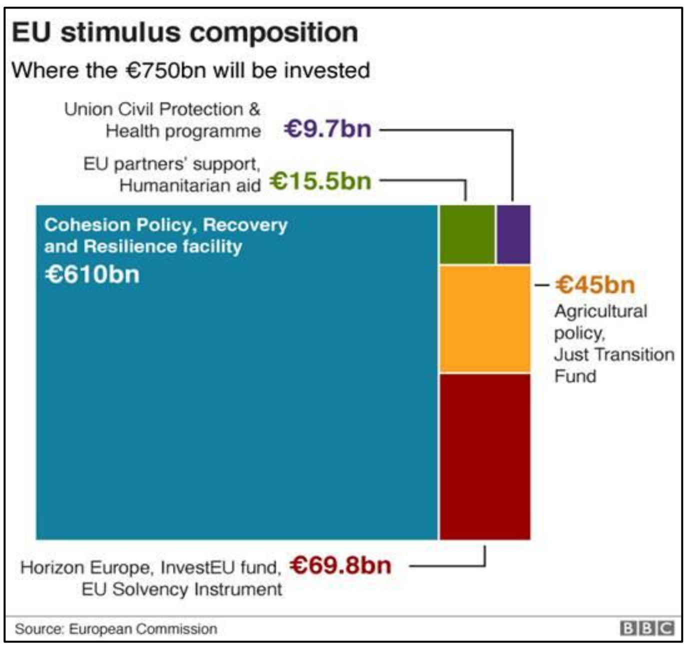
What to focus on in Global Macro for the week of June 1st, 2020

Macro Themes on the Radar:

Europe

Last week the European Commission delivered a fleshed-out version of the "Merkron" proposal for the European recovery fund. Rather than converting some of the proposed €500bln in grants into loans to placate the "frugal four" (Sweden, Austria, Denmark and the Netherlands) they added €250bln in loans for a new program size of €750bln. A smart move that ups the ante. There is a growing expectation that after much back room dealing and negotiating something along these lines will be endorsed by leaders. This is likely to take months, and even after ratification by the Council and approval by the EU parliament, there will need to be national ratification in the member state parliaments. Then, if all goes well, the €750bln in debt could be issued starting in January 2021.

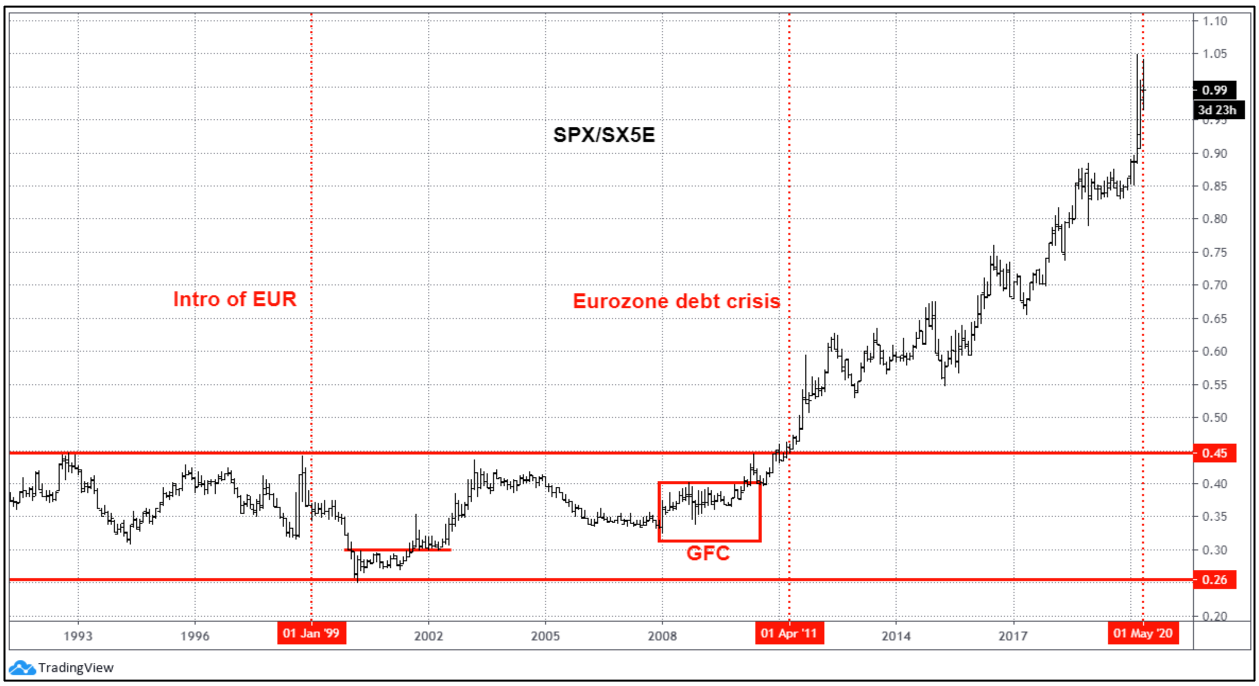


The European Commission proposal for €750bln recovery fund *would make the EU the largest SSA issuer (Sovereigns, Supranationals, Agencies) in the world*. Since the 2011-12 crisis, EU has issued only €3bn per annum on avg, even in the peak year of 2011, gross issuance did not exceed €30bn.

