What to focus on in Global Markets for the week of February 3rd, 2020

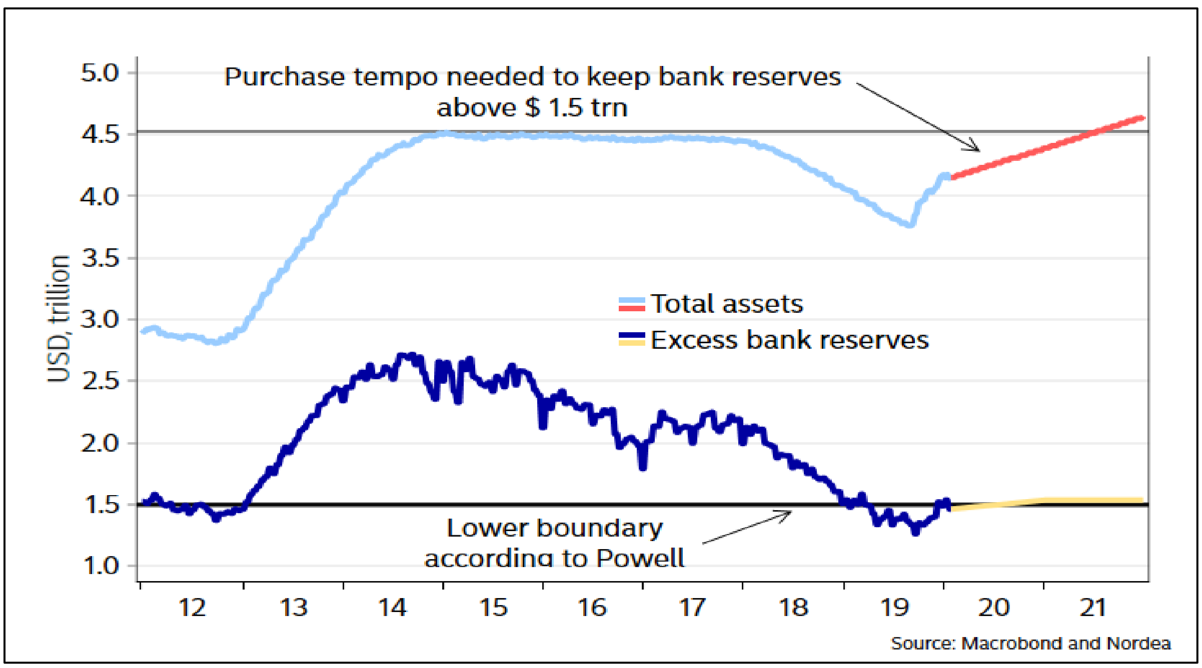
Macro Themes on the Radar:

Last week's FOMC

Overall, the Fed stuck with and expanded on what has been a developing theme regarding the inflation part of the mandate. They continue to be worried that inflation is too low and that the constant undershoot is self-reinforcing. They are concerned that persistently low inflation does not allow them to reload Fed Funds during the booms and that they are then unable to deliver the required rate cuts during a bust. Chairman Powell made it clear that they don't want to find themselves in the ECB's shoes.

To that end, they tweaked the statement to read "back to" vs. "back near" the 2% inflation target. Powell said the change was meant to indicate that currently 2% is really the minimum. He noted that they are not comfortable persistently running below 2%, especially at a time in the cycle when inflation should be moving up. It remains to be seen if this asymmetric tactic will achieve the symmetrical 2% target over time.

On "Not QE", Powell indicated that the committee sees the need to continue asset purchases so that excess reserves consistently stay above 1.5tr. He hammered home that the intent is just to raise excess reserves to an ample level, and this is not meant to be QE.



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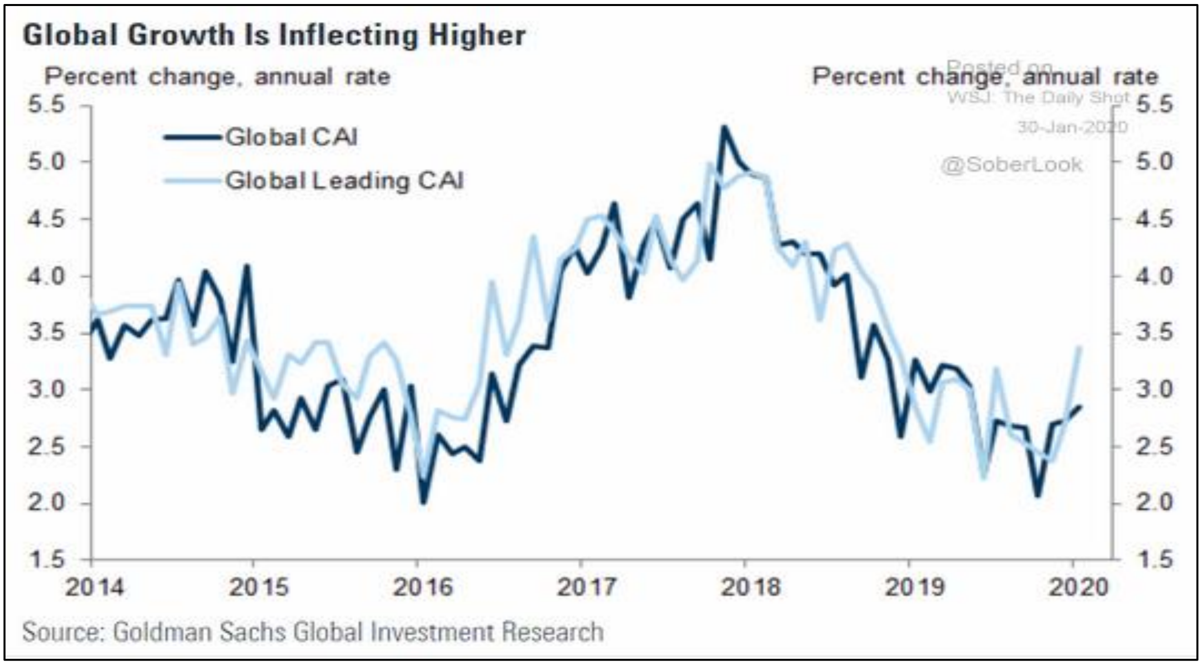
On global growth Powell said, “There are grounds for what I would call cautious optimism for the global economy,” “We are not at all assured of a global rebound but there are signs and reasons to expect it—and then comes the coronavirus… we'll just have to see what the effect is globally.”

