What to focus on in Global Macro for the week of July 18th, 2022

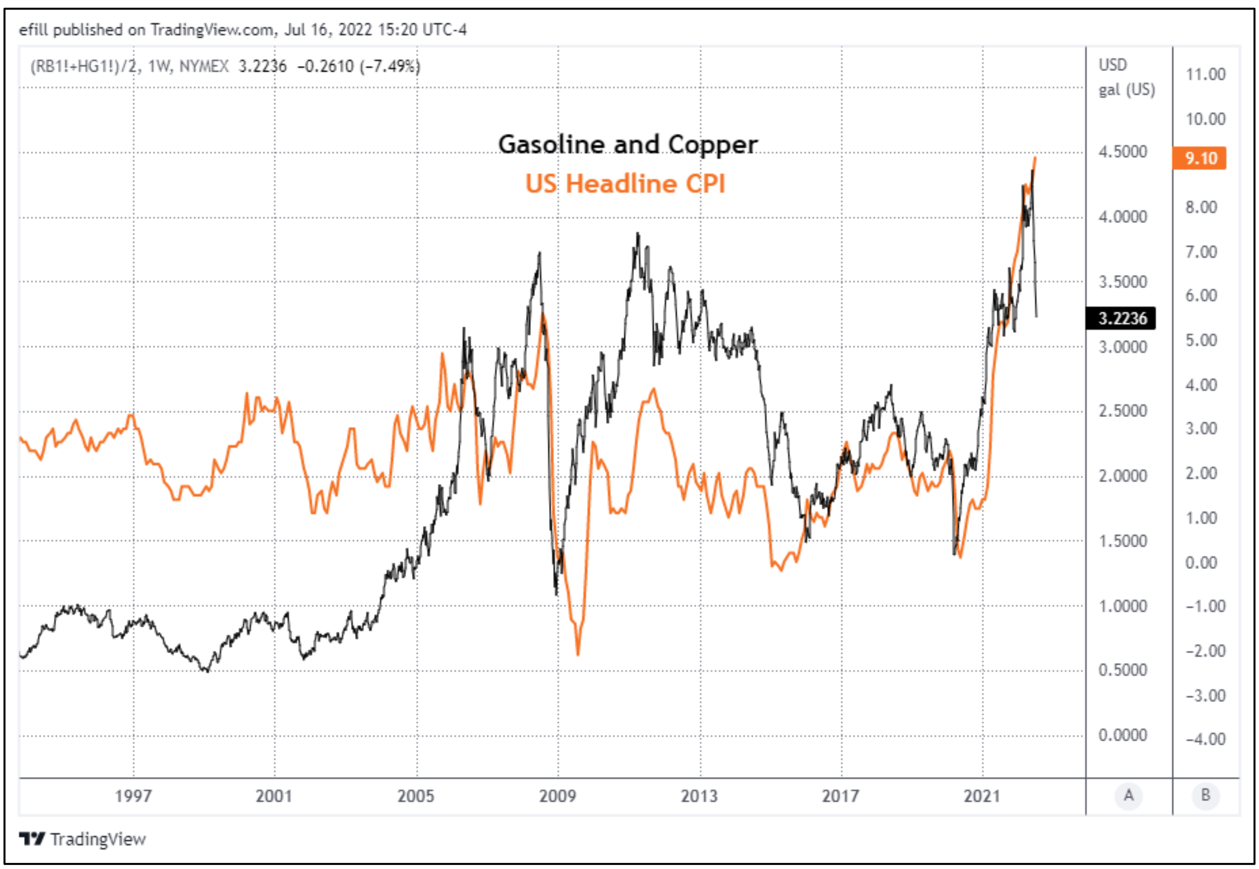
Markets continue to face a complex mix of Macro inputs.

A determined Fed in the face of last week's still high inflation data and the still firm labor market is being met with the growing feeling that the appearance of a recession of unknown magnitude is only a matter of time.

While it is certainly true that inflation in the US has broadened out, components have included rents, new and used cars, furniture, apparel, and airline fares as drivers, but food and energy, have been among the biggest contributors.

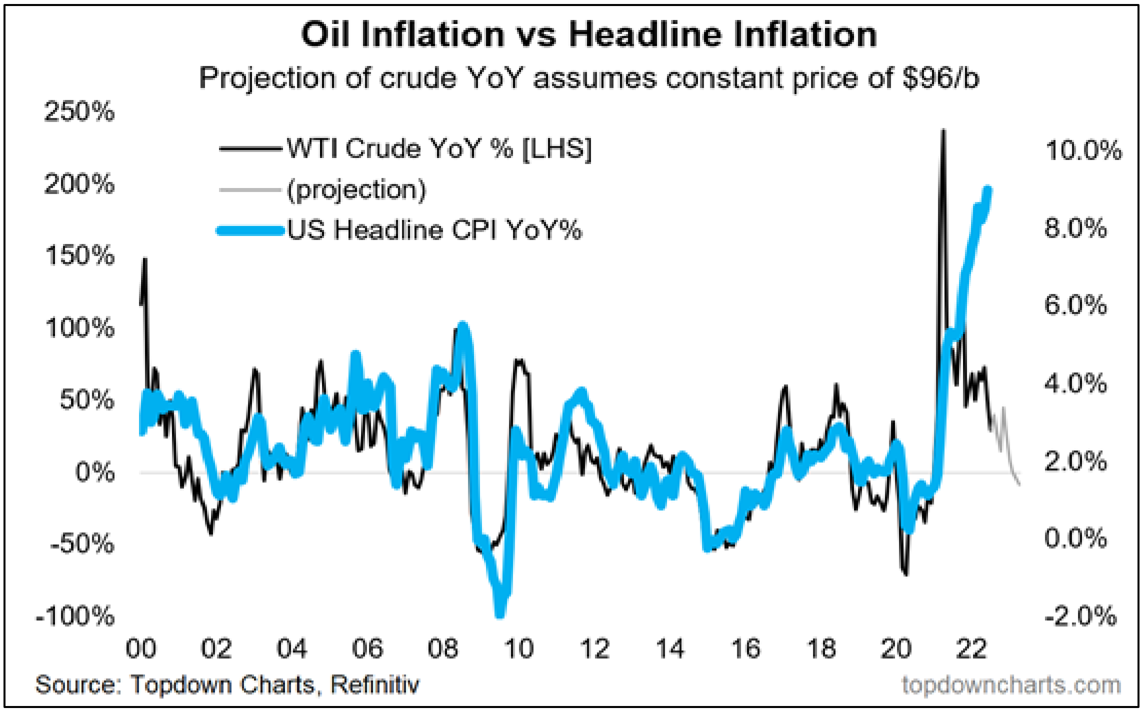
With global supply chain issues continuing to ease amid initial signs of demand destruction, many commodity prices have started to ease.

Energy and industrial metals have taken a beating as global growth concerns have intensified.

