Stargazer
Asset Management

What to focus on in Global Macro for the week of April 27th, 2020

Macro Themes on the Radar:

On Thursday, Eurozone leaders came to an initial agreement to create a EUR 1Trl Recovery Fund to assist in the recovery from the pandemic. The discussions remain in very early stages and few details were provided. In fact, any further discussion on the details seem to have been postponed until early summer. The northern block led by the Netherlands and Germany continued to resist calls from Italy, Spain and France for the issuance of joint debt.

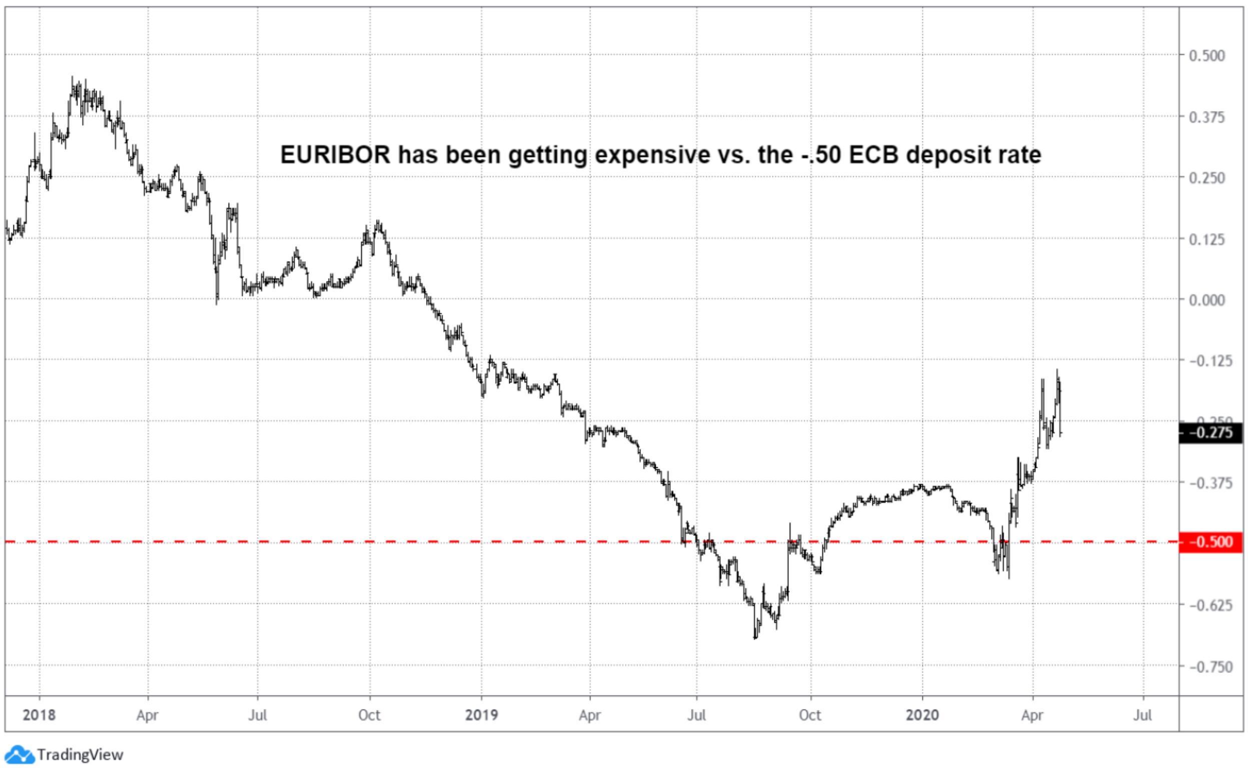
In a recent poll published by Il Giornale, "*as many as 40 percent of Italians represent a withdrawal from both the eurozone and the European Union, while 41.7 percent of Italians want to remain part of both institutions. Most Italians, around 59.9 percent, oppose the use of the European Stability Mechanism (ESM), an EU guarantee fund that could lend money to Italy to combat the coronavirus pandemic.*" The bitterness against Germany in particular, continues to rise in Italy.

In the meantime, the ECB will be left to do "whatever it takes" 2.0 to ensure that sovereign spreads don't widen excessively. However, the ECB is not happy about how the governments are handling the crisis and Lagarde was reported to have told EU leaders that they are doing too little too late.

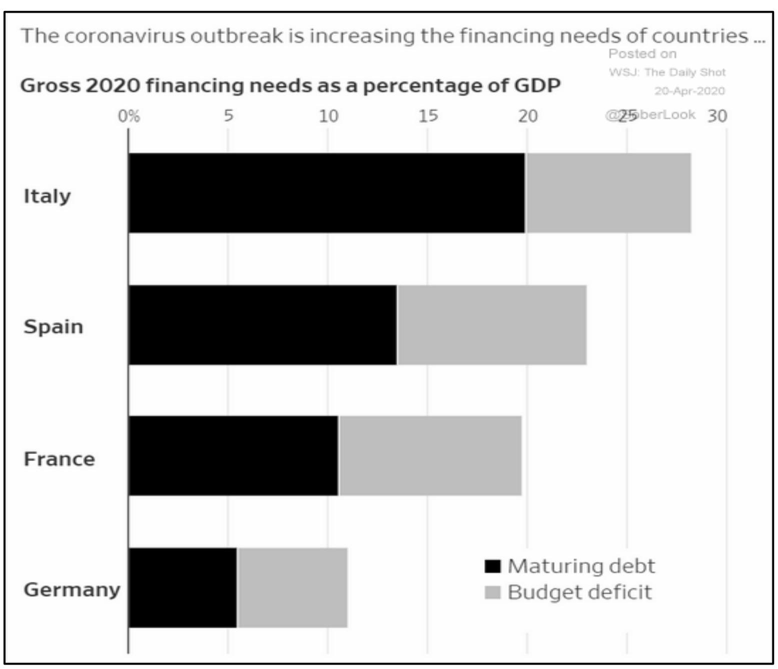
The liquidity being provided by the ECB is apparently not reaching everyone equally. Euribor vs. OIS on Thursday reached new recent highs as did Euribor itself. There seems to be continued fragmentation in the ability of banks to get short-term funding. Of the 18 banks on the panel that sets the Euribor rates, 7 are based in Italy, Spain and Portugal.

After Thursday's news of at least some theoretical progress via the Recovery Fund the funding crunch eased somewhat but expect continued headlines until something more sustainable is hammered out.

Essentially, the Eurozone governments have continued to punt the problem to the ECB, but this may open another battle front if it triggers a renewed debate on de facto monetary financing. Since the northern block can more easily be out maneuvered and out voted at the ECB, this route is clearly enticing to the frustrated Italians and their allies.