GS – Global Current Activity Indicator. Just as things were stabilizing …



What to Focus on Now:

nCoV

Let's face it, we have no idea how bad this is. There are lots of claims and denials about the ease with which it spreads, the mortality rate and the total number of infected. There are two main problems in answering these questions: 1) It is still early in the outbreak, and the seemingly long incubation period is complicating its management and analysis. 2) As with economic data, no one believes the Chinese virus/health data. Add to this the claims from various sources on the internet that the virus is an escaped bioweapon, and it's no surprise markets are on edge. Uncertainty = risk reduction.

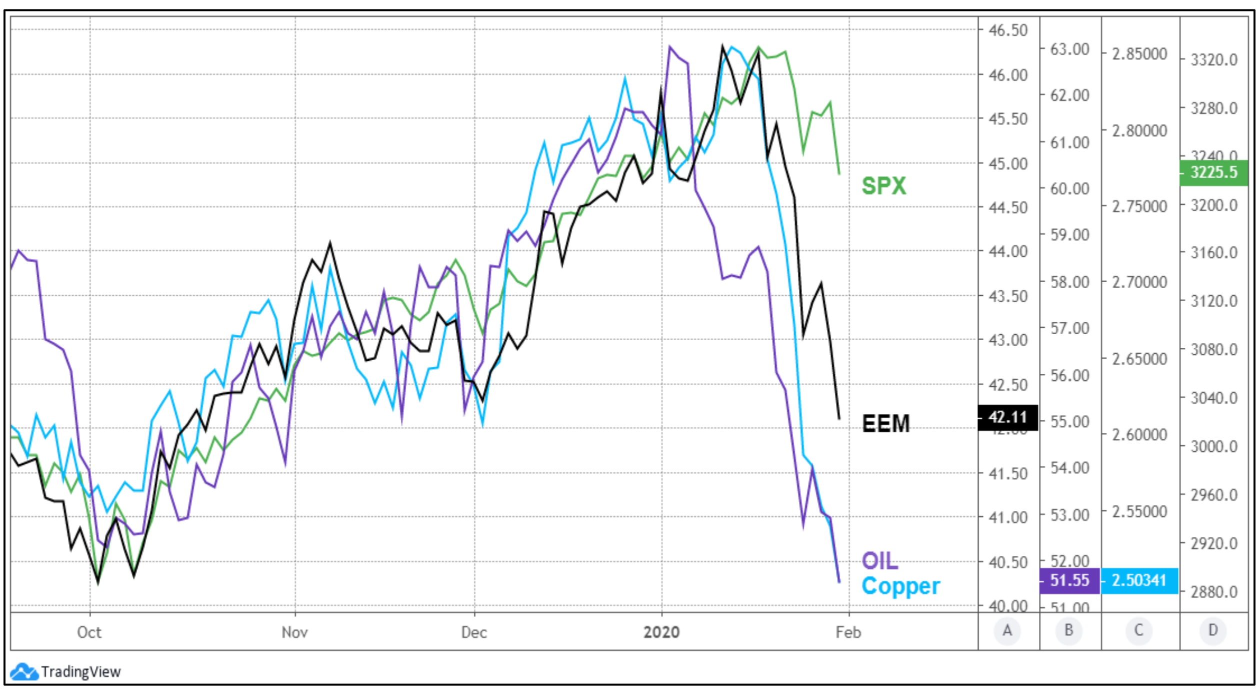
China is uniquely positioned to act aggressively. For most democracies it would be much harder to lock down 60m+ people by decree. However, markets are feeling their aggressive handling of the situation as a double-edged sword. On one hand it brings a higher probability of containment. On the other hand, it begs the question; why are they feeling the need to be so aggressive if the mortality rate is only 1-2%?

Headlines like this one are getting people's attention:

"China's Premier Li had a call with European Commission President Ursula Von Der Leyen on Saturday afternoon, asking the EU to facilitate China's urgent procurement of medical supplies from its member states through commercial channels, according to a statement on State Council's website."

The markets are focused on what the economic effects will be. At this point a slowing of Chinese and global growth is a given, but how much? The SARS epidemic is everyone's favorite analog; however, China's GDP is now 4x the size it was in 2003 and responsible for 17% of global GDP and a higher percentage of the growth. That is before you take into account potential supply chain and trade disruptions. Again, we just don't know how long this will last or how bad it will get.

Not surprisingly, those markets with the highest beta to the Chinese economy have been hit the hardest. As the world's largest energy consumer, it's no surprise that Oil has been smashed. China also accounts for almost 50% of the global Copper consumption. Not only is China a primary component of most EM indices but the knock-on effects for its trading partners is obvious. By comparison, US equities have, so far, held up.



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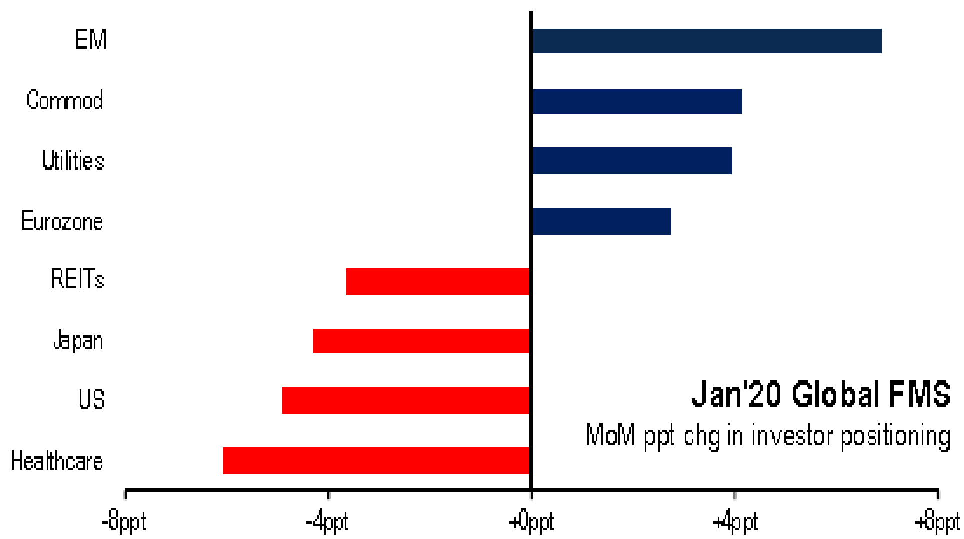
The virus is hitting at a bad time.

