Stargazer
Asset Management

What to focus on in Global Macro for the week of May 18th, 2020

"No amount of sophistication is going to allay the fact that all your knowledge is about the past and all your decisions are about the future." Ian Wilson (former Chairman of GE)

Macro Themes on the Radar:

China/US

China/US relations continue to be very strained as the US Administration refuses to let up on claims that China mislead the world regarding COVID-19. Talk of reparations and retaliation is increasing. As it is playing well at home and there is some support internationally, out of Europe and even Australia, I don't expect this to go away anytime soon. The fact that economies are already in the ditch makes the situation more volatile. It removes some of the constraints that worries about the economic impact of a confrontation would otherwise impose. How serious this will get is unknown, but the incentives to back down are low for both sides leaving us with a potentially dangerous set-up.

Europe

In the meantime, northern and southern eurozone members remain at odds.

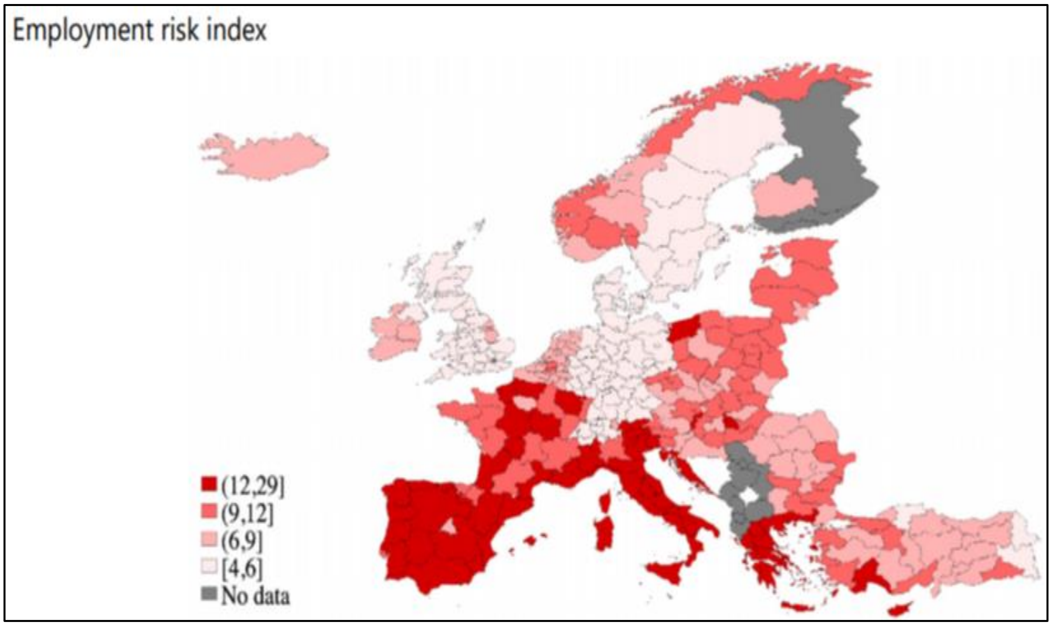
The creation of the eurozone was supposed to elevate living standards across the board, but the south increasingly feels it is being left behind. The coronavirus outbreak has only accelerated this building resentment. With southern economies, already in a weakened state and being especially hard hit by this crisis, anger is boiling to the surface. Add to that the unwillingness of the wealthier northern countries to issue shared debt and the challenge of ECB policy by the German Constitutional court, and you have the makings of a new eurozone crisis.

In the end, the German Constitutional court decision addresses the German view that the ECB does not have the mandate to use one eurozone members budget to finance the budget of another eurozone member country. The ECB is suggesting it may not respond to the court, while the European Commission has threatened to sue Germany over the ruling.

Perhaps expecting a broadside counter from the EU, German parliament last week passed a law making the burning of the EU flag a punishable offense.

The economic divide is growing in Europe…

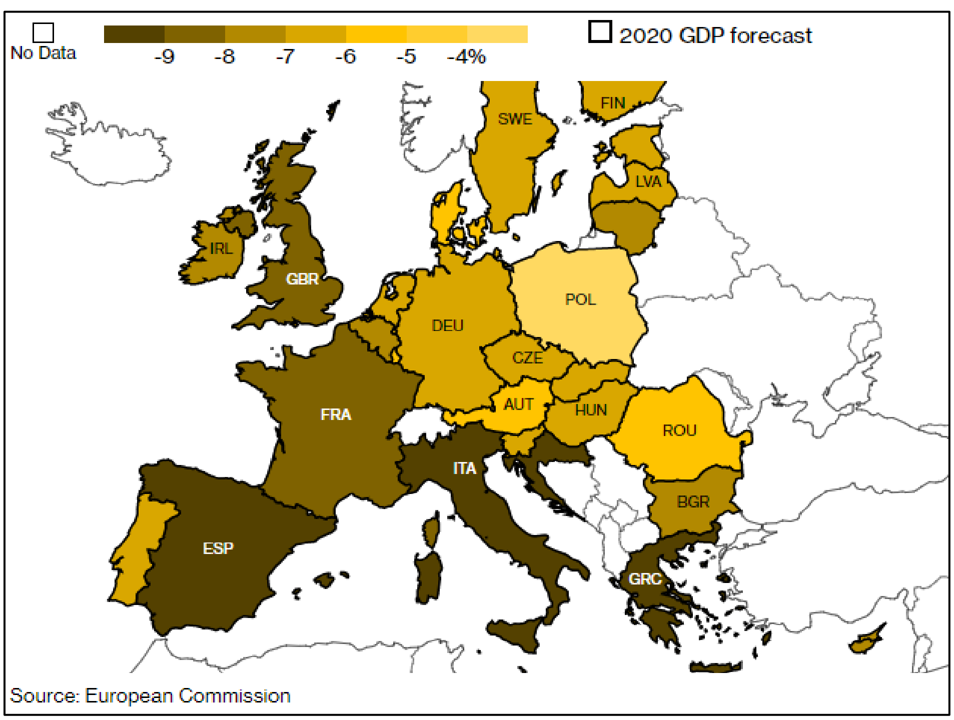
Note how in this chart from the BIS on employment risk from COVID-19, the southern countries are glowing red.