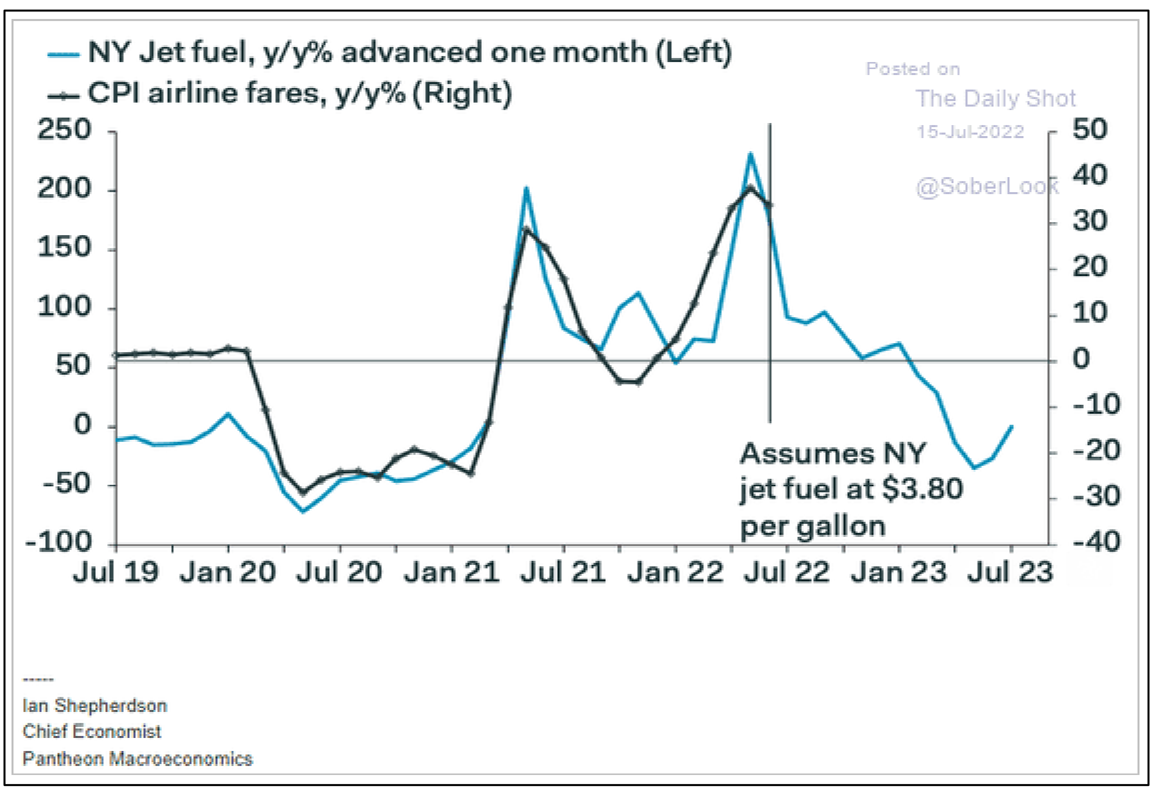


Given that the last high inflation print was largely driven by the recent jump in energy prices, there is hope that we will see a meaningful improvement in the coming months as those prices have started to fall.

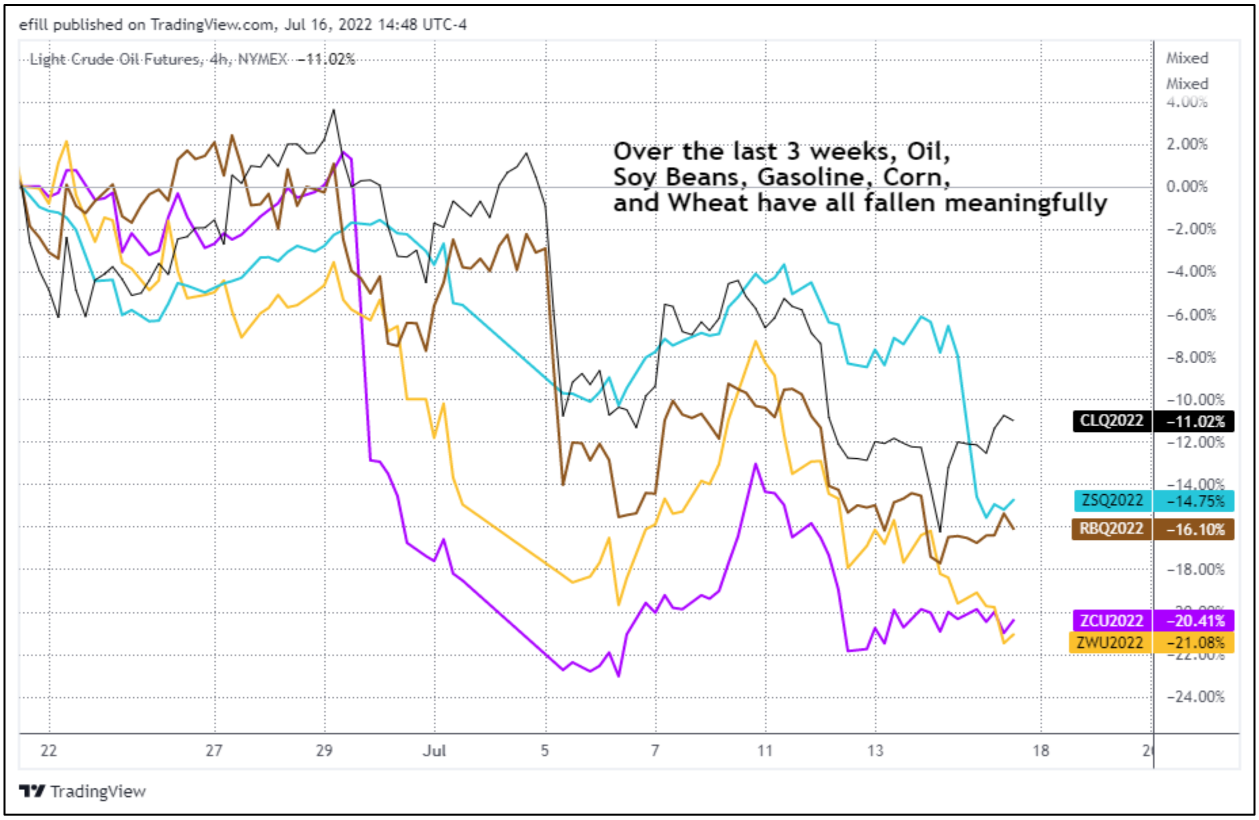
Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649



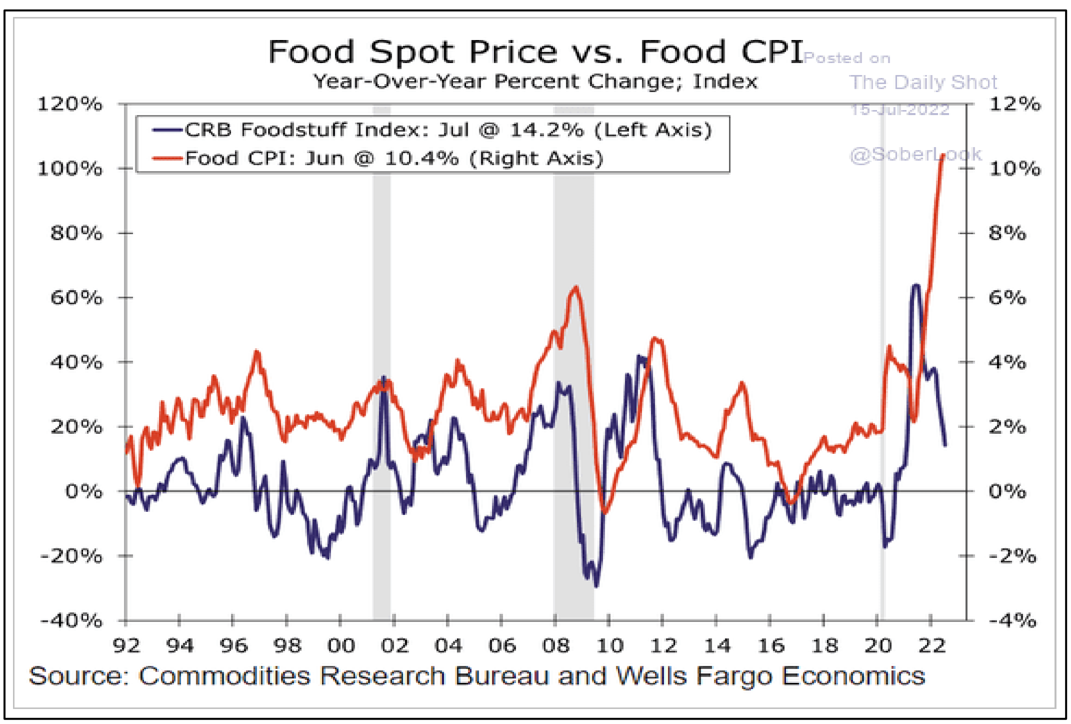
Energy prices leak into core inflation numbers as they directly affect input costs for things like airline fares.



