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What to focus on in Global Macro for the week of March 23rd, 2020

Macro Themes on the Radar:

Global Central Banks and Governments are throwing everything and the kitchen sink at the coronavirus induced economic "sudden stop". The Administration is now talking up to 10-12 weeks of lockdown.

The monetary and fiscal stimulus headlines are coming so fast that they are hard to keep track of and are now so numerous that it would take multiple pages to list them all.

Suffice it to say they take a few different forms:

Central Banks

- Rate cuts
- QE (expanded instruments)
- Liquidity provisions (Repo, CPFF, PDCF, etc.)

Governments

- Fiscal stimulus (running at 4-10% of GDP, depending on the country)
  - Small business support and loans (Mnuchin talking $4T on Sunday)
  - Cash for consumers
  - Assistance to healthcare providers
  - Assistance to States and regions in dealing with the crises
  - Bailouts for companies either via loans or equity stakes

This is unprecedented fiscal stimulus in terms of both size and scope and is historically outsized, partially because we have hit the limits of what CB's are now able to accomplish with their remaining tools.

The current situation is unlike any seen before, in that there is a matrix representing the cost of the disease vs. the cost of the prophylactic that is being priced. As the path here is so uncertain and government reaction so overwhelming, the recessionary outcome will be a function of how the governments react both in terms of lockdowns and the spending designed to fill the hole those policies inevitably bring.

On one hand we risk an out of control public health crises, on the other the possibility that the medicine is worse than the disease.

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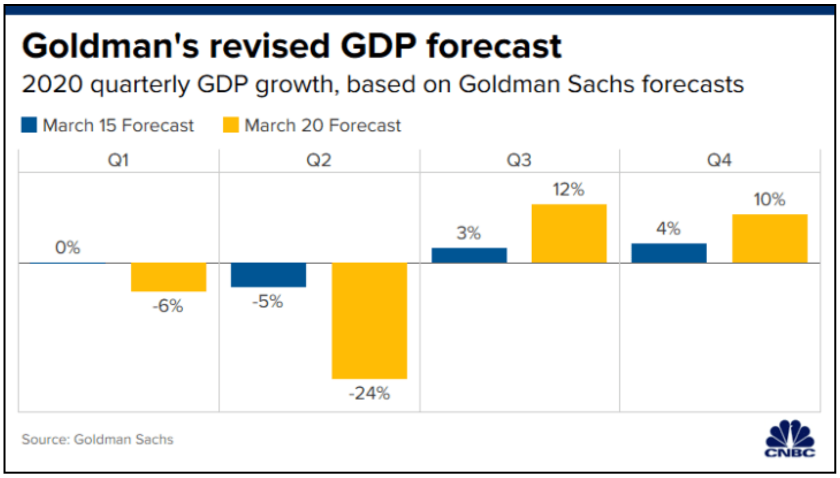
In the meantime, growth forecasts are falling rapidly. The hope is still that we get a V or U recovery, but it may be deeper than first thought.



Two quick examples of how extraordinary the fiscal and liquidity adds are…

Even Germany has come to the fiscal spending table. Their balanced budget commitment known as “Schwarze Null” (black zero) has become another victim of the virus. They are set to unveil a EUR 600B bailout fund to deal with the economic fallout. Considering the size of the relative economies, that would be like the US doing nearly $3.5T.

Not to be outdone, the Fed and Congress continue to ratchet up their level of commitment on an almost daily basis. The Administration is now talking $2T in assistance. The Fed has committed to continued liquidity provisions that are astounding in size. If fully utilized the term repo alone could amount to over $6T. The commercial banks have been encouraged to borrow at the Discount Window without the usual stigma and the Primary Dealers are being provided liquidity via the Primary Dealer Credit Facility. The PDCF was first set up in 2008 and was reactivated on Friday.

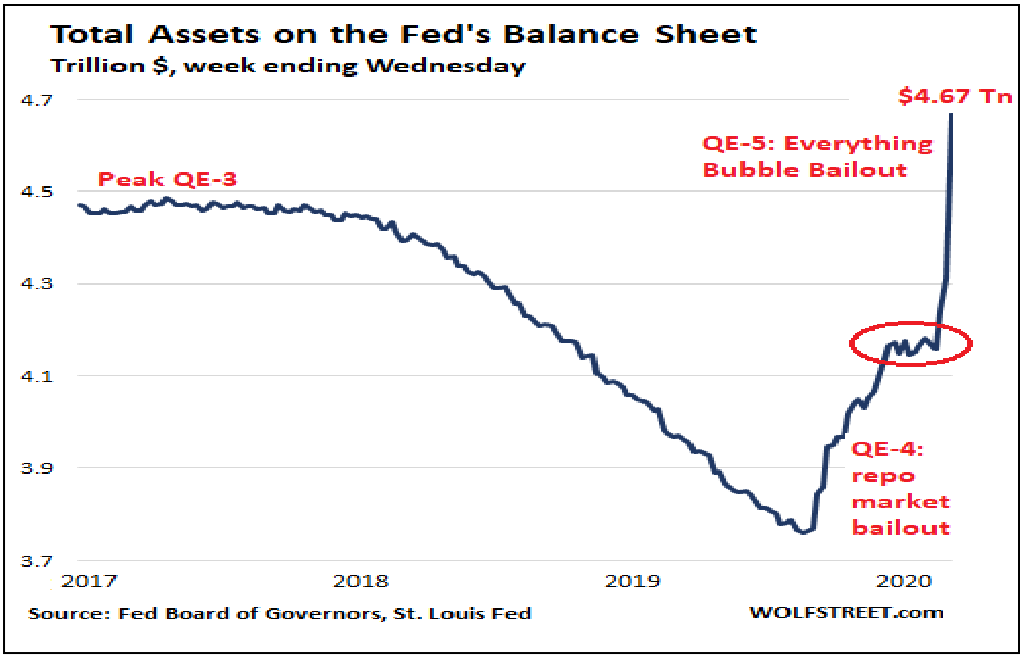
The list of collateral accepted into the PDCF is very broad…

“Collateral eligible for pledge under the PDCF includes all collateral eligible for pledge in open market operations (OMO); plus investment grade corporate debt securities, international agency securities, commercial paper, municipal securities, mortgage-backed securities, and asset-backed securities; plus equity securities. Foreign currency-denominated securities are not eligible for pledge under the PDCF at this time.”

Here is the term sheet from the Fed if you are interested.

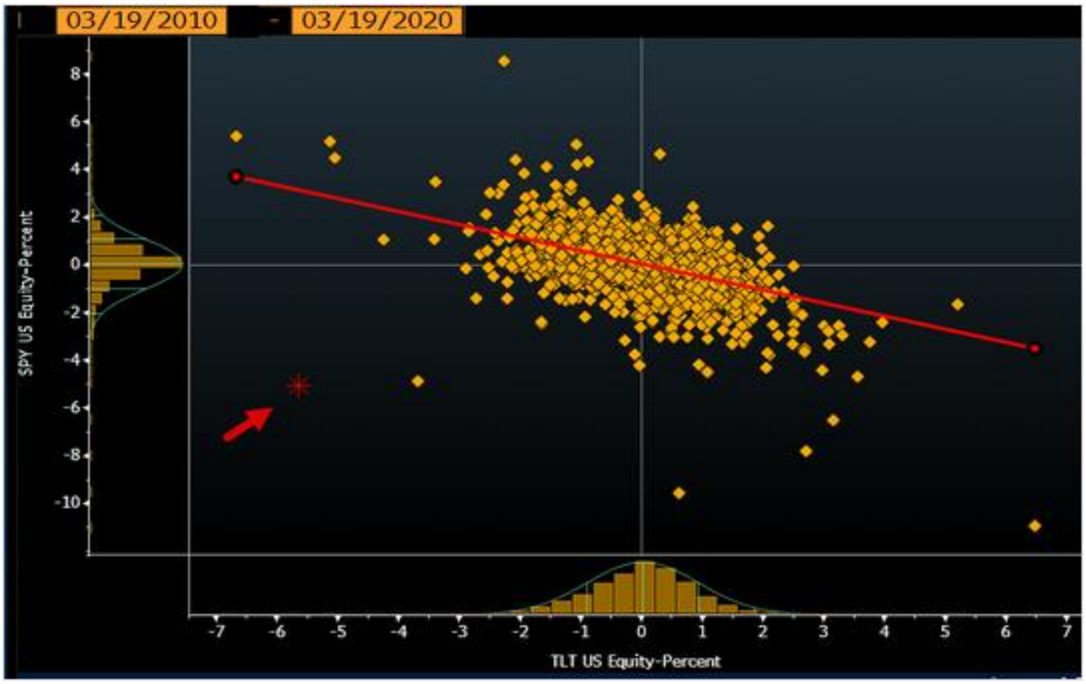
The PDCF essentially allows Primary Dealers to buy individual equities and immediately pledge them to the Fed. Note that the Fed is not allowed to buy them outright. Wild stuff.