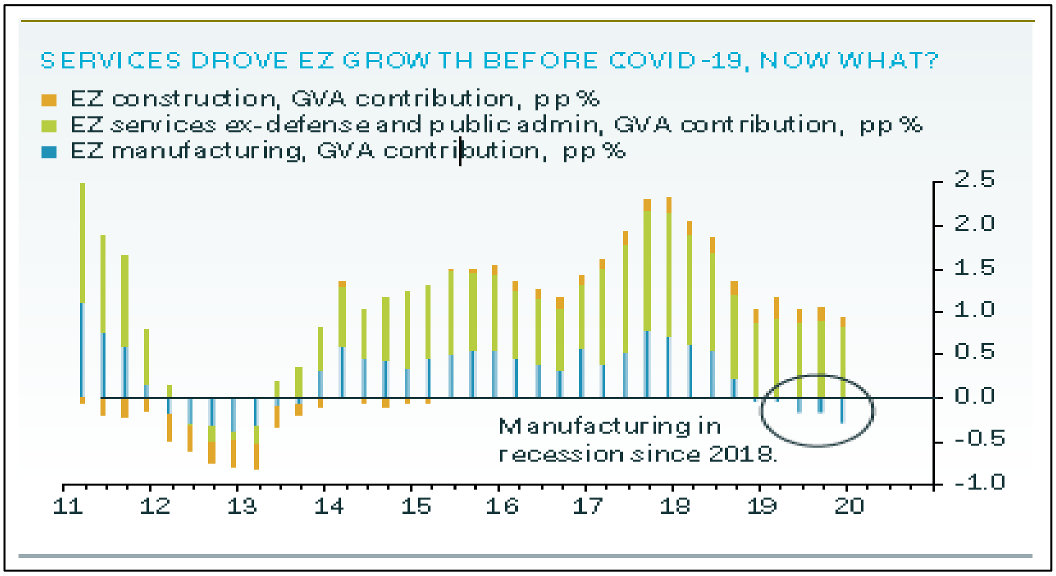
This panel shows the employment risk index for each region, i.e. sectoral exposure interacted with the share of employment among small firms out of total employment. Darker colors denote higher exposure, a higher share of employment among small firms or a higher risk index.

Sources: BIS

Here is one from the European Commission with 2020 GDP forecasts. Different side of the same coin when it comes to Spain and Italy.

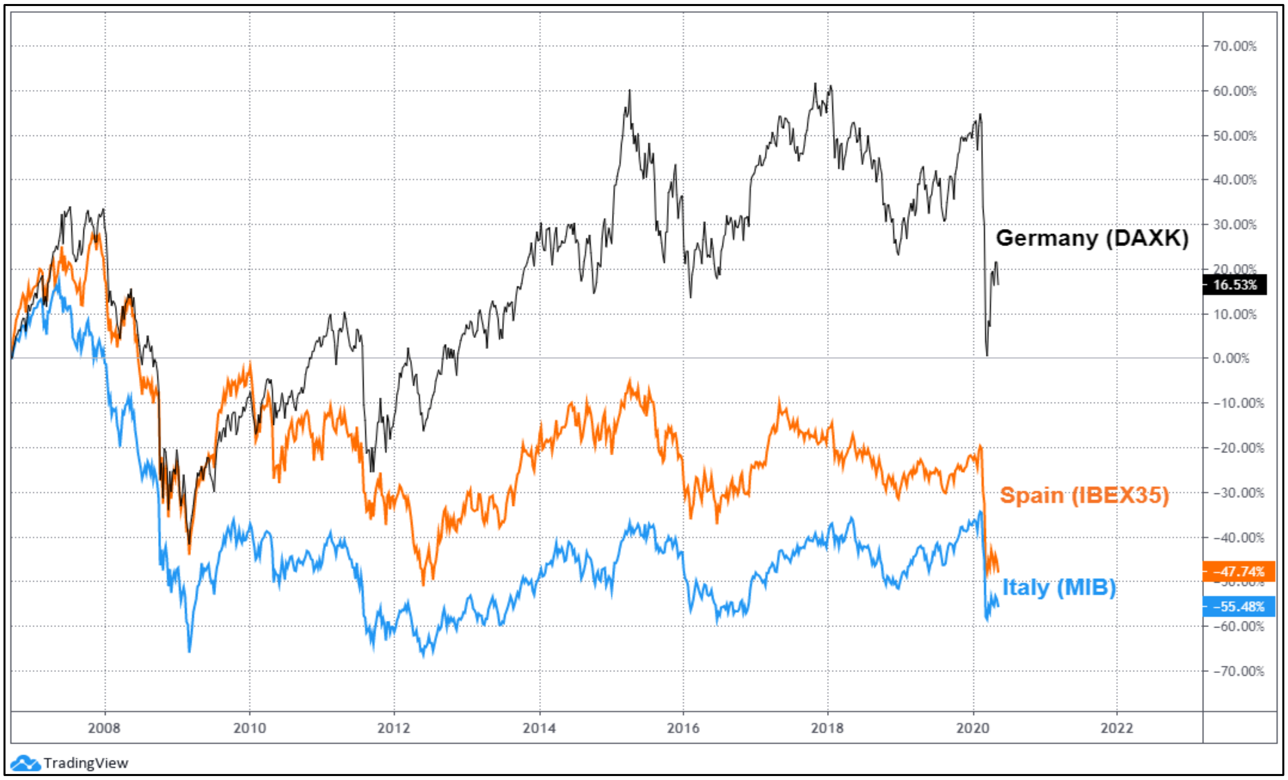


Services were driving what little EZ growth there was before the crisis. They will have been hard hit.

