Themes and Charts for 2021

"What gets us into trouble is not what we don't know. It's what we know for sure, that just ain't so." Mark Twain

As we head into the closing days of a disturbing and bizarre year, you will be inundated with economic and market predictions. In powerful contrast to 2020 when the catch words quickly included "uncertainty" and "unprecedented" as the pandemic unfolded, the start of 2021 seems best defined by the word "consensus".

The coming year for markets will be driven by the battle between inflationary and deflationary forces. The outcome and sequencing will drive prices. With market participants and commentators expecting an end to the pandemic, economic recovery and continued large monetary and fiscal support, it is no wonder that most see a strong reflationary impulse. Fair enough, and there are certainly times when the consensus can be right for extended periods of time.

The reflation outcome would go hand-in-hand with the following:

- A gradually steepening yield curve and higher long end rates
- A further rebound in "value" vs. "growth" and of small caps vs. large caps stocks
- Financials and energy / commodity related equities perform
- Fed policy keeps front end pinned at zero for 2-3 years (global CB's have similar policy)
- QE continues globally at current rate for foreseeable future bringing continued asset price inflation, while fiscal spending brings reflation to Main Street
- Dollar trends lower (support virtuous reflation cycle)
- Industrial commodities trend higher (falling dollar supports)
- Continued flow into Emerging Markets (falling dollar supports)
- Europe, Japan and China benefit as well as capital flows out of concentrated US "growth" allocations (falling dollar supports)
- Credit spreads remain tight
- Potentially continued bubble-like runs in some sectors like clean energy, etc.

So, what could go wrong?

Assuming the fundamental read is correct and durable, the question becomes whether people are already positioned for this outcome. While a lack of positioning is no longer a tailwind for markets, it isn't clear that we are yet at "maximum long". Aggregate hedge fund positioning has risen quite a lot, and asset management firms have taken down cash balances appreciably. There are certainly signs of euphoria, the market is expensive and there is the smell of the '99 bubble in the air as retail day traders and call buyers have exploded in numbers. The real question remains who are the buyers from here?

If rates now expected to stay low "forever", is it the bond for stock switch? Or are US and global indices pushed higher as a potentially huge rotation trade gathers momentum?

Here are a few things that could create volatility in 2021, upsetting the apple cart or sharply accelerating current trends:

- Virus mutations or complications mean vaccine is ineffective in quickly ending pandemic.
- Does the damage already done to the global economy surface, as liquidity is no longer able to hold off insolvency in various pockets of the private sector? (Hard for policy makers to deal with if they can't reach those sectors directly)
- Do markets start to worry about the torrid pace of fiscal expansion globally? Does that destabilize government bond yields as a risk premium is priced? (return of the bond vigilantes not likely unless inflation jumps)
- Stronger than expected growth and inflation calls into question whether Fed can hold to its current forward guidance projections. Long-end yields rise more quickly than anticipated. How does the Fed react? (a jump in yields could destabilize markets and economy, while the Fed attempting to hold them down via YCC etc. could accelerate dollar decline)
- Democrats take both Georgia Senate seats and market prices expanded fiscal spending and higher taxes for the wealthy. (accelerate dollar decline)
- Yellen (re)endorses US strong dollar policy. (doubt it, but this idea has been shopped around over the last week in various publications)
- Thanks to the effects of COVID, China is now set to take over the position of world's largest economy from the US by 2028. Continued and expanded friction with the West could bring more damaging trade developments or even military confrontation.

