What to focus on in Global Macro for the week of February 22nd, 2021

Macro Themes on the Radar:

With bond yields rising at an accelerating pace globally last week, markets have started to pay attension.

Both Fed and ECB minutes from the prior meetings were released and the CB's acknowledged near-term inflationary pressures, but vowed to look through them, seeing them as transitory.

From the Fed minutes: "*... participants emphasized that it was important to abstract from temporary factors affecting inflation-such as low past levels of prices dropping out of measures of annual price changes or relative price increases in some sectors brought about by supply constraints or disruptions-in judging whether inflation was on track to moderately exceed 2 percent for some time.*

With regard to upside risks, some participants pointed to the possibility that fiscal policy could turn out to be more expansionary than anticipated, that households could display greater willingness to spend out of accumulated savings than expected, or that widespread vaccinations and easing of social distancing could result in a more rapid boost to spending and employment than anticipated."

The message from the ECB was much the same. I guess they wanted to drive it home for Valentines Day. (many of the responses on Twitter were...unkind)

In the near-term the stars look alligned. Cost-push inflation from supply-side bottle necks and rising commodity prices on one hand, and demand side pressures from additional fiscal stimulus on the other. Don't forget the base effects. Add in the largest jump in money supply ever seen (+26% in M2) and very easy financial conditions. With the pump already primed, the iminent reopening boom is expected to unleash a torrent of pent up economic activity as the bored and homebound are set free. Finally, we have a Fed that has already commited to continue it's easy money policies until we get an inflation overshoot to make up for past undershooting of the target.

In the meantime, Treasury Secretary Yellen continues her calls to "act big" regarding further stimulus, echoing her view that doing too little holds more risks than doing to much. Prompt and forceful action could get the country back to full employment, in as little as a year from now,

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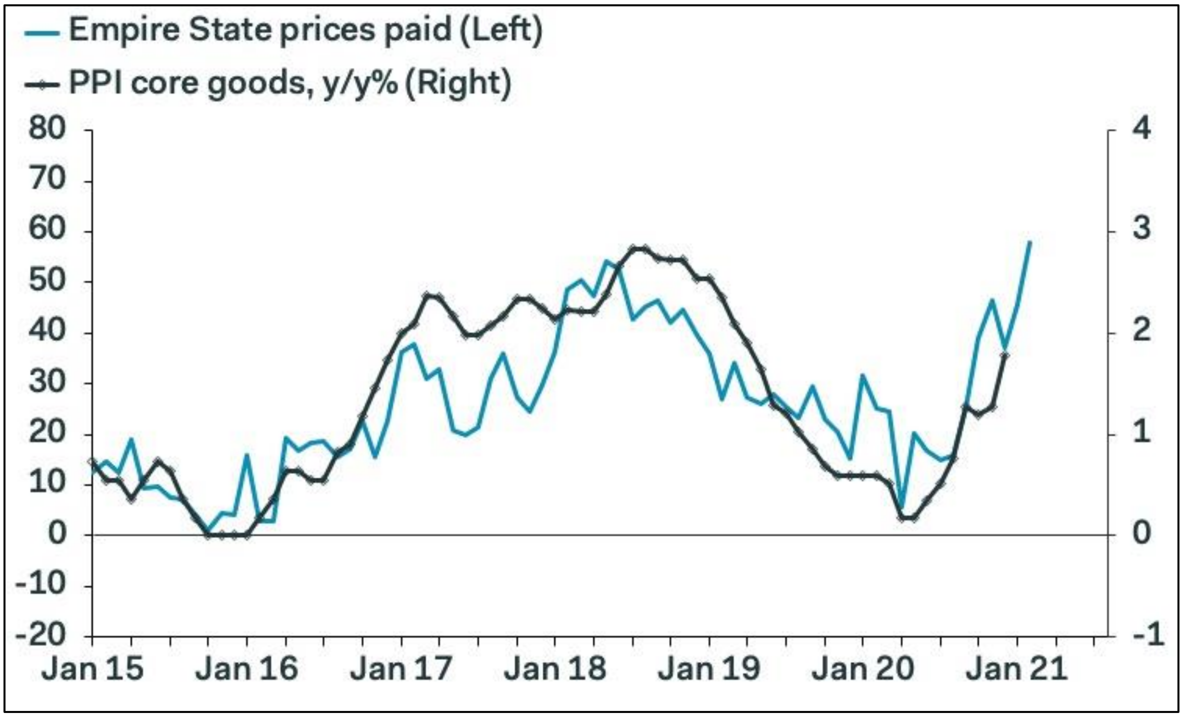
she contends. Larry Summers continues to take the other side, saying it will quickly overheat the economy and push inflation higher, forcing the Fed to reverse course.

Last week's higher than expected PPI print caught the markets attension. More high inflation prints are likely to follow in the coming months.



However, the difference between a transitory jump in inflation and a new inflation trajectory will in the end depend on the global outlook. No longer are country specific output gaps as important as the aggregate global picture. Continued de-globalization could reduce the runway, but so far probably hasn't been impactful enough to make a huge difference. A persistantly and meaningfully weaker USD from here could have more longer-lasting effects on inflation as well.

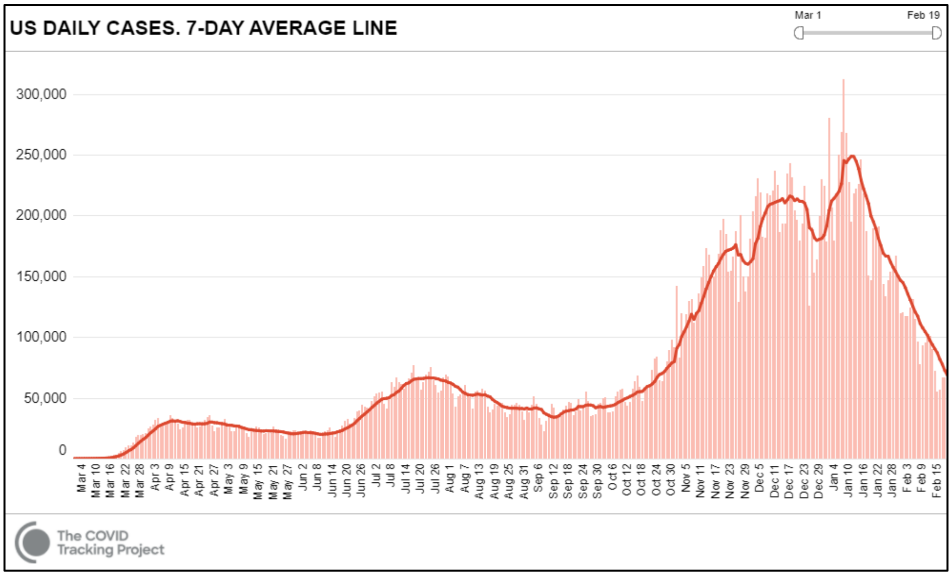
The question is, can the Fed hold the line on tighter policy or do they waver as the market challenges them? Do they have the ability to stick with the "transitory" story, or do they blink? Any wavering on AIT could result in a "taper tantrum" 2.0 now.

Over the weekend a Johns Hopkins Doctor proposed that we could be much closer to herd immunity than is generally believed. The combination of vaccinations and a 6x undercount of how many people have already had the virus means that it is all over by April, according to his thinking. As you would expect there was all sorts of pushback.