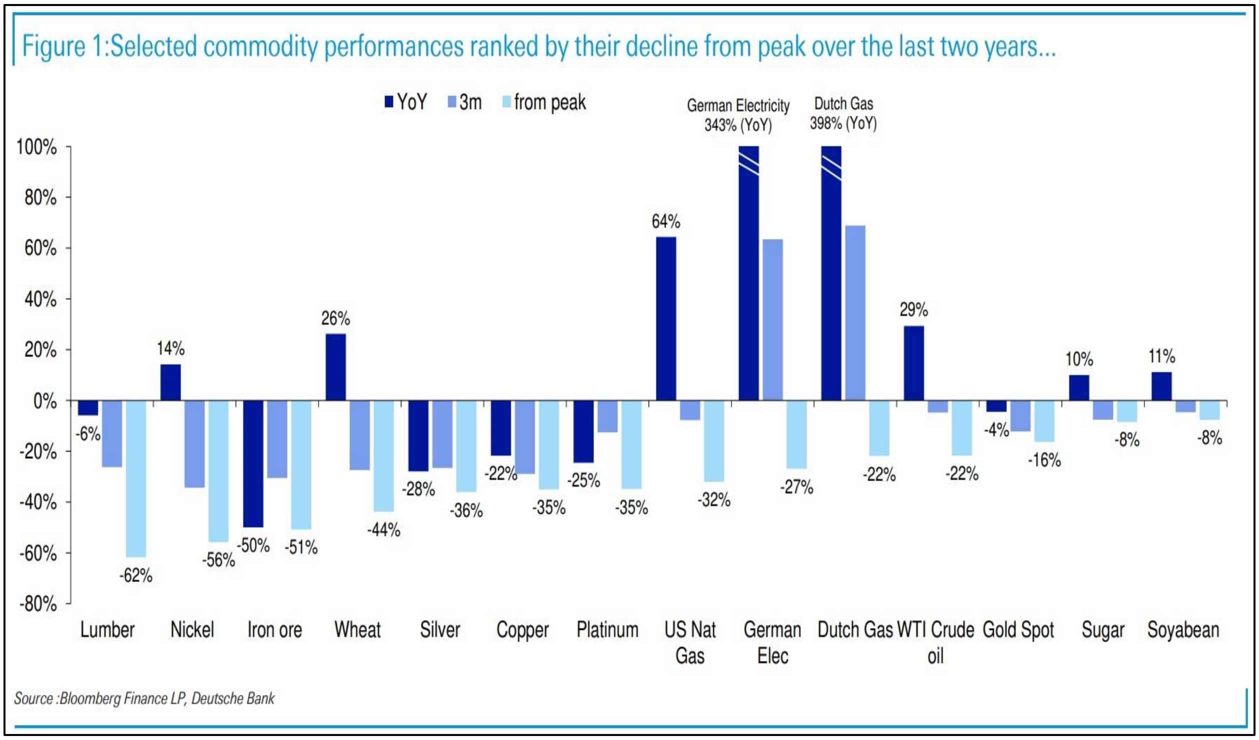
The story for food is much the same as prices of wheat, corn, and soybeans have been hit hard.



The food component in CPI should start to fall soon.



The commodity decline has become very widespread.



As El-Erian remarked on Twitter last week:

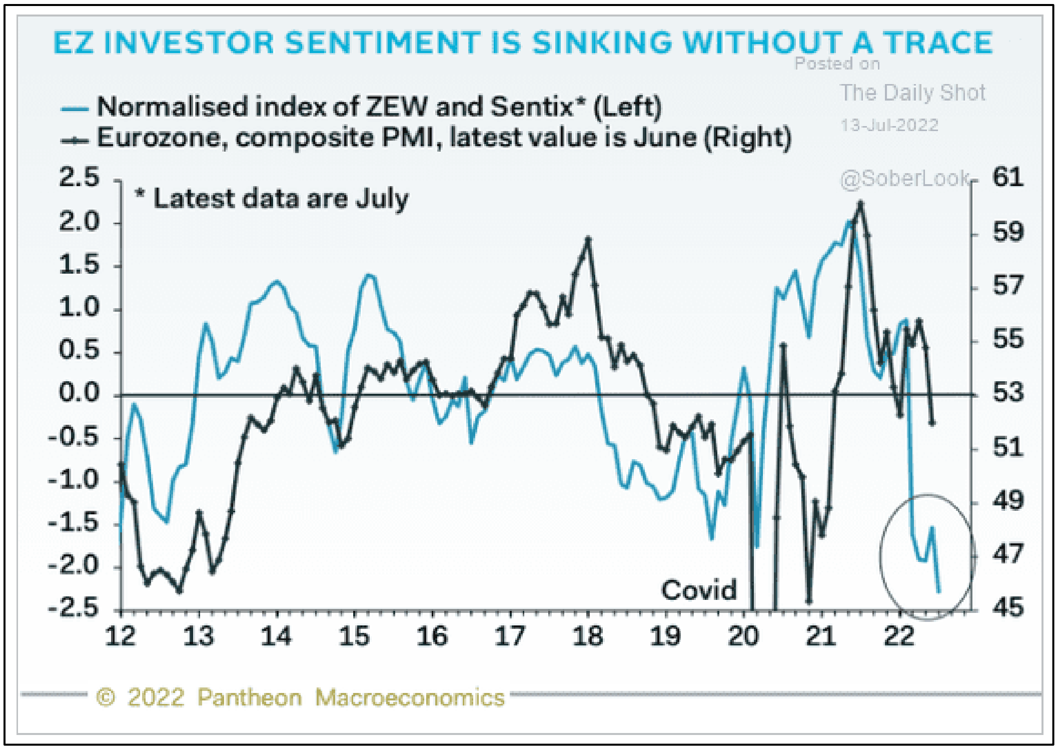
"Good news: Commodity prices pivot from inflationary to dis-inflationary. Bad news: Other drivers of inflation are broadening. Makes forecasting beyond 3 months (lower inflation) tricky, with the possibility of a rebound thereafter."

ECB

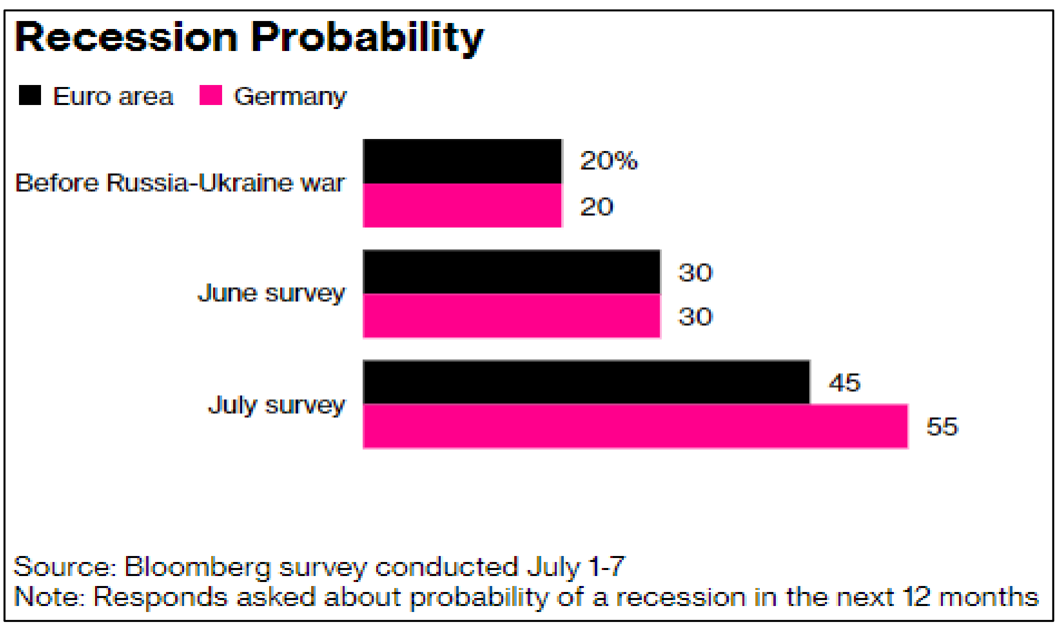
Markets expect a 25bp hike on Thursday leaving the deposit rate at -25bps, arguably still disturbingly low given the inflation backdrop.