With all this, and I am sure even more to come, what will happen to the Fed's balance sheet over the next few months? Will we go from the current $4T+ to $10T? $20T?



With massive government debt being issued globally, bond markets have been caught in the crossfire of increased issuance and portfolio liquidation. The correlations assumed by many of the most popular investment strategies like Balanced (60/40) and Risk Parity strategies have broken down in recent days. Stocks and Bonds are not supposed to go down together.

SPY vs. TLT



Most models assume interest rates go down in a recession. Usually, you get a steeper yield curve once the Fed starts cutting because front end rates fall faster than long end rates … what if it steepens because long rates go up?

Could we end up with Yield Curve Control in the G7?

If it did come to that, the FX market would become the pressure-relief valve.

Normally, these would be scenarios so outlandish that they aren't worth contemplating. However, outlandish scenarios are unfolding every day, so you need to keep an open mind.

Europe

Here is a table that gives a nice summary of where the jump off point is for the largest economies going into the outbreak.

It highlights what poor shape Europe was already in. Italy in particular had the painful combination of high Debt/GDP, no growth and high unemployment. Spain was close behind. Germany is going to have to take on a big load if the Eurozone is going to survive this intact.

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COUNTRIES	GDP	GDP YoY	GDP QoQ	Interest rate	Inflation rate	Jobless rate	Gov. Budget	Debt/GDP	Current Account	Population
United States	21200	2.30%	2.10%	0.25%	2.30%	3.50%	-4.60%	106.90%	-2.30	329.13
China	14200	6.00%	1.50%	4.05%	5.20%	3.62%	-4.20%	50.50%	0.40	1400.05
Euro Area	14000	1.00%	0.10%	0.00%	1.20%	7.40%	-0.50%	87.90%	3.10	341.90
Japan	5110	-0.70%	-1.80%	-0.10%	0.40%	2.40%	-3.80%	238.20%	3.50	126.01
Germany	4040	0.40%	0.00%	0.00%	1.70%	3.20%	1.50%	61.90%	7.60	83.20
United Kingdom	2910	1.10%	0.00%	0.10%	1.80%	3.90%	-1.80%	80.80%	-4.30	66.65
France	2890	0.80%	-0.10%	0.00%	1.40%	8.10%	-2.50%	98.40%	-0.60	66.98
India	2800	4.70%	1.10%	5.15%	6.58%	7.80%	-3.34%	69.62%	-2.10	1312.24
Italy	2030	0.10%	-0.30%	0.00%	0.30%	9.80%	-1.60%	134.80%	2.60	60.36
Brazil	2020	1.70%	0.50%	3.75%	4.01%	11.20%	-7.10%	77.22%	-0.77	210.15
Russia	1750	1.70%	0.80%	6.00%	2.30%	4.60%	1.80%	14.60%	7.00	146.80
Canada	1740	1.70%	0.10%	0.75%	2.20%	5.60%	-0.70%	89.70%	-2.60	37.78
South Korea	1690	2.30%	1.30%	0.75%	1.10%	3.30%	-1.60%	36.60%	4.70	51.71
Spain	1460	1.80%	0.50%	0.00%	0.70%	13.80%	-2.50%	95.50%	1.90	46.94
Australia	1450	2.20%	0.50%	0.25%	1.80%	5.10%	-0.60%	40.70%	-1.50	25.60
Mexico	1200	-0.50%	-0.10%	6.50%	3.70%	3.80%	-2.00%	46.00%	-0.20	126.58

What to Focus on Now:

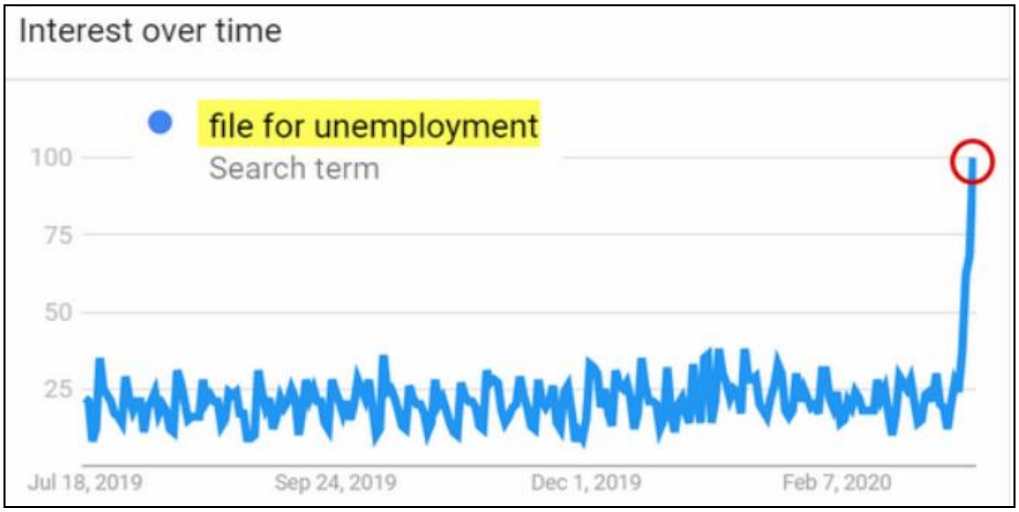
There are dislocations, liquidations and correlation breaks all over the markets.

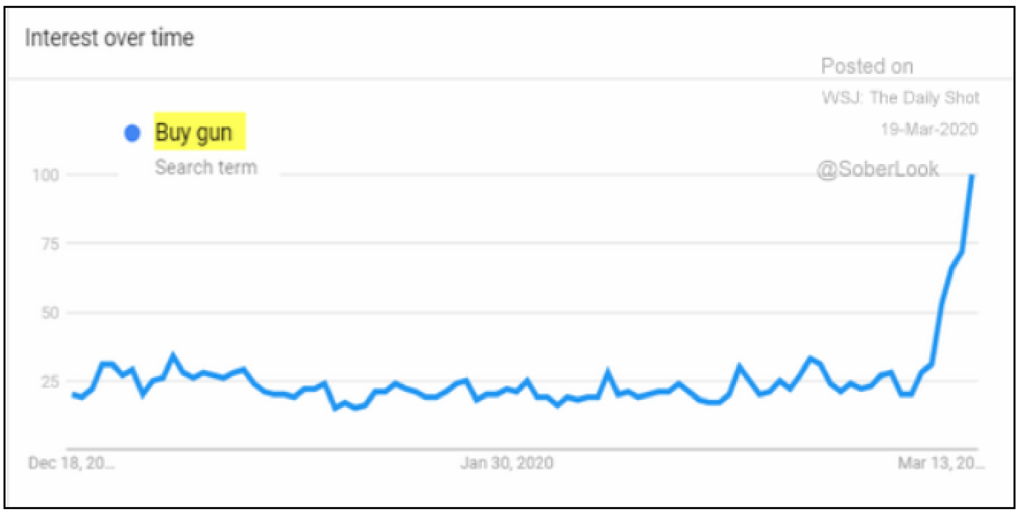
It was only 6 weeks ago that we had the bull market in everything. Now everything from equities to credit, long maturity government bonds to precious metals, have been hit. The only real winners have been T-Bill's (yields went negative last week) and the USD.