Increasingly however, markets may price this scenario.

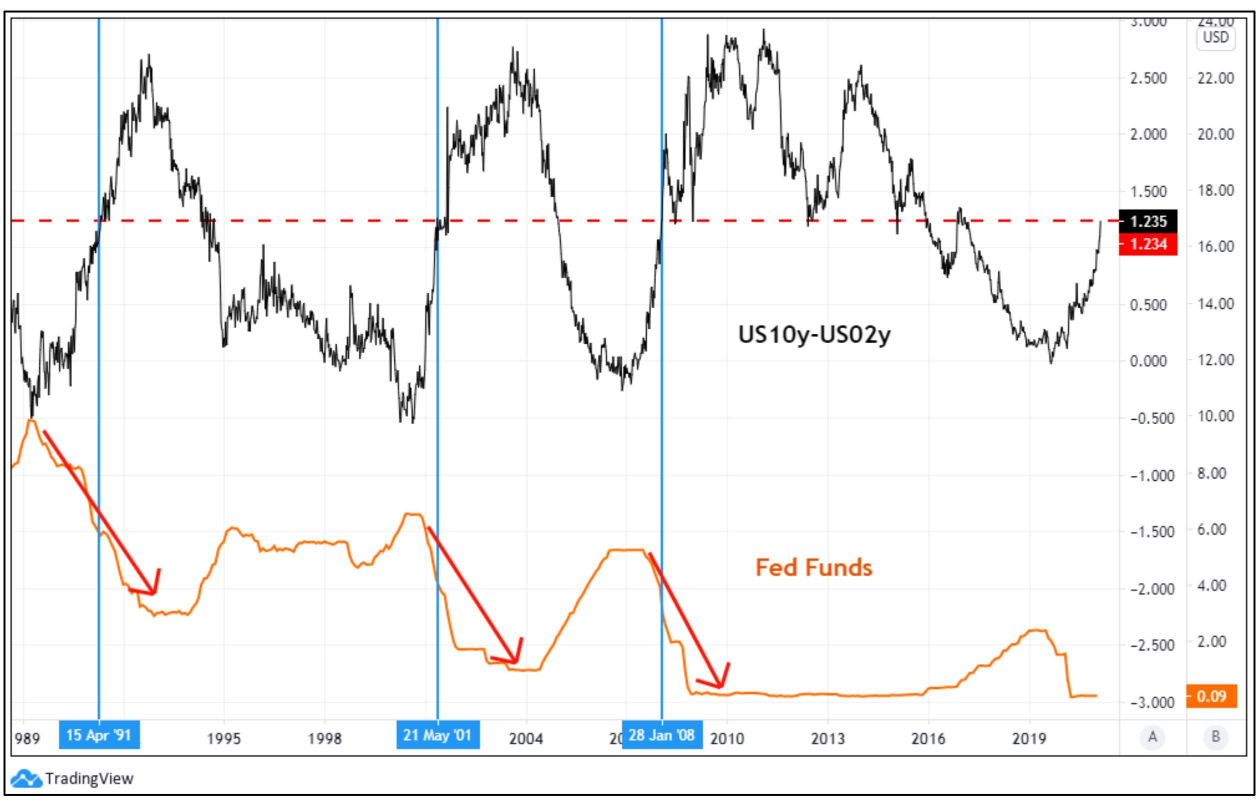
The impressive continued drop in COVID cases certainly isn't holding back the jump in yields.

US daily cases are now down more than 75% from the January highs.



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

The yield curve has been in the news a lot with the jump in long end yields. However, I would note that what we are seeing is **not** the "usual" scenario. Again, COVID is breaking the rules. Usually, the Fed is in the middle of an easing cycle when the curve gets to this level. Maybe in practice we are again, but this time fiscal spending is doing the easing as rates are already at the ZLB. (It would be interesting to construct a fiscal spending adjusted Fed Funds rate.)



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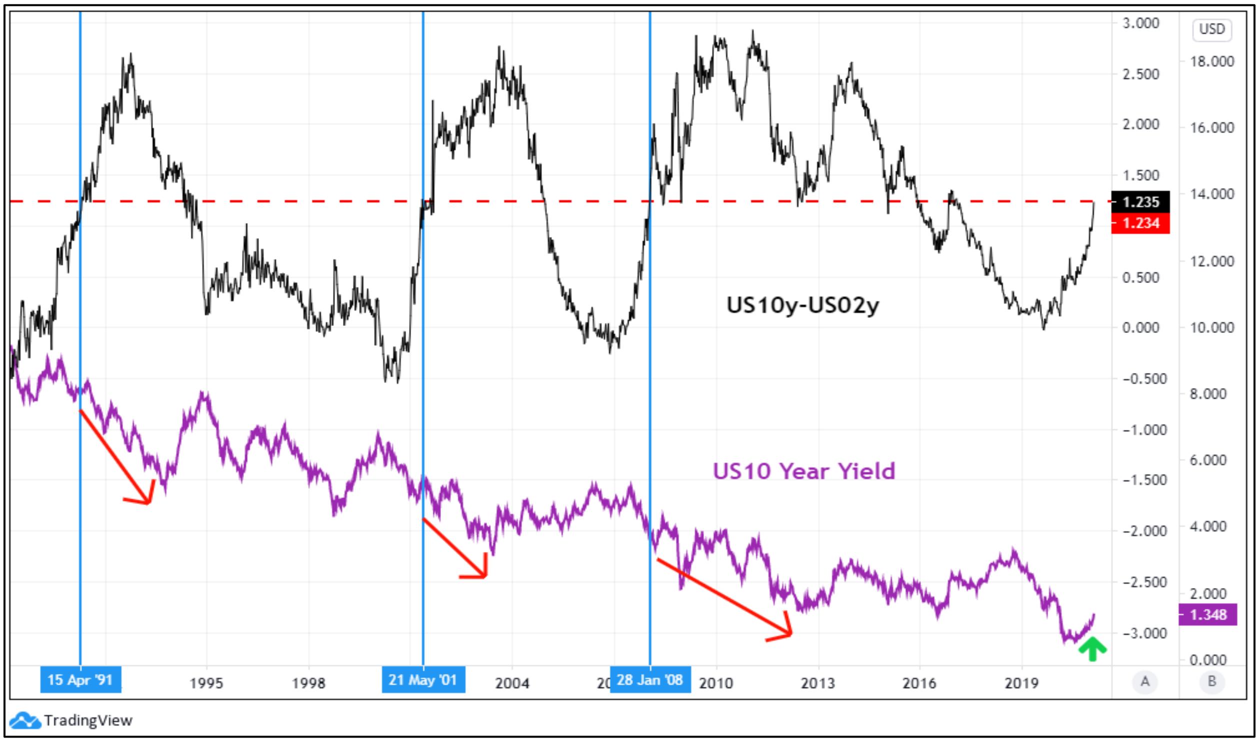
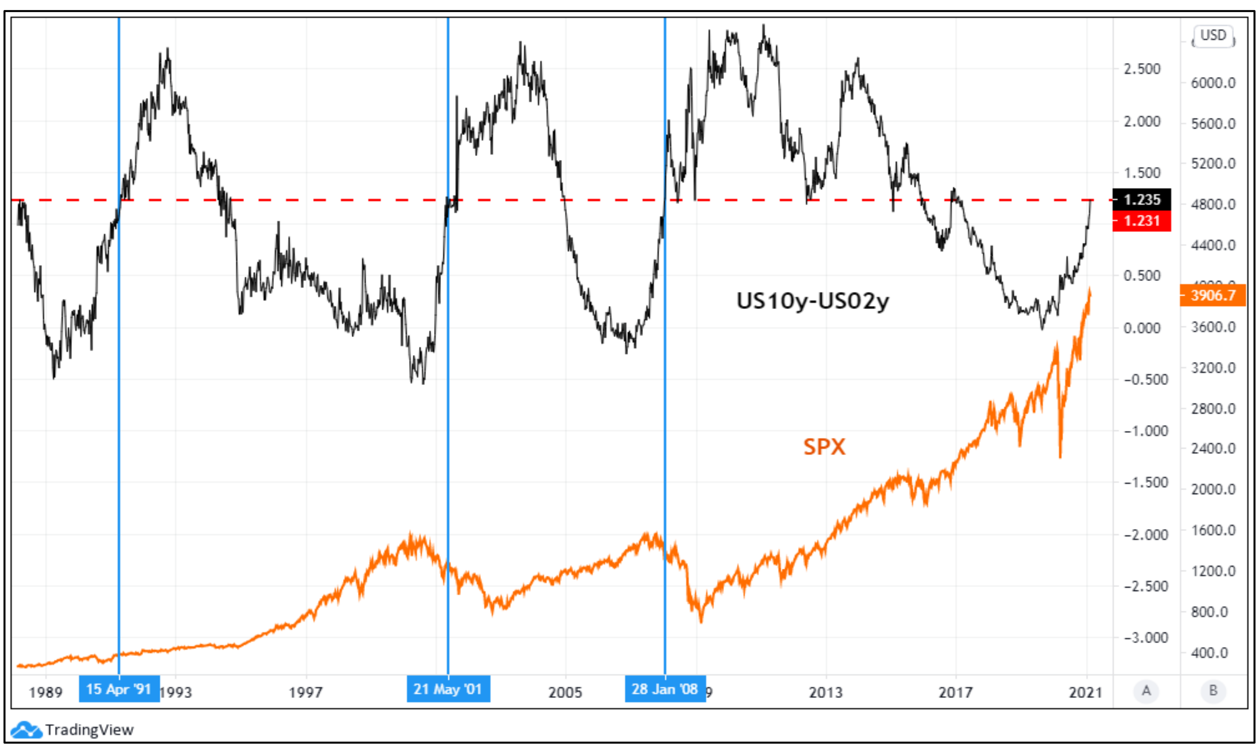
Generally during a steepener, bond yields are falling, just not as quickly as the Fed is cutting front end rates. This usually happens as the economy is still deteriorating…



