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What to focus on in Global Macro for the week of March 8th, 2021

Macro Themes on the Radar:

Markets feel like they are on a seesaw that is slowly being raised off the ground by rising bond yields. The higher it goes the more dangerous it gets for the participants and the higher volatility goes. On one side are the academics and central bankers who think the economy still needs a great deal of support in the form of continued monetary and fiscal stimulus and is likely to need it for some time to come. While they acknowledge some inflation is likely in the near-term, they see it as transitory and not an impediment for the current policy mix for years to come. On the other side of the seesaw we have the global markets, they're not so sure. Not only have long-end yields been rising, but recently the front-end yields and the belly of the curve have popped. Can the Fed and others really keep all the moving parts under control, long enough to execute their plan to let the economy run hot, and not worry about inflation until it has been above "persistently" above 2% "for a while"? (Fed's Clarida has mentioned it could require a year above)

I think this set-up all but guarantees a much more volatile market than people have become accustomed to since the 2008 recovery started.

After making new highs in yield last week the bond markets took a breather. The Fed and ECB remain undeterred in their dovishness. The only question for them is whether the rise in yields is just a natural progression, as markets price higher growth and recovery, or whether the run higher has been too far, too fast, and is prematurely impacting financial conditions, effectively tightening for them before they are ready. The ECB is going with both rationales, as competing council member statements hit the wires. However, overall, they are showing more concern given the very low Euro area inflation/growth and the disastrous vaccine rollout by the EU.

Until last week, the Fed was firmly in the "natural progression" camp. However, they too have now "raised an eyebrow" over the last couple of weeks. Markets have been looking for hints of impending intervention and got a few crumbs on Thursday from Powell. He acknowledged that the recent jump in bond yields "was notable and caught his attention," and that he "would be concerned by disorderly conditions in markets or persistent tightening in financial conditions that threatens the achievement of our goals." At the same time, he went out of his way to reassure markets they were not ready to start tapering the bond purchases and far away from the day when they would hike rates.

With the latest $1.9 trl package (a whopping 9% of GDP) now added, expectations for economic growth, particularly in the US, are zooming.

Markets are starting to worry about overheating, as are some economists.

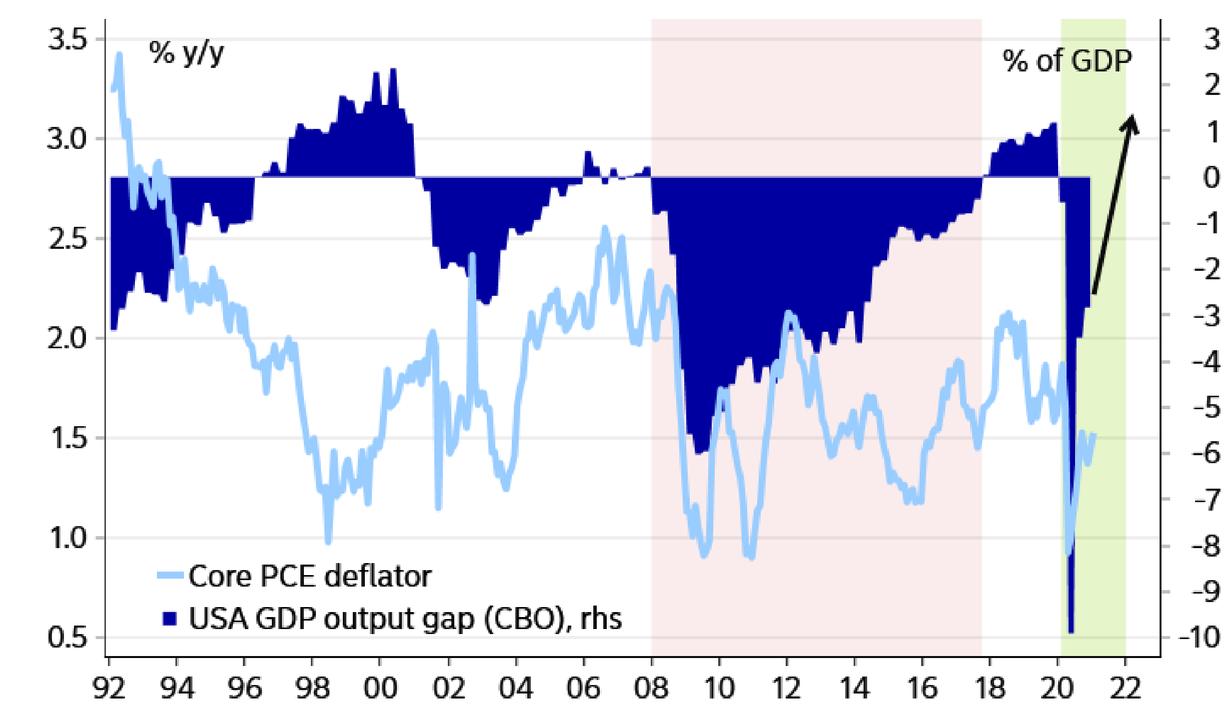
I thought these recent comments from economist Ed Yardeni highlight that view nicely:

"The V-shaped recovery in real GDP will remain V-shaped during the first half of this year and probably through the end of the year. However, it will no longer be a 'recovery' beyond Q1 because real GDP will have fully recovered during the current quarter. Thereafter, GDP will be in an 'expansion' in record-high territory." And goes on to say that, "Too much of a good thing is often just too much." … "The economy is hot and will get hotter with the bonfire of the fiscal and monetary insanities."

Given the nature of the crises and the size of the policy response, the team at Nordea thinks the output gap could be closed relatively quickly.

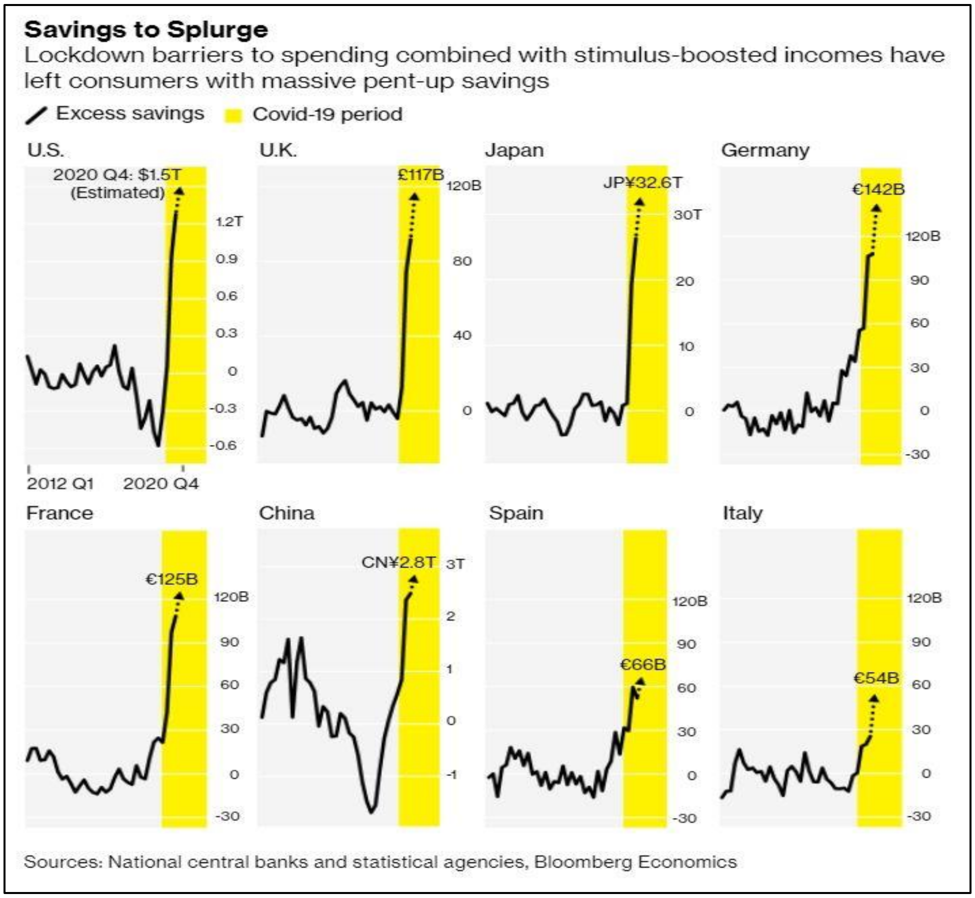
"It took 10 years for the US economy to close the output gap created by the financial crisis. This time it could take as little as 1.5-2 years. The conclusion is similar for the Euro area."

Chart 3. Will we see a markedly positive output gap already 2022?