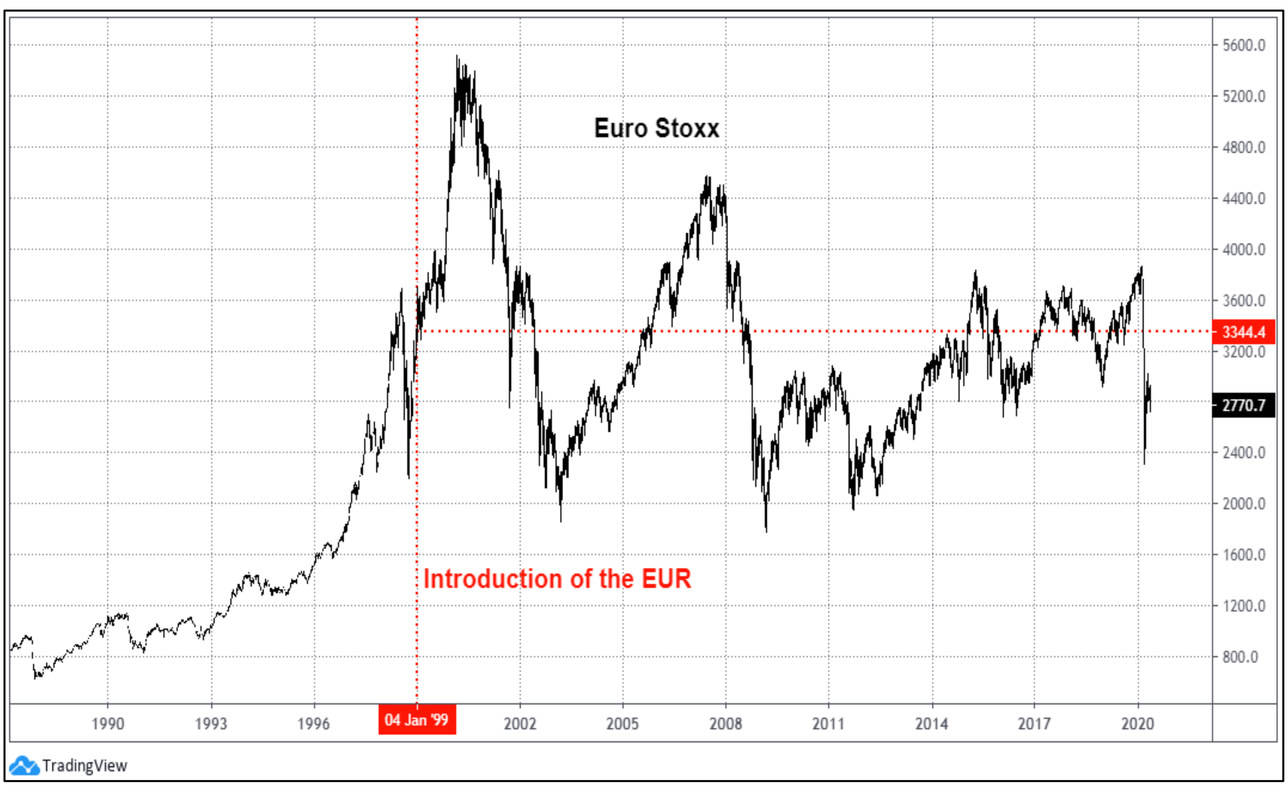


Again, Italy and Spain are taking the biggest hit given their dependence on tourism.

Again, the dynamics of the COVID crisis only serve to accelerate and broaden an already existing divide. This crisis comes on the heels of the damage done during the GFC, from which Italy and Spain have never recovered, despite the efforts of the ECB.

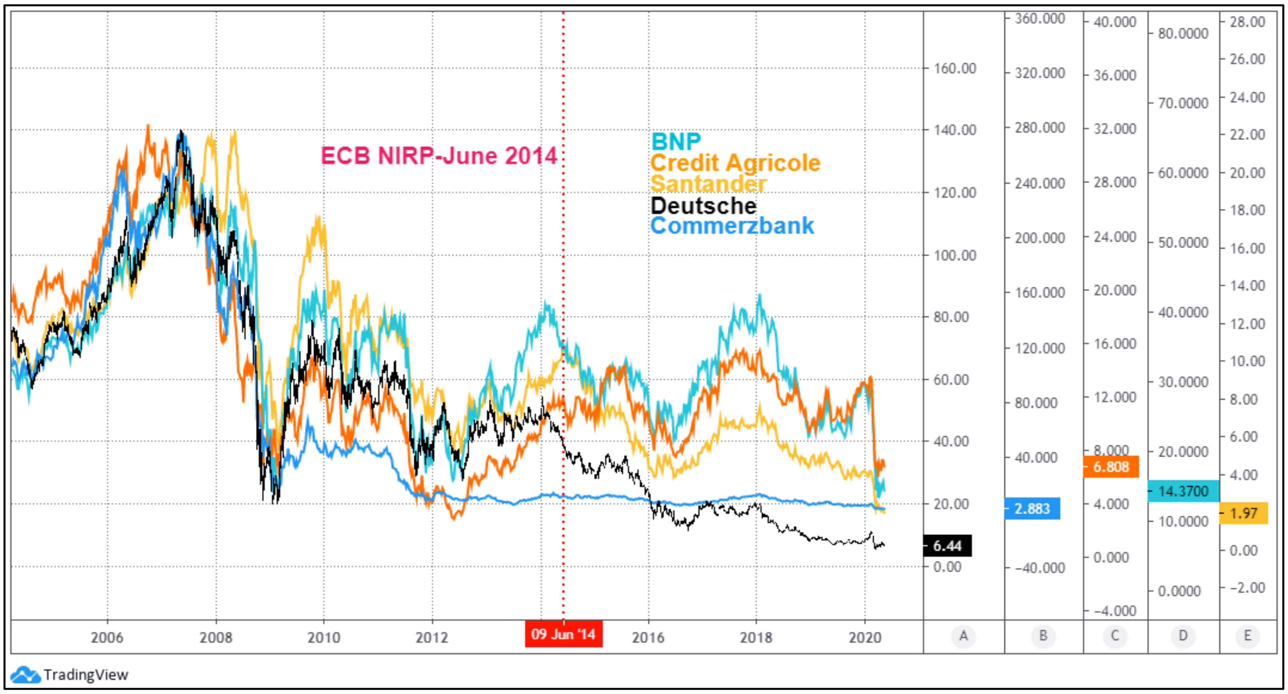


European equities, as a whole, have not made any progress since the introduction of the EUR at the start of 1999.

