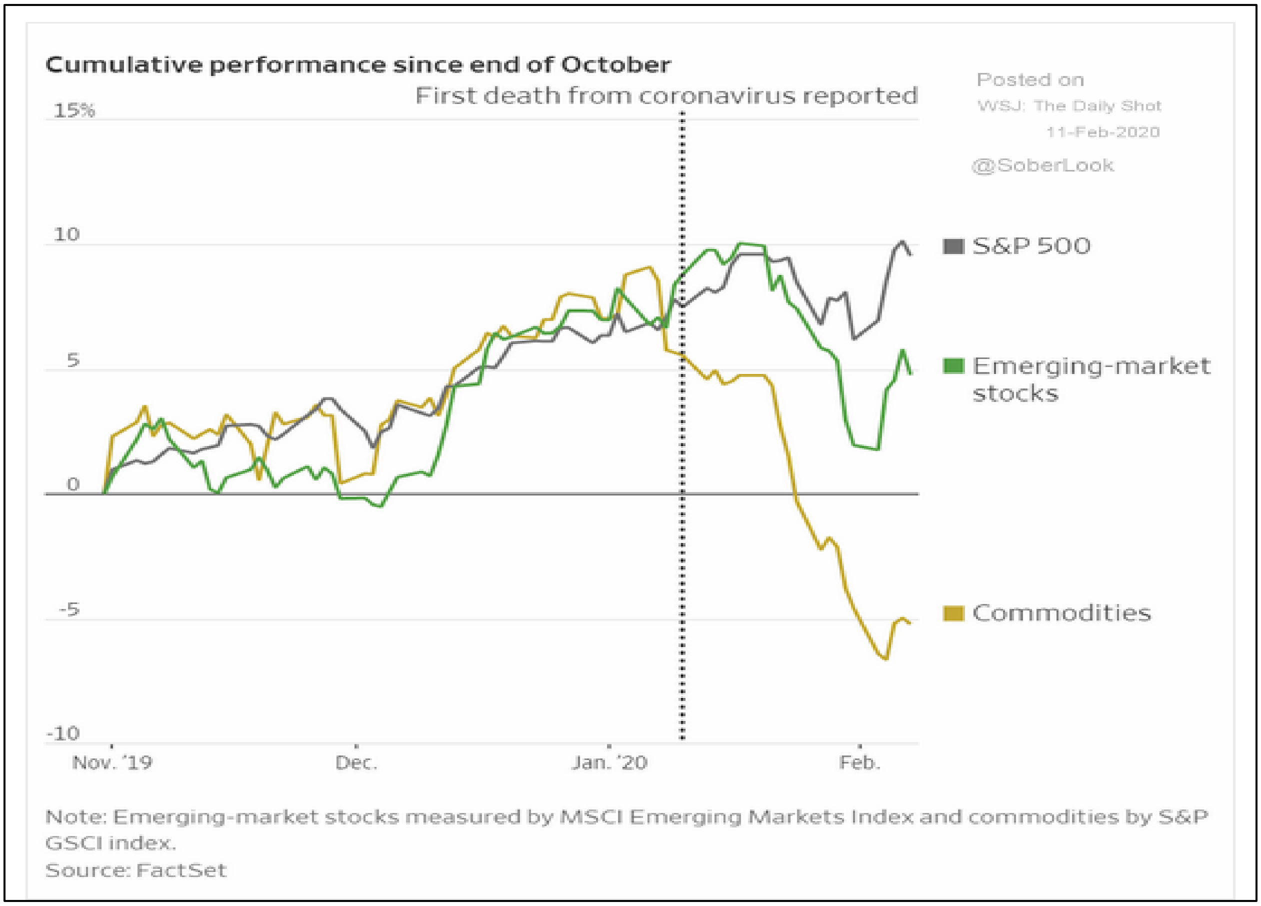
I think we have now come to a point however, where the SARS analog is of doubtful value in terms of the size of the global growth hit we will likely see from coronavirus.

There is clearly lots of fear on the ground… between government and self-imposed lockdowns, activity has slowed dramatically.



But more importantly, China now has a much bigger role to play in global consumption, trade and growth than it did during SARS.

Markets have repriced since the start of the outbreak to account for the most direct effects.



But is it enough? Early last week the WHO projections were still that the virus would be under control by April.

Markets are hoping this is true and that a V-shaped recovery will follow for China, as huge amounts of stimulus and government support combine with pent-up demand.

Delayed recovery however could mean that a longer and deeper asset price adjustment is still ahead of us.

When looking at how China's role with regard to global demand has changed since the SARS outbreak, this table really amazed me…

China's Importance Now And In 2003

China's Annual Consumption As % Of Global		
	2002	**2019**
Crude Oil Consumption	6.6%	13.5%*
Crude Steel Consumption	22.6%	47.5%*
Copper Consumption	17.8%	53.3%**
Aluminum Consumption	16.5%	57.3%**
Nickel Consumption	7.2%	53.3%**
Zinc Consumption	21.0%	48.4%**
Iron Ore imports	21.0%	64.3%*
Semiconductors Sales	5.0%	34.6%**
Smartphone Sales	11.2%***	29.2%
Personal Computer Sales	2.4%	20.0%
Passenger Cars Sales	7.3%	34.5%*