Investors had just finished piling into EM and Commodities, hoping that the aggressive Central Bank easing of the last few months was starting to turn global growth higher. PMI's and new orders were just starting to perk up. With the long running US equity market outperformance, these markets were seen as comparative value plays.

Here is BoA/ML's assessment of MoM % change in investor positioning from two weeks ago. Notice what the top two flows had been over the last month.

Exhibit 1: Jan FMS show investors bullish, but not euphoric



Source: BofA Global Fund Manager Survey

For the moment the reflation trade has been postponed, as investors are now being forced to reverse course. The fear of the unknown is powerful and until we see a slowing rather than an acceleration of reported cases, the pressure will be on.

The following graphic indicates the MoM return as of Friday's close.

Notice the bottom three contestants represent the very sectors investors just got done buying only a couple of weeks ago.

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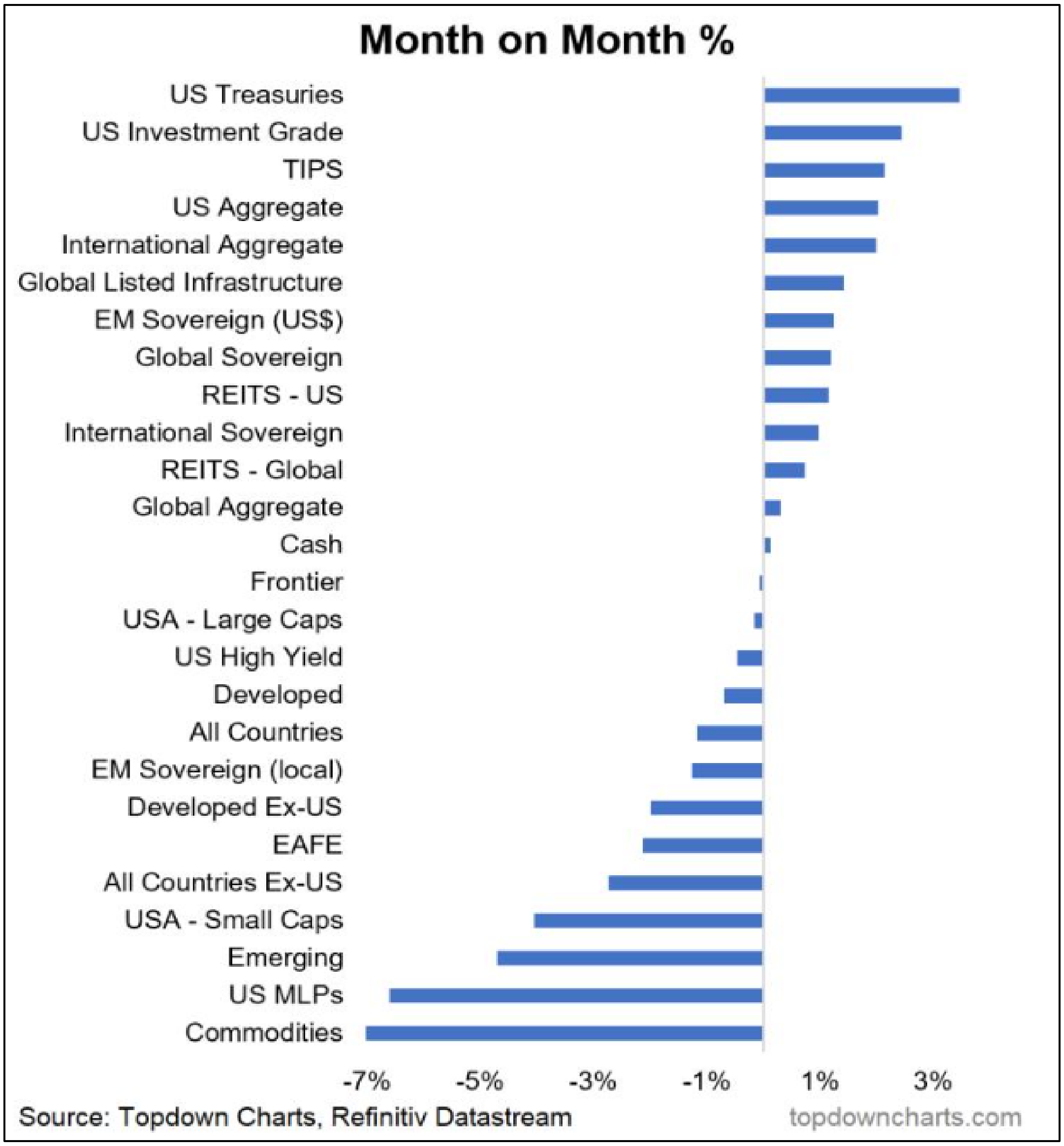

As we wait for more clarity on where this is going, it is worth thinking about what the jump off point was for Chinese data.

Chinese Manufacturing PMI has been flat (neither growing nor contracting, at 50).