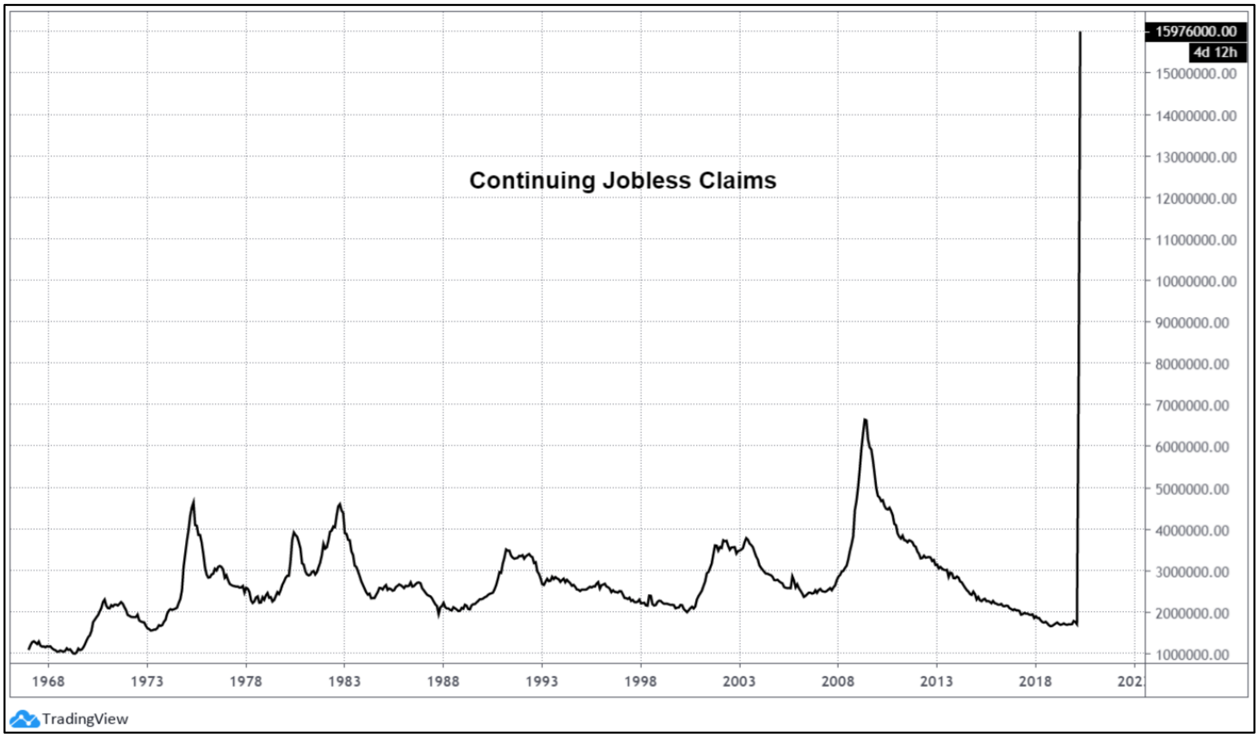
As Italy's debt to GDP approaches 160% and deficits explode, the ECB support is becoming more and more critical.



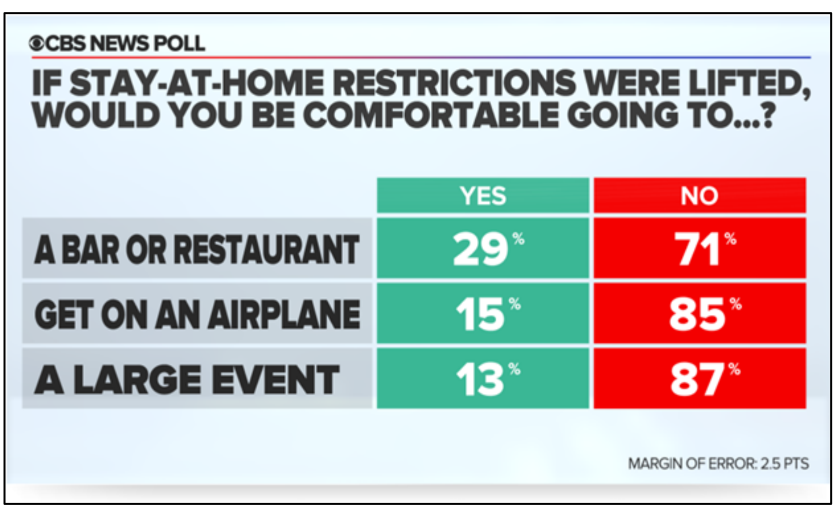
Stargazer
Asset Management

What to Focus on Now:

The data is probably now about as bad as it gets. Unemployment, PMI's and sentiment are at extremes.

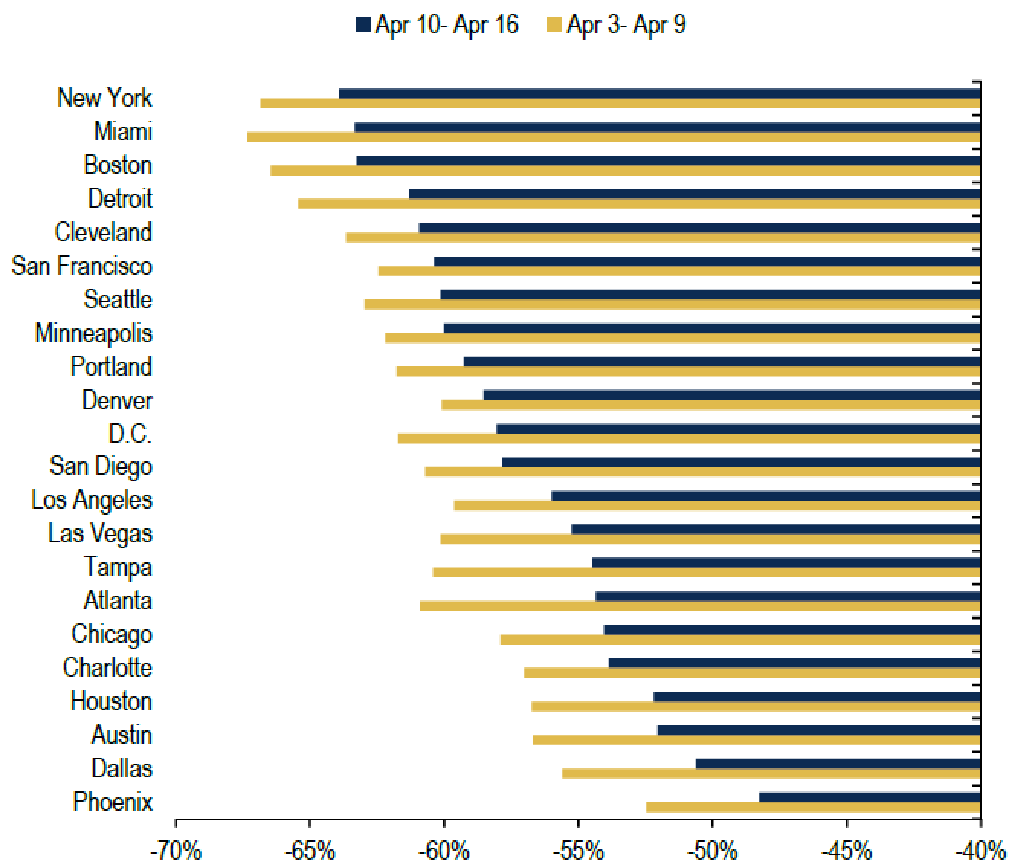


The big question is how far and how fast does it recover? As long as there is no vaccine or effective therapeutic, consumption could be slow to return to the previous levels. By design, of course, the phases of re-opening will reinforce this.



While the plunge in consumption of goods and services has been ugly, there are some signs of stabilization and even recovery as extreme fear subsides.

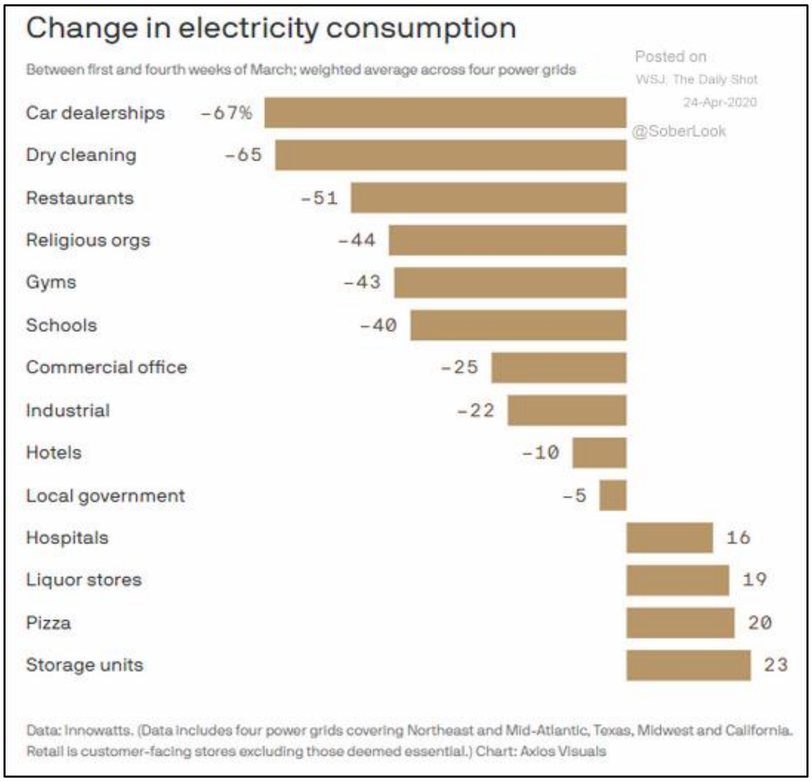
Chart 25: Change in spending at discretionary services and goods by major Metropolitan Statistical Area (MSA) (% change from pre COVID-19 levels)