Two out of three times since 1990, stocks were heading south as a result.



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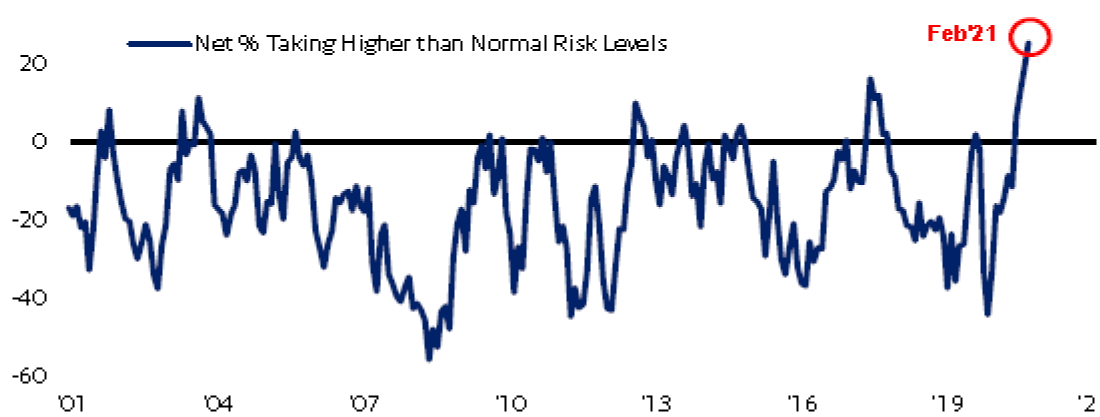
This time the interest rate story is different. Usually, the economy is slowed and eventually weakens as tighter monetary policy takes away the punch bowl. This time the virus did the job and did so very suddenly. On the response side however, the large fiscal spending is the key difference. It acts much more quickly on the economy than rate cuts. Now we could have a scenario where the economy is suddenly switched back on. The fact that we have a curve steepener led by rising long end rates rather than falling front end rates, means we have a much less predictable path ahead and the potential for increased volatility across markets.

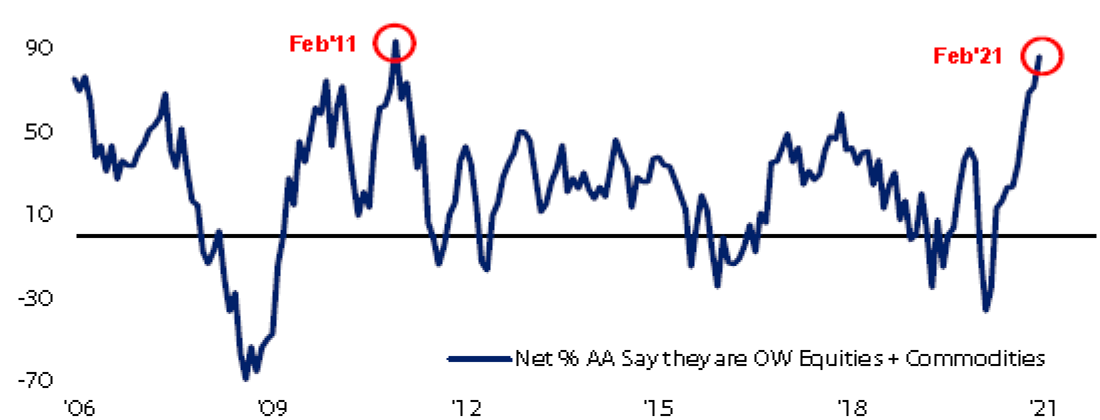
Certainly, investors can see the re-opening of the economy coming. How much is already priced?