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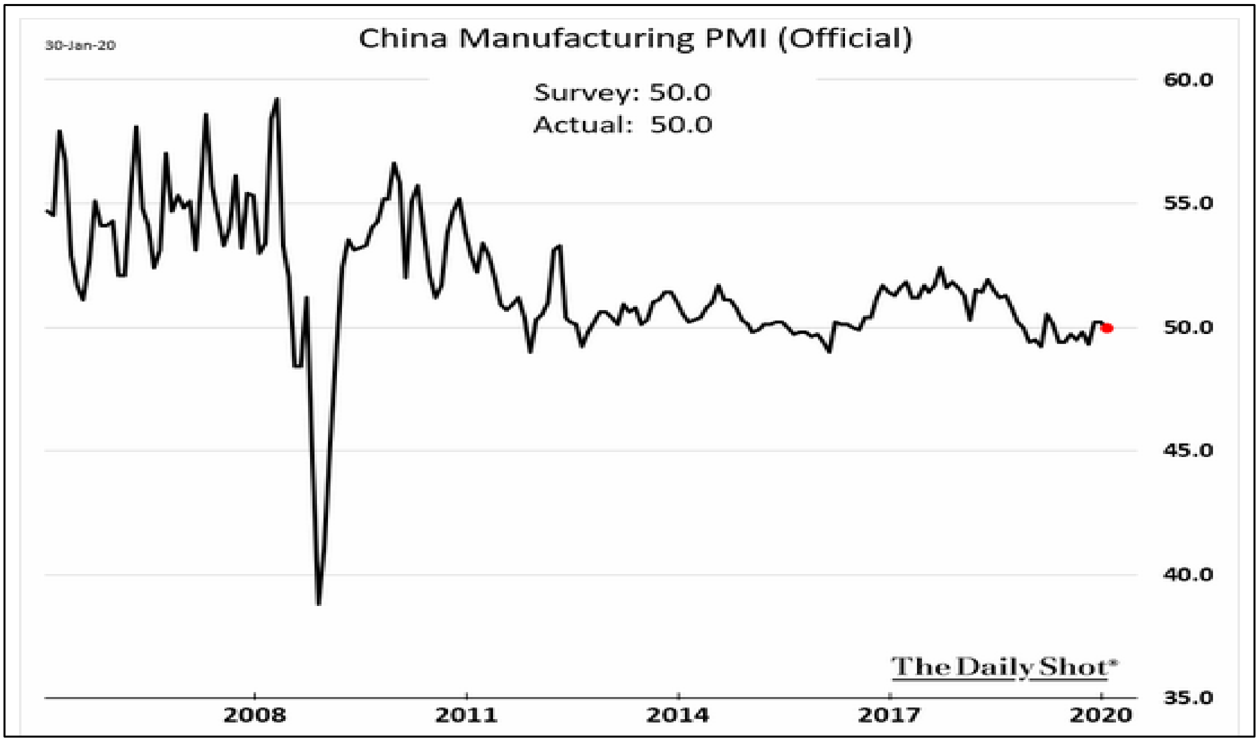
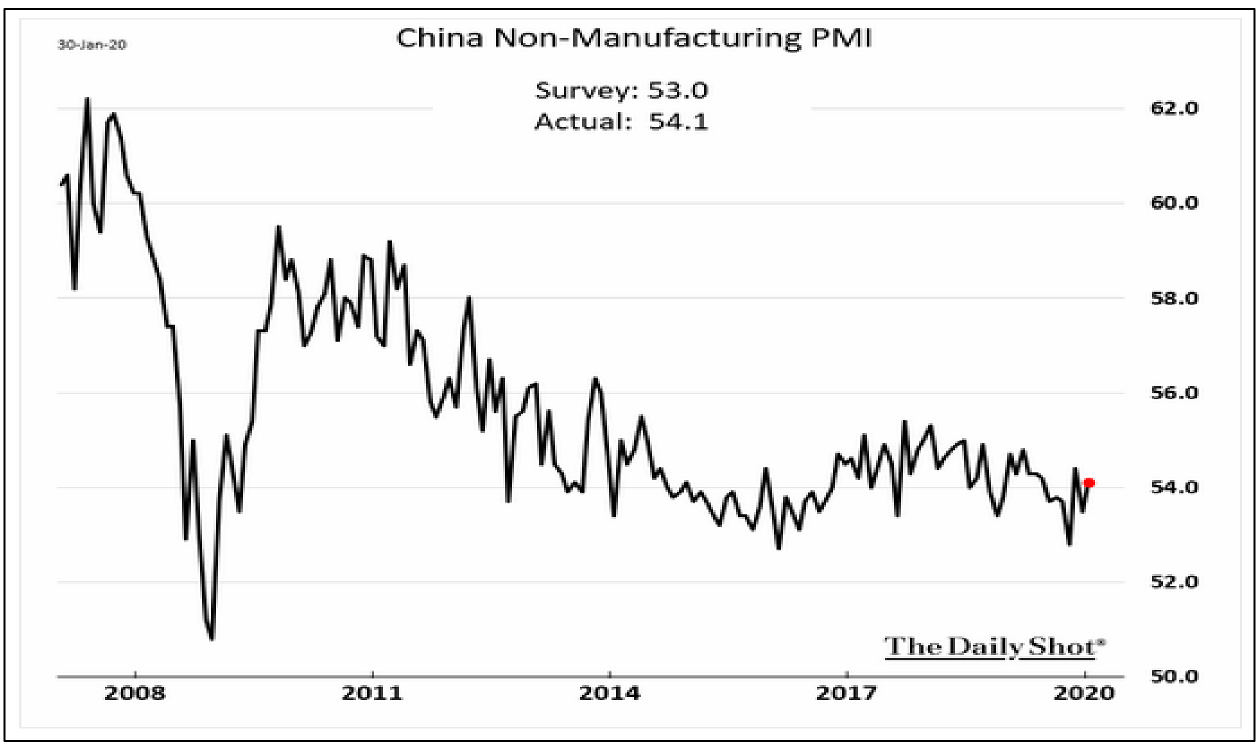


Non-Manufacturing was healthy at 54.1. An important one to watch for nCoV effects.



