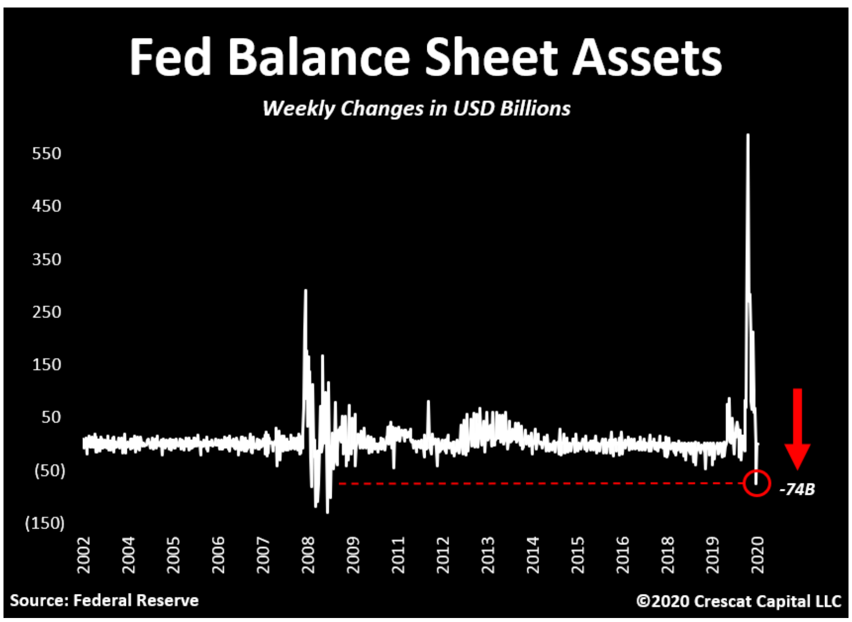
What to focus on in Global Macro for the week of June 22nd, 2020

Macro Themes on the Radar:

Fed and Treasury

There was a lot of debate about the shrinking of the Fed balance sheet this week. It did in fact shrink by -$74bln. The main reason for this, however, was a decline in the utilization of the FX swap lines. At the same time, the usage of the repo facility declined by $79bln. However, that was more than offset by an increase in MBS purchases of $83bln. We saw similar volatility in the Fed's balance sheet back in 2009 when some emergency liquidity facilities started to see lower utilization while QE was still accelerating. Breakdown of this weeks Fed b/s report here.

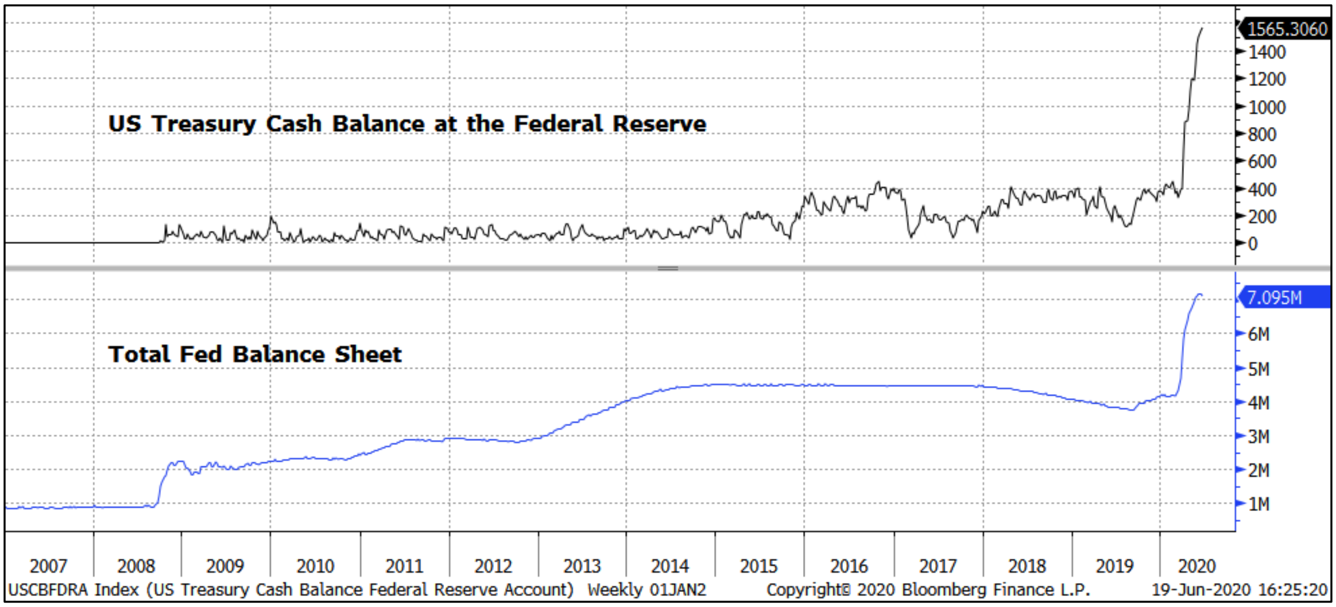


More interesting I think is what has been going on in the Treasury General Account. Before 2008, the Treasury had accounts with various US commercial banks. After 2008, the Fed became the Treasuries "banker". The TGA, is where the proceeds go from the government's debt issuance. The balance increases as borrowing by the Treasury outpaces spending, then again falls when the money is actually spent.