The game changer here remains the potential willingness of member states to have a common debt issuance and large wealth transfers within the EU. While in practice it will take months for the money to actually arrive, the effects on sentiment and the newfound confidence in the unions ability to persist, is already starting to be felt. We will see if the sausage actually makes it out of the back of the EU machine, but for now there is optimism that this could provide a near-term solution and a path to a longer-term one. The ability to reach a 27-member consensus would be key. Amusingly, people are referring to it as a MEGA (as opposed to MAGA) plan.

The ECB's Lagarde recently warned that the eurozone economy is expected to shrink between 8%-12% this year. Add to that a eurozone harmonized inflation rate at 0.1% and it is easy to see why the ECB is expected to increase its PEPP at the policy meeting on Thursday. However, they really have limited room at this point and with the recent German Constitutional court decision, everyone is very focused on their actions. As such the fiscal option is critical.

Will any / all of this be enough to bring European stocks and the EUR back to life? The GFC and the European debt crisis were a double hit to Europe. Add in the powerful dominance of US tech, and the role it has played in the US indexes, and you had the recipe for the last decade of European underperformance.



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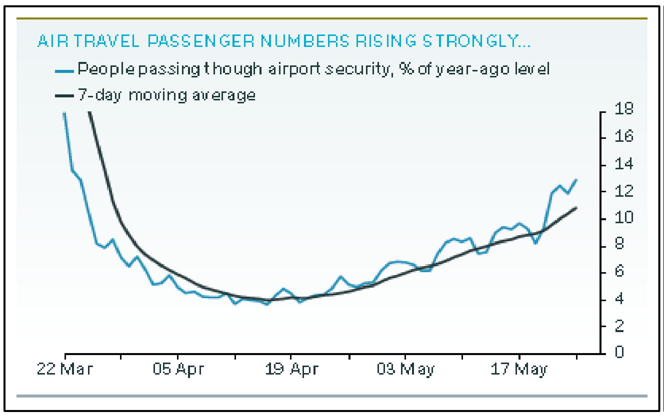
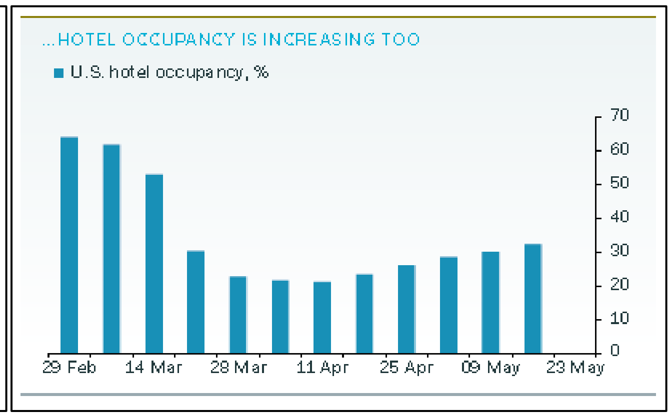
US

With the country well on its way to re-opening, the economy is starting to come back to life. Economic numbers are bouncing and will continue to improve significantly in the coming weeks and months.

Even the worst hit sectors are coming off the lows. (Source: Pantheon Macroeconomics)



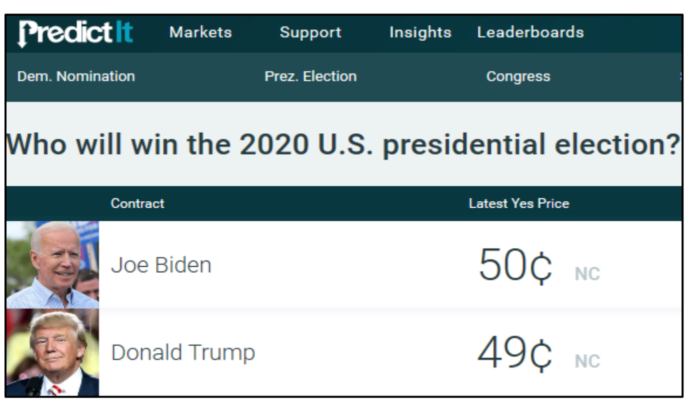


When we look back at what just happened it really is stunning and unprecedented.

As late as February 19th, we made a new all-time high in the S&P 500, only to then fall 35% over the next five weeks only to be followed by the biggest and fastest rally in nearly 90 years. Over the last two months, the unemployment rate has gone from the lowest level in 50 years to the highest in 80 years. The result has been a relentless deluge of liquidity and spending from the Fed and the US government to bridge and fill the sudden crater that opened up in front of us. So far it has worked.

As if that wasn't enough for one year, we also currently face:

- continued economic uncertainty
- riots in 30 US cities over the weekend
- increasing geopolitical and economic tensions with China. New security law for HK.
- a close Presidential election with increasing policy uncertainty for candidates



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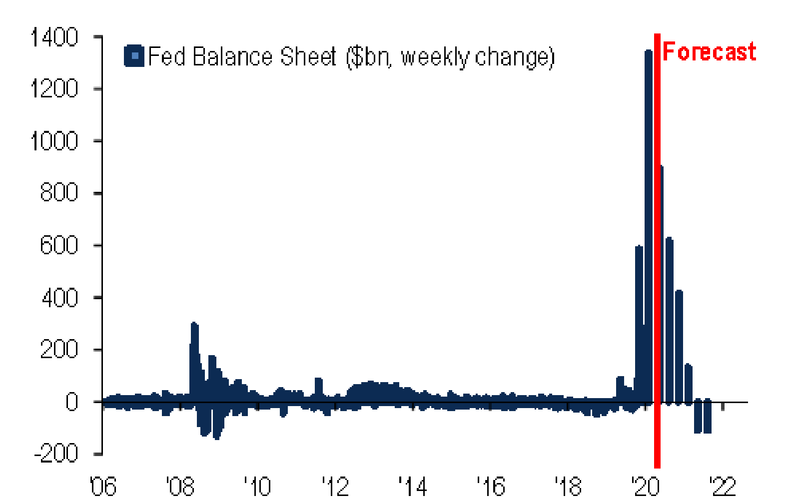
- monetary policy uncertainty around negative rates, Yield Curve Control, reduced central bank asset purchases.