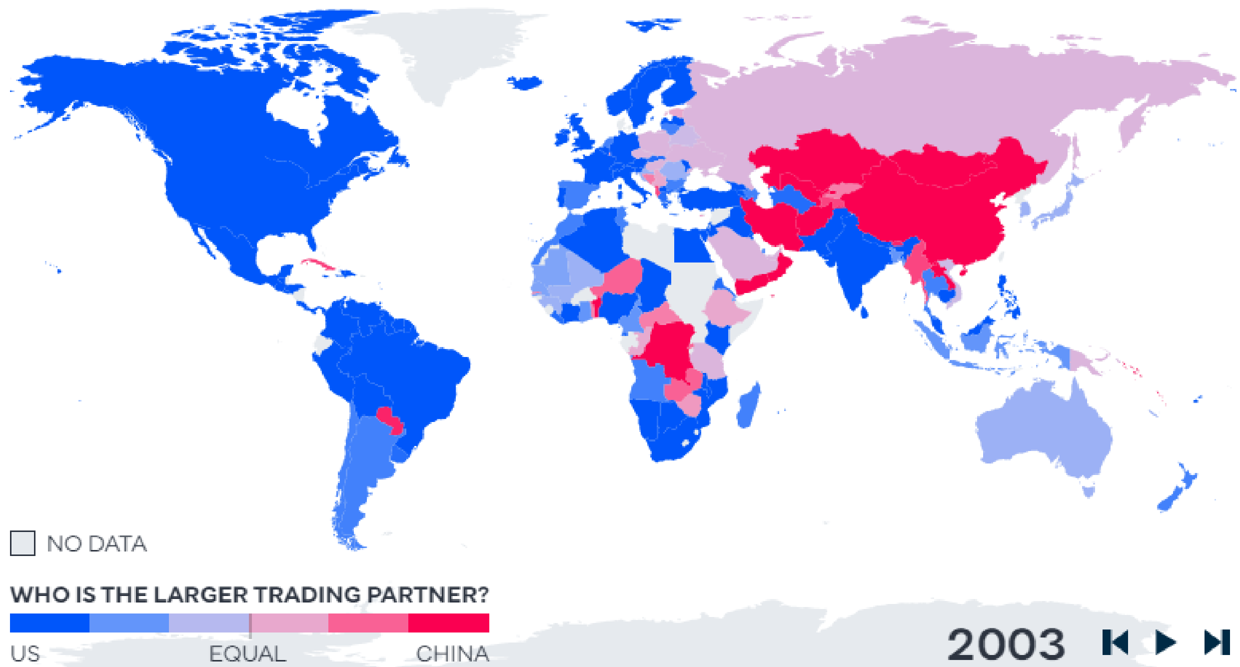
I'm inclined to agree with Mohamed El-Erian's recent social media post…

"As much as I hate saying this, I strongly suspect that estimates of the CoronaVirus-induced hit to GDP may well prove too optimistic — across the board."

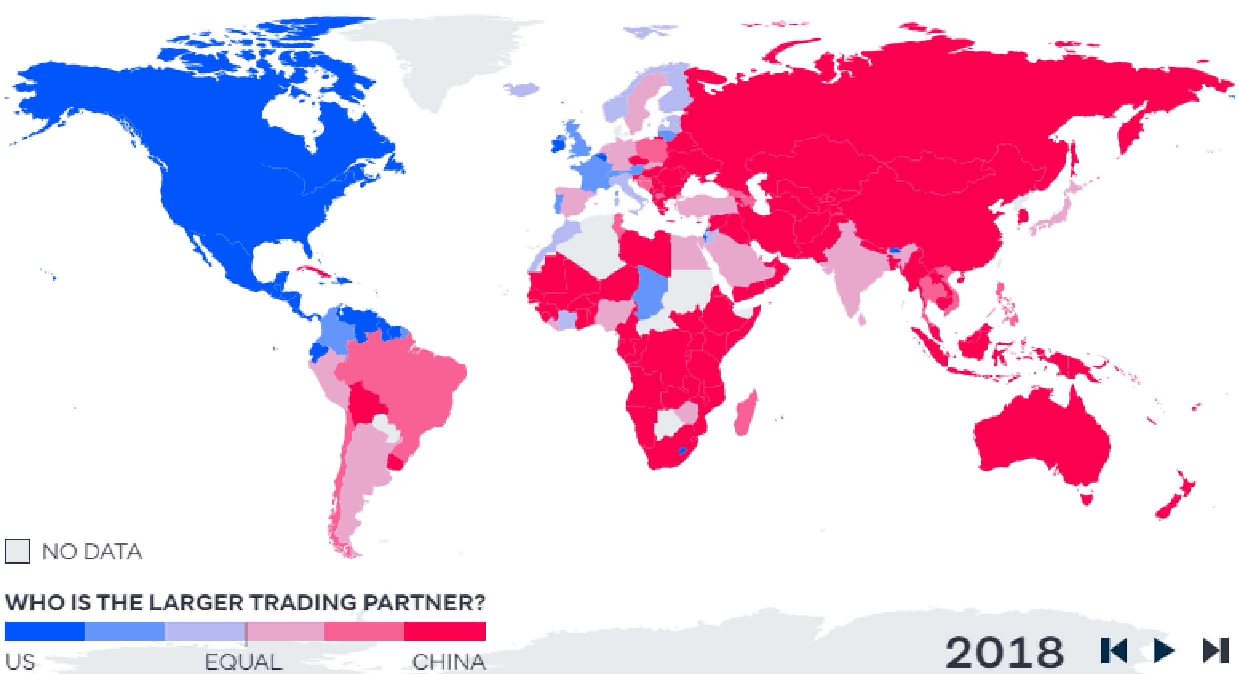
The following two charts show how China's role in global trade has grown since the 2003 SARS outbreak. It shows the US vs. China, as largest trading partner. It only goes to 2018 but given the trend, 2019 was probably more of the same.

Here is the link if you want to see the animated version.
https://vividmaps.com/the-us-china-trade-war-who-dominates-global-trade/

WHO DOMINATES GLOBAL TRADE?



WHO DOMINATES GLOBAL TRADE?