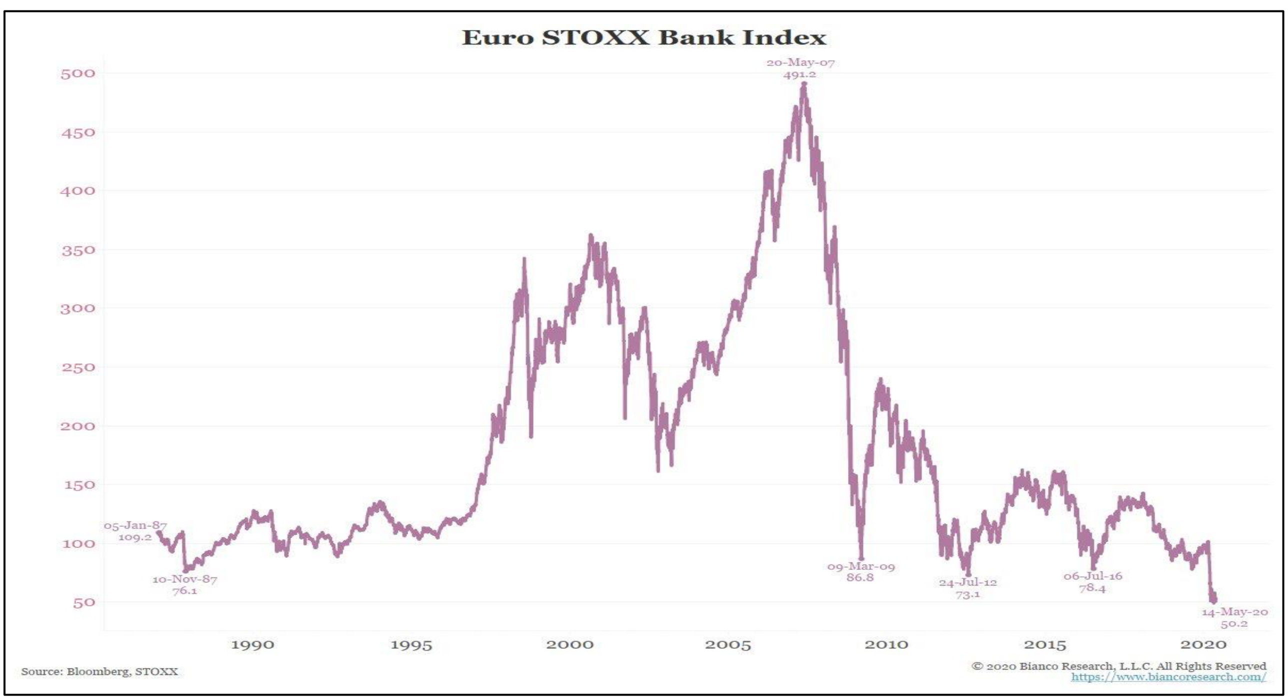


European banks have been especially poor performers. They were hard hit in 2008. Then again by the European debt crisis in 2011-12 and finally by the Negative Interest Rate Policy existing since mid-2014.

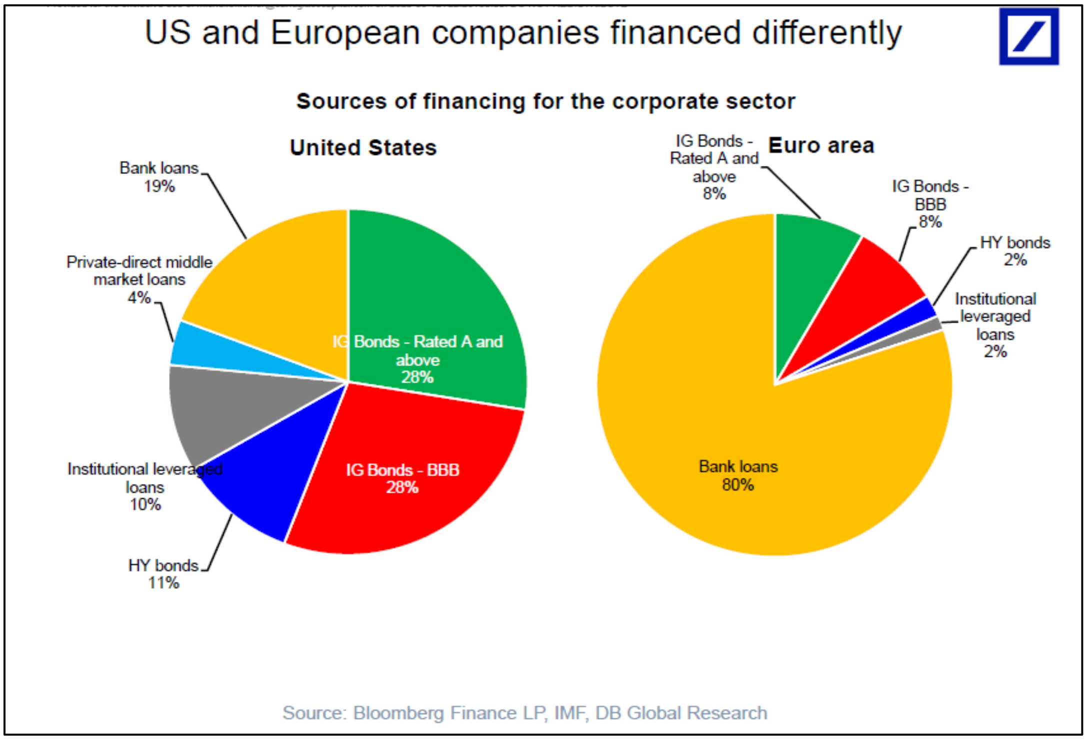
Some of the big names …



… and the broader index.