The big question for investors is what happens after that? With real wages falling and Russian energy supply shocks potentially leading to rationing, German and indeed sentiment across Europe has been plunging. The ZEW German investor morale fell to -53.8 last week, below even the March 2020 pandemic lows. Now add heightened concerns about "fragmentation" as an unstable coalition in Italy has led to the attempted resignation of Prime Minister Mario Draghi, seen as a pillar of stability, representing European unity of purpose. Insiders say he is determined to resign, while many in government, business, and labor are asking him to stay. He is due to address Parliament on Wednesday, the day before the ECB meets. These are trying times for the ECB and Ms. Lagarde.

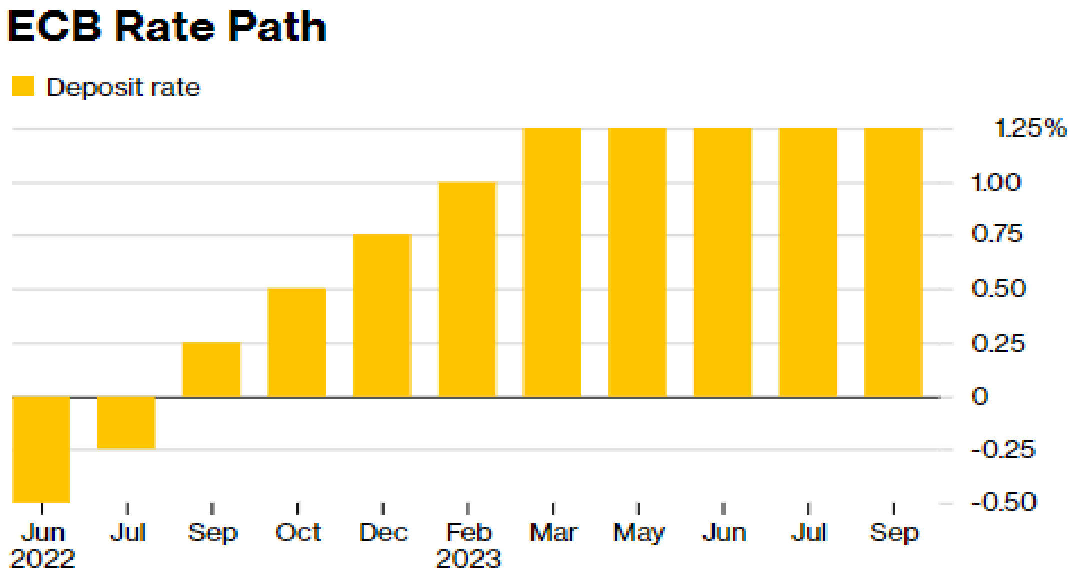
The sentiment is deteriorating quickly. Will PMIs follow?



A recession is being increasingly priced.

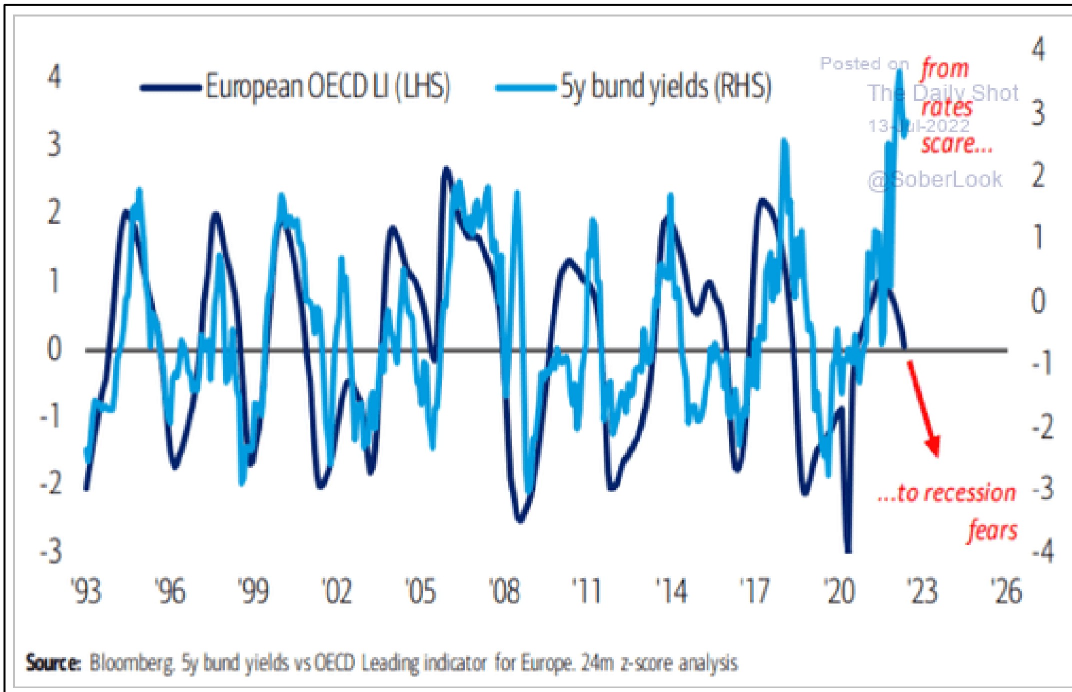


I have serious doubts that the ECB will be able to enact the hikes that are expected after initial lift-off.



Source: Bloomberg survey conducted July 1-7
Note: No rate decisions in August, November 2022, January, April, August 2023

Leading indicators are also pointing to a lower terminal rate.



Source: BofA Global Research; III Capital Management

Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649

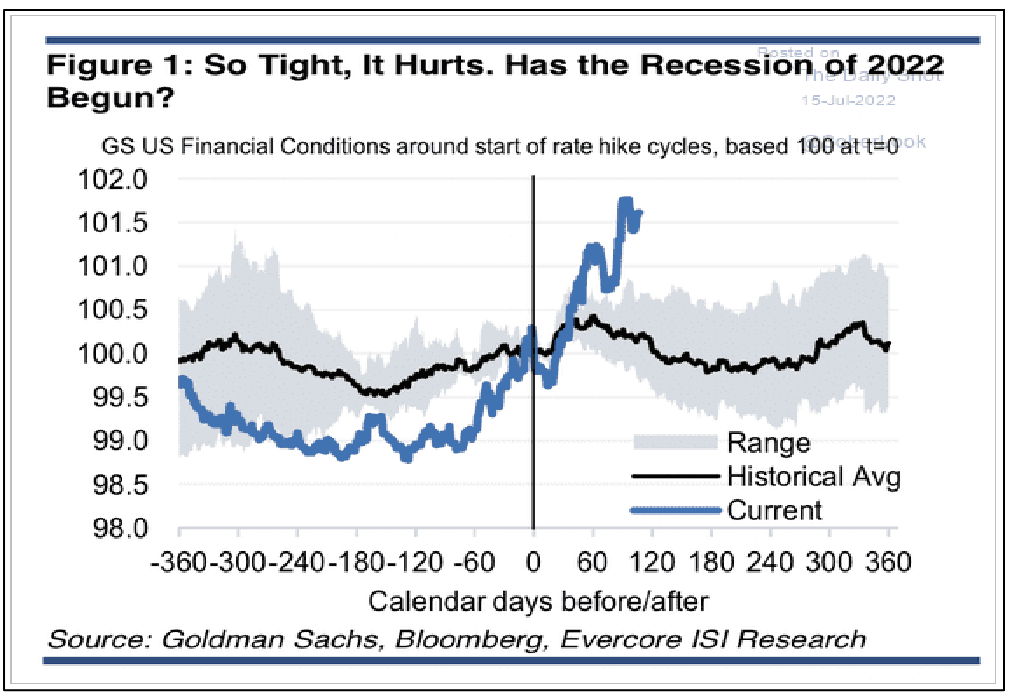
China – Continued growth concerns are only adding to global growth worries and general EM underperformance. China again announced measures to increase fiscal support but so far hasn't had much to show for previous efforts.