Earning expectations are quickly falling and so is sentiment. Lockdowns and fear for physical safety have continued to grow and are knocking down both supply and demand.

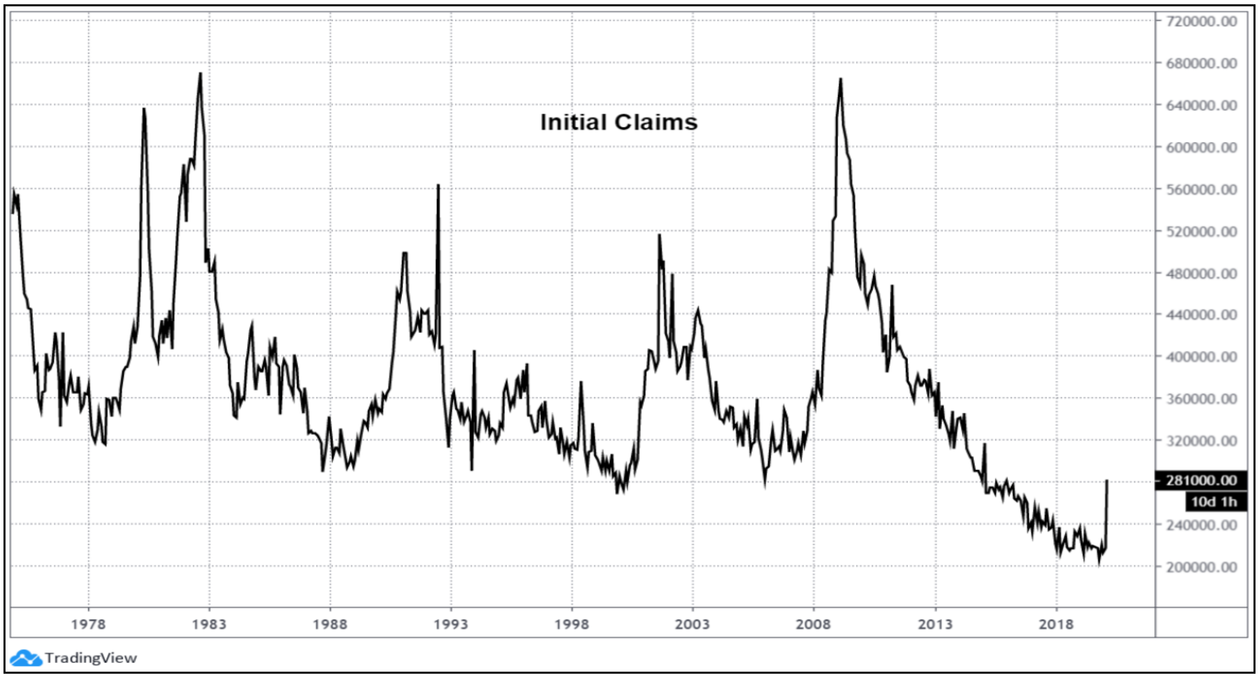
It took a while, but now people are worried.

Google searches (from Google Trends) …





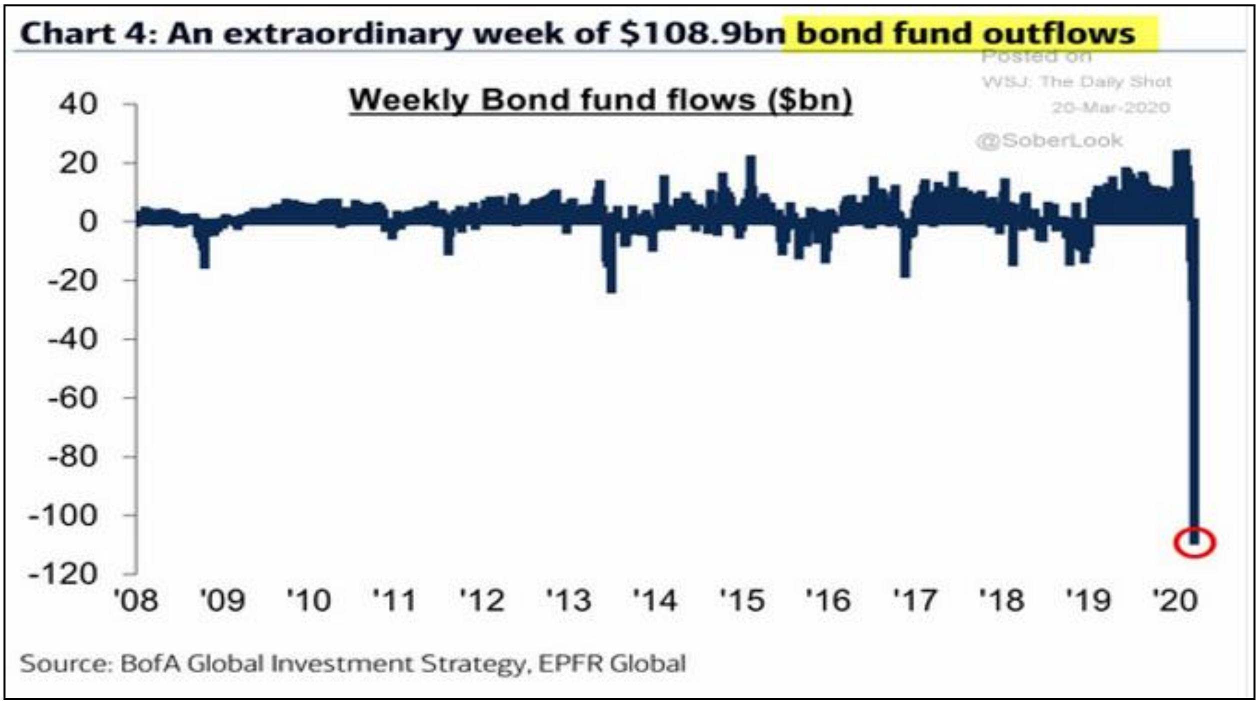
With the big jump last week in initial claims and Mnuchin and GS throwing around unemployment numbers between 6.5 and 20%, it is no wonder.