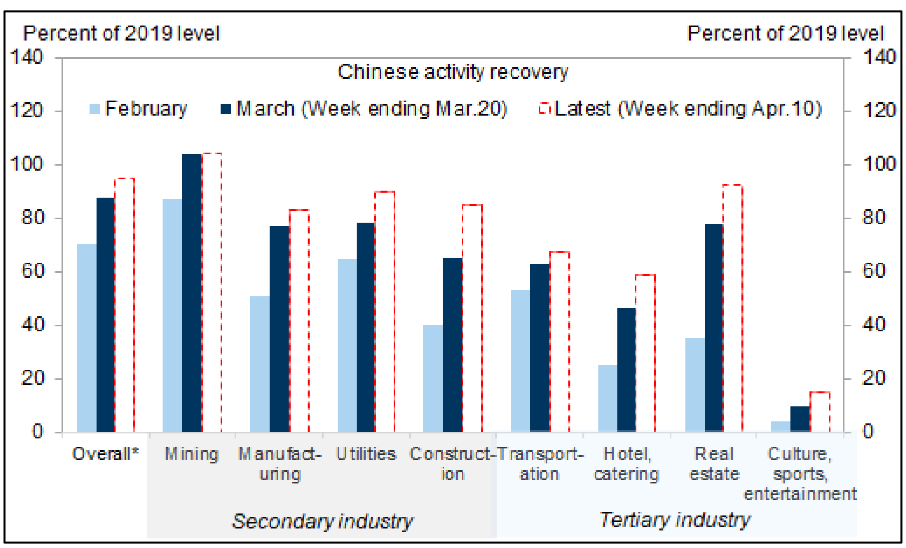
Source: BAC internal data

Note: To calculate the % change, we took the average of 7-day period specified in the chart legend (Apr 4-10th and Mar 28- Apr 3rd) and compared with the average of February. Discretionary services and goods include: include entertainment services, restaurants, clothing, department stores, and furniture stores.

Of course, as always there are winners and losers, and they appear to shake out more or less as you might expect.



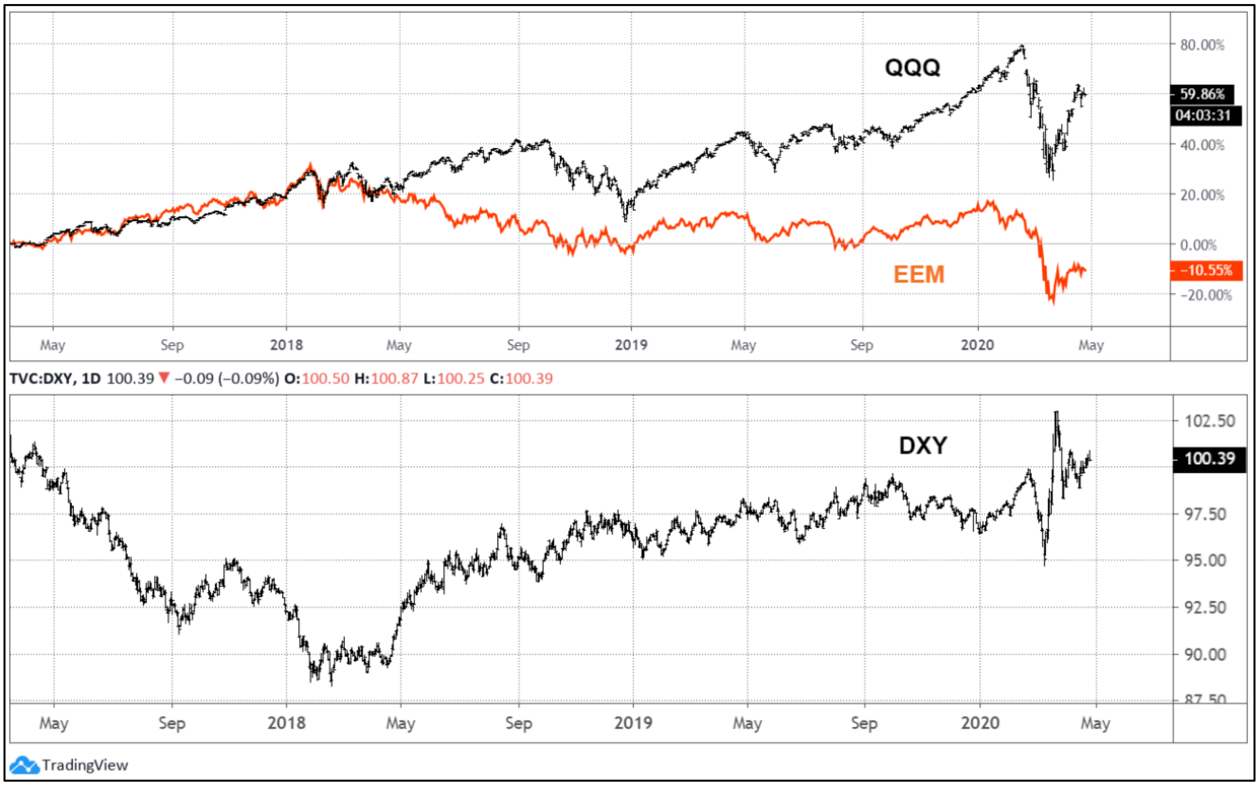
With China still the best template for what the initial recovery will likely look like, this chart provides some further context. As you would expect manufacturing is quicker to bounce than other areas. Given the differences in the importance of consumption vs. manufacturing in China and the US, this could provide some disappointment for the speed of a US recovery.



USD

So far, the dollar has been unable to turn decisively lower; that matters, a lot. Despite all the QE and exploding US debt.

