Stargazer
Asset Management

What to focus on in Global Macro for the week of June 1st, 2021

Macro Themes on the Radar:

Fed Taper Debate and Inflation

Last week, various Fed officials continued to say that much of the inflation pop would be transitory but that they expect the Fed would start talking about tapering asset purchases soon. In a speech, Fed Governor Quarles said, “In particular, we may need additional public communications about the conditions that constitute substantial further progress." That point may indicate that we will get more color at the Fed’s June meeting. Volatile employment data will likely complicate the process. That combined with a continued commitment to “telegraph taper well in advance” still puts the odds of any announcement off until the September meeting and the actual taper off until the end of the year. Overall, markets continue to look for higher near-term inflation followed by a slow reversion back to the 2% ish level next year.

The main inputs for inflation remain:

- Price of imports (USD matters)
- Aggregate demand vs. Supply across the economy (this is a mess at the moment as strong demand meets dislocated supply)
- Inflation expectations (slowly rising)
- Inertia in the inflation process (won’t be clear for many months)

In the short term, inflation numbers will need to be higher for longer to get the market worked up sufficiently, to get the next leg higher going in yields, or employment will need to surprise on the upside after last month’s much weaker than expected number. The range for this Friday’s nonfarm payrolls print is wide, to say the least. Consensus is in the high 600k area, but with lots of dispersion. The whisper number is probably closer to 800-900k. I think that in the next few months the employment numbers could more easily catch markets offsides than the inflation prints. A couple of unexpectedly strong months would ensure a September taper announcement and potentially bring forward rate liftoff expectations.

ECB

With the June 10th meeting approaching, there has been some pushback from various ECB members regarding the slowing of the PEPP’s previously instituted “significantly faster” pace of purchases. I think it is a close call, but if they do reduce the purchases back to the previous pace, they will take great pains to communicate that in their view this isn’t a taper but an “operational adjustment.” Markets may see it differently, however.

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China

Last week, Kurt Campbell, the U.S. coordinator for Indo-Pacific affairs on the National Security Council said, "The period that was broadly described as engagement has come to an end," adding that the "dominant paradigm is going to be competition." That seems to sum up US-Sino relations at the moment. With Congress pushing forward on a bill to bolster U.S. economic competitiveness and confront China's rise, and the U.S. reopening an investigation into the origins of COVID, relations are likely to remain strained for the foreseeable future. China will not play the deflationary role it once did vis-a-vis the US economy, going forward.

Infrastructure / Budget

"A billion here, a billion there, soon you're talking real money." That quote attributed to the late Senator Dirksen seems almost quaint these days.

Biden has proposed a $6T budget, rising to $8.2T by 2031. Republican and Democratic lawmakers are haggling over the proposed infrastructure bill that now looks likely to come in between $1-$2Trl, one way or another. What strikes me is that none of that is deflationary! In the near-term there will be an inflation peak and a valley. Globalization and the size and policy of governments will determine what happens after that on the inflation front. While it is currently beyond the tradeable horizon, you need to keep thinking about what is building up in the valley on the other side of the hill we are currently climbing. Inflation is a process, and if it does rise from here, it will take years to reach a sustainable critical mass. It will also likely require multiple policy missteps and some outside shocks. That is not the current issue at this point. Instead, what matters to markets at this point is whether things will develop along lines that force the Fed to blink, despite the new framework.

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

Equities

The S&P is pretty much where it was six weeks ago. Bonds and most currencies have seen similar price action.

The NASDAQ and the Russell are closing in on four months of a trading range, while the DJIA and the SPX have been the winners.

After a nice run to start the year, European equities finally made new highs last week after six weeks of sideways. Let's see if they can sustain the break and gather some new momentum.

Despite all that, Europe still has not been able to break higher on a relative basis in the bigger picture.

EM has not been able to make much headway either. An initial break higher on a relative basis at the start of the year quickly failed.

Greater China exposure in EM proxies has not helped. Last week, however, Chinese equities broke higher.

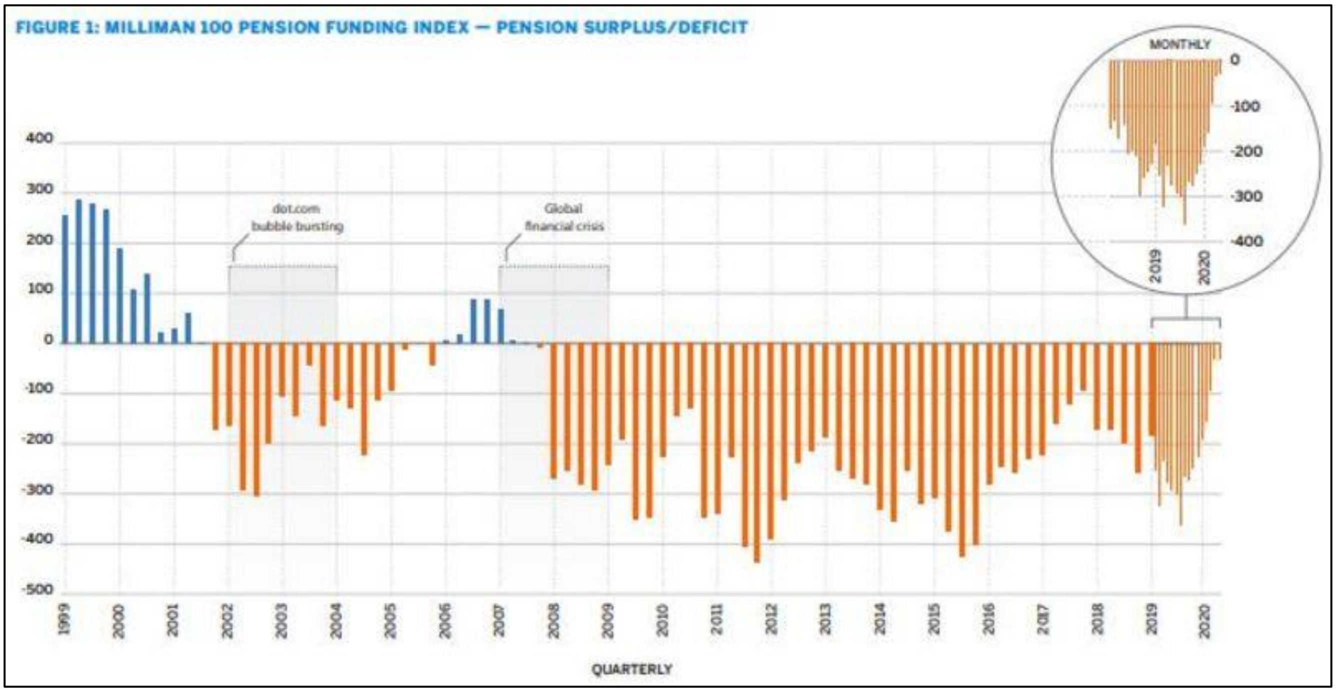
The Asian rebound is still looking solid overall.