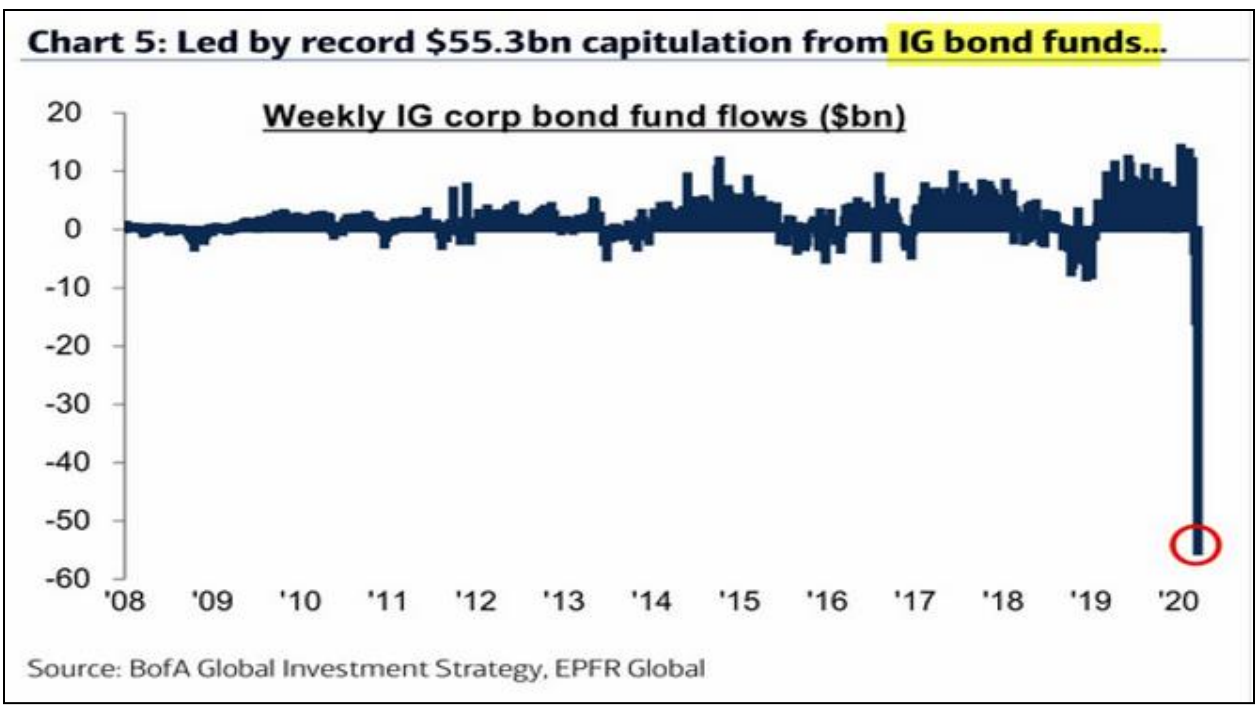
With Friday's inability to bounce yet again in equities, people are throwing out -30% calls for S&P earnings and 1,800 index targets. Everyone knows it's a buy at some point, at least for a bounce, but when? Until now it's just been about liquidation, and it has been across asset classes.

Every equity index chart looks pretty much the same.

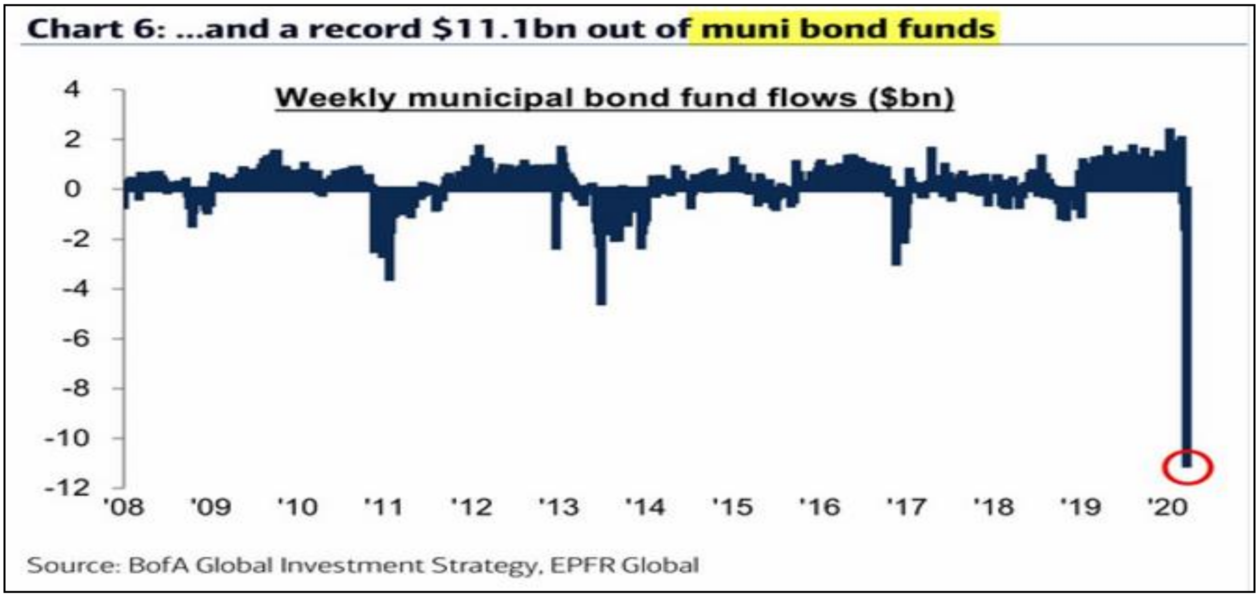
Bond flows have gone from extreme inflows to extreme outflows…



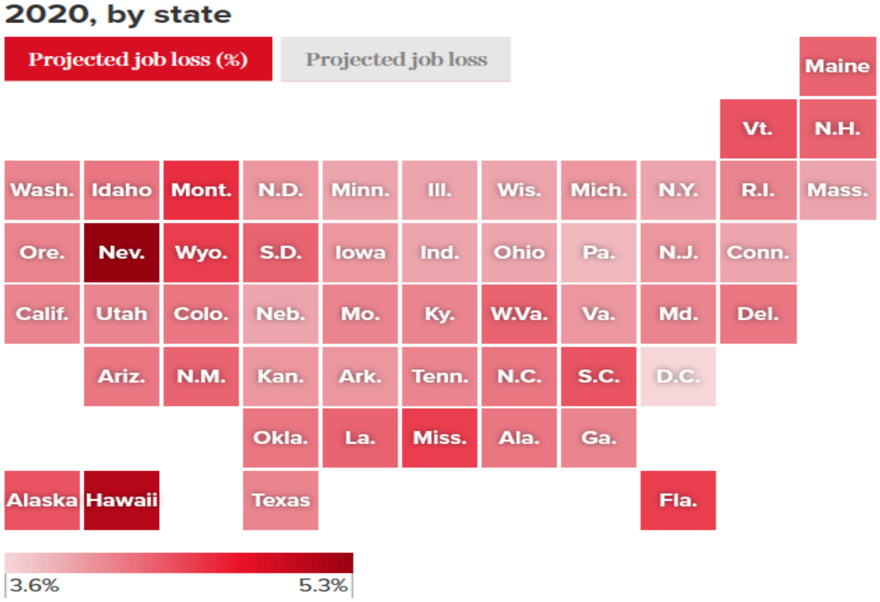
Investors have fled corporate IG and HY.



With the impending burden on Municipalities from the outbreak and the resulting downshift in economic output and tax yields, Muni's have been hit too… See most vulnerable States for jobs.



Estimated jobs lost due to coronavirus by summer 2020, by state

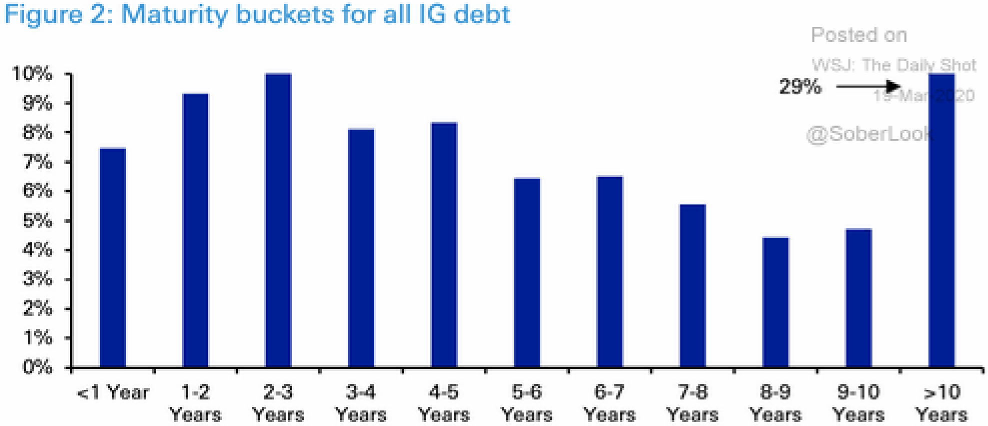


Click map to view data.

