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What to focus on in Global Macro for the week of January 24th, 2022

Macro Themes on the Radar:

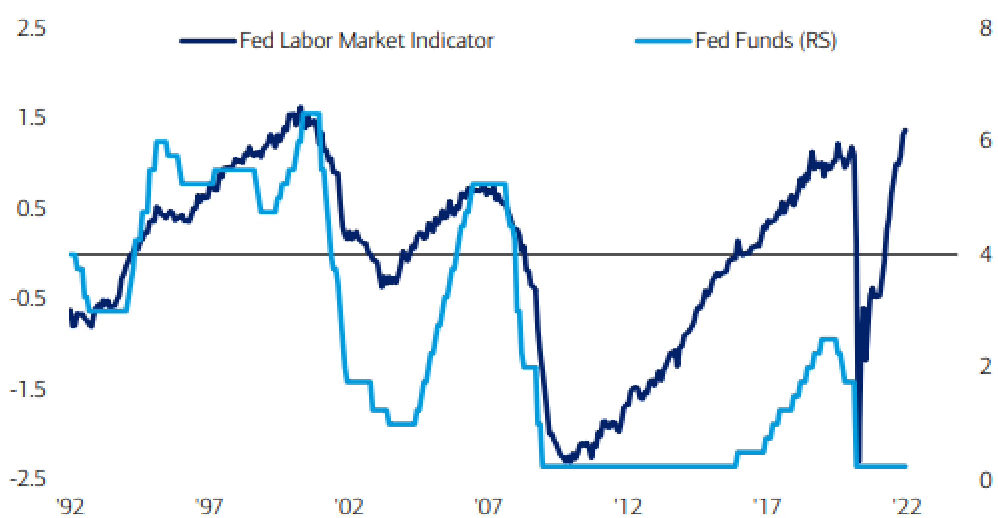
With Friday's price action putting the cherry on top of a wild week, we now face the Fed announcement on Wednesday.

It should be an interesting meeting. Not because of any likely policy changes at this point, but because the markets will be carefully watching for signs that they are maintaining or backing off the recent hawkish rhetoric. Given where inflation is, there is really no "Fed put" in sight for equities here unless they specifically mention them as a factor.

With tight labor markets given the current participation rate and rising wages, the Fed will likely embark on its tightening cycle at the March meeting, baring something major.

Chart 3: Fed behind the curve

Fed Labor Market Indicator vs Fed Funds



Source: BofA Global Investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

Economic data looks like it is going to be very messy over the next few months. The next payrolls report will be an interesting one given the massive seasonal adjustment that are always included for January as the holiday hiring is unwound. With so much noise in the payroll data currently, the markets and the Fed have been focused on the unemployment rate. There is also increasing talk that multiple factors could lead to lower ISM and PMI prints in the coming months. If we do see increasingly soft data, it will be interesting to see how the Fed squares that with the inflation issue. Then, add the fact that omicron looks like it is peaking in some areas at least. That could provide some tailwind. Like I said it is all very messy.

