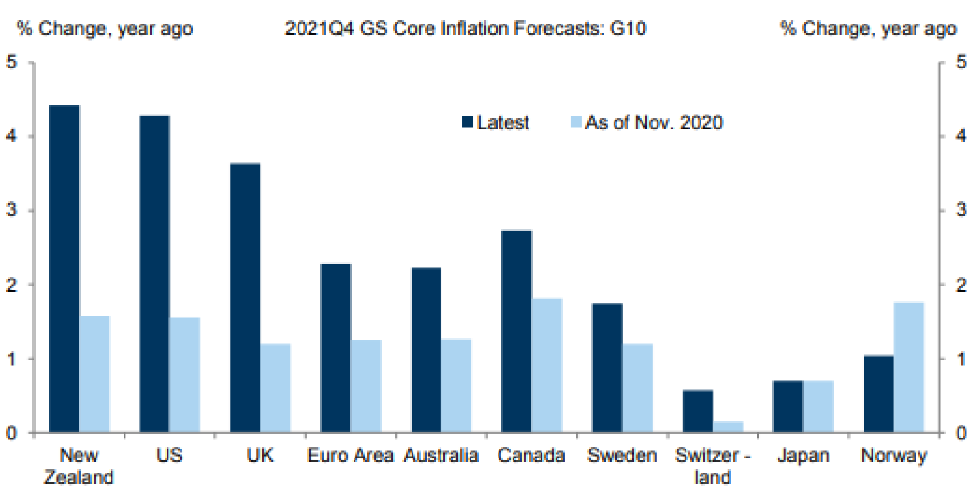
What to focus on in Global Macro for the week of December 6th, 2021

Macro Themes on the Radar:

Between Powell retiring "transitory" from the inflation discussion, plenty of volatility across markets, and a confusing US employment report, there was plenty to digest last week.

So far, worries about omicron have had very little effect on the recent hawkish shift at the Fed. With the next Fed meeting on the 15th, they have been increasingly vocal that a faster taper is coming. Basically, inflation has been so far above what was expected that it is becoming hard to ignore. Powell basically acknowledged that continued easing of monetary conditions at this point is no longer justifiable as a result.

Exhibit 7: Inflation Has Been Much Higher Than Expected in Most G10 Economies



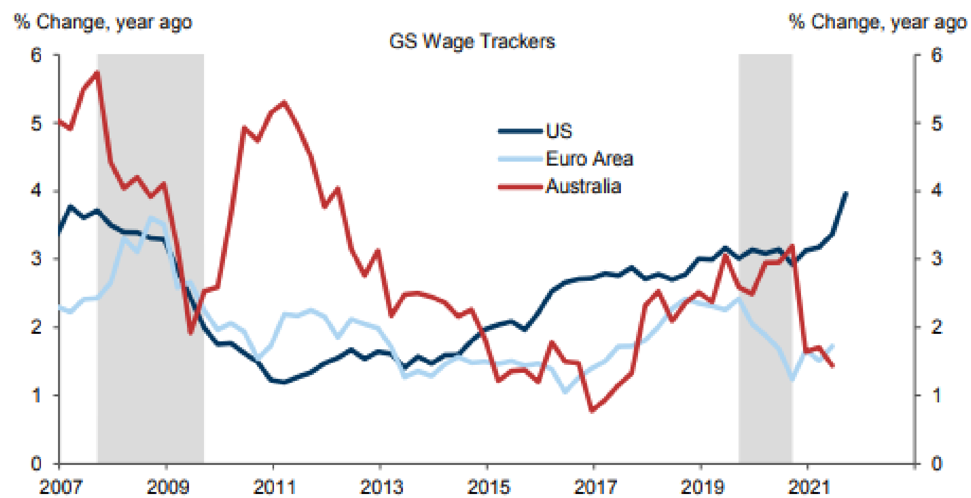
Core inflation is PCE ex food and energy in the US; HICP ex food, energy, alcohol and tobacco in the Euro area; CPI ex freshfood in Japan; CPI ex food, energy, alcohol and tobacco in the UK; the average of common, median and trimmed mean inflation (BoC preferred) in Canada; trimmed mean (30%) in Australia; CPI ex food, energy and fuel in New Zealand; CPI adjusted for tax changes and ex energy products in Norway; CPI with fixed interest rate ex energy in Sweden; CPI ex fresh and seasonal products, energy and fuel in Switzerland.

Source: Goldman Sachs Global Investment Research

We will see if Friday's weaker than expected payrolls number elicits any comments from the Fed in the coming days. The larger than expected fall in the unemployment rate (to 4.2% from 4.6%, well below the consensus of 4.5%) and the seemingly outsized seasonal adjustment (shaving an extra 200k jobs off the headline number) still point to a strong underlying employment picture.

With the participation rate remaining stubbornly low, full employment may be closer than expected. Especially in the US, were rising wages have made the "transitory" inflation stance increasingly difficult to maintain.

Exhibit 12: Softer Wage Growth in the Euro Area and Australia



Note: grey bars denote US recessions.

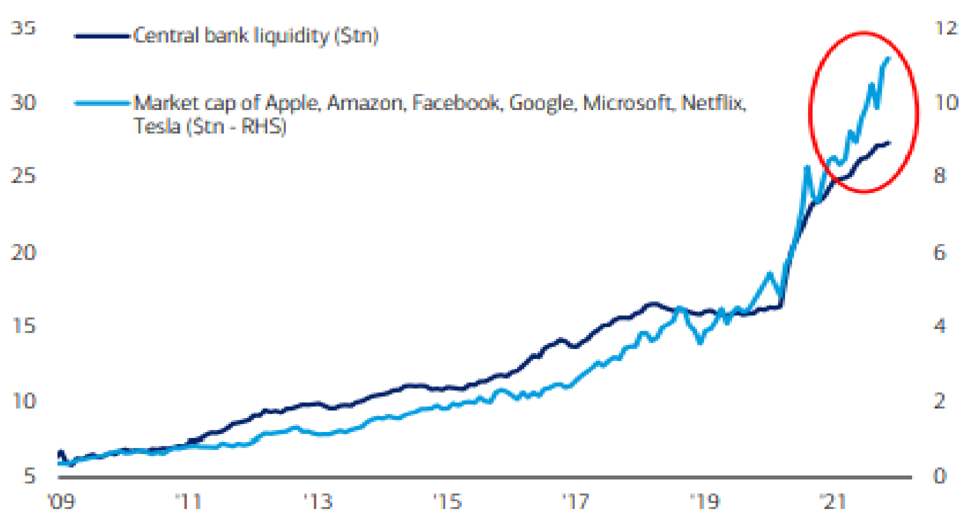
Source: Goldman Sachs Global Investment Research

Will taper matter for equities? It has long been held that QE is inflationary for assets rather than goods and services (fiscal spending does the lifting there). In the past, markets have often become more volatile during and after taper. Long-end yields have also tended to fall.

We often see charts showing the apparent correlation between a rising Fed balance sheet and equities, especially large-cap tech stocks.

Chart 9: Slowing central bank liquidity not yet reflected in stocks

Central vank liquidity vs tech market cap

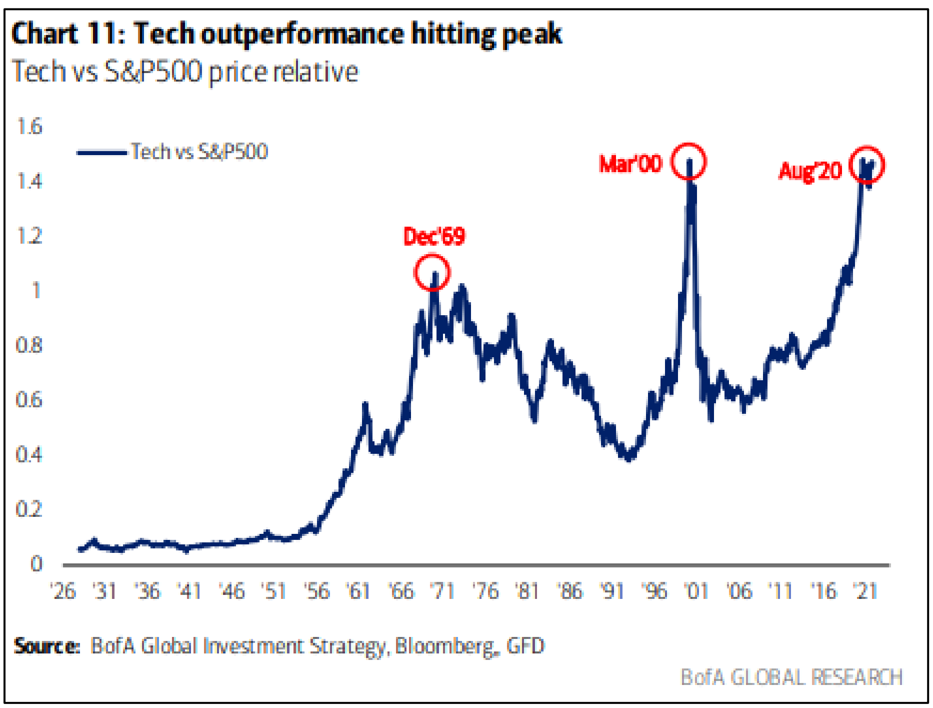


Source: BofA Global Investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

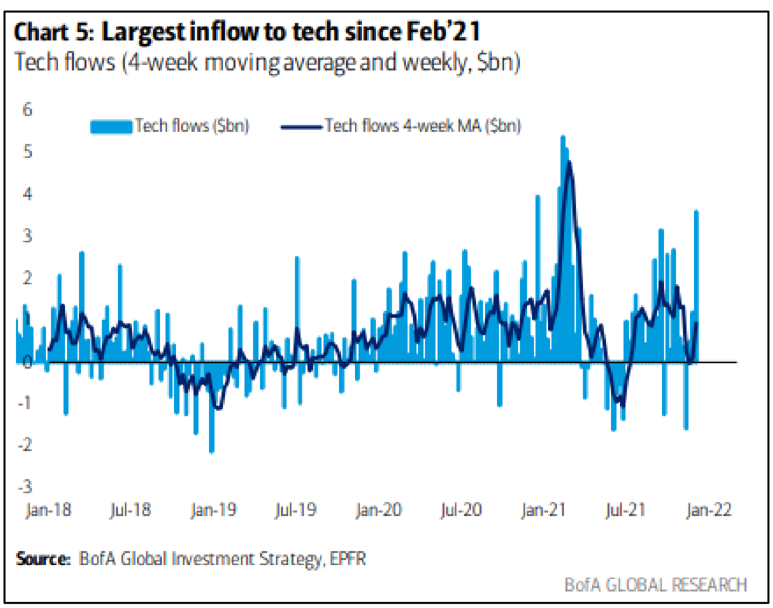
There even seems to be some evidence that there is causation.

With tech having been the unchallenged global equity leader for the last decade, a change in that dynamic is likely to come with some meaningful volatility. Previous peaks certainly delivered that.

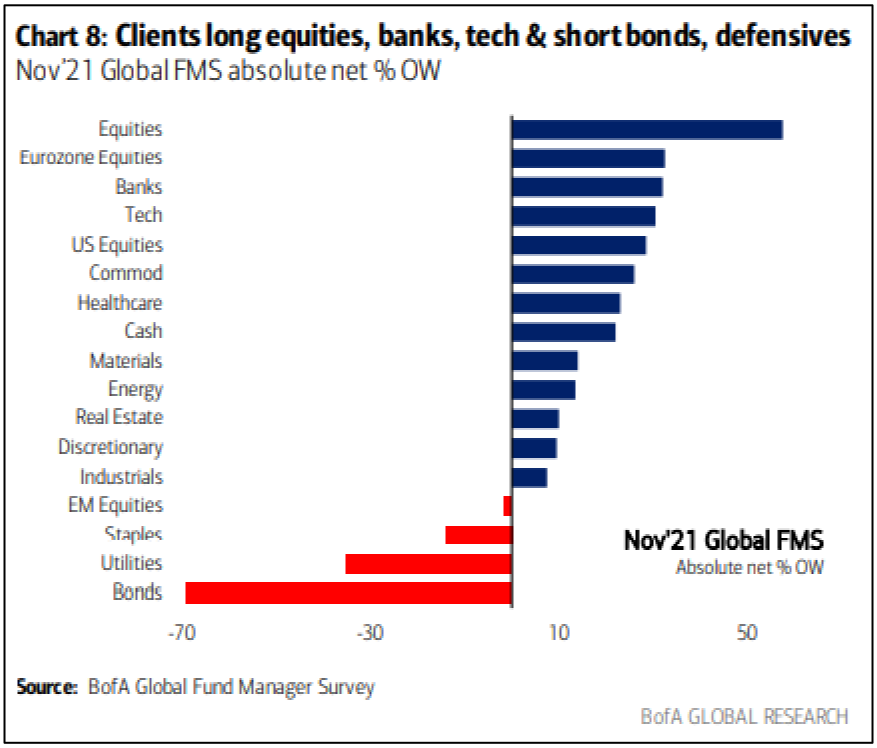


Zooming in to the current price action, it is pretty hard to say that we have yet seen a turn in the trend. It is one to watch however…

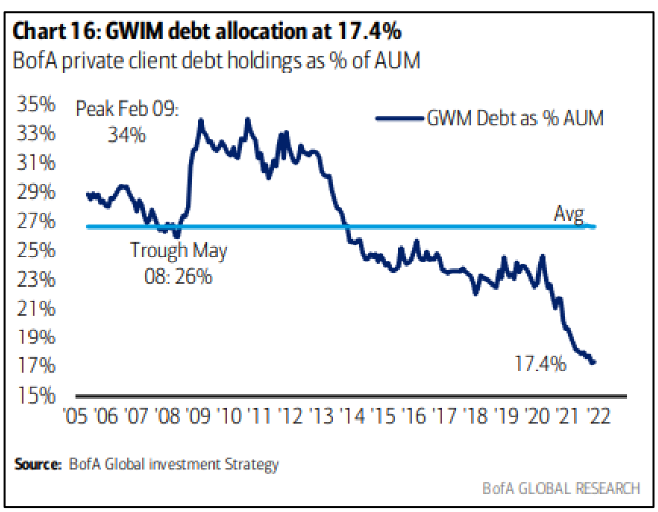
Friday's selling aside (chart goes thru Wednesday), tech flows have remained strong.

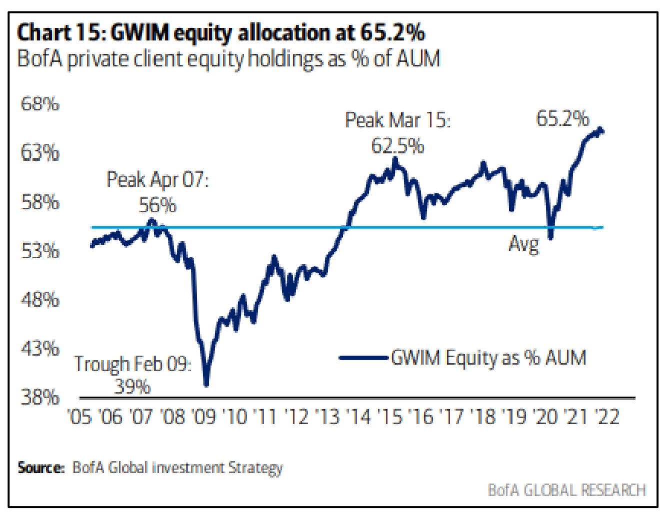


In the meanwhile, while there has been some large institutional selling going head-to-head with retail buying over the last week or two, the market has remained long stocks (especially Europe, Banks, and Tech) and short (underweight) bonds. That is true for institutional investors…



… as well as high net worth.





The underweight in bonds has been increasingly painful in recent days.

What to Focus on Now:

With the Fed turning more hawkish and the likes of Larry Summers not only calling for an end to QE but that the Fed needs to signal 4 rate hikes in 2022 to restore credibility, the curve flattening has accelerated. Now, led by falling long-end yields.