Note: Map shows employment loss consistent with a Goldman Sachs March 15 forecast of GDP growth for the first half of 2020, which assumed moderate stimulus measures are taken. Subsequent projections by other forecasters predict even steeper GDP losses that would translate into greater job losses.

On the US investment-grade corporate debt side, Deutsche Bank reports that about $500B in debt is set to mature over the next 12 months.

Figure 2: Maturity buckets for all IG debt



Source : Deutsche Bank, ICE Indices

Here is a sector breakdown.

Figure 3: IG debt maturing in next 12 months by sector

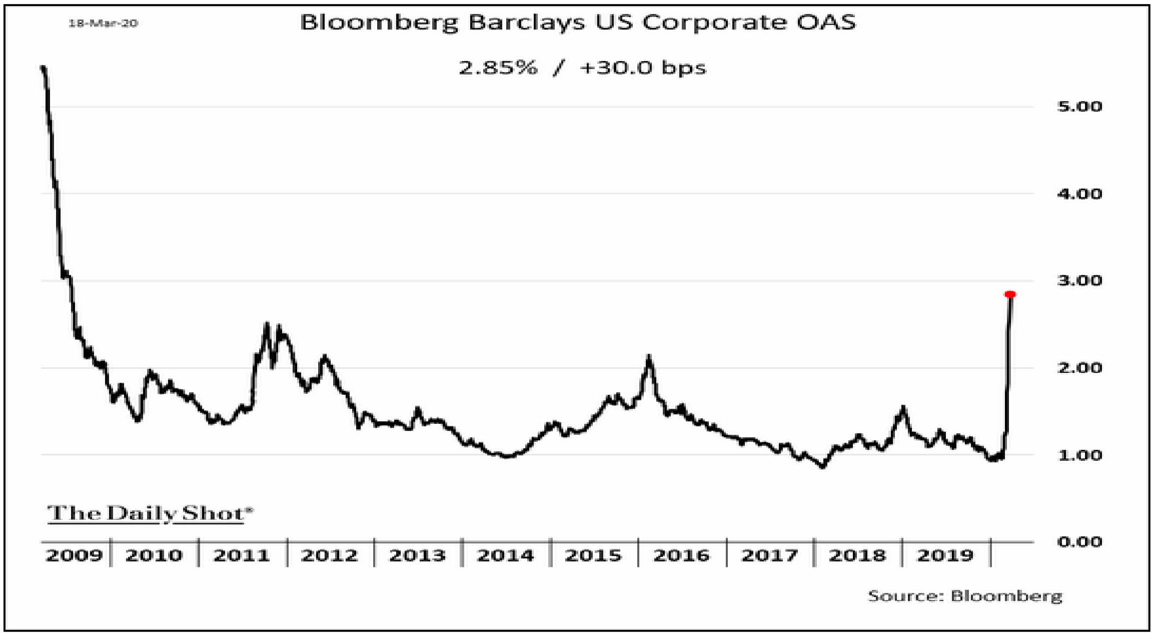
Sector	<1y Maturity	as % of Total	as % of Total Sector Debt
Banking	216,448	40.8%	12.6%
Energy	42,250	8.0%	5.3%
Technology & Electronics	38,032	7.2%	7.1%
Healthcare	32,572	6.1%	4.9%
Automotive	32,224	6.1%	15.1%
Capital Goods	30,908	5.8%	9.0%
Consumer Goods	23,800	4.5%	5.8%
Utility	23,173	4.4%	4.0%
Insurance	18,746	3.5%	6.6%
Retail	14,961	2.8%	6.7%
Basic Industry	13,243	2.5%	4.2%
Telecommunications	11,378	2.1%	4.1%
Financial Services	10,882	2.1%	5.7%
Transportation	7,461	1.4%	4.4%
Media	6,349	1.2%	3.0%
Services	3,300	0.6%	4.2%
Real Estate	3,050	0.6%	1.7%
Leisure	1,350	0.3%	4.5%

Source : Deutsche Bank, ICE Indices

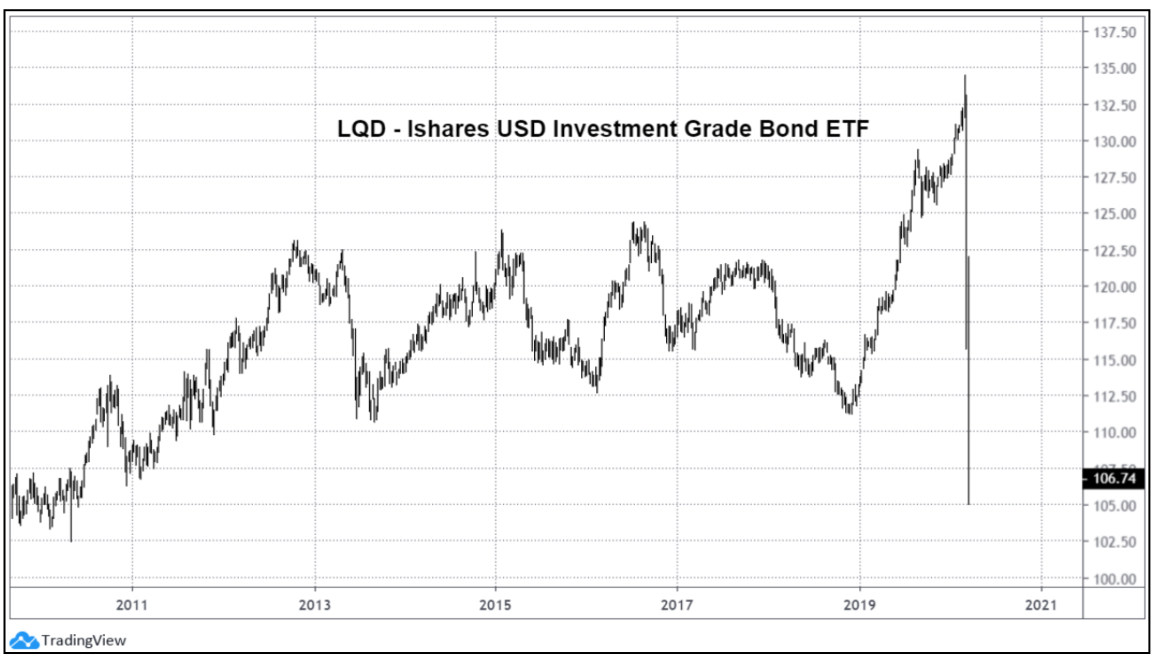
Contact: efill@stargazerfunds.com / +1.203.219.3649

As Flows have reversed out of Fixed Income, spreads have widened dramatically, but not anywhere near to the 2008 levels. While this is an economic event, 2008 was really a credit event.