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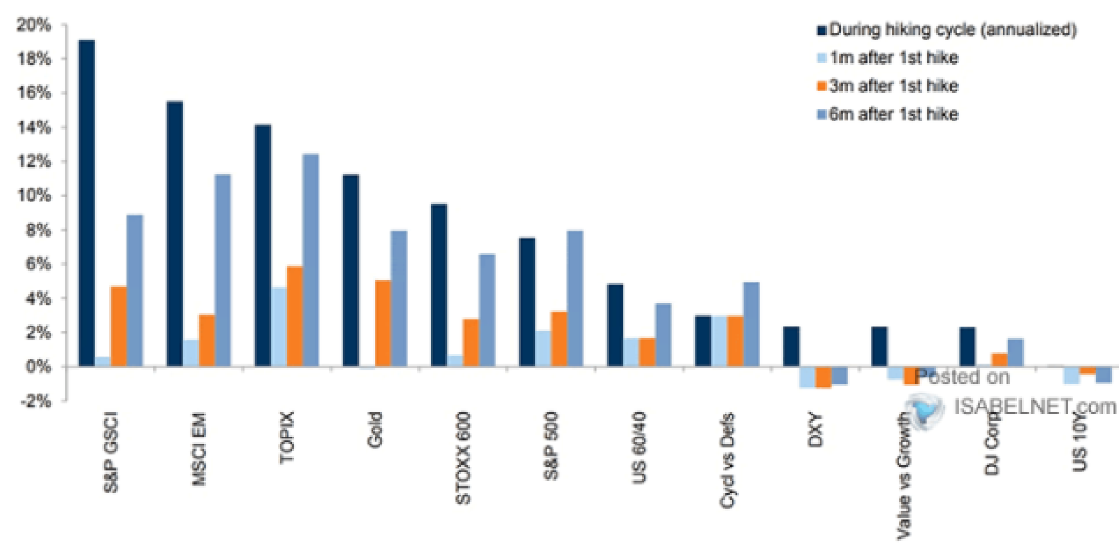
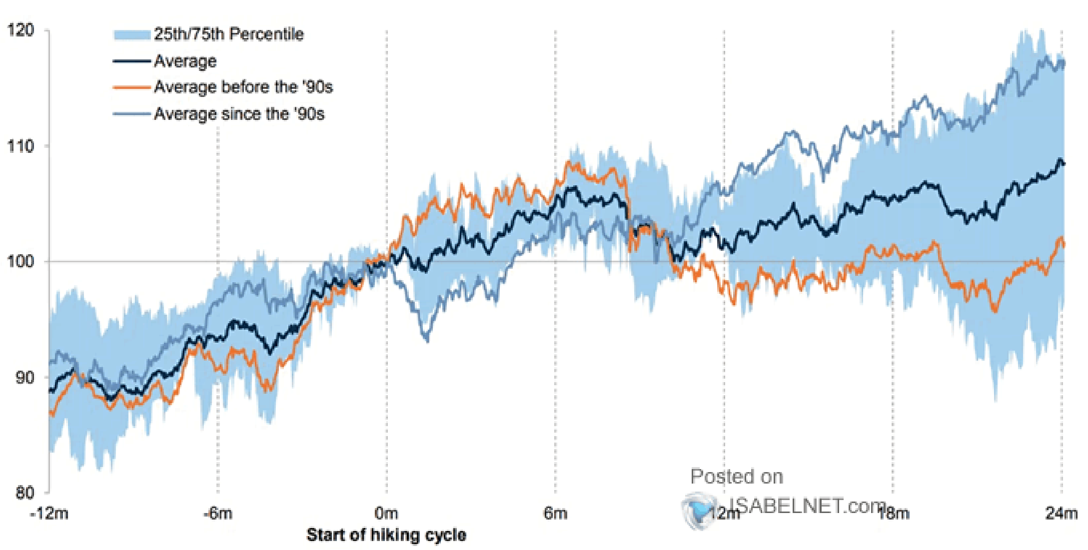
I am seeing lots of charts that show how equities go up during hiking cycles. Fair enough, but I do think the unprecedented actions and reactions this time make that a very hard comparison. Also, given how much dispersion there can be in an "average" outcome I would take this type of analysis with a big grain of salt.

Exhibit 7: Risky assets tend to perform well during hiking cycles with commodities and equities leading
Total return, data since 1970



Source: Datastream, Haver Analytics, Kennet French, Goldman Sachs Global Investment Research

Exhibit 10: S&P 500 delivered positive returns during Fed hiking cycles, but less so early on since the 1990s
S&P 500 around the start of Fed rate hike cycle since 1970 (indexed to 100)