Exhibit 11: All-time high in investors taking "higher-than-normal" risk
Net % Taking Higher than Normal Risk Levels



Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

Exhibit 15: FMS Global equity + commodity allocation highest in 10-years
Net % AA Say they are OW Equities + Commodities

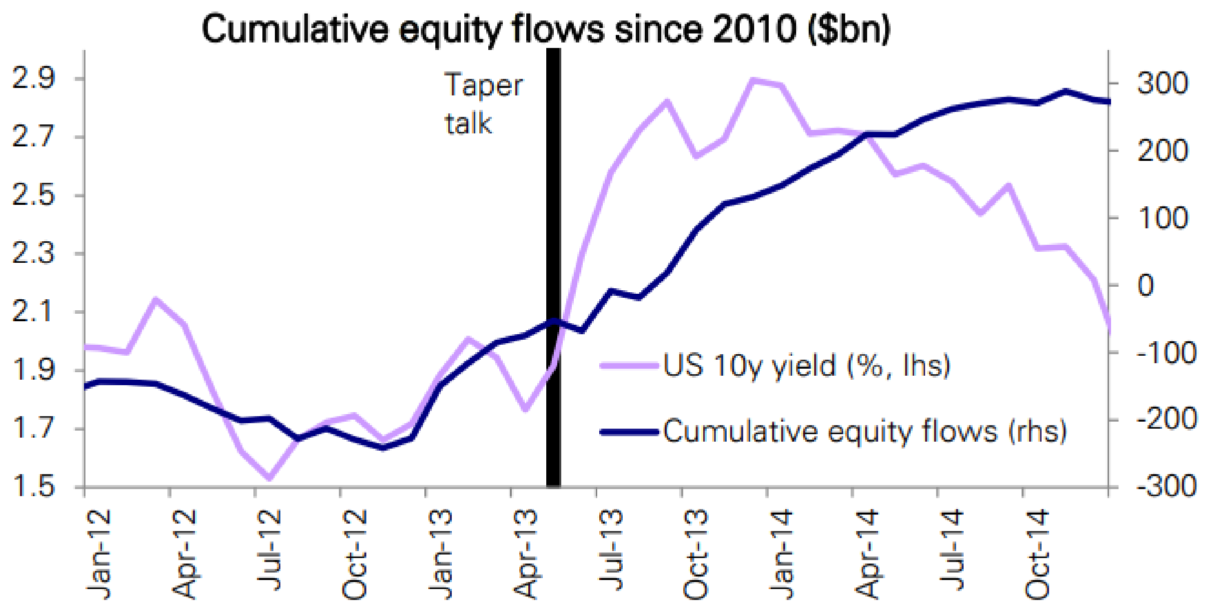


Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

Over the last 20 years, faster growth and higher bond yields have not been bad for stocks.

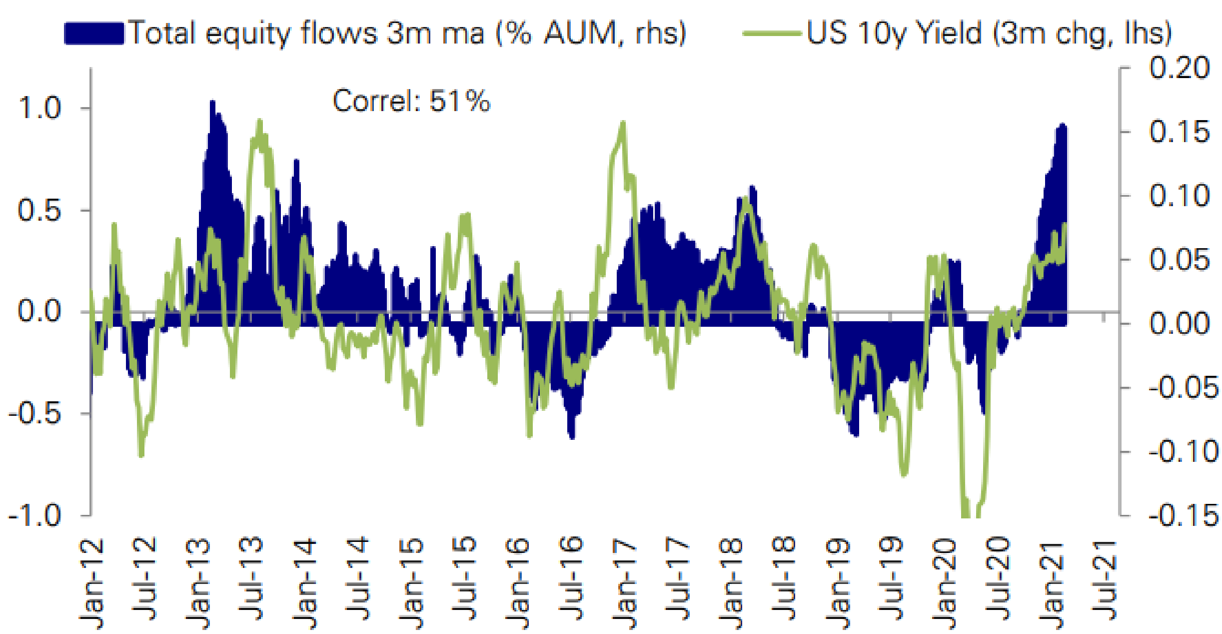
Even during the 2013 taper tantrum, equity flows remained strong.

Figure 9: The taper tantrum in 2013 saw enormous inflows into equities



Source : EPFR, FRB, Haver, Deutsche Bank Asset Allocation

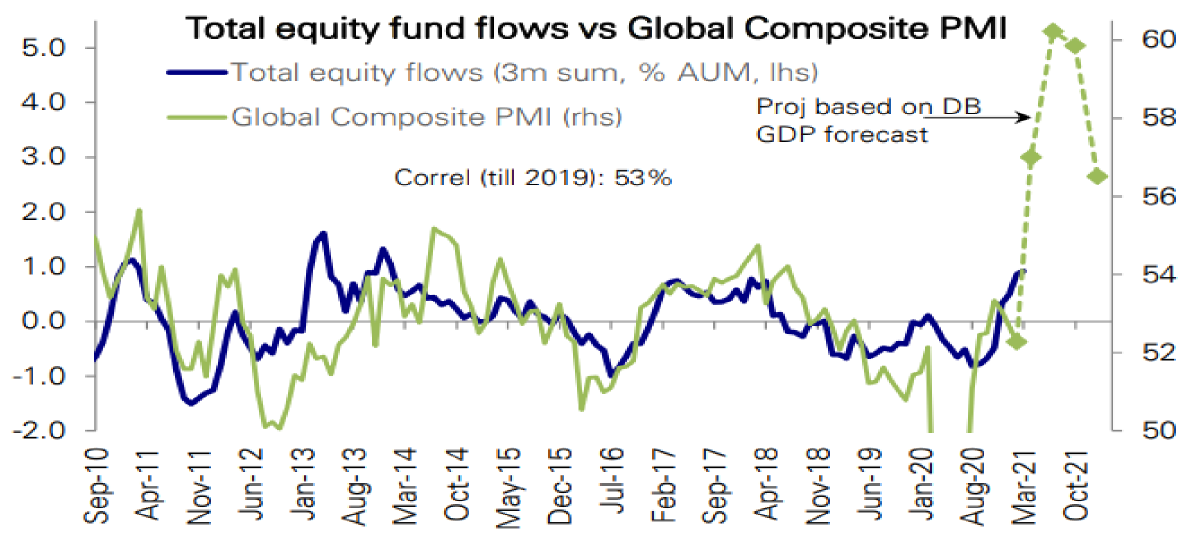
Figure 3: Rising rates associated with strong equity inflows ...



