Stargazer
Asset Management

What to focus on in Global Macro for the week of December 13th, 2021

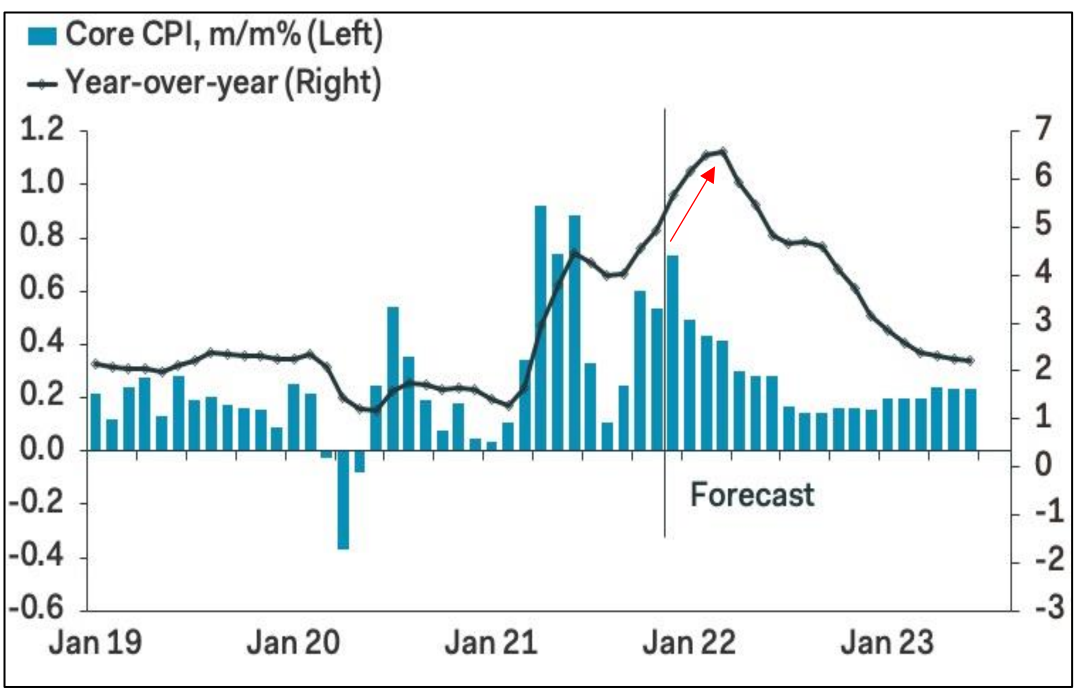
Macro Themes on the Radar:

This week, we have a number of central banks meeting to decide on monetary policy going forward. The Fed is by far the most important. With three hikes now largely priced for 2022 it will be interesting what the dot plot in the Fed's projections looks like. With a likely speeding of taper to be announced this week, the market will be very focused on when the first hike is likely to occur and how aggressive subsequent hikes are likely to be. So far, the market has looked through any renewed COVID fears as well as what looks to be an increasingly uncomfortable Fed. The Fed's dual mandate, even under flexible inflation targeting, increasingly looks fulfilled.

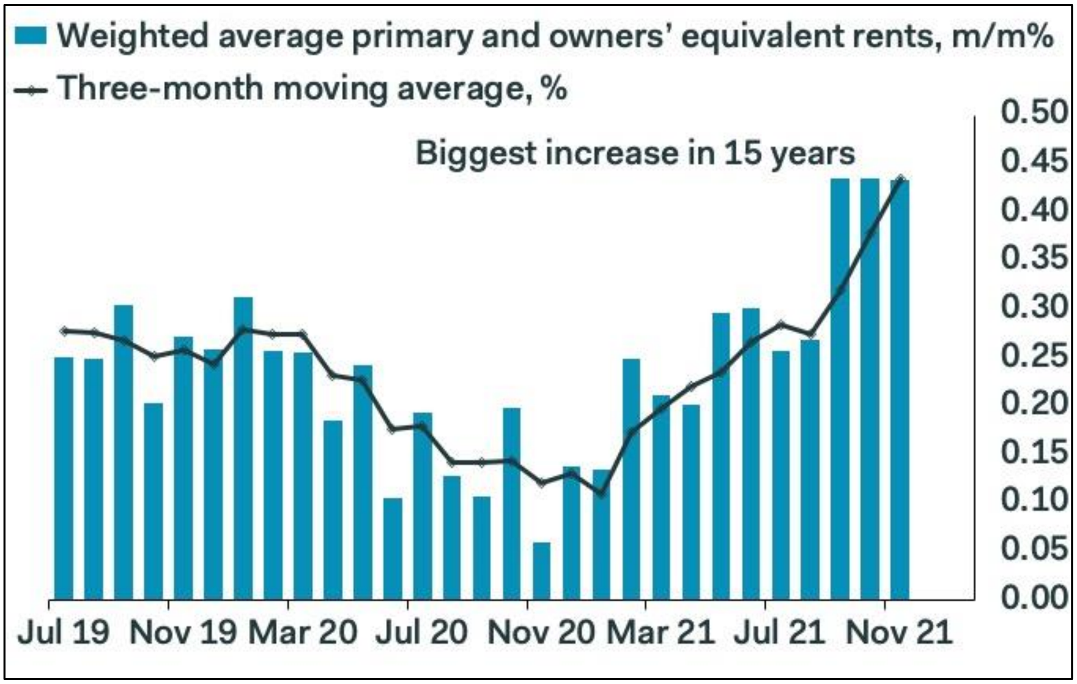
Last week's US inflation data realized the already high expectations but didn't deliver any further surprises. With the big numbers already priced, the market took the numbers in stride.

The current 6.8% headline rate is now the highest since 1982. However, it is likely close to peaking for the time being. How much it comes off is the big question.

The core inflation rate, however, is likely to rise further, and of course that is the one policy makers are focused on. Used car prices, airline fares, and lodging costs may have only deferred larger increases still to come. Primary and owner equivalent rents still look like they have upside built in, that is yet to be realized in the numbers. Some analysts think core inflation won't peak until February or March, at an eye-popping 6.5-7%. That potential further jump explains the Fed's hawkish pivot in recent weeks.