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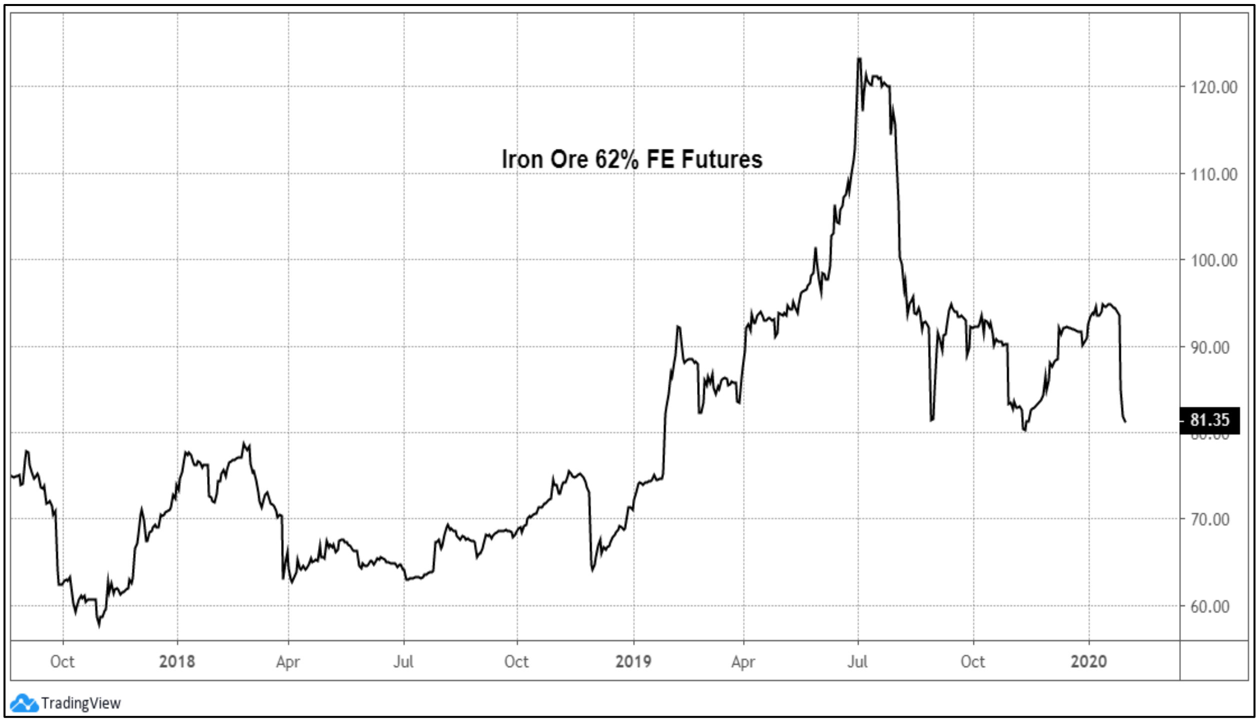
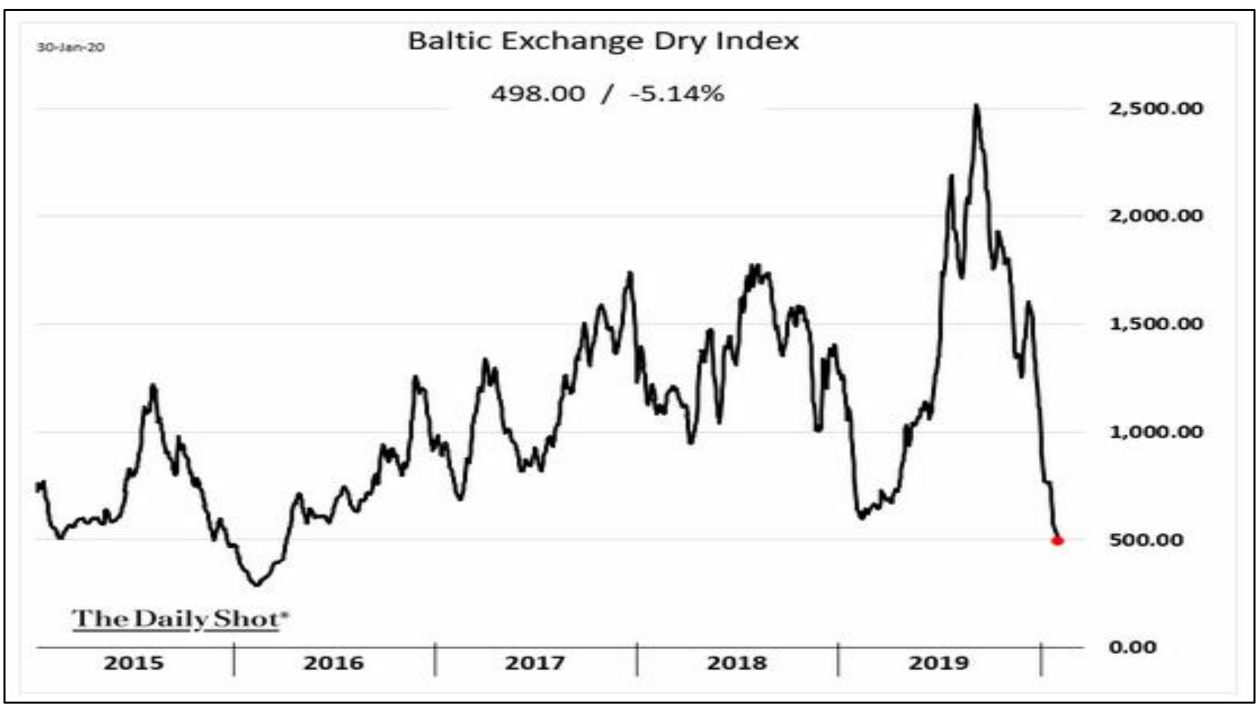
China accounts for 70% of global Iron Ore imports.



Shipping index for dry goods can act like a rate of change for things like Iron Ore.