Bloomberg summed up the current situation well:

> *"China's economy grew at the slowest pace since the country was first hit by the coronavirus outbreak two years ago, making Beijing's growth target for the year increasingly unattainable as economists downgrade their forecasts further. Goldman Sachs Group Inc. cut their 2022 growth forecast for China to 3.3% from 4%. The country has been beleaguered by the "Zero Covid" policy of virus suppression. There is little sign the policy will soon be dropped, with parts of Shanghai still in lockdown even as cases stabilize. Separately, China's banks have detailed 2.11 billion yuan ($312 million) of loans at risk to the increasing number of homebuyers refusing to pay mortgages on unfinished homes."*

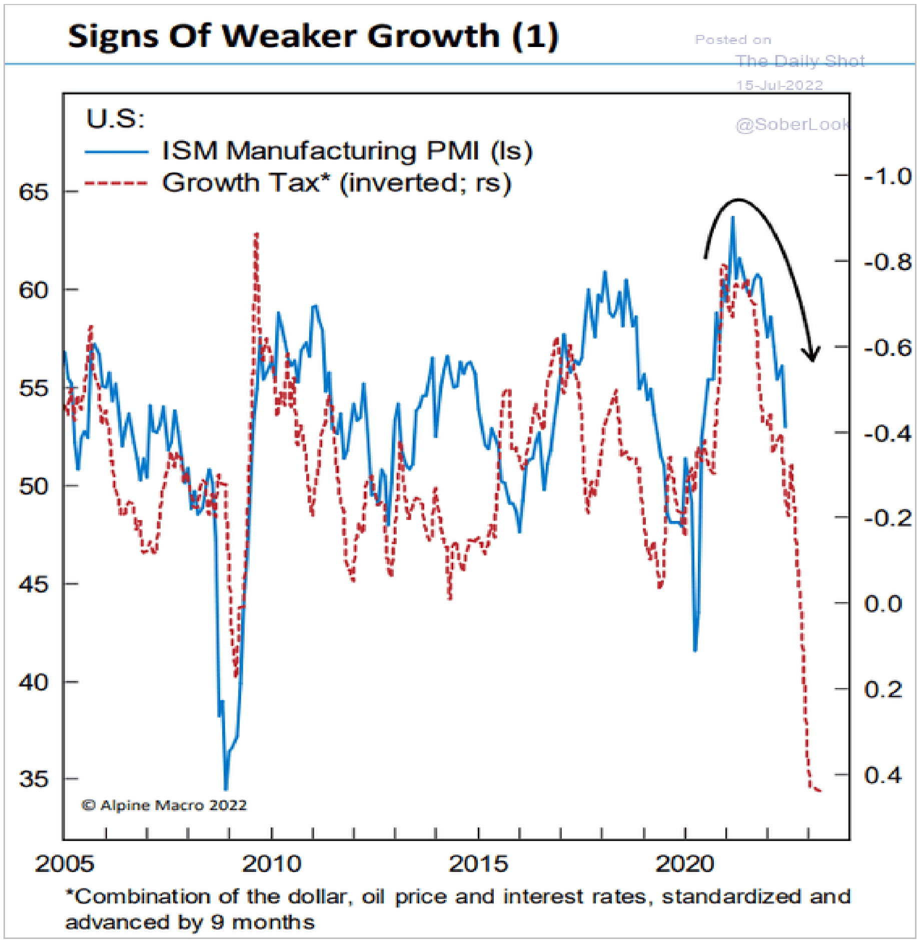
US Economy

As discussed before, the tightening of financial conditions we have experienced in this cycle has been faster and more pronounced. We will see if the output matches the input.



Stargazer
Asset Management

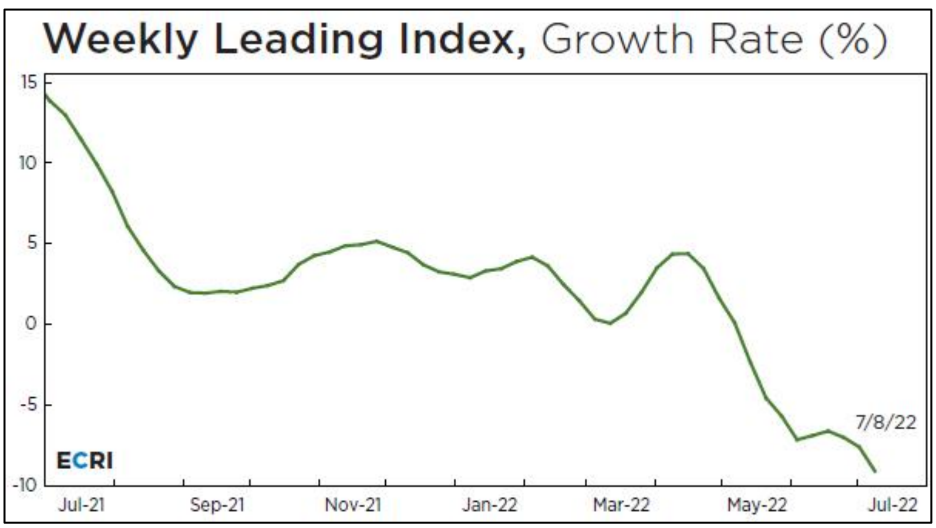
Alpine Macro's "growth tax" is another form of financial conditions that includes not only interest rates and the dollar, but also oil prices. The economy reacts with a lag.



*Combination of the dollar, oil price and interest rates, standardized and advanced by 9 months

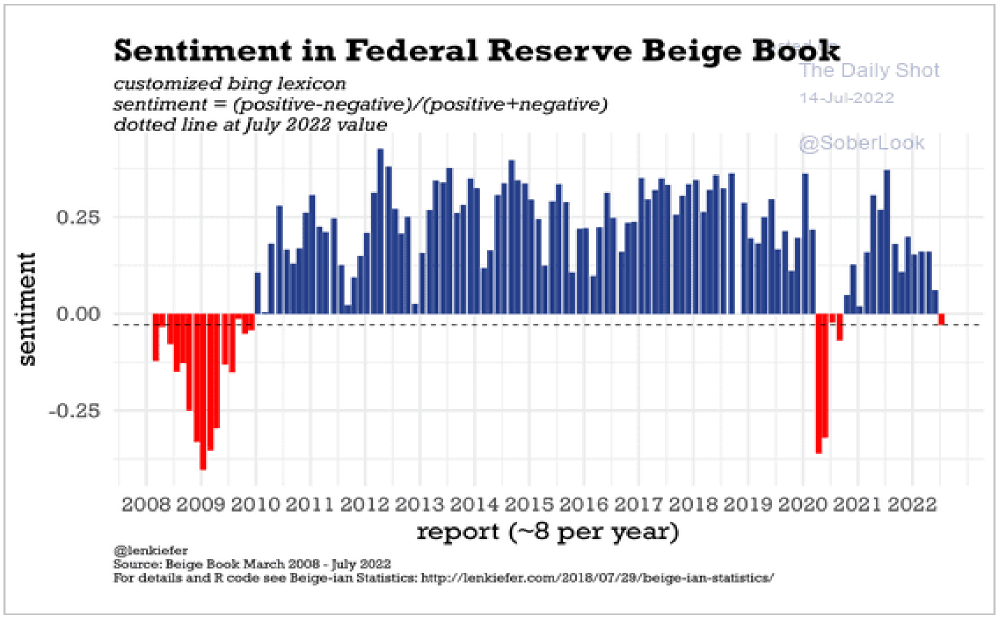
Source: Alpine Macro

ECRI's weekly Leading Index is making new lows.



Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649

Sentiment in the Fed's Beige book is now negative, something generally reserved for recessions.