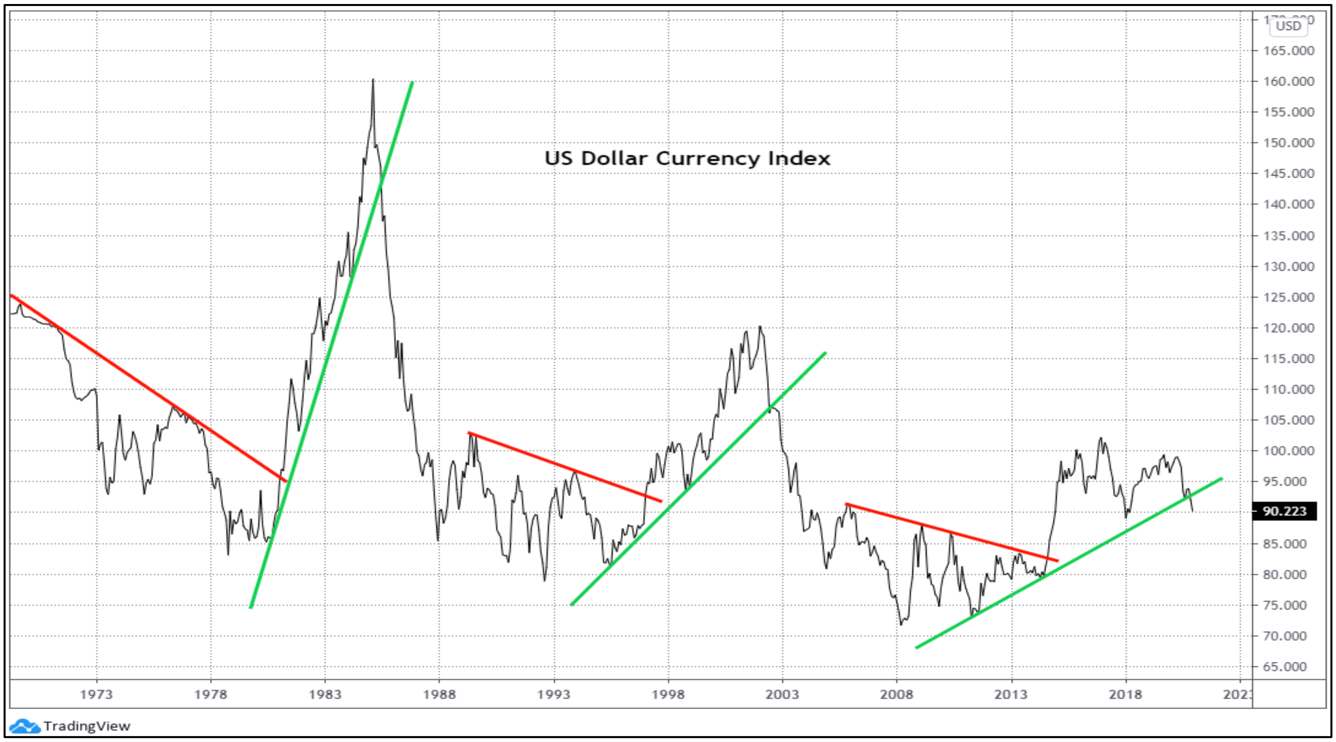
I'll wrap up the year with a few key charts to ponder and watch.

A relatively strong USD since 2008 is now weakening. If it lasts, it will have wide ranging effects on everything from global equity allocation and performance, to commodity prices. A weaker USD is THE way to drive commodity prices higher and I would be hard pressed to believe policy makers would want to short-circuit that now, given their constant proclamations seeking higher inflation. Positioning is stretched given how obvious this is to investors, and sudden USD short covering rallies can be expected. However, a soft dollar should be the preferred path until it is decided that inflation has returned sufficiently. Or, unless there is a lasting economic relapse that again concentrates capital in the US.

The USD and Bond markets remain key for asset allocation and monitoring risk. Keep an eye out for those "tells" across asset classes.

Stargazer
Asset Management

The dollar has seen repeating cycles since 1971. Have we started a new wave lower?



A falling dollar tends to help foreign equity markets. Even equity market dogs like Italy and Spain can rally when the capital flows become more adventurous.