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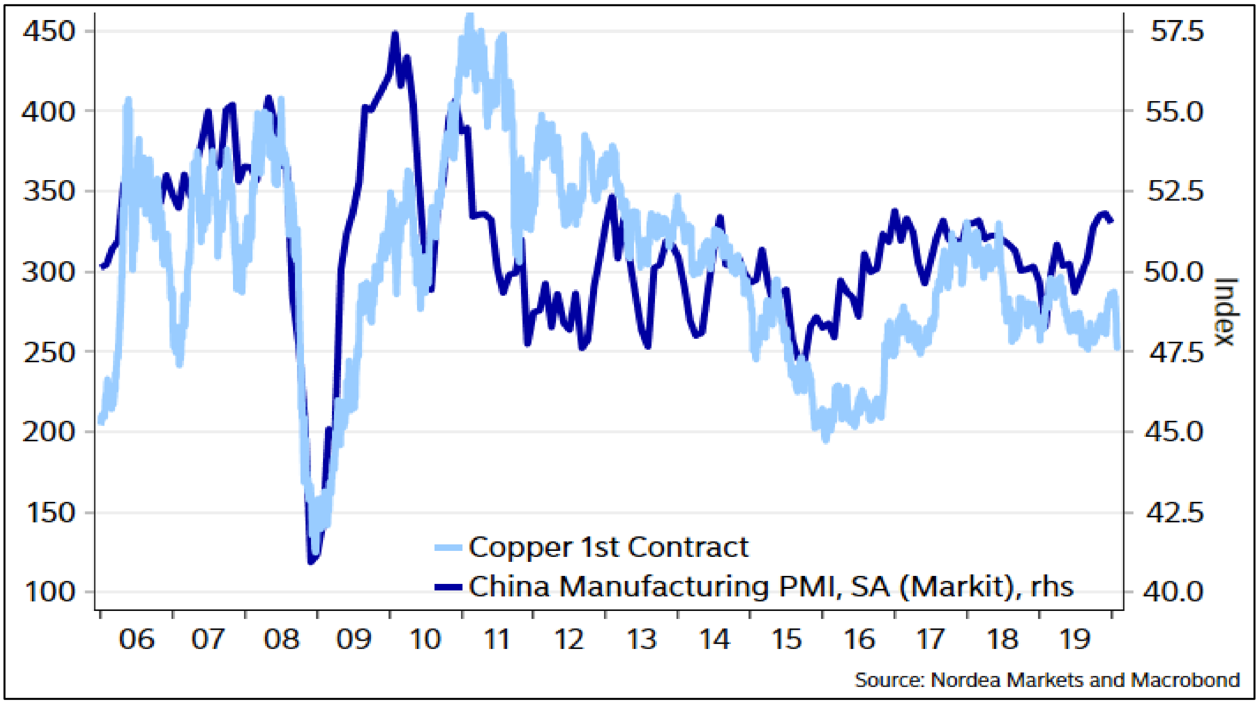
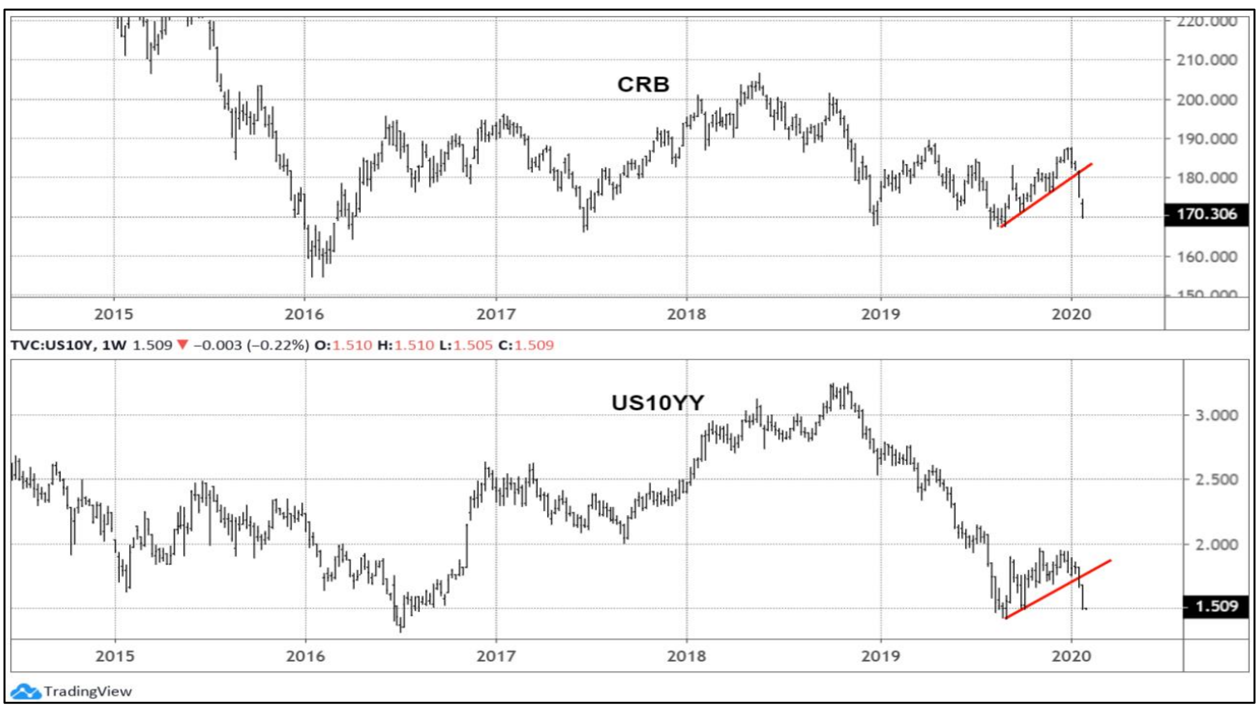
The recent fall in commodities like Copper, probably means more weakness ahead for Chinese Manufacturing PMI (as you would expect). Yields reprice with commodities.





The deflationary impulse in commodities and the implications for global growth of this "virus shock", are driving down global bond yields.

The Dollar is mixed as the unwinding of positions is driving the price action. Commodity and EM currencies have of course been under pressure. EUR, CHF and JPY have been in demand as carry trades are unwound and some money goes home.

For many currency pairs, the dollar bottomed a month ago and has been rallying ever since. The more EM and Commodity exposure the currencies have, the bigger the moves have been.

The price action in the EUR, CHF and JPY are making it look like the USD in general weakened last week.

In fact, the DXY put in an outside range week, last week. This is often a trend reversal indicator, and the EUR may continue to rally in the near term, but it is likely to be more reflective of a washout than anything more durable.

If virus concerns persist, I expect we will see more of this bifurcation in DM and EM currencies.

Outside range week in DXY:

EURAUD does a good job of illustrating this divergence between DM and EM currency values. The rise in negatively yielding currencies as positively yielding currencies fall is an ugly unwind.

In commodities, the fall in Copper vs. Gold rhymes with what is happening in currencies. This is another fear trade. EM and the Copper/Gold usually move broadly together, which I think makes sense. Occasionally they diverge. While EM equities have had a bad few days, they are not yet pricing what commodities are.