Source: Bloomberg, Goldman Sachs Global Investment Research

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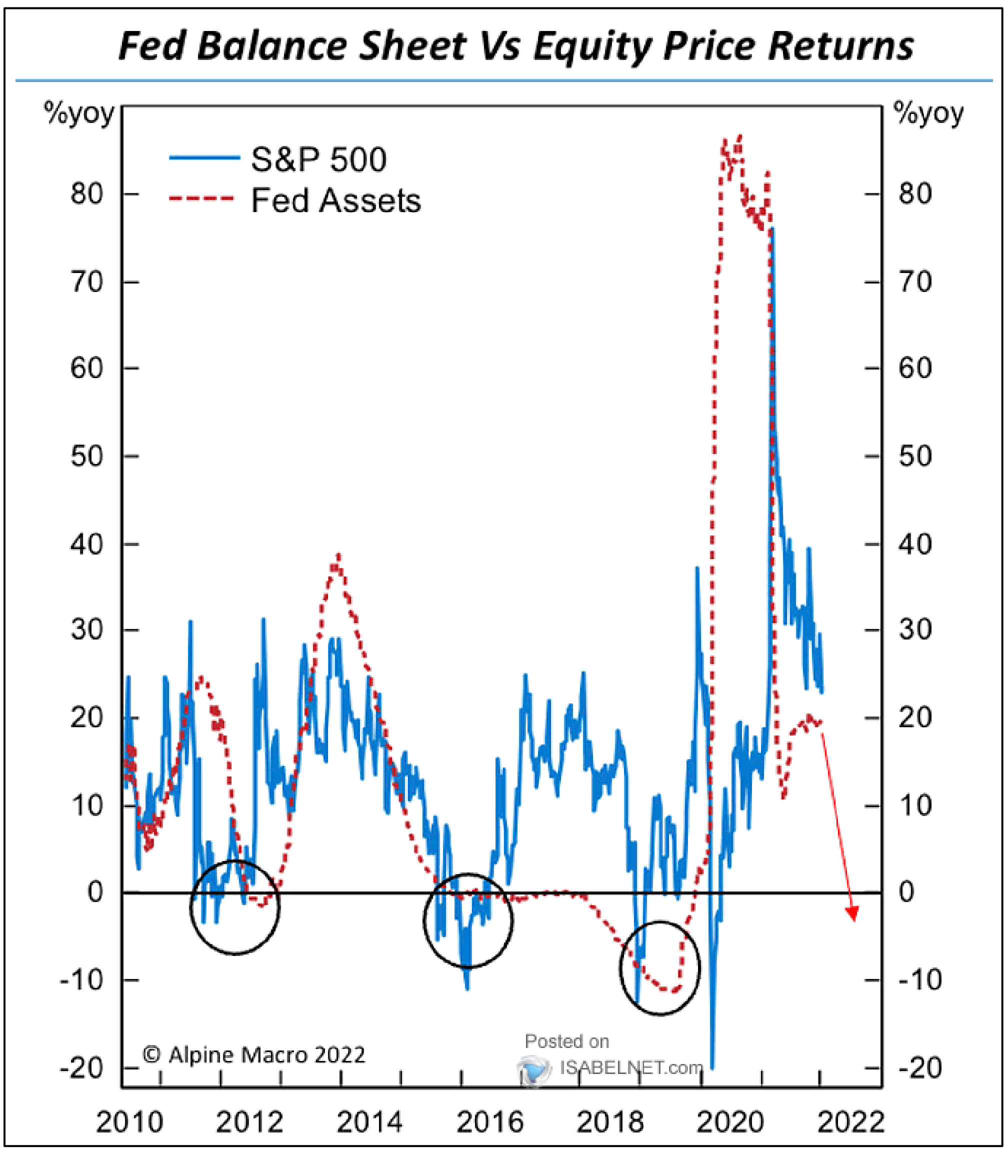
The market has already priced four hikes for this year. That can continue to shift as events unfold, but that market pricing is already having an effect on the economy. The Fed will now either validate what has already been priced or not, but at least to some extent that tightening has already occurred. The big outstanding question then remains: what is going to happen with the balance sheet? QE is supposed to end in March (as of now they are still easing, absurdly). Do we go right to QT? do they wait a few months? It is going to be really important to understand how they view QT. increasingly, there have been hints that it is a tightening tool just like rate hikes. This is going to be the hot topic this cycle and there will be lots of debate again whether it is the stock or the flow that matters. I have always thought the flow. Remember that we have really only seen QT once before, in 2018/19 and markets were very volatile during that period. At the end of QE1 and QE2, they just stopped buying assets for a while (2 circles on the left of the chart below) but didn't reduce the balance sheet.