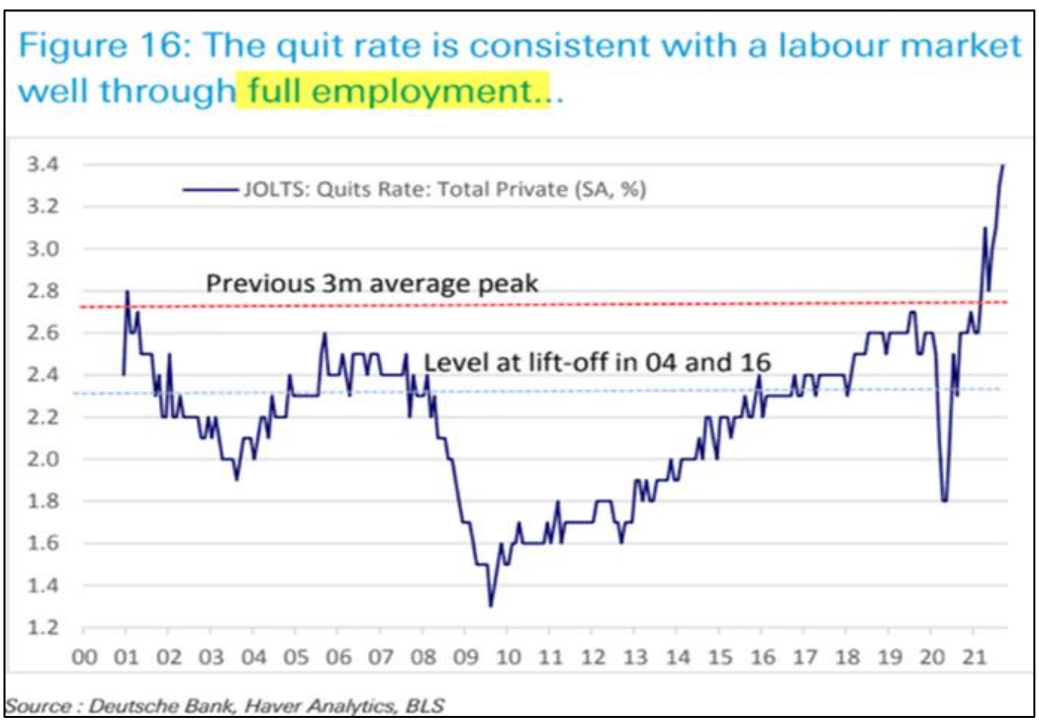
Source: Pantheon Macro



Source: Pantheon Macro

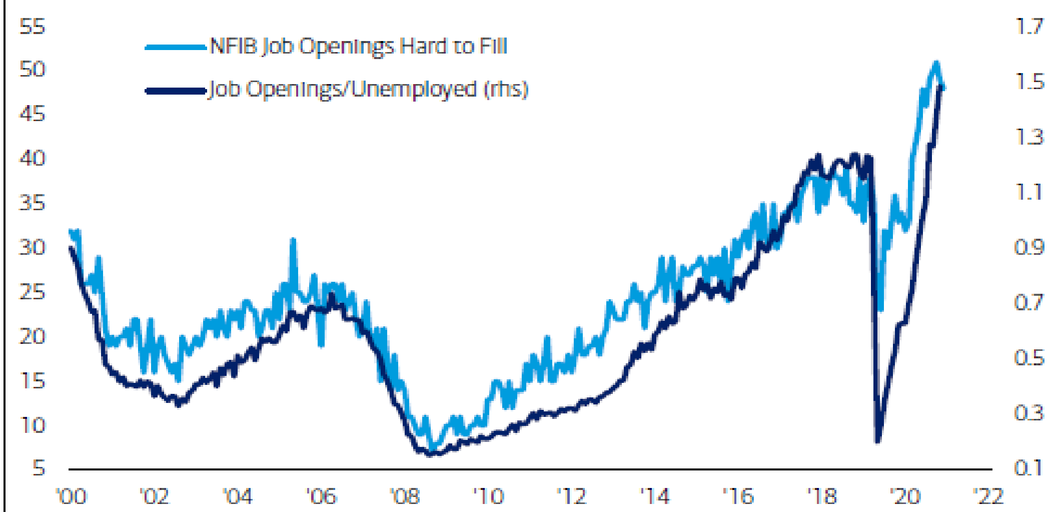
On the employment side of the mandate, there are now 11 mln outstanding job openings.

The quit rate, which continues to rise, correlates well with wages, and as such, is a good measure of labor market slack.



The U3 Unemployment Rate has fallen to 4.3% now, now just below the average for the five years preceding the pandemic. There are now 1.5 jobs available for every person that lost a job during the pandemic.

Chart 9: Labor market overheating
NFIB Job Openings Hard to Fill vs Job Openings/Unemployed

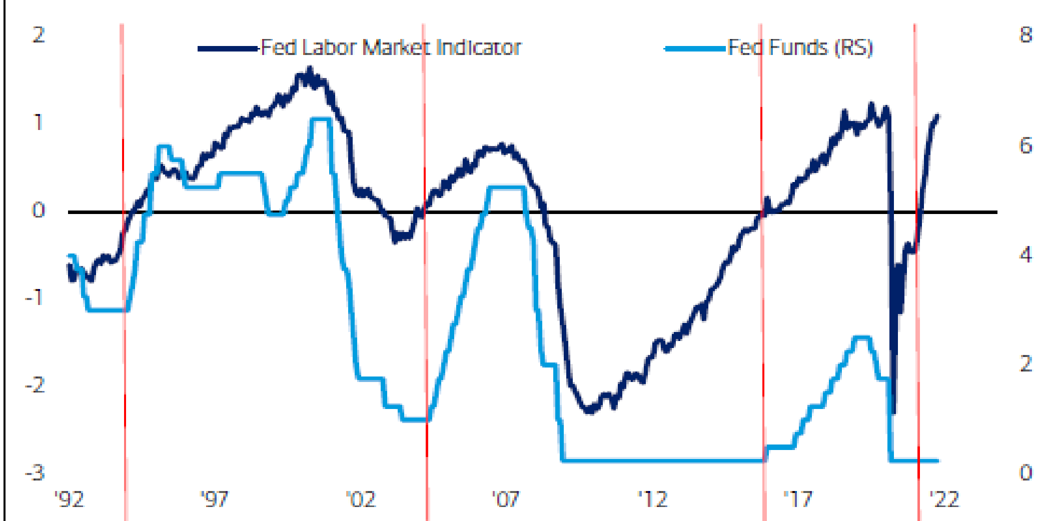


Source: BofA Global Investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

Even with the AIT framework delaying tightening, it is probably time.

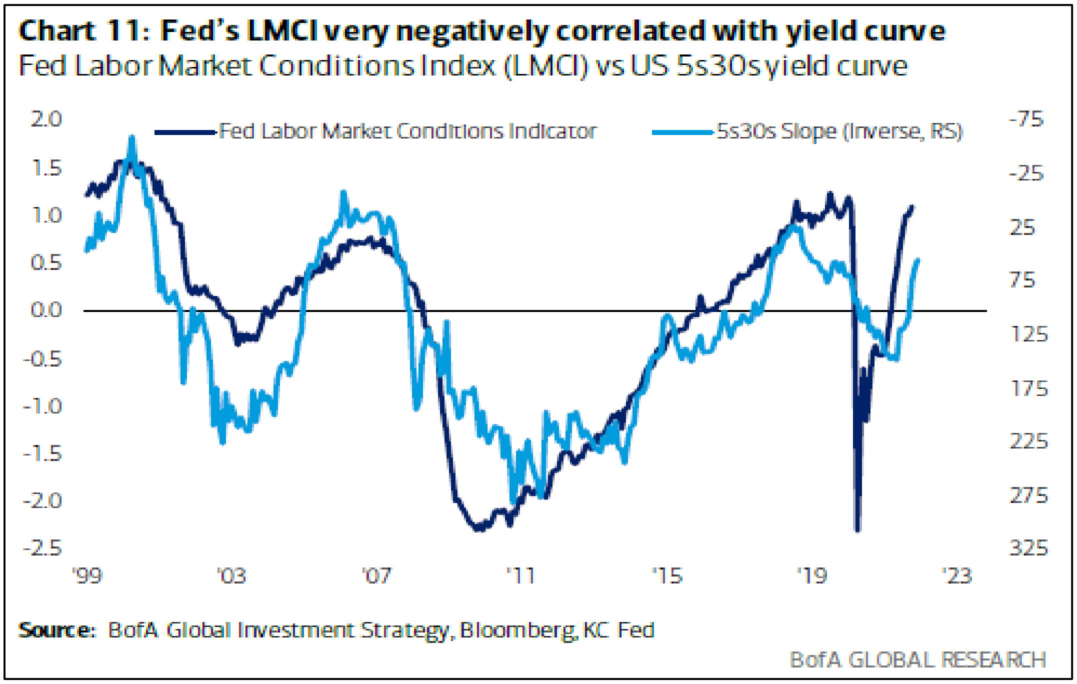
Chart 10: Fed's Labor Market Conditions Index near 20-year high
Fed Labor Market Conditions Index (LMCI) vs Fed Funds



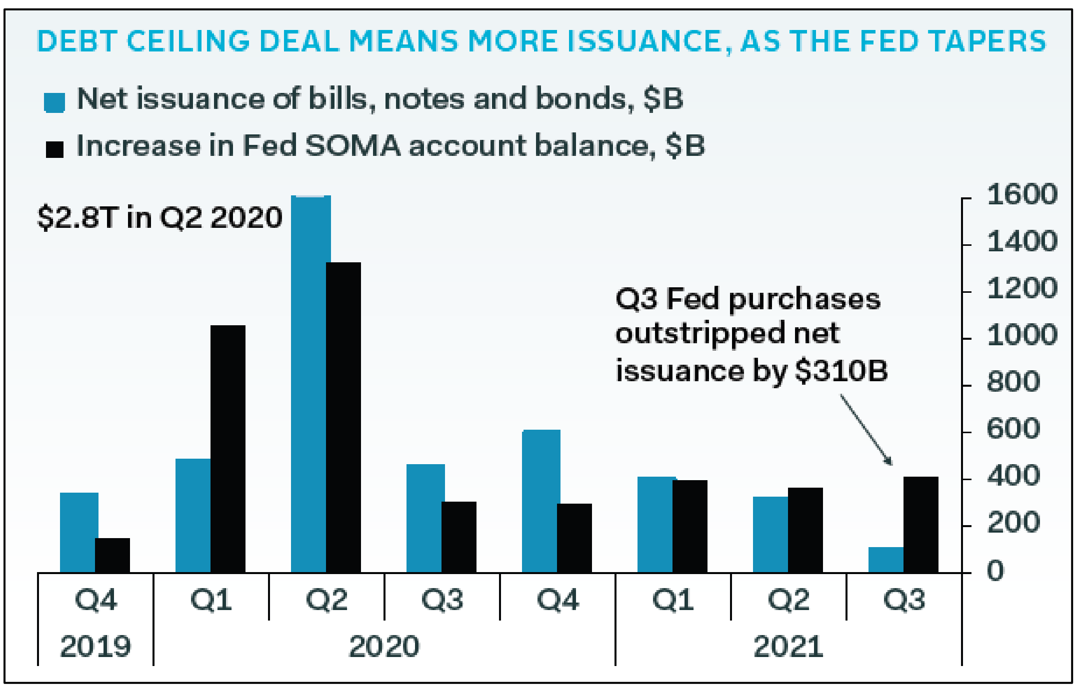
Source: BofA Global Investment Strategy, Bloomberg, KC Fed