The yuan has been strengthening and recently has taken another leg higher vs. the USD. There has been concern that the PBoC would protest further strength and they have in fact been intervening to slow the yuan rally both directly and via proxies in the past few months. A PBoC official recently wrote an article saying that they should let the Yuan appreciate to counter higher commodity prices. The article was then deleted, and another official issued a statement that the currency would remain "basically stable". It didn't help for long as the rally soon recommenced.

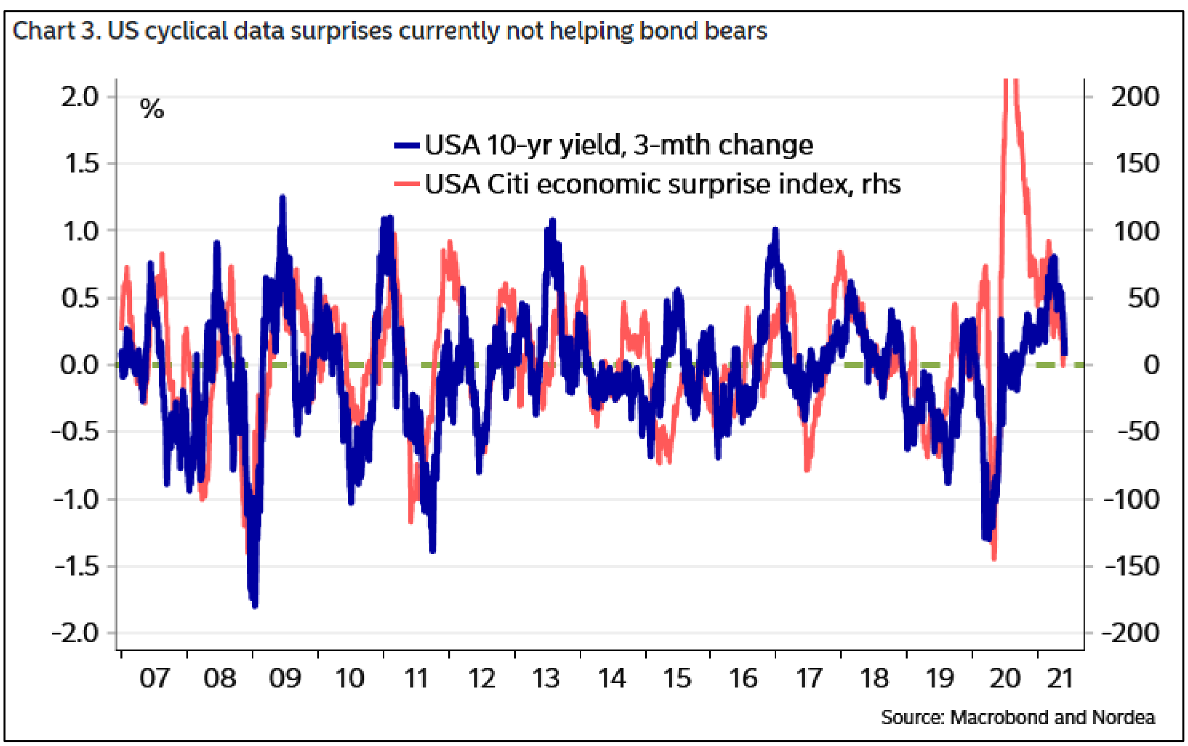
In the meanwhile, Chinese regulators continue to warn regarding global asset bubbles. Liang Tao, vice chairman of China Banking and Insurance Regulatory Commission, said at the International Finance Forum in Beijing on Saturday that unprecedented pandemic easing measures by developed countries has contributed to asset bubbles and that they could burst as interest rates start to rise.

Bonds – They have been going sideways as they work off extreme oversold conditions and positioning.