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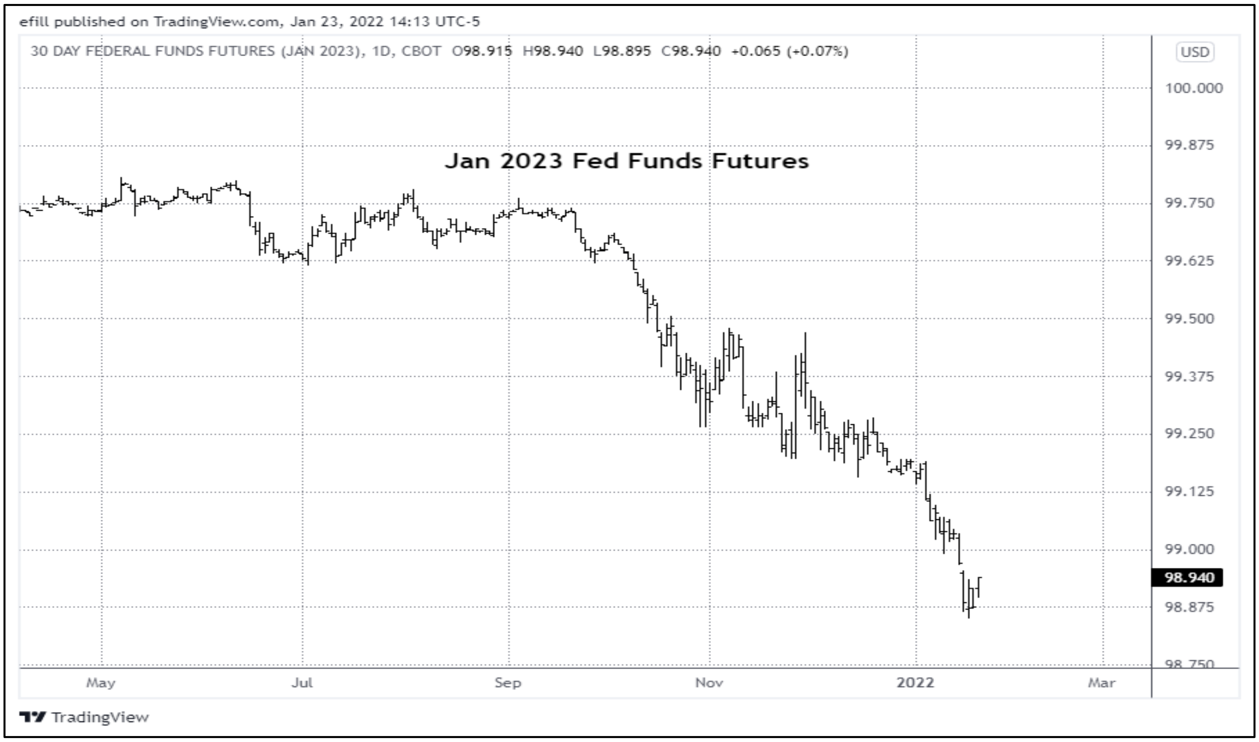
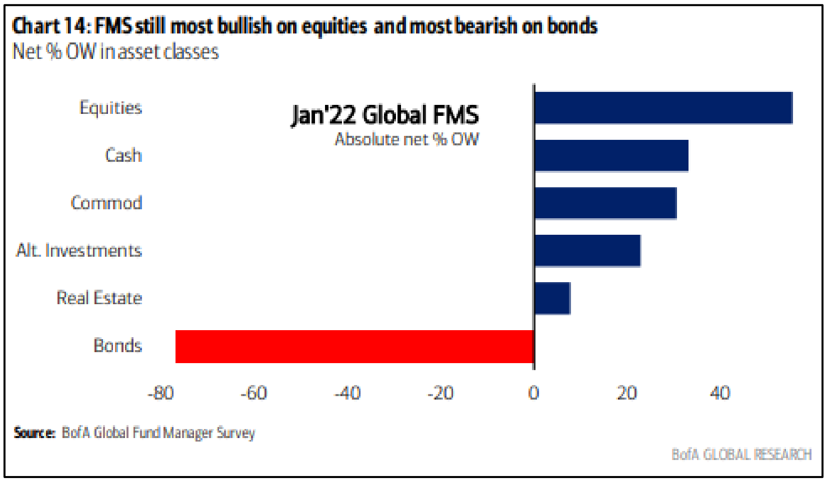
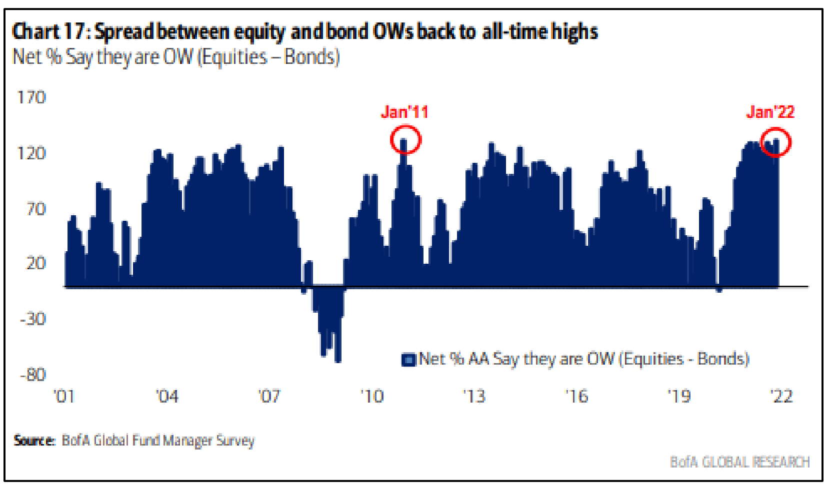
Let's check in on what impact last week's equity selloff had on interest rates. So far, the equity move has not been enough to rock the hiking view all that much. From the extremes on Wednesday, we have taken off about 10bps of Fed hikes for the year and taken 10-year yields down about the same.