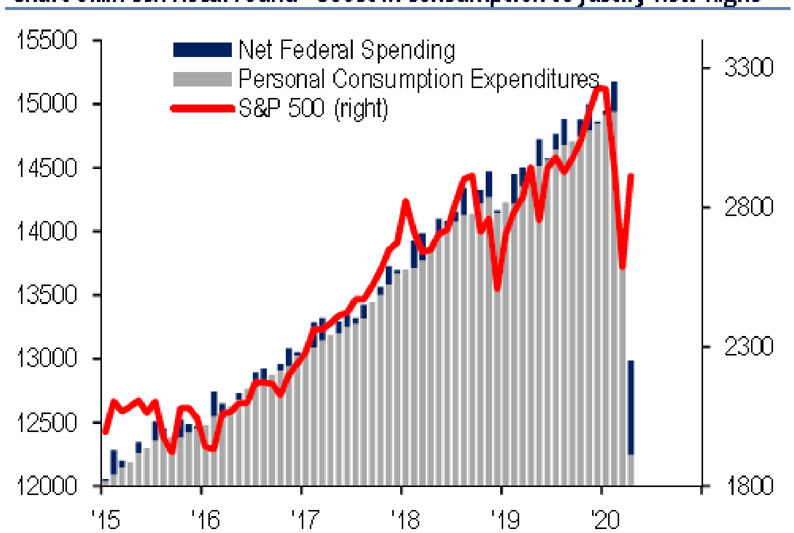
Chart 5: Fed bazooka to fade in coming months....



Source: BofA Global Investment Strategy, Bloomberg

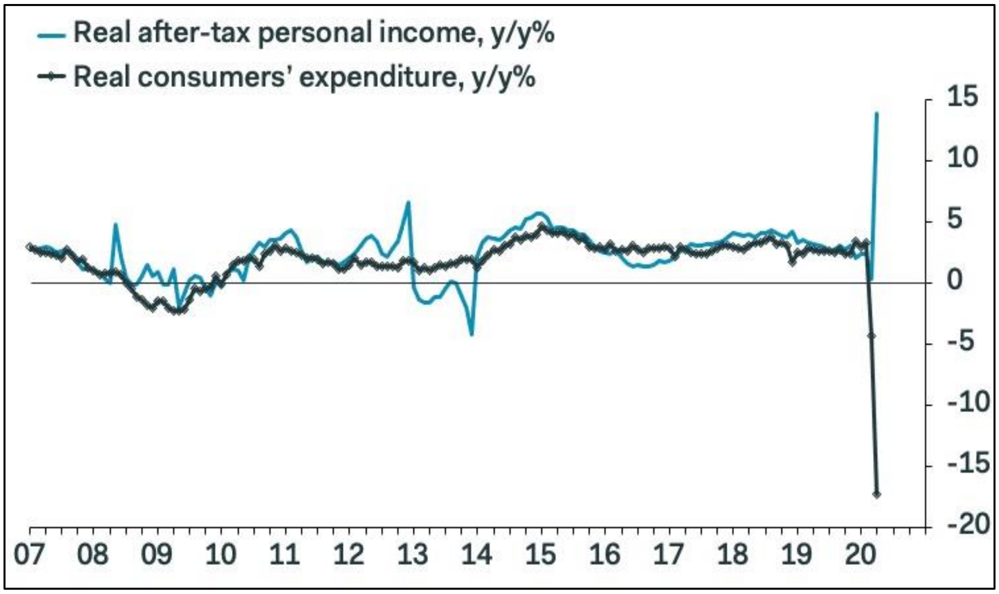
- when will a vaccine be available?
- is more US fiscal stimulus coming?
- will consumption return to pre virus levels and how long will it take. On the last reading, Personal Income jumped 10.5% ($3trl in government transfers) but people couldn't easily spend it, so the savings rate rocketed to 33%. Is a spending rebound next?

Chart 6:...fresh fiscal round+ boost in consumption to justify new highs



Source: BofA Global Research, Bloomberg, BEA, Treasury

The divergence between income and spending that we have seen is another one for the record books.



Source: Pantheon Macroeconomics

- will debt be a problem for growth or even solvency?
- do we end up with inflation or deflation?