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

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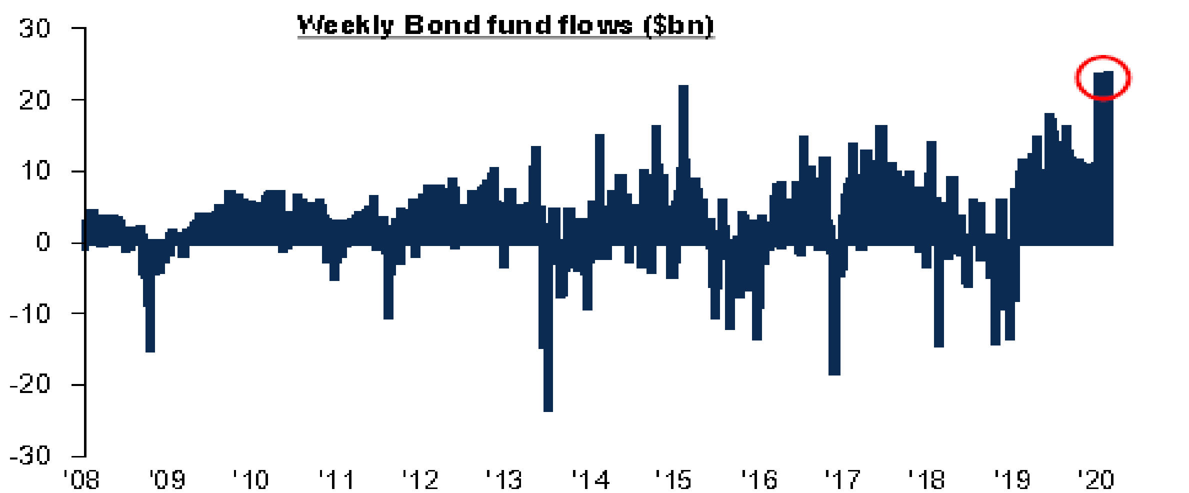
Investors continue to pile into Bonds ... as Equity flows pick up as well... from BoA/ML

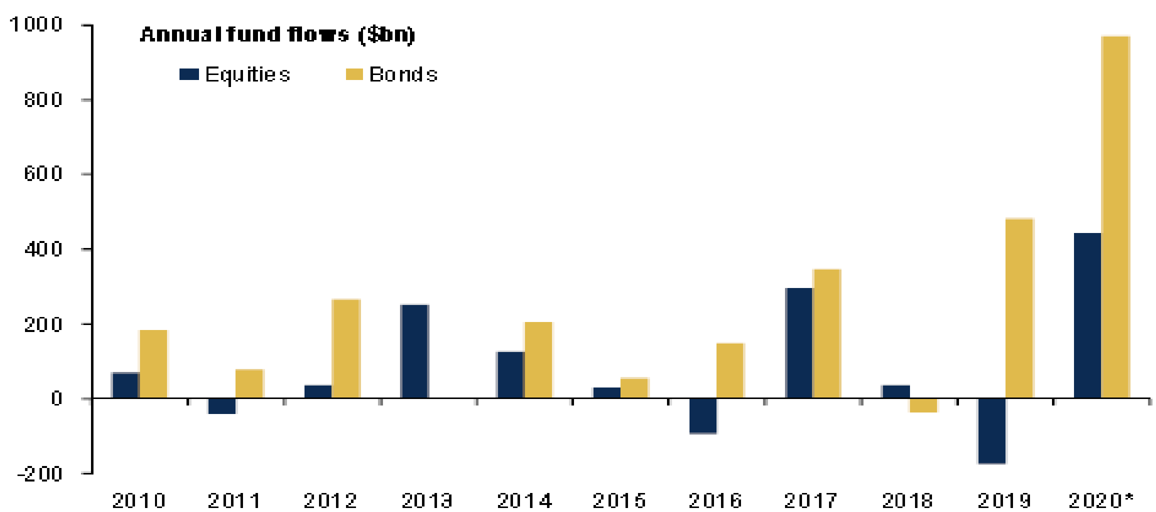
$1tn bond bubble: biggest weekly inflow ever into bond funds ($23.6bn – Chart 3); inflows to bonds annualizing almost $1tn in 2020; sizeable $12.5bn equity inflows too...equity flows annualizing record $443bn (Chart 4).

Chart 3: Biggest ever week of bond funds inflows



Source: BofA Global Investment Strategy, EPFR Global

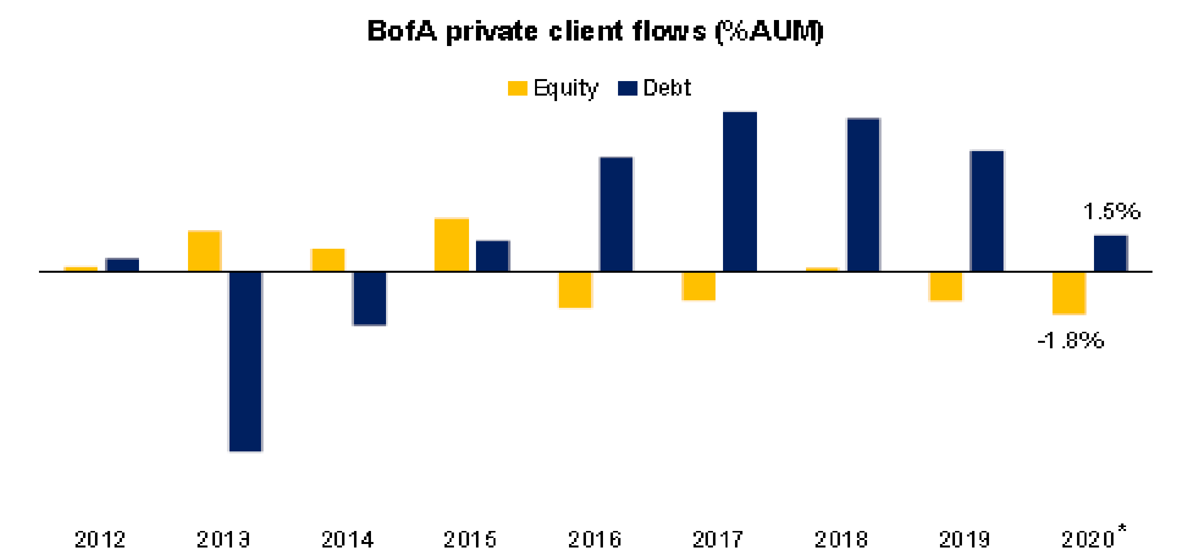
Chart 4: Record annualized inflows into bond & equity funds