BofA GLOBAL RESEARCH

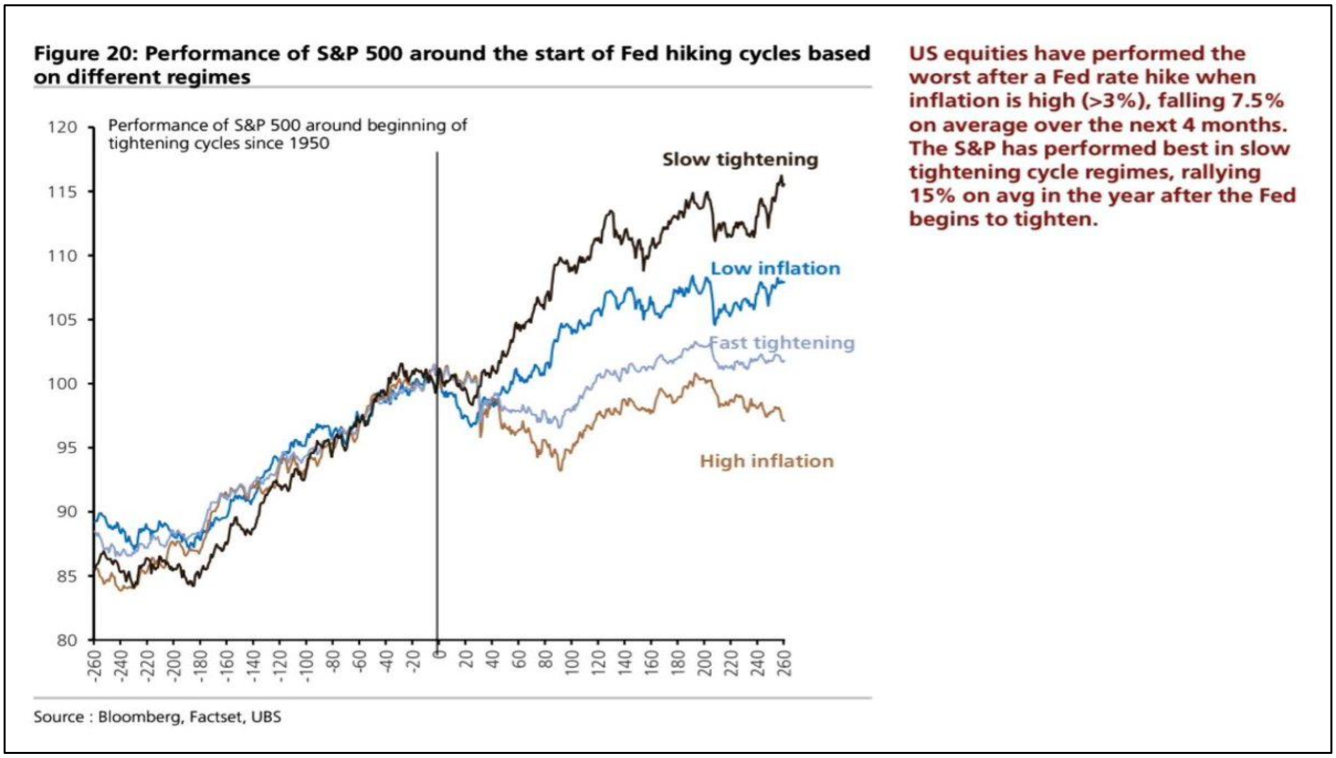
The curve sees it coming.



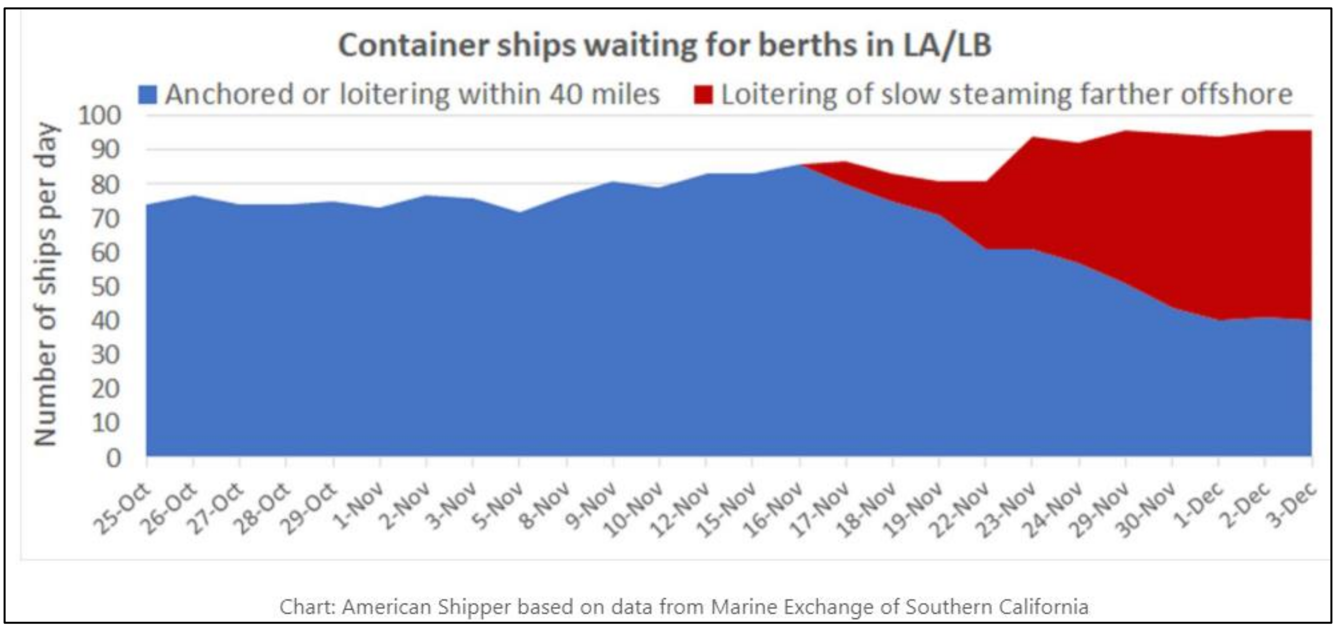
So far, the front end had been doing a lot of lifting (with higher rates) but the long end hasn't even tried to push up yields. We will see if the end of QE while issuance picks up, makes a difference. Remember, in the third quarter the Fed bought four times the net issuance of all bills, notes, and bonds. With the debt-ceiling deal, issuance is set to jump as Fed buying slows/ends.



Will it matter? If not, the market will get increasingly concerned about a quickly flattening curve, with a long-end unable to hold its own. With the first hike potentially already in May, into a high inflation environment, this is an interesting chart. Note, -30 and +60 days around the first hike.