It is generally difficult for any economy to do well if the banks are hobbled. That is especially true in Europe where financing options for corporations are more limited than for example in the US.



With the EUR ranges getting tighter it is time to watch for a break.

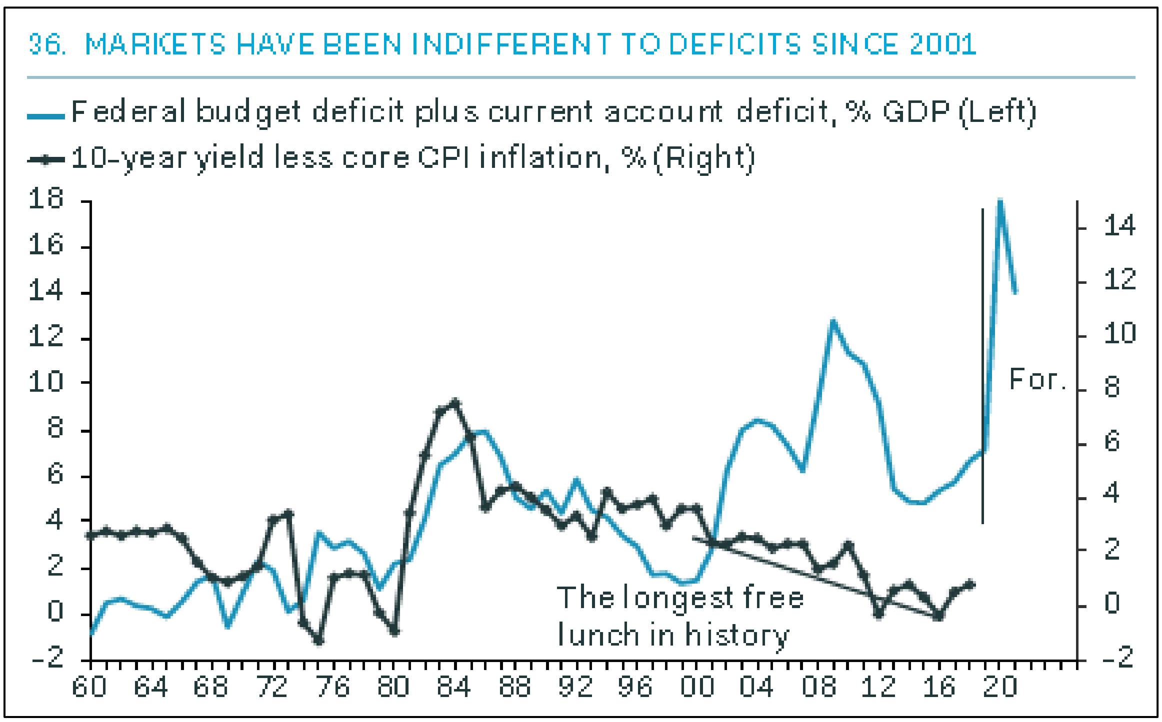
The eurozone has always tried to keep down volatility and muddle through. One of these times, maybe soon, they will have their hand forced. A decision will have to be made, as the status qou is becoming harder and harder to maintain.

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

Yields

The long end of the US curve has been very placid since the COVID/Fed induced plunge in yields. There are a lot of moving parts here.

So far, the ballooning deficit and increased issuance have not mattered. In fact, it has been a long time since the days of the "bond vigilantes" when deficits like this were seen as inflationary.



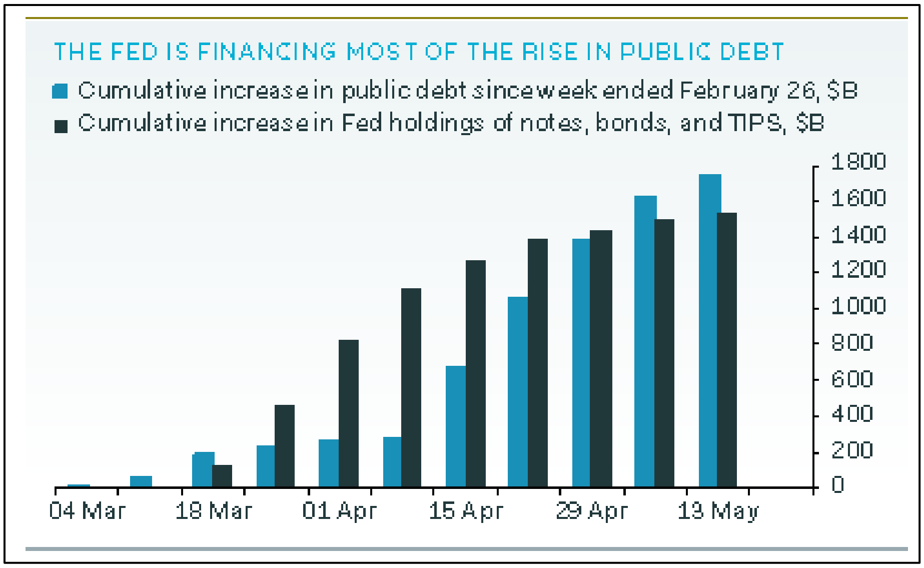
Source: Pantheon Macroeconomics

Of course, it is not that simple. Fed Funds are now back at zero and some are expecting negative rates in the US. Add to that large buying across the curve by the Fed and the potential for some type of Yield Curve Control.

So far, they are buying up most of the new supply.