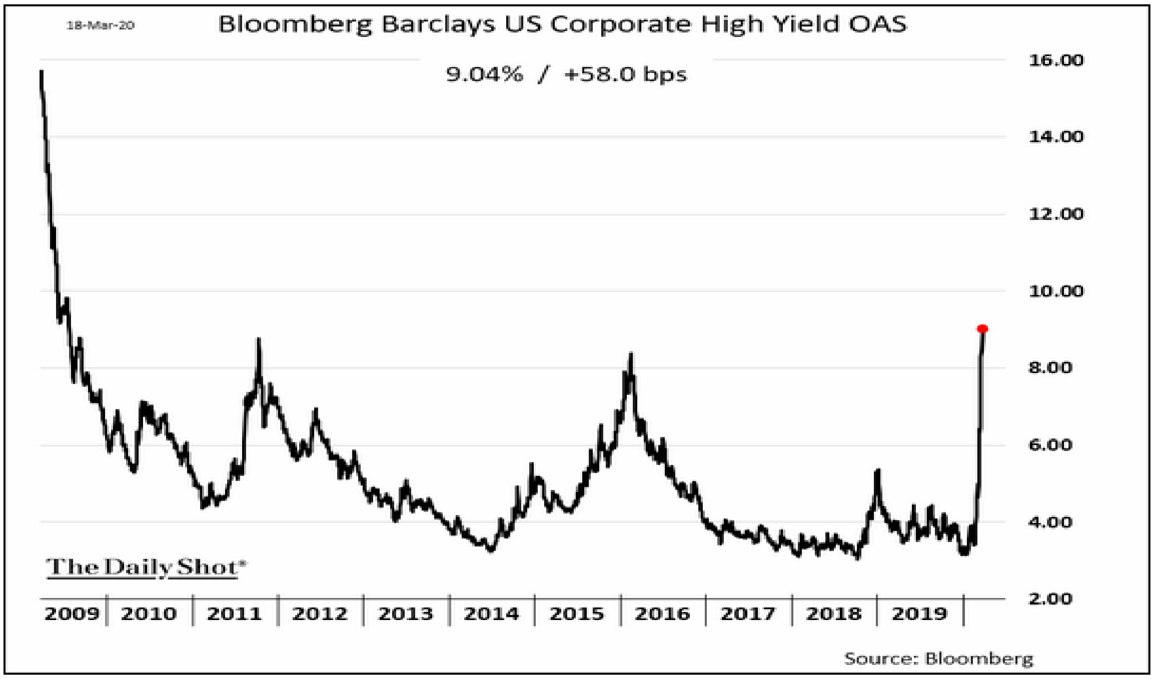
Investment Grade



The ETF has been smashed. Easy Liquidity.

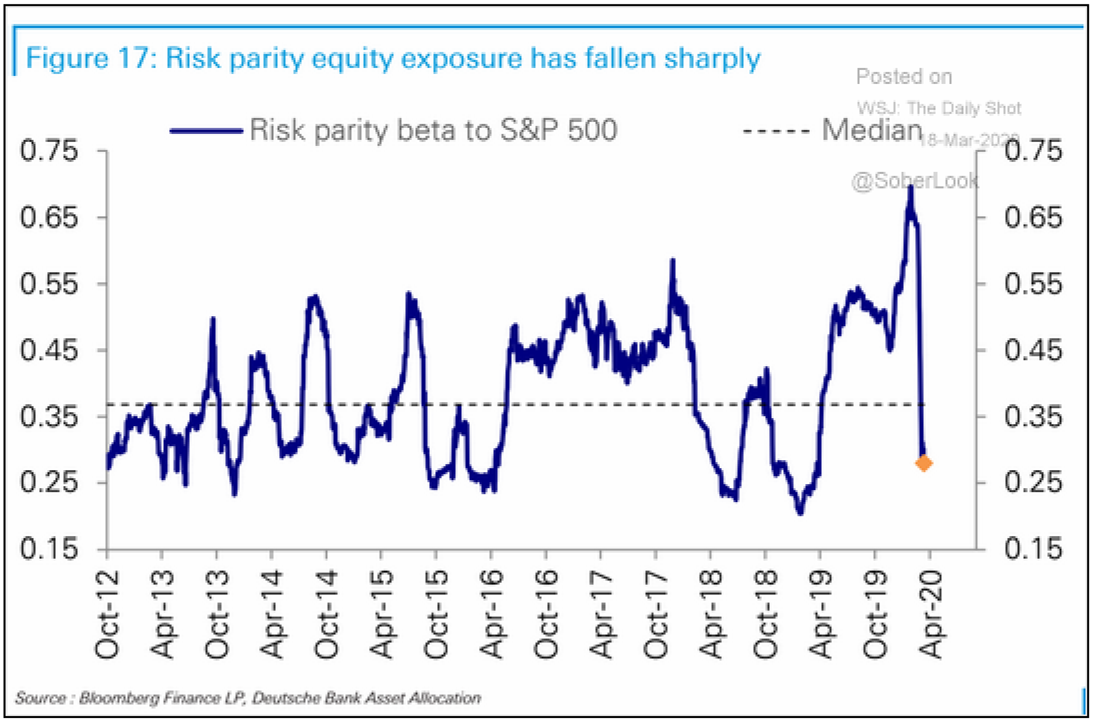


High Yield smashed too, with cash flow being paramount…

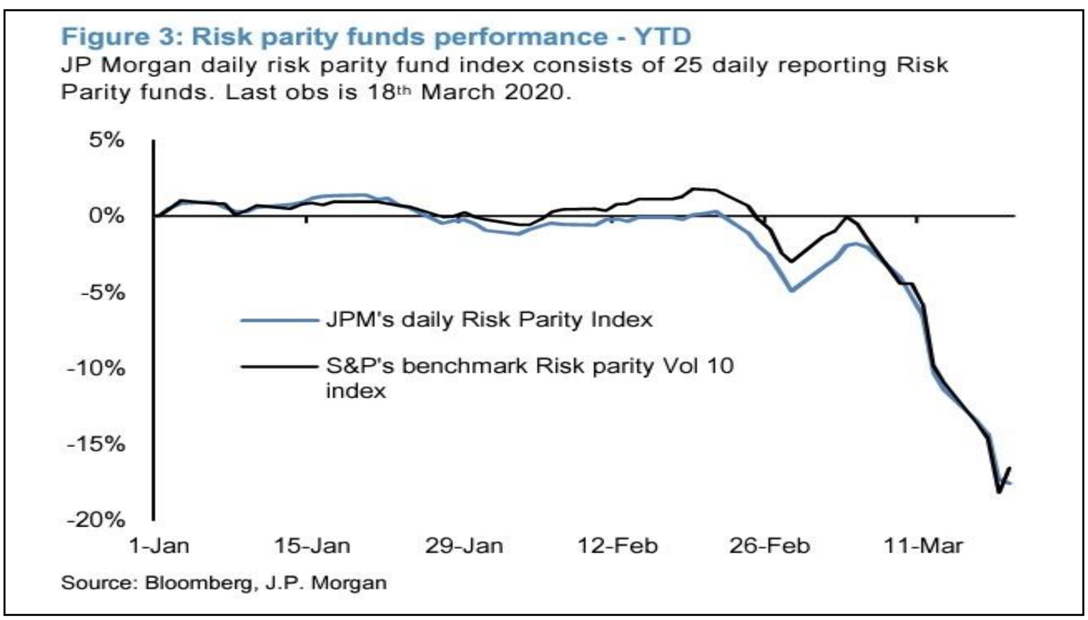


And liquidity in the underlying even more challenging.

With Equities and Fixed Income getting hit there has been unaccustomed pain for Risk Parity strategies. Higher volatility, rising correlations and rumored redemptions have forced selling across asset classes by these managers.



Risk Parity is not doing what it was designed to do….