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

China and HK FX

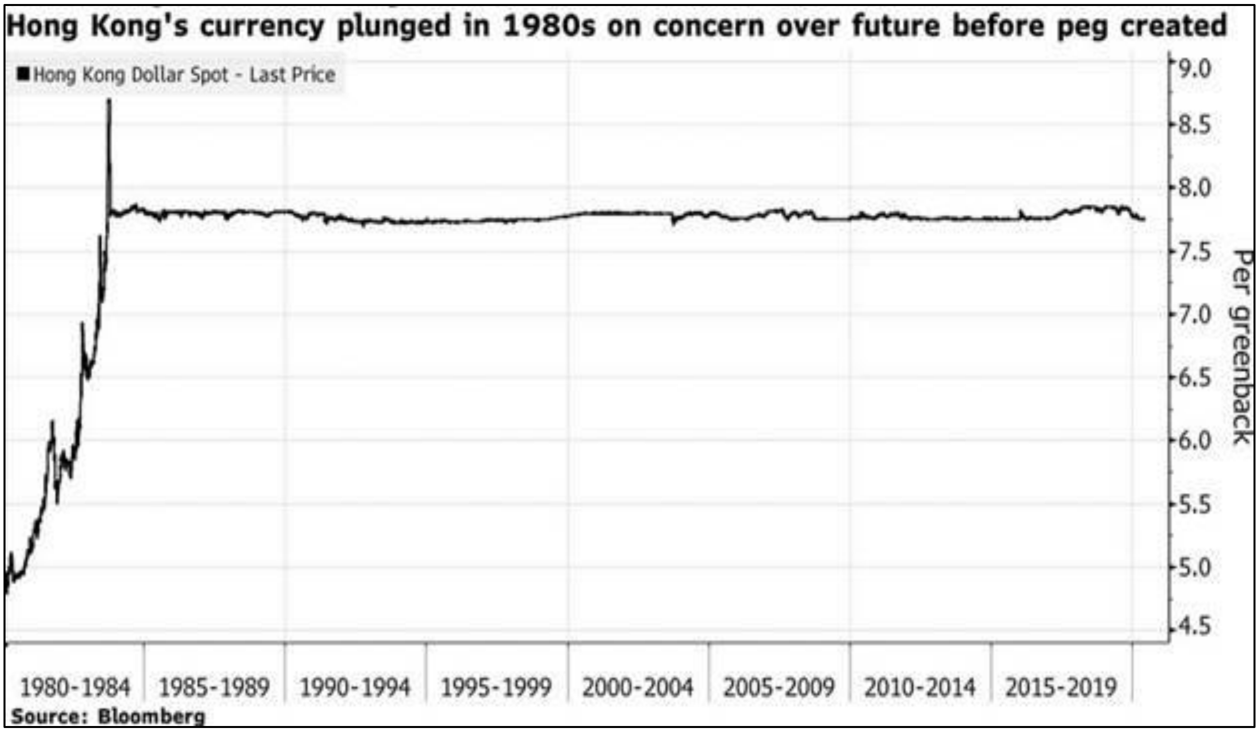
Lots of talk that China is going to devalue HKD, or CNH and CNY. Maybe all of them.

There would be two reasons to allow meaningful currency weakness.

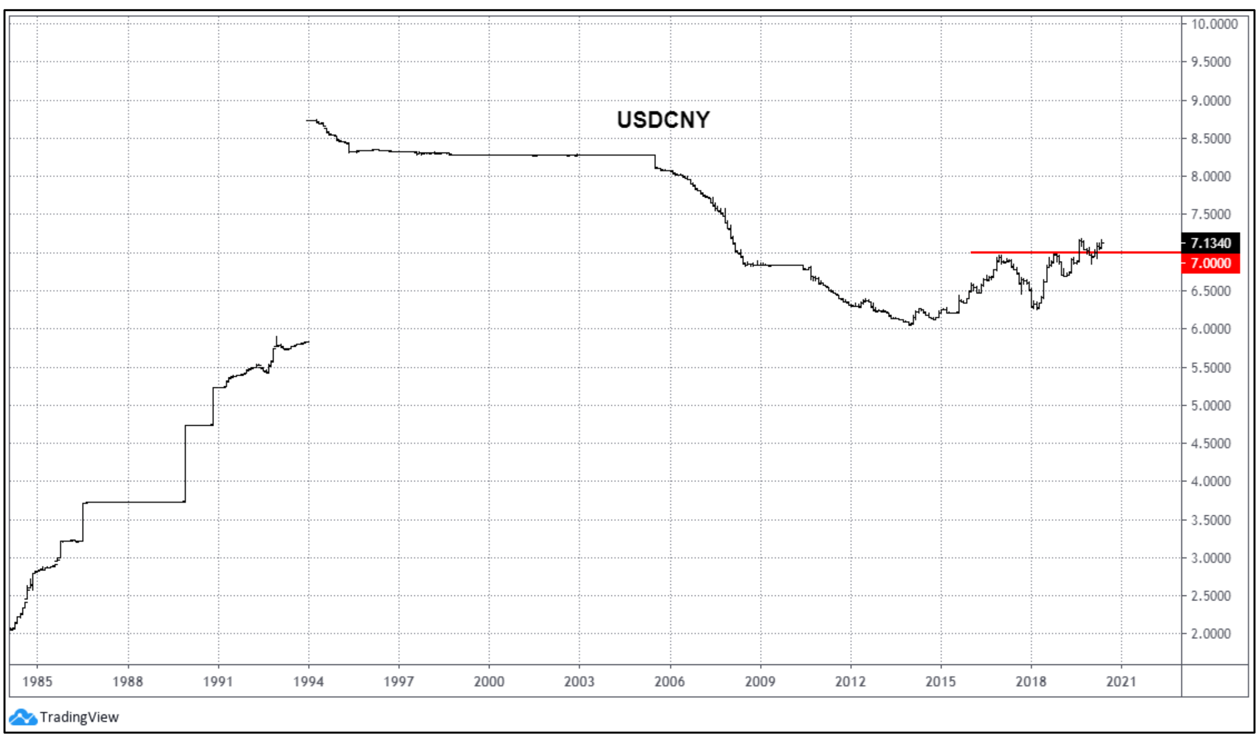
1) Political desire: With the sensitivity of the Trump administration to "currency manipulation" such a move would be very inflammatory given the current tensions. What would be gained? Maybe as a negotiating tool if moves are relatively small.
2) Economic need: The timing here doesn't feel right. A slow weakening would be expensive as they would see capital flight and need to spend resources to prevent the currency from falling faster should the move build momentum. A larger one-off devaluation (like the 50% fall in 1994) seems like an admission of weakness, both internally and externally, and unbecoming a rising superpower. It doesn't seem that at this point there would be a sufficient cash flow or solvency issue to warrant a meaningful devaluation or have one forced on them.

