What to focus on in Global Macro for the week of December 20th, 2021

Macro Themes on the Radar:

Last week was a busy one for global central banks. The Fed, ECB, BoE, and BoJ all met, and all continued the process of slowing or reversing monetary accommodation. As the tsunami of central bank liquidity starts to subside, it will be interesting to see how markets react. I continue to expect more volatility. First, in asset markets as global QE is reduced, then, in the real economy as rate hikes progress.

As always, the Fed plays an important role given its position at the helm of the worlds reserve currency.

Fed Meeting and key take-aways:

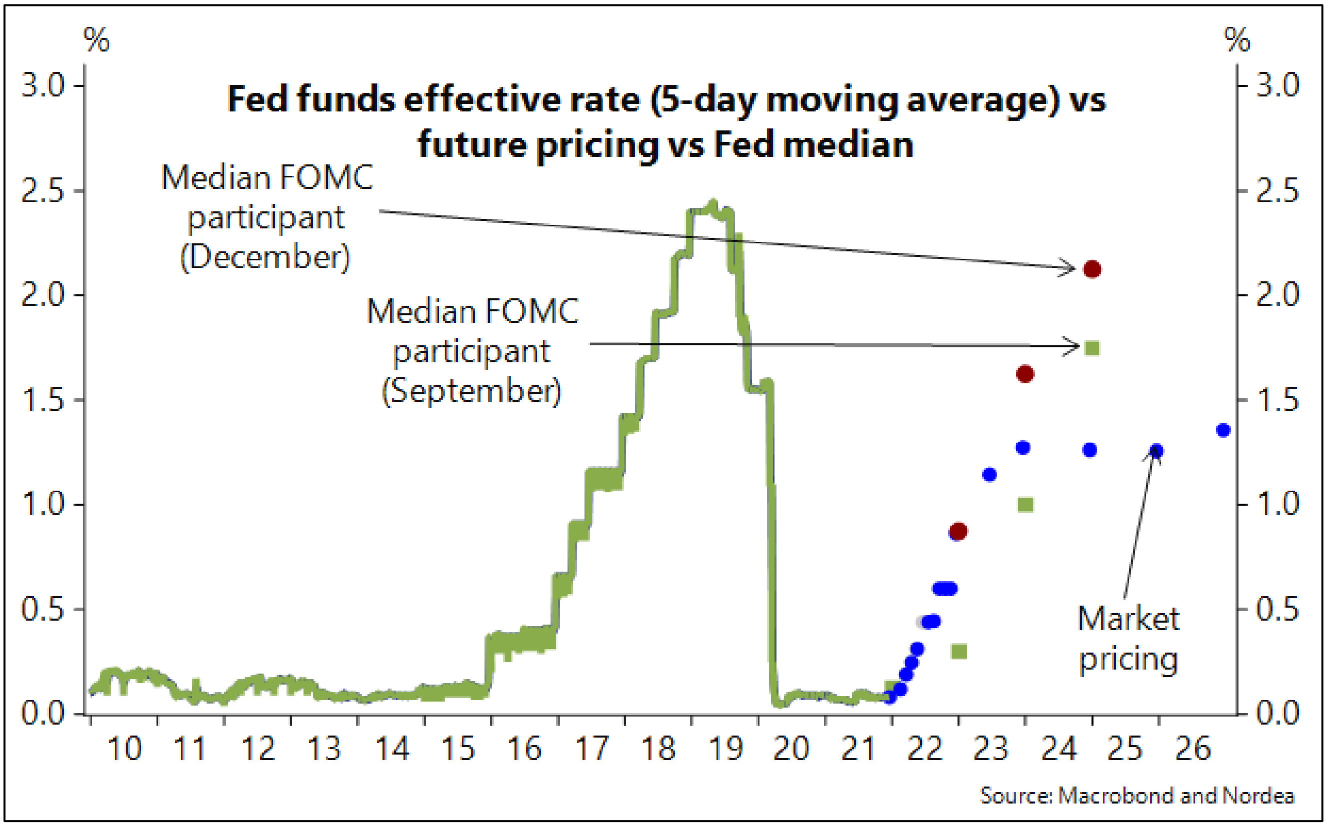
"There's a real risk now, I believe, that inflation may be more persistent and … the risk of higher inflation becoming entrenched has increased" – Jay Powell, Federal Reserve Chair

- They have switched from "transitory" to "persistent" when discussing inflation
- With the faster taper, QE will end in mid-March
- Fed almost went to this pace of taper at the November meeting but held off fearing it would roil markets
- Fed's members (via dot plot) caught up with market expectations for 3 hikes next year. The big disconnect however is that the Fed expects a neutral Fed Funds rate of 2.5% while the market only thinks it will get to 1.5%
- Fed now sees US as very close to or at full employment
- There won't be much of a pause between the end of QE and the first rate hike
- Each successive wave of COVID has had less economic impact and Powell expects that to again be the case. Won't affect QE taper either way

- They are sticking to the idea of being reactive to data rather than acting on forecasts. This is part of the new framework they have adopted, and to me means that they will increasingly be a source of volatility as they will always be playing catch-up and then dealing with the "long and variable lags" associated with monetary policy.