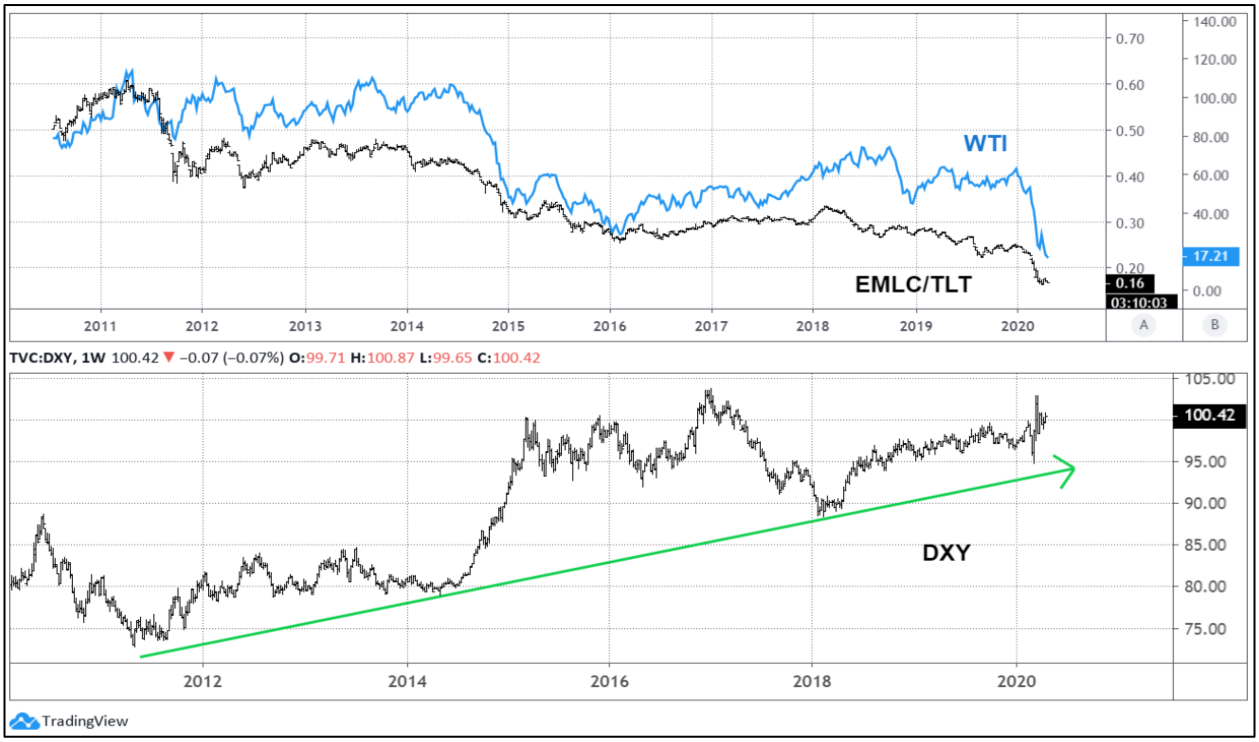
A strong dollar world is one where Growth (it is hard to find) outperforms Value (there is plenty of it). That is true domestically and internationally.



For the USD, as the worlds reserve currency, strength or weakness tends to be accompanied by self-reinforcing cycles. The cause/effect tends to be a bit like the chicken or the egg argument. Does USD strength bring slower global growth or is it the result of slower global growth. The answer is it depends, of course.

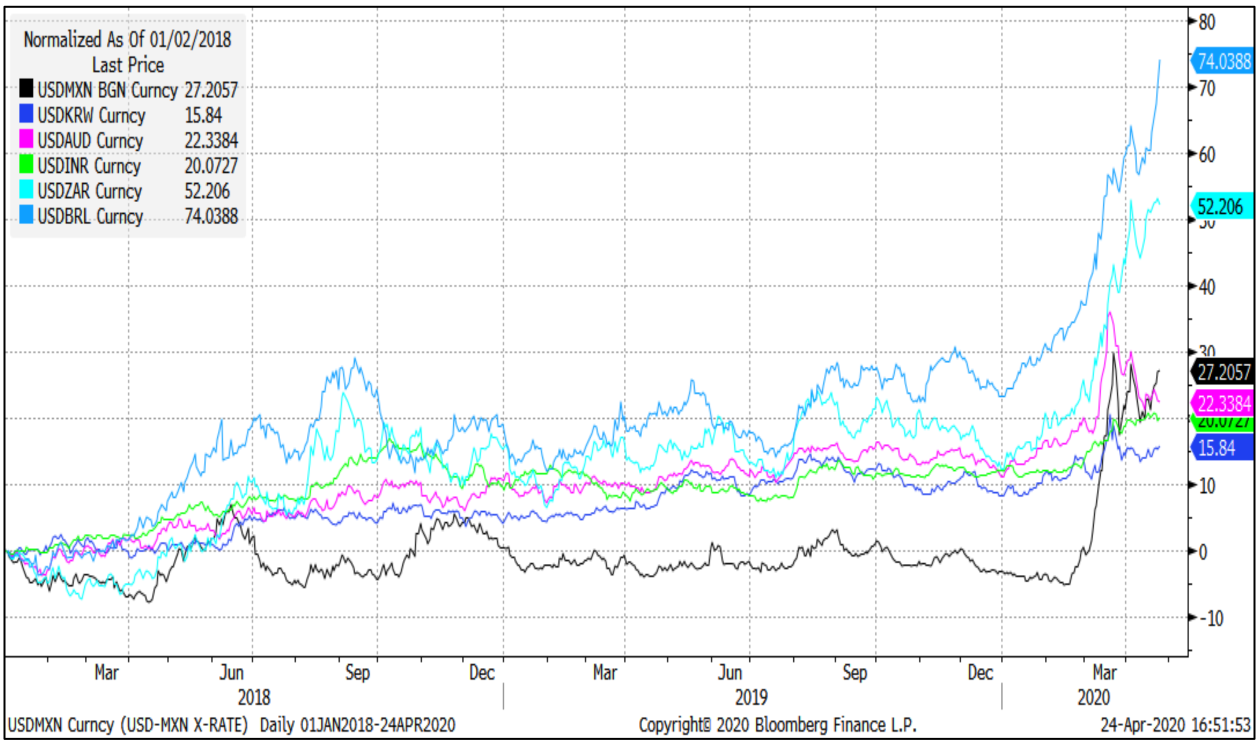
In the above chart, the USD bottomed in early 2018 and global growth started to peak. The dual effect of falling global growth and a rising USD was a strong headwind for EM. At the same time the USD based instruments with the highest growth rate attracted the marginal investment dollar.

If we go back to the second half of 2011, when this larger USD trend started, we can see how some other measures of global growth have done in the below chart. Again, there is circularity as Oil prices generally suffer during both a strong USD environment and with weakening global growth. EMLC (EM local currency bonds) underperformed TLT (longer term US Treasuries), also not surprising as higher USD and lower global growth took hold.



As the positive feedback loop for the USD and US growth stocks (FAANGM) kicked in, the US equity market started to outperform the rest of the world. It has continued to do so.

During the corona-crisis and its global growth shock, many EM currencies have taken another leg lower. A continued crisis of confidence in EM growth prospects just makes matters worse.



A strong currency due to high credibility and continued demand can be a hard thing to reverse. Just ask the Swiss or the Japanese who have struggled with this issue persistently.

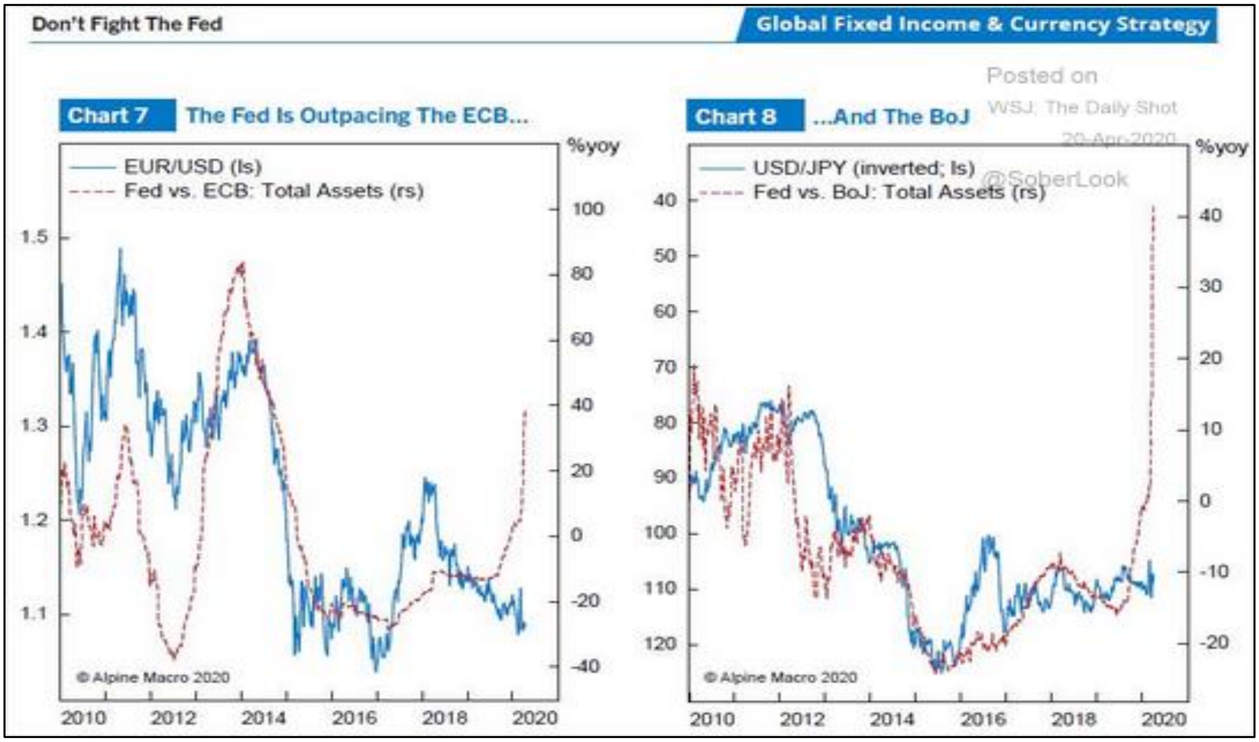
If the US is the primary global growth source, it is to some degree a victim of its own success with regard to the strong dollar.