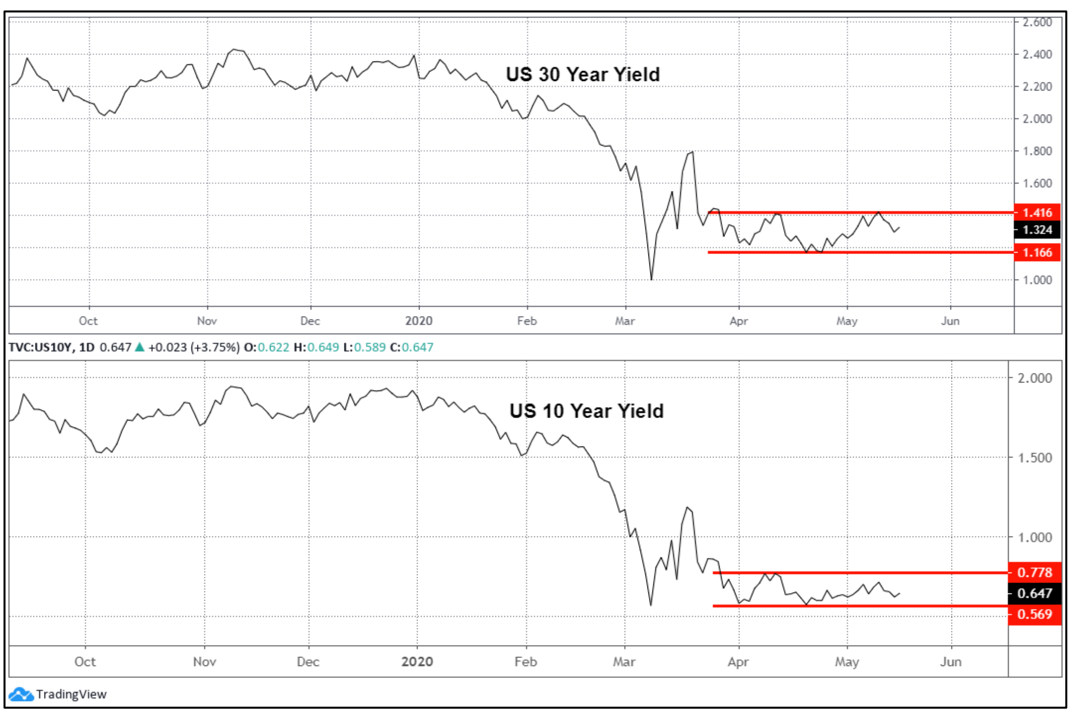
What happens if that slows?

As lockdowns end, what happens if the economic numbers beat expectations in the near-term, but it isn't reflected in yields?



Source: Pantheon Macroeconomics

With so much direct and indirect intervention in this market I have very little confidence that price is passing along useful information. If I believed it was, I would be concerned that it is not confirming the price action in equities. Previous bouts of US QE were accompanied by rising bond yields as market participants bought the reflation narrative. Despite what the Fed says about it lowering rates, they actually rose during QE. In Europe on the other hand, yields did go down during QE. While it made borrowing cheaper for some countries and maybe cheapened the currency, it didn't do much to invigorate the economy. Let's hope we are not migrating to the European reaction function, and that it is just the Fed's buying holding down yields.



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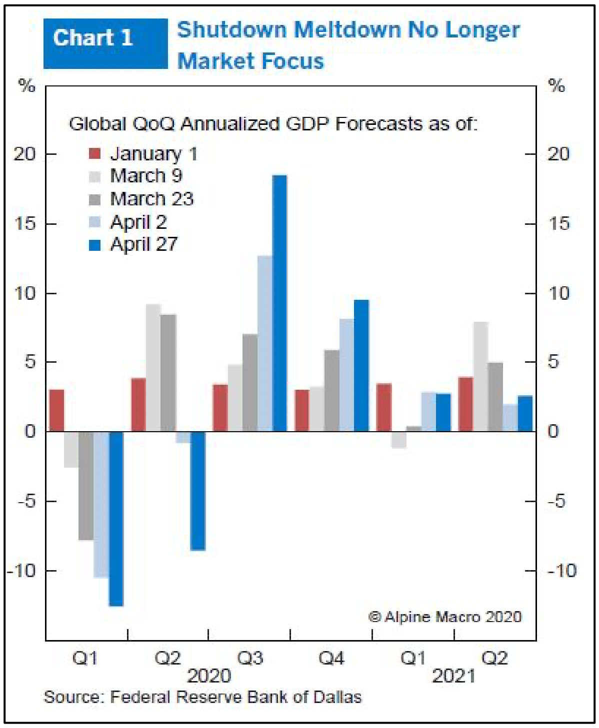
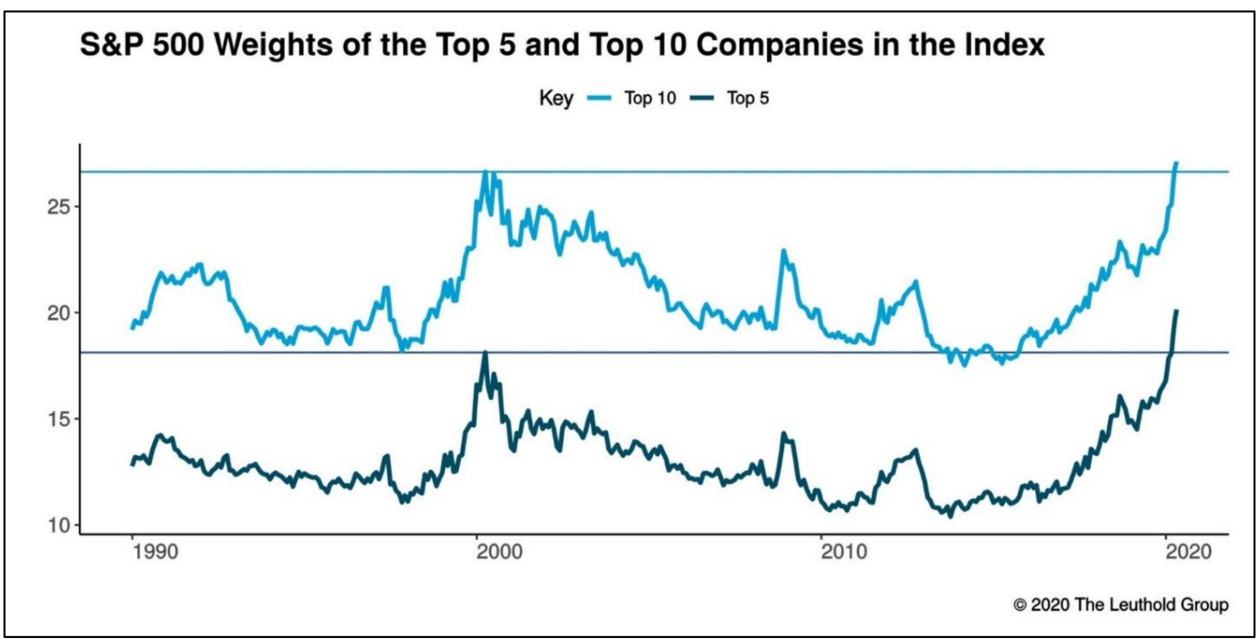
Stocks