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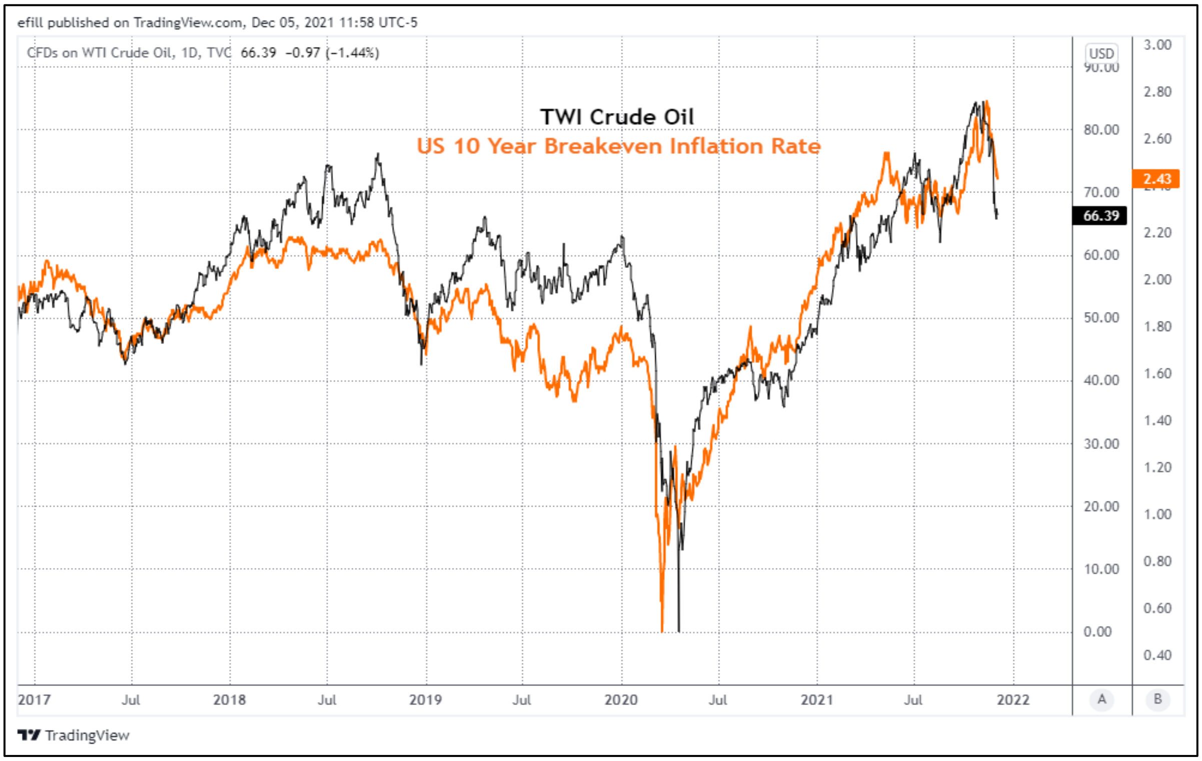
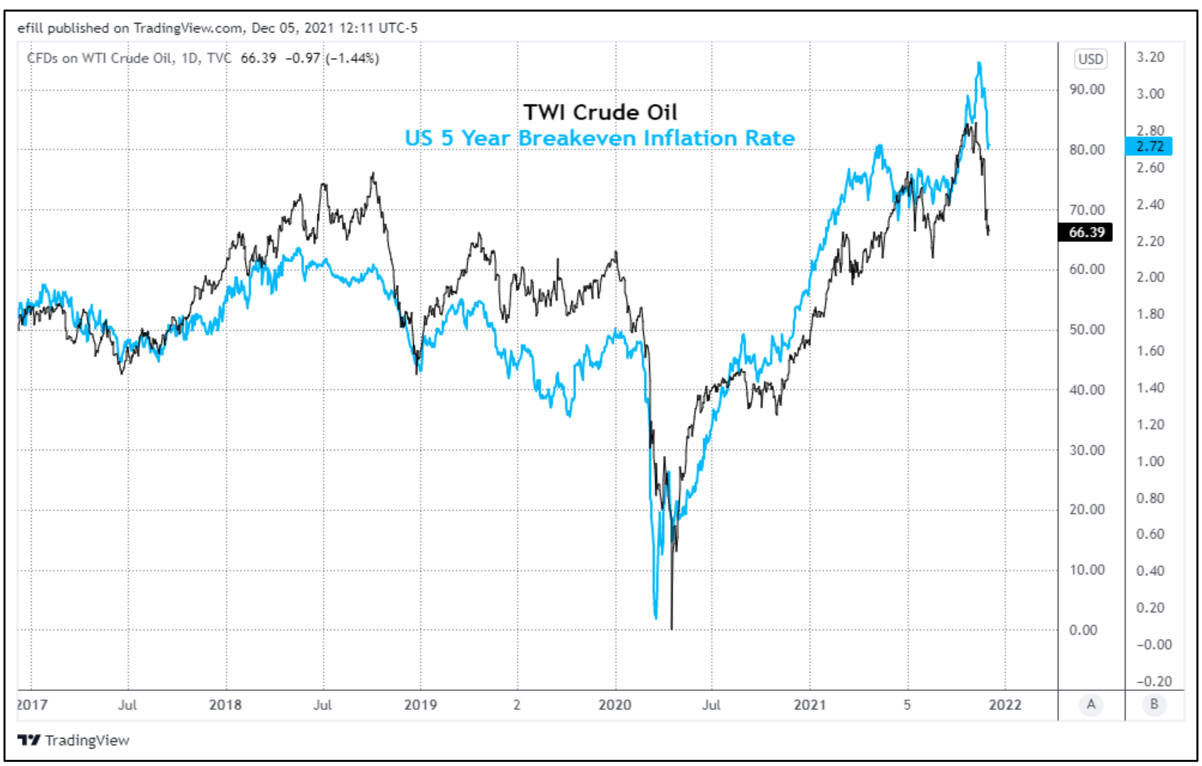
Inflation expectations have been falling. Don't forget the important role that energy prices play here. The strong dollar fits with this as well as it is a disinflationary headwind for commodities.





The inflation breakeven is:

Nominal 5yy (1.15%) minus 5y TIPS yield (-1.56%) = Breakeven inflation rate of 2.71

Since the Fed could now be forced to become an inflation fighter after all, the market is starting to price a deflationary impulse and maybe a policy error.

Which is why the long end is rallying and the curve is flattening.

This is the 5-year TIPS yield … heading back up?

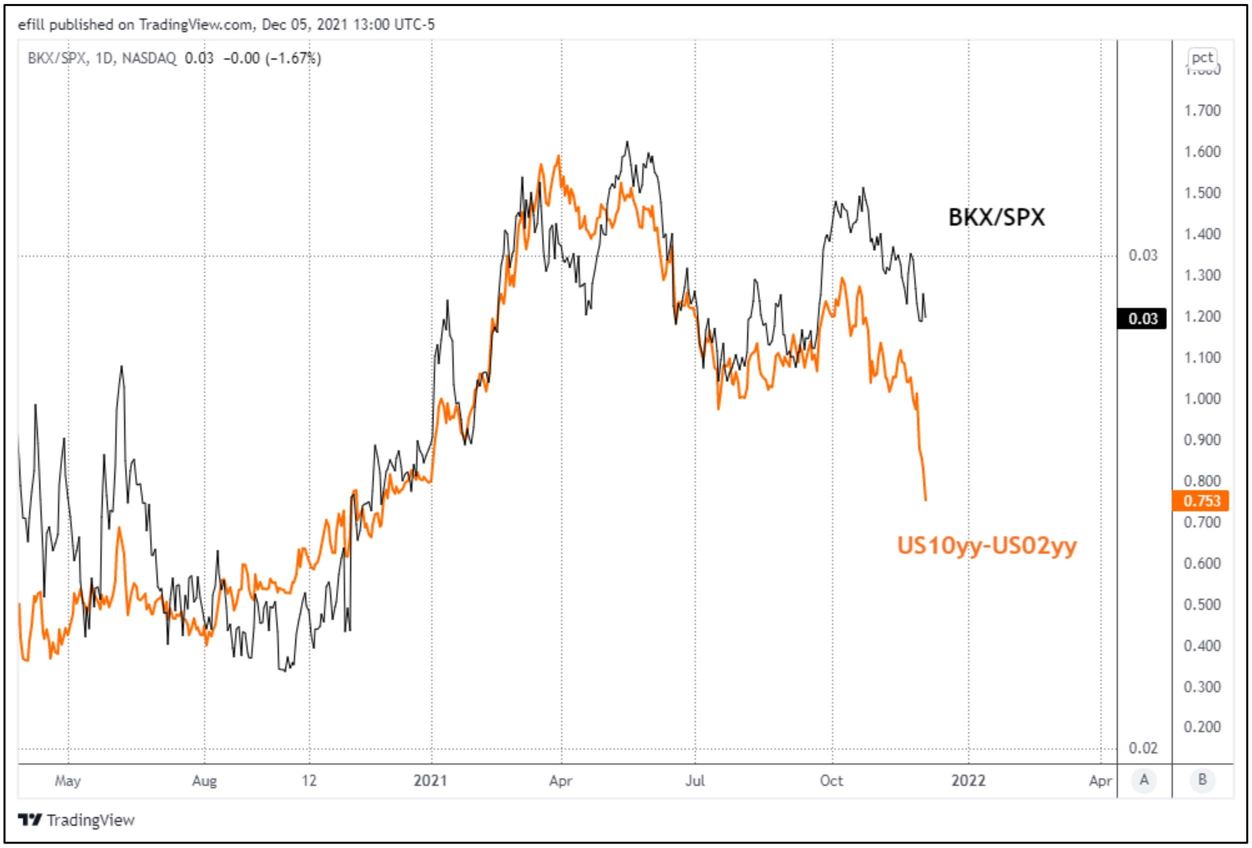
So, if investors think inflation is going to end up being more than the breakeven rate, people will buy TIPS, if they think it will be less, they will sell TIPS.

Given the large amount of flows we have seen into TIPS over the last few months, this would be a disappointing outcome for those holders. Add to that the fact that the Fed has been a buyer of TIPS as part of QE, which is about to go away.

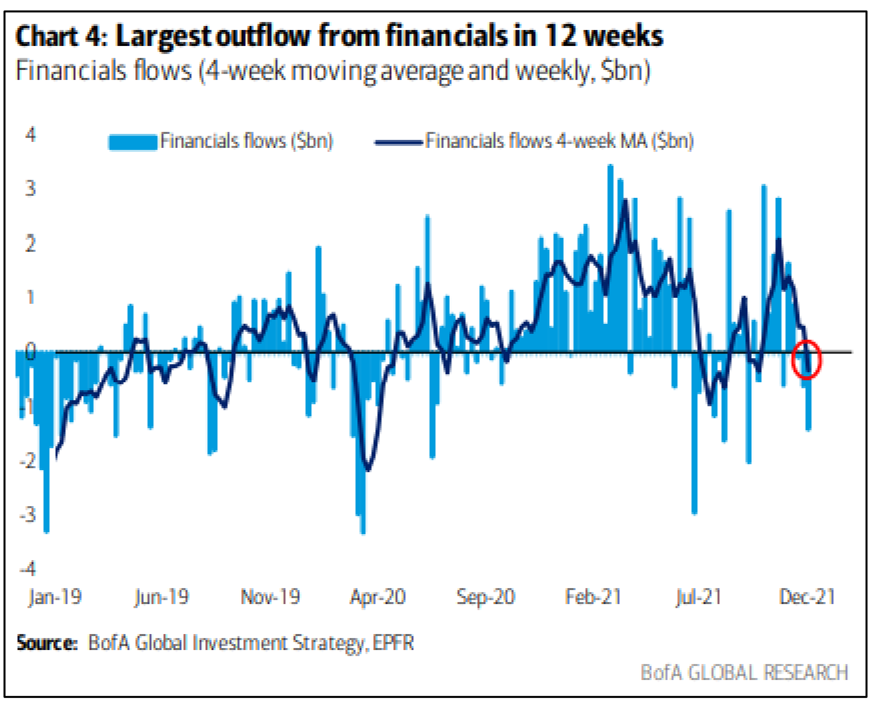
The long-end driven flattening we are seeing is starting to impact flows in equities as well.

Banks, a popular long, are starting to look potentially expensive if the yield curve keeps flattening here.

Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649



Flows may be starting to reflect that.



We are a long way from financial conditions being tight, however, on margin, the end of QE and the strong dollar seem to be starting to weigh on some of the more aspirational equities. ARK Innovation, which is chocked full of those names, has been illustrative of the cold water currently being poured on the "exponential age" trades.

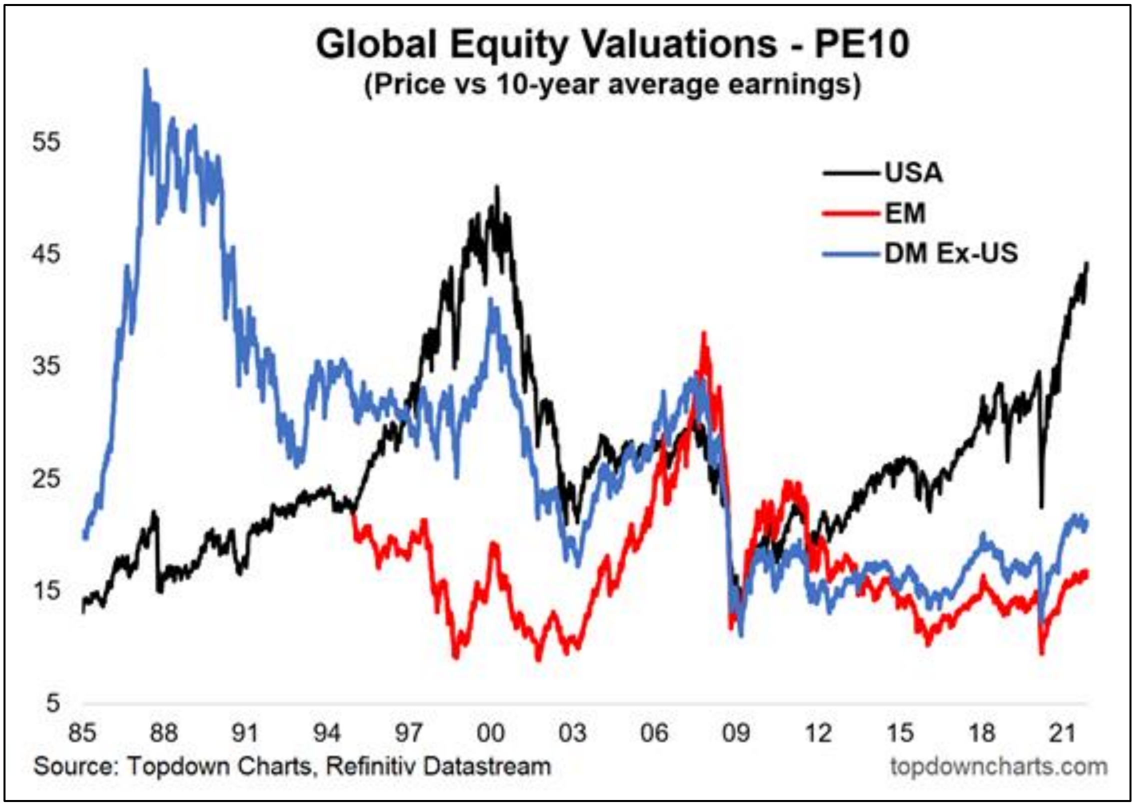
With the US clearly expensive, or at least the dominant large cap-tech names are, I keep hearing about what a bargain Europe is. Positioning certainly reflects that now. Unfortunately, price action, so far, has not delivered outperformance vs. the S&P.

The rationale is clear, but I will get interested when the relative performance starts to get some momentum. Value trades with no momentum can just be traps.

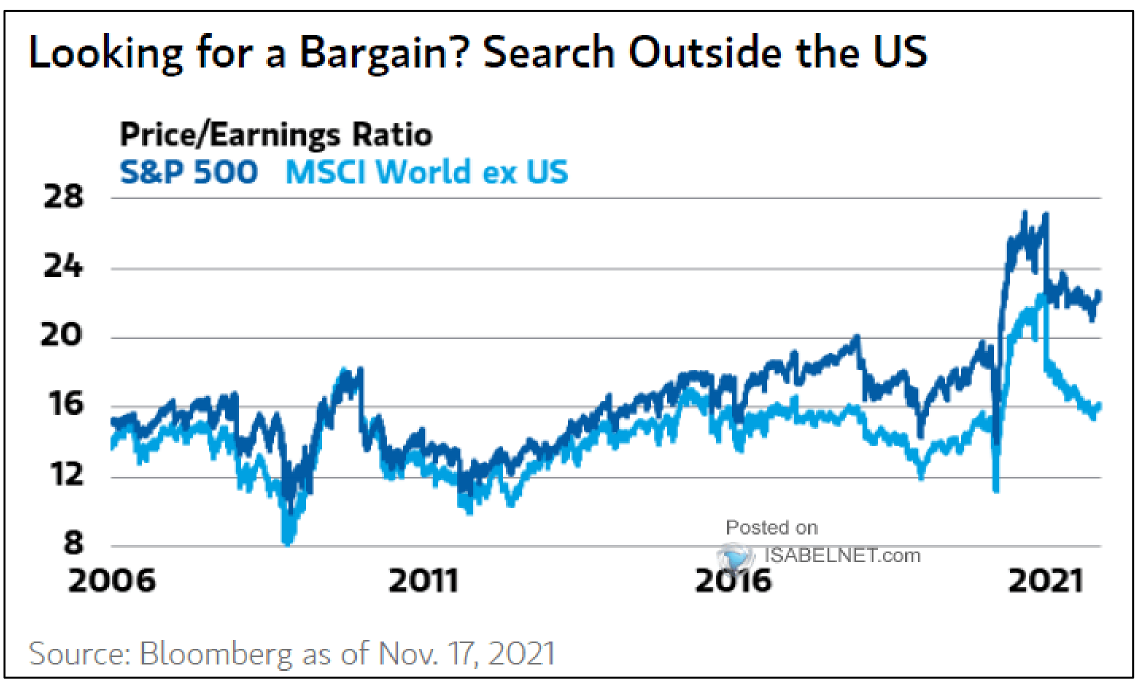
Both Europe and EM are cheap … or is the US just expensive.

These charts are all over the place.

Like this…



and that…



I guess my concern is that if anything goes wrong now in Europe, there are almost no levers left to pull. Lagarde said last week that she saw any rate hikes next year as very unlikely, raising the specter that the ECB sits out the whole cycle… again.

Deposit rates are still -50bps, and they are continuing QE. The ECB's balance sheet, at 81% of GDP, is already more than twice that of the Fed's, in GDP terms.

The good news for Europe is that the recent spike in COVID cases seems to have paused as the number of cases has plateaued in some countries and is now even falling in some of the hardest hit. The other good news, this time for potential fiscal spending, is that with the SPD's coalition taking over from the Merkel's CDU, German and potentially European purse strings might be easier to open.

Still, in the near-term a lack of relative outperformance, combined with high positioning, makes the downside vulnerable.

If we get much through 4000, it could trigger a further sharp selloff.

COVID

Two items caught my attention.

According to a biomedical company called Nference, Omicron could be more transmissible because it is a combination of COVID and the common cold. They are guessing that someone was "co-infected" and that the genetic material of the two viruses was mixed. This might not be bad news if it turns out to be more transmissible but less dangerous.

Study: Omicron could be more transmissible due to sharing genetic material with common cold | TheHill

On the potentially less positive side, Niall Ferguson, in a Bloomberg Op-Ed over the weekend, wrote the following:

"On Thursday, the number of Gauteng patients in intensive care for Covid almost doubled from 63 to 106. Data from a private hospital network in South Africa that has over 240 patients hospitalized with Covid indicate that 32% of the hospitalized patients were fully vaccinated. Note that around three-quarters of the vaccinated in South Africa received the Pfizer Inc.-BioNTech SE vaccine. The rest got the Johnson & Johnson vaccine. Yet these are not the data that worried me the most last week. Those had to do with children. Between Nov. 14 and 28, 455 people were admitted to hospital with Covid-19 in Tshwane metro area, one of the largest hospital systems in Gauteng. Seventy (15%) of those hospitalized were under the age of five; 117 (25%) were under 20. And this is not just a story of precautionary hospitalizations. Twenty of the 70 hospitalized toddlers progressed to "severe" Covid. Up until Oct. 23, before experts estimate omicron began circulating, under-fives represented only 1.8% of cumulative Covid hospital admissions in South Africa. As of Nov. 29, 10% of those now hospitalized in Tshwane were under the age of two."

In truth it is still just too early to say if Omicron will turn out to be a meaningful development either way… the next two weeks should be telling.

CPI on Friday!

Important Macro Data Releases and Events for the Week

Monday 12/6/2021		Chinese Trade Date (Nov)
		RBA Interest Rate Decision and Policy Statement

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Tuesday 12/7/2021	EU	EcoFin Meeting
	EU	GDP (Q3)
	EU	ZEW Survey - Economic Sentiment (Dec)
	DE	ZEW Survey - Current Situation and Economic Sentiment (Dec)
	US	US Trade Data (Oct)
	US	Nonfarm Productivity and Unit Labor Costs (Q3)
	JP	GDP (Q3)
Wednesday 12/8/2021	CA	BoC Interest Rate Decision and Policy Statement
	CN	CPI & PPI (Nov)
Thursday 12/9/2021	US	Initial Jobless Claims
	US	Initial Jobless Claims 4-week average
	US	Continuing Jobless Claims
Friday 12/10/2021	DE	Harmonized Index of Consumer Prices YoY (Nov)
	US	**CPI Headline and ex-food and energy (Nov)**
	US	**Michigan Consumer Sentiment Index (Dec)**

Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649

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