But there is another problem, as the global reserve currency there is a lot of outstanding USD debt globally and a constant need for USD funding. If other countries are experiencing poor growth, the resulting credit and cashflow issues can only exacerbate the need for USD.

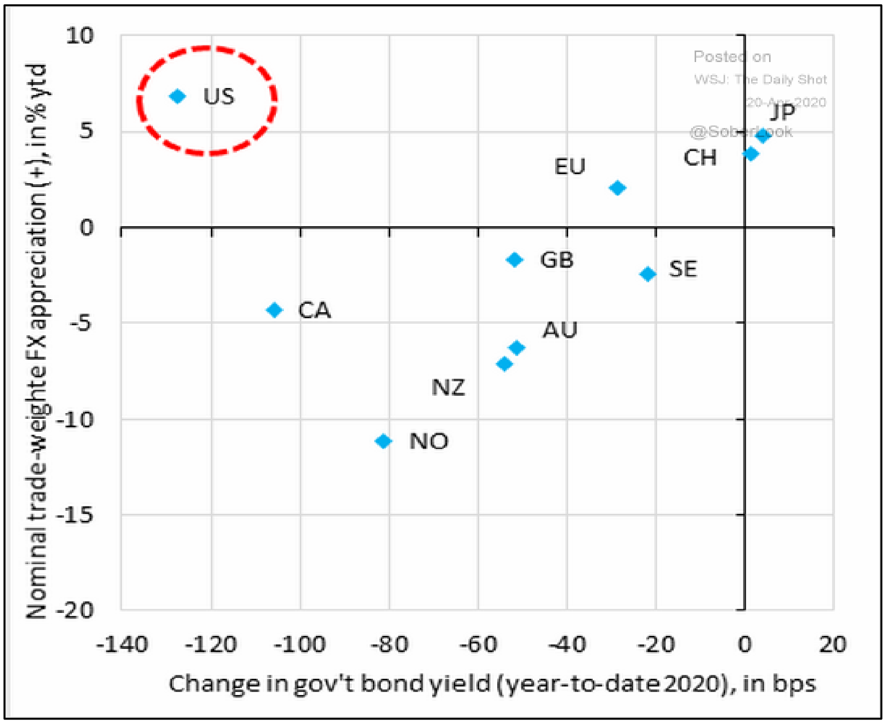
It is one thing for the US to blow out its supply of USD liquidity, but that doesn't mean we have the ability to stimulate other countries economies the way we can support our own.

Europe and Japan, for a number of reasons, have found it very difficult to generate any lasting or meaningful growth or inflation. During the current crisis Europe continues to flounder and the lack of confidence this generates for economic actors, is very meaningful.

The Fed and the US government have certainly reacted to this crisis with a flood of liquidity, market support, credit and grants. The crisis response is totally unprecedented, and, on a scale, no other country has done. The narrative that follows from these actions is that with all these additional dollars, the USD must weaken. So far however it has not done so in any meaningful way.



Not only is the liquidity provision astounding, but the drop in Treasury yields and front-end rates has been fast and furious.



However, the USD is stronger than you might expect given the fall in Treasury yields.

For now, there is continued demand for USD, both from those who <u>want</u> them as a safe haven and from those who <u>need</u> them to supply liquidity and funding.

It is certainly possible that what has been done just takes a little while to work its way through the system and into all the cracks. If that is the case, watch for increasing USD weakness to become apparent. As noted above, if that can help kick off a virtuous cycle for global growth that includes higher commodities, improving EM performance and a global shift towards Value it will lift many boats. This would be the hoped-for outcome for global Central Bankers. We will see if it develops.

If they feel it is not going as planned, be ready for Yield Curve Control, by which the Fed would put a ceiling on how high different Treasury yields on the curve can go. I would expect them to start near the front of the curve and move further out if they feel they need to do more. The hope is that you raise inflation expectations as Treasury yields are no longer allowed to rise. A nice side effect would be that if inflation expectations do materially rise the USD would be one of the only escape valves (as yields can't rise) and it should be hit as a result.

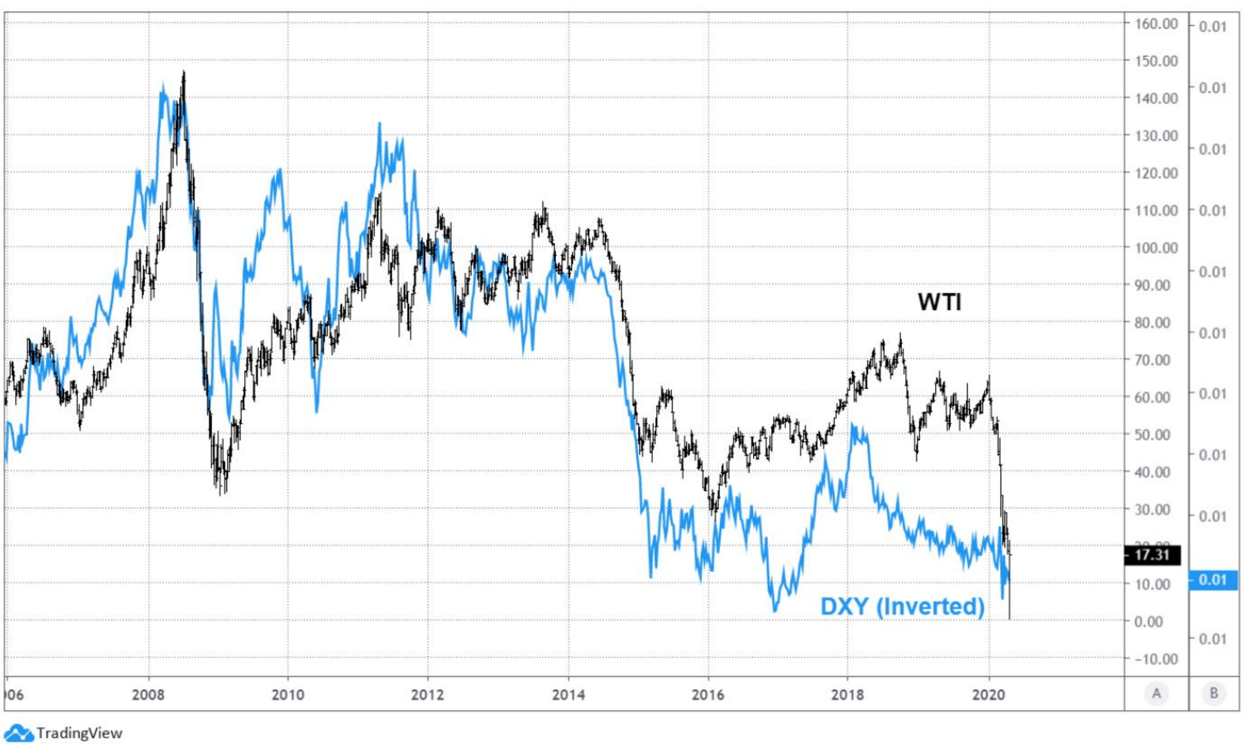
BoA/ML had an interesting table that looked at the oil price correlation to the relative performance of a number of the assets that have been out of favor.