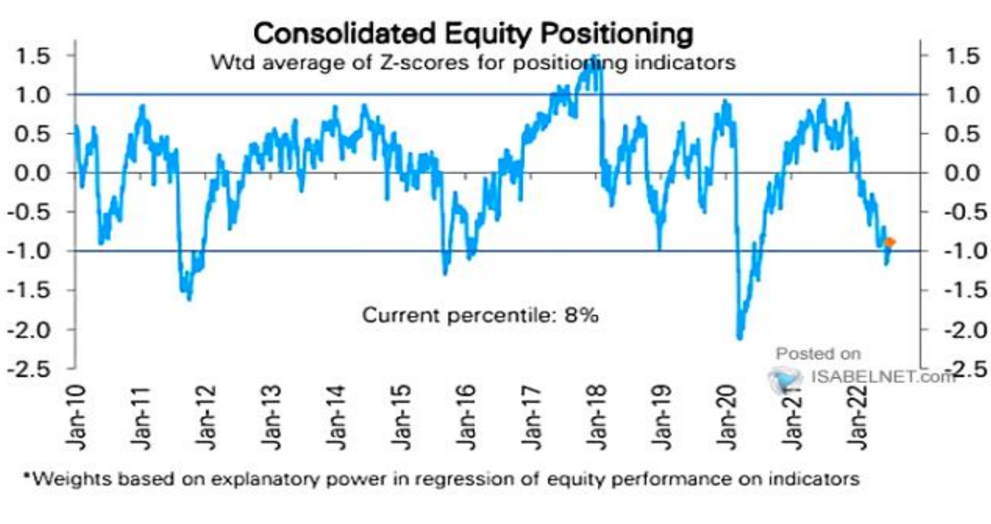


Source: @lenkiefer

We will see if the drop in commodities we are seeing can have a positive effect on sentiment and markets in the coming weeks and months as inflation fears are taken down a notch and markets think about a slowing in the pace of hikes. The flip side would be a stagflationary outcome.

Equities - With institutional investors having raised cash and cut positions, markets are certainly primed for a squeeze higher if FOMO kicks in.

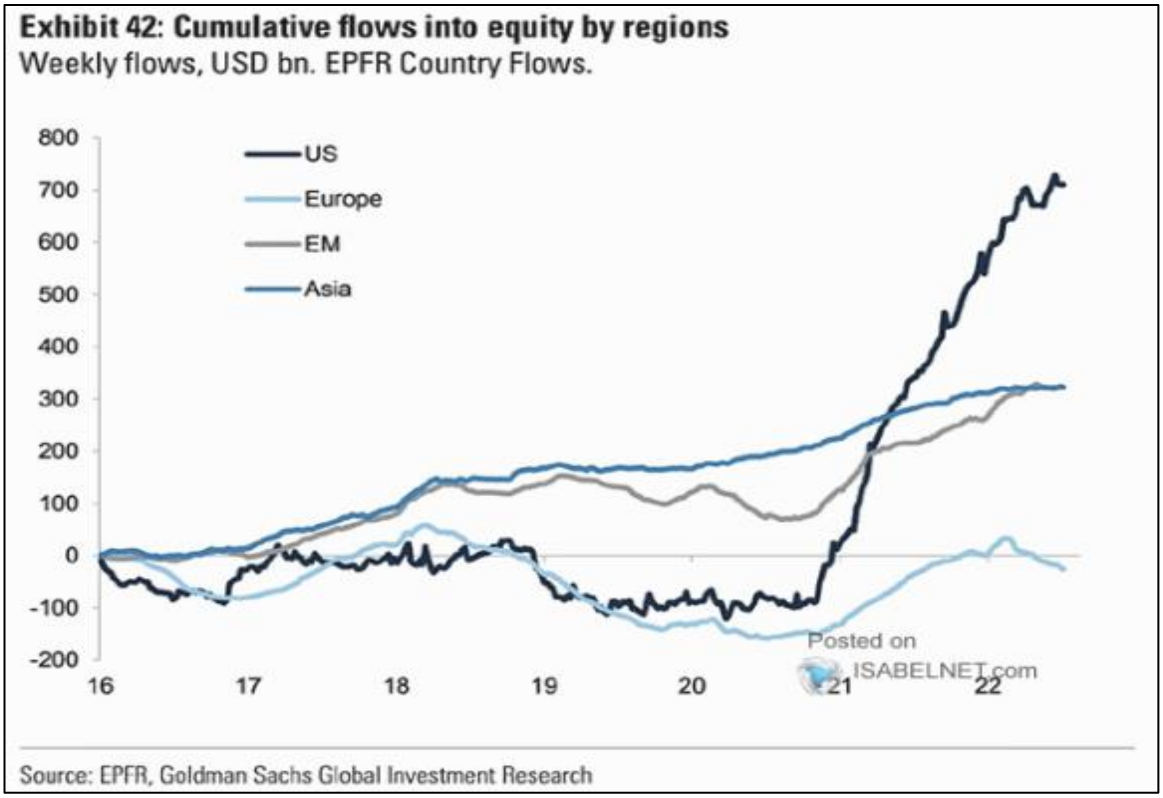
Figure 1: Consolidated equity positioning[1]



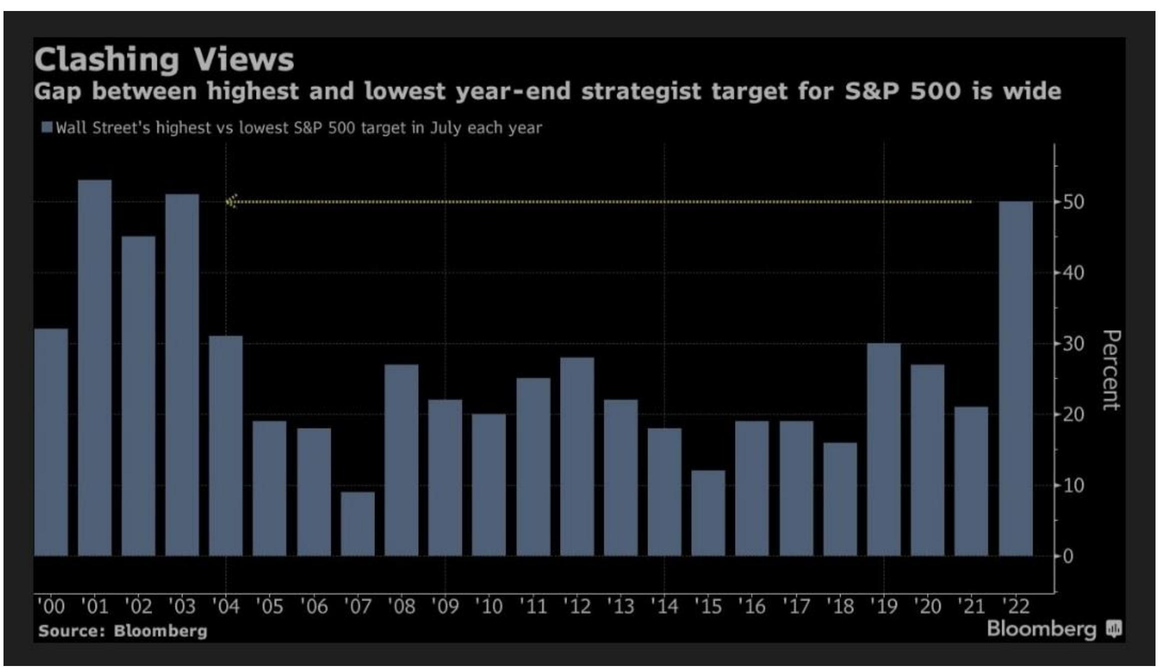
*Weights based on explanatory power in regression of equity performance on indicators