- When asked if the current low yields on long-end Treasuries were worrisome given the curve flattening, Powell suggested that US long-end yields were primarily low because of low competing sovereign yields. In other words, the Eurozone and Japan are holding down the US yields, as people seek better returns. He acknowledged there might also be some built in view on behalf of the market regarding what the neutral rate will be. Remember, the Fed now sees the terminal Fed Funds rate at 2.5%, while the market is pricing it at 1.5%. (Some would argue this implies that the market doesn't think the economy would be able to stomach rates above 1.5%, maybe due to high debt levels at home and abroad). Will the market have to move up, or the Fed move down?

Markets are pricing a fast start, but only a short cycle.



Don't forget that QE has historically tended to push up yields, while taper and the suspension of QE has tended to push down yields.

The dollar has broadly tended to fall during QE, and rally as it ends.

Equity vol has tended to rise as QE ends.

The COVID crisis and response has made the current period extraordinary in terms of the fiscal spending, bottlenecks and shortages, and the inflationary outcome that have resulted. However, don't expect the reduced stimulus not to shake up the status quo.

ECB

Unlike the Fed and the BoE, the ECB took the most dovish path possible, delivering a slow taper of their own.

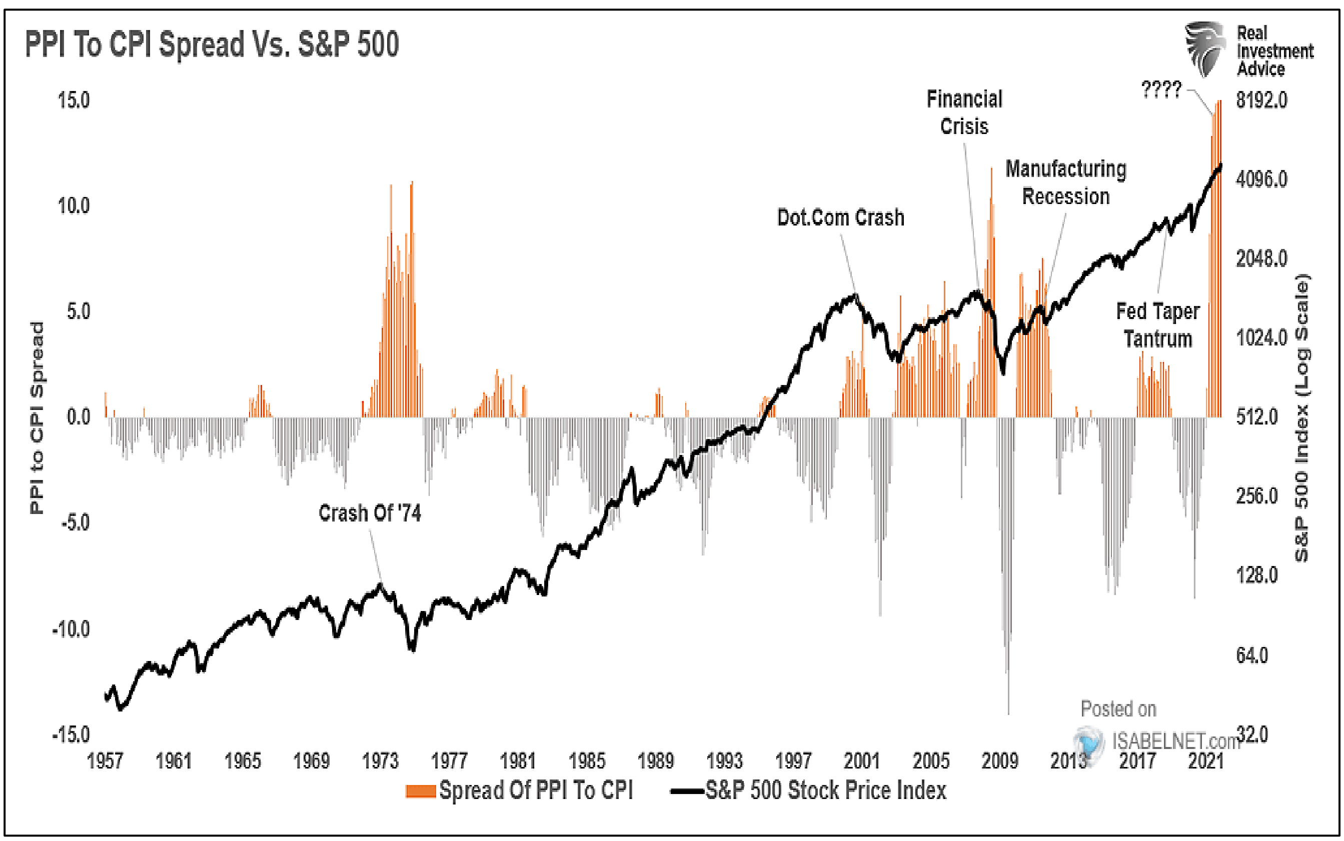
They expect to be back to the pre-pandemic pace of net asset purchases by the end of next year. A rate hike is not expected until the end of 2023 at the earliest. In addition, the expiring PEPP could be restarted at any time if needed to augment the continuing Asset Purchase Program. The madness continues as German 30-year bonds still trade -0.05%!