Table 2: ... boost in oil prices to benefit distressed assets

Asset	10Y Correlations
EM bonds vs IG bonds	0.82
Energy vs Tech	0.82
EM stocks vs Nasdaq	0.71
US value vs growth	0.66
US small cap vs large cap	0.64
Small cap value vs large cap growth	0.64
EM vs DM	0.64
EM energy	0.59
HY bonds	0.50

Source: BofA Global Investment Strategy, Bloomberg

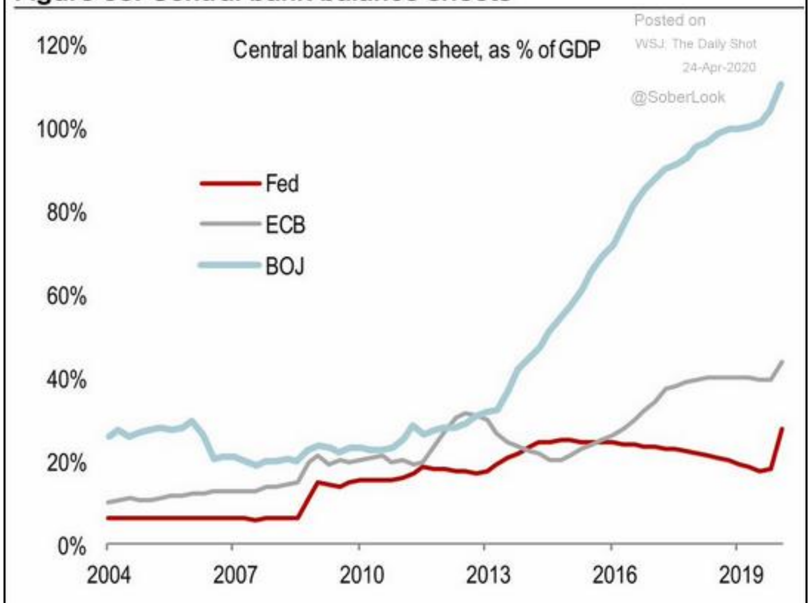
But really, while they point to oil as the driver, that is really just part of the virtuous cycle that a falling USD traditionally needs to be a part of. Rather than oil, it may be the USD that should be focused on as the driver of these correlations.



A quick side note on weakening a strong currency…

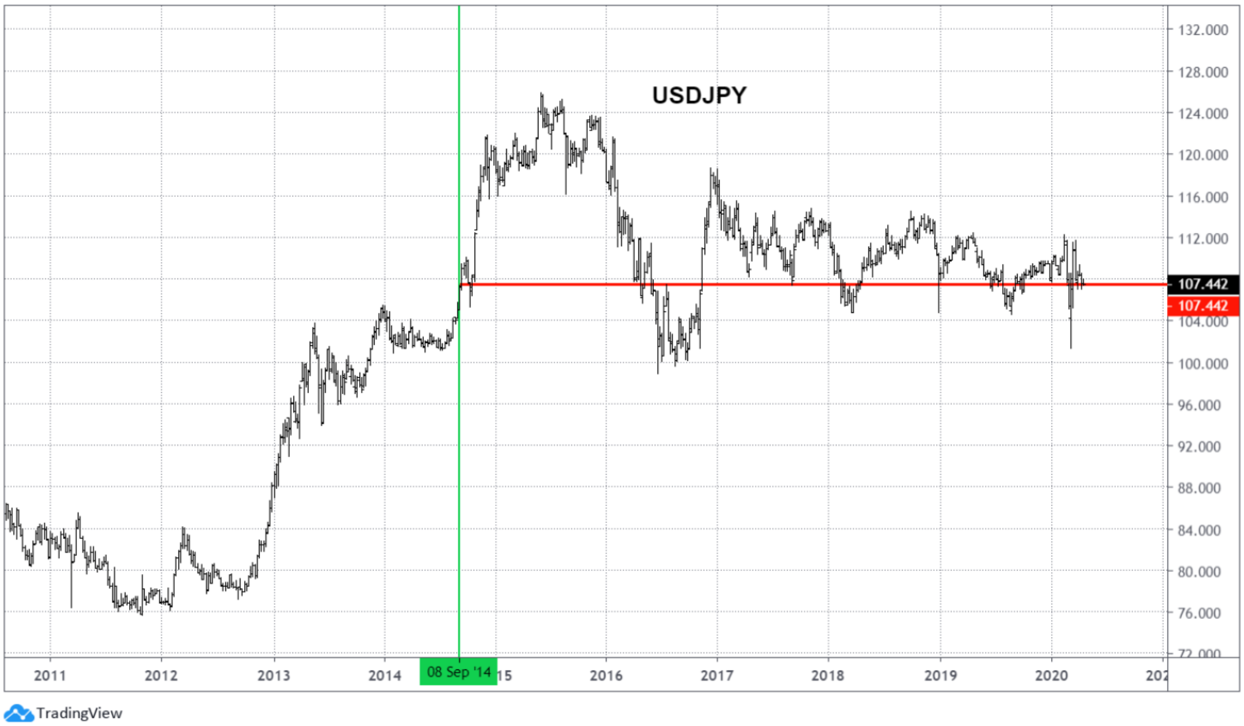
Back in 2012 the Yen was very strong and punishing the Japanese export economy. As part of a grand plan they cranked up QE to weaken it. The Balance sheet really got going as of 2013 and hasn't looked back.

Figure 38: Central bank balance sheets



Source: Refinitiv, Credit Suisse research

However, the cumulative effect on the Yen, while initially dramatic, lasted for only a bit over a year. The last 5 years of balance sheet expansion have had no effect on the Yen.

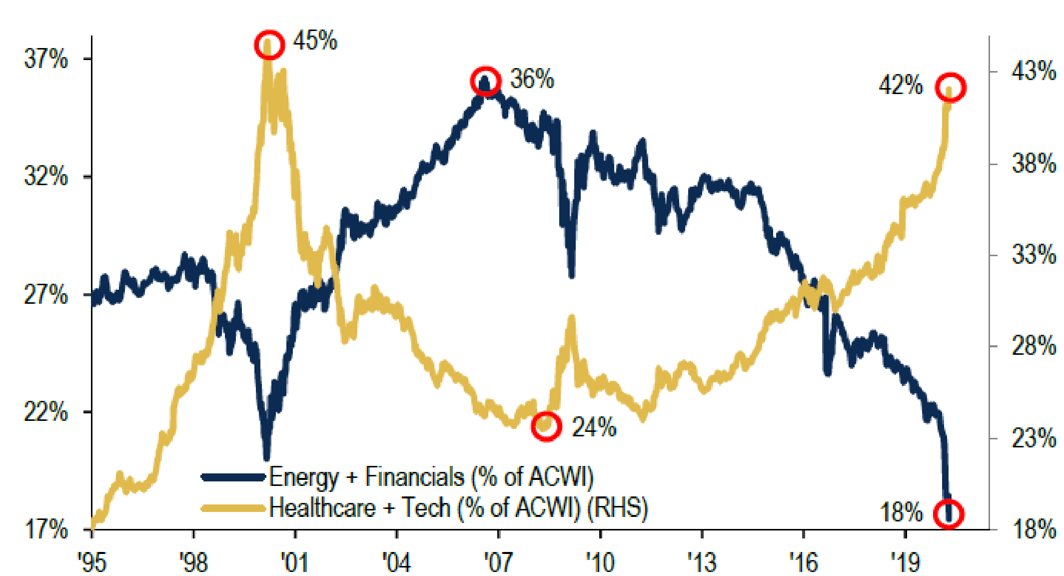


Charts Pack

Where are we? With so much dispersion between sectors and globally I thought it might be worth spinning through some charts. Tech. and Healthcare are the kings.