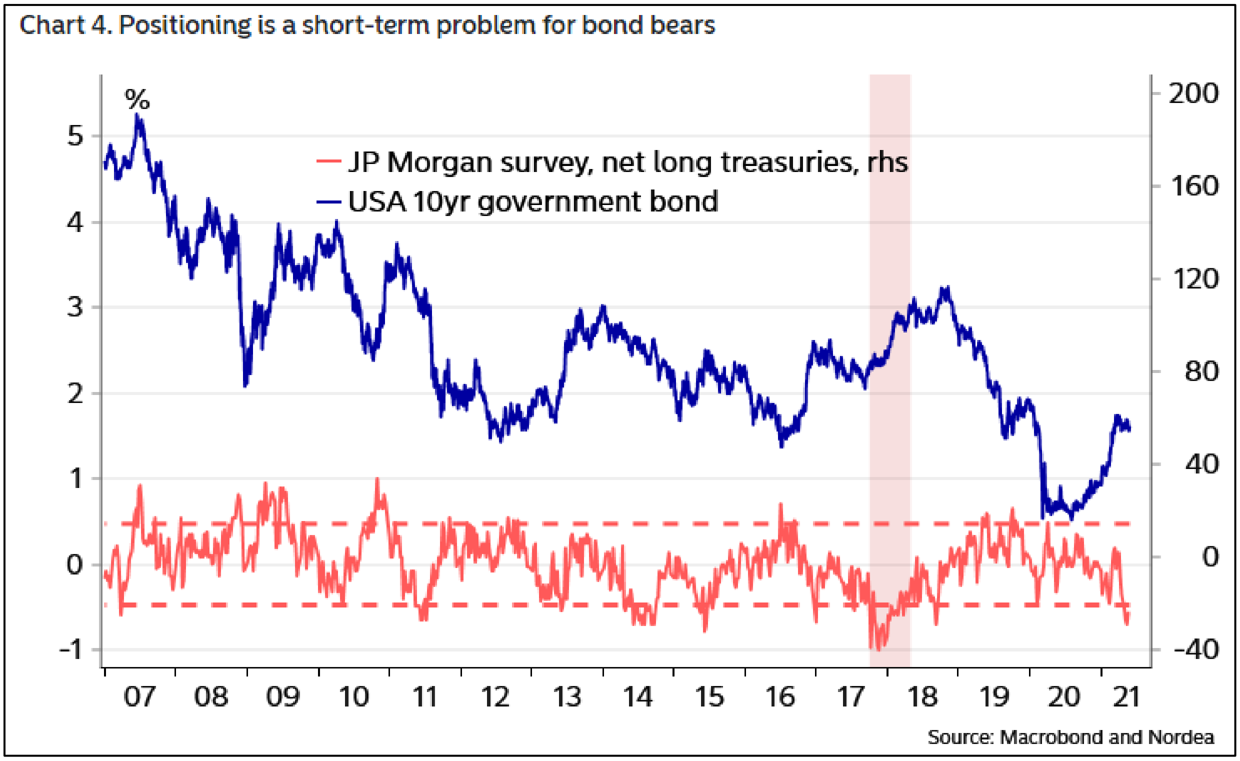
At the same time demand has picked up as pension plans find themselves almost fully funded for the first time since the financial crisis, thanks to the global equity rally. Potentially, $3.5Trl could be looking for a new home in fixed income as they effectively take some chips off the table.



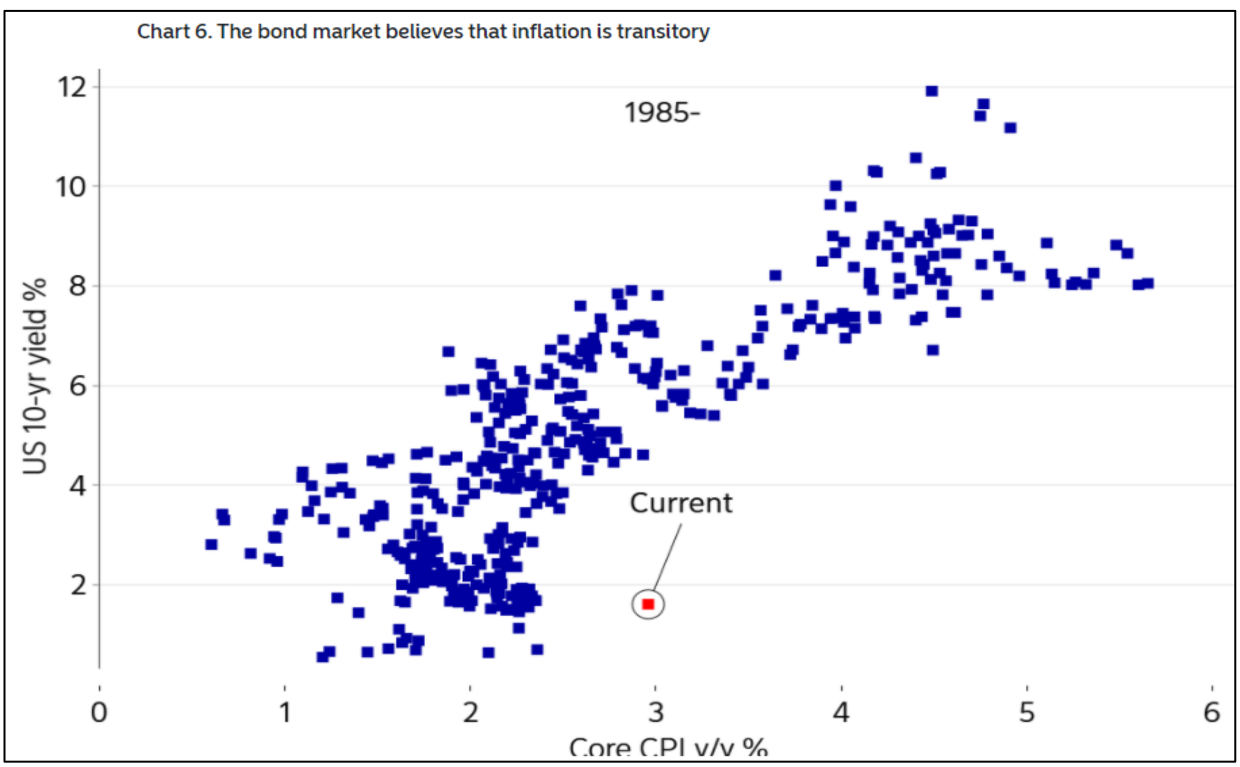
Another factor is that US data has stopped surprising to the upside. Historically, that has often meant sideways bond prices for the time being.