Another possibility would be that they announce a consolidation of currencies and that a structured devaluation of some kind is part of that process. A move towards one country, one currency.

USDHDK is pegged between 7.75 and 7.85 … still.



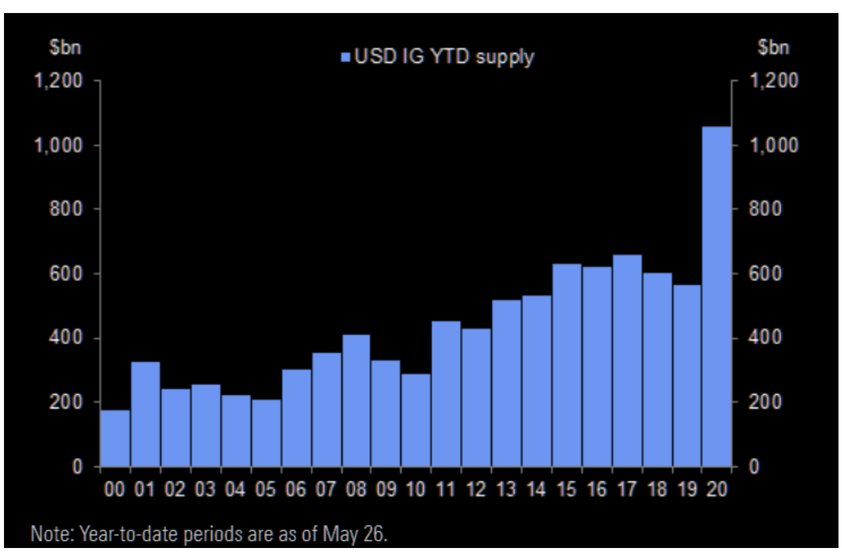
USDCNY made the news last year when it broke above 7.00 for the first time since 2008. Since then we have been trading either side of that level.



USDCNH, the tradable offshore Yuan, popped through the highs on Wednesday only to get knocked back down on Thursday and Friday. This is certainly worth keeping an eye…

Credit

So far, this year has seen over $1trl in US High Grade issuance (vs. $600bln average for the last 3 years at this point YTD). Insurance and offshore demand seem to be willing buyers. After the Fed announced its intension to support corporate credit markets, US investors bought as well. At this point, the Fed has only bought corporate bonds via ETF's rather than directly. The Corporate bond ETF buying has amounted to $3bln so far; a drop in the bucket. The signaling worked!



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Stargazer
Asset Management

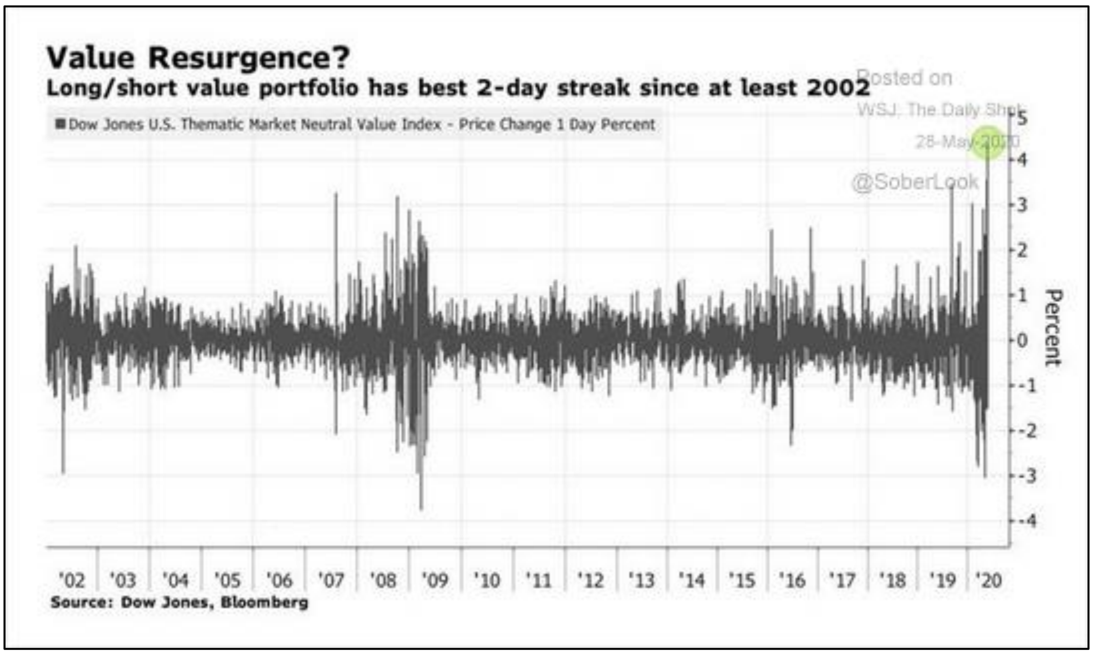
Markets

While we may not see a V bottom in the economy, it has been very close to one in equities. Within only a few weeks we went from 1% of S&P 500 stocks being above their 50-day moving average to 96%.

With investors still positioned defensively (longs have been in technology and defensive sectors like healthcare, utilities and staples) the temptation to buy downtrodden value stocks is strong.