Source: BofA Global Investment Strategy, EPFR Global. * 2020 flows have been annualized

Interestingly, private clients continue to sell equities, which perhaps reflects the growing sense of disconnect between asset prices and economic growth/risks that I discussed last week. Investors feel like it is too good to be true, and that the US equity markets outperformance is "artificial" in some way. We will see if their caution is warranted or if they are just more fuel for the rally as they are forced in by FOMO.

Chart 6: BofA private clients keep selling equity strength



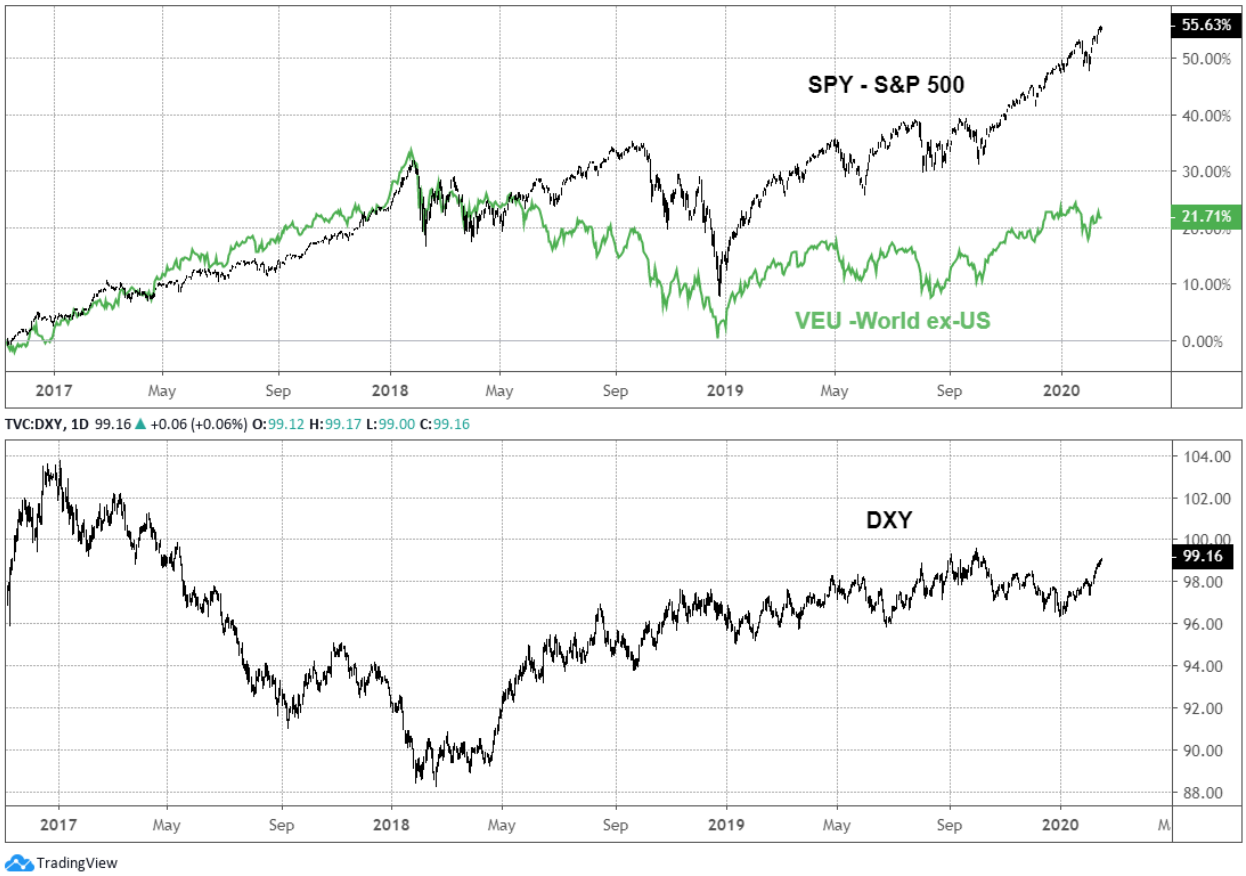
Source: BofA Global Investment Strategy, BAC data, * 2020 flows have been annualized

US Exceptionalism Continues

What investors may also be sensing is how very unusual the current set-up is.

There seems to be a growing circularity and feedback loop in the relationship between the Dollar, Bonds and US Equities. They are all going up together, and as they do are reinforcing each other.

In early 2018 there was a break in what had been synchronized global growth and reflation. Much of the world started to slow but the US motored on. The Fed was hiking, and the dollar rallied. Eventually that combination and the growing divergence to the rest of the world created the ugly Q4 2018 selloff that was a kind of downside catch-up trade to what the world ex-US has already been experiencing. The Fed soon reversed course and the worlds CB's went on a massive easing binge. Global markets recovered but US outperformance was there to stay, as was the stronger USD.



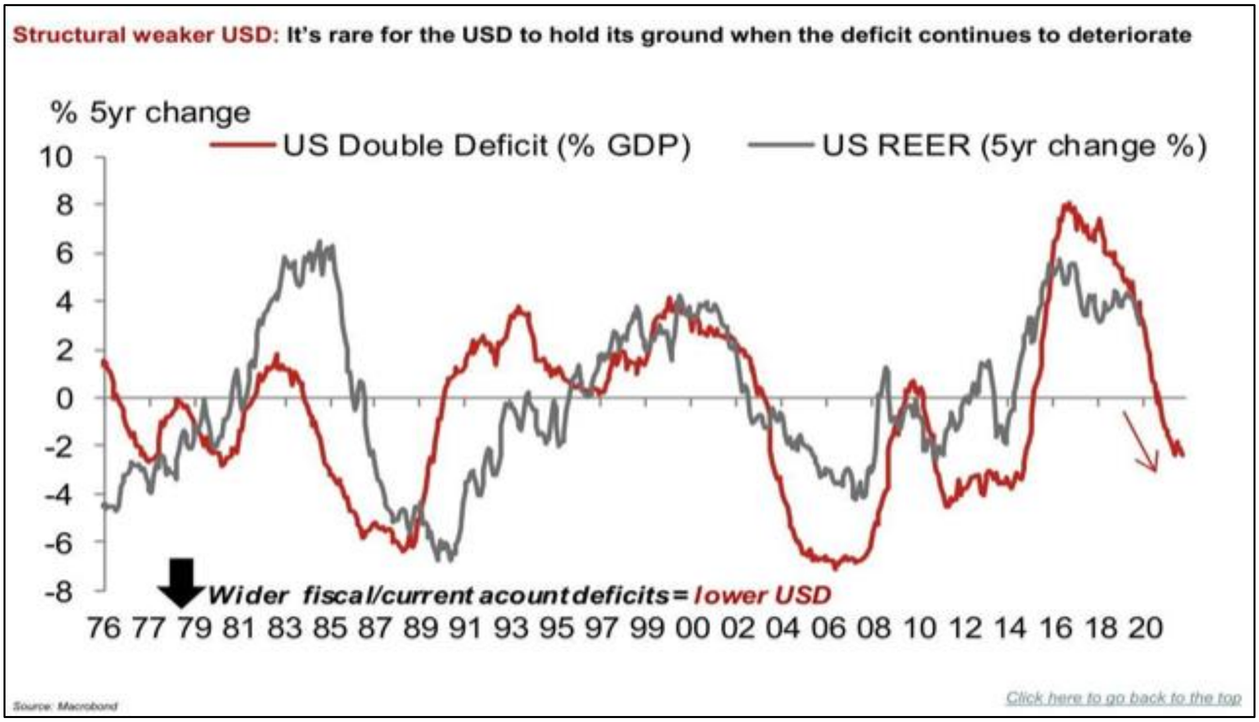
US growth has been relatively good, and as a result, the global version of the growth vs. value trade has favored US equities. US bond yields have remained relatively high vs. the other developed markets, attracting bond buyers. In both cases US markets have the capacity and liquidity to absorb large flows. The dollar has remained strong despite Fed cuts, global trade shocks and the coronavirus, given this combination of relative growth and yield.

Despite a large amount of liquidity from the Fed, large and growing current account and fiscal deficits, the USD has not only been unable to weaken materially but has recently been strengthening again.

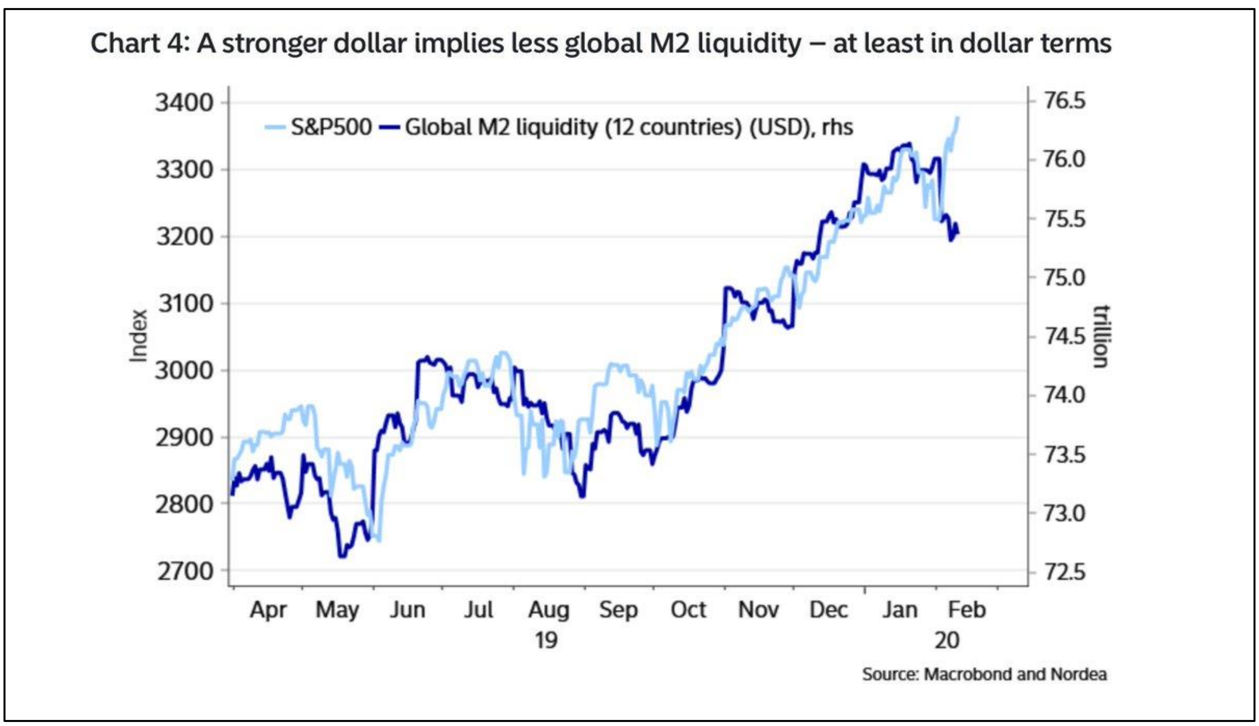
Again, this is a very unusual situation…

A strong USD is tough on global growth which in turn supports US bonds and US growth stocks… keeps the money flowing to the US… keeping the USD strong.

And around we go…



The dollar is worth watching here as further appreciation will eventually have an effect.



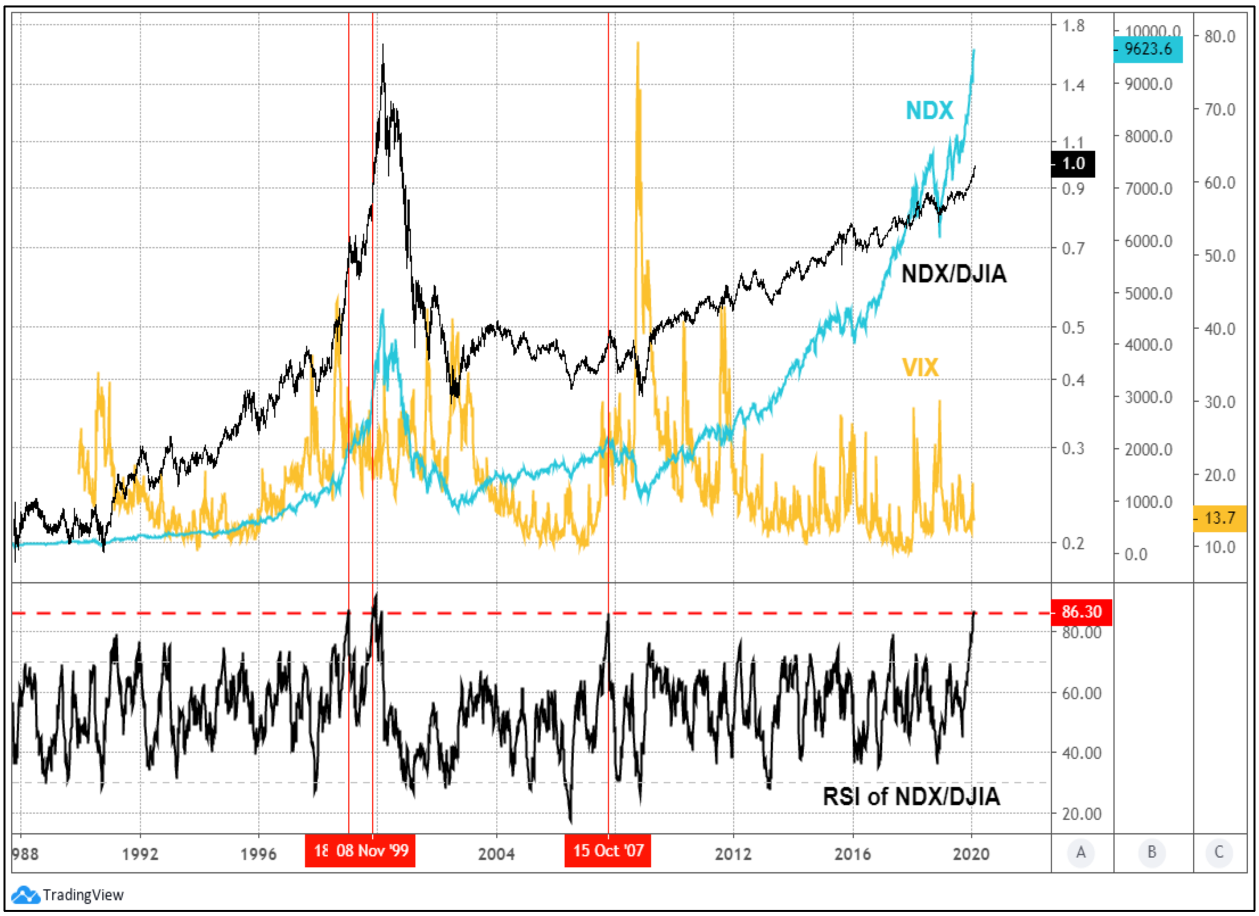
Not only does FX volatility tend to pick up when the USD rallies…

But often, so does equity volatility.

The hunt for growth stocks has not just brought capital to the US but has concentrated it in the large Technology names (as discussed in previous pieces). The resulting outperformance by the NASDAQ has become extreme.