Source : EPFR, FRB, Haver, Deutsche Bank Asset Allocation

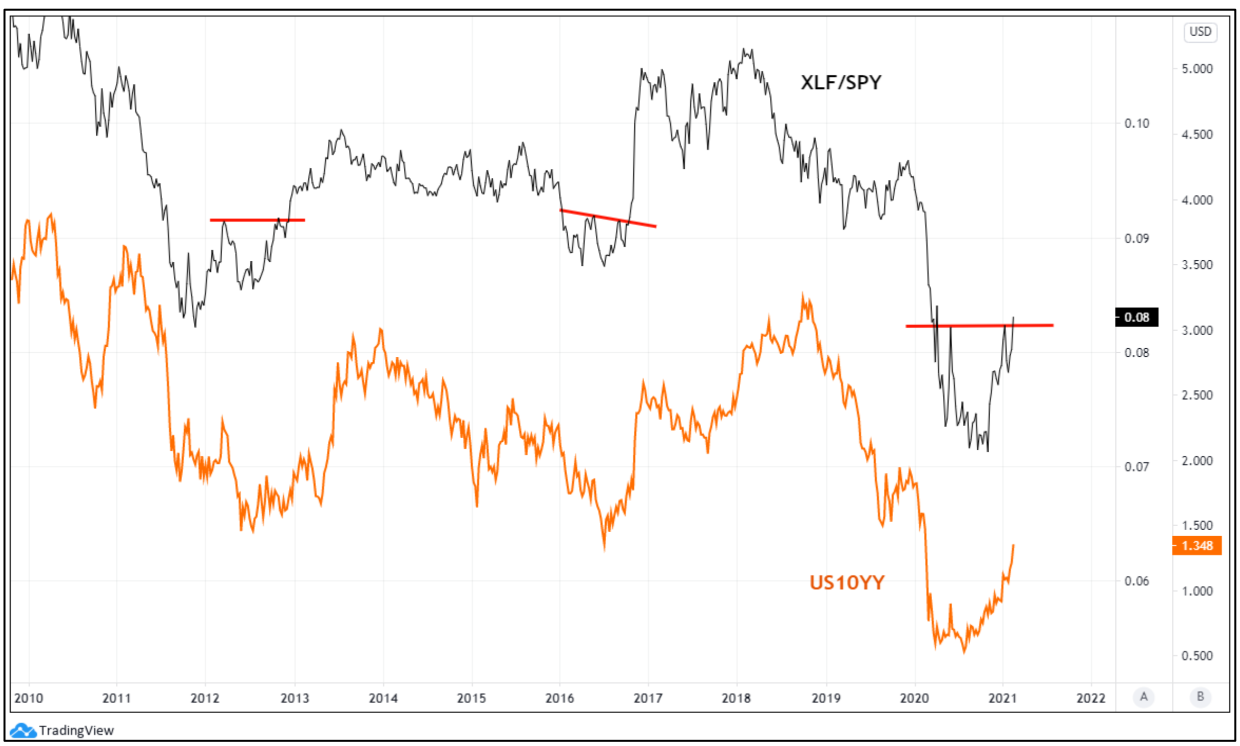
All the stimulus and pent-up demand has people expecting explosive growth. That should continue to put upward pressure on yields and at least in theory support stocks. Again, the question remains, how much has already been discounted this time?

Figure 11: Equity flows are running a little ahead of global PMIs but have plenty of room to go higher if our house forecasts of very strong global growth materialize



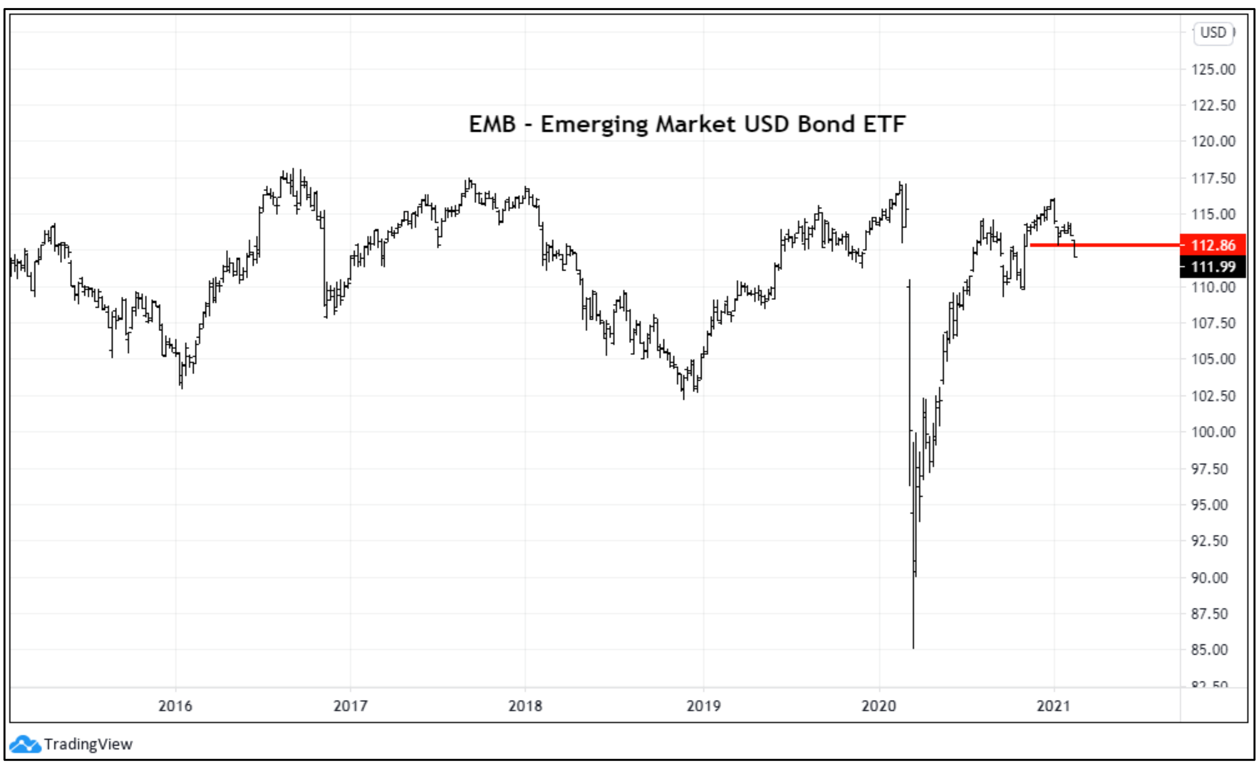
Source : EPFR, Markit, Haver, Deutsche Bank Asset Allocation

A big jump off the lows already, but financials should have more upside if yields keep going.



With credit spreads already very tight, despite a huge amount of issuance, corporate bonds could end up trading primarily off Treasuries now. They cracked a bit last week.

The same goes for EM USD bonds.