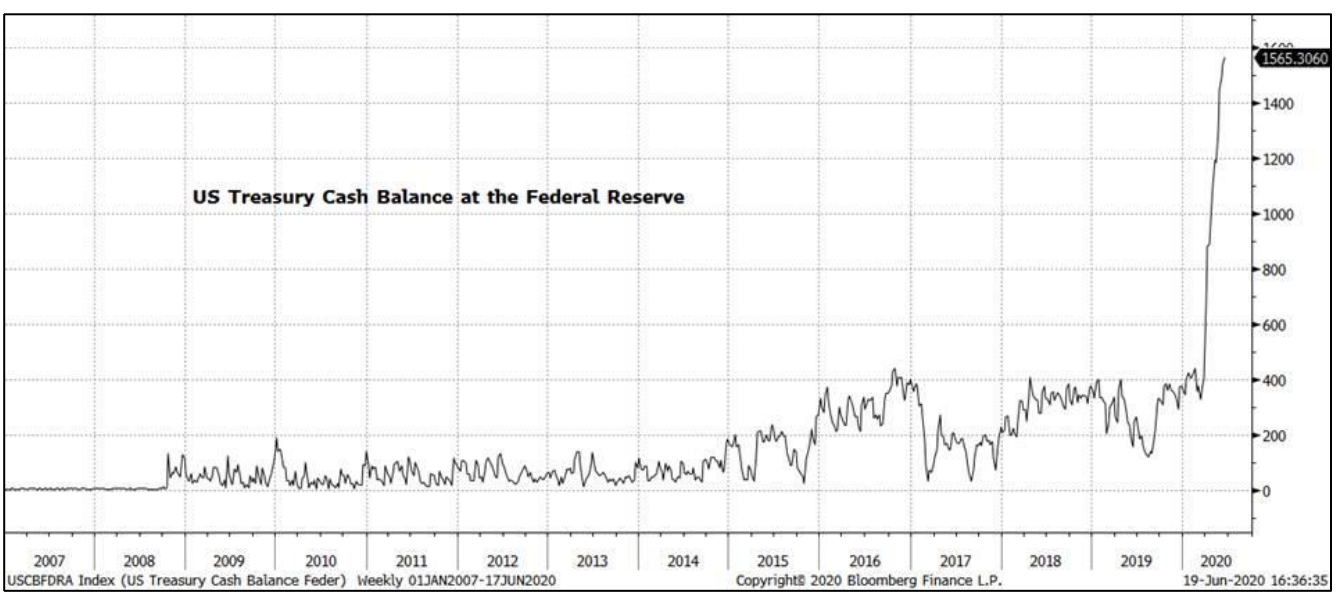
When taken in combination with the above-mentioned drop in the Fed's b/s, the liquidity drain last week was a meaningful -$120bln.

In recent weeks, the growth of the Fed's b/s was about equal to or greater than the growth in the TGA account. Government debt issuance was taking cash out of the markets, but the Fed was more than offsetting it via its b/s growth (QE, FX Swap lines, Repo, etc.)

Think of it as a huge freshly dammed lake being filled from a river (the economy). Normally all that water being diverted would leave the people downstream wondering what happened. However, in this case the Fed has been pumping in enough additional water that no one downstream noticed anything but ample amounts of the liquid(ity). While the Treasury drained from the economy, the Fed added via QE, and then some.



Currently we have a very large balance in the TGA. Between 2008 and 2015 we rarely saw the TGA exceed $200bln. Since 2016 it has fluctuated in a wider range but rarely exceeded $400bln for long. We have now sprinted to $nearly $1.6Trl. Eventually, this account will be drawn down and the money spent. Keep an eye on this. The speed with which it is spent (pre-election?) and where it goes will matter to the direction of markets and vary across asset-classes.



Stargazer Asset Management

ECB

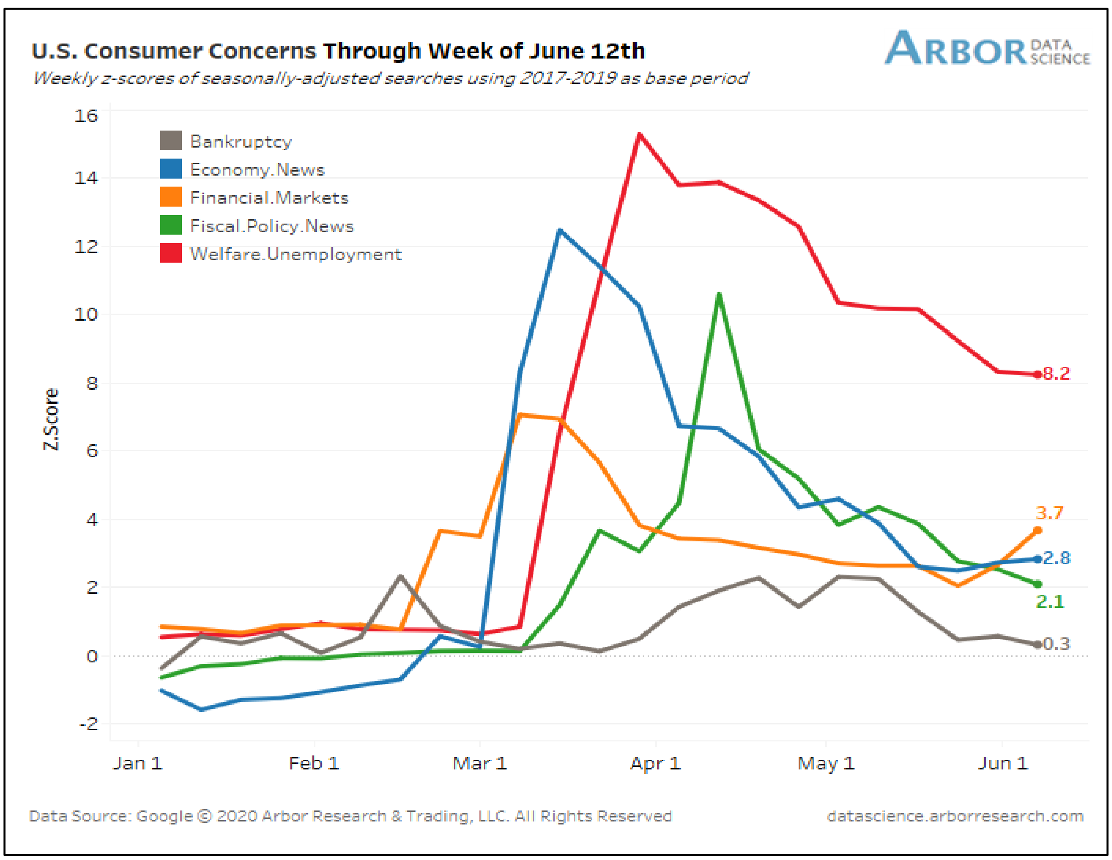
A lot more liquidity in Europe…

Last Thursday, the ECB announced the results for the latest TLTRO-III auction.