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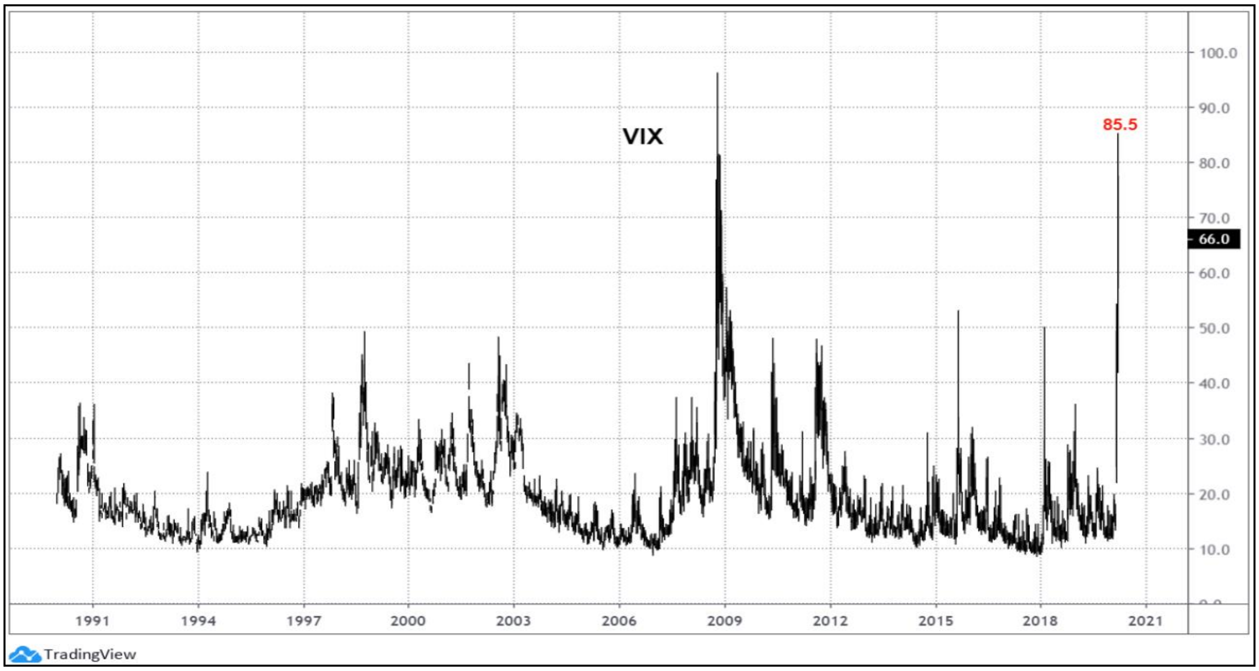
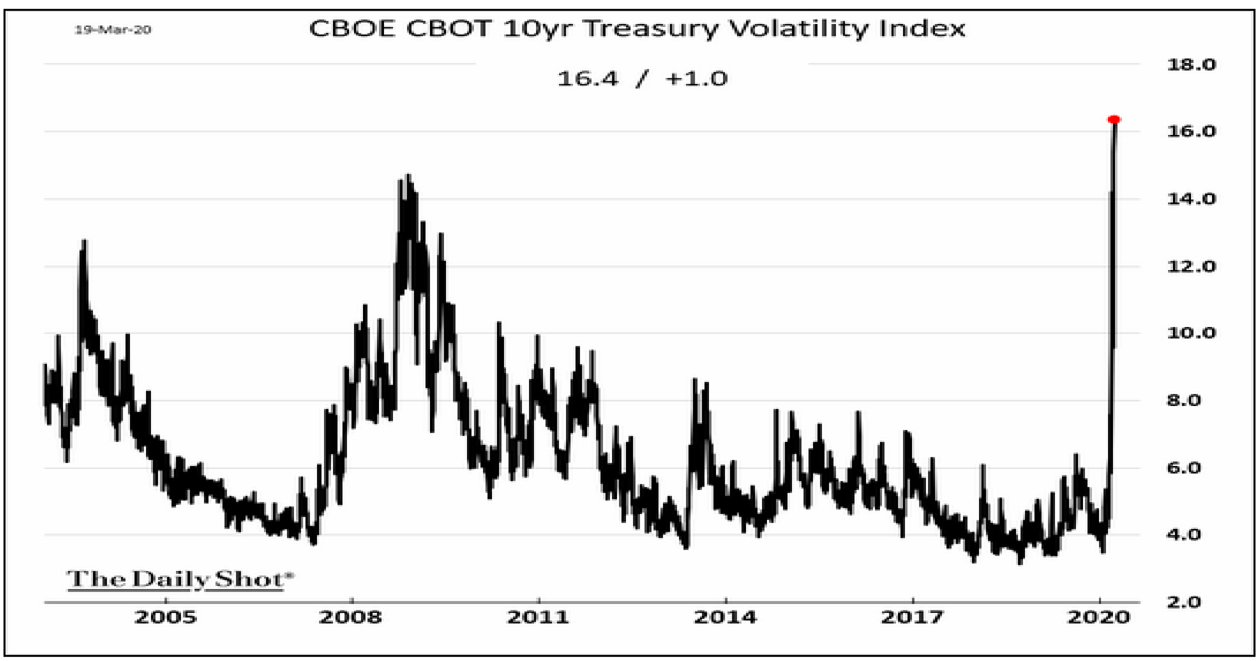
Volatility has soared across asset classes... No place to hide!

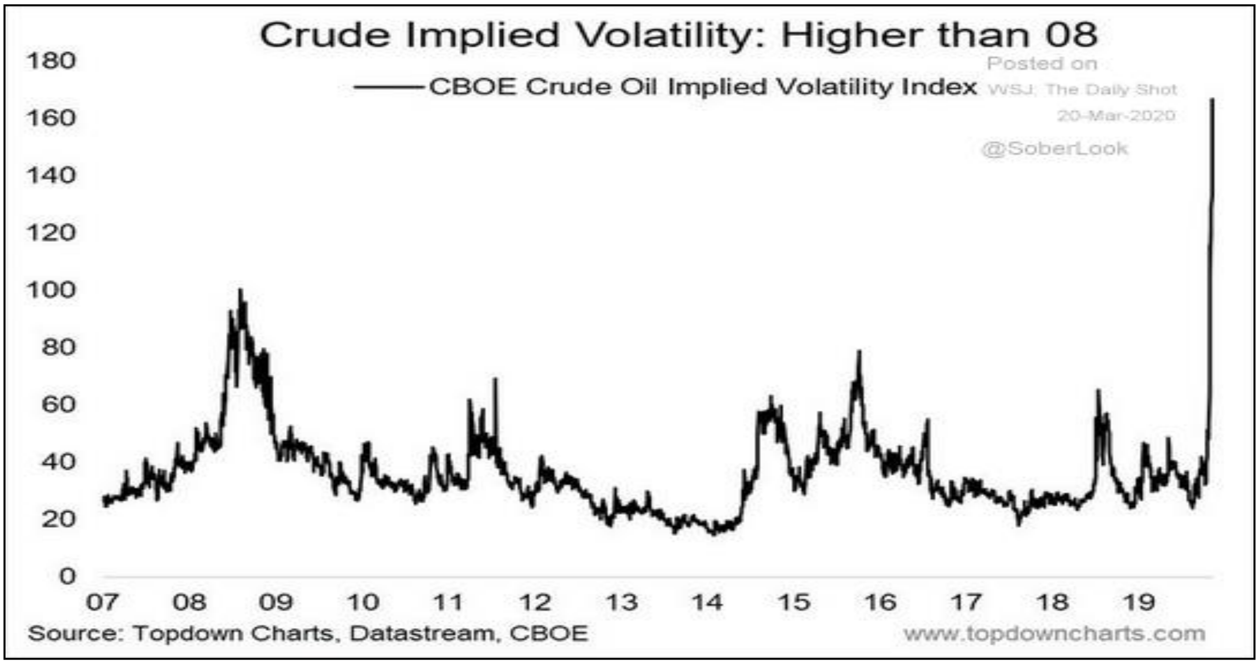
Stocks



Treasuries



Oil



Perhaps the most important single asset class at the moment is FX. The USD has been on a tear. Left unchecked we could get a powerful USD rally that would be very destabilizing.