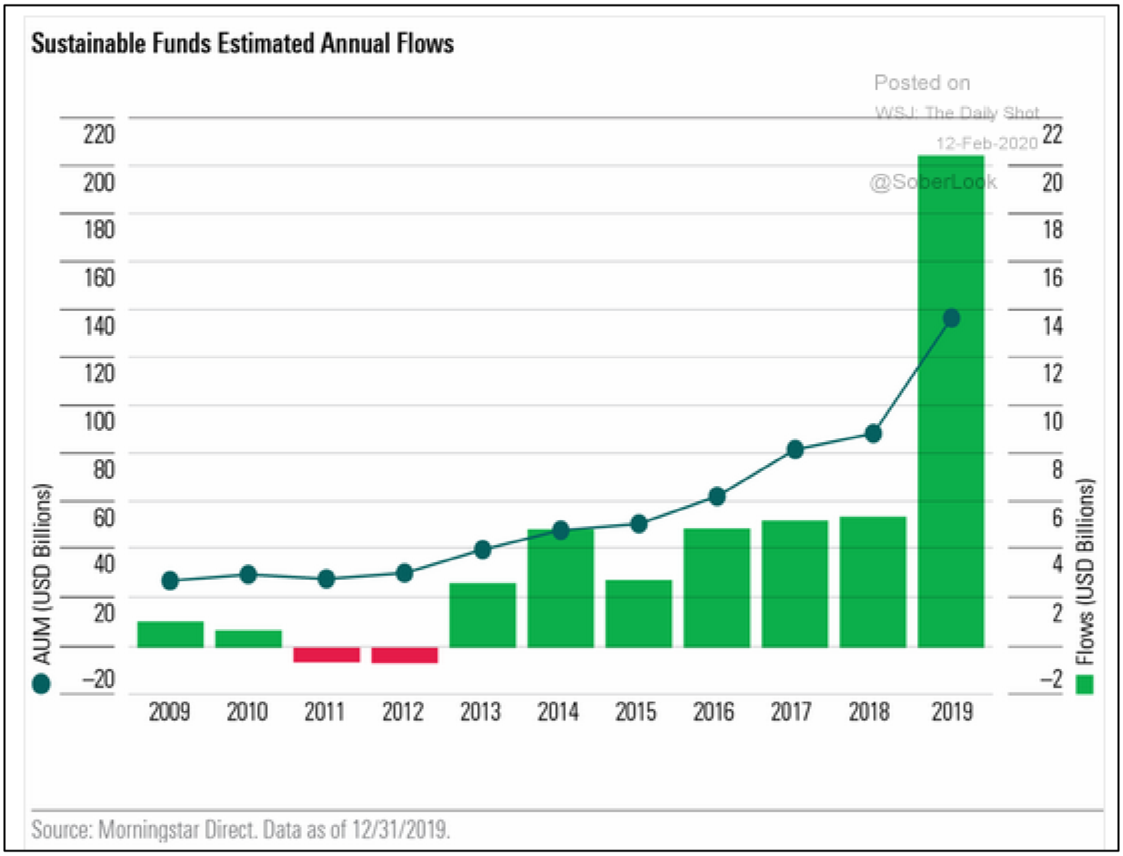
Below we have the relative performance of the NDX vs. DJIA. We have only seen this level on the RSI of the ratio three other times in the last 30+ years. While the sample size is small, what happened over the next 12 months was so explosive that it is worth contemplating. The two 1999 instances heralded massive gains ahead (100+% over the next year from Jan. '99) followed by the internet bust. The 2007 extreme on the other hand came very close to nailing the markets high before the GFC.

With the VIX at 14, I think it is time to come up with some longer-term structural plays that allow you to have Vega and Gamma to play with.



ESG and Sustainable Investing

While the concept of Sustainable and ESG investing has been around for a while, it has steadily been gaining traction. Last year looks like it was finally the breakout year.

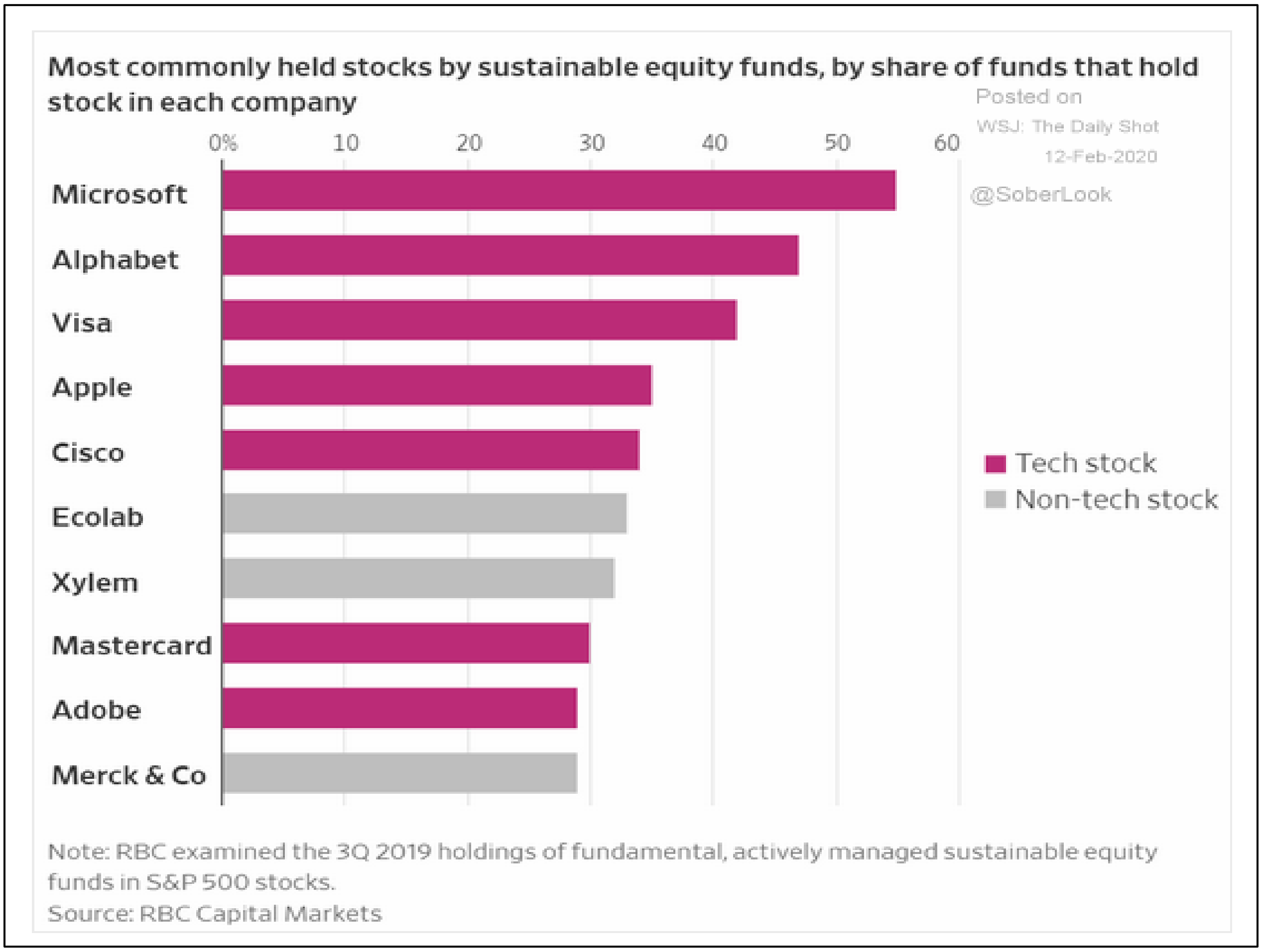


This appears to be a paradigm shift for investors and the market. In some ways it is potentially similar to the move we have seen toward passive and indexed investing, although it has arrived more abruptly.