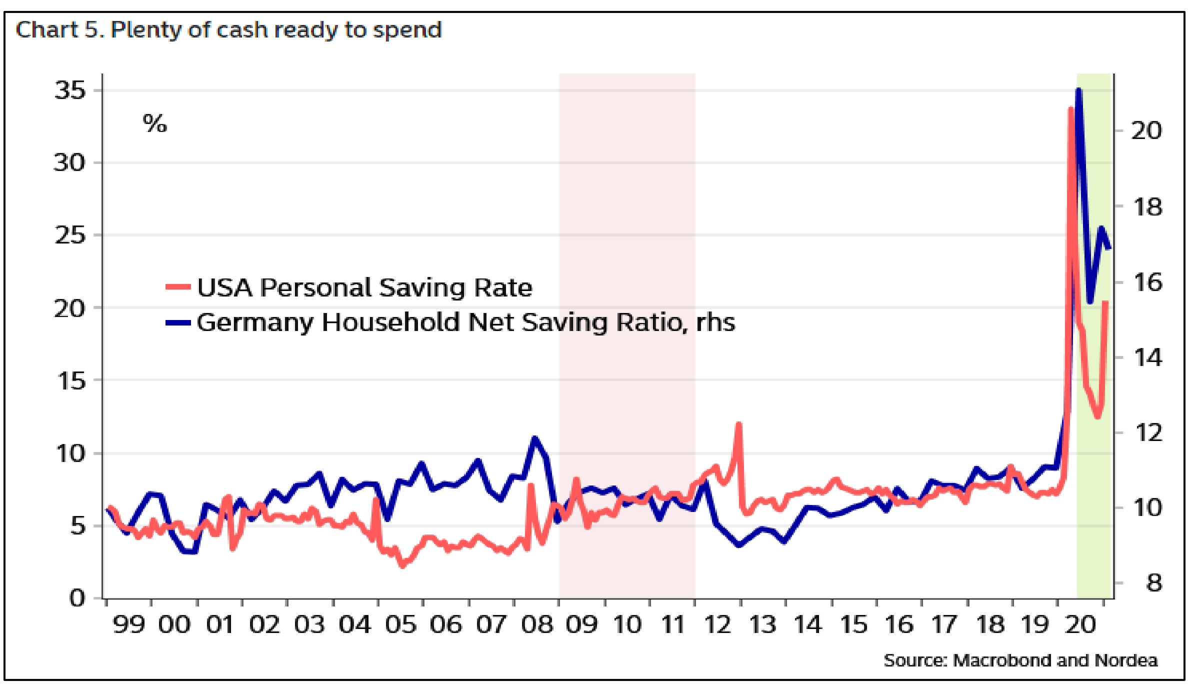


Source: Macrobond and Nordea

One huge unknown is that we don't really know what will "actually" happen when the global economies fully re-open. The huge amount of fiscal stimulus and the inability to freely spend due to lockdowns has resulted in a never before seen jump in personal income during a recession and a very large accumulation in personal savings.



Note, this chart does not include the just passed $1.9 trl US package.



While we wait to find out the real-world outcome, the markets will either challenge or accept the Fed's chosen path.

Recently, they have been challenging them. So now what? The next Fed meeting is March 16-17. There are a number of things people are watching as it approaches. If the Fed decides that the move in real yields and nominal yields so far does not warrant any active response, I think it won't be long before the markets take yields higher again.

If they do choose to respond, sighting that they don't want financial conditions to tighten prematurely, here are some of the options.

Of course, they could engage in some type of Yield Curve Control. This comes in a number of potential flavors.

Rather than flat-out setting a ceiling on yields in one or various maturities (very aggressive and very doubtful at this point) the market is leaning towards an Operation Twist 3.0, if they were to actively respond at all. I think it's a little early given the magnitude of the bond move and the relative stability of the equity indices, but the Fed has not been afraid to act under Powell so never say never.

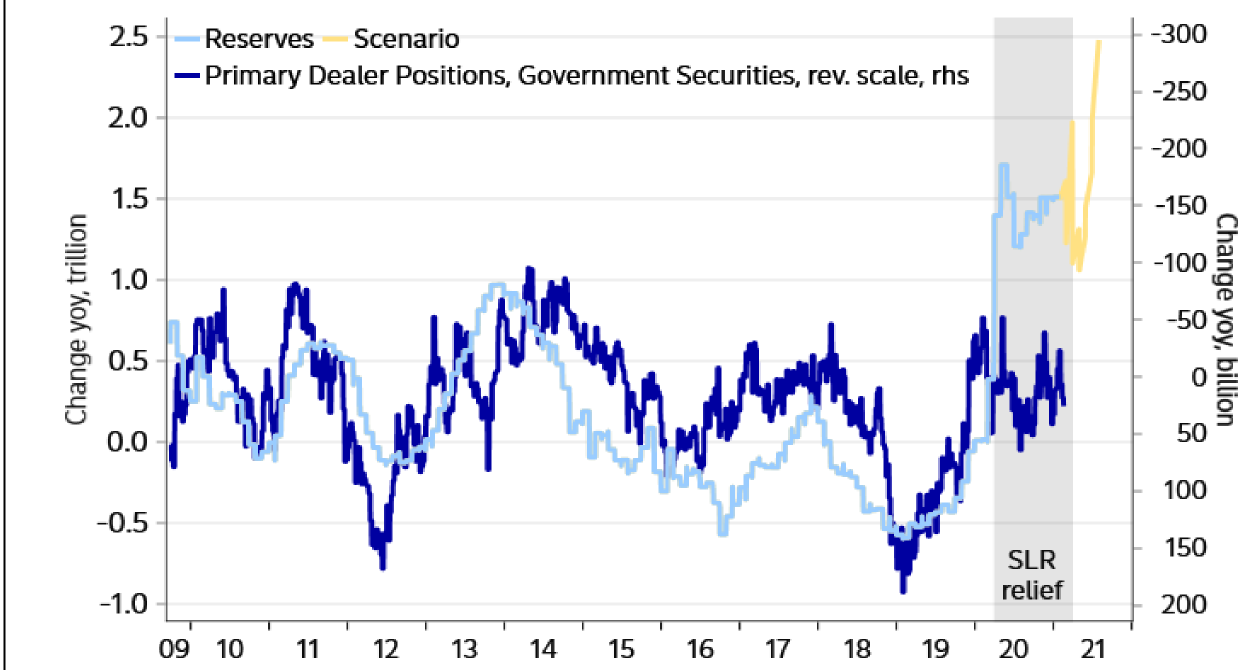
"Twisting" would involve the Fed selling shorter maturity paper and buying the same USD amount of longer-duration securities. This would support front end yields and nudge down longer-end yields.

The timing for this could be handy, as T-bill yields have been under a lot of downward pressure for a number of reasons, including a potential fall in the TGA going forward. At the same time the spike in longer-dated yields is potentially becoming, shall we say, inconvenient. If you're the Fed, you don't need to be seen losing control of both the front and the back-end yields.

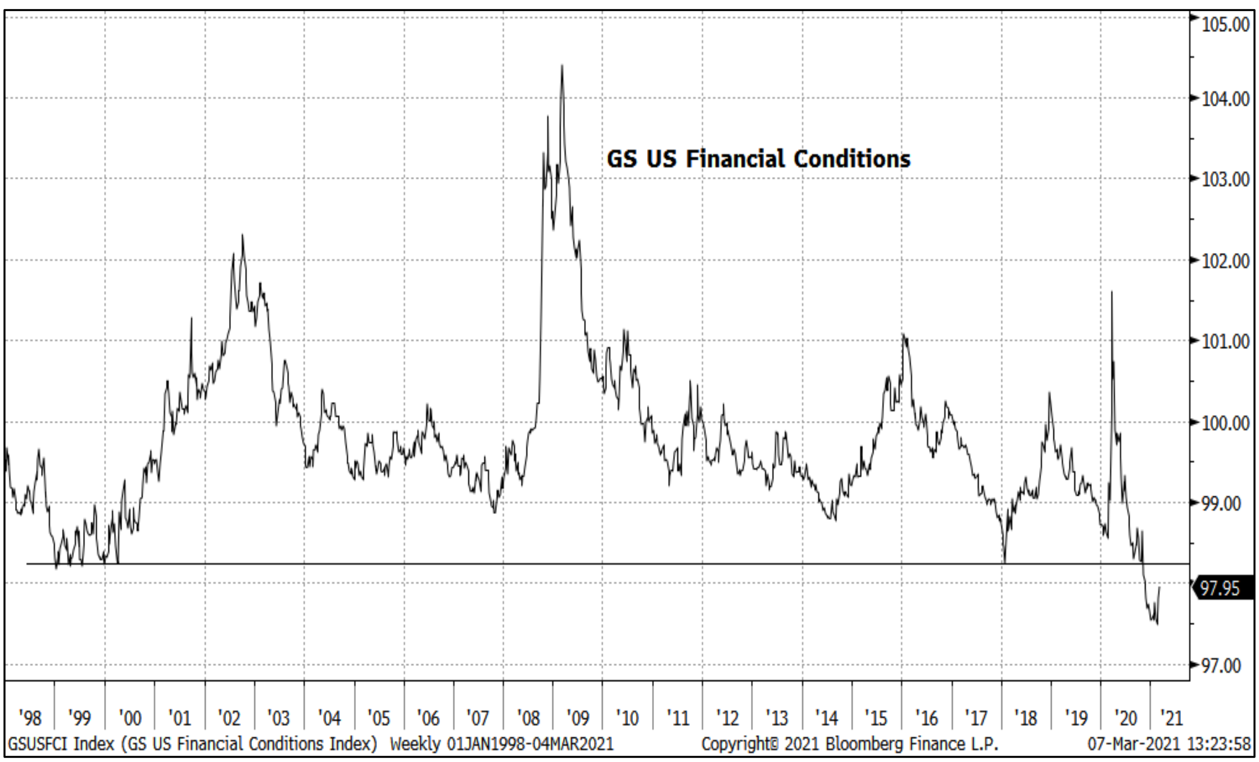
Some Fed watchers think they might increase the interest on excess reserves, IOER, from .1% to .15%.

Another item to look for is an extension of the Supplementary Leverage Ratio (SLR) relief that expires on 31 March this year. This was implemented back on April 1st of last year, and excludes Treasury holdings and deposits at the Fed from the calculation of this ratio for banks. In theory, if the relief is not extended, banks could become sellers of their Treasury holdings. The fact that this exemption has not been extended so far may have already played a role in the recent selling.