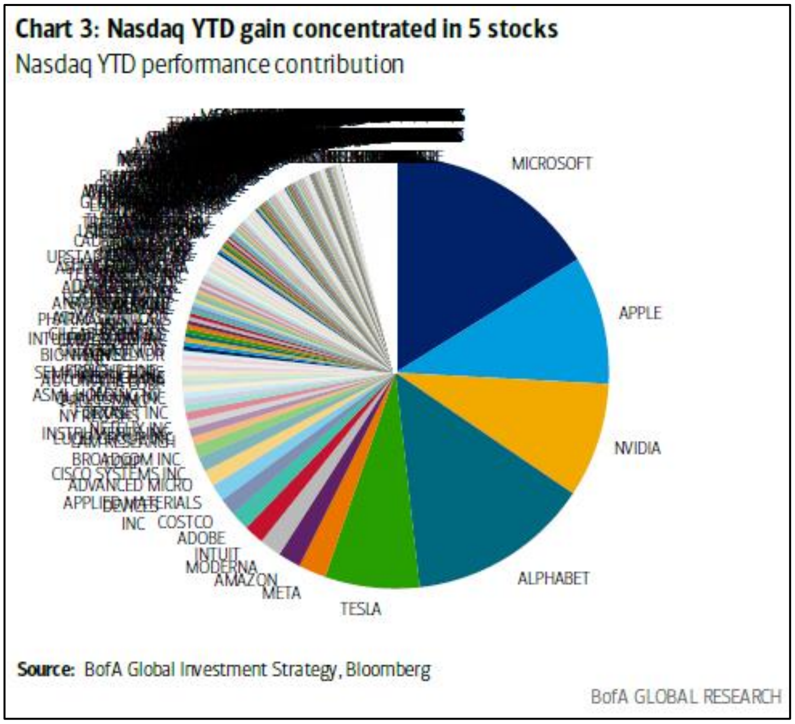
Bottlenecks update – Waiting ships in LA and LB have been falling, which is potentially good news, but some of that is attributable to ships slowing and staggering their approach. [WSJ]



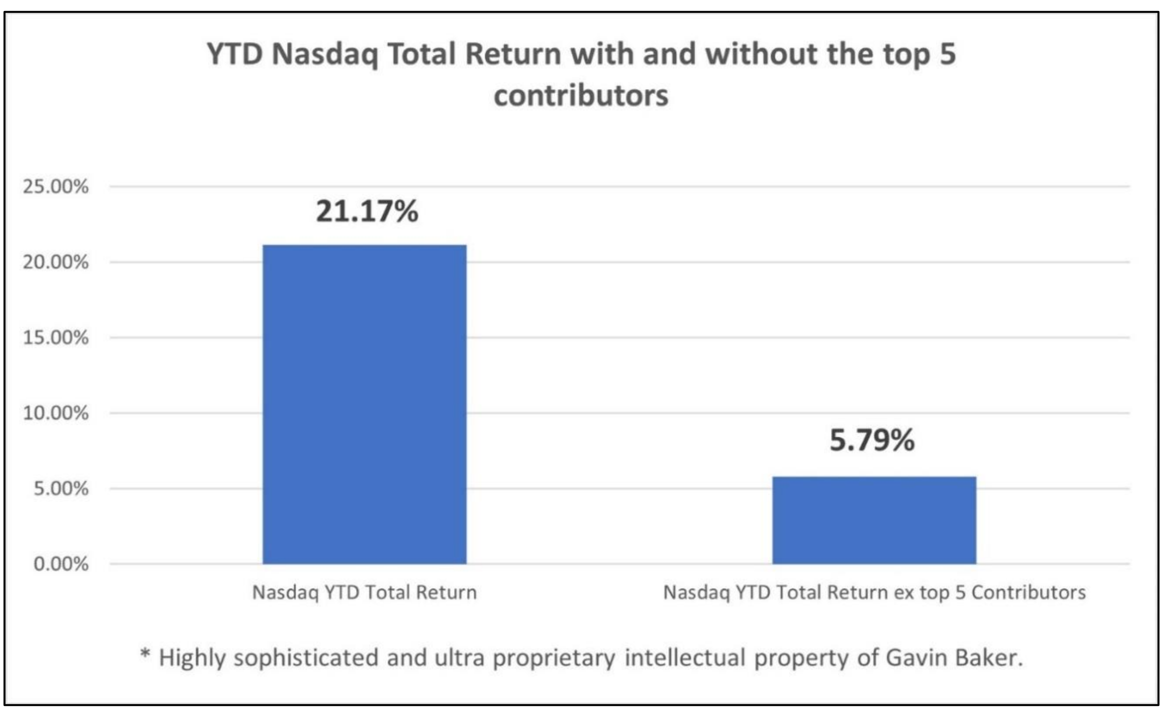
<u>What to Focus on Now:</u>

Equities

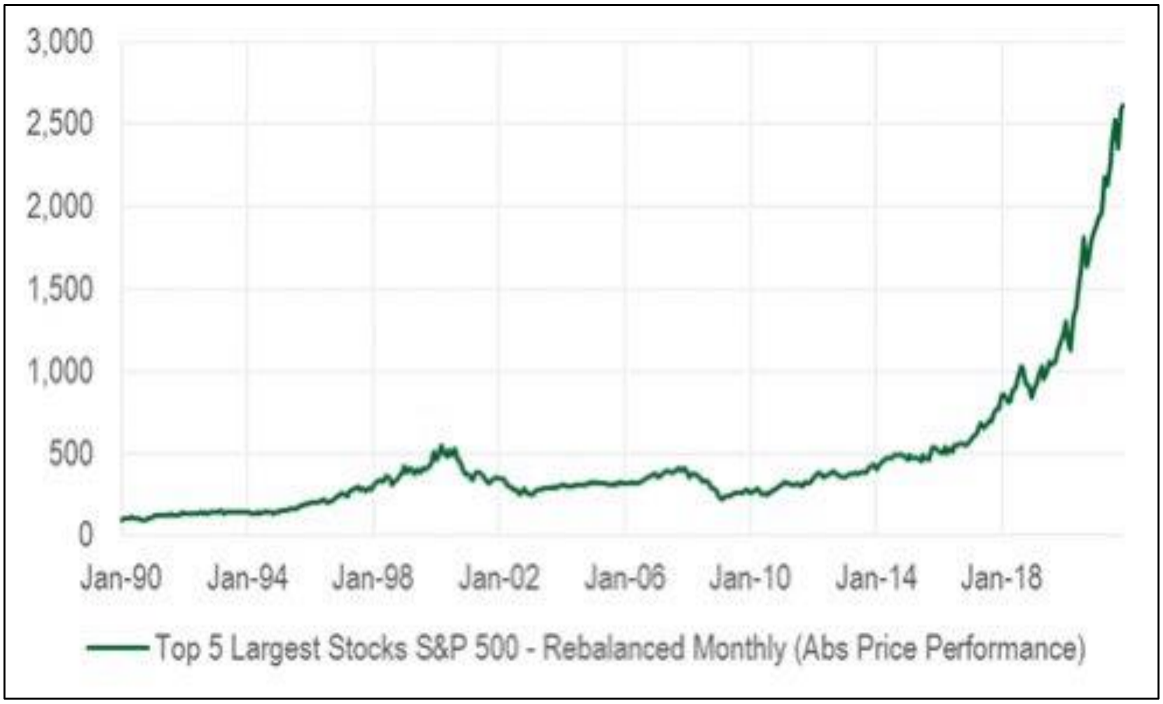
US large cap tech is still king.



Prices have been moving fast, but as of early last week, this was the spread. With and without.

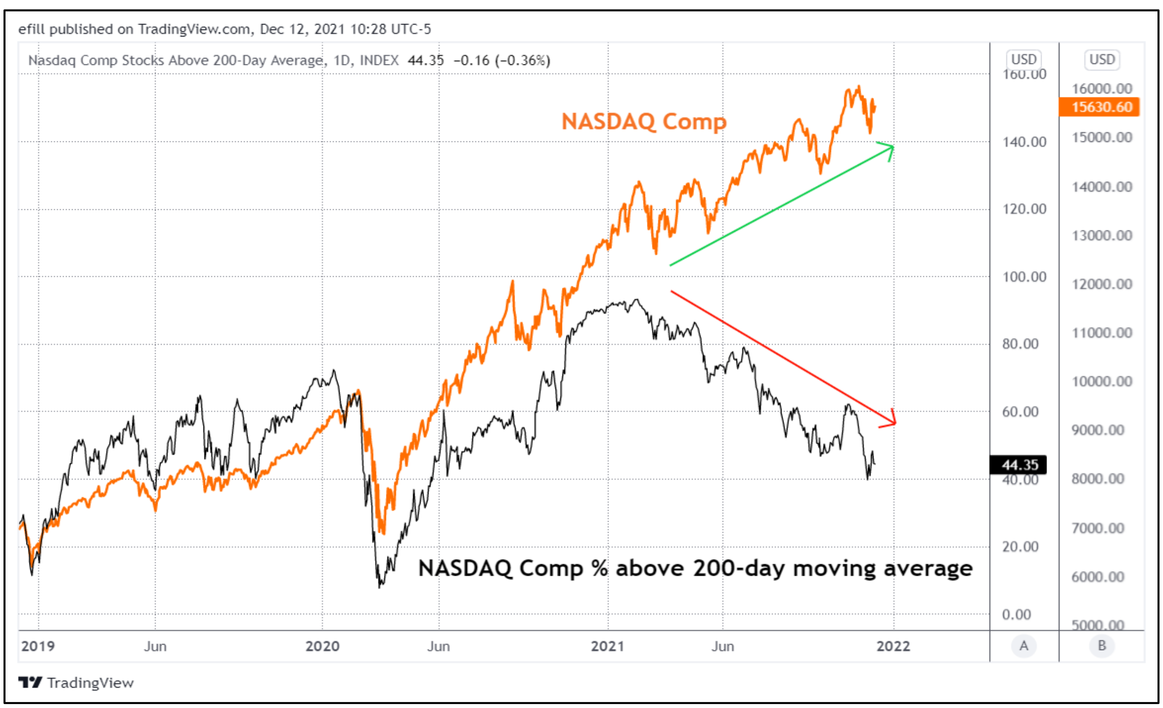


What it looks like if you just held the top 5 largest stocks, and rebalancing monthly.

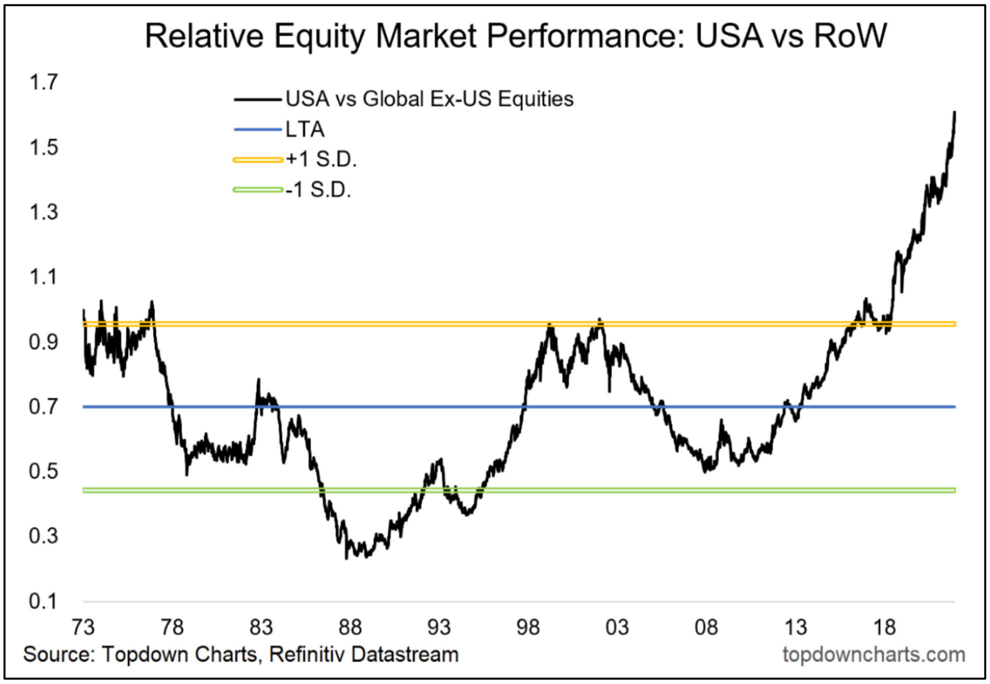


Source: Cornerstone Macro

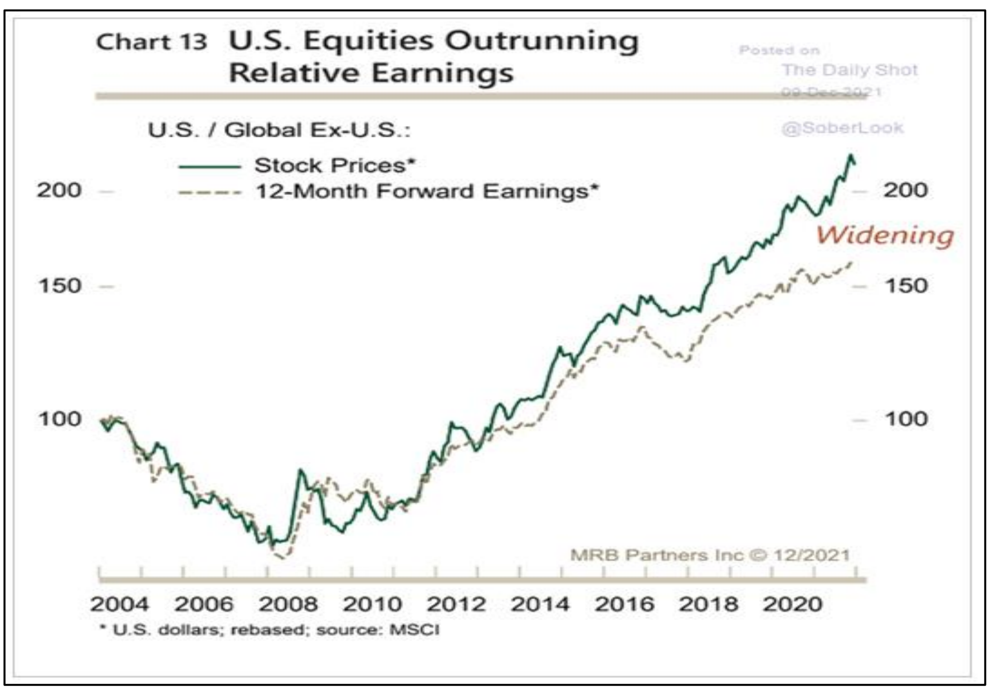
The degree of narrowness has become astounding in resent months.



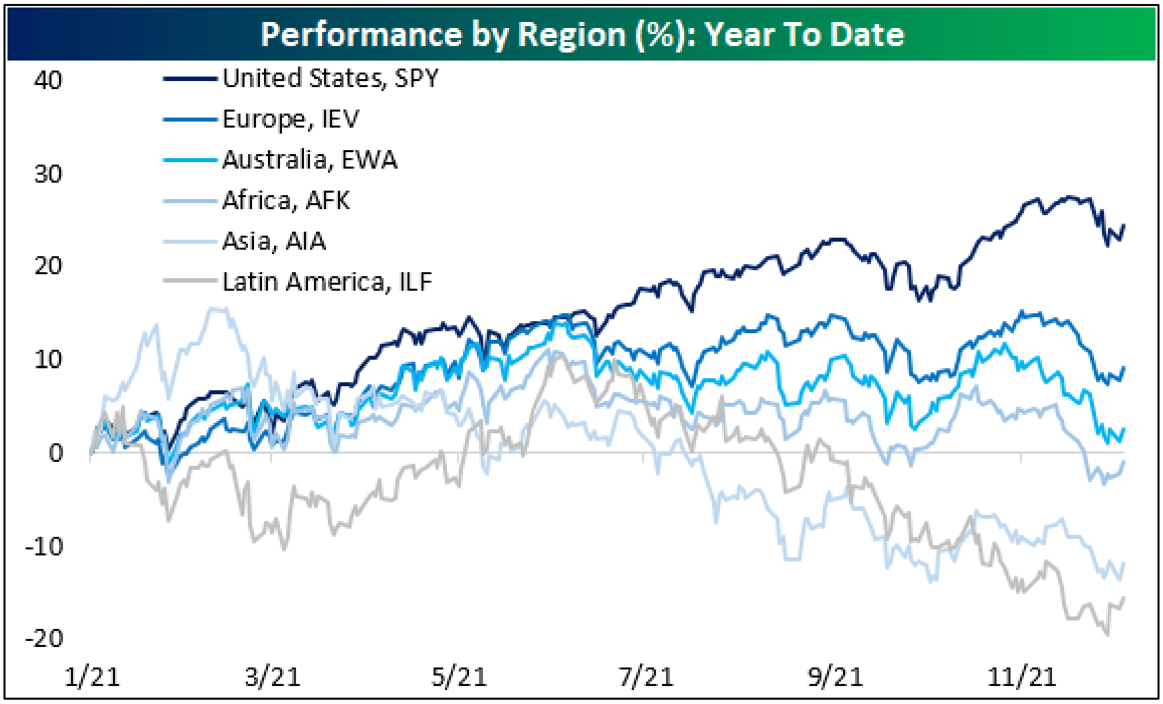
Of course, the US large cap dominance and the resulting narrowness of the rally continues to have global ramifications as well.



Equity price outperformance has largely been the result of earnings outperformance. However, in recent years, price outperformance has taken on a life of its own. This chart shows US share price outperformance relative to the rest of the world vs. US earnings outperformance.



A snapshot of YTD relative global performance.



Source: Bespoke Investment Group

Everyone remains eager for the global "value" trade. However, as mentioned last week, there still isn't much to report in terms of a shift in relative performance. Europe, not so much…

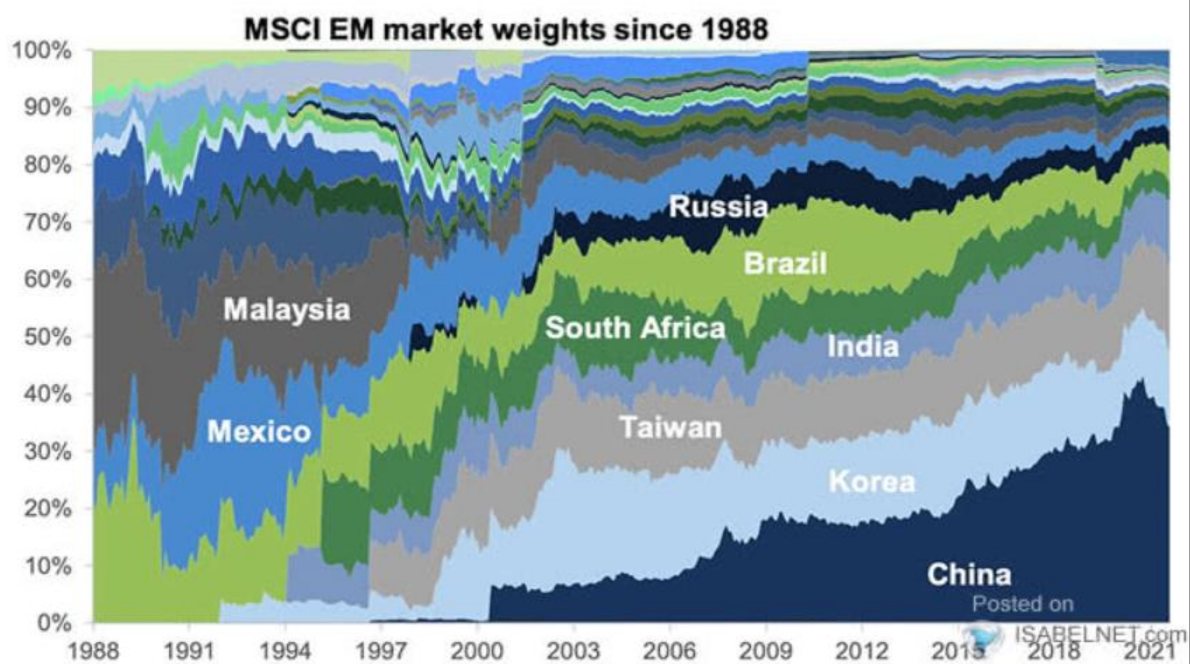
As mentioned previously, the market remains underweight EM but bullish… a situation likely to be resolved by a violent price move, one way or the other.

A recent JPM note ticked off their reasons for being bullish EM as follows:

- *Bad news is priced in (China slowdown, CB tightening, inflation, currency weakness and continued COVID headwinds)*
- *EM valuations are cheap and trade at a wider than historical discount to DM*
- *Expect the phase-out of US exceptionalism and convergence of the EM growth, valuation multiple, and reopening differentials vs. DM*
- *Constructive on China equities*
- *EM remains under-owned by global investors*

The China bit is key, as China has not only become a larger player in global GDP but also in its direct weighting and via its regional influence.

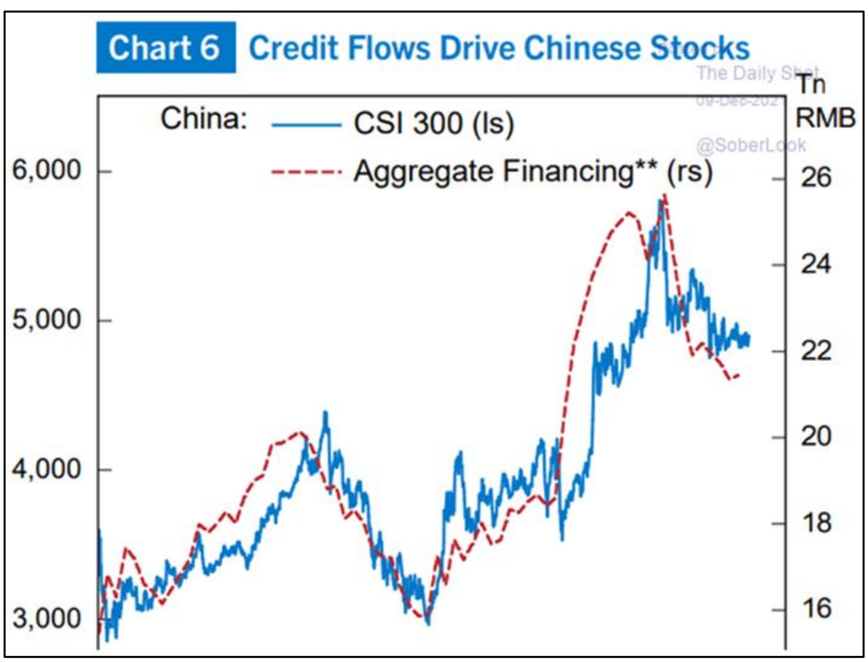
Exhibit 1: The weight of China in MSCI EM doubled over the past five years from about 20% in 2015 to a peak of 43% in 4Q last year



Source: FactSet, MSCI, Goldman Sachs Global Investment Research

With the recent RRR cut by the PBoC on the heels of deteriorating property sector issues (Evergrande USD default), the markets have come to the conclusion that the PBoC is engaged rather than ignoring a potential crisis. There is also a growing feeling that although the easing may not be the start of a cycle, it is part of a concerted effort that will include an increase in infrastructure spending in the coming months.

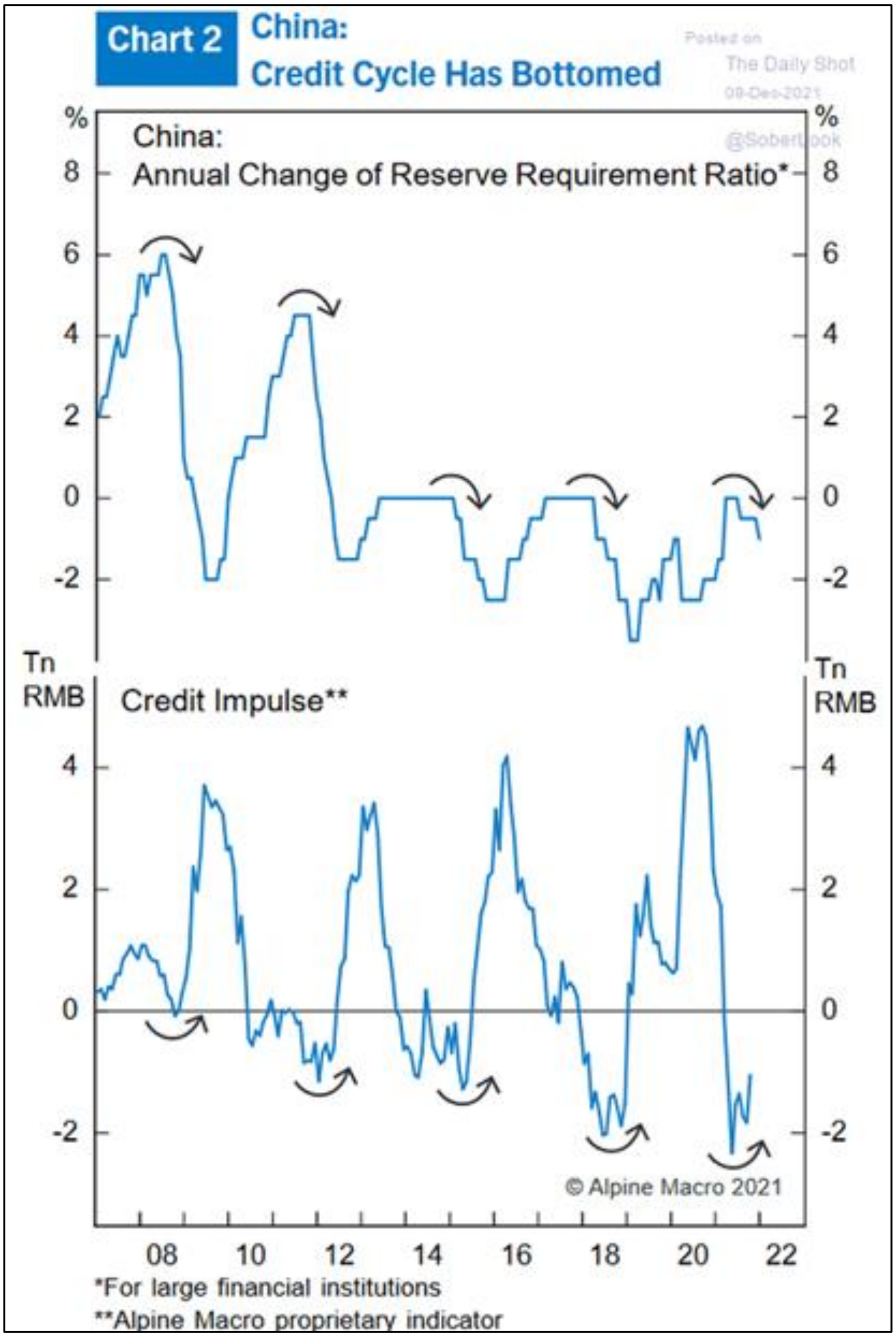
If EM is to be a winner in 2022, it will need to include Chinese equities. YTD, they have been big laggards.



There has tended to be a strong correlation between PBoC rate policy and credit availability and Chinese equities.

We will see if hopes for a credit revival are met, given Chinese reluctance to allow increased economic leverage, as they have been trying to achieve exactly the opposite.

Usually, RRR cuts have been part of a cycle, not one-offs, but the PBoC has tried to downplay that potential this time. Will the usual credit cycle be kicked off? Less likely this time around I would argue but could still be the case, even if the magnitude is somewhat diminished.



Source: Alpine Macro

In either case, Chinese equities may be starting to take notice.

The Yuan has been a dramatic outperformer in FX, largely due to the large trade surplus.

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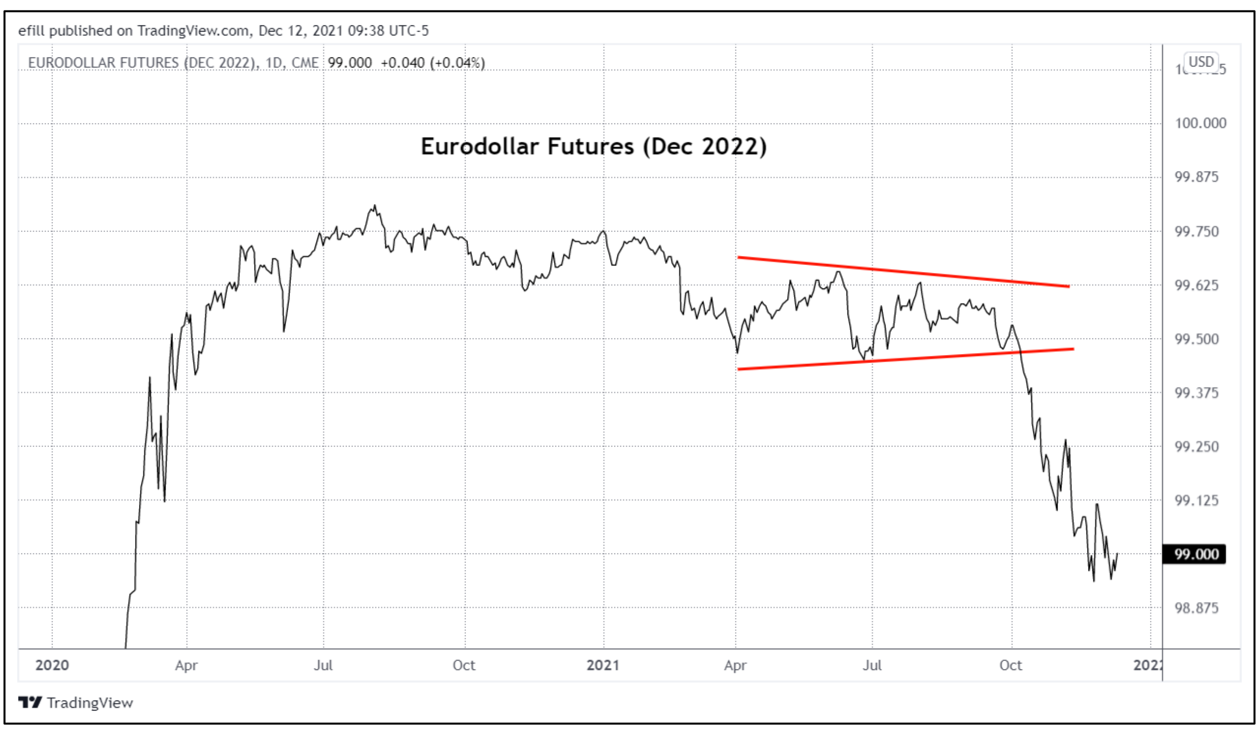
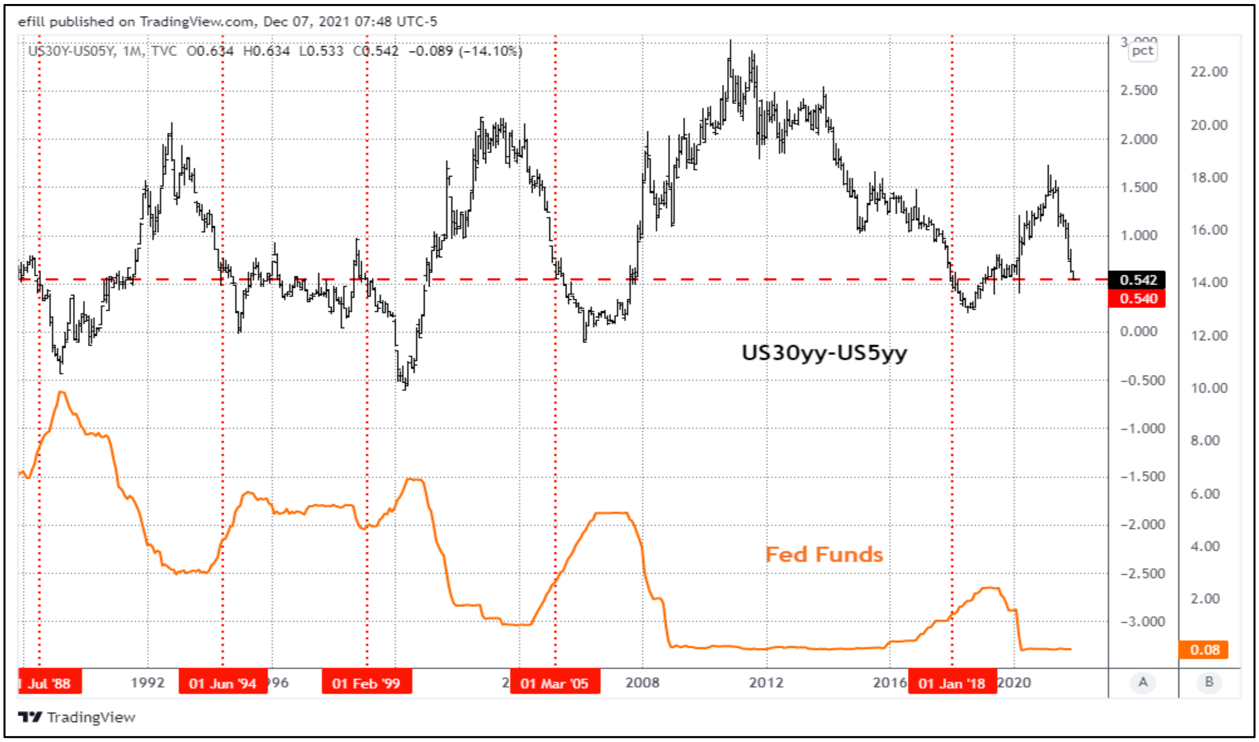
EM has certainly struggled on a relative basis. We will see if these developments are enough to turn the trend in any meaningful way. Some USD weakening would help the sector, especially in the other big weightings like BRL, INR, and ZAR.