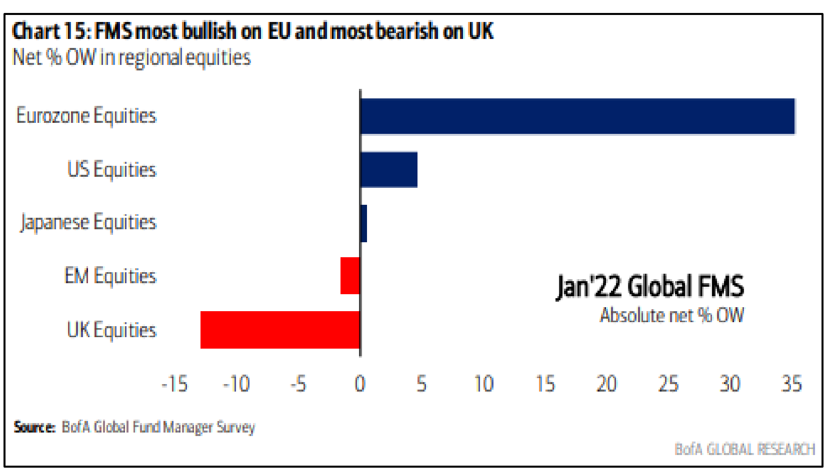
What to Focus on Now:

I'm sure the price action over the last few days will have changed positioning a bit, but as of a week ago investors remained firmly long stocks and short bonds.





Europe and the US have been the favorites. The rotation into Europe has been striking.



Outperformance has potentially just started, but so far has just shielded from some downside.