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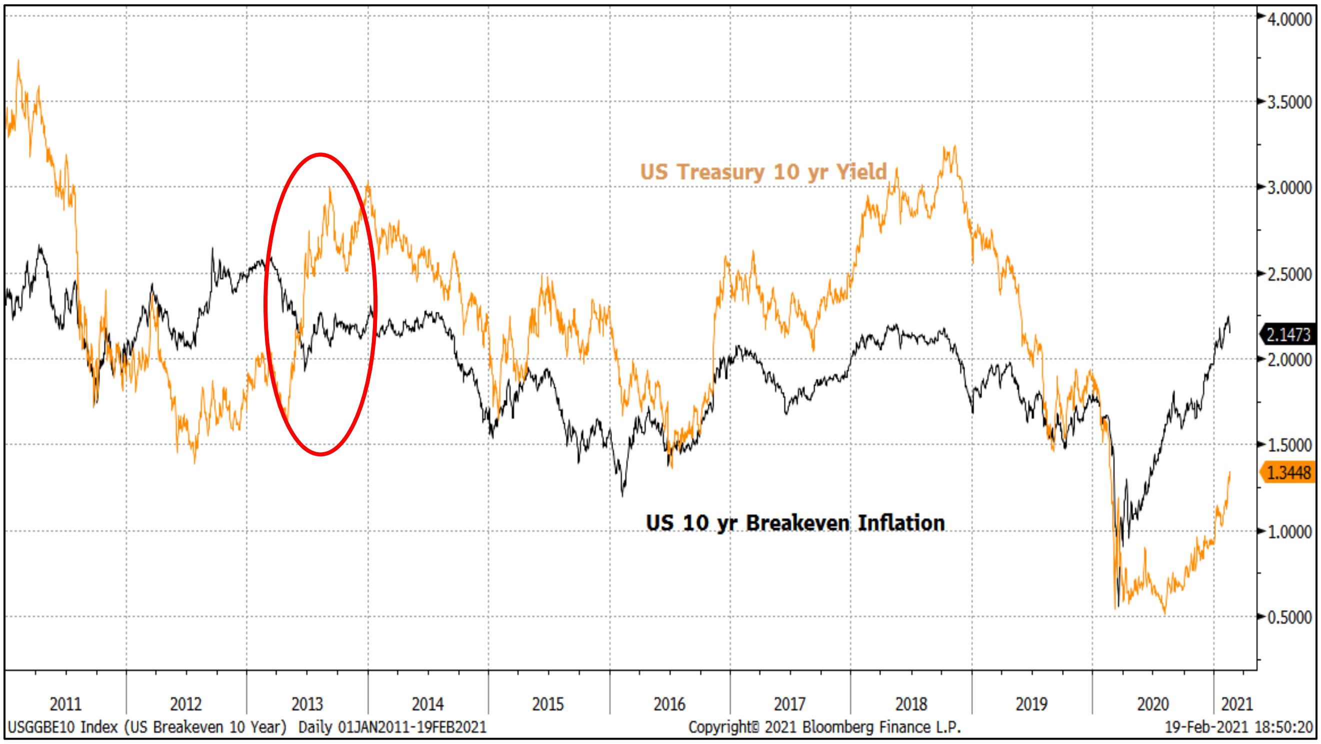
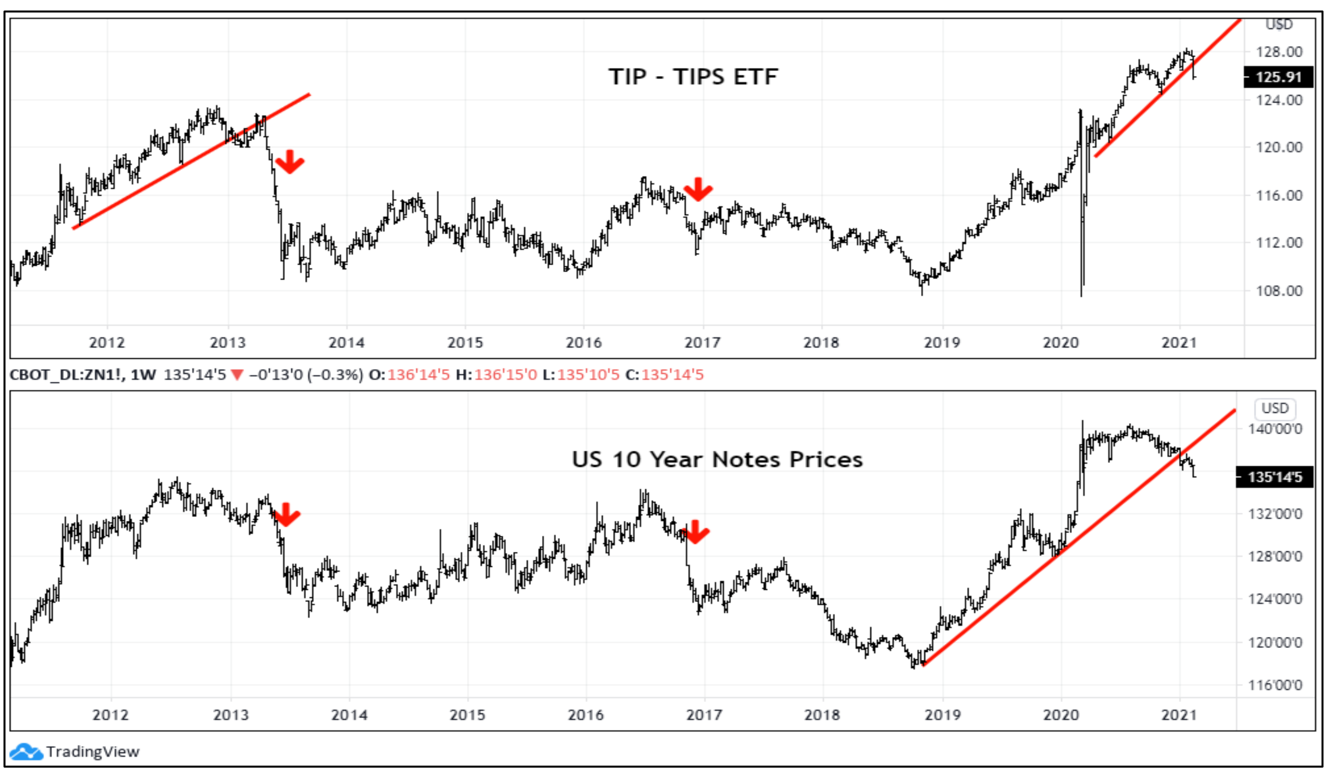
Inflation expectations have exploded over the last few months. Now Treasuries are starting to close the gap. A 2013 type bond market tantrum could actually take down inflation expectations as financial conditions tighten. Lots of people have been buying TIPS as an inflation hedge...





There are a couple of scenarios here:

- Yields slowly rise but not quickly enough to trigger a sudden tightening of financial conditions. The Fed would be happy with this as it wouldn't necessarily challenge AIT and wouldn't potentially cut short their ability to keep rates lower for longer in order to reach their employment goals.
- Yields rise quickly as inflation fears are stoked by subsequent inflation prints and a quicker recovery in growth and employment then currently expected. Selling in bonds brings more selling. This could quickly evolve into markets mounting a challenge to their low rates commitment. It could become a version of the taper tantrum of '13, where the timing of rate hikes was suddenly brought forward.

After spending a year looking at and formulating their new policy framework, there will be a high bar to caving on the AIT commitment. The question is, what can they do if they are aggressively challenged by the market? Yield curve control is possible but could be very tricky to implement. For starters, they would likely reinforce their forward guidance, again. Look out for this next week as we will be hearing from not just Powell but a number of other Fed speakers. A further step, should they start to worry about a premature jump in yields, could be to move the current QE out to longer dated paper in a new "operation twist". Further escalation would be to set a yield ceiling on paper out to five years or some other point nearer the front of the curve. However, the more they do the more they risk trying to put the fire out with gasoline.