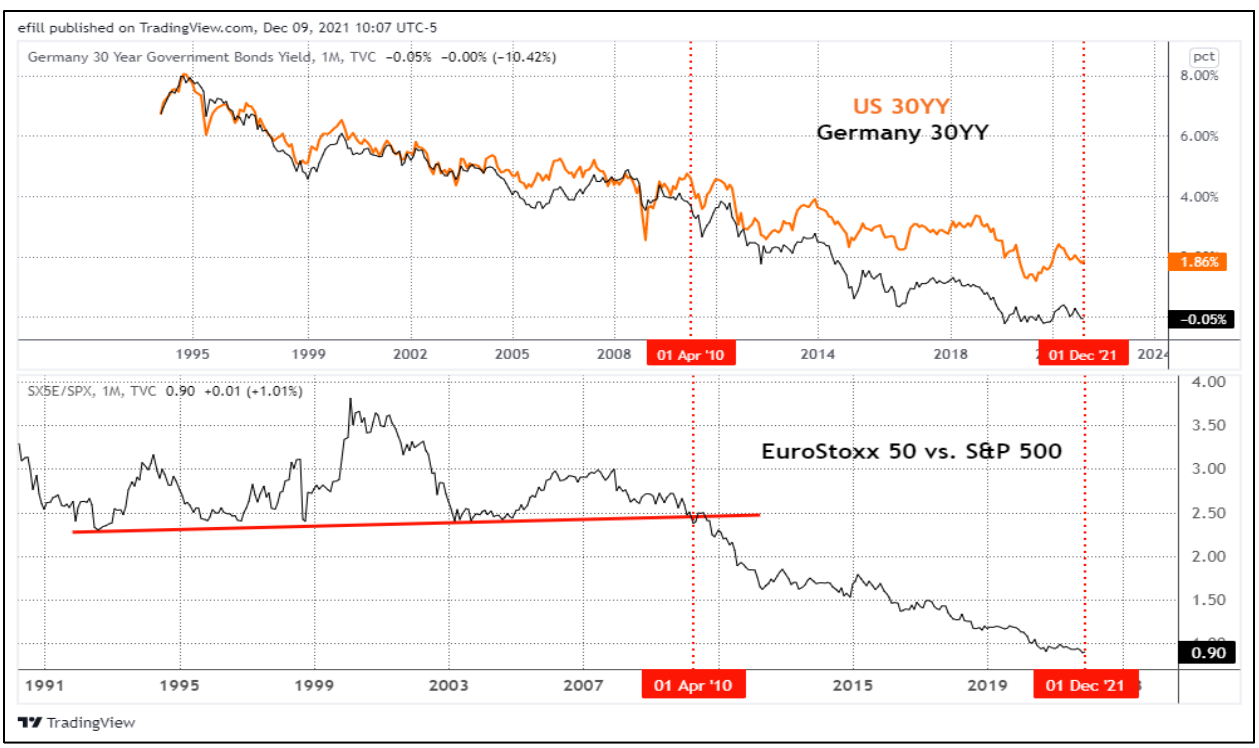
Fixed Income - Three Fed hikes next year are already priced…



Again, this amount of flattening is unusual given that hikes have not yet started.

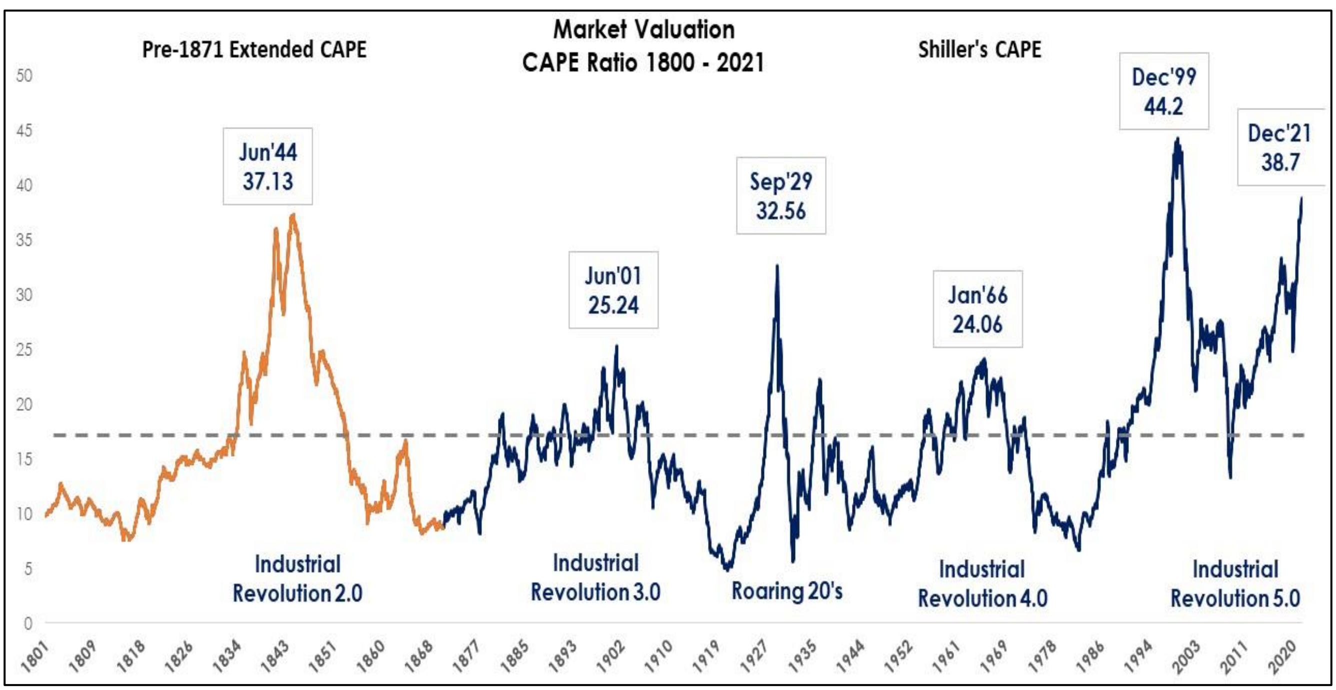


While unrelated, I thought this was an interesting one… German and US yields diverged as European equities began to really underperform the US. Lower interest rates don't always mean higher equities, sometimes they just mean less growth and weaker earnings.



FX - After a 30% increase in M2 (much larger than other countries/regions) and $2Trl of QE from the Fed, the USD is back where it started.

Bonus Chart



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Although the Fed the only one expected to make any changes (via faster taper of QE), next week is all about central bank decisions with the Fed, ECB, BoJ, BoE, and SNB all on the docket.

Important Macro Data Releases and Events for the Week

Monday 12/13/2021	Industrial Production and Capacity Utilization (Oct)
Tuesday 12/14/2021	Industrial Production (Oct)
	Producer Price Action (Nov)
	Industrial Production and Retail Sales (Nov)
Wednesday 12/15/2021	CPI across Europe (Nov)
	Retail Sales (Nov)
	BoC CPI (Nov)
	Fed Interest Rate Decision, Policy Statement and Press Conference
Thursday 12/16/2021	Markit PMIs across Europe - Prel (Dec)
	SNB Interest Rate Decision and Policy Statement
	BoE Interest Rate Decision and Policy Statement
	ECB Interest Rate Decision, Policy Statement and Press Conference
	Philadelphia Fed Manufacturing Survey (Dec)
	Markit PMIs (Dec)
	Initial Jobless Claims
	BoJ Interest Rate Decision, Policy Statement and Press Conference

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Friday
12/17/2021

CPI (Nov)

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