While the USD has been strong for a while now against EM currencies as you would expect, the recent rally vs. G7 is a new development and signals a real USD funding shortage. The Fed and G7 counterparts have been trying to address it and the Fed has redoubled its efforts to pump USD to those in need via the swap lines.

Federal Reserve announces the establishment of temporary U.S. dollar liquidity arrangements with other central banks
Press Release - 3/19/2020

Coordinated central bank action to further enhance the provision of U.S. dollar liquidity
Press Release – 3/20/2020

They will keep trying to drown the market in USD liquidity in order to arrest this potentially toxic USD rally. The danger, is that if we have a similar situation as in Repo where the effects are temporary and the liquidity doesn't get through to those most in need. I expect FX volatility to remain high in the coming months.

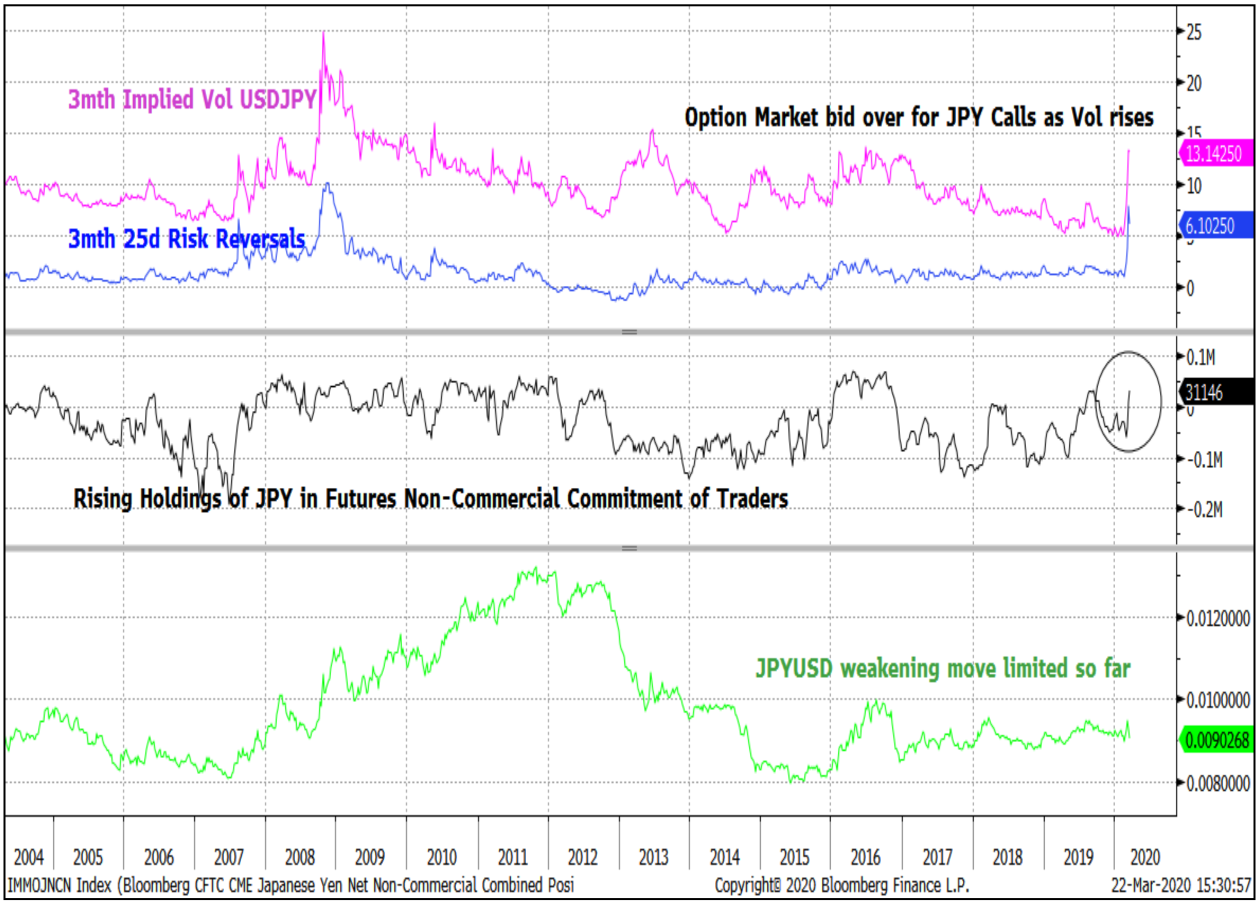
Don't be surprised if the authorities take increasingly strong steps to try and stem this move. Some have even suggested that this could result in a new version of the 1985 Plaza Accord.

The problem is that in the relative game of FX, there are few reasons to buy any of the other currencies at this point. In the absence of very dramatic policy action, the path of most pain is most likely at the moment.

USDJPY looks particularly interesting as the market is having a hard time coming to terms with a falling JPY in this environment.

112.40 is a big level

The market is not yet on board for further USDJPY strength.



Gold

Another potentially interesting trade here is Gold.

A world of massive currency creation via CB's and fiscal spending creates strong potential for this "currency".

The USD strength and liquidation of positions across asset classes has knocked it down. There is some talk of Middle East reserve managers being sellers to raise cash (same rumors re Treasuries).

However, we seem to have stabilized and the price could start grinding higher again as we switch narratives from a substitute for negative yielding currencies and bonds to an alternative to easily printable currencies.

With simultanious USD and Gold strength potentially resulting in a push-me-pull-you situation for now, another interesting paired trade could be Gold vs. EUR.

While this may take a little time to develop and/or have a few false starts, the fundamentals and technicals line up. Keep an eye on it.

Here is Gold vs. JPY as well...

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Most of the data is just too far behind the fast-moving events of the last few weeks. Here are a few that might at least give a feel for the initial drop in activity.

Important Macro Data Releases and Events for the Week

Monday
3/23/2020

Chicago Fed National Activity Index (Feb) Forecast: - , Prior: -.25

Tuesday
3/24/2020

Leading Economic Index (Jan) Forecast: - , Prior: 90.3

Markit Manufacturing PMI (Mar) Forecast: - , Prior: 48

Markit PMI Composite (Mar) Forecast - , Prior: 50.7

Markit PMI Composite (Mar) Forecast - , Prior: 51.6

Markit Services PMI (Mar) Forecast: - , Prior: 53.2

Markit Manufacturing PMI (Mar) Forecast: - , Prior: 50.7

Markit Services PMI (Mar) Forecast: - , Prior: 49.4

Markit PMI Composite (Mar) Forecast: - , Prior: 49.6

New Home Sales MoM (Feb) Forecast: - , Prior: 0.764M

Wednesday
3/25/2020

IFO -Business Climate (Mar) Forecast: - , Prior: 87.7

IFO - Current Assessment (Mar) Forecast: - , Prior: 93.8

IFO - Expectations (Mar) Forecast: - , Prior: 82

Nondefence Capital Goods Orders ex Aircraft (Feb) Forecast: - , Prior: 1.1

Durable Goods Orders (Feb) Forecast: - , Prior: -0.2%

Contact: efill@stargazerfunds.com / +1.203.219.3649

Durable Goods Orders ex defense (Feb) Forecast: - , Prior: 3.7%

Durable Goods Orders ex Transportation (Feb) Forecast: - , Prior: 0.8%

Thursday 3/26/2020	GfK Consumer Confidence Survey (Apr) Forecast: - , Prior: 9.8
	Economic Bulletin
	Initial Jobless Claims Forecast: - , Prior: 281k
	Initial Jobless Claims 4-week ave. Forecast: - , Prior: 232.25k
	Continuing Claims Forecast: - , Prior: 1.701m
Friday 3/27/2020	Michigan Consumer Sentiment Index (Mar) Forecast: - , Prior: 95.9

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