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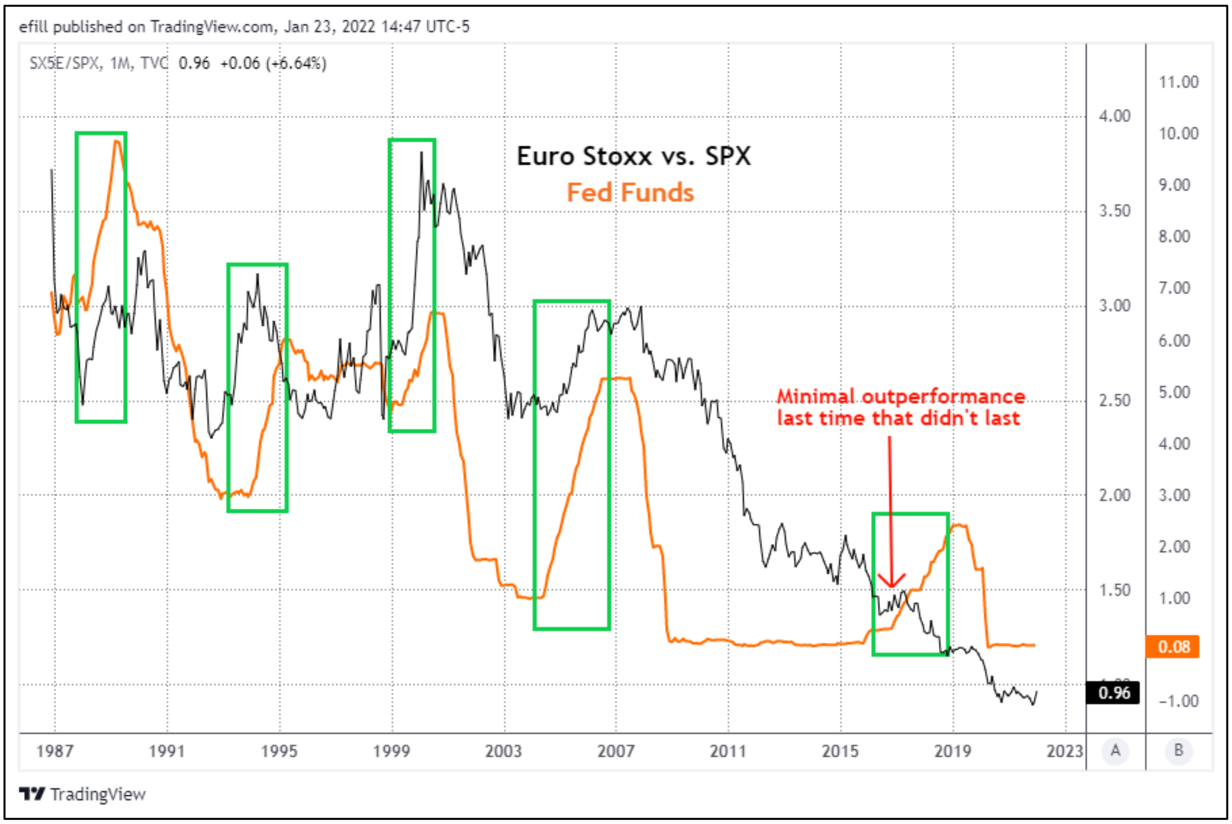
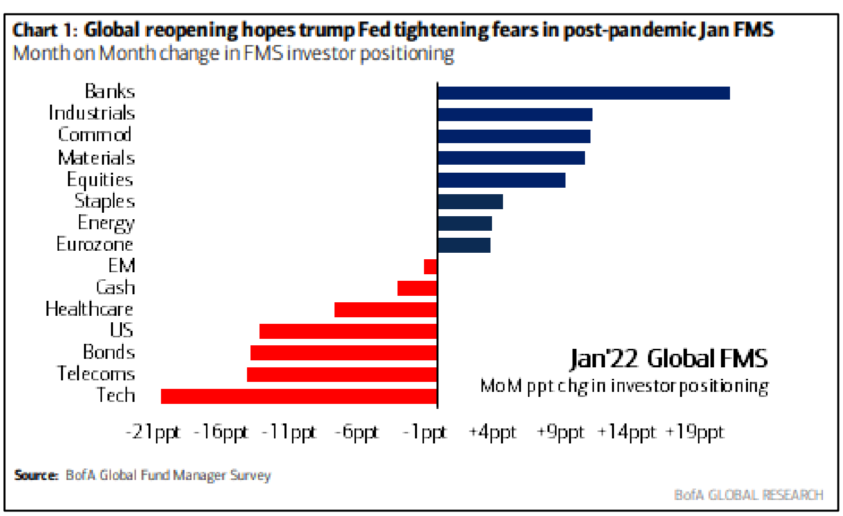
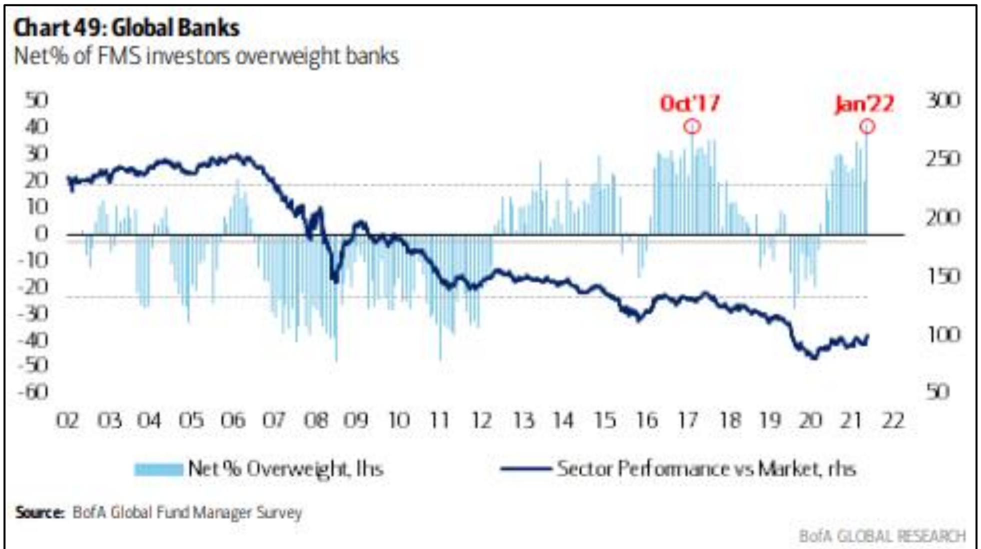
With the Fed's hiking cycle likely about to kick-off it is worth noting that we have often seen various degrees of European outperformance curing at least part of the hiking cycle. During the last cycle however, it was minor and didn't last. Did QT play a role? Certainly, global growth slowed in 2018 and capital flows came to the US as a result, and the dollar rallied. This time people are expecting continued capital flows out of expensive US "growth" as investors look for less expensive plays abroad. Watch the dollar here, as a weaker USD would help to confirm.