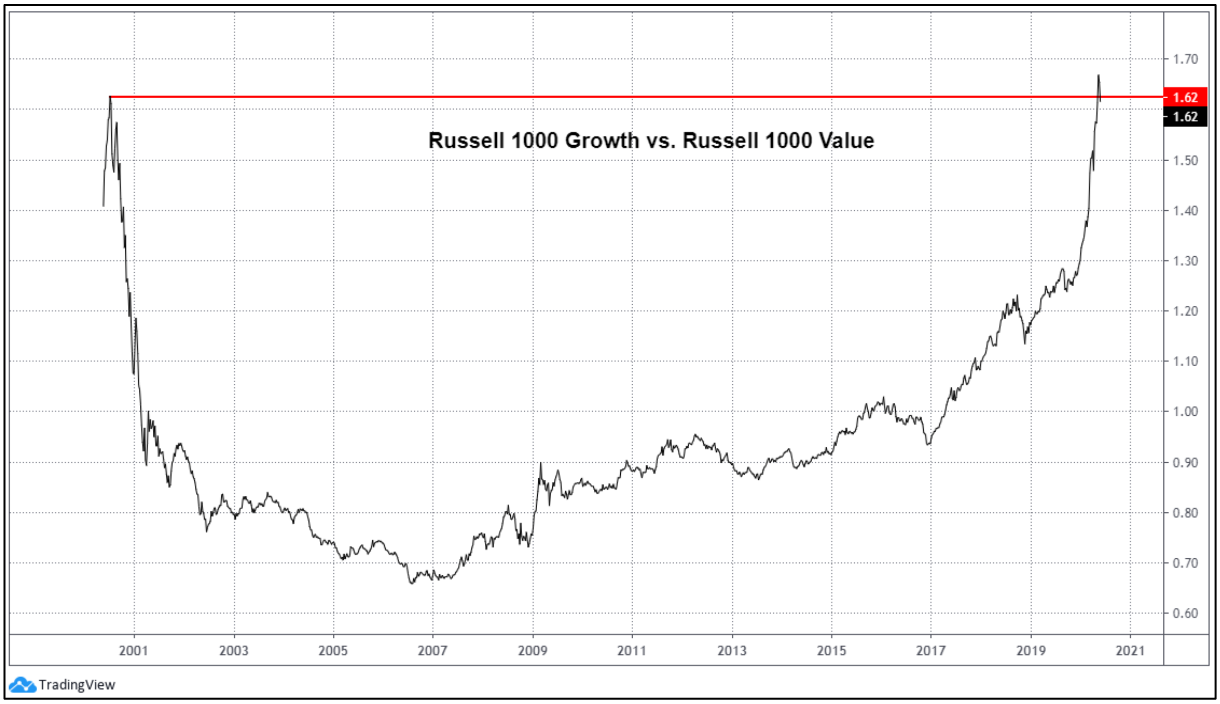
Sure enough, we saw a meaningful pop last week in value vs. growth. For it to be more than another short-term head fake in a well-entrenched trend, we will need a few ingredients.

On Tuesday and Wednesday of last week the market jumped into value stocks like it hasn't in a while (chart is from Wednesday). By the end of the week they were being knocked back down, so the jury is out on how sustainable this will be.