A change in the markets view on when Fed hikes will start may be needed to get the next leg higher in yields. Just starting to talk about talking about taper may not be enough...

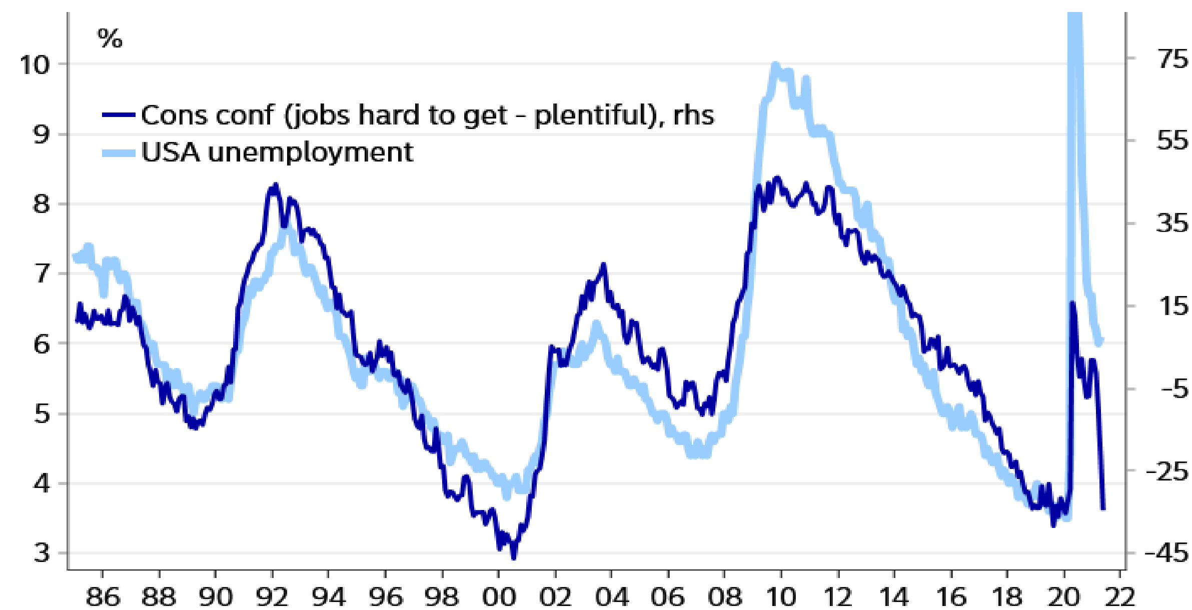


For now, the bond market thinks inflation is "transitory". Source: Nordea Research



Recent initial jobless claims are making people feel more confident that strong employment data is in the cards. If the current demand/supply bottleneck breaks, we could make quick progress towards the "string" of positive releases that Chair Powell is looking for.