Stargazer
Asset Management

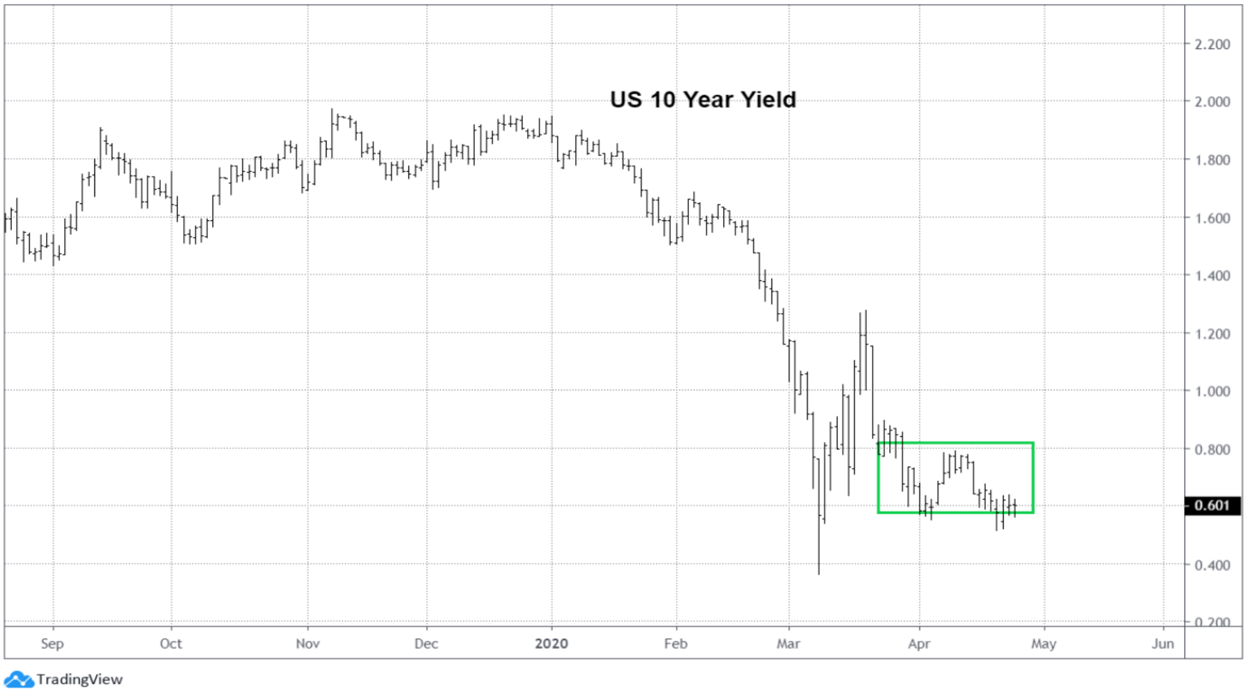
Chart 2: Polarization in sector dominance... buy humiliation at all-time lows



Source: BofA Global Investment Strategy, Datastream

As discussed, USD vs Developed markets is still holding in. Vs. EM, it is still shining.

US 10 year yields have been back and forth between 60 and 80bps for a month now.

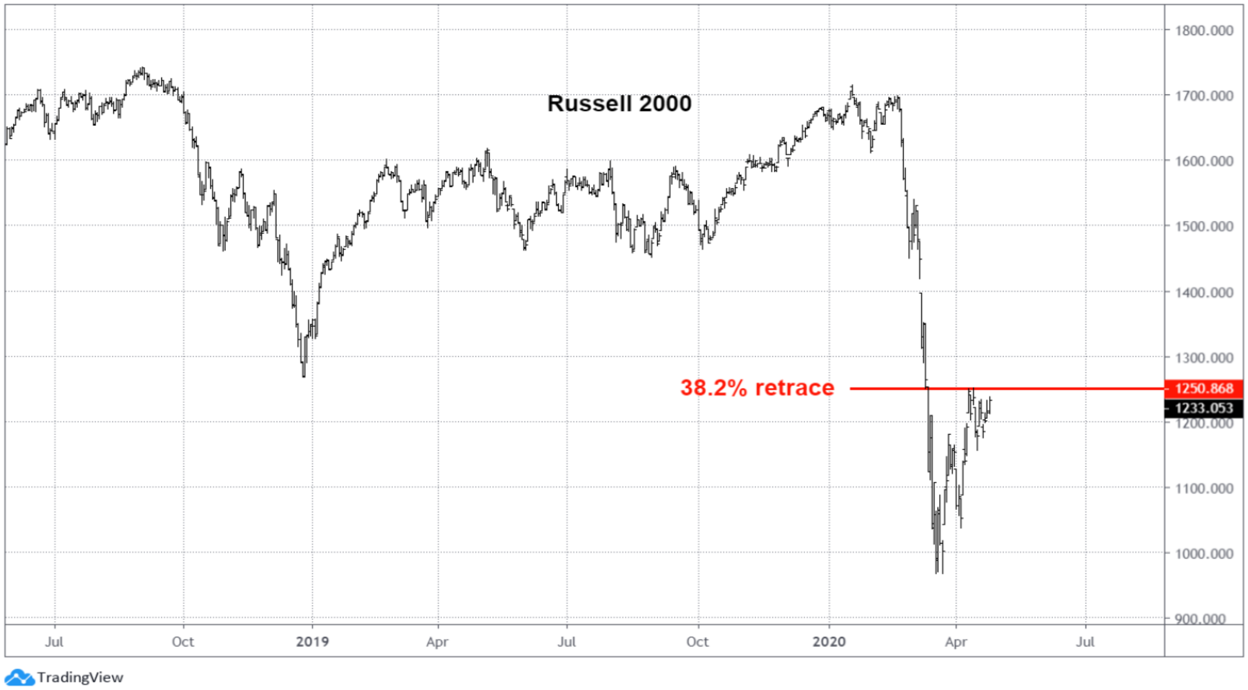


In Japan, the Nikkei has had a pretty typical bounce for equity indices.