In total, a whopping €1.308trl was taken up by 742 banks (no stigma here). About €760bln was to replace maturing facilities, while there was an additional €550bln in new borrowing. I'm sure the generous terms didn't hurt. For the first year, funds were available at -1%, for years two and three at -.50%. This can only be seen as a success for the ECB, as it not only injected a great deal of liquidity but should help bank revenues (a bit) and allow banks to buy short dated paper of countries like Spain and Italy. The next auction is on September 24th.

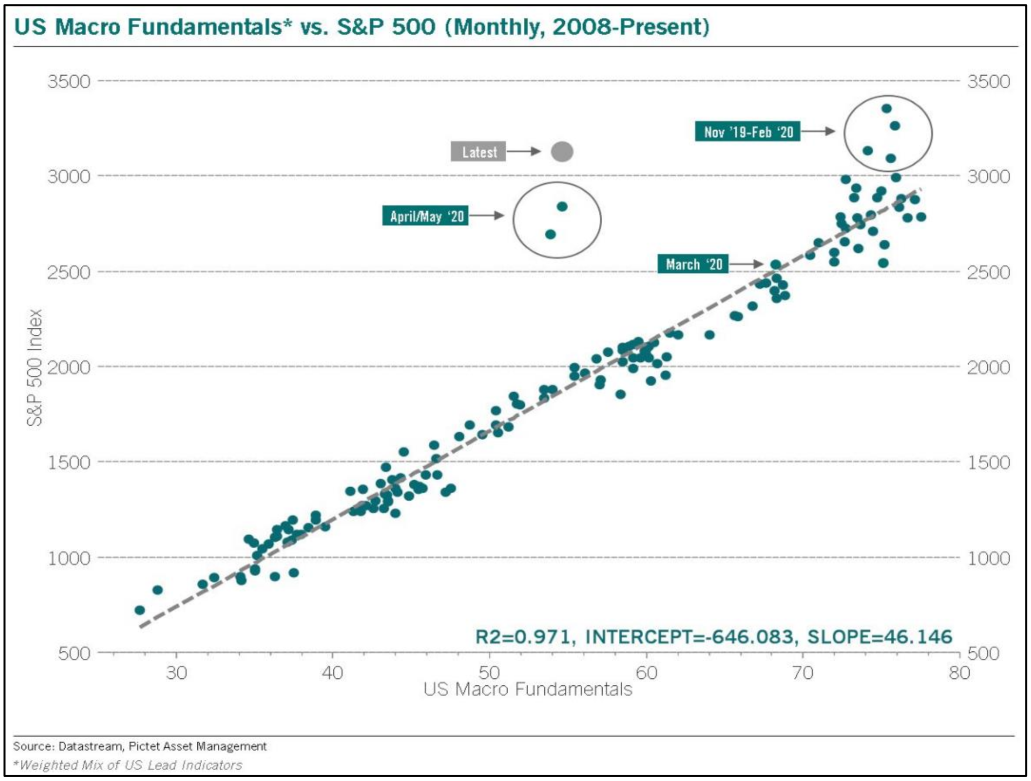
What to Focus on:

The mix of economic reopening and rising markets has certainly had a calming effect on some of the consumers financial fears.



(Arbor Data Science: Google searches for these terms)

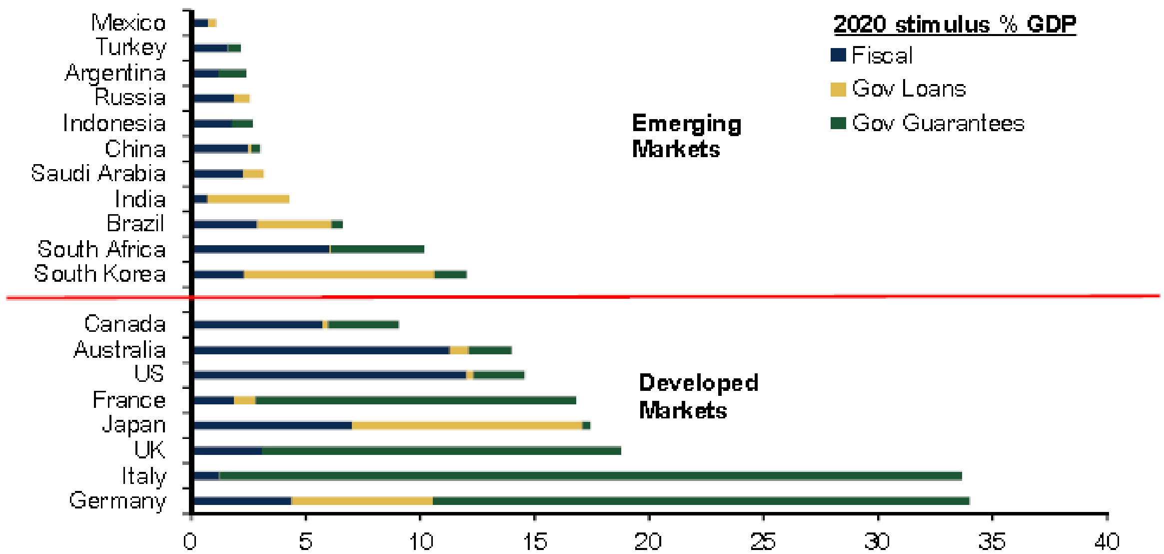
However, there continues to be a glaring divide between economic data and the equity markets powerful rebound.



Old guard investors like Buffett, Tepper, Druckenmiller, Grantham and Cooperman are facing off against the "buy the dip", TINA and "don't fight the Fed" crowd.

So far, the later have been in control. Stimulus: 1, Pushing on a string: 0 … The bullish argument is simple, stimulus has worked in the past for investors and now they are doing more than ever.

Chart 7: Fiscal bazooka in 2020 bigger in developed markets than emerging markets



Source: BofA Global Investment Strategy, BIS

BoA calculates that when you put together the total global monetary and fiscal stimulus this year, it amounts to $18.4trl or 20.8% of global GDP.

Upside risk is driven by the idea that all this stimulus will have to go somewhere, and the markets are drinking from a firehose of liquidity while it lasts. As Powell recently said, “we are not even thinking about thinking about raising rates”. In addition, there is a lot of money on the sidelines that needs to be forced back in before we can get a lasting top. Finally, the narrative says the dollar is heading south, and a plunging currency is good for stocks in nominal terms. With potential reflation and a falling USD, you can buy value stocks, both in the US and globally.