Chart 7. Households find it extremely easy to find a job



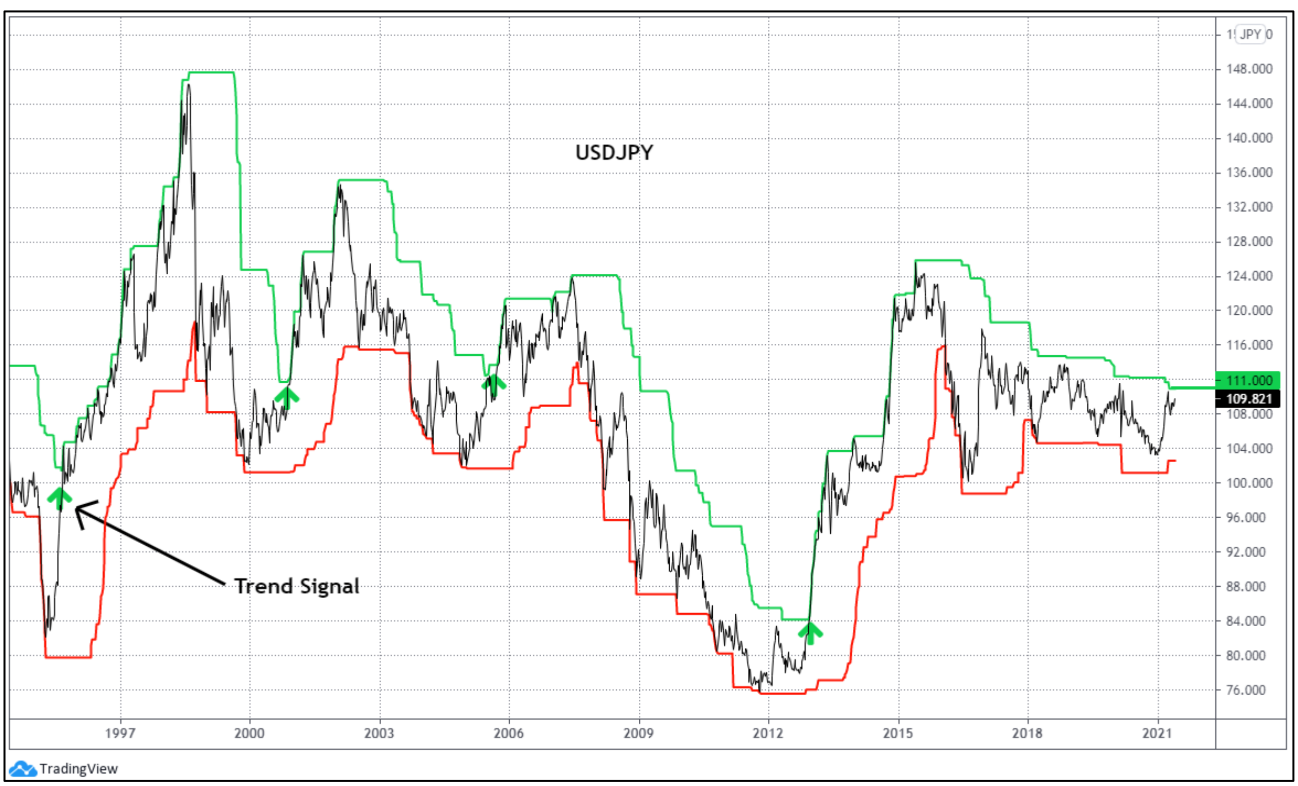
Source: Nordea Markets and Macrobond

FX – The USD rejects lower prices again. This coming week will be key for what happens next.

In the meanwhile, the Yen is at critical levels vs. a number of currencies.

This is big picture stuff… worth keeping an eye on if yen weakness is a broad-based development.

In USDJPY we are getting very close to a new long-term trend signal on a break of 111.00.



The last one was back in 2012!

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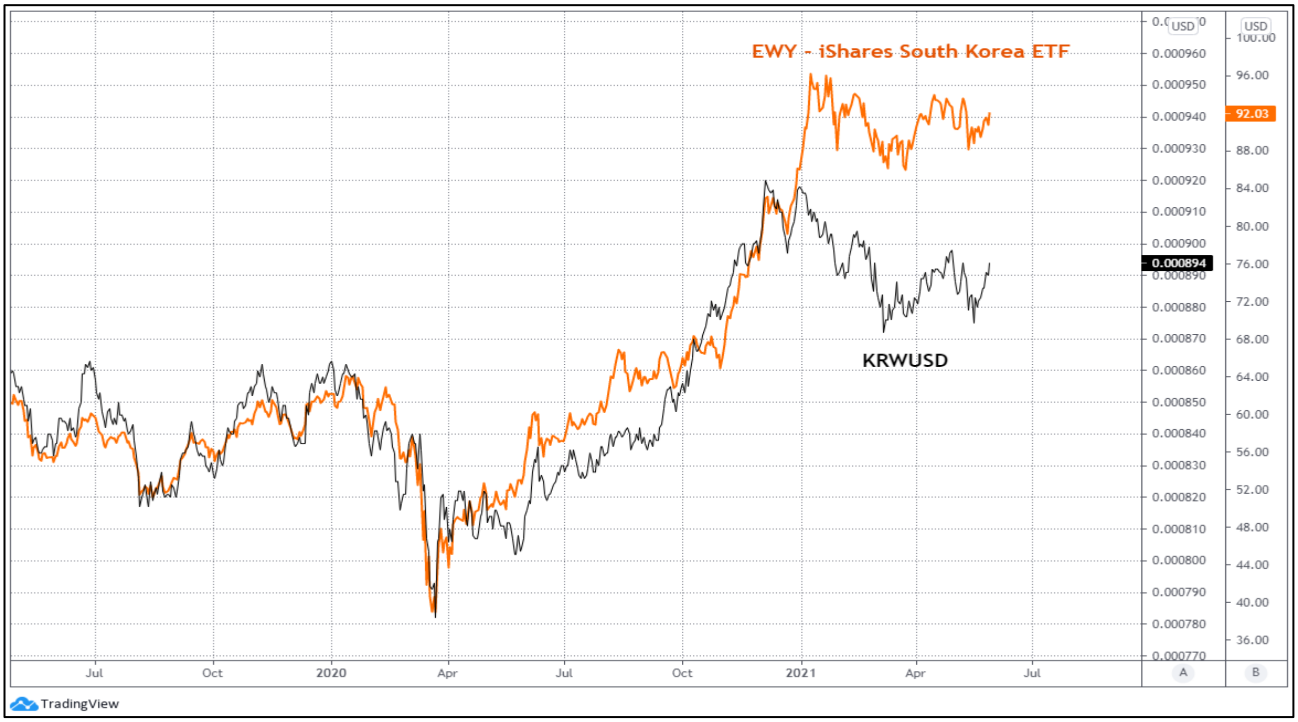
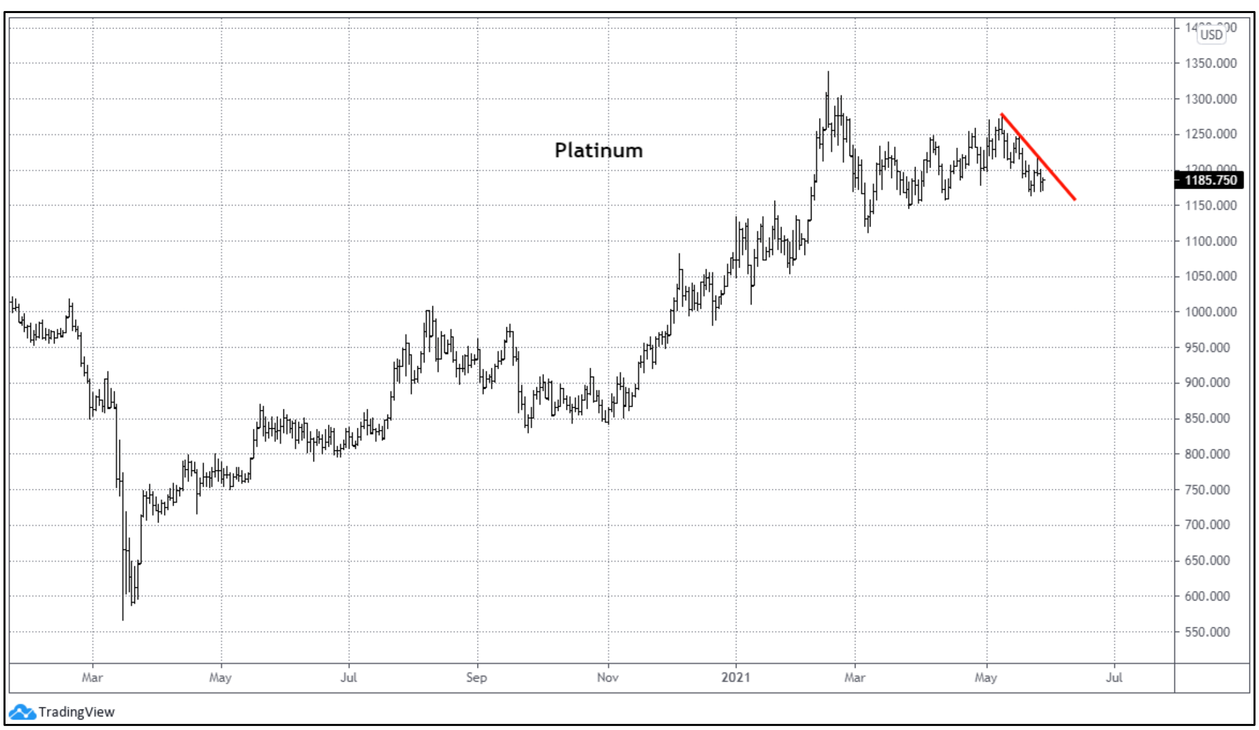
Here is another potentially interesting pair of charts. After a pause, South Korean equities and currency could be ready for another leg to new highs…