Regarding inflation:

It is broadly thought that PPI is now close to a peak, but that CPI has room to continue moving higher over the coming months, possibly only topping in February or March. That would certainly keep the pressure on the Fed and could put the March meeting in play.

Here is next year's FOMC meeting schedule: January 25-26, **March 15-16, May 3-4** June 14-15, July 26-27, September 20-21, November 1-2, December 13-14

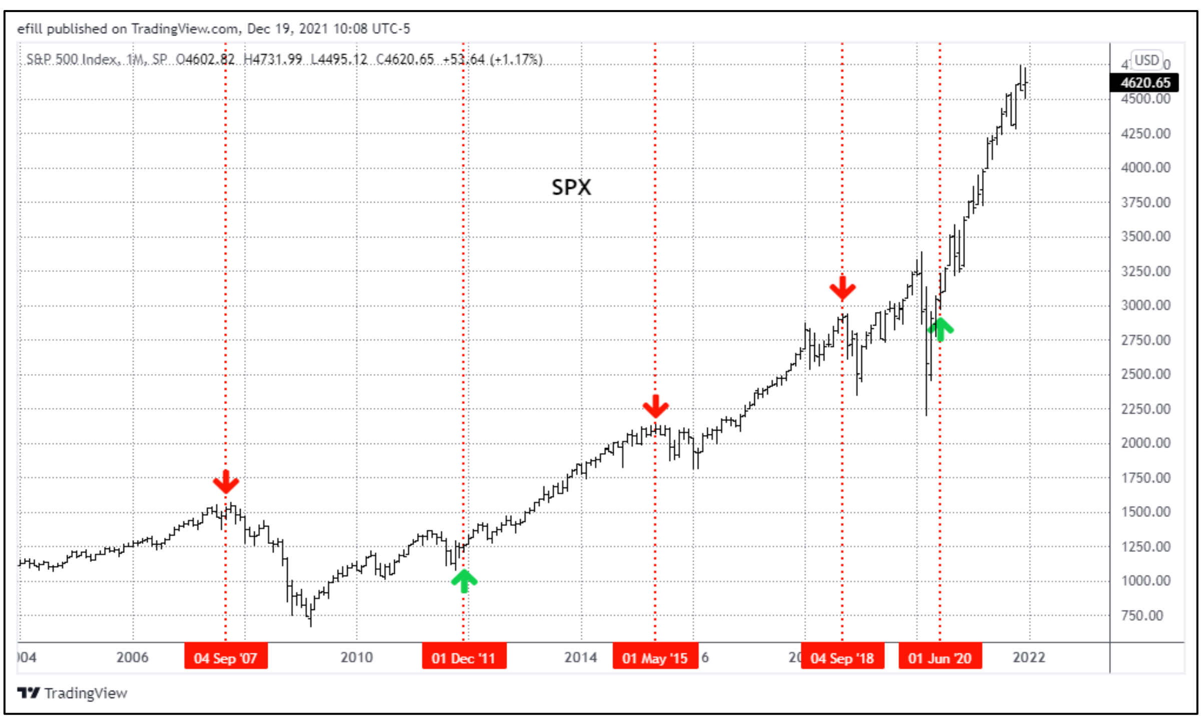
I thought this chart was an interesting way to look at how a fast inflation increase can lead to a wide spread between PPI (leads) and CPI (lags) and how that can be destabilizing.



What to Focus on Now:

With all the talk about how narrow the market is, I thought this was an interesting chart (GS).

Below I have marked the low breadth extremes they highlight. It does seem to produce some interesting turning points from which the market either finds new leadership or turns down.



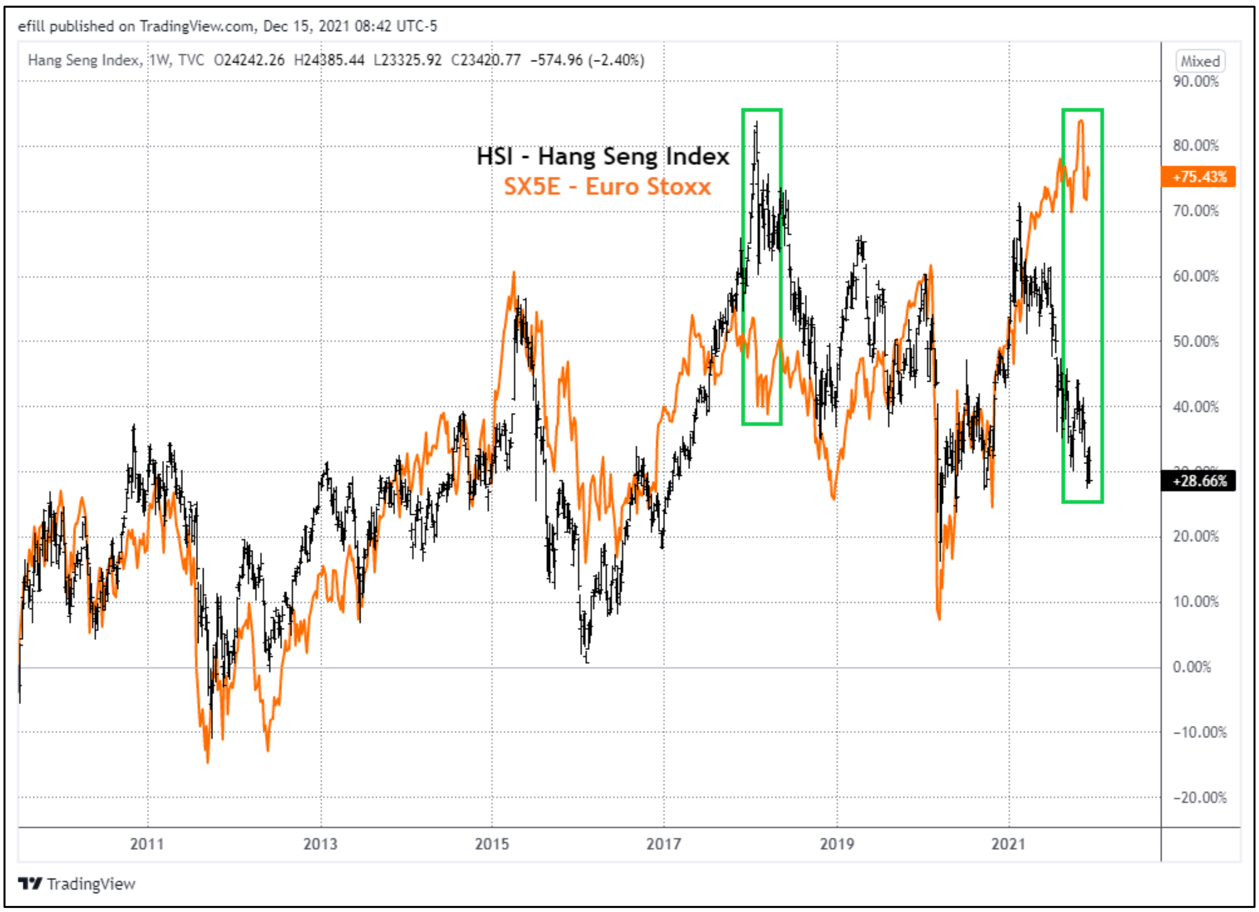
Given last week's weakness in the tech leadership, the timing for the shift looks like it might have arrived.

We will see if this is just a relative performance pause or a turn.

China continues to be a concern as the mix of COVID pressures, tech crackdown and real estate sector credit concerns have not yet been actively counteracted by PBoC or government fiscal support. As China continued to attempt broader deleveraging, they are only providing the minimum support as they try to walk the line between supporting the economy while not actively reigniting speculation that could push leverage back up.

HK listed shares have taken the brunt of these policies. Historically, there has been good correlation between the Hang Send and European equities.

Over time, big directional divergences tend to close. Does COVID muddy this relationship as it has with many others? Is the current policy mix in China such an outlier that it breaks the previous relationship? Maybe, but I suspect the link has always been via global growth, so it isn't clear to me that that has changed.



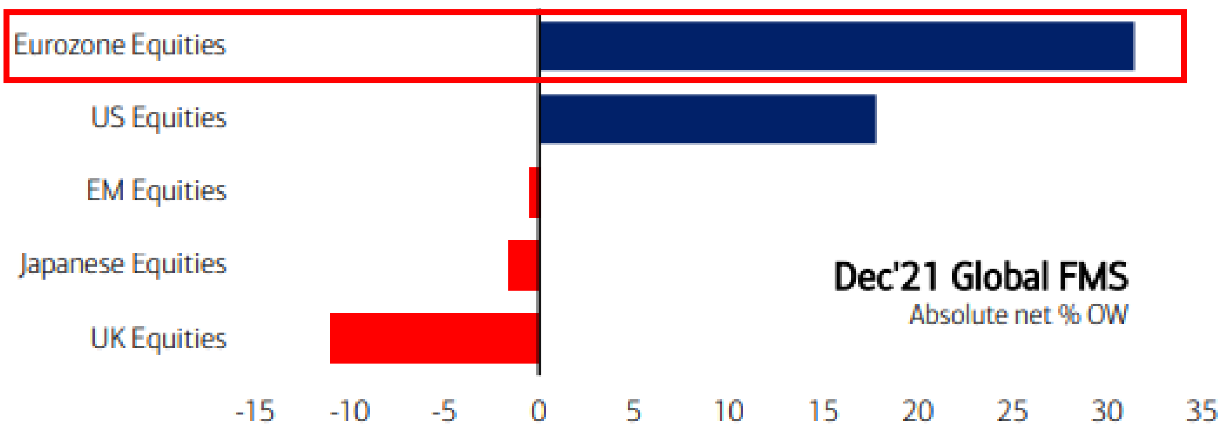
The poor performance by EM (Yes, some of it is China's big weighting) has historically been a macro warning sign. At a minimum, it remains worth watching.

With regard to Europe, the challenges have been adding up in recent weeks and months, COVID continues to weigh, as does the unfolding energy crisis. Add to that the fact that the ECB has a very empty looking toolbox, should anything go sideways.

In the meanwhile, sentiment and positioning remain high.

There are plenty of bulls who see Europe as a value play vs. an expensive US.

Chart 15: FMS most bullish on EU and most bearish on UK
Net % OW in regional equities



Source: BofA Global Fund Manager Survey

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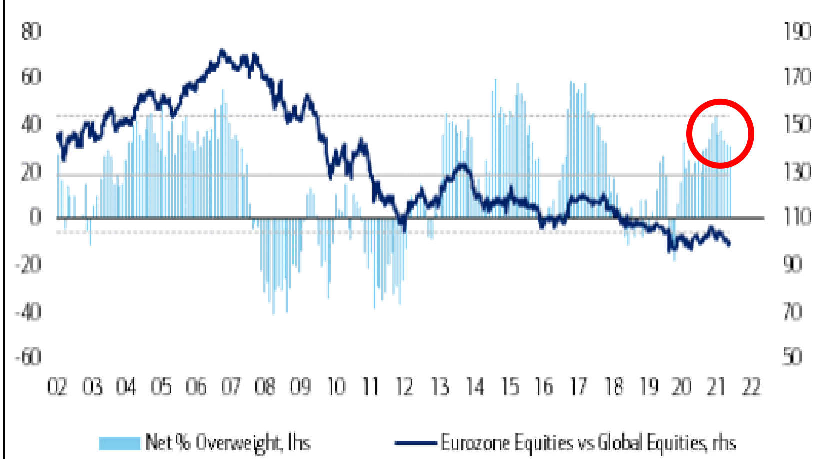
Despite a lack of outperformance so far, positioning still reflects the bullish sentiment.

Chart 40: Net % AA Say they are overweight Eurozone Equities
Net% of FMS investors overweight EU equities



Source: BofA Global Fund Manager Survey

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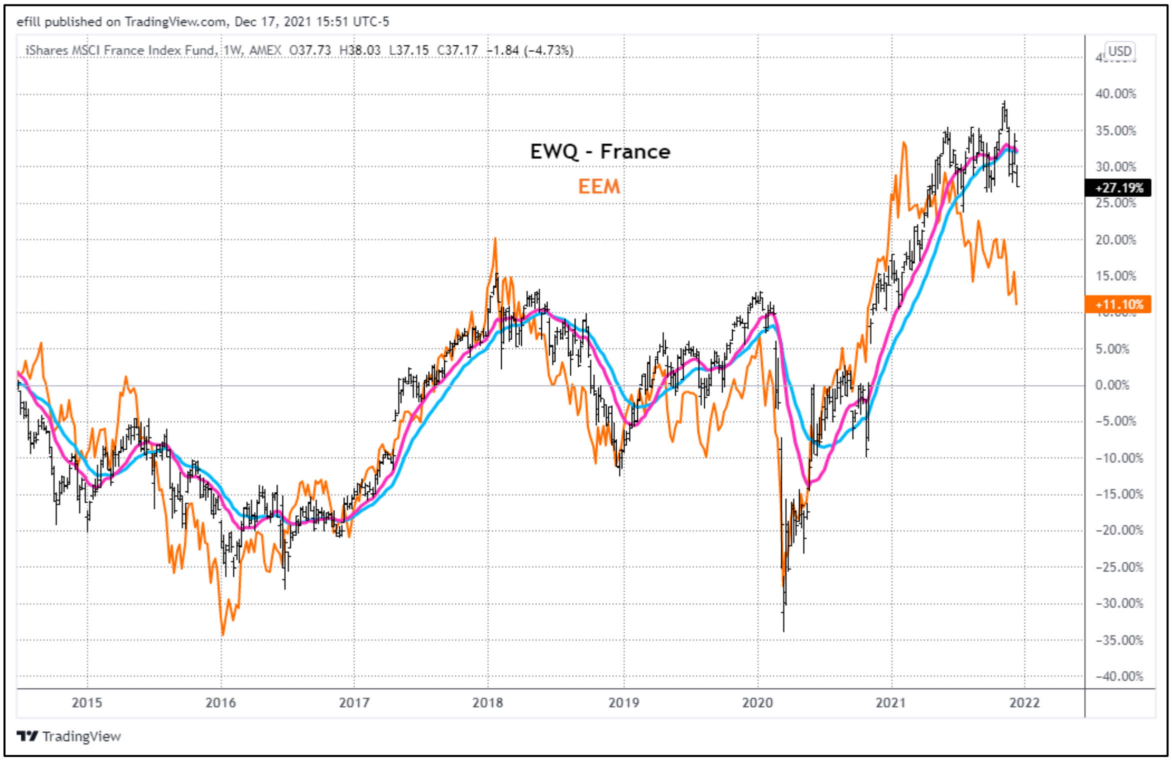
Allocation to Eurozone declined 2ppt MoM to net 31% overweight.

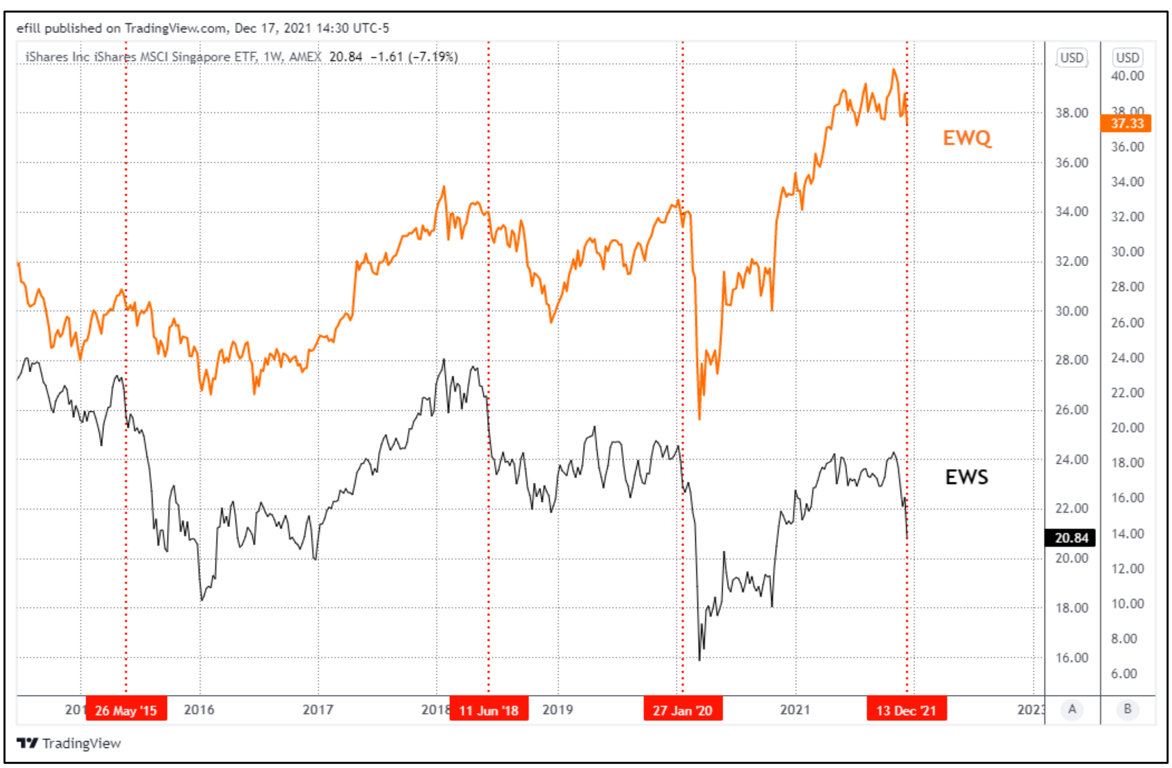
Current allocation is 0.6 stdev above its long-term average.

From a technical point of view, European equities have stalled after becoming overbought. A loss of momentum combined with already very bullish sentiment and positioning, potentially opens up the downside for a deeper correction.

A good European proxy, France, looks both stretched and in danger of rolling over. Again, the divergence with EM is striking.



Singapore (EWS ETF), a good non-Japan Asia growth proxy, has led France lower in the past.



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The recent weakness in Singaporean equities coincided with last week's nascent Gold bounce. We will see if that trend continues. Historically, an uptrend in GLD/EWS has correlated with higher equity volatility.

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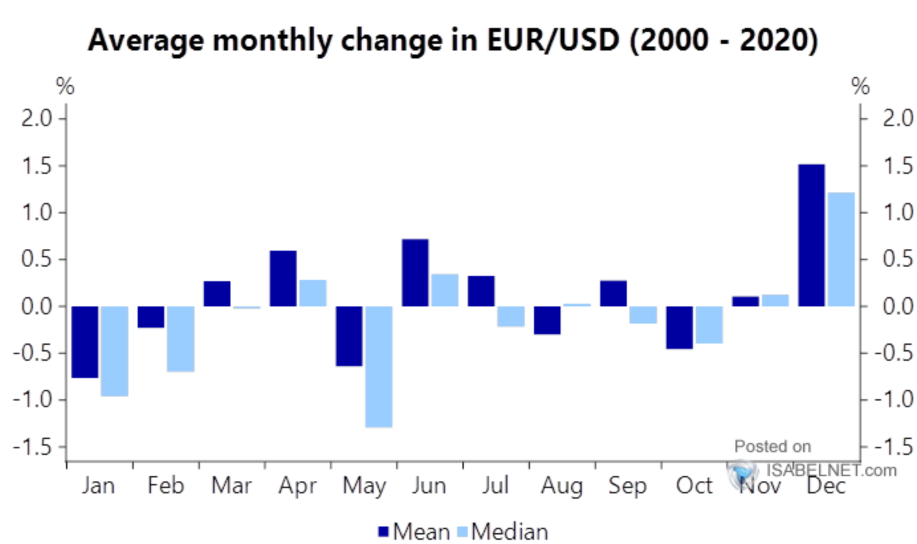
Chart 7. EURUSD tends to depreciate in January

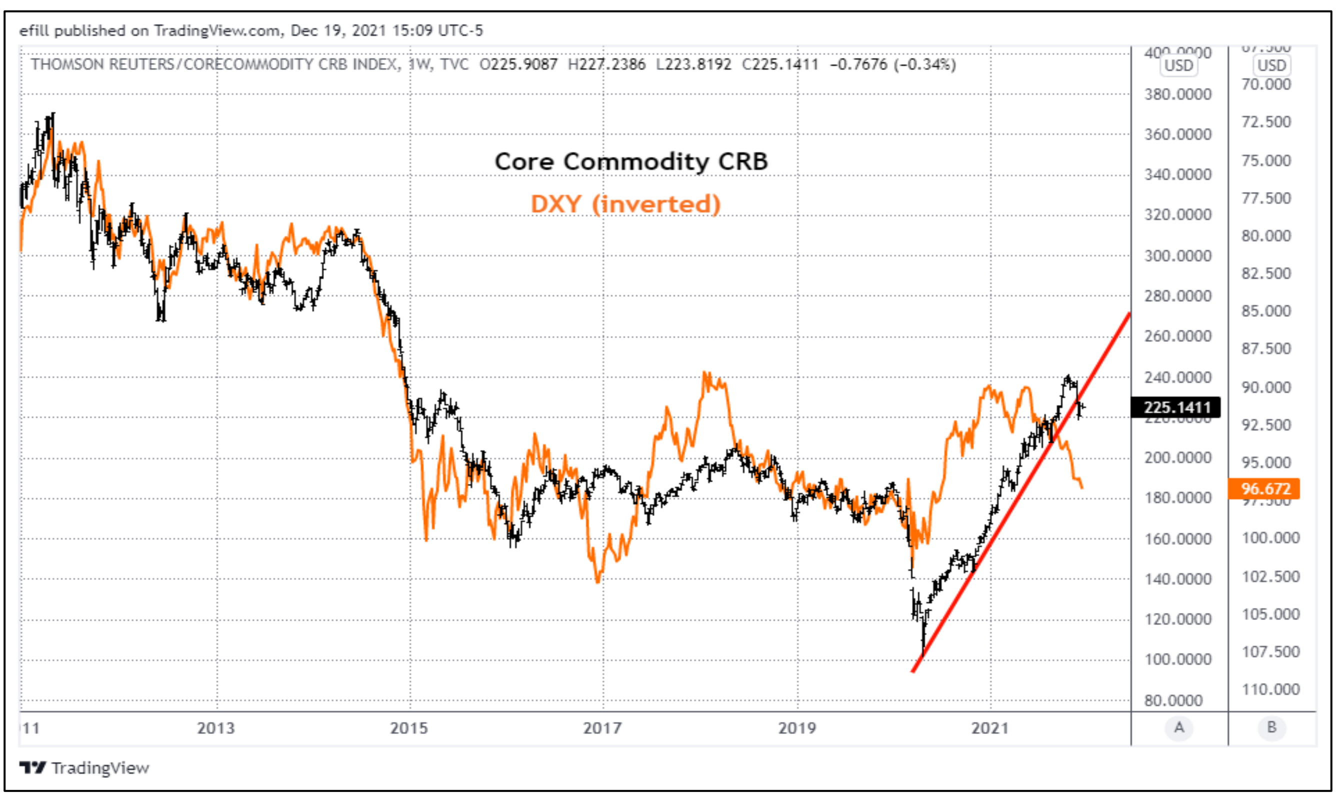


Source: Nordea and Macrobond

I continue to focus on the importance of the dollar strength we have been seeing. December often exhibits weak seasonality for the dollar. That hasn't materialized this year, at least not yet.

Continued, or accelerating USD strength from here is another macro warning, and often goes hand-in-hand with EM weakness. See 2018.

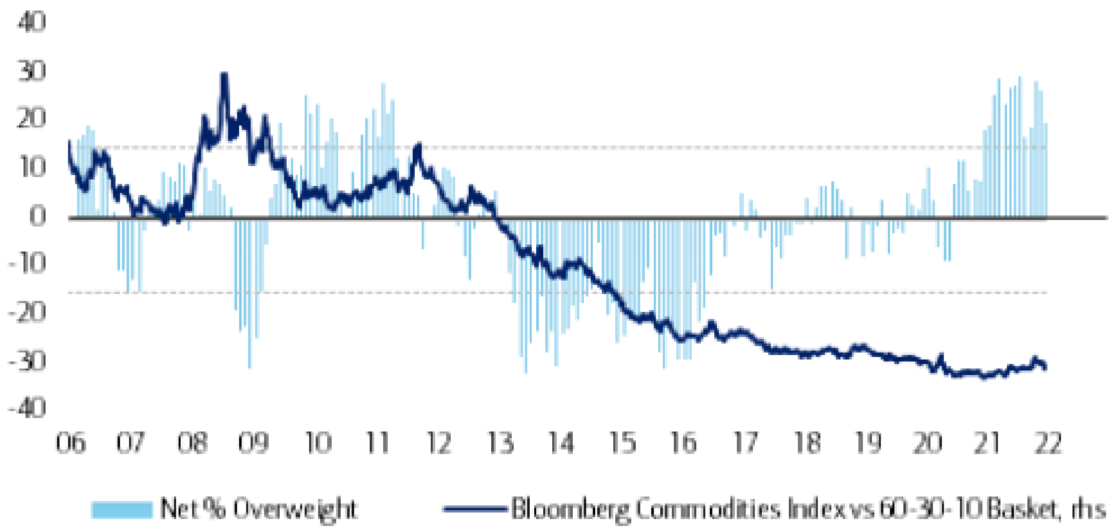
Continued USD strength is likely to put downward pressure on commodities, even in this new world of pandemic-driven extremes.



Positioning in commodities remains meaningful.

Chart 36: Net % AA Say they are overweight Commodities

Net% of FMS investors overweight commodities



Source: BofA Global Fund Manager Survey

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Important Macro Data Releases and Events for the Week

Monday
12/20/2021

- PBoC Interest Rate Decision (Sunday evening ET)
- RBA Meeting Minutes

Tuesday
12/21/2021

- Gfk Consumer Confidence Survey (Jan)
- Retail Sales (Oct)
- Consumer Confidence (Dec)
- BoJ Monetary Policy Meeting Minutes

Wednesday
12/22/2021

- Chicago Fed National Activity Index (Nov)
- GDP Annualized Q3

	Core PCE QoQ Q3
	PCE Prices QoQ Q3
	Consumer Confidence (Dec)
Thursday 12/23/2021	Initial Jobless Claims
	Initial Jobless Claims 4-week average
	Continuing Jobless Claims
	Core PCE - Price Index MoM and YoY (Nov)
	Durable Goods (Nov)
	Non-defense Capital Goods ex-Aircraft (Nov)
	Personal Income and Spending (Nov)
	Michigan Consumer Sentiment Index (Dec)
Friday 12/24/2021	Christmas Day Holiday

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