The bears think valuations are already very high and that the US has already massively outperformed the rest of the world for years. (NASDAQ etc. as discussed last week) They worry that global credit defaults are coming and that just as everyone piles back in, an economy that can only get back to 90% of its previous self will mean a double dip in markets.

The key variable for me and what should keep volatility higher in the coming years, is that the time of the central banks is fading, and the time of politically driven policy and fiscal activism has arrived. This was already a shift in the making… but COVID jammed it into high gear. Many taboos have already been broken and so far, it is being tolerated by the markets without any negative side effects. This emboldens policy makers to keep going, testing the limits further. Eventually this means more volatility in markets.

This is a big change in the backdrop for markets, inflation, trade and currencies. With COVID leaving all participants with more debt, there is no going back now.

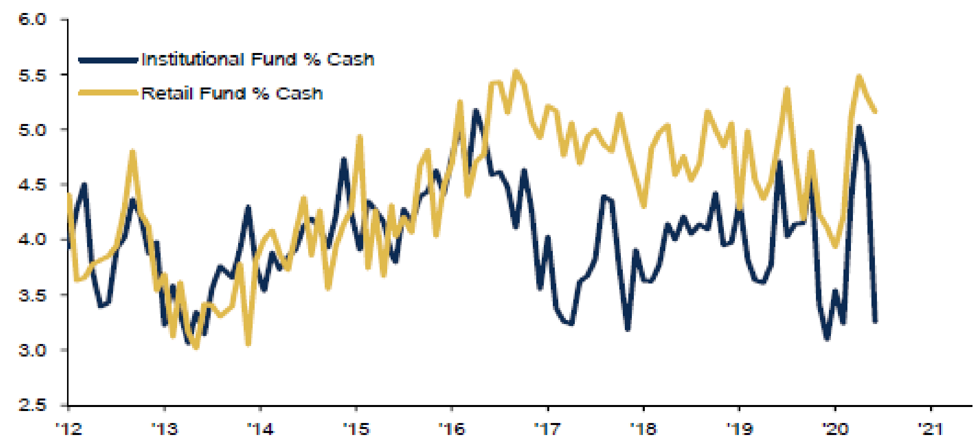
Cash on the sidelines?

There are really two types of cash on the sidelines.

1) Fund managers who have gone to cash with some portion of their AUM. The assumption being that this will help drive asset prices higher as it is reinvested.

Institutional funds (e.g. pension funds / insurance companies) have been the ones buying equities and retail funds (e.g. mutual funds / unit trusts / investment trusts) still have cash to deploy.

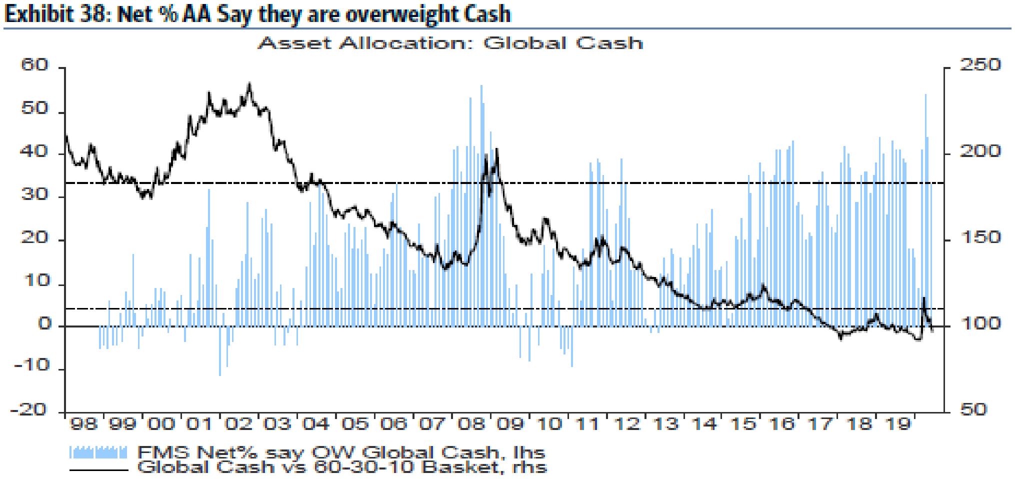
Exhibit 10: Which of the following comes closest to your current cash position in your portfolio?



Source: BofA Global Fund Manager Survey, Bloomberg

The BoA June FMS shows cash level down from 5.7% to 4.7%, biggest drop since Aug'09 (led by institutional not retail investors)

Exhibit 38: Net % AA Say they are overweight Cash



Source: BofA Global Fund Manager Survey

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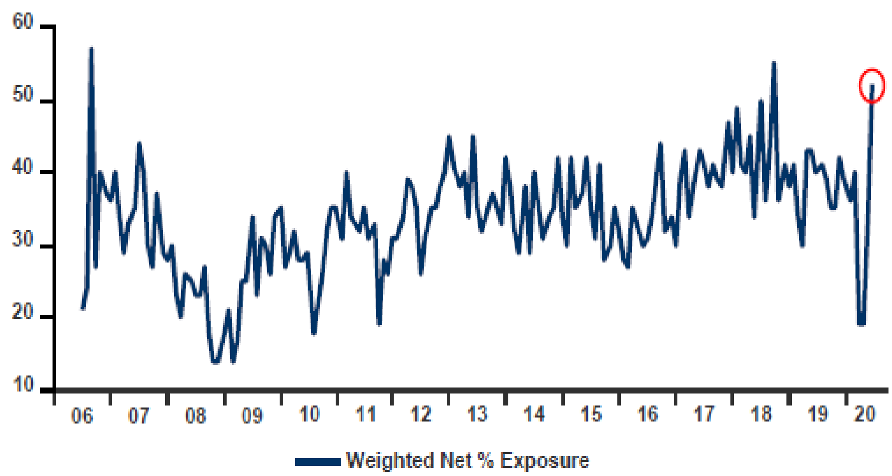
Hedge fund net equity exposure "skyrocketed" according to BoA to 52% up from 34%, to highest level since Sept'18.