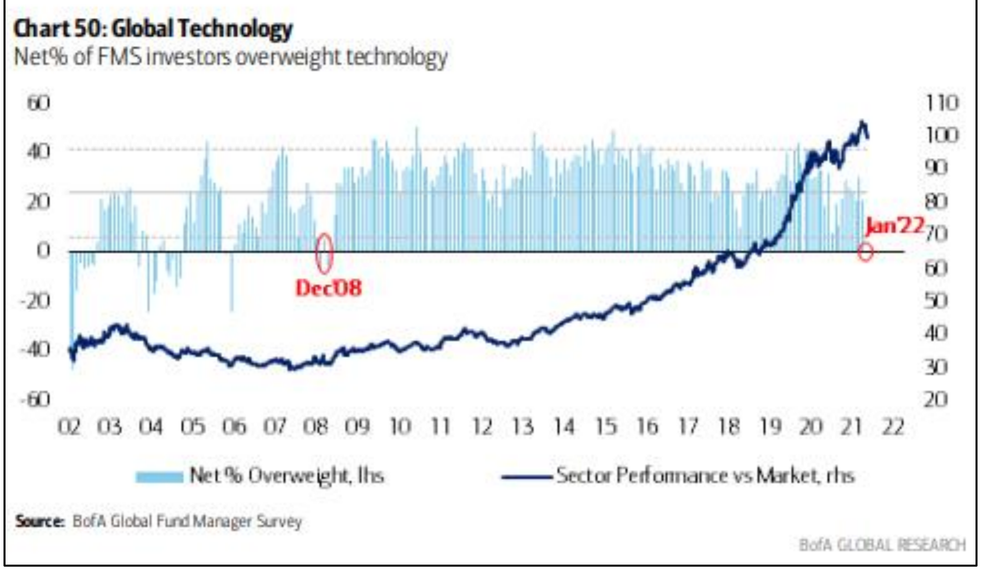


An omicron peak and the Fed tightening cycles have been getting priced via the MoM flows.