The preference for sustainable investing is funneling capital to some firms and sectors as it is draining it from others. Which of course to some degree is the point of it.

As discussed in previous weeks there are many ways of determining what are suitable investments and whether it is the E, the S or the G component that is driving the choices for any given company.

Clearly sectors like Energy have suffered given their fossil fuels exposure. That is fairly straight forward to understand. However, some of the most popular holdings are less intuitive. Here you need a deeper understanding of the factors being used for selection.



As with the Utility Sector, where some of the firms are in high demand due to exposure to renewables, the rush into ESG etc. is likely to have unexpected outlets at times. This shift may change long standing sector relationships and lead to all sorts of out/underperformance. Most importantly, this shift in capital allocation is only starting.

This week's data: We have a mix out this week and it may be hard to tell how much it is taking coronavirus into consideration. ZEW out of Germany and PMI updates for US and Europe will be worth keeping an eye on.

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Important Macro Data Releases and Events for the Week

Monday
2/17/2019

- Eurogroup Meeting
- Industrial Production YoY (Dec) Forecast: -3%, Prior: -3%
- FDI YTD YoY (Jan) Forecast: - , Prior: 5.8%
- New Loans (Jan) Forecast: 3000 B, Prior: 1140 B
- ECB Lane SPEECH

Tuesday
2/18/2019

- RBA Meeting Minutes
- EcoFin Meeting
- ZEW Survey - Economic Sentiment (Feb) Forecast: 30, Prior: 25.6
- ZEW Survey - Economic Sentiment (Feb) Forecast: 20.4, Prior: 26.7
- ZEW Survey - Current Situation (Feb) Forecast: -10, Prior: -9.5
- Machinery Orders MoM (Dec) Forecast: -9%, Prior: 18%
- Machinery Orders YoY (Dec) Forecast: -1.3%, Prior: 5.3%
- Imports YoY (Jan) Forecast: -1.3%, Prior: -4.9%
- Exports YoY (Jan) Forecast: -6.9%, Prior: -6.3%

Wednesday
2/19/2020

- Inflation releases including: CPI YoY (Jan) Forecast: 1.4%, Prior: 1.4%
- Building Permits MoM (Jan) Forecast: 1.45 M, Prior: 1.42 M
- Housing Starts MoM (Jan) Forecast: 1.39 M, Prior: 1.608 M
- PPI ex-Food and Energy YoY (Jan) Forecast: 1.2%, Prior: 1.1%

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		BoC Consumer Price Index Core YoY (Jan) Forecast: 1.8%, Prior: 1.7%
		FOMC Minutes REPORT
Thursday 2/20/2020		European Council Meeting
		Employment Change s.a. (Jan) Forecast: 31k, Prior: 28.9k
		Unemployment Rate s.a. (Jan) Forecast: 5.2%, Prior: 5.1%
		PBOC Interest Rate Decision Forecast: - , Prior: 4.15%
		Producer Price Index MoM (Jan) Forecast: 0.2%, Prior: 0.1%
		Gfk Consumer Confidence Survey (Mar) Forecast: 9.8%, Prior: 9.9%
		ECB De Guinos **SPEECH**
		ECB Monetary Policy Meeting Accounts
		Philly Fed Manufacturing Survey (Feb) Forecast: 12, Prior: 17
		Initial Jobless Claims Forecast: 210k, Prior: 205k
		Initial Jobless Claims 4-week ave. Forecast: - , Prior: 212k
		Continuing Claims Forecast: - , Prior: 1.698m
		CPI ex- Food & Energy Forecast: 0.9%, Prior: 0.9%
Friday 2/21/2020		All Industry Activity Index MoM (Dec) Forecast: - , Prior: 0.9%
		Markit Manufacturing PMI (Feb) PREL Forecast: 44.8, Prior: 45.3
		Markit Service PMI (Feb) PREL Forecast: 54, Prior: 54.2
		Markit PMI Composite (Feb) PREL Forecast: 50.9, Prior: 51.1

- Markit Manufacturing PMI (Feb) PREL Forecast: 47.5, Prior: 47.9
- Markit Service PMI (Feb) PREL Forecast: 52.2, Prior: 52.5
- Markit PMI Composite (Feb) PREL Forecast: 51, Prior: 51.3
- CPI YoY (Jan) Forecast: 1.4%, Prior: 1.4%
- CPI YoY Core (Jan) Forecast: 1.1%, Prior: 1.1%
- ECB's Lane **SPEECH**
- Retail Sales ex-Autos MoM (Dec) Forecast: 0.4%, Prior: 0.2%
- Retail Sales MoM (Dec) Forecast: 0%, Prior: 0.9%
- Markit Manufacturing PMI (Feb) PREL Forecast: 51.4, Prior: 51.9
- Markit Service PMI (Feb) PREL Forecast: 53.5, Prior: 53.4
- Markit PMI Composite (Feb) PREL Forecast: - , Prior: 53.3
- Existing Home Sales MoM (Jan) Forecast: 5.48 M, Prior: 5.54 M
- Fed's Brainard **SPEECH**

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