Exhibit 11: Hedge Fund current net exposure to the equity markets



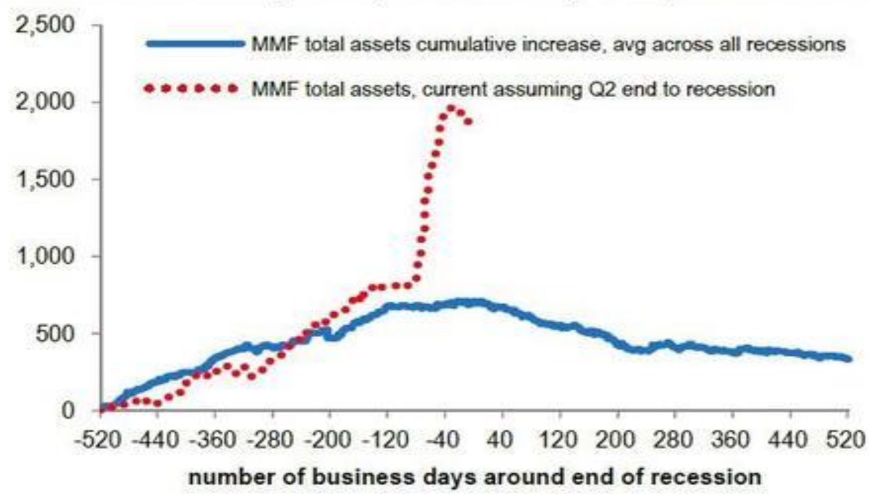
Source: BofA Global Fund Manager Survey, Bloomberg

2) Cash in Money Market Funds. This is a much less certain source for investment capital. Some of it may be permanently sidelined for various reasons while some of it might just be temporarily parked in MMF's.

However, the MMF balances have popped onto everyone's radar because they have exploded and only just started to roll.

Chart 7: Enormous dry powder -- very little of recession-era inflows into cash have been reversed this spring

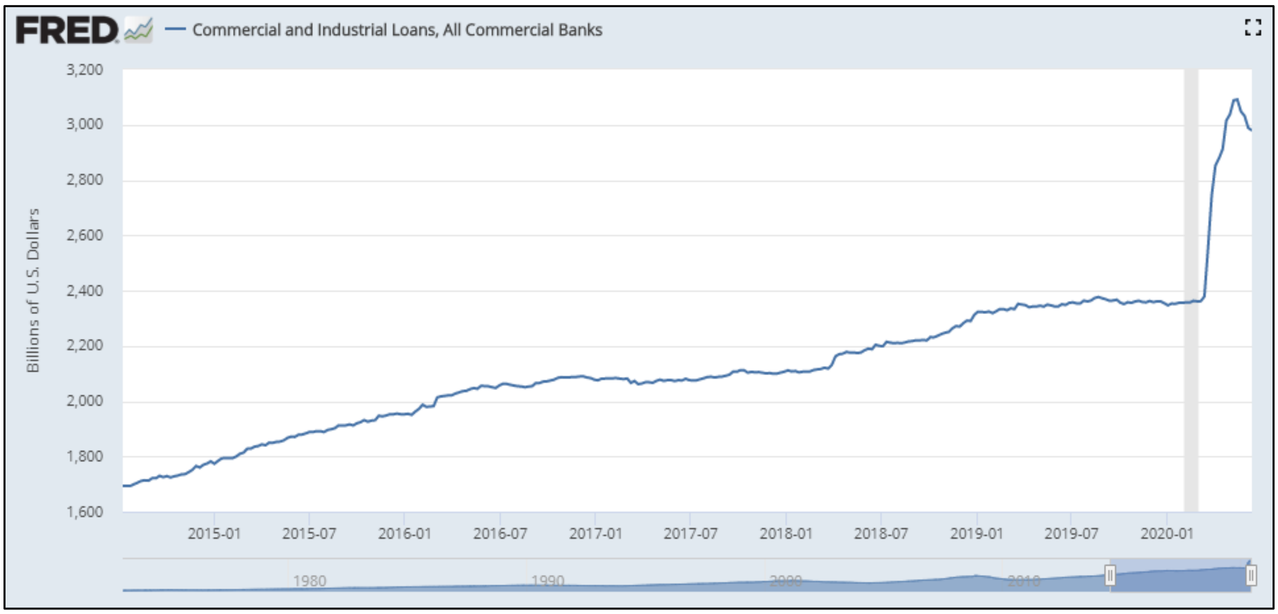
Cumulative change in US money market fund holdings (retail and institutional) in the two years before and after the end of US recessions in USD billions. Average of last three recessions (1990-91, 2001 & 2008-09) in blue, 2020 recession in red.



Source: J.P. Morgan, ICI

Just like the Treasury and the TGA we looked at earlier, corporations have been borrowing large amounts by drawing down on their bank lines, issuing debt and issuing CP.

C&I Loans alone have jumped in the neighborhood of 650bln. (Notice the little rollover…)



I'm going to go out on a limb and say that some meaningful portion of those funds are sitting in institutional MMF's. That is money that is never going into equities.

Growth vs. Value

As noted, institutional investors have been buying equities.