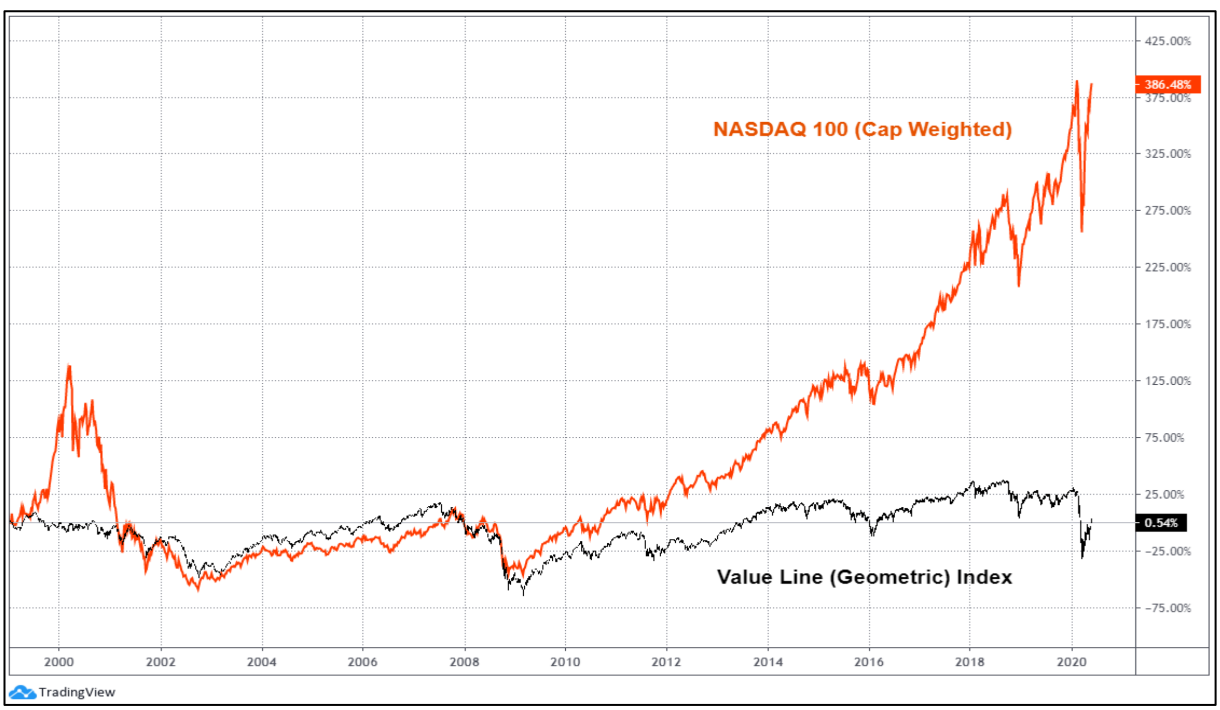


We are now back to 2000 Tech Bubble extremes in terms of growth outperformance. That of course doesn't mean it can't keep going, but just that it takes an unusual combination of factors to get us here. At that time, it was the mad rush to a new technology and its potential applications that drew money to US technology. The US was outperforming in terms of global growth, there was plenty of liquidity and the USD was strong. There are obviously some similarities. There are also lots of differences.

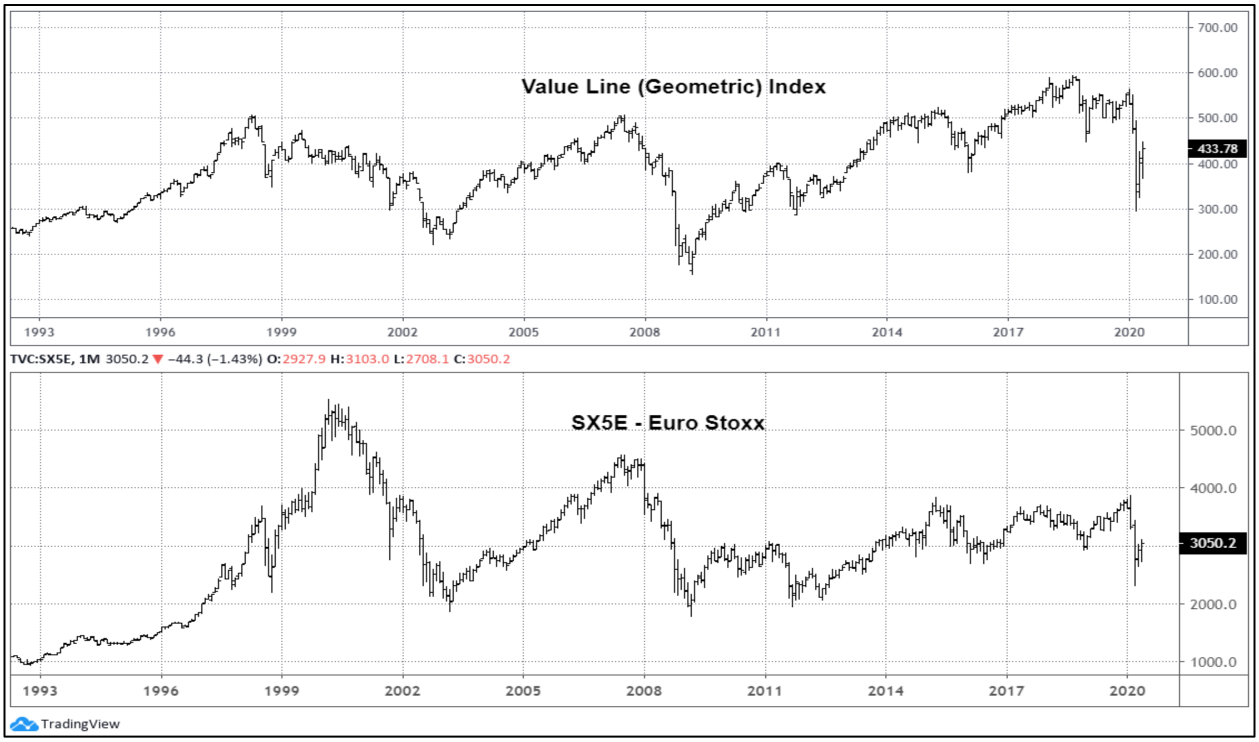
Back then everyone got over the tips of their skis and eventually the bubble popped, taking down markets overall, but also totally reversing the leadership. Amazingly, the March market selloff saw no reversal of leadership. Instead, the ongoing trends were reinforced.



Since the GFC it has continued to be all about the big cap NASDAQ growth stocks. The Value Line (Geometric) Index, an equally weighted index of 1,675 stocks is designed to give you an idea of how the average stocks has done.



This looks a lot more like the European markets.



Because of my background in FX, I find these relative trades easy to relate to. In FX a currency pair can be driven by changing expectations in either currency, or both simultaneously.