So much rotation can be tricky, especially when the stuff you are selling has such a big weighting in the indices, vs what you are buying.





I think last week we got a taste of how that can go wrong.

By the end of the week, it felt like forced liquidation, and some panic from retail that didn't want to give back last years big gains in the indices.

That does raise a question in my mind. Last year saw huge inflow into equities. Apparently more in those 12 months than in the previous 20 years, combined.

If at some point, we get a selloff that last for a bit, or a rally and then new lows, it is probably worth thinking about what the average price of all those purchases is. I'm going to guess that zone is another 2-4% from here.

Even with all the selling in the US, some EM markets barely budged. A testament to what people own. Brazil, for example, still managed to but in an up weak.

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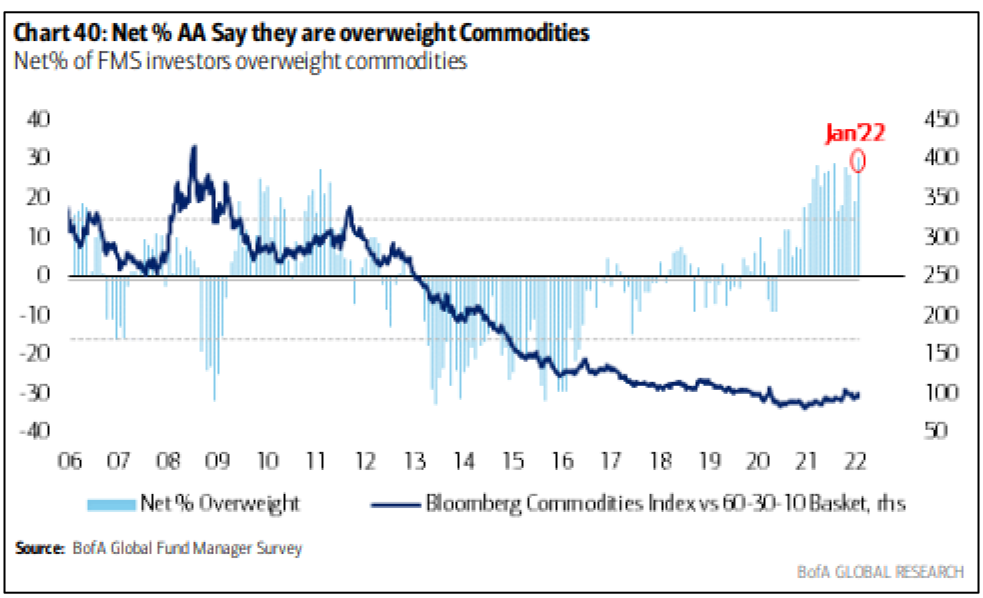
With energy a huge component in most commodity indices, most of them printed new highs last week. Last time the market was this long, was early 2011. No loss of momentum yet and seemingly good fundamental so doesn't mean it can't go more but just something to keep in mind.



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Gold, Silver, and Platinum all perked up last week despite rising real yields. It will be interesting to see if they can consolidate the gains a bit here and push on. USD weakness would of course help.

Next week the Fed looms large, but we also have global PMIs and the Bank of Canada rate decision (expected to hike). With the Ukraine situation unresolved, expect more geopolitical headlines.

Important Macro Data Releases and Events for the Week

Monday 1/24/2022	Markit Manufacturing and Service PMIs for Europe and US (Jan)
Tuesday 1/25/2022	Housing Price Data (Nov)
	Consumer Confidence (Jan)
Wednesday 1/26/2022	New Home Sales (Dec)
	BoC Interest Rate Decision and Policy Statement
	FOMC Interest Rate Decision and Policy Statement 2pm, Press Conf 2:30pm
Thursday 1/27/2022	Durable Goods Orders (Dec)
	Initial Jobless Claims
	Initial Jobless Claims 4-week average
	Continuing Jobless Claims
	GDP (Q4)
Friday 1/28/2022	Core Personal Consumption Expenditures - Price Index

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Michigan Consumer Sentiment (Jan)

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