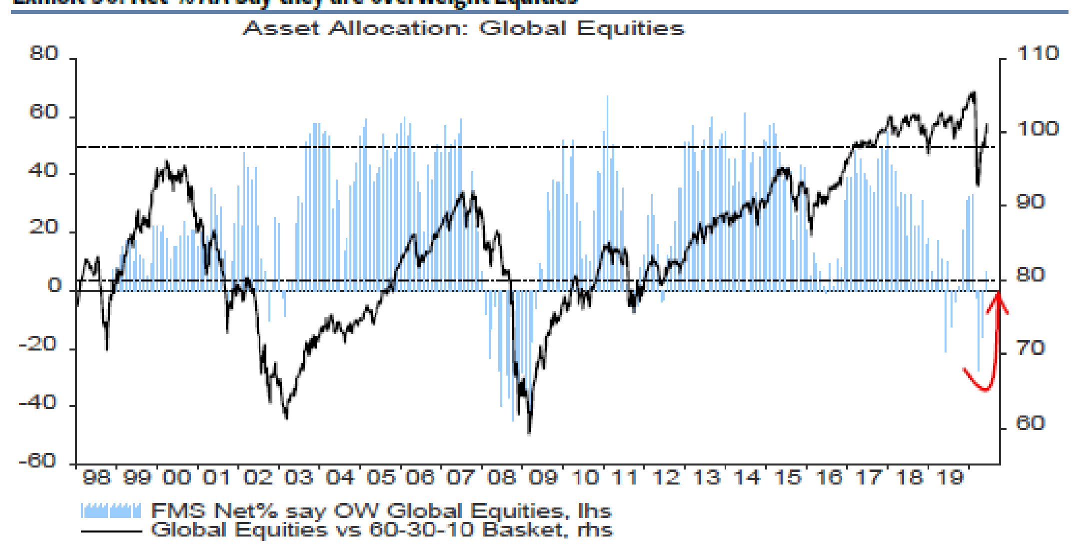


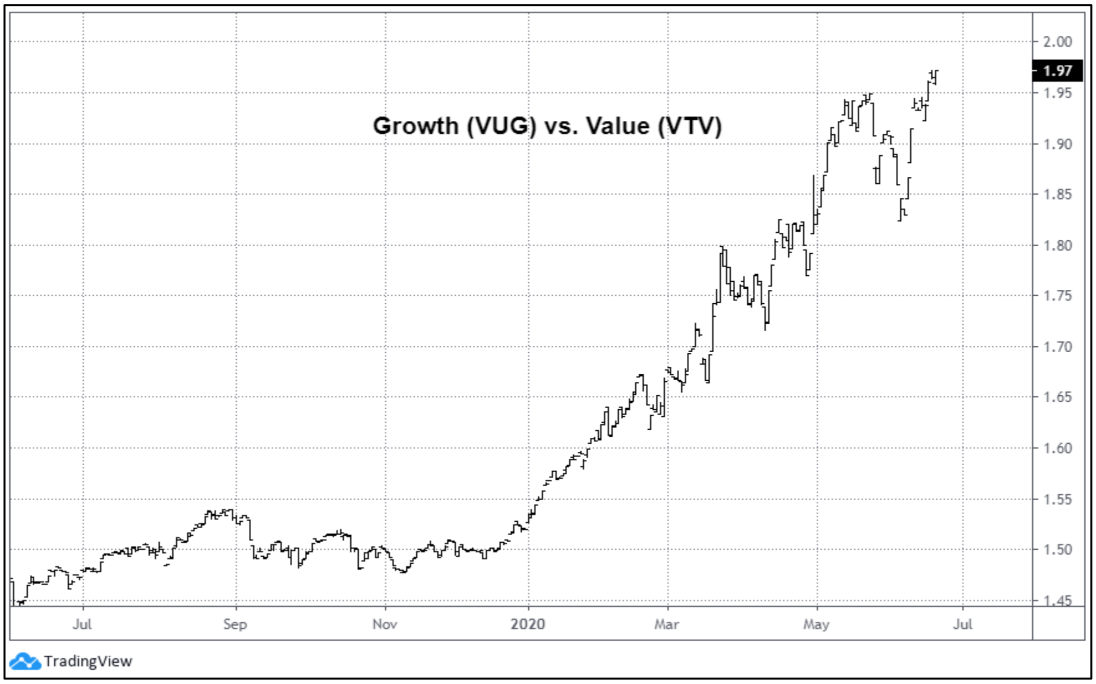
Exhibit 36: Net % AA Say they are overweight Equities

Source: BofA Global Fund Manager Survey

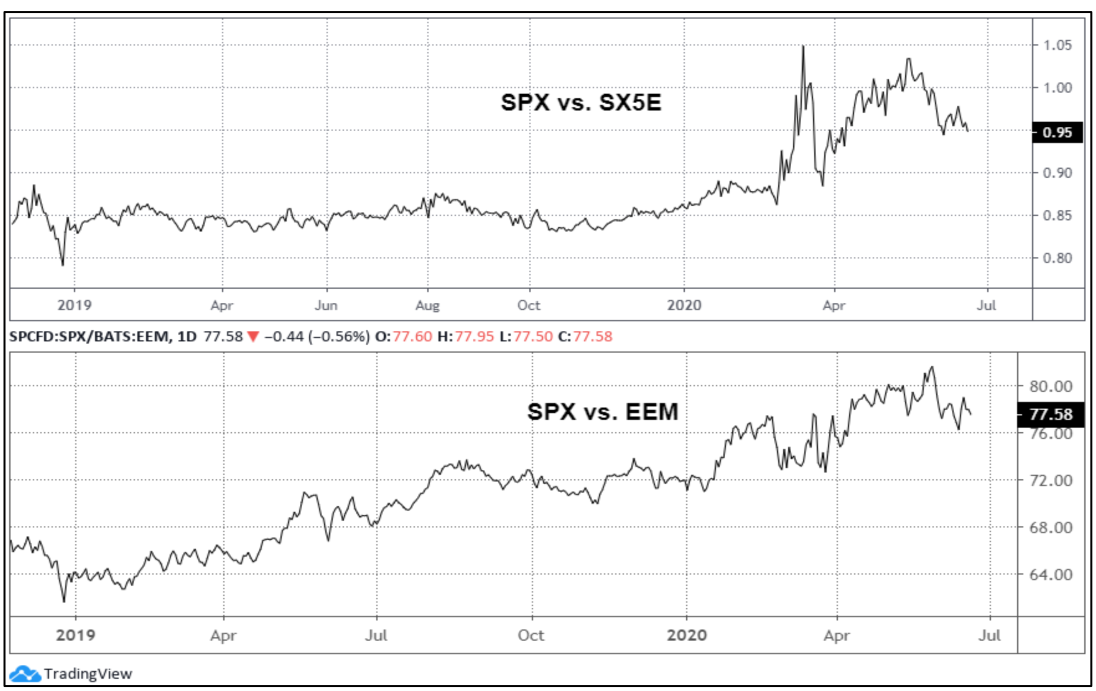
They have been buying “value”. Globally by buying EM and Europe; in the US, by trimming underweights in Banks, Energy, Materials and Industrials.

Initially the flow was confirmed by the price action, but that has faded.

Over the last week, “growth” has taken back the reigns in the US for the moment.



While internationally “value” has been holding on to nascent signs of a turn.