Chart 8. Expired SLR relief could trigger further bond selling



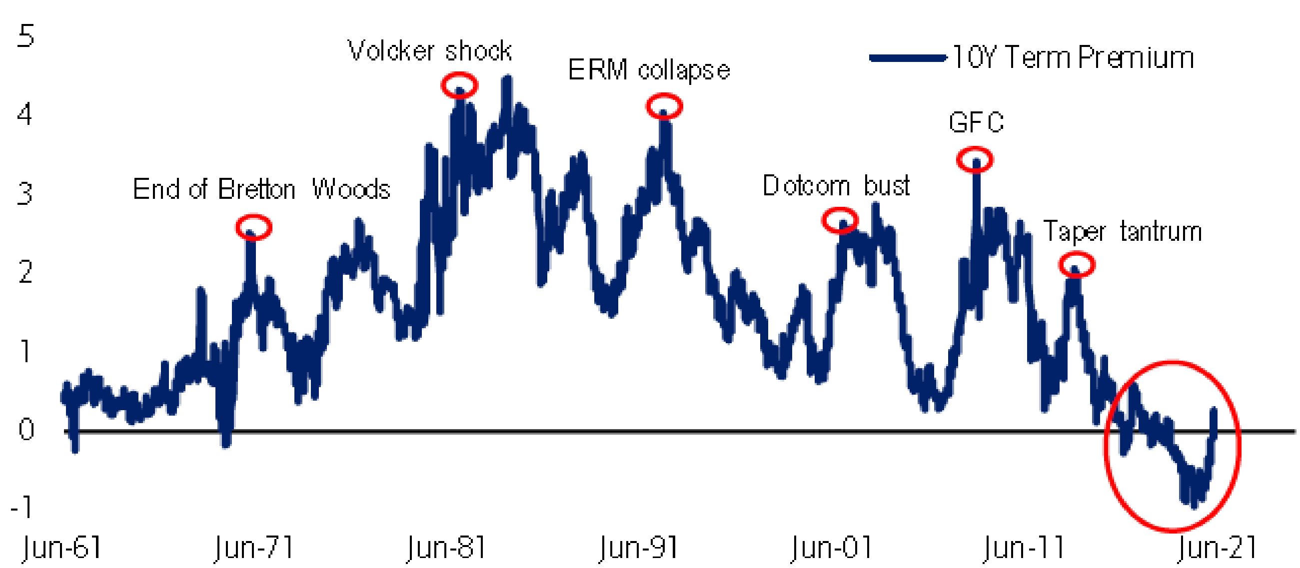
Eventual Twist, or even full YCC, will be an acknowledgement that the move higher in yields is seen as counterproductive to government policy. So far, however, financial conditions are easy.



Watch real yields and the dollar. If they continue to both go higher, financial conditions will tighten, potentially at an accelerating pace. That will all but guarantee eventual Fed action and some form of YCC.

This was an interesting chart from BoA on rising term premium in 10-year Treasuries. They see it as potentially the end of an era. If the Fed does go on to resolutely follow a new policy of opportunistic reflation, it may well be.

Chart 3: Rising term premium signals investment regime change
US 10-year Treasury Term Premium, Percent



Source: BofA Global investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

Chart 9: 2021 is the Mirror Image of 2020
Major Investment Themes for 2020 and 2021

2020	2021
Virus	Vaccine
Lockdown	Reopening
Bust	Boom
Deflation	Inflation
Big Rally	Big Rotation
Wall Street	Main Street
Bulls	Bears
Credit	Commodities
Large	Small
US	EAFE/EM

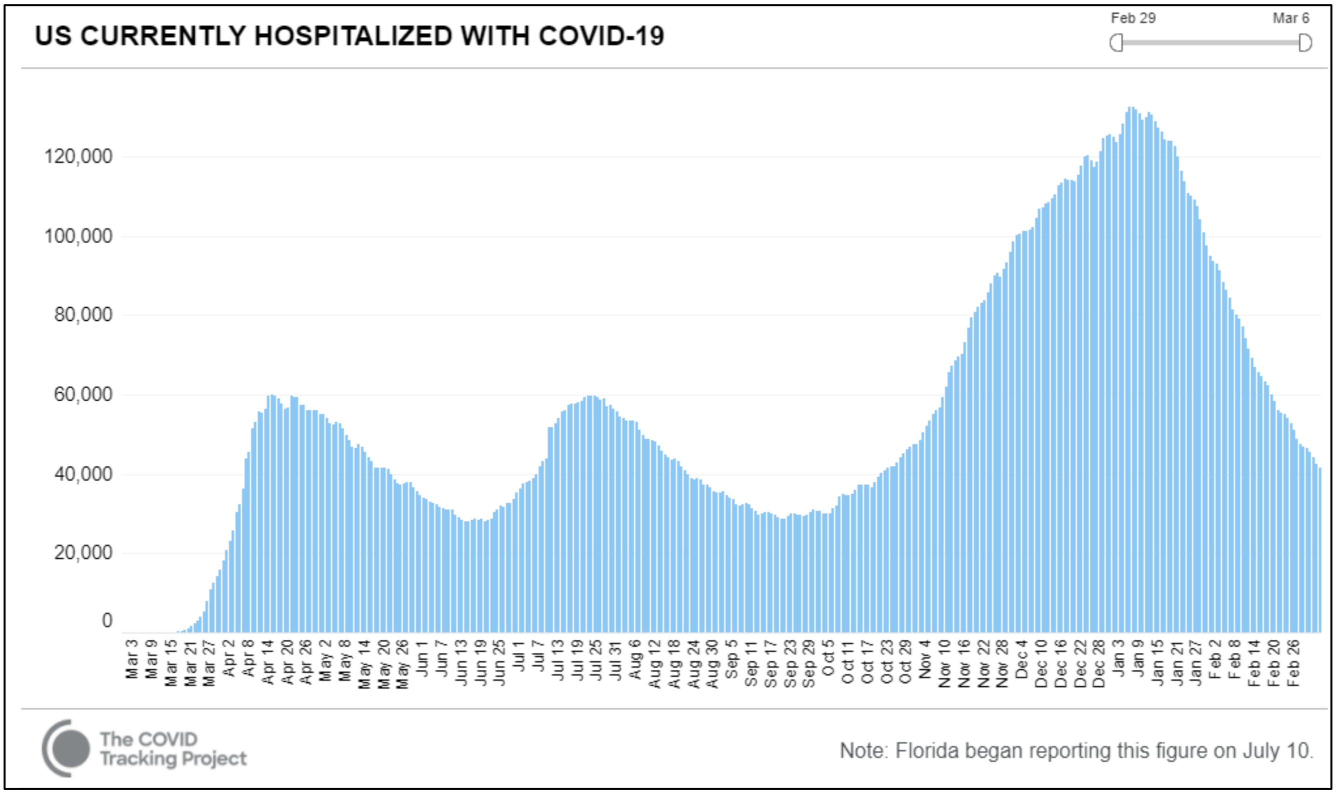
Source: BofA Global Investment Strategy

BofA GLOBAL RESEARCH

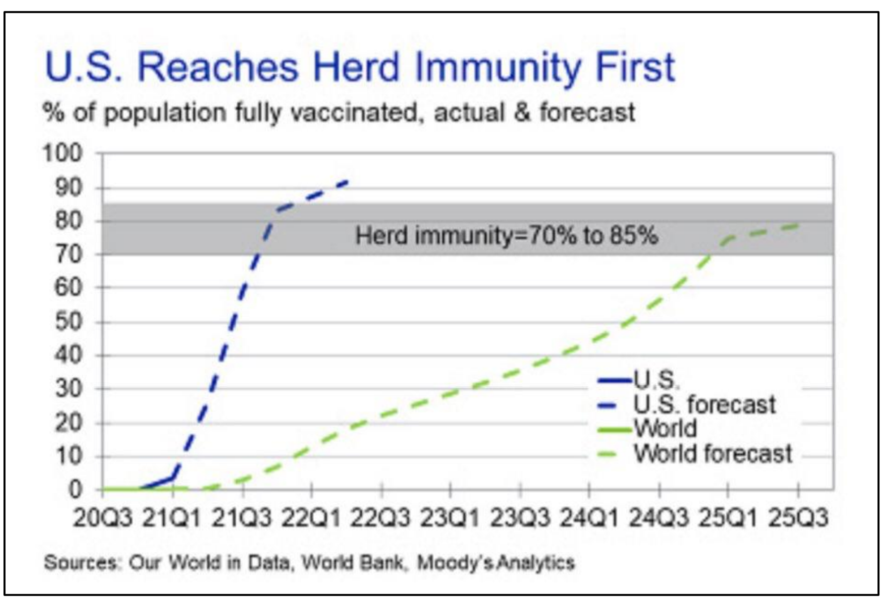
I liked this one too. There is lots of change in the air vs. what markets have been used to. I like finding ways to be long volatility and gap risk. This should be a good active management vs. passive management environment.

COVID

Still heading in the right direction as the US vaccine rollout gathers steam. We will see if we get an uptick with a number of states announcing re-opening to various degrees, but so far so good.



I thought this was an interesting one with potential relative performance implications.



What to Focus on Now:

Last week was the fifth up week in a row, gaining 50bps during the run, which is a lot given we started at 1.07%.

However, it has been the quick jump in the belly of the curve that really got people thinking.

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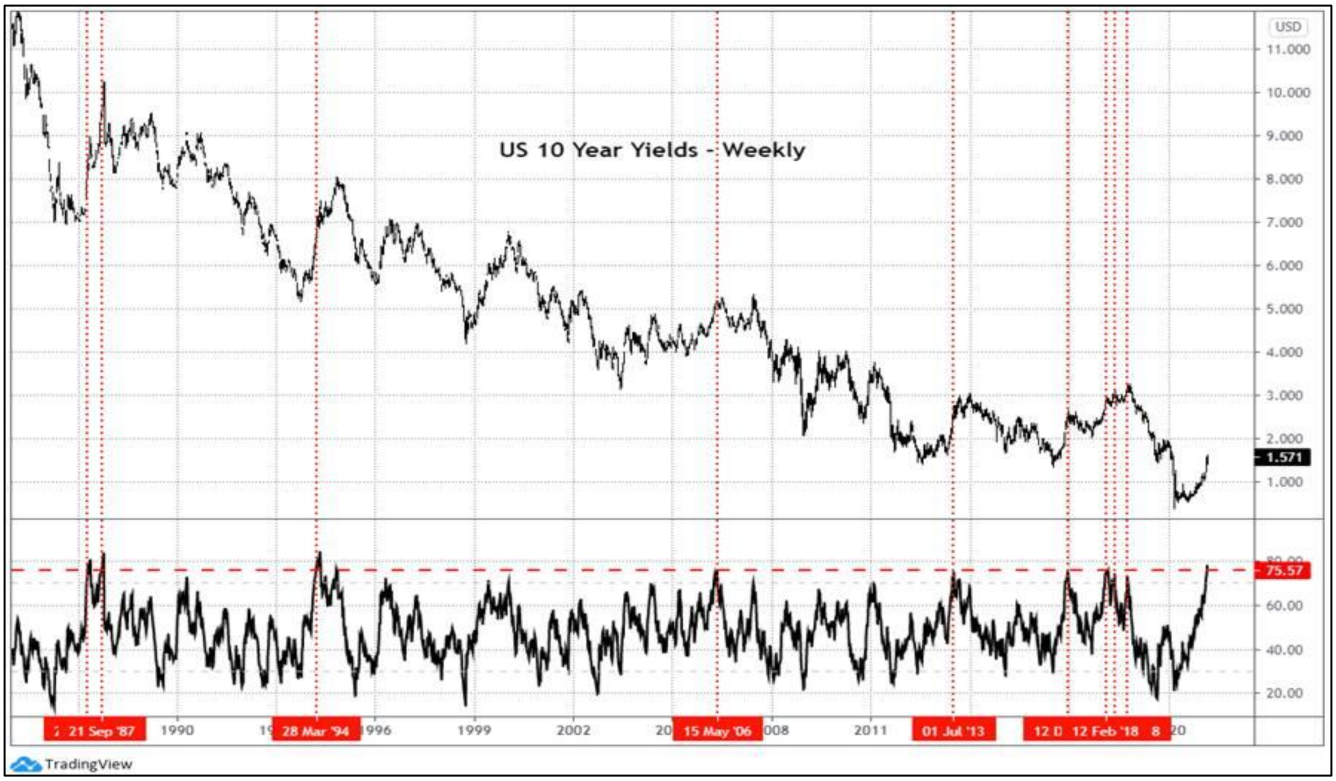
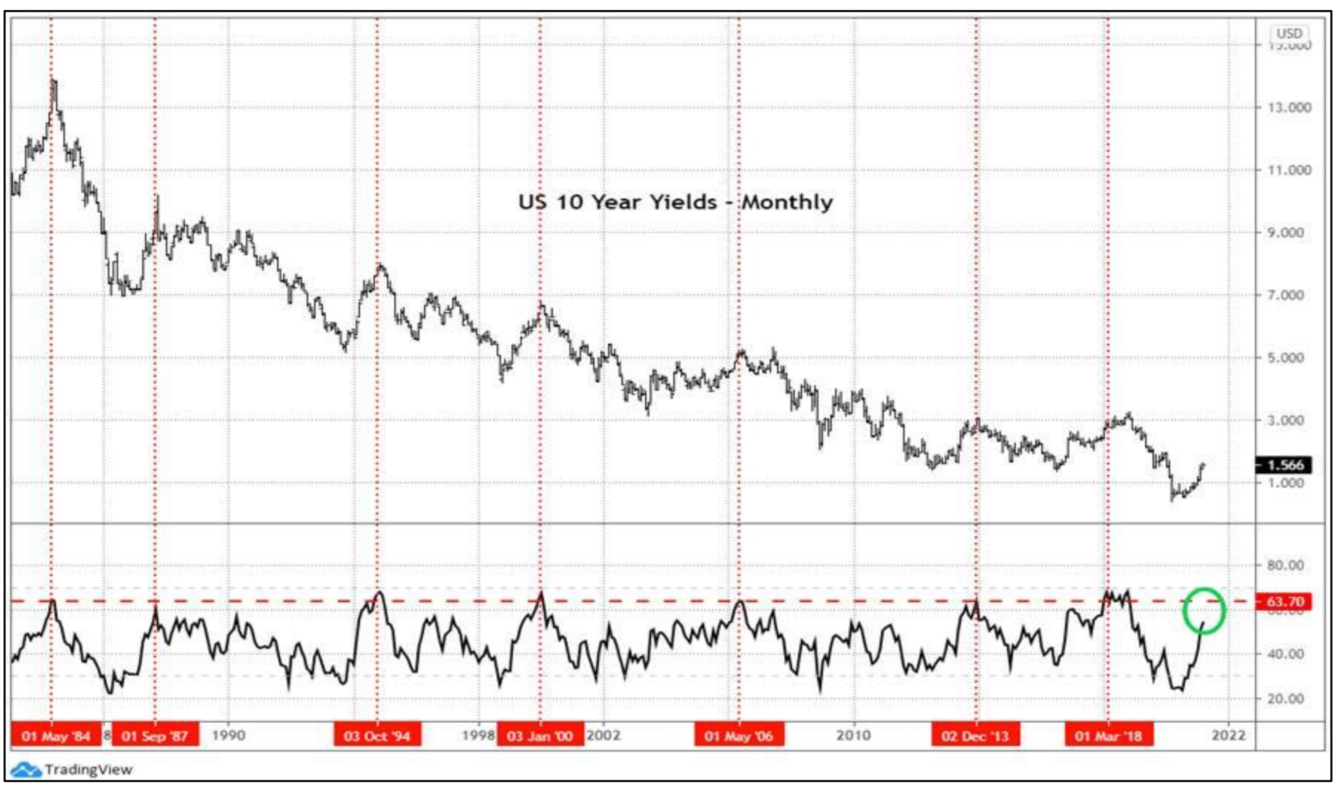
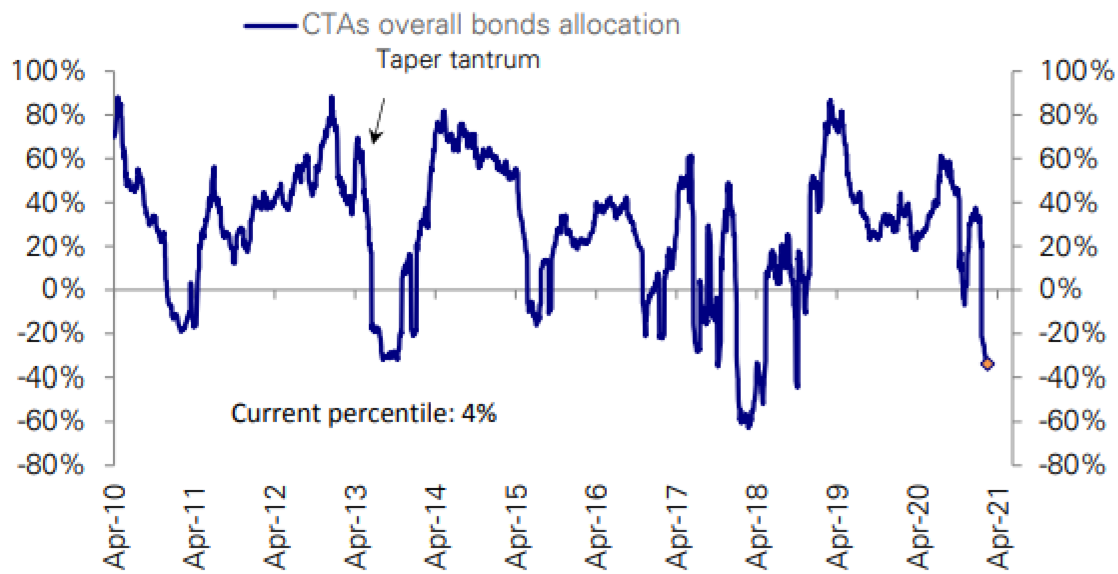
Lots of people pointing out how overbought we are on the weekly RSI below, but usually that just means we need a breather before another run. The monthly chart still has room before we get to "crazy".





CTA's are rather short bonds now however…

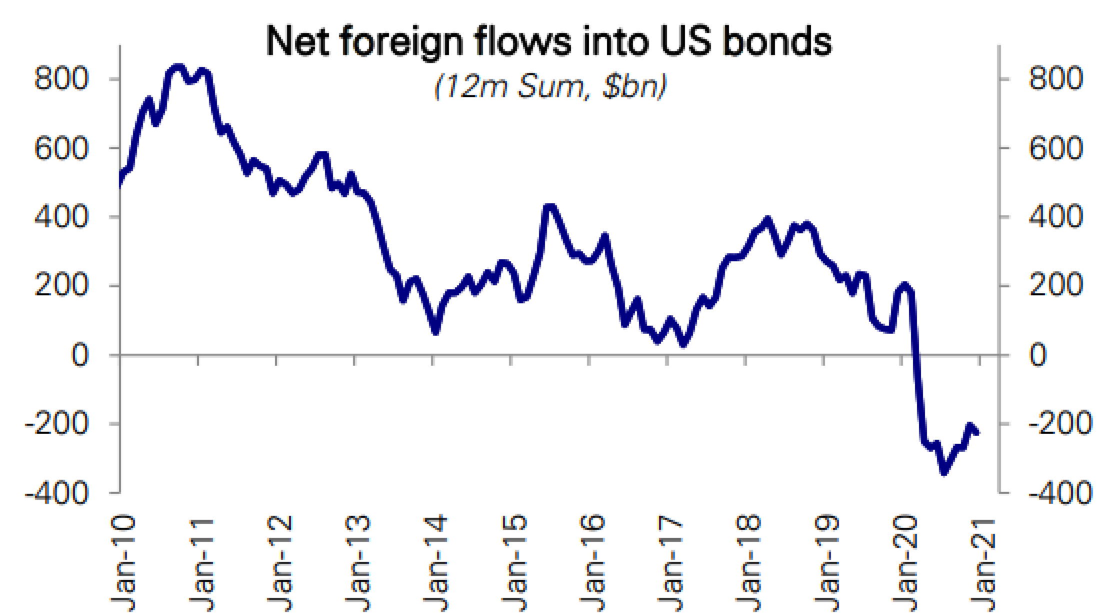
Figure 6: Bond positioning for CTAs is now below taper tantrum lows



Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

And foreigners have already been big sellers… but still plenty of other holders.