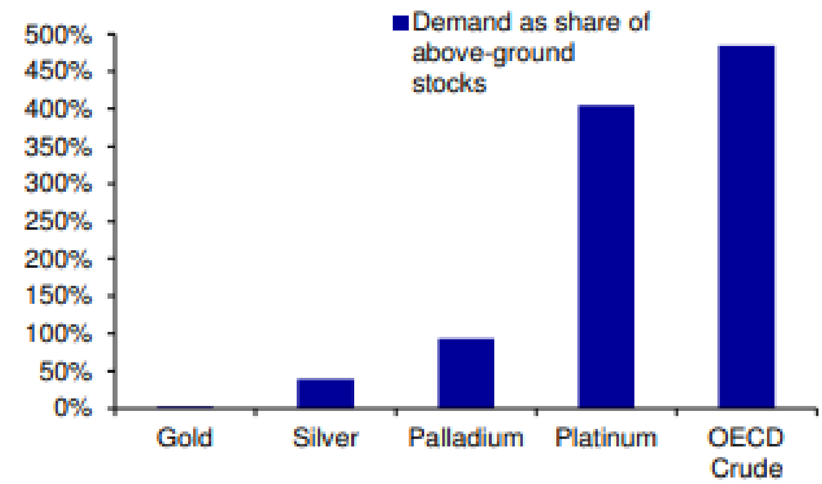
Commodities – Gold has been holding up with quiet bonds and a softish USD. All eyes on next week…

The further you get into the more "industrial" precious metals, the less progress we have been able to make lately. Gold, in some ways, is its own animal. From DB… "Gold explains 62% of the variance in silver's annual performance since 2000, 31% for platinum, and only 6% for palladium." Part of the reason for the recent underperformance is probably that they are working off the huge percentage moves they have already had off the March 2020 lows.



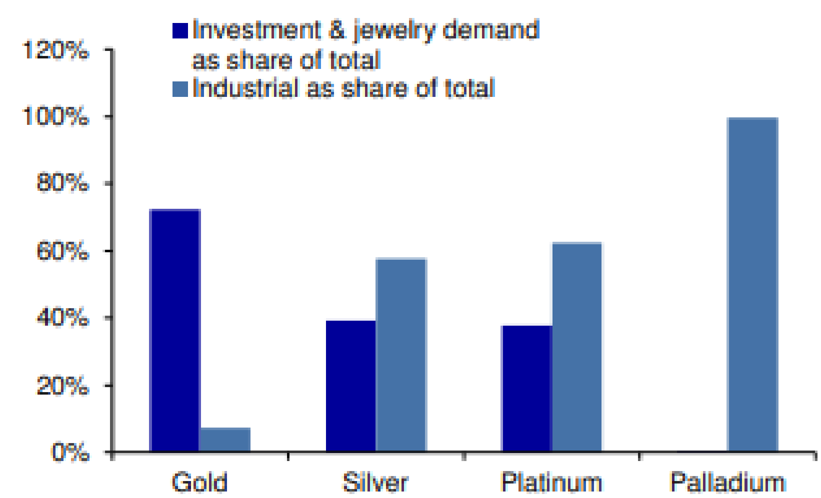
As you can see from the above chart, platinum has not been able to make much progress in months. However, with the fundamental story looking increasingly interesting, and platinum sensitive to increased demand, I'm looking for price to confirm that the timing is right.