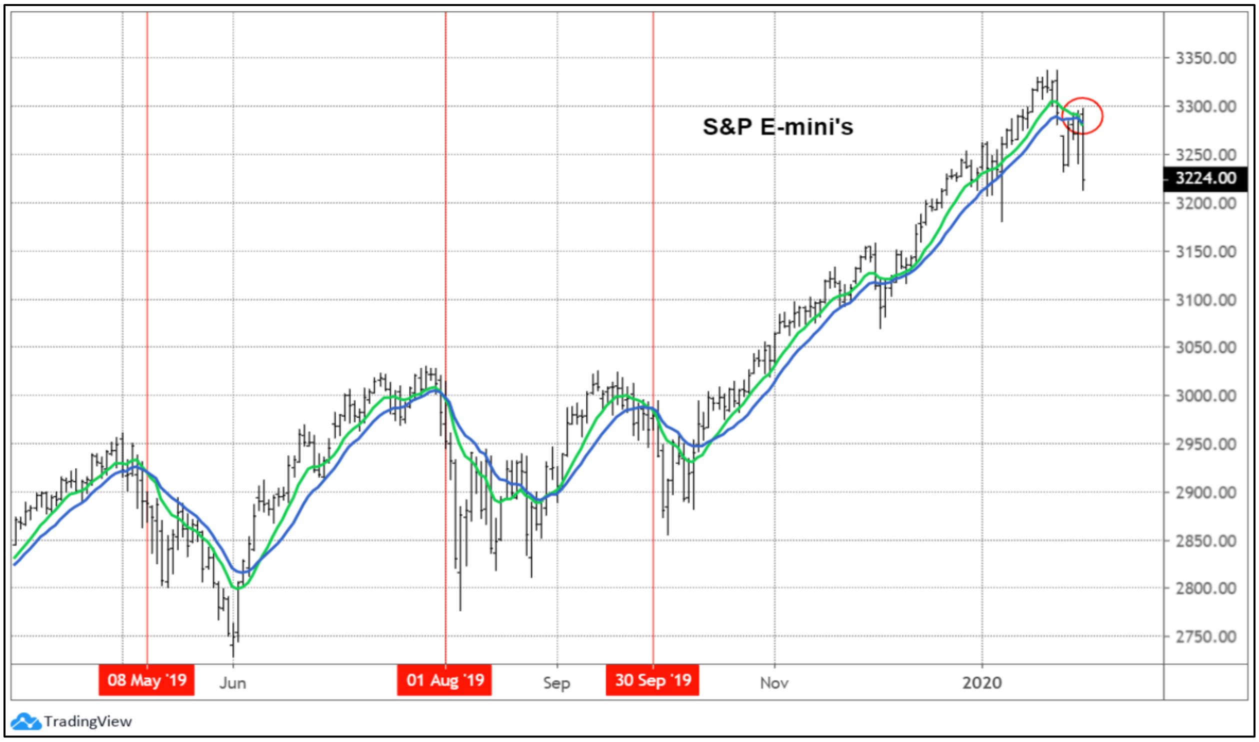
Clearly, how this current potential shock to global growth develops, will have big implications here. Who will be right?

That brings us to Developed Markets equities.

Europe, Japan, the Russell and the NYSE all had momentum roll over earlier last week. For the S&P it only really rolled on Friday.

The NASDAQ will probably do so on Monday. Here the power of the leading technology stocks has continued to support the US.

A roll in momentum gives no guarantees, but highlights that the probability of a further sell-off is higher than otherwise and that the market must prove itself.


S&P E-mini's
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01 Aug '19
Sep
30 Sep '19
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2020
TradingView

Euro Stoxx


SX5E
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May
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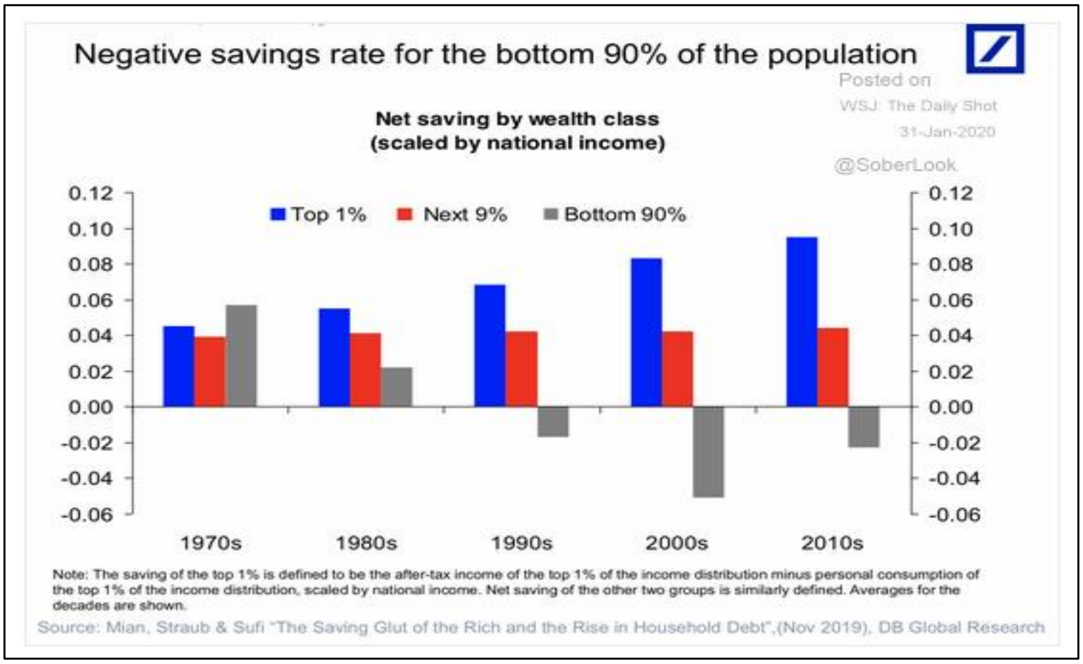
The Rise of Sanders

With regard to Sander's rise in the polls, I thought the following three charts are worth contemplating.