Keep an eye on 5-year yields. They were ground zero in '13 and a further pop in yields would indicate hike expectations are being brought forward. They are now just peeking out of the range.

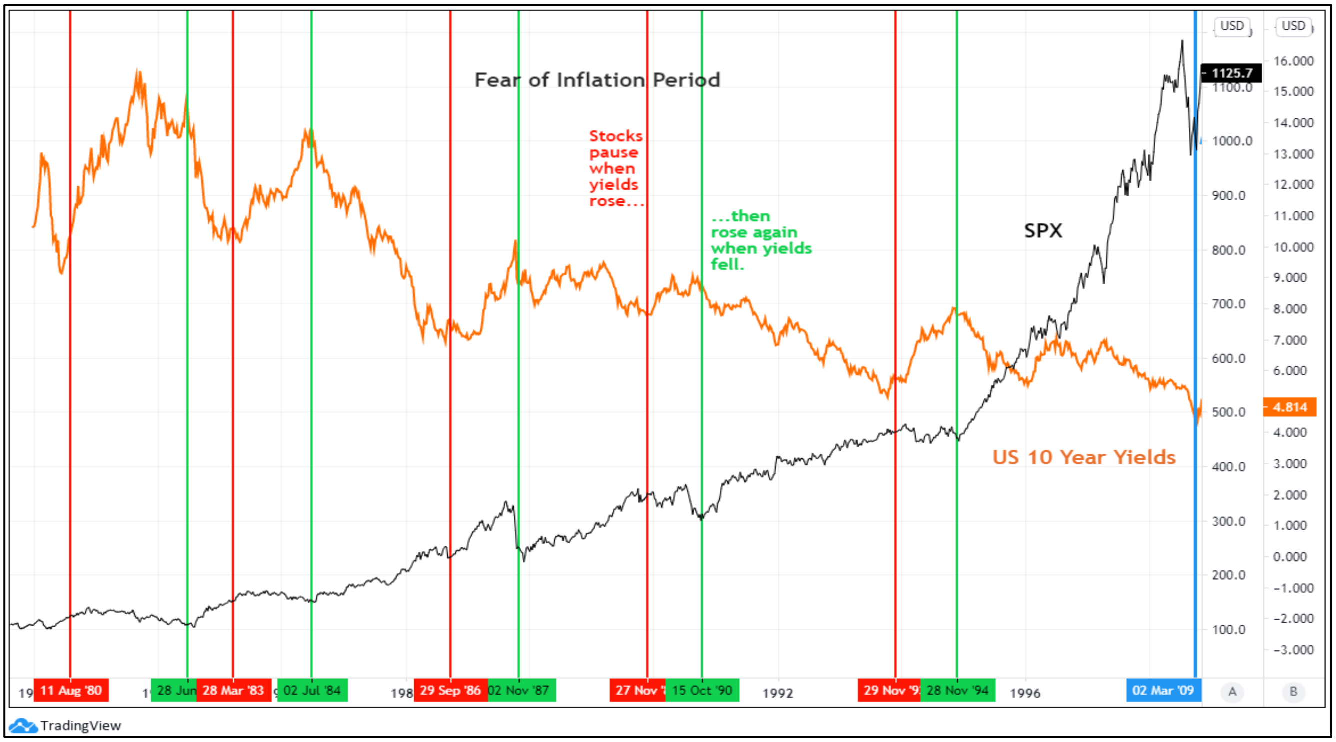
If you think US stocks are expensive and already have a growth surge discounted, keep an eye out for outperformance in Europe. They have had a very hard time with the slow vaccine rollout, but that is now due to accelerate.

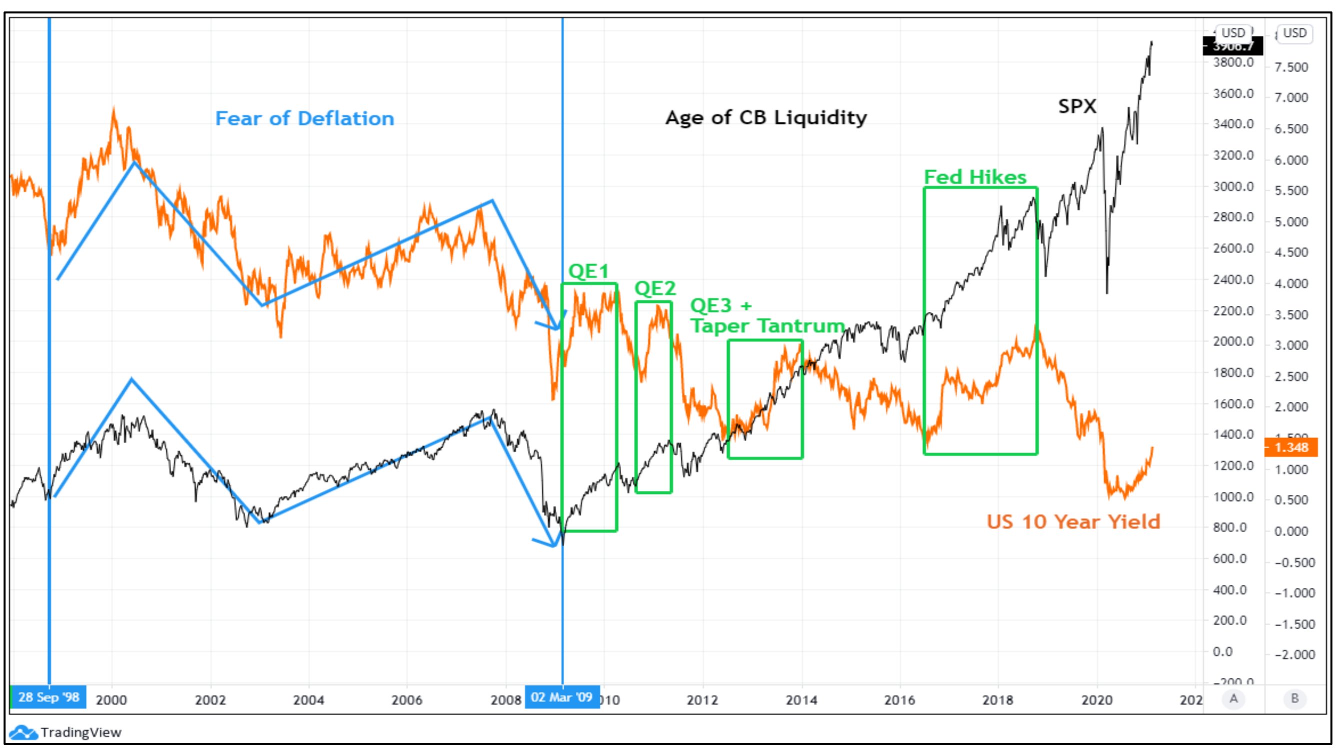
Longer term, Japan is approaching big levels vs. some US indices.

Gold has been suffering as higher yields have been pushing up real yields. However, it is interesting to note that it is still holding in relatively well.

Not surprisingly, precious metals like silver and platinum, with more industrial applications, are doing even better.

One more high-level note on the relationship between equities and yields. Between the 1970's and 1998, the fear of inflation meant that higher bond yields were bad for stocks. Stocks would go sideways or down with rising yields then take off when yields came back off. The Russian default and the failure of LTCM Capital Management in 1998, were an abrupt turning point.