Figure 1: Palladium and platinum markets consume greater shares of inventory



Source : World Gold Council, Silver Institute, World Platinum Investment Council, Metals Focus, IEA data from Monthly Oil Data Service © OECD/IEA 2021, www.iea.org/statistics, Licence:www.iea.org/t&c; as modified by Deutsche Bank

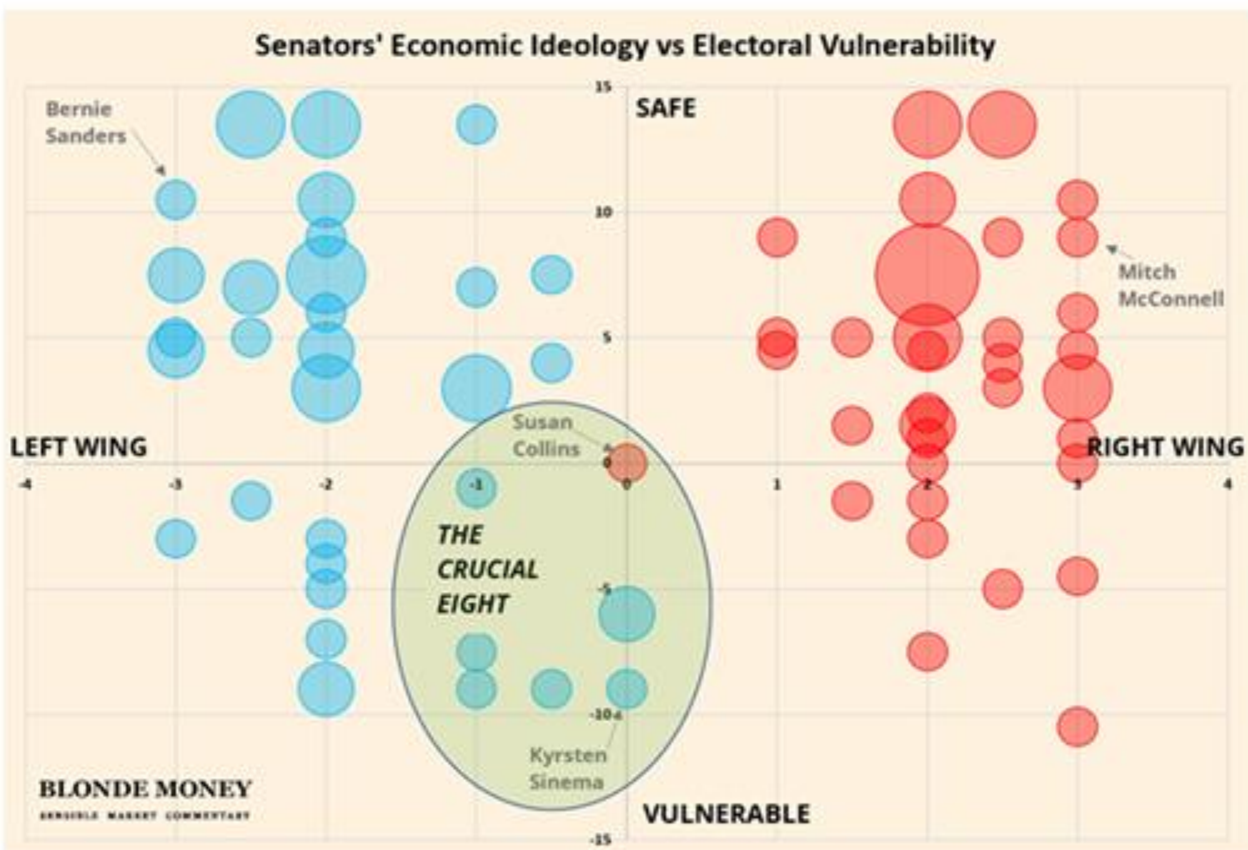
Figure 2: Industrial demand has larger footprint in palladium and platinum markets



Source : World Gold Council, Silver Institute, Johnson Matthey

Other items of interest…

With some big battles to be fought in the Senate and combatants already eyeing the mid-terms, I thought this was an interesting one from our friends at Blond Money.