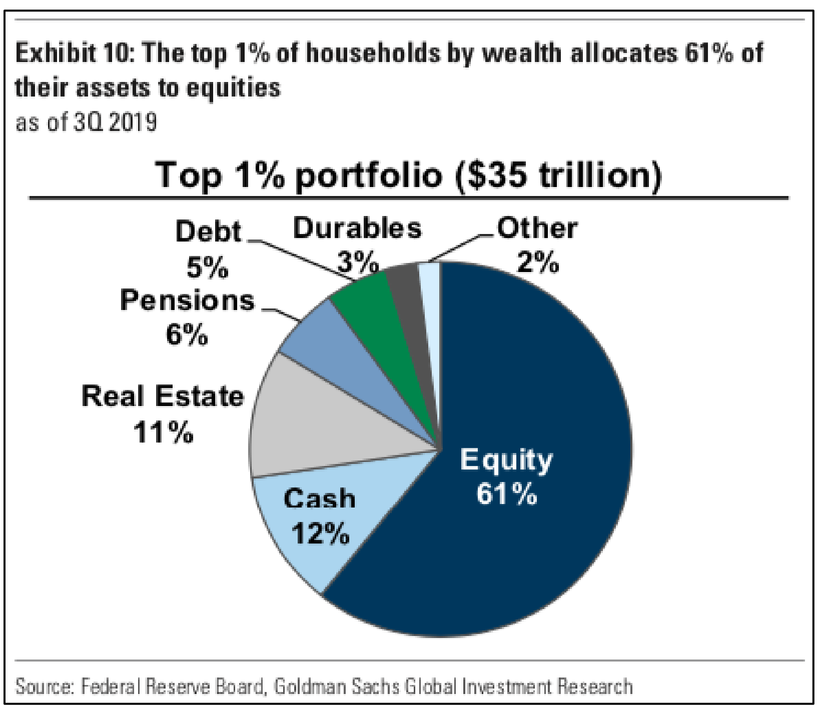


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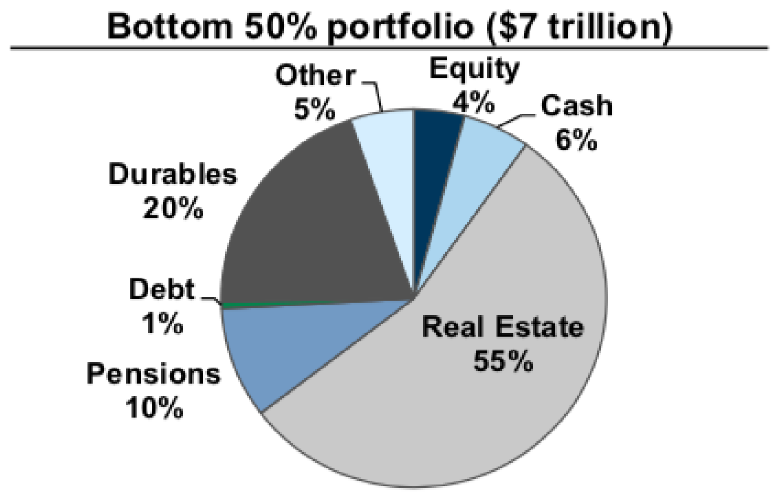
Exhibit 13: The bottom 50% of households allocates 4% of their assets to equities
as of 3Q 2019



Source: Federal Reserve Board, Goldman Sachs Global Investment Research

<u>Actionable Trades and Developments:</u>

<u>Equity Indexes:</u> Small short in S&P via futures and options.

<u>Fixed Income:</u> Long June 98.50 Eurodollar calls.

<u>Commodities:</u> Still like Gold big picture but sidelined for now. Watching Copper and Oil as they have taken the brunt of the downside so far. Might give an early tell if things not as bad as being priced.

<u>Currencies:</u> Long AUDUSD downside gamma.

<u>Lots of Global PMI's out this week, but they are unlikely to catch much of the recent action, so strength will be ignored other than as a starting point.</u>

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Important Macro Data Releases and Events for the Week

Monday
2/03/2019

- Caixin Manufacturing PMI (Jan) Forecast: 51.5, Prior: 51.5
- Markit Manufacturing PMI (Jan) Forecast: 45.2, Prior: 45.2
- Markit Manufacturing PMI (Jan) Forecast: 49.8, Prior: 49.8
- Markit Manufacturing PMI (Jan) Forecast: 49.6, Prior: 50.4
- Markit Manufacturing PMI (Jan) Forecast: 51.7, Prior: 51.7
- ISM Manufacturing PMI (Jan) Forecast: 51.7, Prior: 51.7
- ISM Prices Paid (Jan) Forecast: - , Prior: 51.7

Tuesday
2/04/2019

- RBA Interest Rate Decision and Statement Unch at .75% is expected
- Factory Orders MoM (Dec) Forecast: 0.7%, Prior: -0.7%

Wednesday
2/05/2020

- Caixin Service PMI (Jan) Forecast: 52.6, Prior: 52.5
- Markit PMI Composite (Jan) Forecast: 49.5, Prior: 51.1
- Markit PMI Composite (Jan) Forecast: 50.9, Prior: 50.9
- Retail Sales YoY (Dec) Forecast: 1.3%, Prior: 2.2%
- Markit PMI Composite (Jan) Forecast: 49.1, Prior: 52.9
- ADP Employment Change (Jan) Forecast: 155k, Prior: 202k
- Trade Balance (Dec) Forecast: $-44.6B, Prior: $-43.1B
- Markit Service PMI (Jan) Forecast: 53.2, Prior: 53.1
- Markit PMI Composite Forecast: 53.1, Prior: 53.1

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ISM Non-Manufacturing PMI (Jan) Forecast: 55.1, Prior: 55

BoC Wilkins **SPEECH**

Thursday 2/06/2020	Factory Orders s.a. MoM (Dec) Forecast: 1.1%, Prior: -1.3%
	Economic Bulletin and Growth Forecast REPORT
	Challenger Job Cuts (Jan) Forecast: - , Prior: 32.843k
	Nonfarm Productivity Q4 PREL Forecast: - , Prior: -0.2%
	Unit Labor Cost Q4 PREL Forecast: 1.4%, Prior: 2.5%
	Initial Jobless Claims Forecast: - , Prior: 216k
	Initial Jobless Claims 4-week ave. Forecast: - , Prior: 214.5k
	Continuing Claims Forecast: - , Prior: 1.703m
	RBA's Governor Lowe SPEECH
	Overall Household Spending YoY (Dec) Forecast: -1.7, Prior: -2%
Friday 2/07/2020	RBA Monetary Policy Statement
	Leading Economic Index (Dec) PREL Forecast: 90.8, Prior: 90.8
	Trade Balance s.a. (Dec) Forecast: EUR 20B, Prior: EUR 18.3B
	Industrial Production s.a. MoM (Dec) Forecast: -0.2%, Prior: 1.1%
	Exports YoY CNY (Jan) Forecast: -6.3%, Prior: 9%
	Imports YoY CNY (Jan) Forecast: 19.1%, Prior: 17.7%
	Trade Balance USD (Jan) Forecast: - , Prior: $47.21B

- Exports YoY (Jan) Forecast: -6.3%, Prior: 9%
- Imports YoY (Jan) Forecast: 1.1%, Prior: 16.5%
- Nonfarm Payrolls (Jan) Forecast: 156k, Prior 145k
- Unemployment Rate (Jan) Forecast: 3.5%, Prior: 3.5%
- Average Hourly Earnings MoM (Jan) Forecast: 0.3%, Prior: 0.1%
- Average Hourly Earnings YoY (Jan) Forecast: 3%, Prior: 2.9%
- Labor Force Participation Rate (Jan) Forecast: 63.1%, Prior: 63.2%
- Net Change in Employment (Jan) Forecast: - , Prior: 35.2k
- Unemployment Rate (Jan) Forecast: 5.8%, Prior: 5.6%
- Participation Rate (Jan) Forecast: 65.5%, Prior: 65.5%
- Average Hourly Wages YoY (Jan) Forecast: - , Prior: 3.84%
- Ivey Purchasing Managers Index s.a. (Jan) Forecast 53.3, Prior: 51.9

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