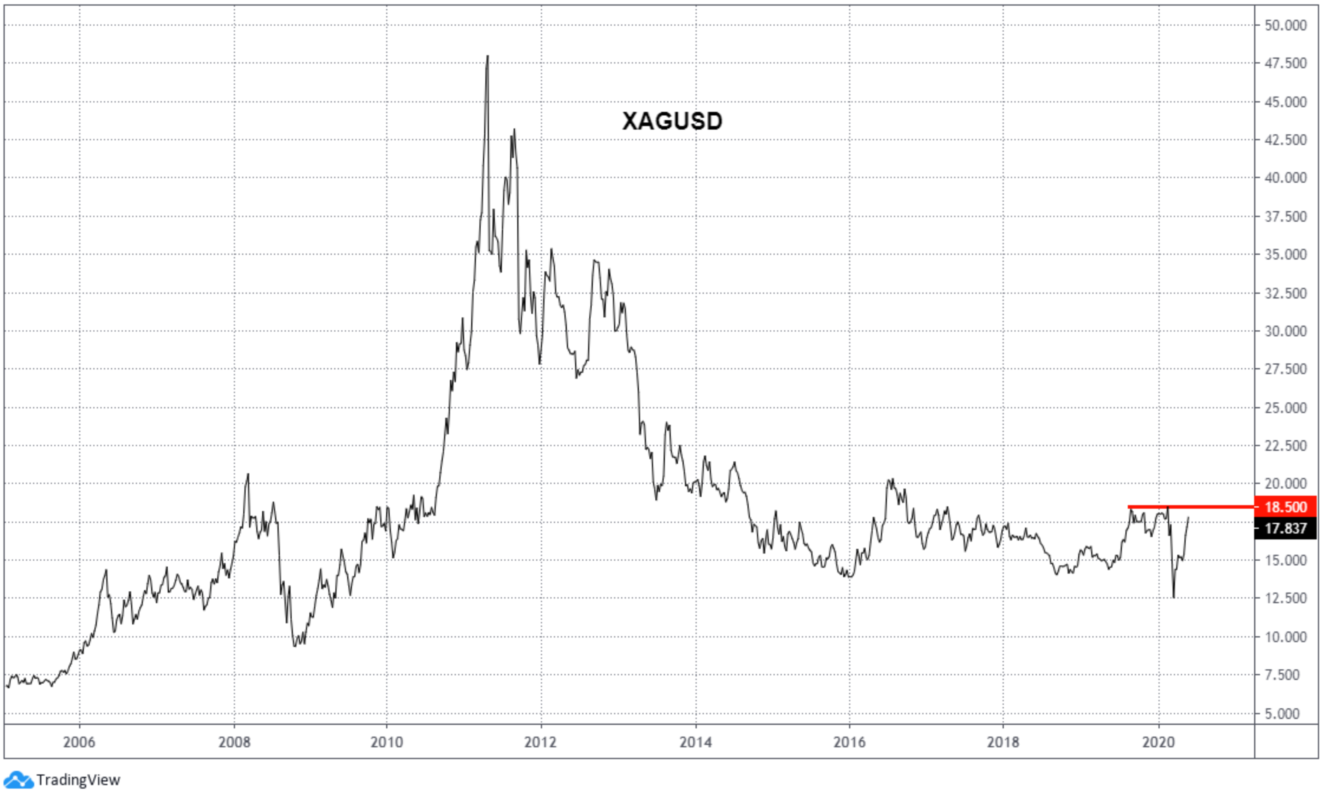
The growth vs. value trade can also have a number of drivers. New vs. old economy, low interest rates, low global growth and a strong USD have kept the trade going. A falling USD, higher global growth, higher interest rates or newfound regulatory zeal vs. healthcare and technology stocks could all contribute to a turn.

As such, the recently weakening USD is interesting. If that persists and is joined by higher global bond yields (assuming that yield curve control doesn't get in the way) a change in equity leadership will become increasingly plausible.

While the dollar has been falling vs. the higher beta growth currencies like AUD and SEK for a while, it has held up very well vs. the bigger majors like EUR, CHF and JPY. Very understandable I think given that they all have negative yields. Now with the USD back at the zero bound and lots of global liquidity maybe we can get more action. The authorities have done a good job drowning global need for USD and the prospect of European debt/recovery fund is giving the global version of the growth vs. value trade the best shot at leadership change it has seen in a while.

With the potential for a weaker USD, at least in the near-term, it is worth looking at some of the commodities. Silver has been on radar for a while and is perking up recently.

With a break above 18.50, it gets even more interesting.



Important Macro Data Releases and Events for the Week

Monday
6/1/2020

- Markit Manufacturing PMI (May) Forecast: 36.8, Prior: 36.8
- Markit Manufacturing PMI (May) Forecast: 39.8, Prior: 39.8
- ISM Manufacturing Employment Index (May) Forecast: 34.1, Prior: 27.5
- ISM Manufacturing PMI (May) Forecast: 42.5, Prior: 41.5
- ISM Manufacturing Prices Paid (May) Forecast: 33.3, Prior: 35.5
- ISM Manufacturing New Orders Index (May) Forecast: 40.3, Prior: 27.1

Tuesday
6/2/2020

- Caixin Services PMI (May) Forecast: 50.3, Prior: 44.4

Wednesday
6/3/2020

- Markit PMI Composite (May) Forecast: 31.4, Prior: 31.4

Markit PMI Composite (May) Forecast: 36.4, Prior: 36.4

Markit Services PMI (May) Forecast: 36.9, Prior: 36.9

ISM Non-Manufacturing New Orders Index (May) Forecast: 18.5, Prior: 32.9

ISM Non-Manufacturing PMI (May) Forecast: 43, Prior: 41.8

ISM Non-Manufacturing Employment (May) Forecast: 35.8, Prior: 30

ISM Non-Manufacturing Prices (May) Forecast: 52.5, Prior: 55.1

Factory Orders MoM (Apr) Forecast: -12.4, Prior: -10.4

Thursday
6/4/2020

ECB Interest Rate Decision/Policy Statement and Press Conf.

Initial Jobless Claims Forecast: - , Prior: 2.123m

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 2.608m

Friday
6/5/2020

Factory Orders s.a. MoM (Apr) Forecast: -20%, Prior: -15.6%

Nonfarm Payrolls (May) Forecast: -9m, Prior: -20.5m

Unemployment Rate (May) Forecast: 19.6%, Prior: 14.7%

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