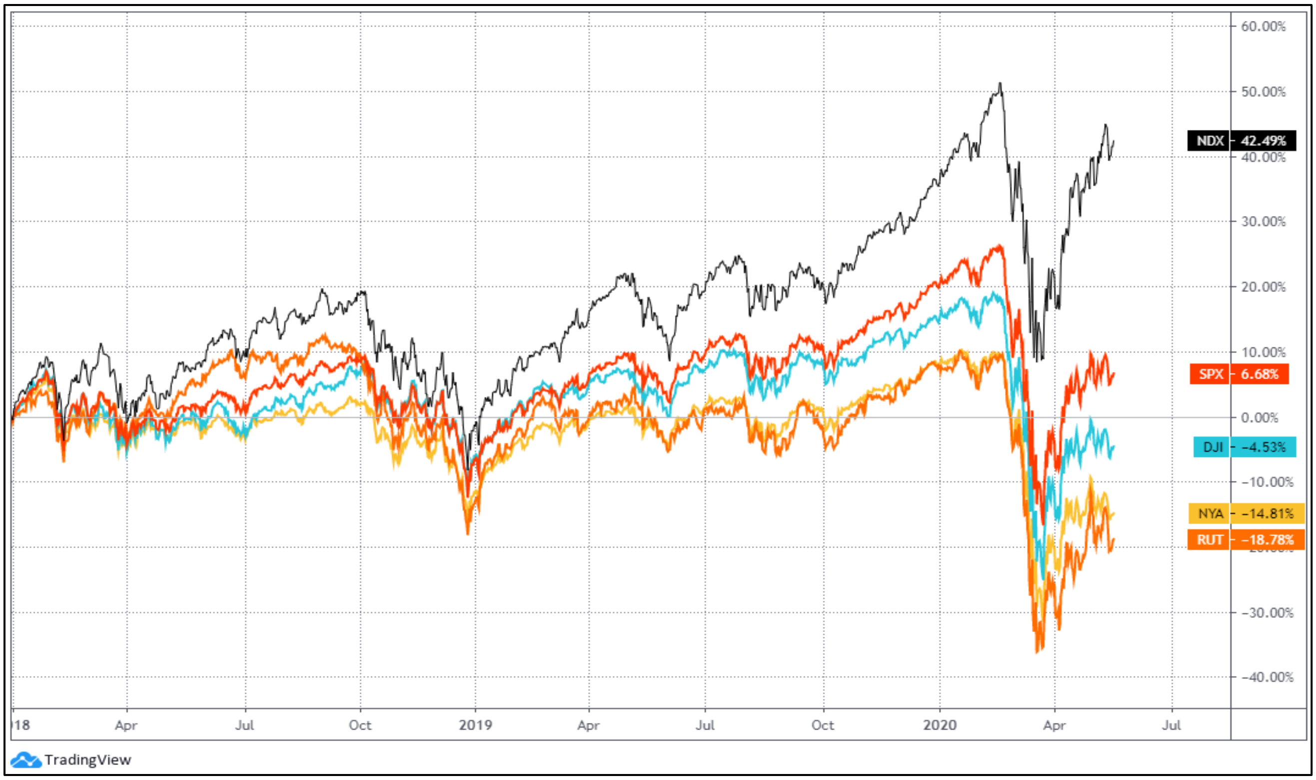


As the depth of the global fall in GDP has become clear, the expected recovery has been pushed out and re-sized to match the plunge.

As discussed last week the performance off the lows has varied a lot across indices. The continued dollar firmness and weak global growth, combined with the direct effects of the lockdowns, has meant that the bigger exposure an index has to the six largest US tech names the better it did.

It only takes a few…





Globally, EM and Europe have continued to perform poorly for many of the same reasons driving the US growth vs. value story.

In the end, better global growth expectations and a weaker USD could turn the trend. However, continued or worsening global growth relative to the US and further USD strength runs the risk of accelerating the US large tech outperformance, even to the point of a full-blown tech bubble 2.0 (at least on a relative performance basis).

FX

EM is all over the place as it continued to be shaken by local virus hotspots, commodity prices, USD strength and scarcity, internal politics and corporate solvency issues.

Developed markets FX is holding at current levels, but I'm still on the lookout for another bout of potential USD strength.

Gold and Silver

Spot Gold got up to 1751 on Friday before backing off a little. Big picture it still seems interesting in this environment, but amazingly almost consensus (and not just the gold bugs). Positioning is quite long by historical measures, but these are times with few signposts so I certainly wouldn't fade it on that.

Maybe more interesting at the moment is what has been going on in Silver over the last few days.

This is one to keep an eye on. Positioning is much lower than in Gold, and the March washout was brutal.

I'm usually not one for "catch-up" trades but the set-up here is definitely intriguing.

The blowout in the VIX took the Gold/Silver ratio to unprecedented heights … it is now breaking down in favor of Silver.

Silver is also looking like a bottom is in place against a number of other assets… I see this as a confirmation that something could be changing.