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Between '98 and the GFC stocks and yields moved together… growth drove both.

Now, in the age of CB liquidity, equities still tend to like growth and higher bond yields, but liquidity will do just fine too. What comes next? Back to fear of inflation in the coming years?

FX

Currencies have been moving, but not as a block vs. the USD. Many DM currencies, especially negative yielders have been indecisive, and range bound. EM and commodity linked currencies have been strong.

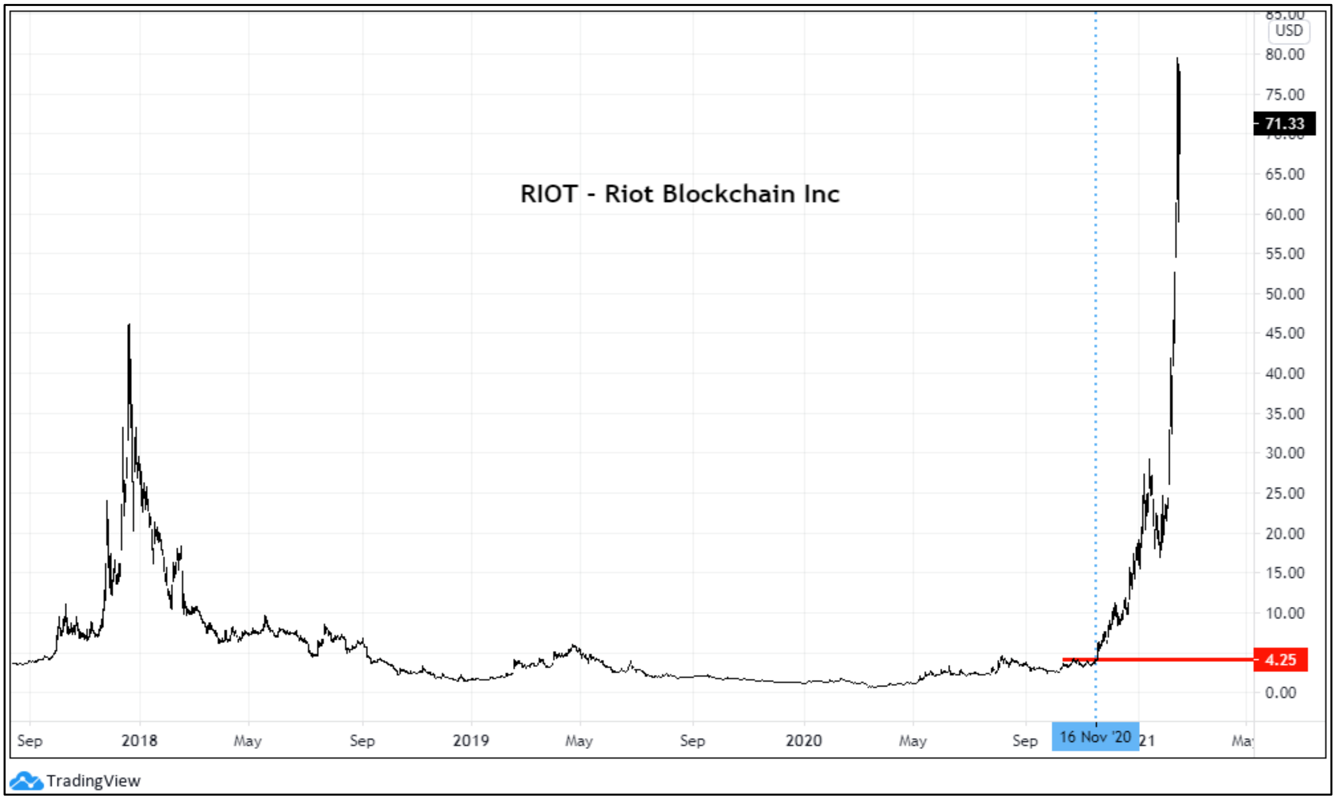
Currencies with zero or positive rates and growth prospects like AUD, CAD and GBP, have been outperforming negative yielders like EUR, CHF and JPY as global bond yields rise.

The opportunity cost of ignorance…

There has been a lot of talk over recent months about precious metals miners and all the leverage they have to the underlying metals given their production cost. This idea really hasn't worked out very well recently in terms of price appreciation for those miners.

It never occurred to me to apply the same logic to Bitcoin miners. I didn't even know there are any publicly traded.

My mistake. I recently stumbled across RIOT. Since November 16, when it broke higher, it has returned 7X the already impressive BTC performance. A lesson to be curious and open minded in these markets.



This week investors will be focusing on US stimulus, with the potential for a floor vote in the House of Representatives at the end of the week. We will also hear from Fed Chair Powell and ECB President Lagarde.

Important Macro Data Releases and Events for the Week

Monday
02/22/2021

- IFO - Business Climate (Feb) Forecast: 90.5, Prior: 90.1
- IFO - Current Assessment (Feb) Forecast: 88.9, Prior: 89.2
- IFO - Expectations (Feb) Forecast: 91.9, Prior: 91.9

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PM Boris Johnson SPEECH

ECB's President Lagarde SPEECH

Fed's Bowman SPEECH

Tuesday
02/23/2021

EU CPI in various forms

Housing Price Index MoM (Dec) Forecast: 1%, Prior: 1%

S&P/Case-Shiller Home Price Index YoY (Dec) Forecast: 8.6%, Prior: 9.1%

Wednesday
02/24/2021

GDP in various forms

Fed's Chair Powell testifies

New Home Sales MoM (Jan) Forecast: 856k, Prior: 842k

Fed's Brainard SPEECH

Fed's Clarida SPEECH

Thursday
02/25/2021

Leading Economic Index (Dec) Forecast: 94.9, Prior: 94.9

Gfk Consumer Confidence Survey (Mar) Forecast: -14, Prior: -15.6

Consumer Confidence (Feb) Forecast: -14.8, Prior: -14.8

Business Climate (Feb) Forecast: -0.34, Prior: -0.27

ECB's Lane SPEECH

Durable Goods Orders (Jan) in various forms

GDP Annualized Q4 Forecast: 4.1%, Prior: 4%

Initial Jobless Claims Forecast: 820k, Forecast: 861k

	Continuing Jobless Claims Forecast: -, Prior: 4.494m
	PCE Prices QoQ (Q4) Forecast: -, Prior: 1.5%
	PCE Core QoQ (Q4) Forecast: 1.4%, Prior: 1.4%
	Fed's Williams SPEECH
	EU Leaders Summit
Friday 02/26/2021	PCE Core - Price Index MoM (Jan) Forecast: 0.1%, Prior: 0.3%
	Personal Income MoM (Jan) Forecast: 10%, Prior: 0.6%
	Personal Spending (Jan) Forecast: 2.4%, Prior: -0.2%
	Chicago Purchasing Managers Index (Feb) Forecast: 61, Prior: 63.8
	Michigan Consumer Sentiment Index (Feb) Forecast: 76.4, Prior: 76.2
Saturday 02/27/2021	Non-Manufacturing PMI (Feb) Forecast: -, Prior: 52.4
	NBS Manufacturing PMI (Feb) Forecast: -, Prior: 51.3