Same thing in Europe…

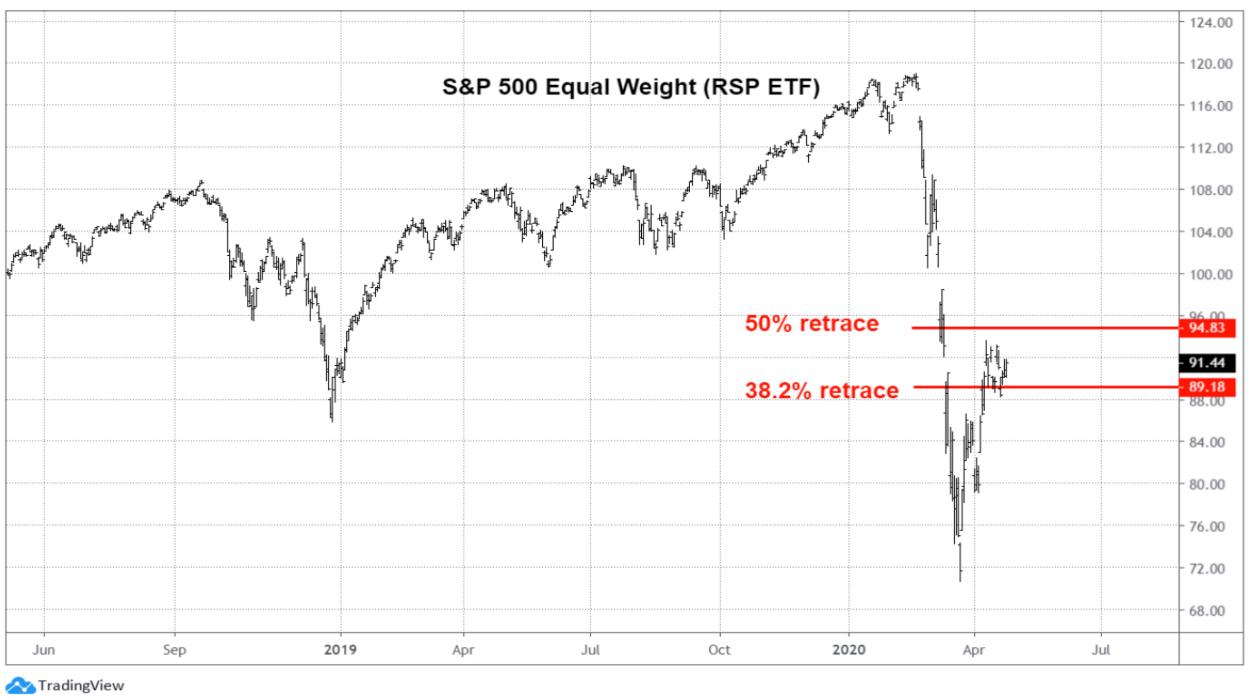
EM as well…

In the US the Russell has been the least impressive.



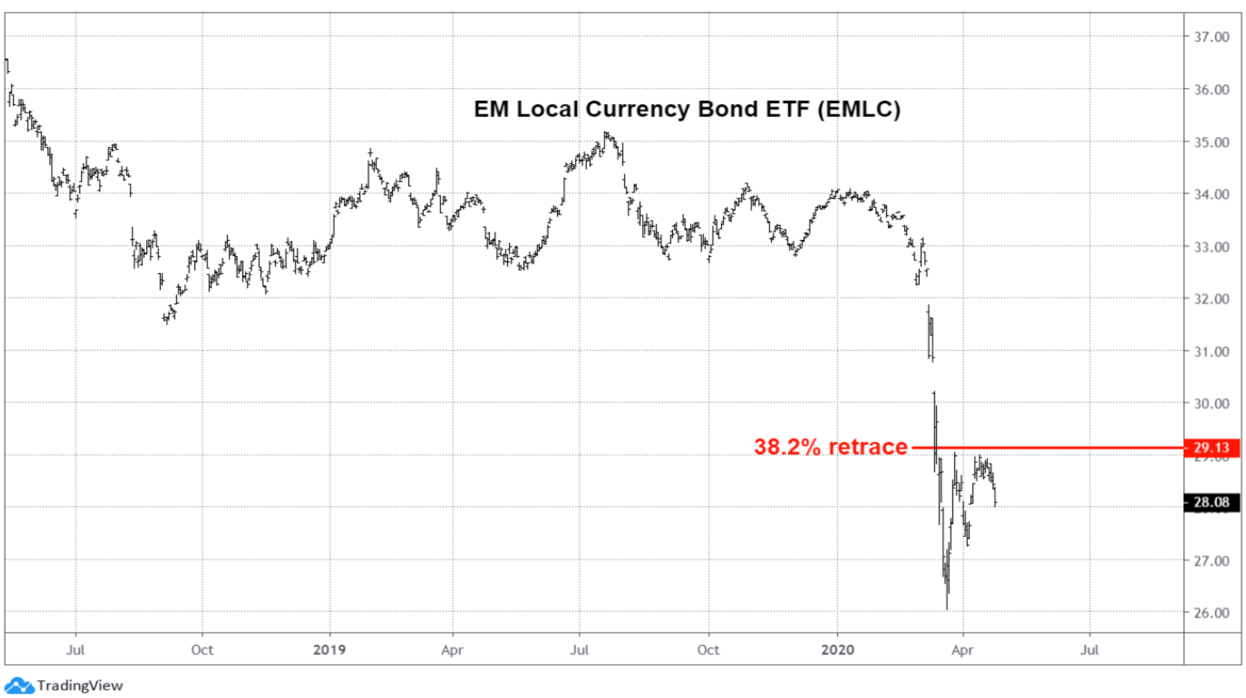
The S&P 500 has done much better…recouping 57ish% of the fall. But note the big Tech names are driving the outperformance. With the 5 largest capitalization stocks worth more than the bottom 350 names, it matters.

The equally weighted version shaves off a chunk as a result.



Front and center is the NASDAQ 100 as does the best job of focusing on those Tech. names.

I'll finish up with this EM local currency ETF… not much of a bounce with weak currencies (strong USD) and credit issues weighing on it. This could be an interesting one to buy some puts on to play for/hedge further USD strength.



So far still no turn in the Growth vs. Value story … watch the USD.

As we pass the peak in terrible data and the worlds starts to slowly re-open, the numbers will again start to matter.

Important Macro Data Releases and Events for the Week

Monday 4/27/2020	Dallas Fed Manufacturing Index (Apr) Forecast: - , Prior: -70
Tuesday 4/28/2020	**BoJ Monetary Policy Statement / Interest Rate Decision / Press Conference**
	ECB Bank Lending Survey REPORT
	Richmond Fed Manufacturing Index (Apr) Forecast: -6, Prior: 2
	Consumer Confidence
Wednesday 4/29/2020	Business Climate Survey
	Harmonized Index of Consumer Prices YoY (Apr) Forecast: 0.1%, Prior: 0.1%
	GDP Annualized Q1 PREL Forecast: -4%, Prior: 2.1%
	Pending Home Sales MoM (Mar) Forecast: -10%, Prior: 2.4%
	FOMC Interest Rate Decision and Press Conference
	Industrial Production and Retail Sales
Thursday 4/30/2020	Non-Manufacturing PMI (Apr) Forecast: - , Prior: 52.3

NBS Manufacturing PMI (Apr) Forecast: 51, Prior: 52

Unemployment Rate and Change

GDP s.a. QoQ Q1 PREL Forecast: -3.3%, Prior: 0.1%

ECB Interest Rate Decision / Monetary Policy Statement and Press Conference

Core PCI MoM (Mar) Forecast: -0.1%, Prior: 0.2%

Initial Jobless Claims Forecast: 3.5m , Prior: 4.427m

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 5.786.5m

Continuing Claims Forecast: - , Prior: 15.976m

Chicago Purchasing Managers Index (Apr) Forecast: 36, Prior: 47.8

Friday
5/1/2020

Markit Manufacturing PMI (Apr) Forecast: - , Prior: 46.1

Markit Manufacturing PMI (Apr) Forecast: - , Prior: 36.9

ISM Manufacturing Employment Index (Apr) Forecast: - , Prior: 43.8

ISM Manufacturing PMI (Apr) Forecast: 36.7, Prior: 49.1

ISM Manufacturing Prices Paid (Apr) Forecast: - , Prior: 47.4

ISM Manufacturing New Orders Index (Apr) Forecast: - , Prior: 42.2

strictest confidence and shall not disclose to any third parties any information material to the opportunity contained herein and, upon review hereof, agrees that any unauthorized disclosure by any party will result in irreparable damage for which monetary damages would be difficult or impossible to accurately determine. Recipients recognize, and hereby agree, that the proprietary information disclosed herein represents confidential and valuable proprietary information and, therefore, will not, without express prior written consent, disclose such information to any person, company, entity or other third party, unless so doing would contravene governing law or regulations. This document is an outline of matters for discussion only.

This document does not constitute and should not be interpreted as advice, including legal, tax or accounting advice. This presentation includes statements that represent opinions, estimates and forecasts, which may not be realized. We believe the information provided herein is reliable, as of the date hereof, but do not warrant accuracy or completeness. In preparing these materials, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources.