Stargazer
Asset Management

What to focus on in Global Macro for the week of May 9th, 2022

The Macro backdrop continues to be very challenging for markets. High inflation combined with rapid central bank liquidity withdrawal, is tricky enough. However, we also have continued geopolitical dangers lurking as a potential May 9th Victory Day announcement threatens to ramp up the Ukraine conflict further. Add to that China's Xi just reaffirmed his commitment to their controversial zero-Covid strategy, warning against "any slackening" in the effort and vowing to crack down on criticism of the policy despite signs of growing damage to the economy.

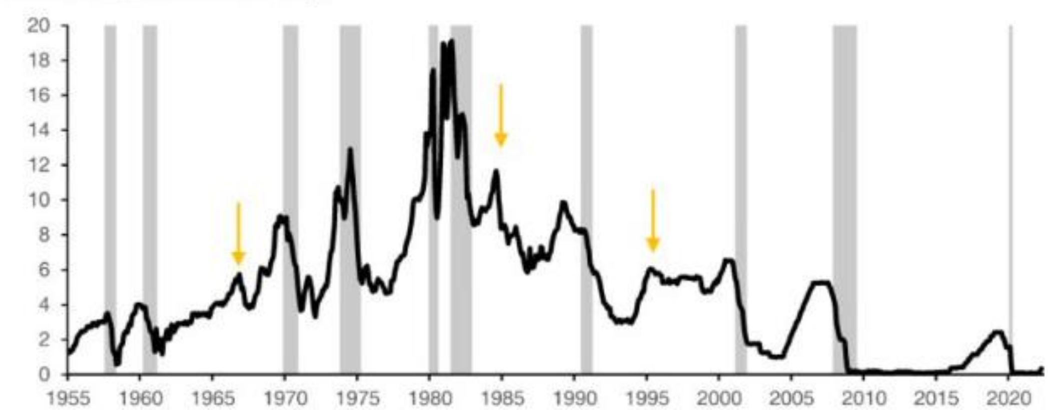
Fed and ECB

After the Fed meeting, everyone was talking about how dovish Powell was. I didn't see it. However, outcomes vs. expectations are what count, and I guess the markets had come to fear some kind of shock and awe given what some of the members had talked about leading up to the meeting. Yes, Powell said "75bps is not something the committee is actively considering", throwing cold water on that idea. Yes, QT is kicking off at half strength for the first few months, before throttling up. However, Powell also said that because of forward guidance (one of their tools), markets have already priced future hikes and that market pricing is already having an effect on the economy.

He stressed that "our tools work on demand", which they are actively trying to reduce, and that they will be checking to make sure that financial conditions are tightening appropriately. Nothing dovish about that. He repeated that the economy is very strong and commented extensively on how the very tight labor market gives them plenty of room to tighten financial conditions. The tightness of the labor market continues to give the Fed hope that they can achieve a "soft landing" for the economy. The historic probability isn't great…

Chart 1 - Soft landing: only 1 in 4 attempts is successful

Effective federal funds rate, monthly averages in %. Gray-shaded areas: Recessions as determined by the NBER. Arrows mark soft landings



Source: Fed, Commerzbank Research

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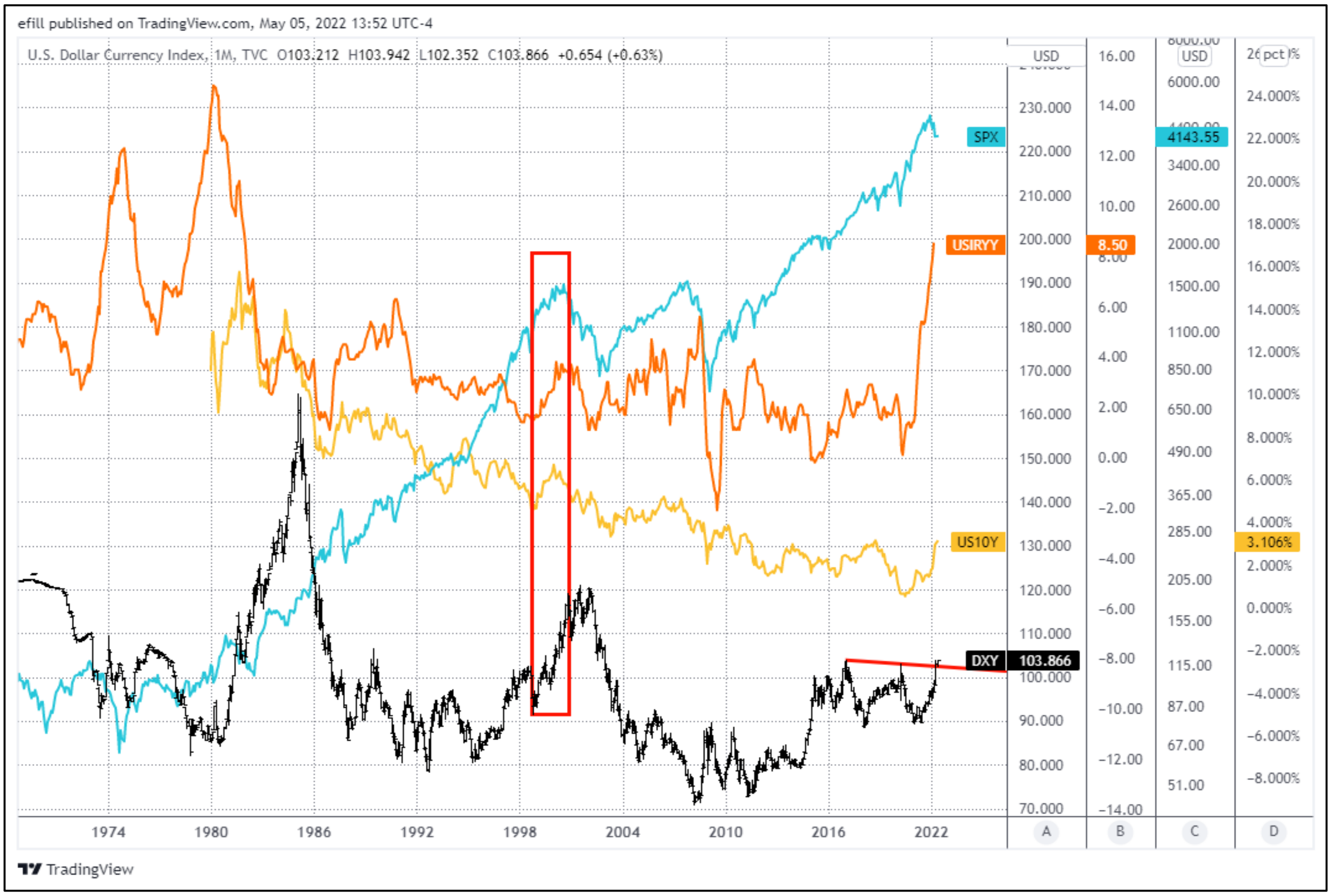
Markets are now starting to focus on the ECB. There were lots of speakers over the last week or so pointing to rate hikes starting as early as July. The markets agree. The ECB's position is much more complicated than the Fed's. Not only do they have the single inflation mandate, but they face a much weaker economic backdrop. Having said that, -50bps is difficult to rationalize given the current inflation prints, so positive deposit rates are likely inevitable. What happens after that though is much less clear.

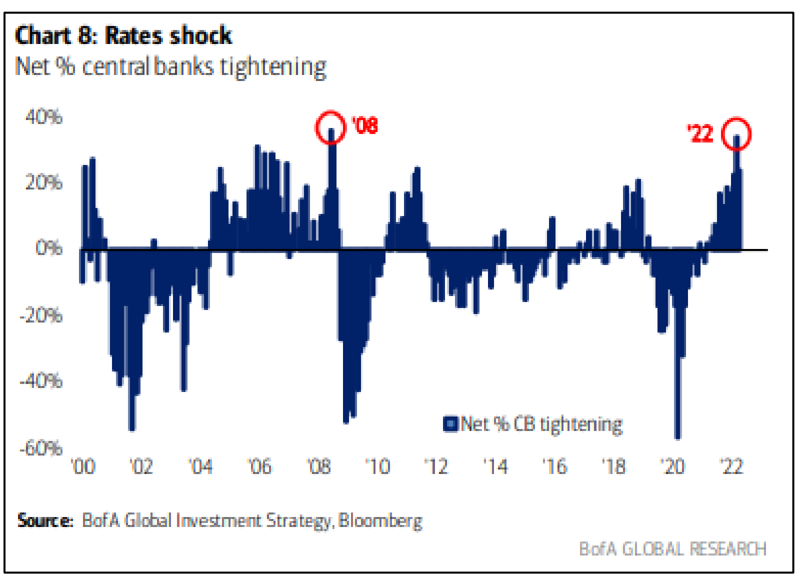
There is little doubt that zero rates and abundant liquidity have profoundly affected both the economy and markets over the last few years, but both these dynamics are now reversing at a very fast pace. We don't really know what the consequences will be.

I would argue we are entering a new regime. Are we cycling back to an environment where markets continually live in fear of inflation, as we had during the 80s and arguably through much of the 90s? Stocks would stall or go down when yields rose, then head higher when yields fell. Or are we headed for something else?

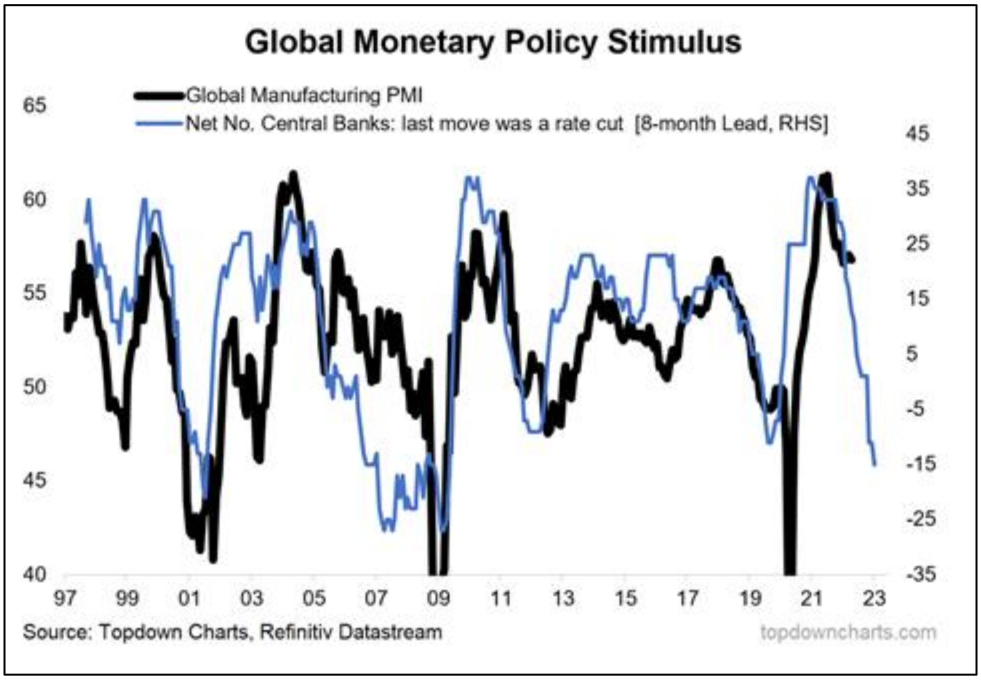
We are also in the middle of a very unusual period during which we are seeing yields/rates rise, the dollar rise, and inflation/commodities all rise at the same time. The only other time we saw that unusual combination with any persistence was in the late 1990s.



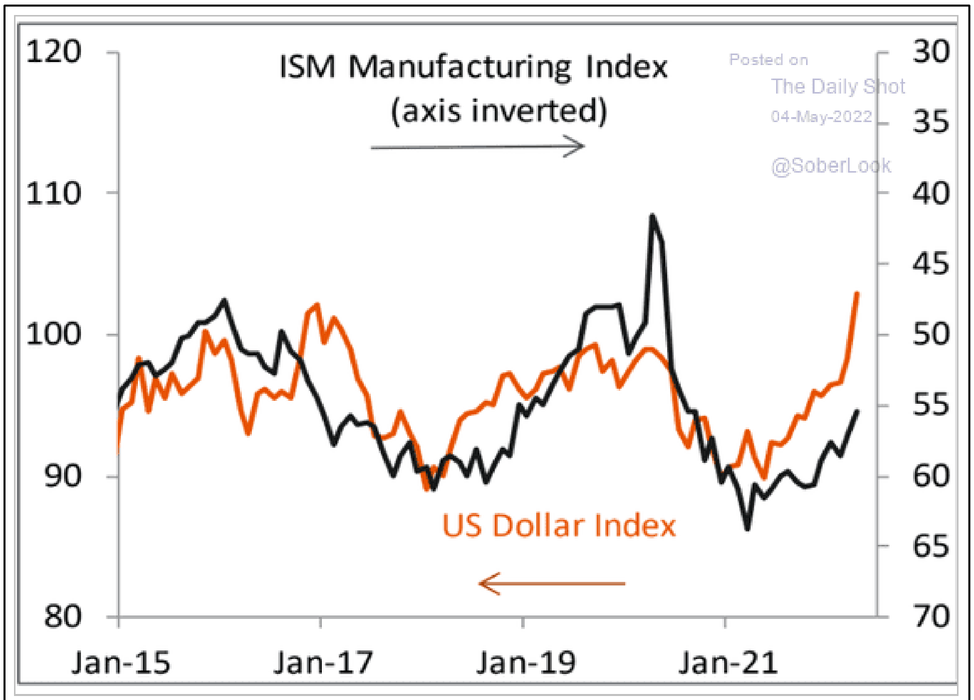
Rate hikes are progressing quickly globally…



Historically that has been difficult for global growth. Given that global PMIs have already been falling there is good reason to think market volatility will remain high.



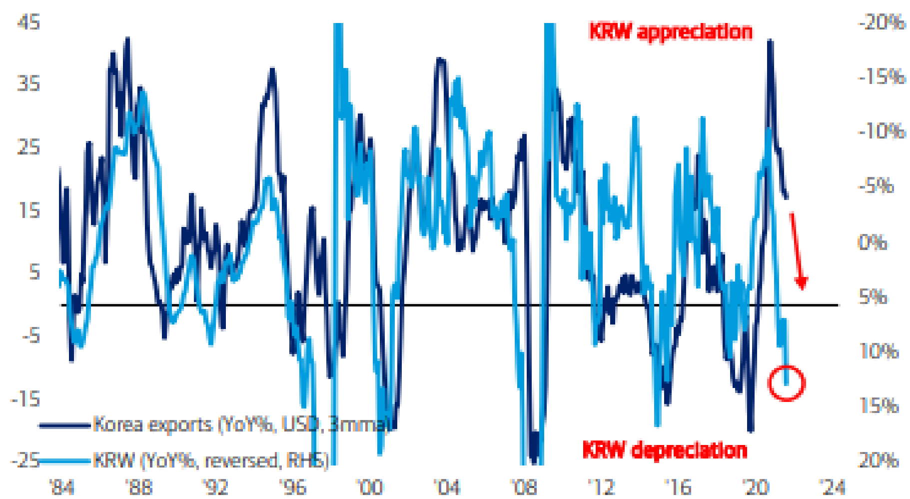
Higher rates AND a higher USD are not likely to be helpful to global growth.



Source: Piper Sandler

With Chinese and European growth being challenged countries like South Korea, which have a high beta to global growth via exports, are already being challenged.

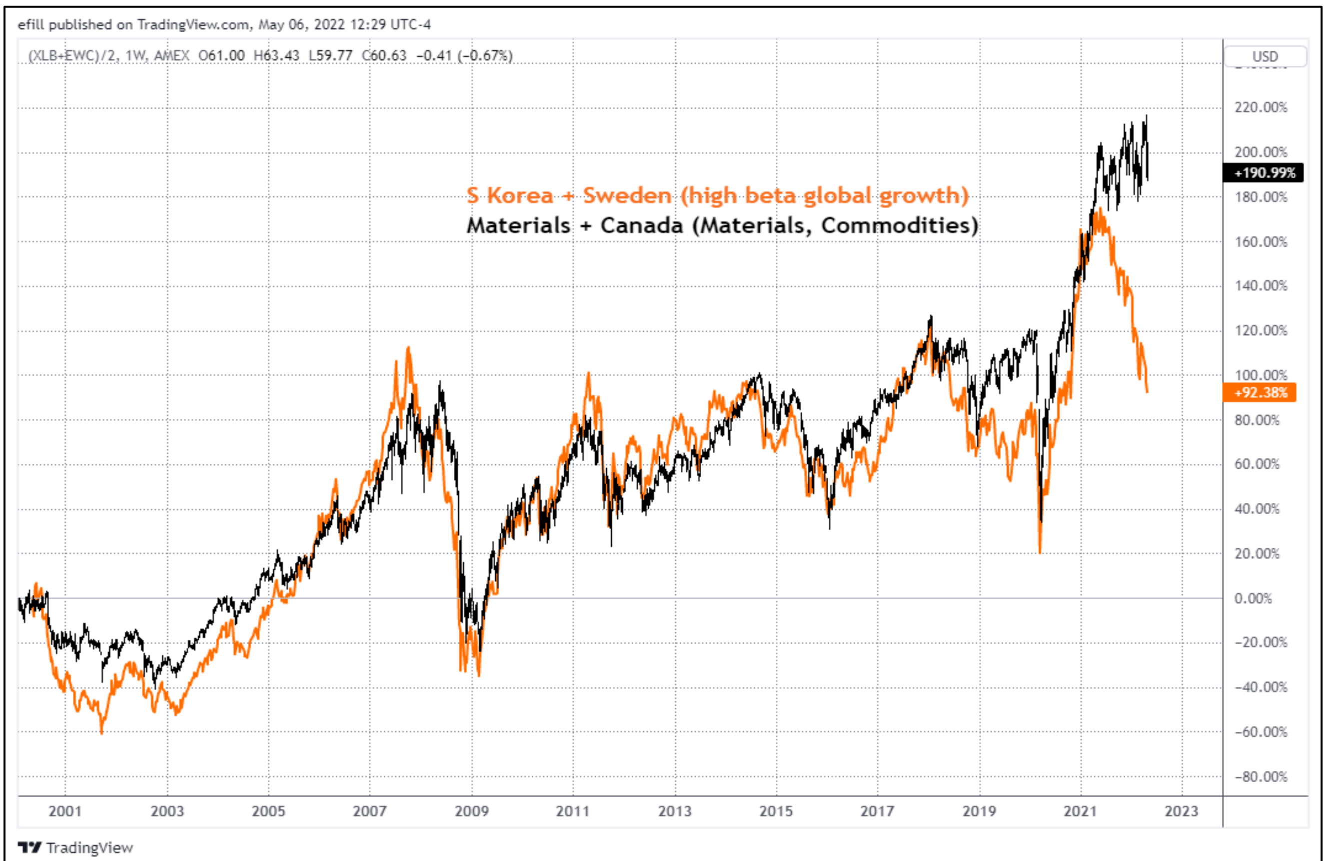
Chart 9: Asian FX deval discounts weaker Asian export growth
South Korean Won vs Exports



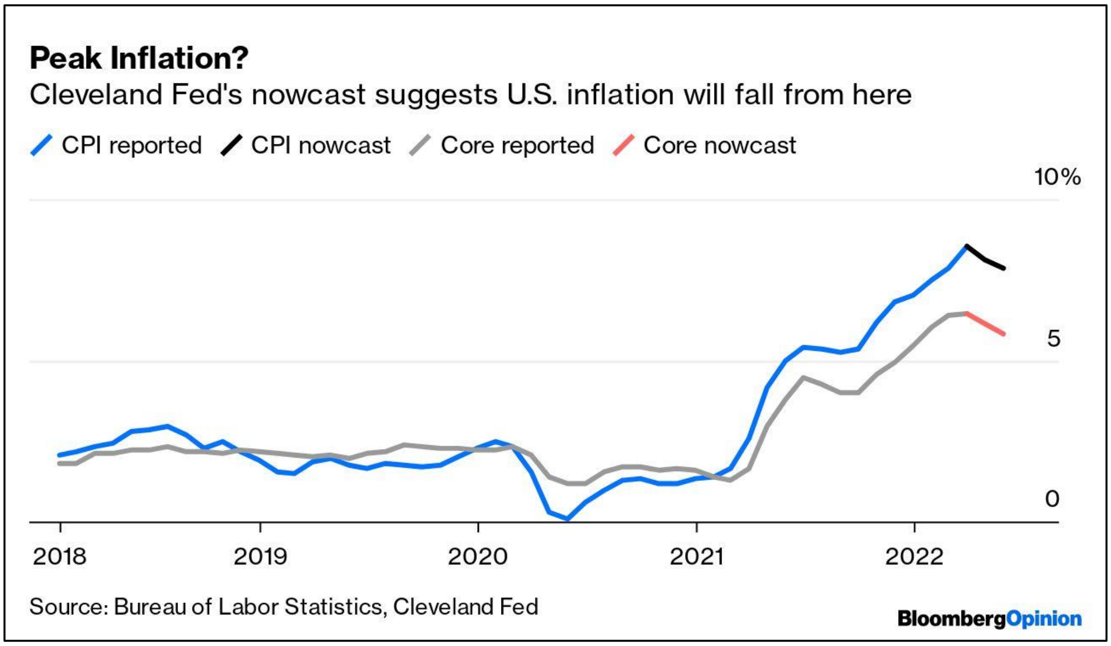
Source: BofA Global Investment Strategy, Bloomberg
BofA GLOBAL RESEARCH

The divergence we are seeing between growth-sensitive countries like Sweden and S. Korea vs. materials stocks and a commodity-linked country like Canada is noteworthy. This chart includes currency exposure to the various countries but that is part of the point.

There will be some big opportunities when this gap closes, assuming it does.



Economists continue to forecast the top and then a decline in inflation numbers starting very soon. How fast and how far it falls continues to be the big question. There is a growing fear that the coming fall, rather than the previous rise, is what will turn out to be "transitory".



The shipping situation remains very complex, and while some areas are seeing signs of relief others remain very tight. The Chinese lockdowns are adding even more complexity.

Here is an excerpt from this week's Freightos market analysis:

The ongoing lockdown in Shanghai – as well as China's Labor Day holiday that saw many factories across the country closed over the first half of this week – continued to make exports scarce. Meanwhile, COVID case counts climbed in Beijing and other cities raising the possibility of additional lockdowns.

Government data released this week showed that manufacturing levels in April were at their lowest levels since just after the initial outbreak in 2020, and that national-wide freight volumes declined 15% compared to last April.

Some ocean carriers announced additional blanked sailings for the end of May and into June, including to the US East Coast, but are attributing them to growing delays and congestion instead, as opposed to a response to falling demand for freight.

Meanwhile, Robert Khachatryan, CEO of freight forwarder Freight Right reports that – for shippers with goods to ship – transpacific "capacity has improved dramatically. We have no issues finding space from Asia to the US."

As demand falls and space becomes available, ocean rates continued to fall this week. In addition, the past few weeks has seen the removal of many of the premium surcharges required for securing *capacity. As a result, Asia – US West Coast rates dropped 19% to $12,596/FEU – their lowest level since July – and Asia - N. Europe rates decreased 3% to $10,565/FEU.*

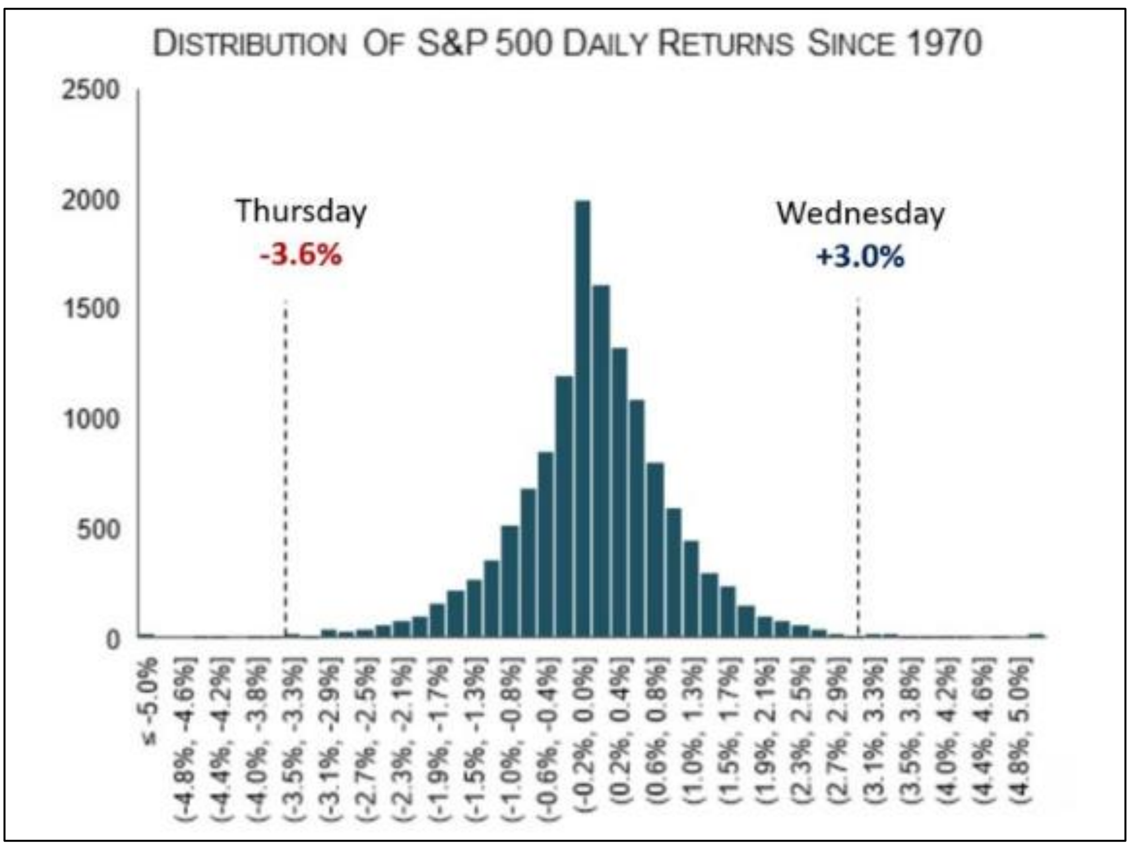
Despite significant cancellations of Shanghai flights, air rates likewise have fallen due to the decrease in demand. Freightos Air Index Shanghai - North Europe rates have fallen 38% since the end of March to $7.37/kg, though this rate is more than triple pre-pandemic norms for this time of year.

The continued lull in ocean volumes will be a welcome chance for destination ports to clear some of the existing backlogs. But longer the lockdown lasts, the larger and the more concerning the coming surge of containers will become for those already-congested ports.

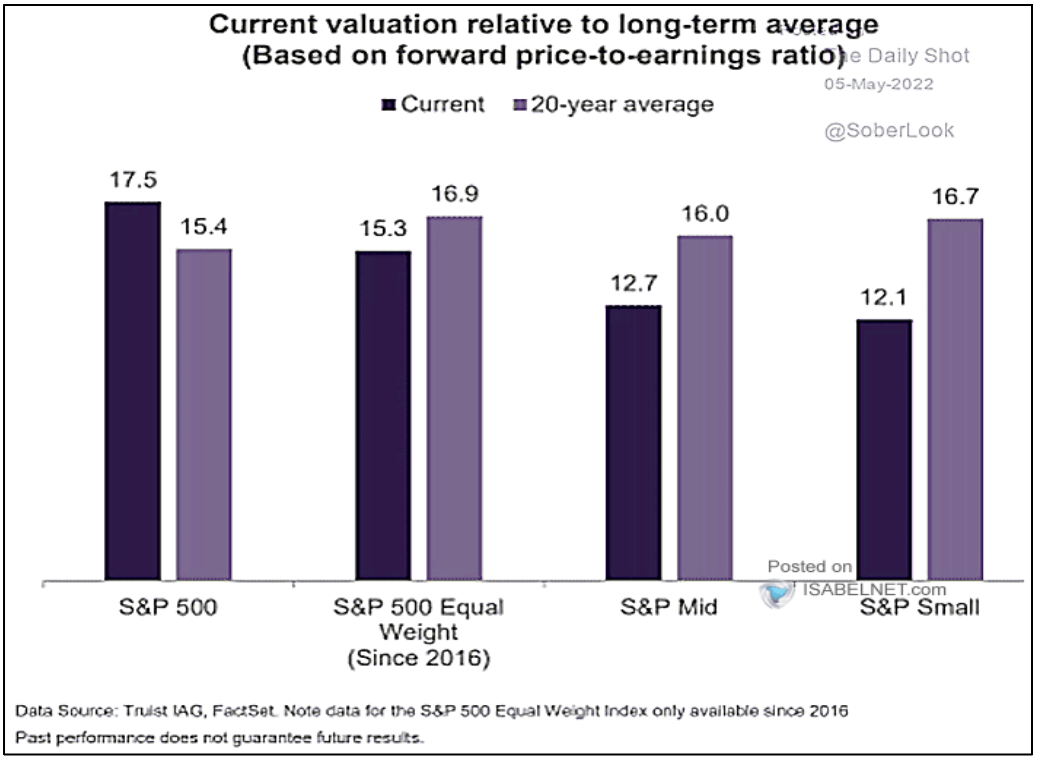
Markets

Last week was wild, again…

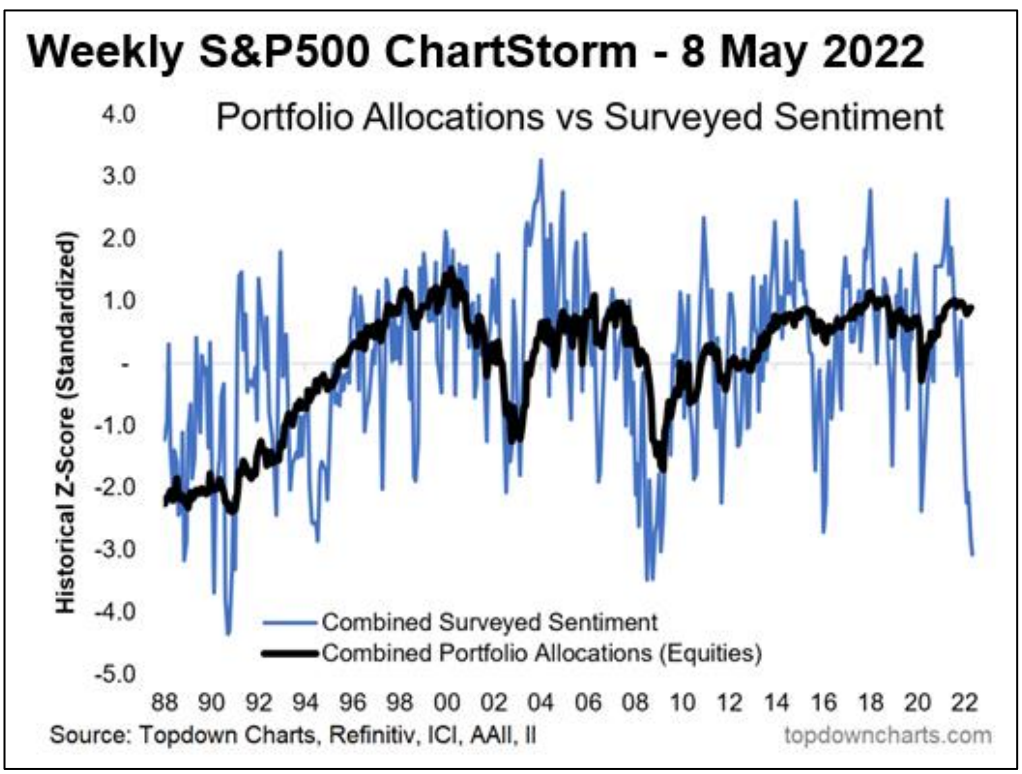
Only 8 other times since 1970 has the S&P500 recorded such large daily returns back-to-back as we saw Wednesday and Thursday.



Big Cap tech holding up valuations for the index… despite bloodshed in many of the other names.



While fund outflows are picking up, sentiment is still way ahead…



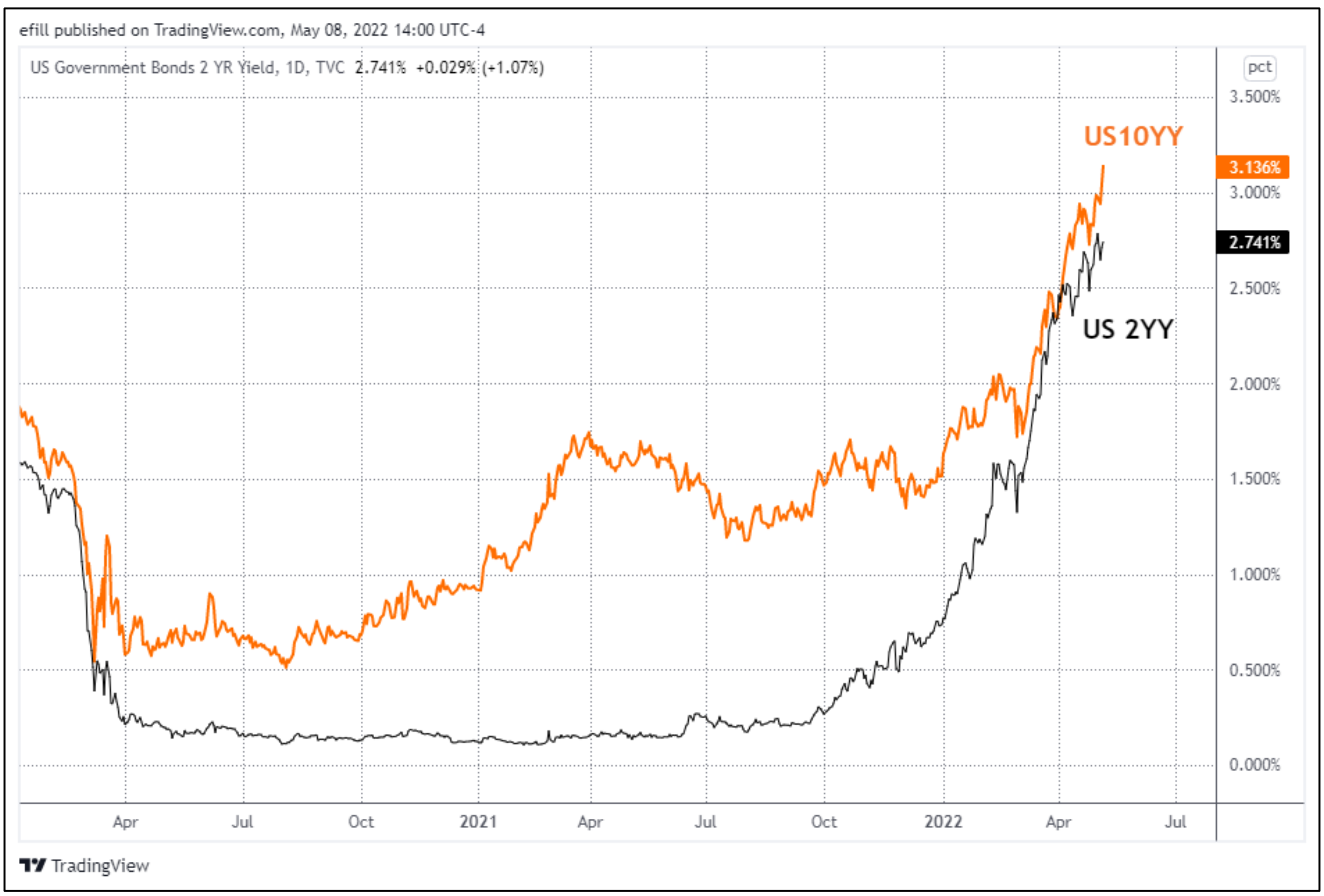
Amazingly there still seem to be some pockets of retail that continue to buy, calling into question how much capitulation we have seen to date.

REUTERS: Retail investors net bought $2.6 billion worth of stocks and exchange traded funds on Thursday, according to Vanda Research. It was the highest level of net buys ever recorded by Vanda, whose data goes back to January 2014, the company said.

It was another very tough week for 60/40 and Risk Parity as there was no place to hide.

BoA's Hartnett commented this week that *"yes all are bearish, but paralysis rather than panic best describes investor positioning YTD…for every $100 into equities past year or so, only $3 has been redeemed; and note $1.1tn of inflow to stocks since Jan'21 had average entry point of 4274 on S&P500, under water but only somewhat."*

In the meanwhile, the relentless selling in fixed income continued. The curve has been steepening and that accelerated as the long-end took the baton at the end of the week.



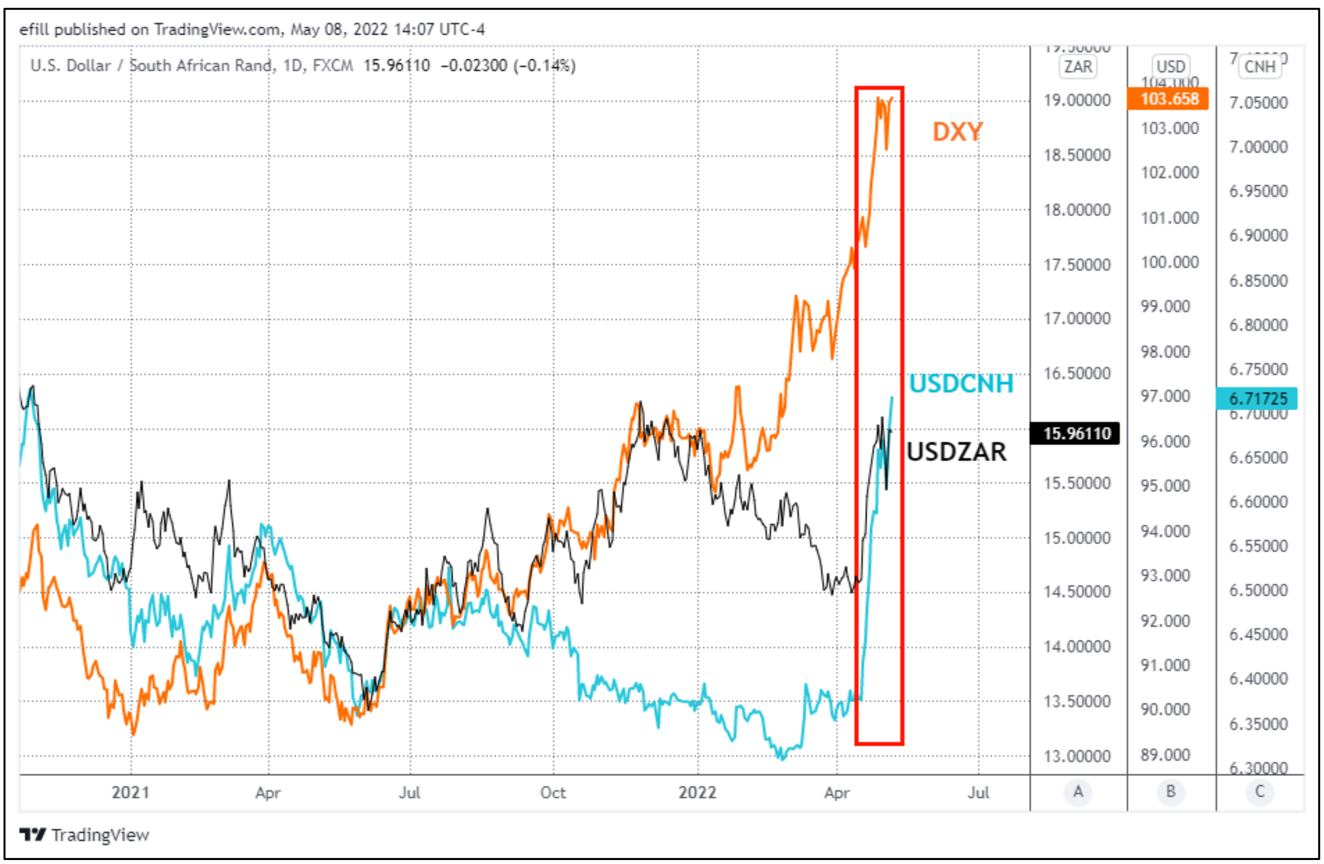
Are bonds to keep heading down until we get a bigger flush in stocks?

Dario Perkins of TS Lombard suggests that we need a growth scare:

The odds of a policy error are increasing, especially when everyone seems to be over-extrapolating COVID distortions into a new secular inflation narrative and when central banks are channeling the virtues of Paul Volcker (or, in Europe, the '70s Bundesbank). What we need is a "growth scare," one that is sufficient to stop central banks freaking out but not large enough to plunge the world into recession. And with all parts of the world facing near-term problems, this scare is now a distinct possibility. Combine China's property slump (and lockdowns) with a massive squeeze on real incomes in Europe, plus tighter financial conditions in the U.S., and perhaps the world economy will deteriorate just enough to put the authorities on a more cautious policy path. In fact, this "soft patch" may be our best chance right now of a "soft landing."

FX

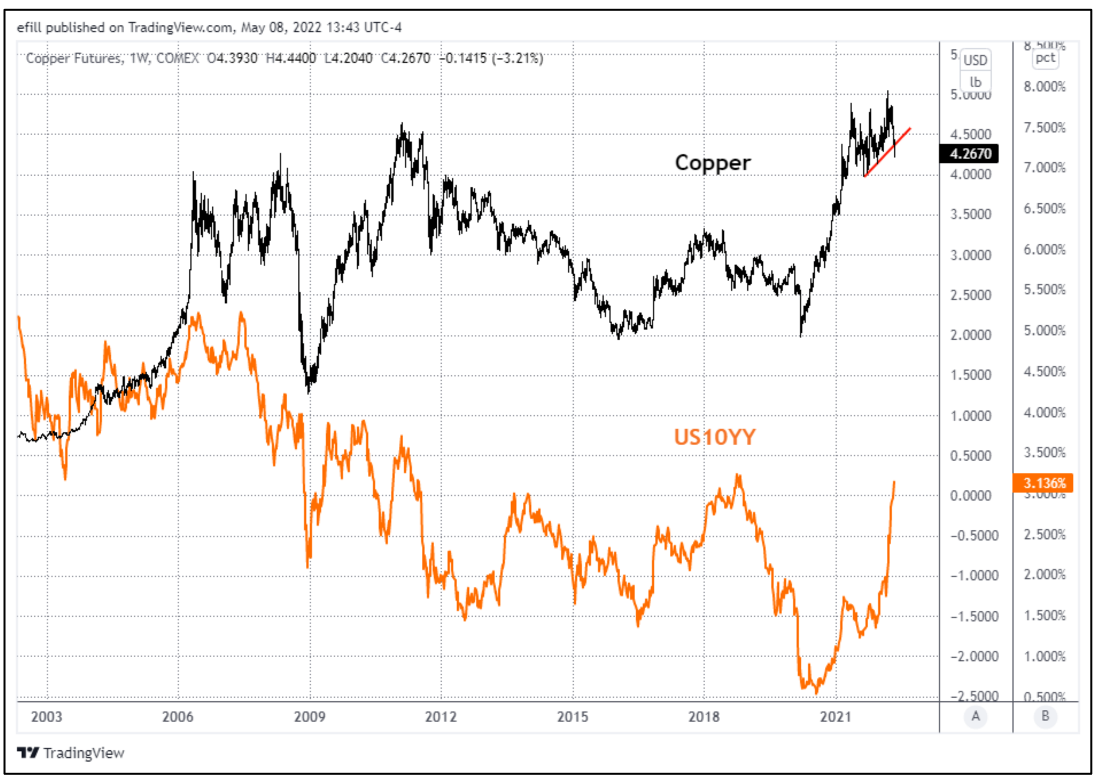
The dollar has stayed strong. The jump higher in the USD vs. Yuan has triggered a fall in other EM currencies as well. Previously, the dollar rally was largely vs. DM currencies.



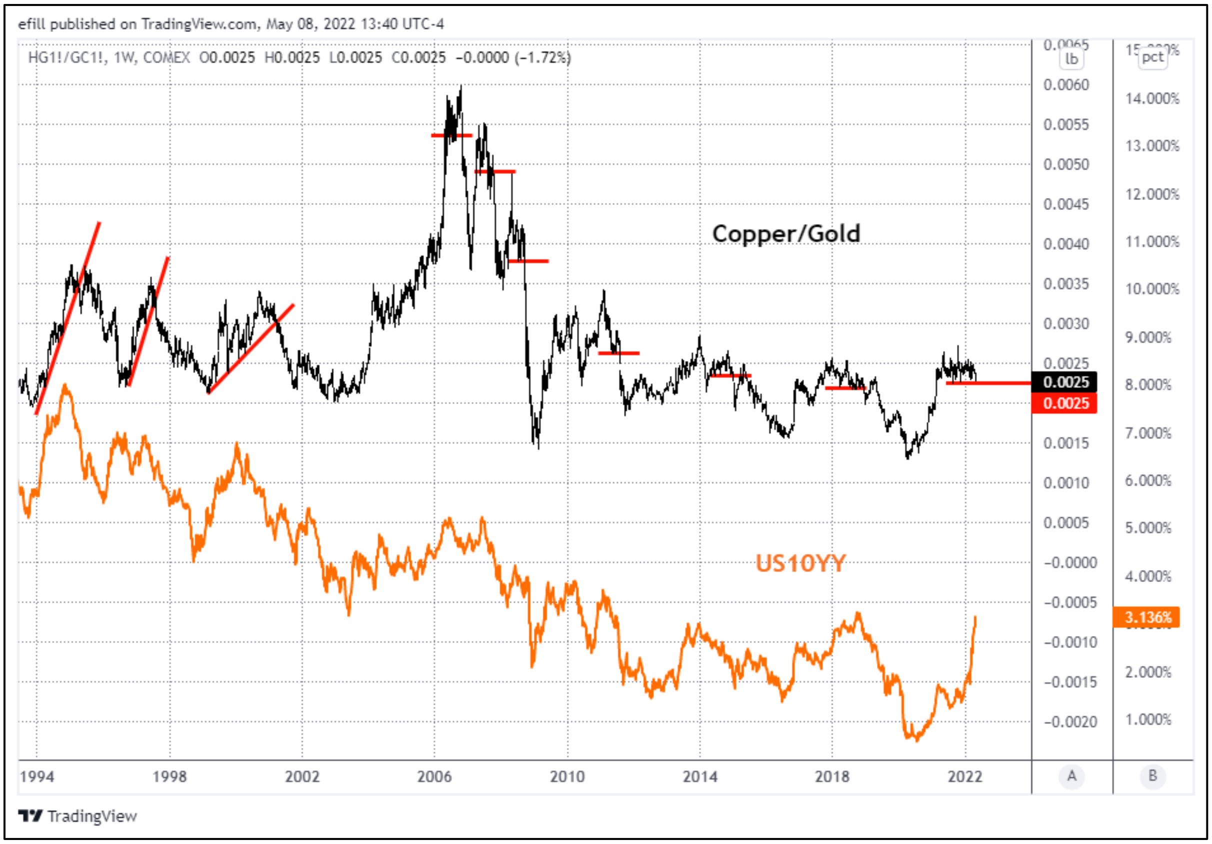
A broadening of the USD rally isn't historically a great sign for markets and tends to bring higher overall volatility.

Even USDHKD is now back at the top of the band, leading to renewed speculation that they will let it go this time. I don't have a strong view on it but think it just adds more uncertainty.

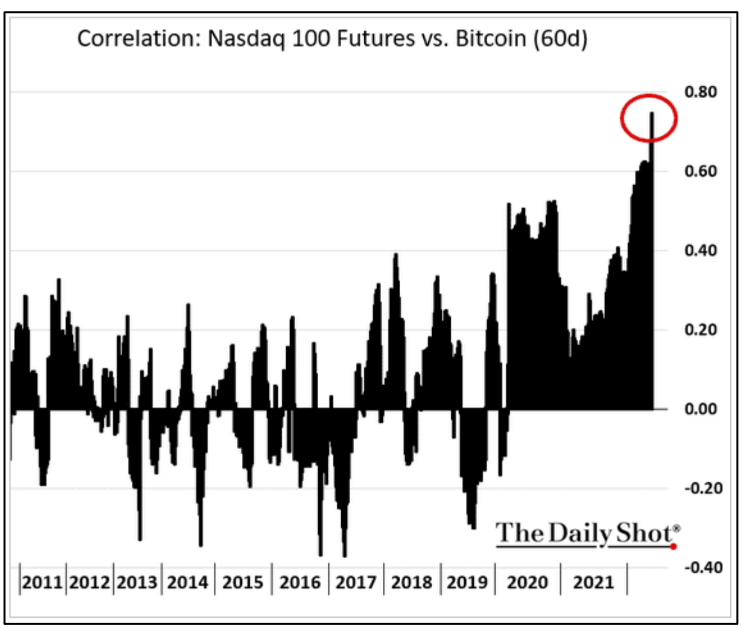
Commodities: Energy markets have remained very firm, but copper has been starting to show some weakness. Given the strong connection to global growth, and Chinese growth in particular, I still think there is more downside for Copper. Historically, yields tend to soften with Copper.



Copper vs. Gold is another one to watch in that respect.



Crypto: With the correlation to equities now very strong, continued weakness in crypto may imply knock-on effects for other markets. The total market cap for crypto is now down 50% and $1.5Trl off the highs. We will see if it matters.



BTC is arguably breaking down here.

Important Macro Data Releases and Events for the Week

Monday
5/9/2022

- EU Economic Growth Forecast
- RBA Minutes

Tuesday
5/10/2022

- UK Employment Data
- EU GDP (Q1)
- Retail Sales (Apr)
- GDP (Q1)

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Wednesday 5/11/2022		CPI (Apr)
		Eurozone HICP (Apr)
		US Housing Data - Building Permits, Housing Starts (Apr)
		BoC CPI - Headline and Core (Apr)
Thursday 5/12/2022		ECB Monetary Policy Accounts
		Initial Jobless Claims
		Initial Jobless Claims 4-week average
		Continuing Jobless Claims
		PBoC Interest Rate Decision
Friday 5/13/2022		Retail Sales (Mar)
		Consumer Confidence

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