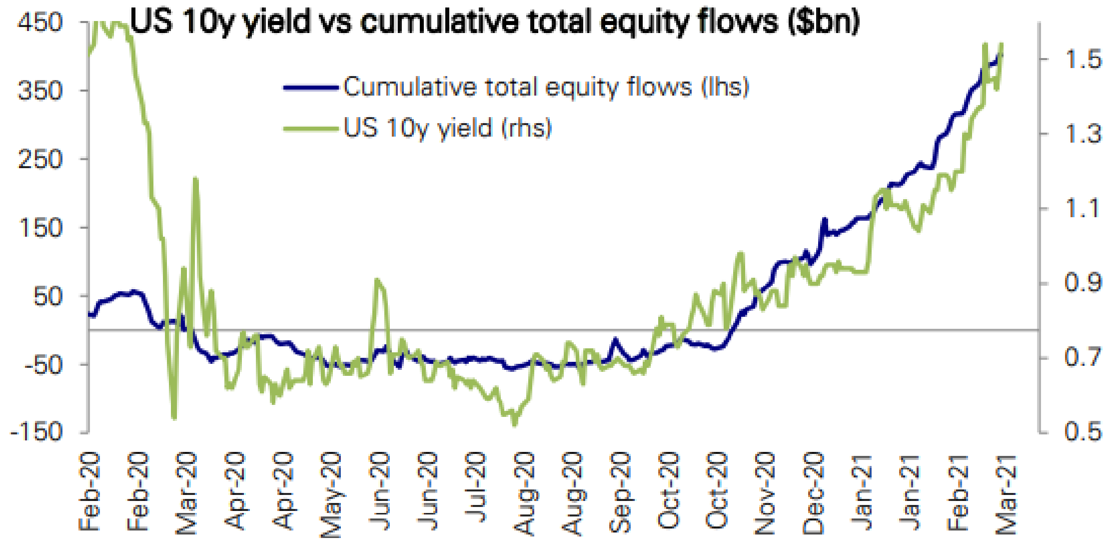
Figure 17: Foreign investors already sold large amounts of US bonds last year



Source : US Treasury, Haver, Deutsche Bank Asset Allocation

As discussed last week, for the last 20+ years, higher yields and higher growth expectations have gone hand in hand. So far that seems to be holding.

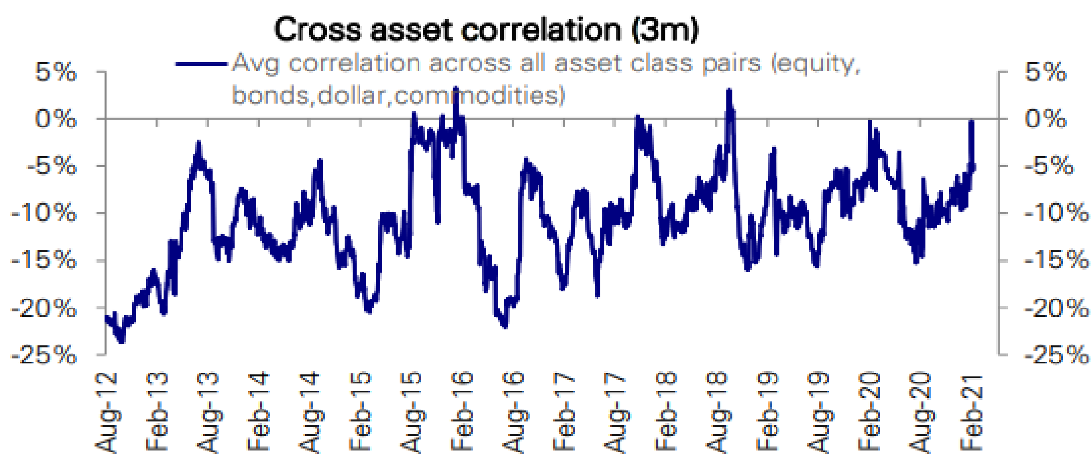
Figure 25: Equity funds meanwhile continue to see solid inflows as rates rise



Source : EPFR, FRB, Haver, Deutsche Bank Asset Allocation

However, the correlation between asset classes is rising, which can foreshadow trouble.

Figure 14: Correlation across asset classes has also been rising, constraining portfolio exposure overall as diversification benefits decline



Average of 3m rolling correlation of daily returns between asset pairs: S&P 500 TR index, Barclays US Treasury TR index, US Dollar Index and CoreCommodity CRB Index

Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

Of the indices, the NASDAQ has had the hardest time with continued rotation. It needs to regain some ground next week to be “safe”, or risk another shot at the lows.

By contrast, other indices have held up well.

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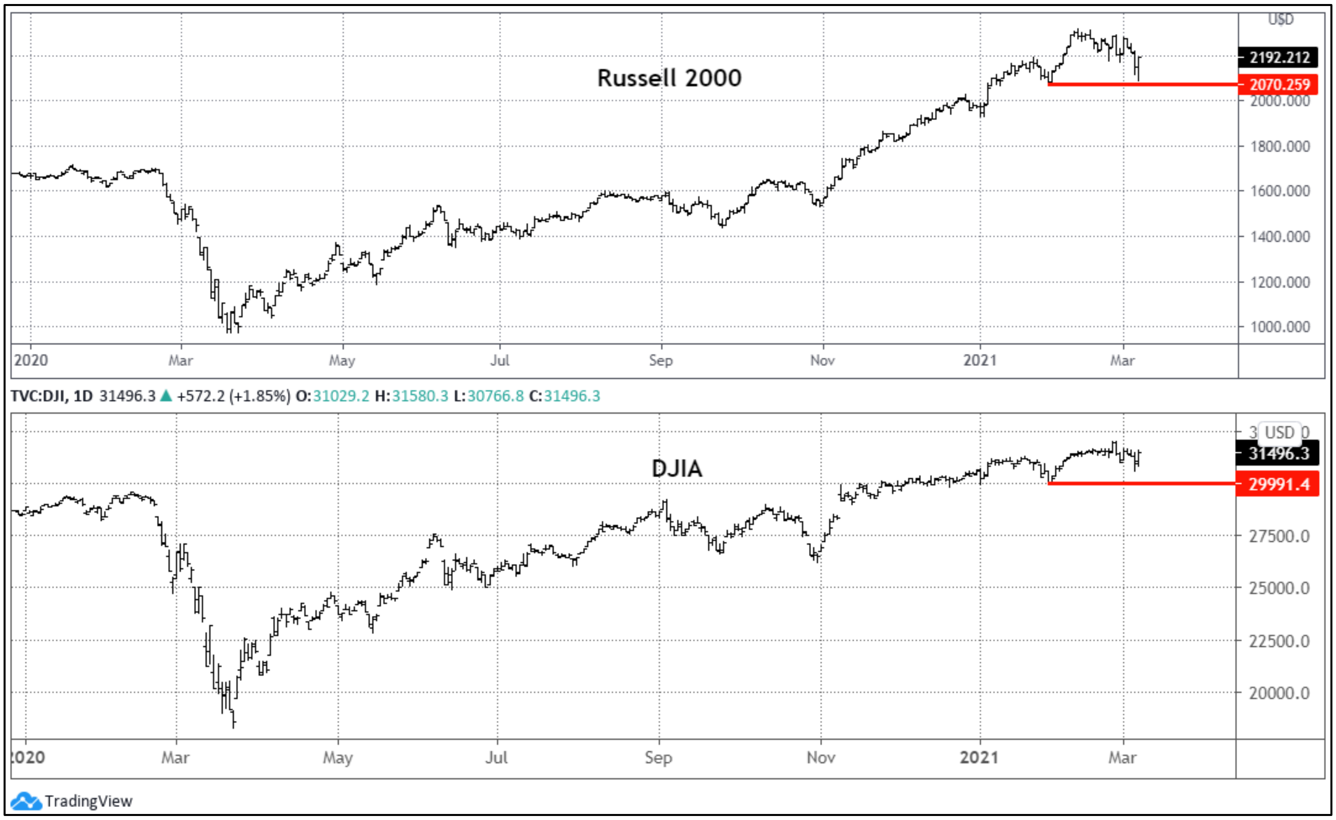
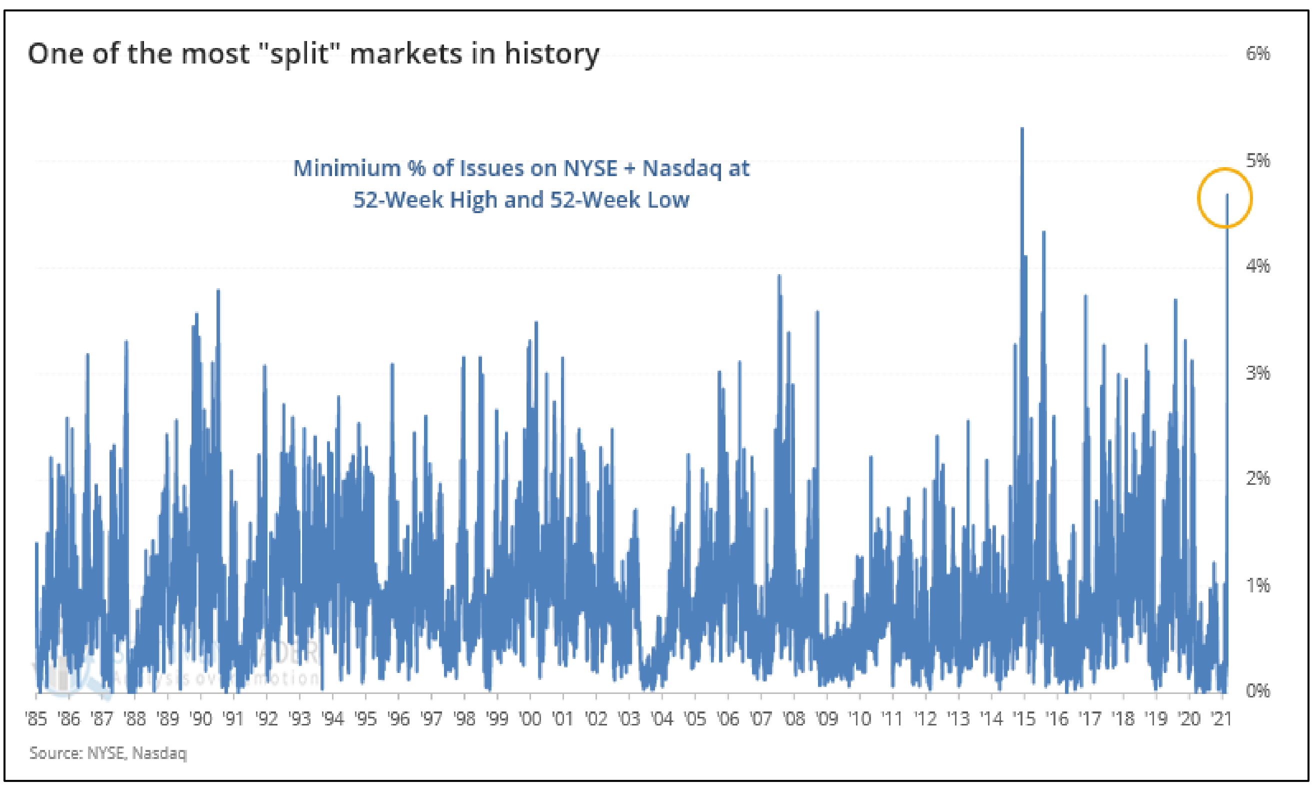
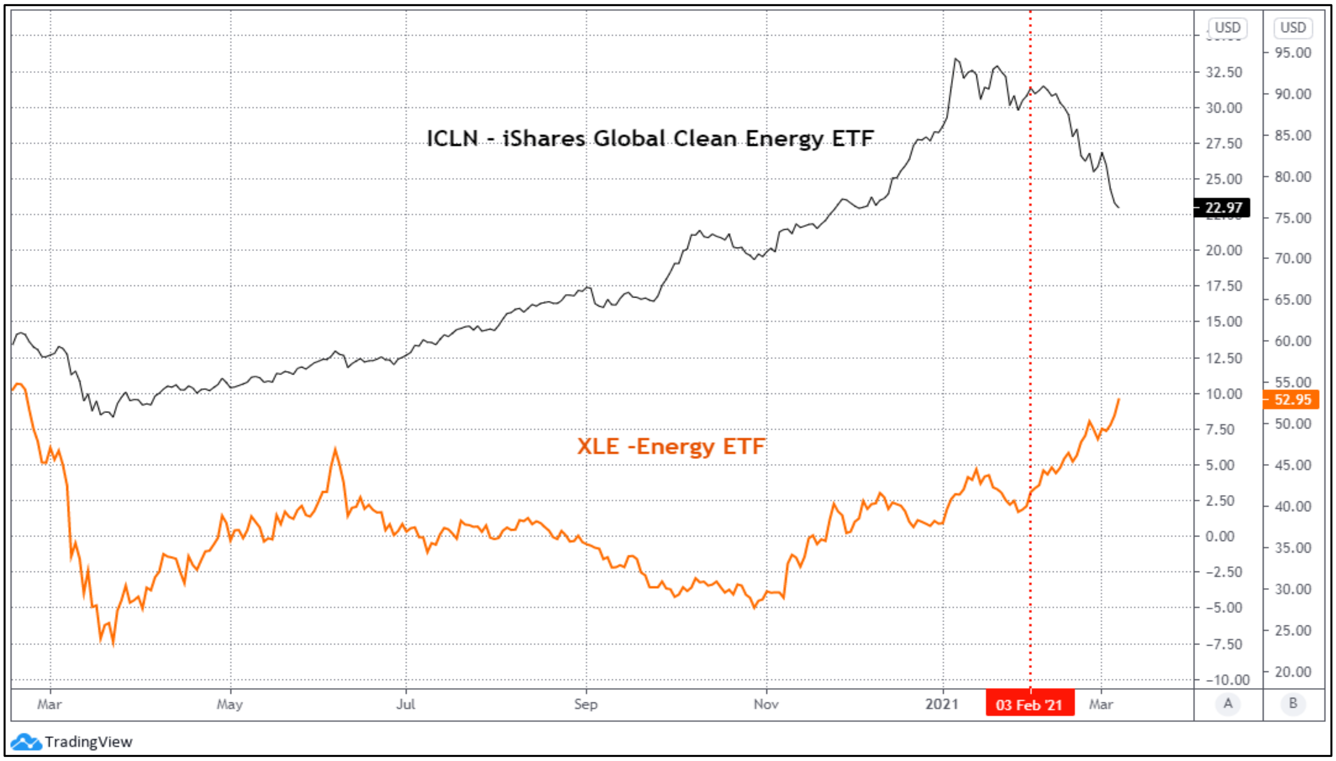


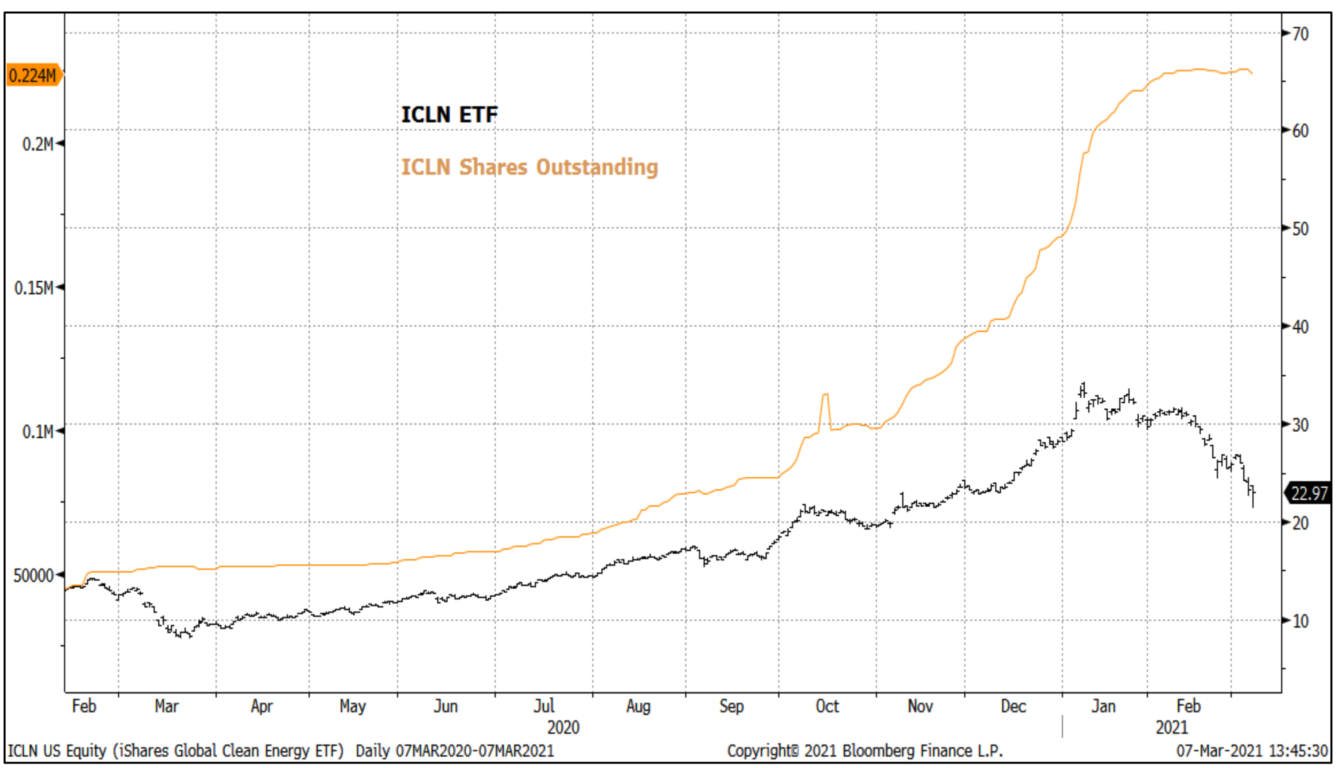
This chart gives you a feel for the high level of dispersion we are seeing between individual stocks.



The most loved have been going down while the least loved have headed higher. Tech and innovation down while reflation and global demand up.



While the holdings have taken down the value of the ETF, investors have not yet sold the ETF itself.



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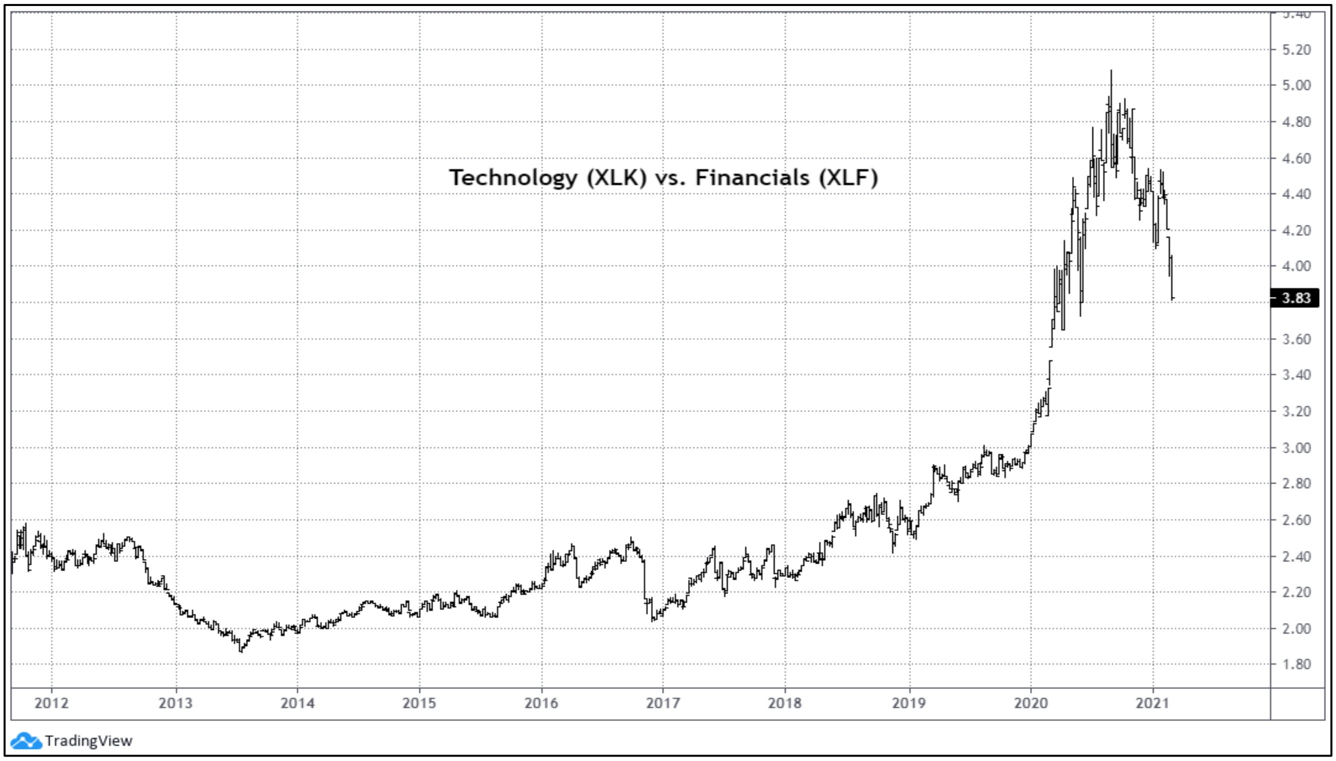
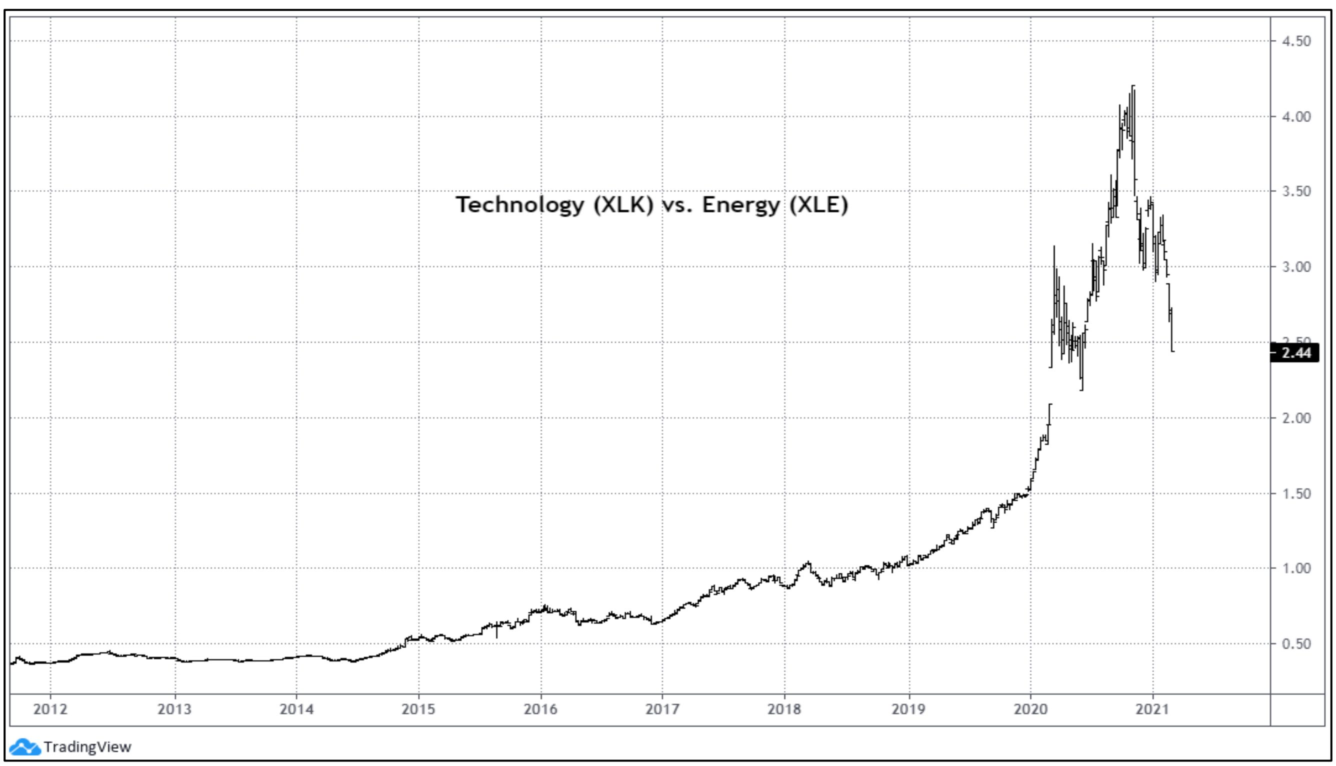
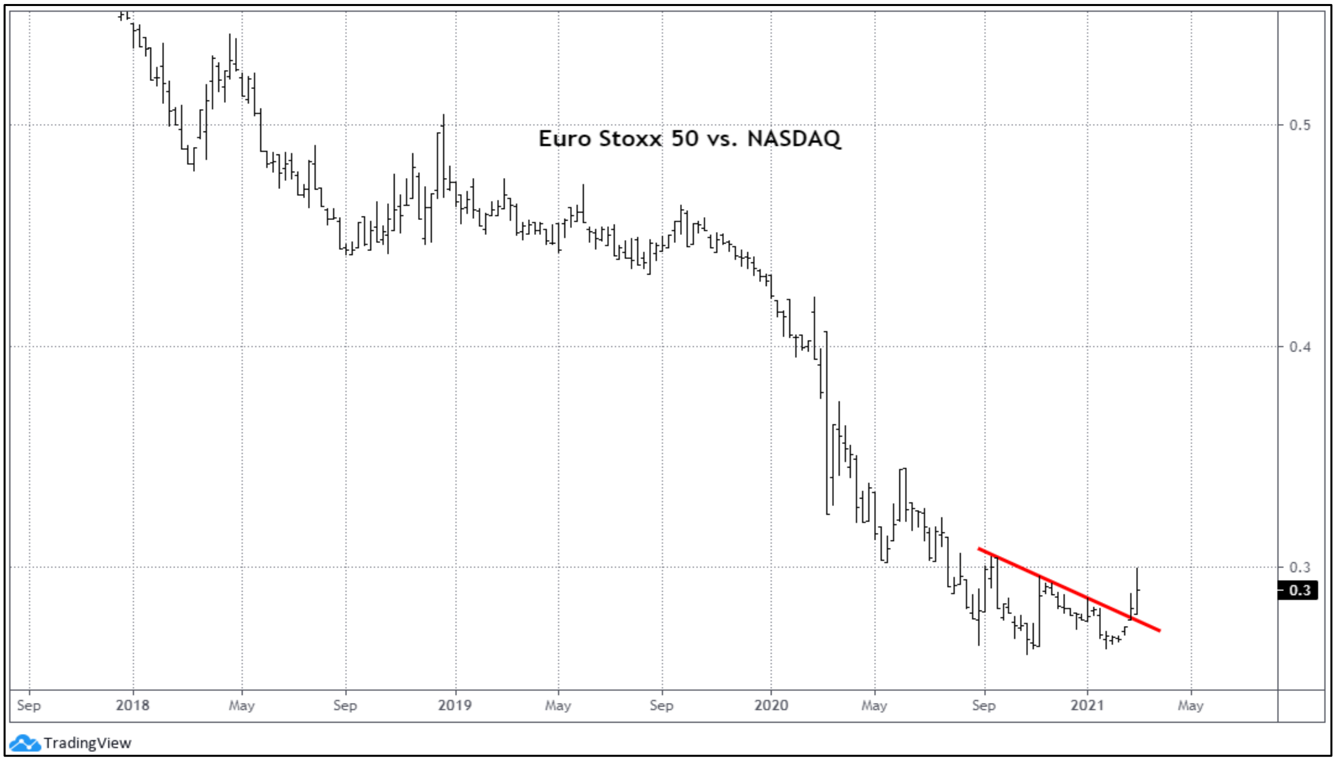
The magnitude of some of the relative moves are starting to add up.





Even long-suffering Europe has for once outperformed the NDX in recent weeks.



Although, to be fair, it has done so by holding up, rather than going up.

FX - With inflation prints not yet driving the show, nominal yields have been pushing around real yields. The dollar has been outperforming especially vs. negative yielders like EUR, JPY, and CHF. More room?

This relationship is a little loose for my taste, but nominal rates are really doing the heavy lifting.

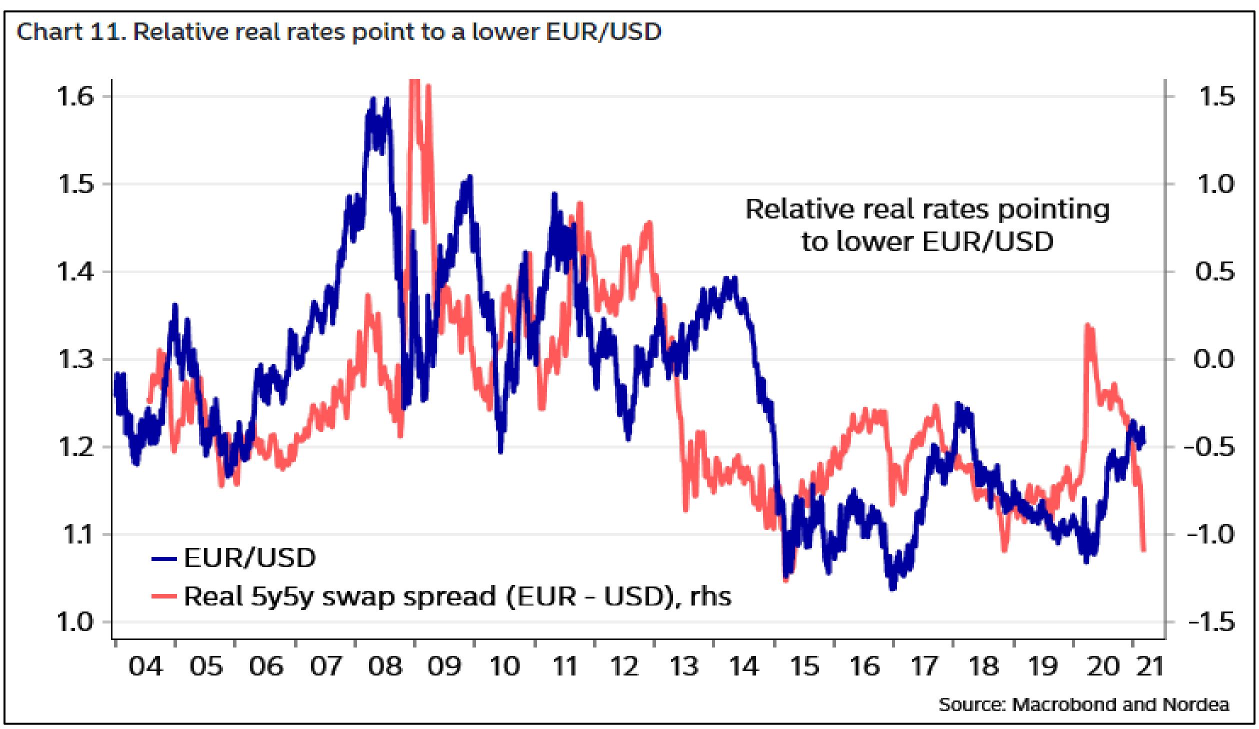
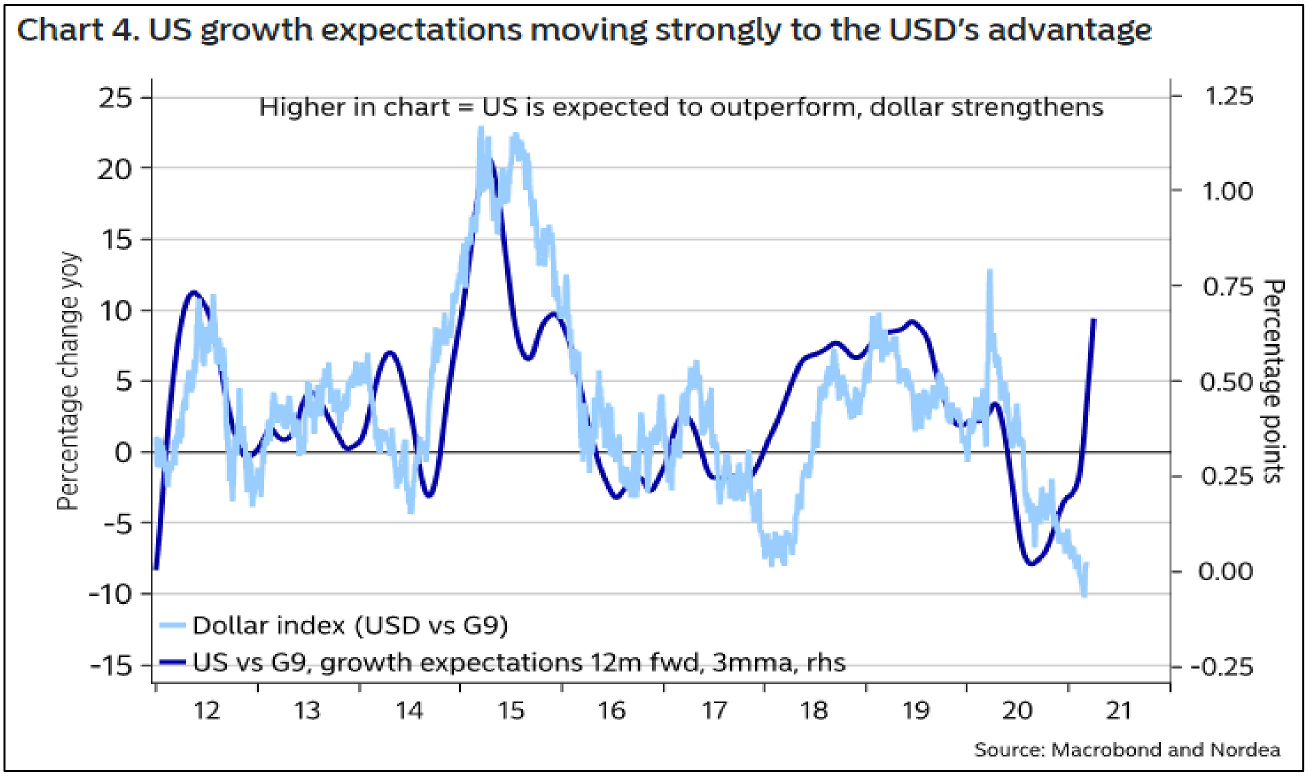


Chart 11. Relative real rates point to a lower EUR/USD

Another way of looking at the same issue is via the change in relative growth expectations for the US vs. the rest of G10. The expected growth divergence is being generated by fiscal spending and vaccine-rollout divergences.

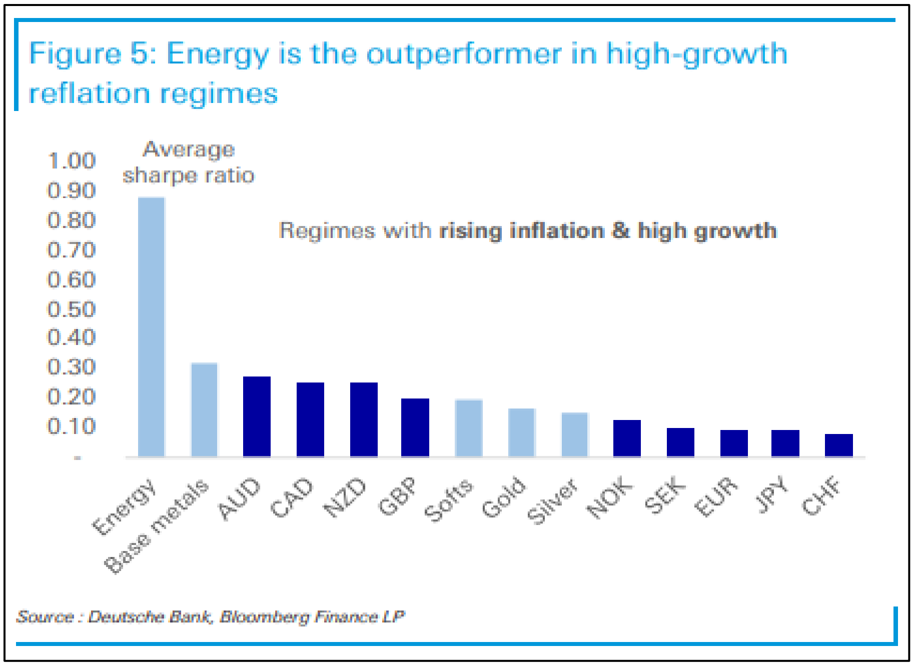


Currencies find themselves in an interesting spot given the continued attempts at managing bond yields by central banks. They are potentially, a purer play on relative growth.

<u>You need to watch the dollar here.</u> Continued strength accompanied by rising bond yields in the US, could quickly become a reason for the Fed to protest, and potentially act, to ward off tightening financial conditions.

If they are pushed into YCC, or the lighter touch Twist, it could quickly reverse a fledgling USD rally as one of the spigots for expressing inflationary trends is turned off, concentrating the flow in those options that remain. Again, I like finding good risk / reward ways of owning some currency volatility.

Oil – With global growth expectations rising, investors buying commodities in general, and some technical factors supporting, Oil has been relentless. Continued USD strength would likely slow the rise, however.



On a side note-

DB published a survey of online brokerage account users, that suggested they would invest a meaningful proportion of future stimulus checks in the stock market.

Figure 1: US Retail investors plan to put a significant chunk of any forthcoming stimulus into the stock market

Next Week -

CPI and PPI

ECB on Thursday - Lagarde, Lane, Schnabel, De Cos and Panetta have all spoked about the move in yields. They are all over the place and I would guess this reflects some disagreement within the Governing Council. Maybe they will explain what envelope they have for "easy financial conditions". So far higher yields have been accompanied by a lower EUR, still tight sovereign and credit spreads and placid equity markets. They will probably stick with jawboning for now, rather than QE based intervention.

Important Macro Data Releases and Events for the Week

Monday
3/8/2021

BoE's Governor Bailey SPEECH

GDP QoQ (Q4) Forecast: 3%, Prior: 3%

Tuesday
3/9/2021

GDP s.a. QoQ (Q4) Forecast: -0.6%, Prior: -0.6%

GDP s.a. YoY (Q4) Forecast: -5%, Prior: -5%

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CPI YoY (Feb) Forecast: -0.4%, Prior: -0.3%

Wednesday 3/10/2021	FDI YTD YoY (Feb) Forecast: -, Prior: 4.6%
	CPI ex food and energy MoM (Feb) Forecast: 0.2%, Prior: 0%
	CPI ex food and energy YoY (Feb) Forecast: 1.4%, Prior: 1.4%
	BoC Interest Rate Decision and Policy Statement
Thursday 3/11/2021	**ECB Interest Rate Decision, Policy Statement and Press Conference**
	Initial Jobless Claims Forecast: 725k, Prior: 745k
	Initial Jobless Claims 4-week average Forecast: -, Prior: 790.75k
	Continuing Jobless Claims Forecast: 4.362m, Prior: 4.295m
Friday 3/12/2021	Harmonized Index of Consumer Prices YoY (Feb) Forecast: 1.6%, Prior: 1.6%
	Industrial Production s.a. MoM (Jan) Forecast: 0.2%, Prior: -1.6%
	PPI ex food & energy YoY (Feb) Forecast: 2.6%, Prior: 2%
	Unemployment Rate (Feb) Forecast: 9%, Prior: 9.4%
	Michigan Consumer Sentiment Index (Mar) Forecast: 78, Prior: 76.8

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