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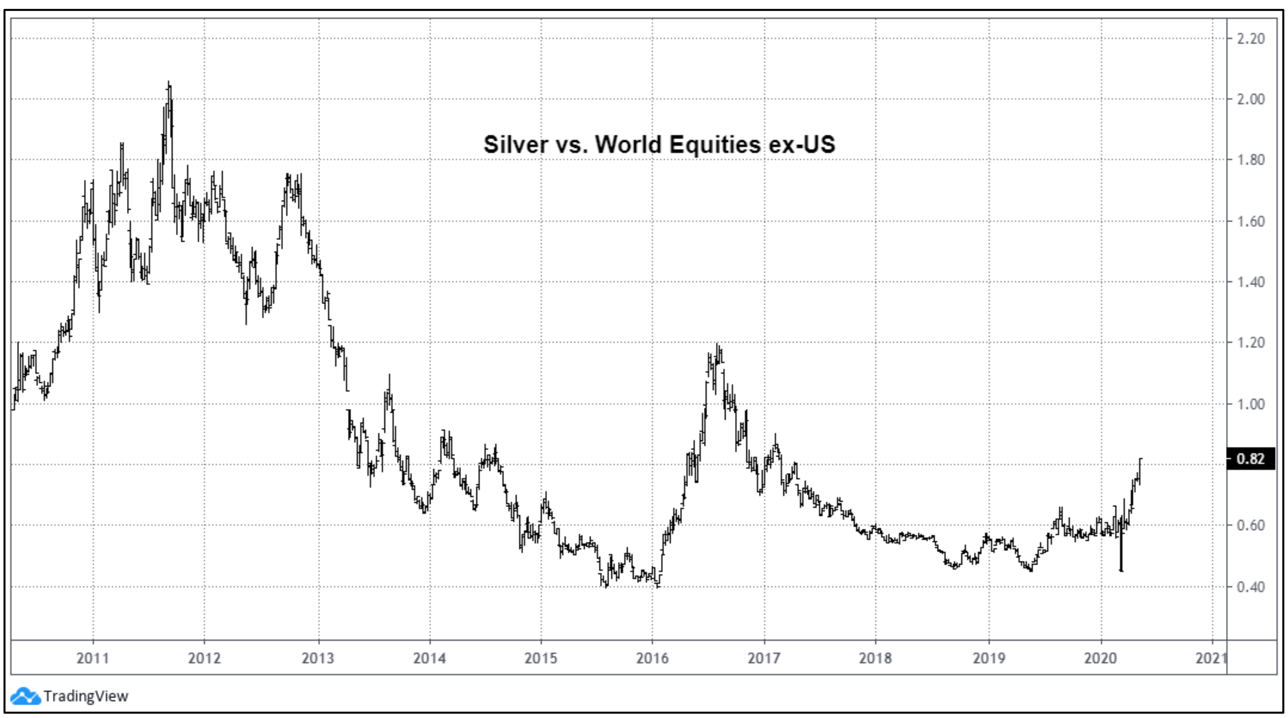
Silver miners are potentially seeing a long-term breakout…

and it has started to outperform global equities ex-US.



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Gold has already seen a big jump vs. US equities as it held up well during the March selloff.

Silver has not yet done so but could be coiling…

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There are some interesting set-ups vs. currencies as well. Meaningful breaks here would go a long way to showing better breadth for Silver.

Here are some others to watch over the next few weeks. Against CAD…

AUD

XAGAUD
45.00000
42.50000
40.00000
37.50000
35.00000
32.50000
30.00000
27.50000
25.66171
06:26:46
22.50000
20.00000
17.50000
15.00000
12.50000
2007
2009
2011
2013
2015
2017
2019
2021
TradingView

CNY

XAGCNY
320.00
300.00
280.00
260.00
240.00
220.00
200.00
180.00
160.00
140.00
116.99
07:09:30
80.00
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
TradingView

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Important Macro Data Releases and Events for the Week

Monday
5/18/2020

- Eurogroup Meeting

Tuesday
5/19/2020

- Industrial Production YoY (Mar) Forecast: - , Prior: -5.2%
- EcoFin Meeting
- ZEW Survey Economic Sentiment (May) Forcast: -12.1, Prior: 25.2
- ZEW Survey Current Situations (May) Forcast: -87.8, Prior: -91.5
- ZEW Survey Economic Sentiment (May) Forcast: 33.5, Prior: 28.2
- Building Permits MoM (Apr) Forecast: 1.04m, Prior: 1.35m
- Housing Starts MoM (Apr) Forecast: .908m, Prior: 1.216m
- **Fed's Chairman Powell Testifies SPEECH**

Wednesday
5/20/2020

- **PBoC Interest Rate Decision / Current 3.85%**
- **FOMC Minutes REPORT**
- BoC's Lane SPEECH

Thursday
5/21/2020

- RBA's Governor Lowe SPEECH
- Markit Manufacturing PMI (May) Forecast: 40, Prior:34.5
- Markit Services PMI (May) Forecast: 26, Prior: 16.2
- Markit Composite PMI (May) Forecast: 36, Prior: 17.4
- Markit Manufacturing PMI (May) Forecast: 38, Prior:33.4

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Markit Services PMI (May) Forecast: -, Prior: 12

Markit Composite PMI (May) Forecast: 24, Prior: 13.6

Philly Fed Manufacturing Survey (May) Forecast: -45, Prior: -56.6

Initial Jobless Claims Forecast: - , Prior: 2.981m

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 3.616m

Continuing Claims Forecast: - , Prior: 22.833m

Markit Manufacturing PMI (May) Forecast: 38, Prior: 36.1

Markit Services PMI (May) Forecast: 30, Prior: 26.7

Markit Composite PMI (May) Forecast: -, Prior: 27

Fed's Clairida SPEECH

Fed's Chairman Powell Testifies SPEECH

Friday 5/22/2020

ECB Monetary Policy Meeting Accounts

ECB's Lane SPEECH

Retail Sales MoM (Mar) Forecast: -, Prior: 0%

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