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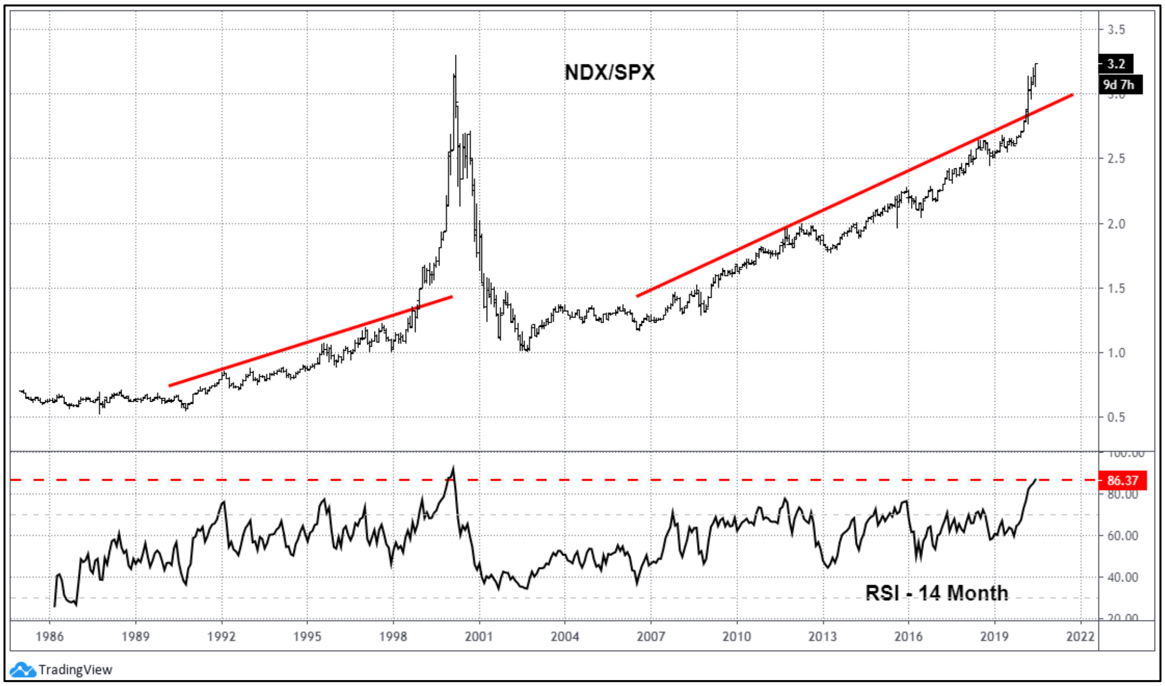
Overall, the NDX has had an amazing run and has only been this overbought vs. SPX in '99 during the exponential phase. The chart doesn't say anything about how much higher it can go but does show how unusual the setup is and that we may be getting closer to a top in this outperformance, if not in price then in time.



USD and Yields

As you know, the ability for there to be a meaningful rotation between "value" and "growth" is highly dependent on a lasting turn in the USD, and preferably a meaningful steepening of the yield curve.

So far bonds have had a few lurches but have had a hard time breaking away from the current range.

With some now looking for the Fed to institute Yield Curve Control by September, things are going to get (even more) interesting. Initially YCC would only be on the front end of the curve, enacted with the intent of strengthening forward guidance. However, if bond markets were to get uppity, would they go further out? While this sort of policy might dampen volatility in bond markets it would almost certainly increase it in other asset classes.

The USD, for all the very bearish calls, hasn't done all that much. USD has fallen 3-4% vs. DM and 8 to 12% vs. EM and the likes of AUD. Having said that, the higher beta currencies had much bigger dislocations during the lockdowns and part of this is just a repricing of the worst case.

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With the dual-deficits and massive liquidity/easy monetary policy, the dollar should fall. However, the relative nature of FX matters and there are lots of factors at play here.

The recent USD weakness has silenced the bulls and brought out all the bears.

Steven Roach, former Chairman of Morgan Stanley Asia, current Yale faculty member, and longtime USD bear has written two impassioned pieces calling for a large fall in the dollar.

https://www.bloomberg.com/opinion/articles/2020-06-08/a-crash-in-the-dollar-is-coming

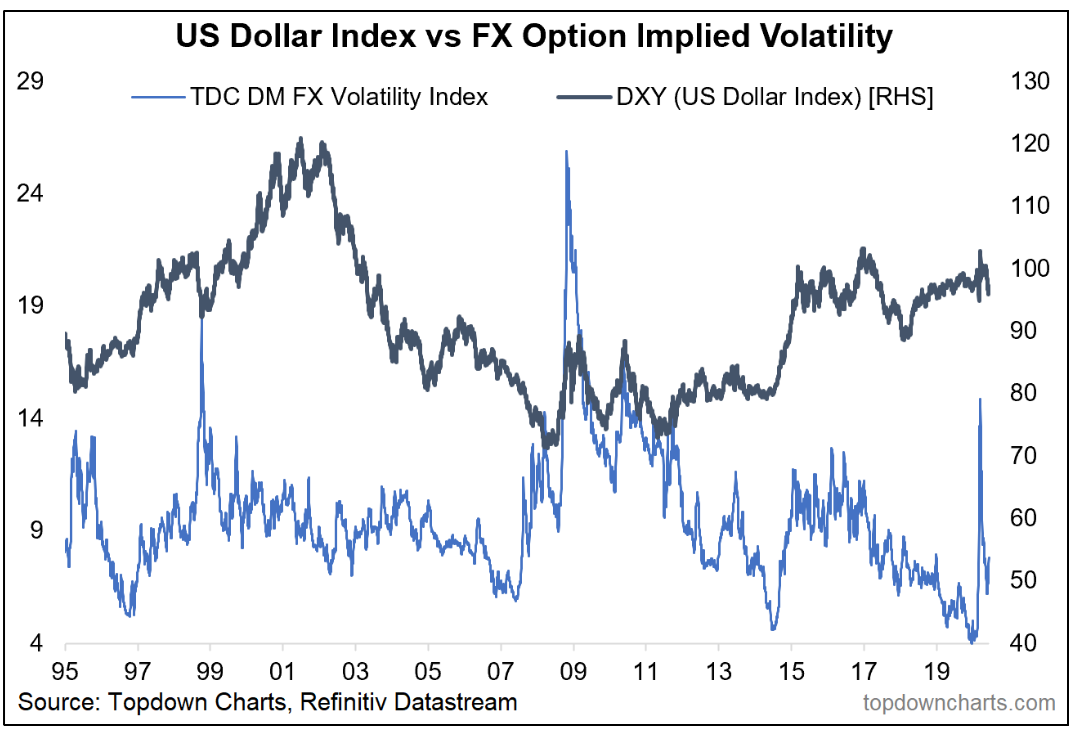
https://www.bloomberg.com/opinion/articles/2020-06-14/dollar-crash-how-will-it-unfold

He tries to refute the TINA argument in favor of the dollar and thinks a big asset allocation shift is coming. He feels Europe is at a turning point (which I have some sympathy for), but also thinks an end to American Exceptionalism is coming. He describes a world that would have much higher inflation and would imply an end to NASDAQ leadership.