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

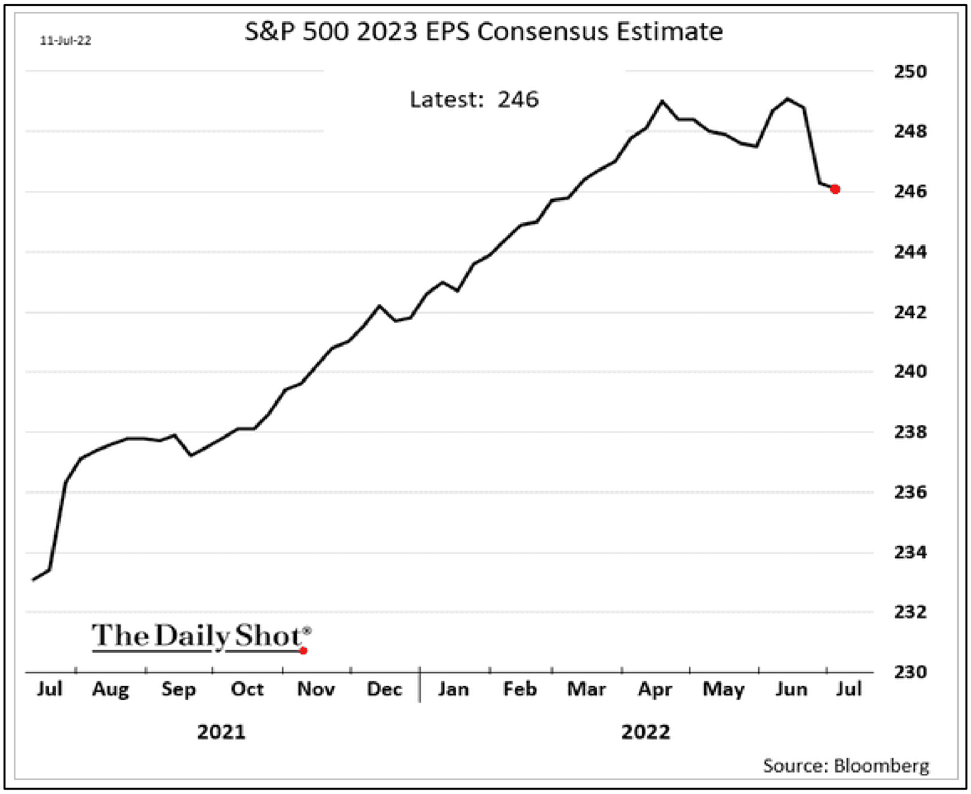
However, overall flows into US equities are near the highs.



Equity strategists are all over the place in terms of where they think equities finish the year as uncertainty continues to loom large.



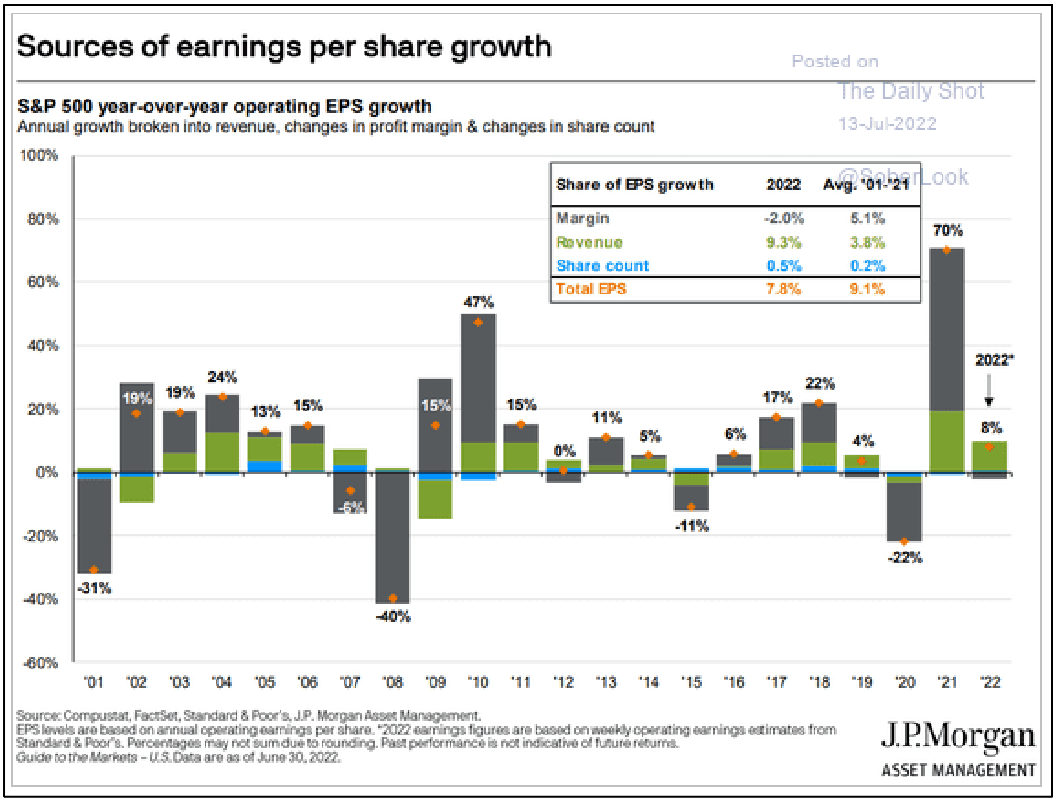
However, earnings estimates are only now starting to really be revised downward.



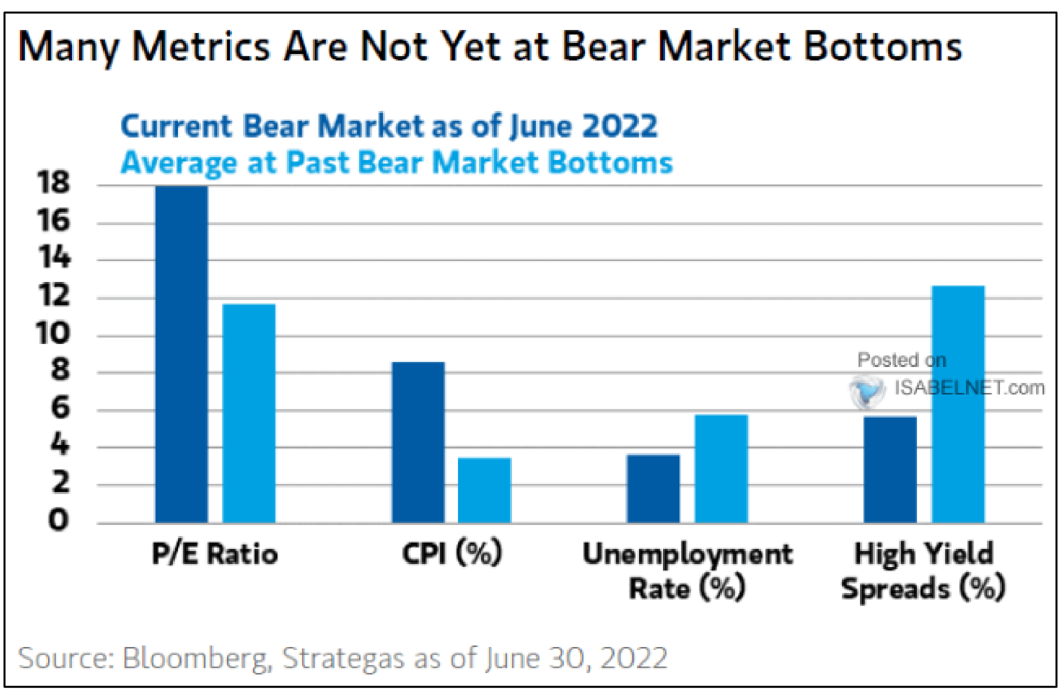
Financial conditions via the USD rally, are not helping.

Stargazer
Asset Management

Margins, fantastic in 2021, are now a concern.

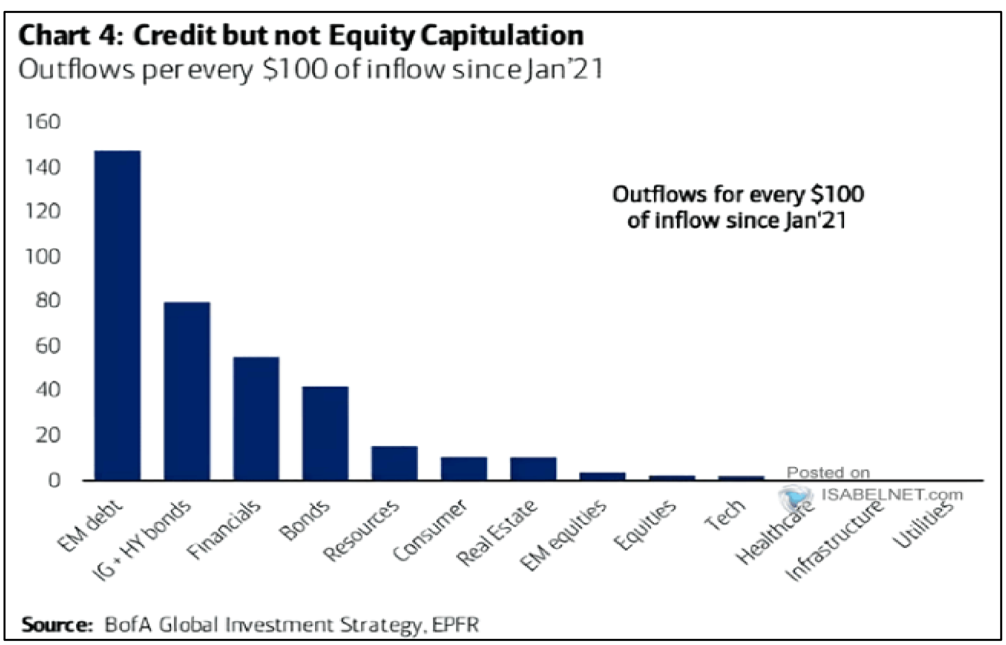


Unless inflation comes off much quicker than now expected, rallying markets, we haven't hit the extremes one usually sees at lasting lows.