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Jon Tester	Montana	Democrat	Healthcare	Retirees	Real Estate	Securities/Investment
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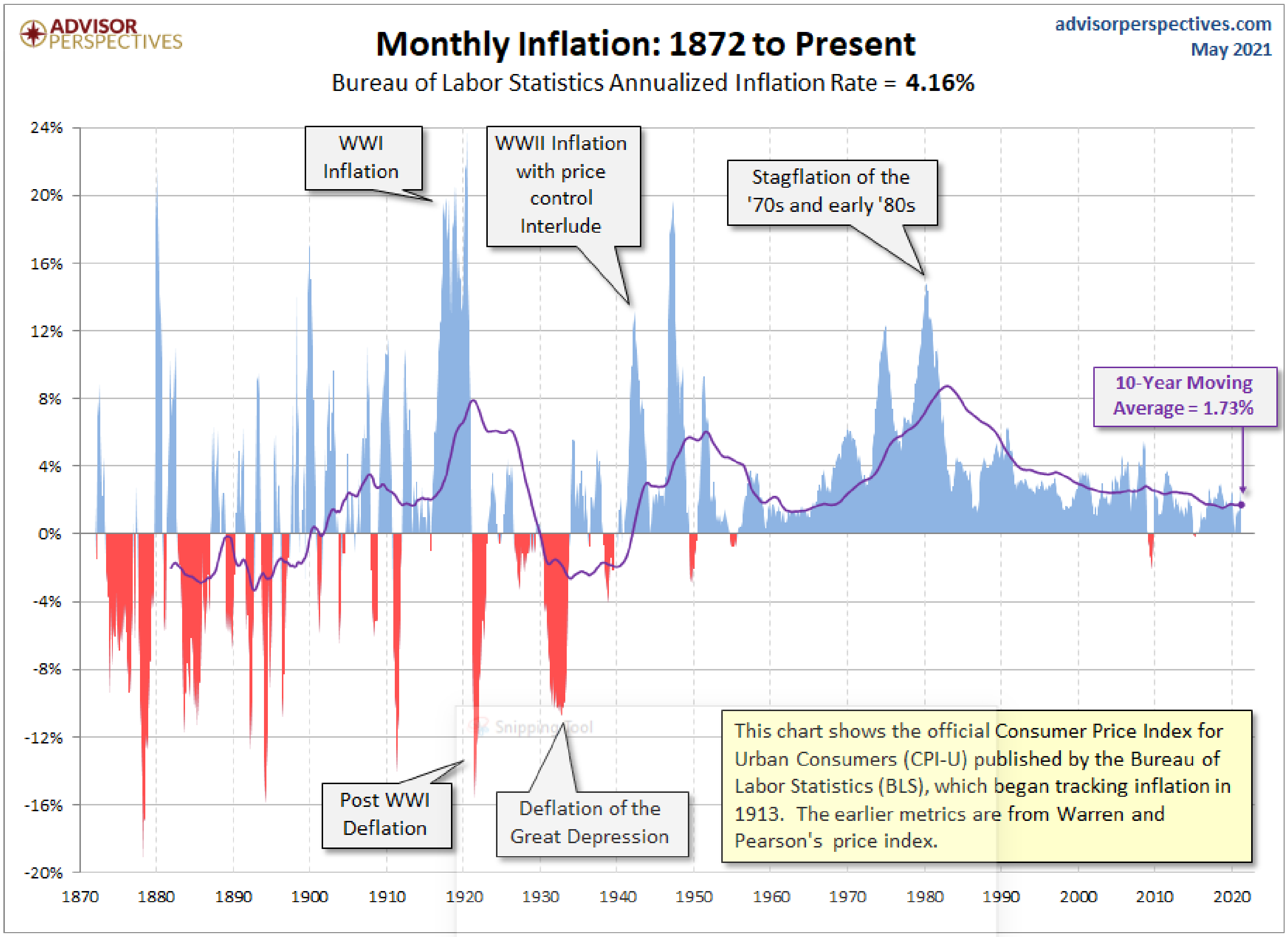
Maggie Hassan	New Hampshire	Democrat	Finance/Insurance	Law Firms	Securities/Investment	Education
Joe Manchin	West Virginia	Democrat	Coal	GOP	Securities/Investment	Oil/Gas

And here is one for big picture perspective on inflation…



On the data front, this week is all about PMI's and US employment numbers.

Important Macro Data Releases and Events for the Week

Monday
6/1/2021

- Memorial Day Holiday
- Harmonized Index of Consumer Prices YoY (May) Forecast: 2.4%, Prior: 2.1%

Tuesday
6/2/2021

- RBA Interest Rate Decision and Statement
- **Markit Manufacturing PMI's for much of Europe (May)**
- CPI YoY (May) Forecast: 1.9%, Prior: 1.6%

- Core-CPI (May) YoY Forecast: 0.9%, Prior: 0.7%
- OPEC Meeting
- **Markit Manufacturing PMI (May) Forecast: 61.5, Prior: 61.5**
- **ISM Manufacturing PMI (May) Forecast: 61, Prior: 60.7**
- ISM Manufacturing Employment Index (May) Forecast: 61.5, Prior: 55.1
- ISM Manufacturing Prices Paid (May) Forecast: 86.1 Prior:89.6
- ISM Manufacturing New Orders Index (May Forecast: 66.3, Prior: 64.3
- BoE's Governor Bailey speech
- Fed's Brainard speech

Wednesday
6/3/2021

- Retail Sales YoY (Apr) Forecast: -0.3 Prior: 11%
- German Buba President Weidmann speech
- Fed's Beige Book
- Caixin Services PMI (May) Forecast: -, Prior: 56.3

Thursday
6/4/2021

- Markit Service and Composite PMIs across Europe
- **ADP Employment Change (May) Forecast: 545k, Prior: 742k**
- Initial Jobless Claims Forecast: -, Prior: 406k
- Initial Jobless Claims 4-week average Forecast: -, Prior: 458.75k
- Continuing Jobless Claims -, Prior: 3.642M
- **Markit Service PMI (May) Forecast: -, Prior: 70.1**
- **Markit PMI Composite (May) Forecast: -, Prior: 68.1**

- ISM Services New Orders Index (May)
- **ISM Services PMI(May)**
- ISM Services Employment Index (May)
- ISM Services Prices Paid (May)
- BoE Monetary Policy Report Hearings
- BoE's Governor Bailey speech

Friday
6/5/2021

- Retail Sales YoY (Apr) Forecast: 9.6%, Prior: 12%
- **Nonfarm Payrolls (May) Forecast: 621k, Prior: 266k**
- Average Hourly Earnings (YoY) (May) Forecast: -0.4%, Prior: 0.3%
- Average Hourly Earnings (MoM) (May) Forecast: 0.2%, Prior: 0.7%
- Labor Force Participation Rate (May) Forecast: -, Prior: 61.7%
- U6 Underemployment Rate (May) Forecast: -, Prior: 10.4%
- **Unemployment Rate (May) Forecast: 5.9%, Prior: 6.1%**

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