Important stuff, so need to be very focused on what comes next in FX.

I'm not yet a confirmed USD bear. Maybe I'm slow to turn, but something isn't clicking for me. For now, I'm looking for more evidence either way.

I thought this was an interesting chart… an initial pop in volatility is often followed by another big trending move in spot.



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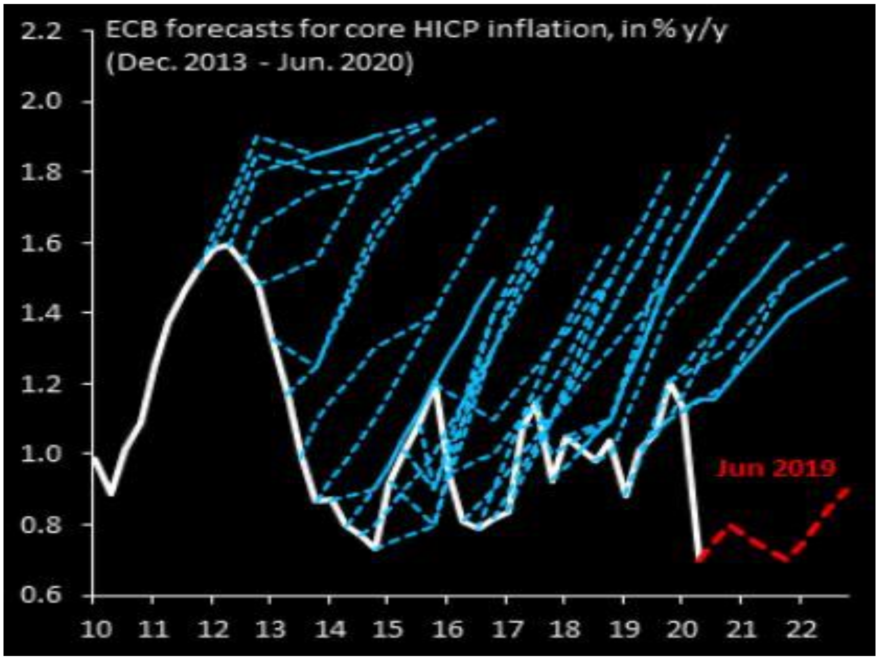
Comedy Chart… ECB inflation forecasts over the years (blue) vs. actual outcome.



Important Macro Data Releases and Events for the Week

Monday
6/22/2020

- PBoC Interest Rates Decision Current: 3.85%
- German Buba President Weidman SPEECH
- Chicago Fed National Activity Index Forecast: -, Prior: -16.74
- Existing Home Sales MoM (May) Forecast: 4.2m, Prior: 4.33m
- ECB's De Guidos SPEECH
- BoC Governor Macklem SPEECH
- ECB's Lane SPEECH

Tuesday
6/23/2020

- Markit Manufacturing PMI (June) Forecast: 41, Prior: 36.6
- Markit Services PMI (June) Forecast: 41.1, Prior: 32.6
- Markit PMI Composite (Jun) Forecast: 44, Prior: 32.3

Markit Manufacturing PMI (June) Forecast: 43.8, Prior: 39.4

Markit Services PMI (June) Forecast: 40.5, Prior: 30.5

Markit PMI Composite (Jun) Forecast: 41, Prior: 31.9

Markit Manufacturing PMI (June) Forecast: 44, Prior: 39.8

Markit Services PMI (June) Forecast: 43.7, Prior: 37.5

Markit PMI Composite (Jun) Forecast: -, Prior: 37

Richmond Fed Manufacturing Index (Jun) Forecast: -, Prior -27

New Home Sales MoM (May) Forecast: .634m, Prior: .623m

Wednesday
6/24/2020

Leading Economic Index (Apr) Forecast: 76.2, Prior: 76.2

ECB's Lane SPEECH

IFO - Business Climate (Jun) Forecast: 85, Prior: 79.5

IFO - Current Assessment (Jun) Forecast: 84, Prior: 78.9

IFO - Expectations (Jun) Forecast: 85.2, Prior: 80.1

Thursday
6/25/2020

All Industry Activity Index MoM (Apr) Forecast: -, Prior: -3.8%

Gfk Consumer Confidence Survey (Jul) Forecast: -21.7, Prior: -18.9

ECB Monetary Policy Meeting Accounts REPORT

Initial Jobless Claims Forecast: - , Prior: 1.508m

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 1.7735m

Continuing Claims Forecast: - , Prior: 20.544m

Durable Goods Orders (May) Forecast: 10.3%, Prior: -17.7%

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- Durable Goods Orders ex Transportation (May) Forecast: 2.8%, Prior: -7.7%
- Durable goods Orders ex Defense (May) Forecast: -%, Prior: -16.6%
- Core Personal Consumption Expenditures QoQ (Q1) Forecast: 1.6%, Prior: 1.6%
- GDP Annualized Q1 Forecast: -5%, Prior: -5%
- ECB's Mersch SPEECH
- ECB's Schnabel SPEECH

Friday
6/26/2020

- Core PCE - Price Index MoM (May) Forecast: 0%, Prior -0.4%
- Core PCE - Price Index YoY (May) Forecast: 0.9%, Prior 1%
- Personal Income MoM (May) Forecast: -6%, Prior: 10.5%
- Personal Spending (May) Forecast: 9%, Prior: -13.6%
- Michigan Consumer Sentiment Index (Jun) Forecast: 79, Prior: 78.9