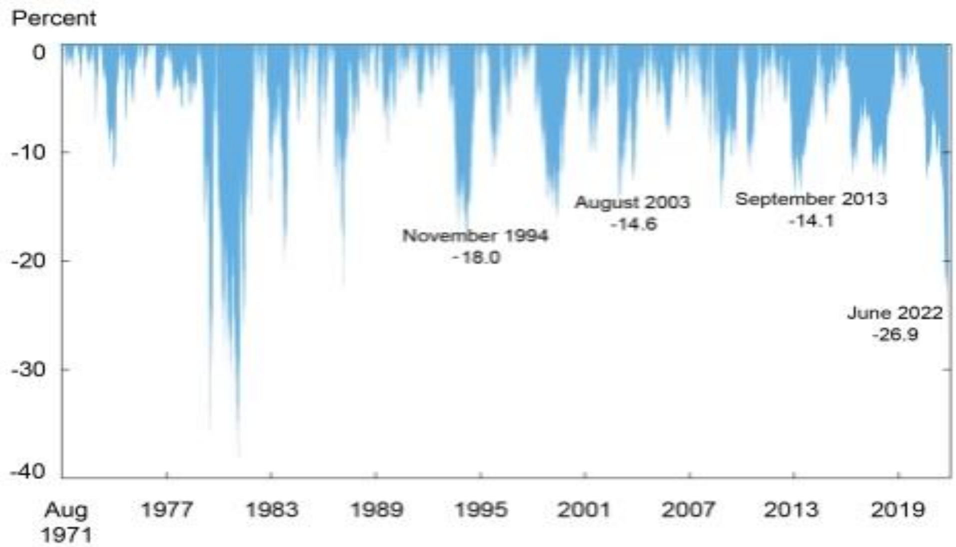
YTD performance divergence of the sectors means that active rotation has been effective.

The real capitulation has been in fixed income.



FI – This selloff has been painful. This chart plots the cumulative return of a hypothetical 10-year, zero-coupon Treasury bond during selloffs back to 1971.

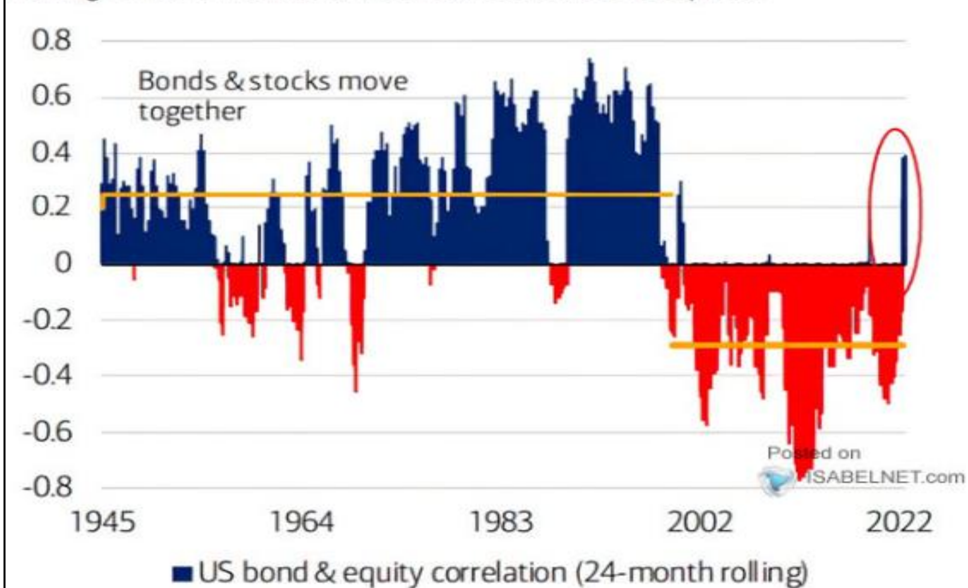
Current Selloff Is Greater than Those Seen in 1994, 2003, and 2013



Source: Authors' calculations, based on data from Gurkaynak, Sack, and Wright (2006).
Note: The chart plots the cumulative returns on a hypothetical ten-year, zero-coupon Treasury bond during bond market selloffs, as defined in the text, between August 16, 1971 and June 17, 2022.

Correlations for stocks and bonds are back to the pre 1998 modus operandi.

Exhibit 18: Bonds don't hedge equities in an inflationary world
Rolling 24 month correlation between US bonds and equities



Source: BofA Research Investment Committee, Global Financial Data

Balanced funds and risk parity funds have had an unusually tough time as a result.

With the inversion picking up steam and duration very short is the long end due for a rally?

Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649

I think we are getting close. The question is how much of a topping process do we need? Is a spike high already in? Last week's good price action despite the high CPI and PPI prints might support that view. Or does the top become more of a process like it was in 2018?

FX

The dollar has done some heavy lifting recently and looks a little tired vs DM currencies. However, for now the trend remains in place with only a little initial loss of momentum, so far. We will see how this develops.

EM has seen some very violent moves in COP, CLP, PHP. We will see if that was some kind of USD blowoff or a warning that the dollar is starting to break things.

I think it would be very worrying for global growth if the dollar were to push on from here and bonds start to rally.

Exhibit 2: Increases in the Rate of Change of the Dollar to this Magnitude Typically Coincide with Periods of Market Stress

DXY has been relentless.

Stargazer
Asset Management

Important Macro Data Releases and Events for the Week

Monday 7/18/2022		RBA Meeting Minutes
Tuesday 7/19/2022		UK Employment Data
		Bank Lending Survey and HICP
		Building Permits and Housing Starts (Jun)
		Interest Rate Decision
Wednesday 7/20/2022		UK Inflation data CPI and PPI
		CPI (Jun)
		Consumer Confidence (Jul)
		BoJ Interest Rate Decision, Policy Statement, and Press Conference
Thursday 7/21/2022		**ECB Interest Rate Decision, Policy Statement, and Press Conference**
		Initial Jobless Claims
		Initial Jobless Claims 4-week average
		Continuing Jobless Claims
Friday 7/22/2022		**PMIs across Europe and the US (prel Jul)**

Disclaimer

This document and its contents are confidential to the person(s) to whom it is delivered and should not be copied or distributed, in whole or in part, or its contents disclosed by such person(s) to any other person. Any party receiving and/or reviewing this material, in consideration therefore, agrees not to circumvent the business proposals explicitly or implicitly contained herein in any manner, directly or indirectly. Further, any recipient hereof agrees to maintain all information received in the strictest confidence and shall not disclose to any third parties any information material to the opportunity contained herein and, upon review hereof, agrees that any unauthorized disclosure by any party will result in irreparable damage for which monetary damages would be difficult or impossible to accurately determine. Recipients recognize, and hereby agree, that the proprietary information disclosed herein represents confidential and valuable proprietary information and, therefore, will not, without express prior written consent, disclose such information to any person, company, entity or other third party, unless so doing would contravene governing law or regulations. This document is an outline of matters for discussion only.

This document does not constitute and should not be interpreted as advice, including legal, tax or accounting advice. This presentation includes statements that represent opinions, estimates and forecasts, which may not be realized. We believe the information provided herein is reliable, as of the date hereof, but do not warrant accuracy or completeness. In preparing these materials, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources.