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What to focus on in Global Macro for the week of November 2nd, 2020

Macro Themes on the Radar:

ECB

Thursday's ECB meeting didn't result in any immediate new policy measures but did reveal that more is coming in December. Given the resurgence of the virus in Europe and new lockdowns and restrictions, the ECB expects the consequences to cause renewed economic pain. Lagarde warned that risks are "clearly, clearly tilted to the downside" and said that the recovery is "losing momentum more rapidly than expected". She pre-announced a "recalibration" of all their instruments at the December meeting. The very dovish tone is expected to translate into a €400-500bln increase and probable extension of the PEPP program. It is also likely to mean more TLTRO and potentially at even better terms (already banks can get financing at -1% if they lend to the economy). I don't think that at these levels in the EUR they would cut deposit rates below the current -0.5% (save that one in case currency manipulation is needed later).

There has been increased discussion about an EU-wide "bad bank". The ECB's chief regulator Andrea Enria warned in an FT op-ed piece that none performing loans on bank balance sheets could reach €1.4T and that a regional "bad bank" is needed. Will the need for recapitalization and the cleaning up of balance sheets eventually lead to nationalization of numerous European banks? It is becoming increasingly likely. The longer the virus hampers the economy in Europe the closer we get to insolvency issues.

Lagarde amusingly pointed out that they don't call the current drop in prices deflation, but rather negative inflation, since it is temporary. Hmmm

She made it clear that fiscal spending by the national and EU treasuries was sorely needed. Let's see if the recent uptick in the crisis can get that flowing. In the meantime, there continues to be no agreement on the EU budget and as a result the Recovery Fund. The practical effect could be that the recovery fund is delayed deep into 2021. The rule-of-law issues with Poland and Hungary are at the center of the debate. We will see if Europe's usual muddle through process is again able to water everything down sufficiently to achieve compromise. If the European economy does quickly weaken it will no doubt facilitate a deal.

Crypto and Central Bank Digital Currencies (CBDC)

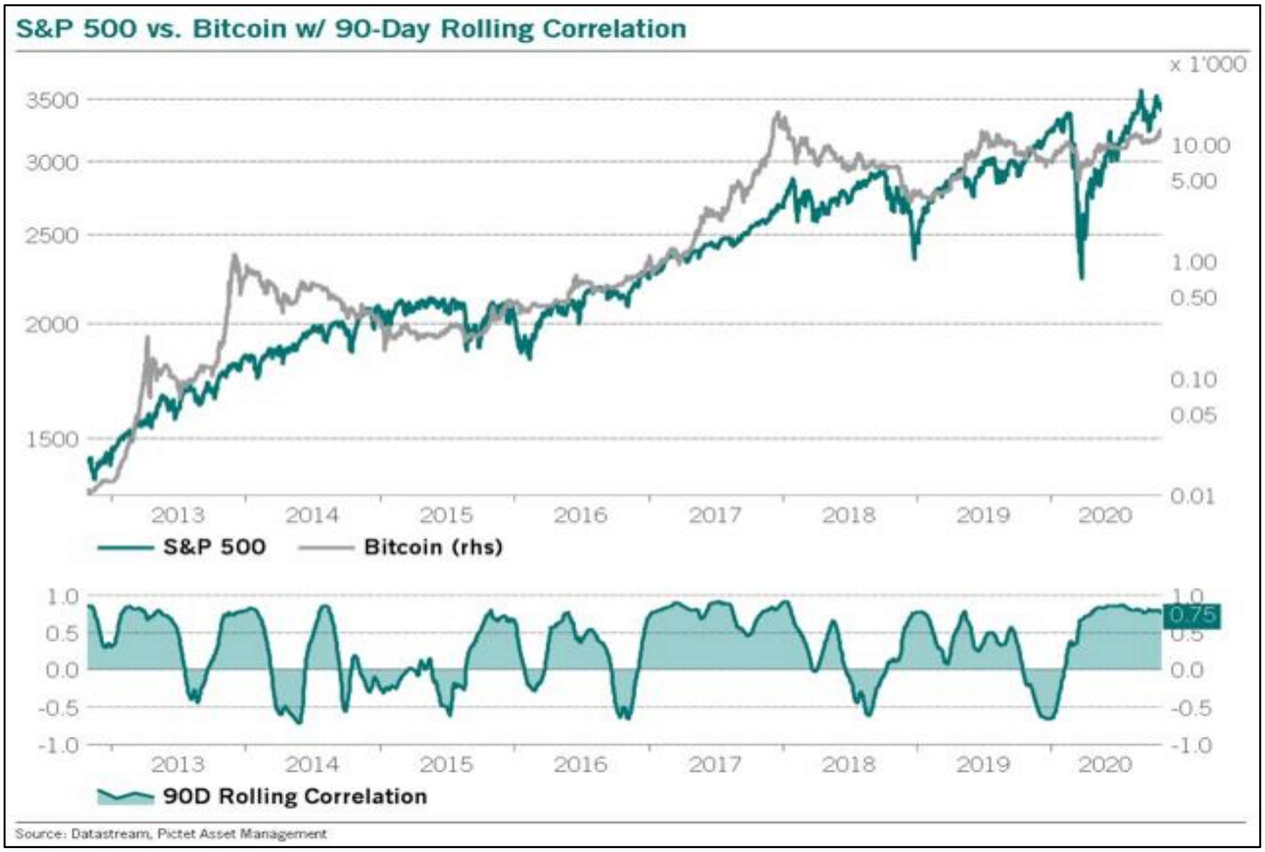
On Sunday Lagarde Tweeted out a video commenting on a CBDC for the Eurozone: "We've started exploring the possibility of launching a digital euro. As Europeans are increasingly turning to digital in the ways they spend, save and invest, we should be prepared to issue a digital euro, if needed."

Recently the BIS in cooperation with seven leading Central Banks put out an initial report on CBDC's.

It seems increasingly clear that this next step is not only under consideration but very likely to occur. In the end, the reason will be that new CB tools and better direct access to the economy are badly needed. That access and ability to make direct payments, instantly control deposit rates and do so across different constituents as needed, will be too much for them to pass up.

In the meantime, markets are reading the growing corporate and CB interest in crypto assets as a green light for Bitcoin.

As noted before the correlation between Bitcoin and US Equities had become very high recently.



The last few weeks have seen a reversal of that however as the crypto currency has outperformed other assets.

Now the price action is actually diverging. We will see if that can be maintained.

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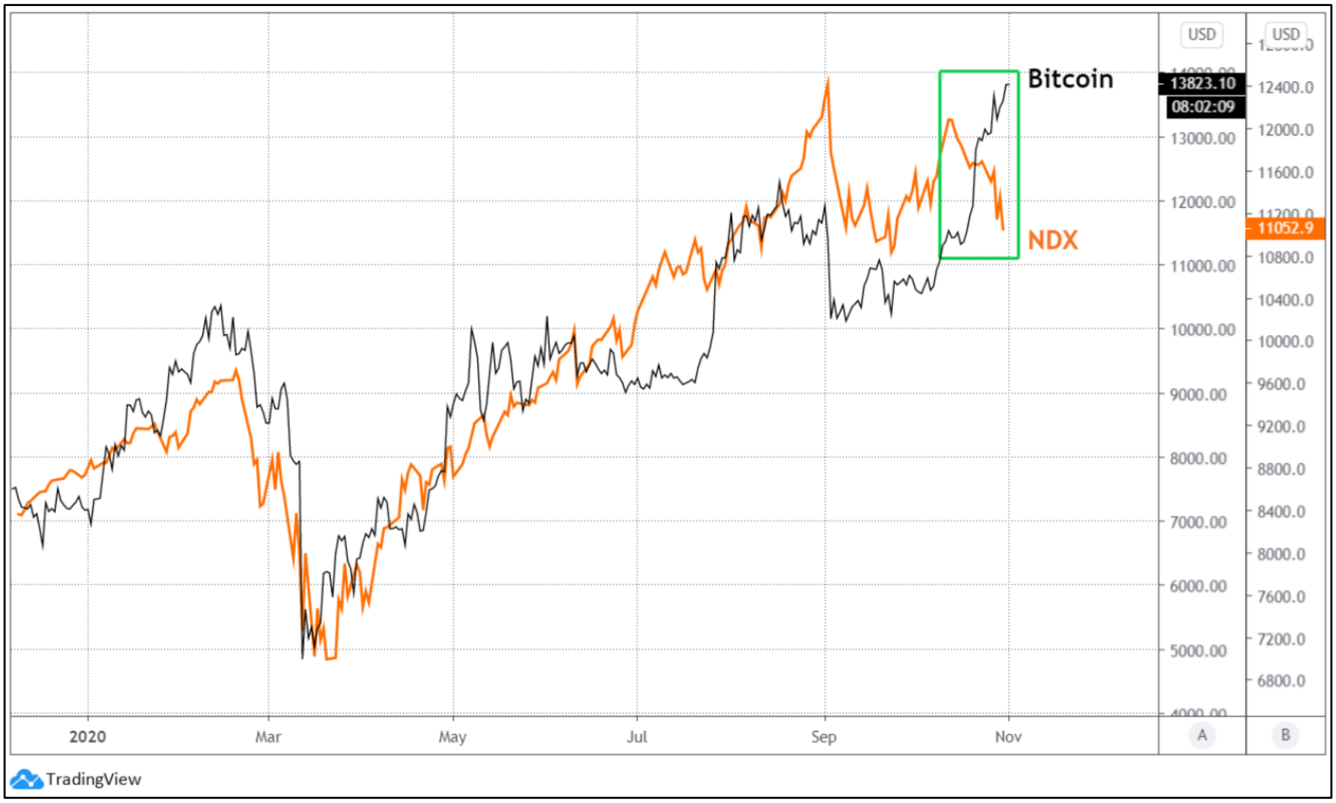
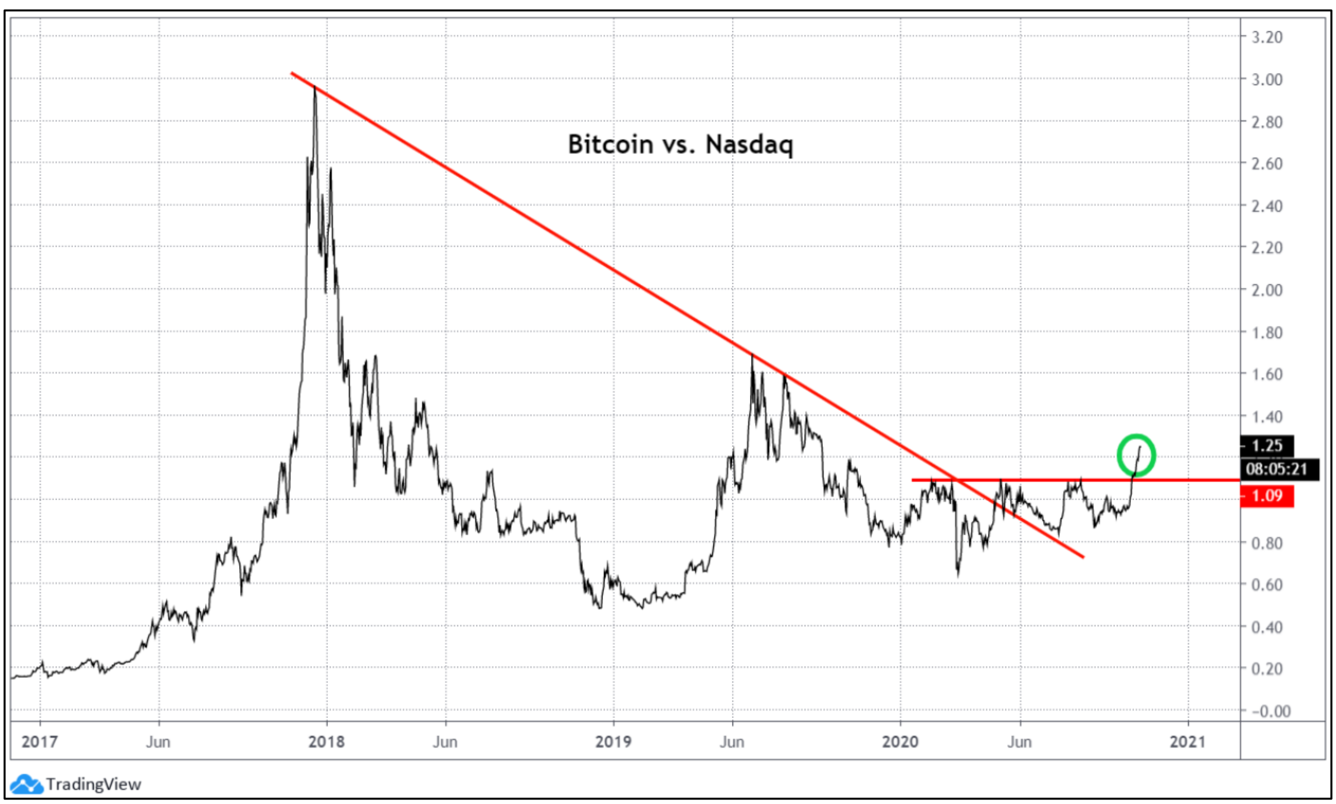


If so, expect more and more CB interest and comments.

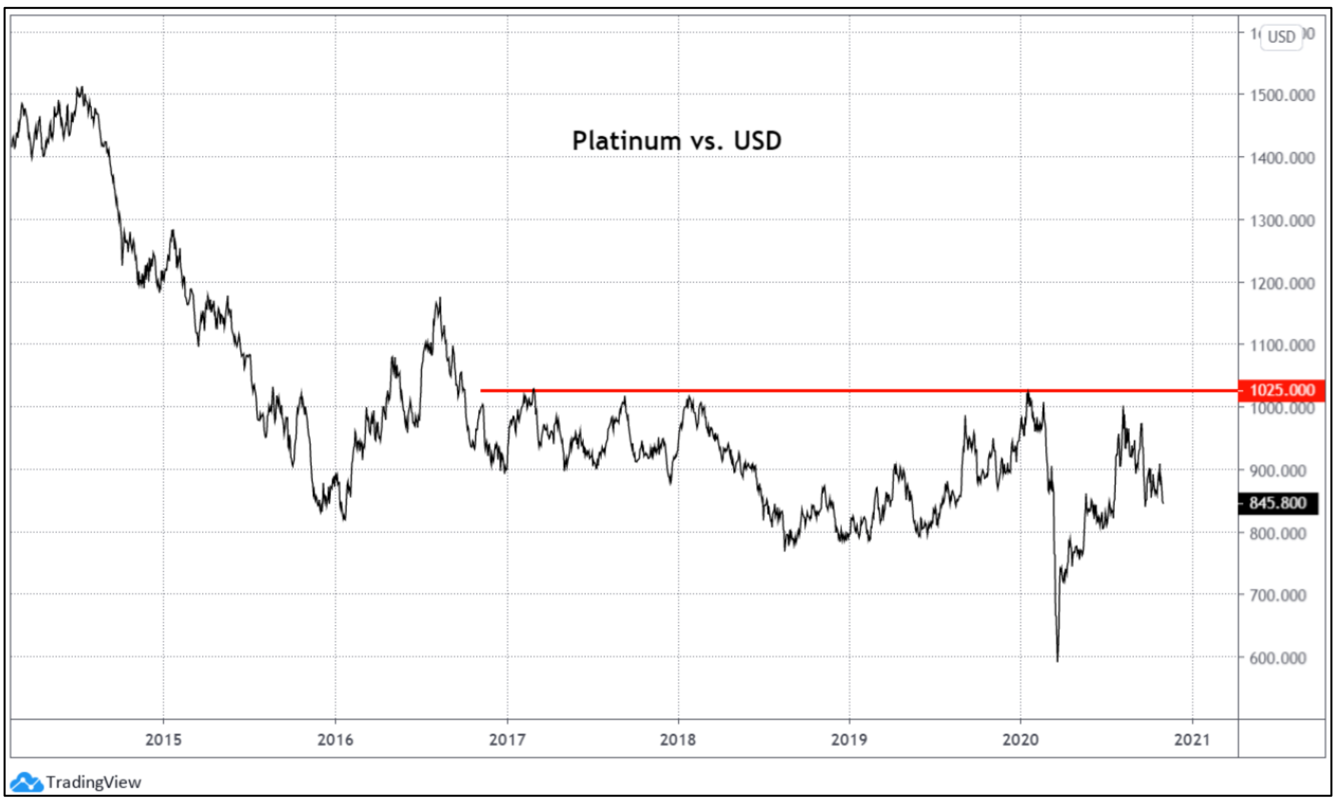


Hydrogen/Platinum

There has been growing interest in Hydrogen related stocks over the last few quarters. The resulting rallies for some of these names have been eye popping, which has quickly led to some analysts already calling them bubble stocks that are way overvalued. However, the global rush to zero emissions sponsored by enthusiastic government fiscal spending and strong demand for ESG assets is only starting.

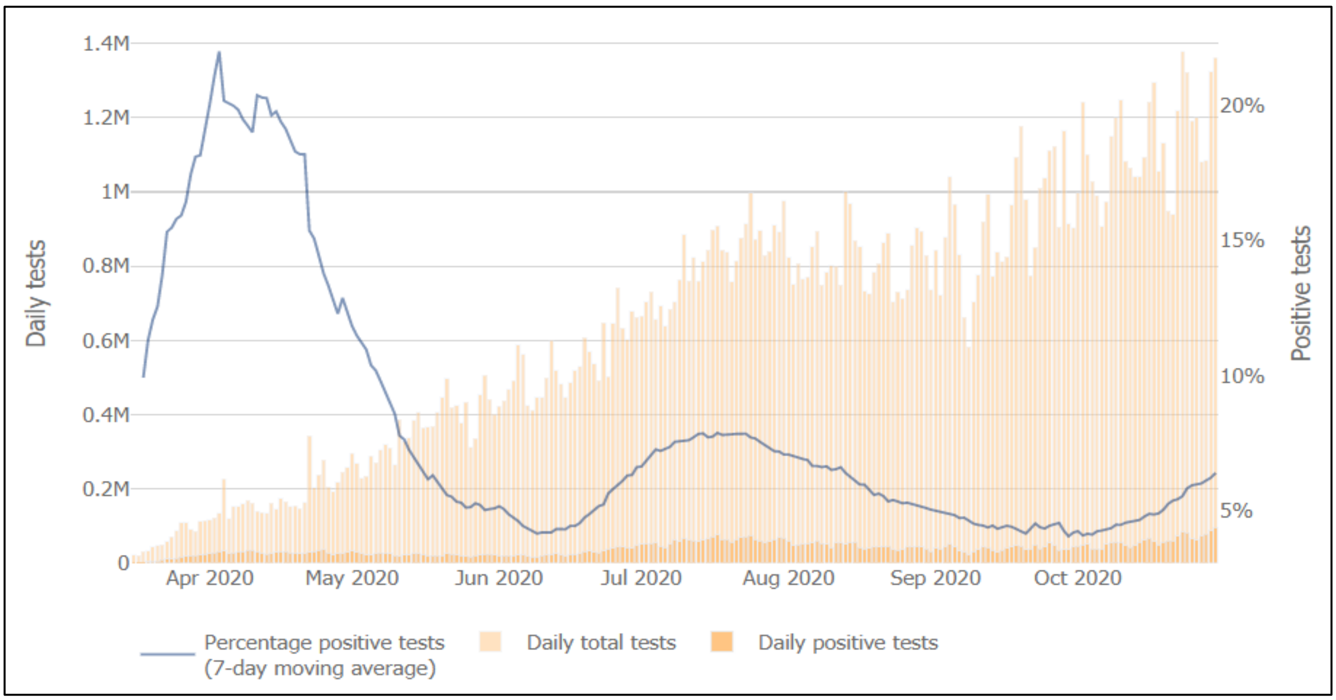
Given the potentially large amounts of government subsidies and direct grants that are likely to pour into this area, getting into the weeds here could be very rewarding. The many facets and multiple approaches to the technology, spread across large and small companies, makes it challenging but worth doing the work.

Aside from Blue and Green Hydrogen demand and supply dynamics, there will likely be spill-over into other assets as well. According to an article in Mining Weekly, 1 oz of platinum will be required per fuel cell battery. Hyundai alone is planning annual output of 700,000 by 2030. While there are no signs of life in the precious metal yet, these are the kind of trades that could be interesting as hydrogen use is scaled up in the coming years. Set an alert at $1,000 an oz.

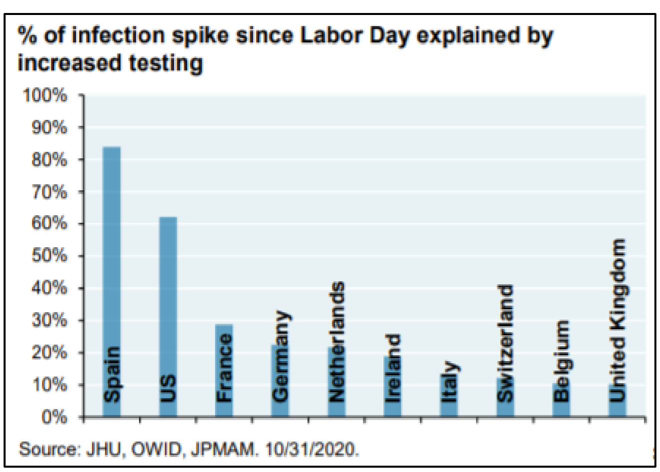


COVID

The recent virus resurgence has quickly fed renewed global growth concerns. While hospitalizations and deaths are the best indicators of what is happening, they are very lagging. As a result, policy makers have been forced to rely on the number of new cases being reported and the test positivity rate. One thing to remember is that back in mid-April, at the height of the first wave, there were only about 155k tests being conducted a day in the US. Now that number is north of 1.3m. As a result, the test positivity rate was very high in April (22% vs. about 6% now) since you only got a test if you were feeling sick and if you were lucky. It also means that it is very likely that the virus was much more widespread back in April than the daily test results indicated. That makes real-time comparisons to the current resurgence difficult.



It also potentially helps explain why mortality rates have been much lower recently than during the first wave. Other explanatory factors are important; improved treatment, lower age of those infected and potentially a weakening virus (although that is still being hotly debated). National and regional differences in infection and death rates further complicate our ability to analyze what is actually unfolding and why.



This slide is from a JPM virus-tracker piece they have been keeping updated. The data is worth a look.

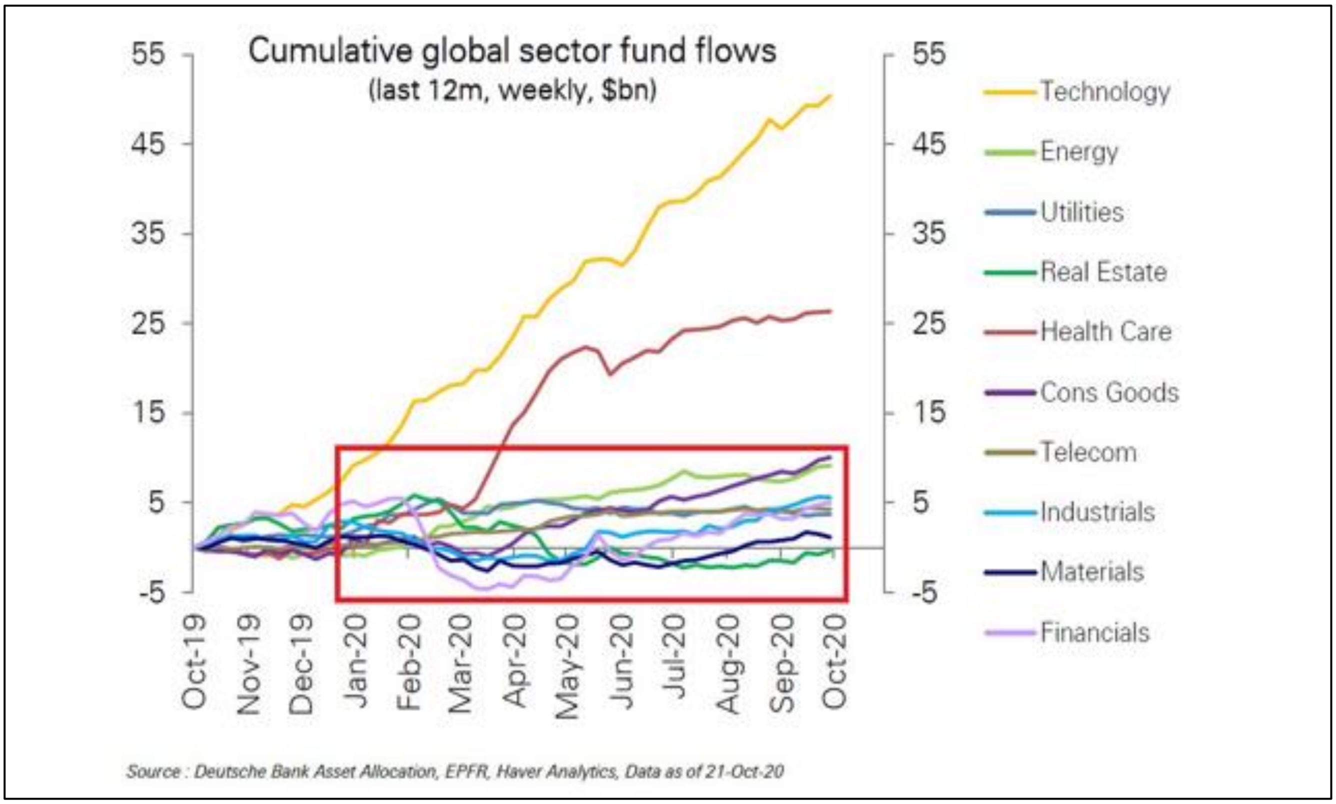
What to Focus on Now:

I don't have much to add on the coming election. Polls still have it for Biden (all the early voting probably supports that) but people are also not ignoring the potential for another 2016 upset, while fearing everything else in-between.

Stocks

Despite all the promise of a rotation away from big tech and healthcare and into the value and small caps, not that much has yet changed.

Yes, some of the flows have flattened but not much of a longer-term reversal to be seen yet.



Of course, given the technological acceleration that accompanied the virus outbreak and the already dominant role of tech earnings vs. everyone else's earnings, it has been difficult tide to turn.

That has not just been a US story but a global story. The world of bytes has ruled.

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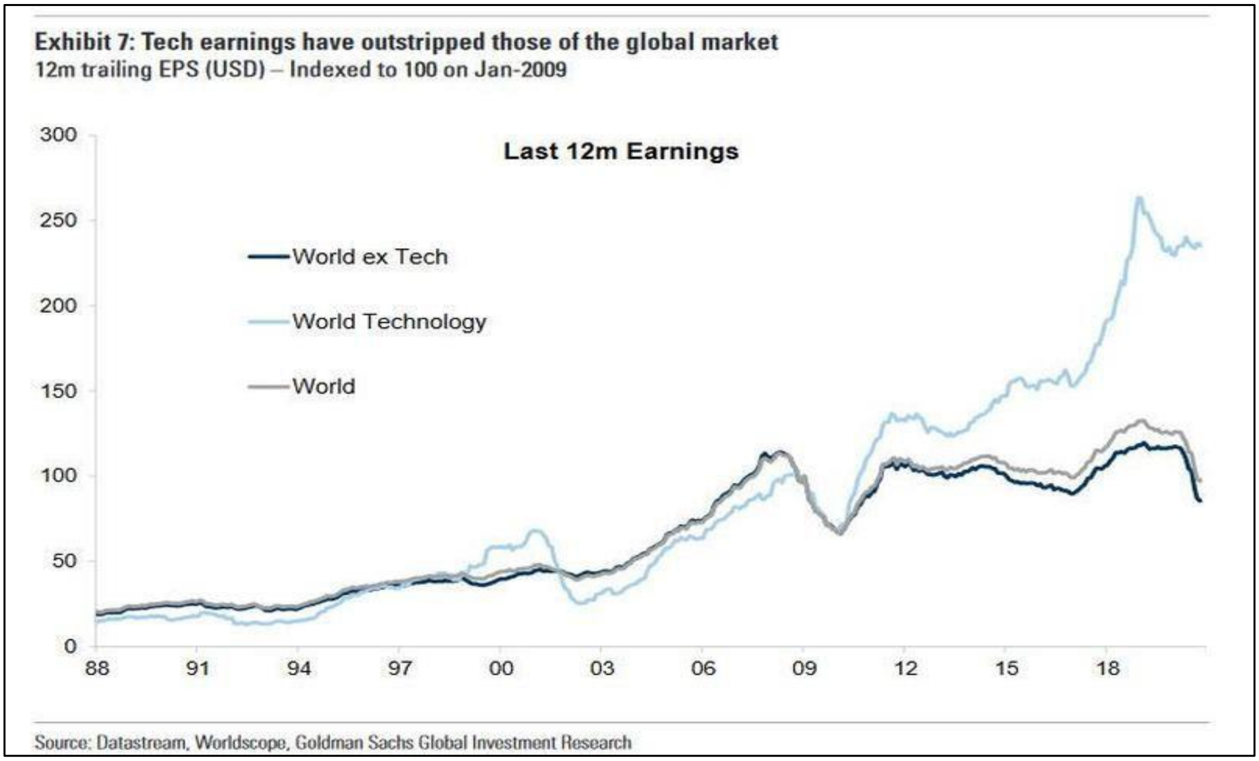


That continues to leave many of the global value plays without momentum.

Nikkei 225 – despite large inflows recently from abroad, still can't get going.

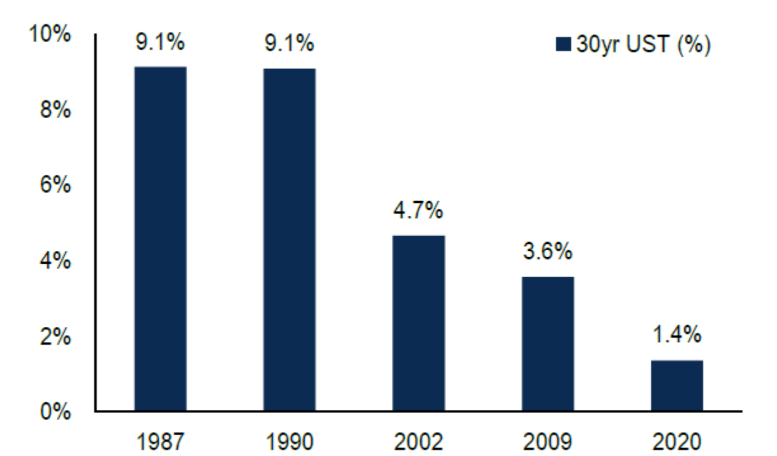
Europe – with the recent resurgence of the virus compounding existing problems, is the big underperformer.

Bonds – Despite recent equity market weakness bond yields are not retreating so far.

This is a big problem for much of the investment world that counts on bonds to act as an uncorrelated and preferable negatively correlated asset when stocks fall.

The buffer in terms of yield that bonds used to provide has been degrading for decades now. However, if price direction can't be counted on either, it will force risk reduction across the portfolio.

Chart 7: Disappearance of bond buffer for asset allocators



Source: BofA Global Investment Strategy, Bloomberg

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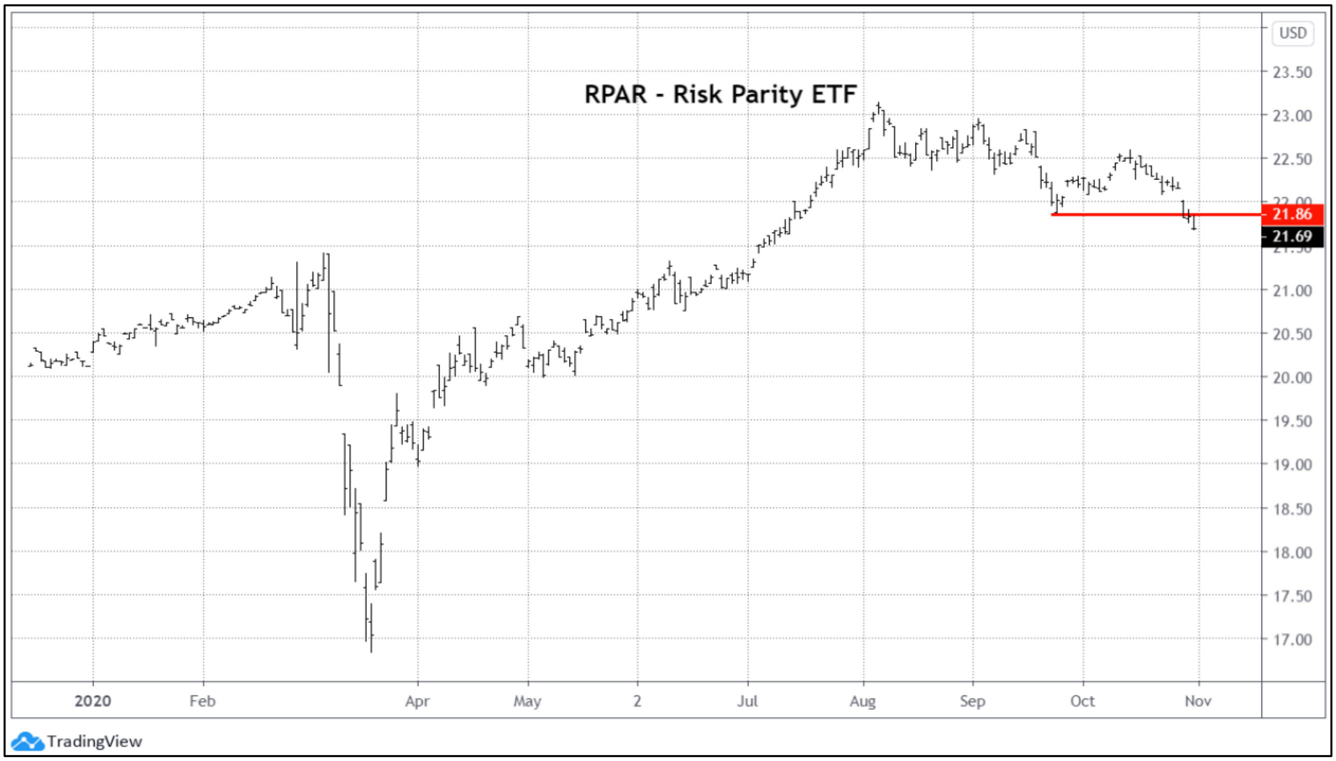
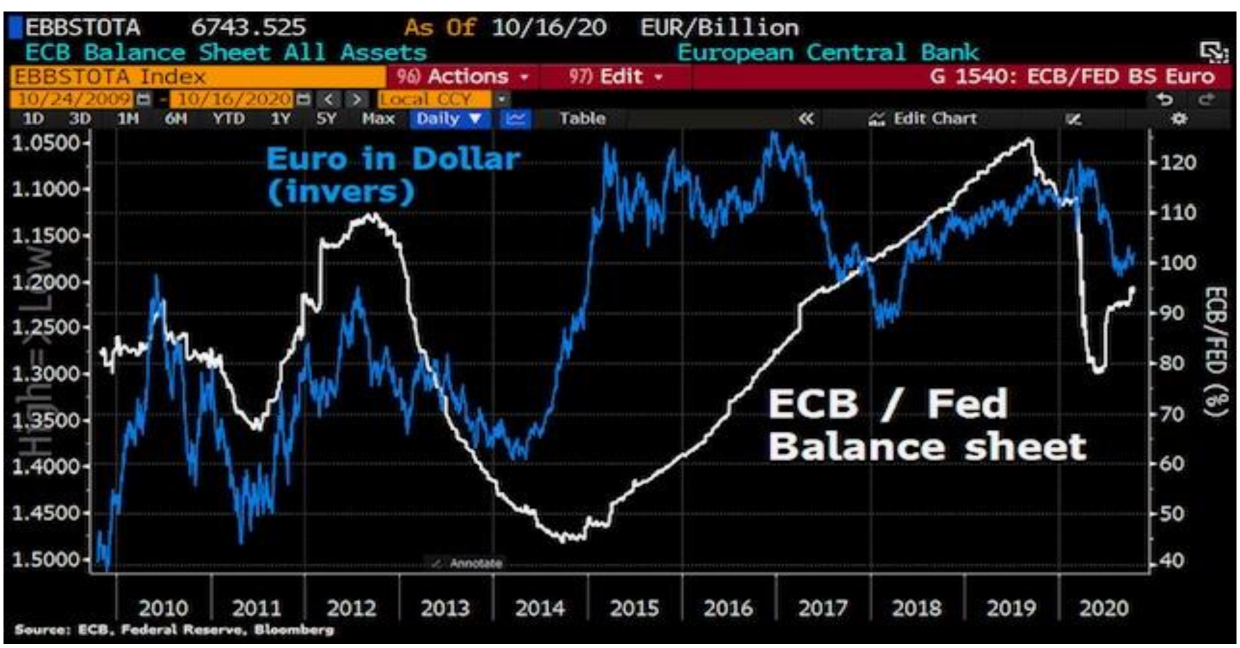
An interrupted rebound for equities and the economy, that can only be counteracted by even more fiscal spending, is a problematic combination for risk parity and balanced funds.

Risk Parity has hit an inflection point here… expect volatility to pick up sharply (no surprise with election setup perhaps). Either we get a quick rebound, or we accelerate to the downside.



FX – Some are pointing out the relationship between relative CB balance sheets and EURUSD.



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While it looks to be a factor to consider along with changes in the relative interest rates, it's clearly not that simple, especially in the near-term.

As always, the path of most pain (positioning and flow) and the role of the USD as the worlds global reserve currency are critical.

For now, the market is still short USD and any further risk unwind will put upward pressure on the dollar.

If you now assume that a higher USD imposes global liquidity constraints on the rest of the globe, you can see how the virtuous/vicious USD feedback loops can quickly kick in.

If equities continue to weaken, bonds do not rally, and the USD strengthens, it will quickly tighten global financial conditions and you will have to start the countdown to another round of CB stimulus/intervention. Which brings me to a point to ponder regarding CB's. If their toolboxes are looking more and more empty, limiting their ability to stimulate the actual economy from here, do they increasingly turn to market intervention? There is a lot of reflexivity between the price of something and its underlying driver. They may consider shortening the line. Look at how their buying of corporate credit worked. Something to keep an eye out for, across global markets going forward...

Gold

Gold has been sideways to lower as the dollar and bond yields have not cooperated. I like buying it now at or below 1800 or if we break back above 1935.

It is worth watching for signs that the correlation to the dollar and bond yields is weakening.

Important Macro Data Releases and Events for the Week

Monday
11/2/2020

- Markit Manufacturing PMI's across Europe (Oct)
- Markit Manufacturing PMI (Oct) Forecast: 53.3, Prior: 53.3
- ISM Manufacturing Employment Index (Oct) Forecast: 40.9, Prior: 49.6
- ISM Manufacturing PMI (Oct) Forecast: 55.6, Prior: 55.4
- ISM Manufacturing Prices Paid (Oct) Forecast: 58.6, Prior: 62.8
- ISM Manufacturing New Orders Index (Oct) Forecast: 45.9, Prior: 60.2

Eurogroup Meeting

RBA Interest Rate Decision and Statement

Tuesday
11/3/2020

Election Day

Factory Orders MoM (Sep) Forecast: 1%, Prior: 0.7%

Caixin Services PMI (Oct) Forecast: -, Prior: 54.8

Wednesday
11/4/2020

Markit Service PMI's across Europe

EcoFin Meeting

ADP Employment Change (Oct) Forecast: -, Prior: 749k

Markit Service PMI (Oct) Forecast: -, Prior: 56

Markit PMI Composite (Oct) Forecast: -, Prior: 55.5

ISM Services New Orders (Oct) Forecast: -, Prior: 61.5

ISM Services PMI (Oct) Forecast: 57.5, Prior: 57.8

ISM Service Employment Index (Oct) Forecast: -, Prior: 51.8

ISM Services Prices Paid (Oct) Forecast: -, Prior: 59

Thursday
11/5/2020

Factory Orders s.a. MoM (Sep) Forecast: 2.6%, Prior: 4.5%

Retail Sales YoY (Sep) Forecast: 2.2%, Prior: 3.7%

Retail Sales MoM (Sep) Forecast: 2.4%, Prior: 4.4%

Bank of England Interest Rate Decision and Policy Statement

Initial Jobless Claims Forecast: - , Prior: 751m

		Initial Jobless Claims 4-week ave. Forecast: - , Prior: 787.75m
		Continuing Claims Forecast: - , Prior: 7.756m
		Fed Interest Rate Decision and Policy Statement / Press Conference
		RBA Monetary Policy Statement
Friday 11/6/2020		Nonfarm Payrolls (Oct) Forecast: 850k, Prior: 661k
		Unemployment Rate (Oct) Forecast: 7.7%, Prior: 7.9%
		Net Change in Employment (Oct) Forecast: -, Prior: 378.2k
		Unemployment Rate (Oct) Forecast: 9.7%, Prior: 9%

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