Contact: efill@stargazerfunds.com / SMS, WhatsApp and Voice at +1.203.219.3649

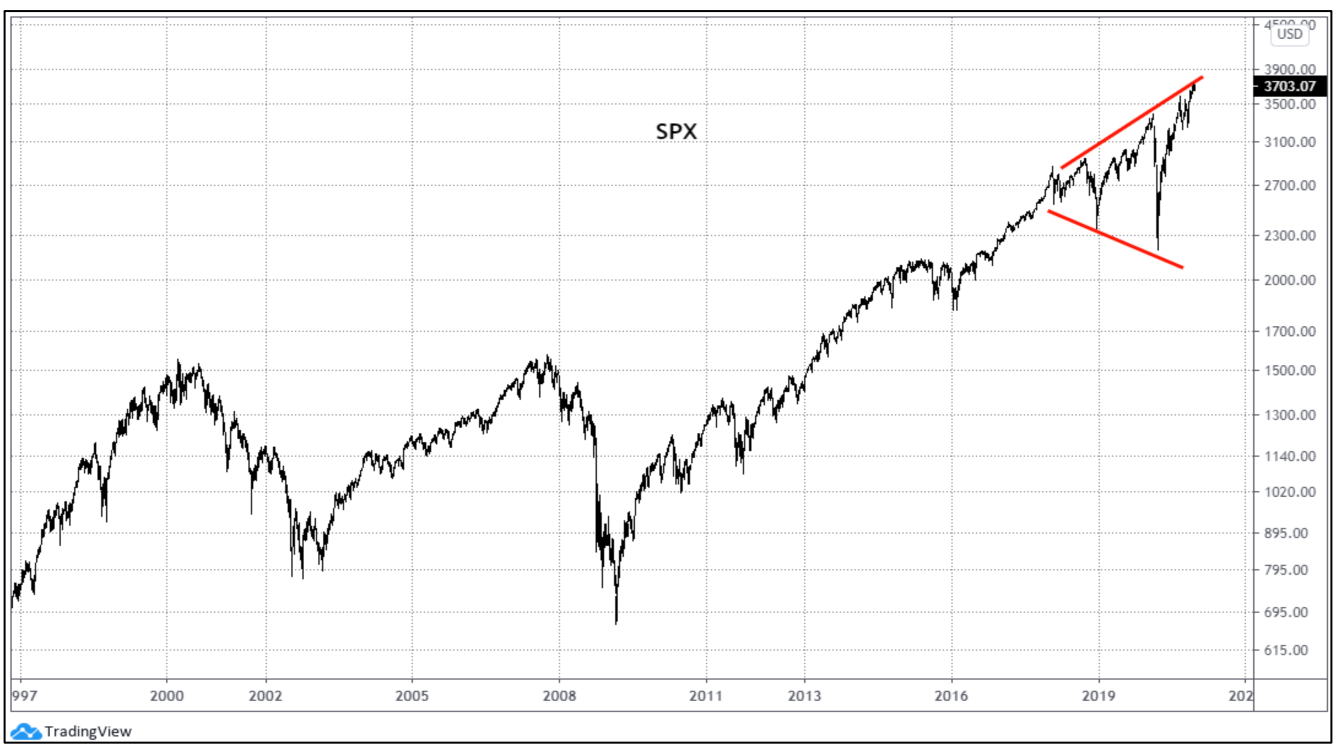
If the dollar stays weak or weakens further, keep an eye on foreign markets that have been chronic underperformers… Europe is the same price it was 20+ years ago.

EM has made no net price progress since the 2007 highs.

Stargazer Asset Management

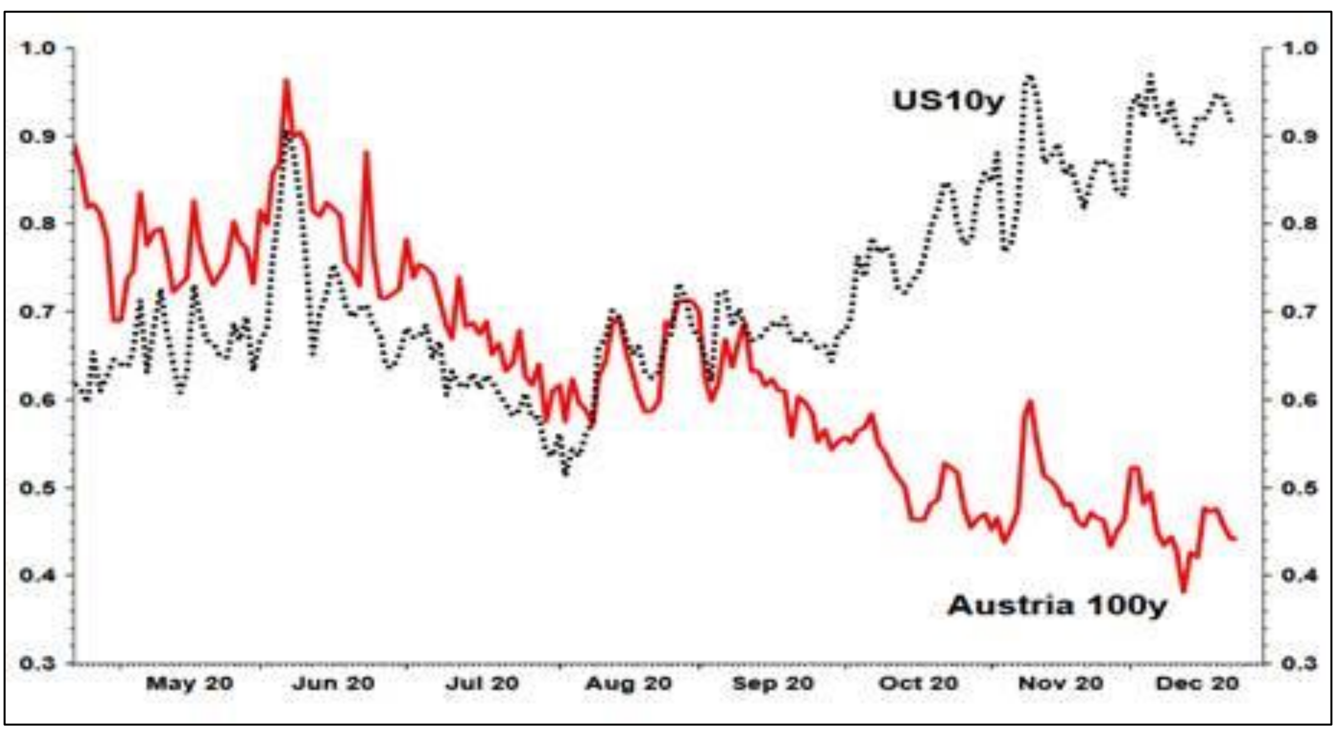
Japan has seen a recent break higher, but it is still well below its 1989 price high.

And US equities which have outperformed everyone else, thanks to US tech, have had a very volatile three years, leaving us with a pattern rarely seen in markets.

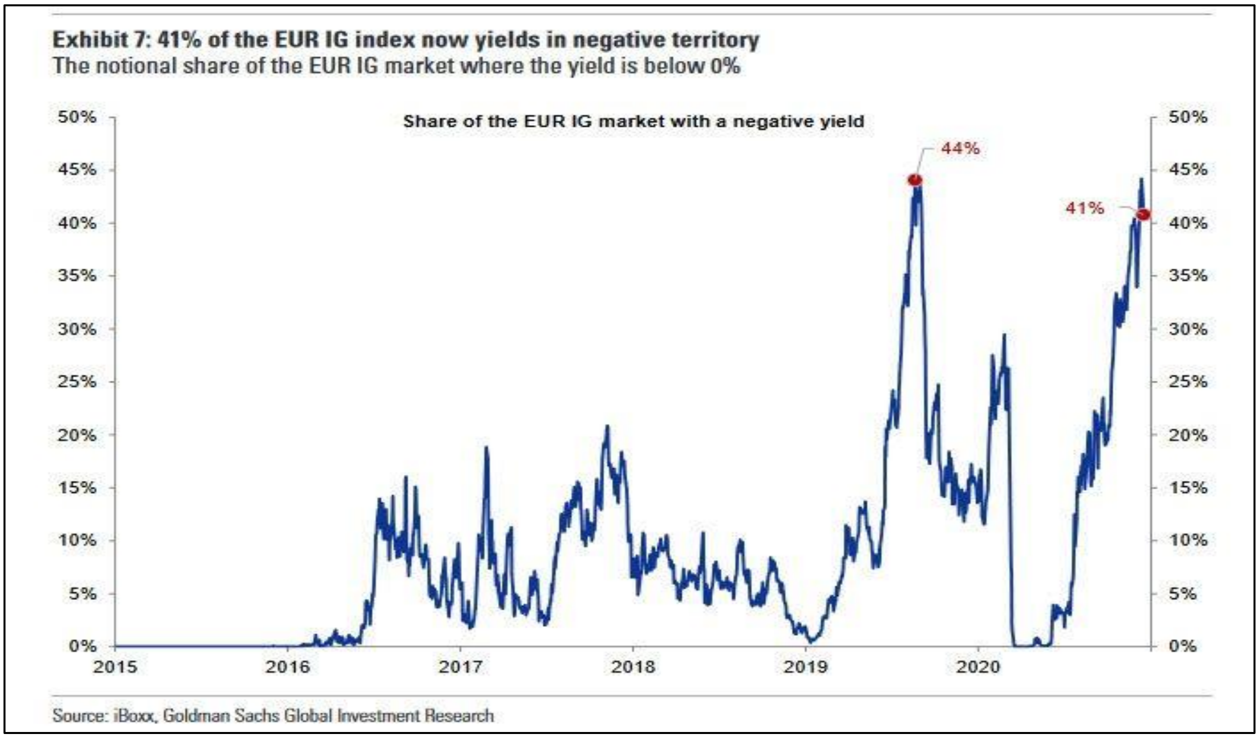


Commodities have come back from the lows as liquidity additions and fiscal spending have driven up asset prices and taken down the dollar. They are now at a big level. Breaking higher?

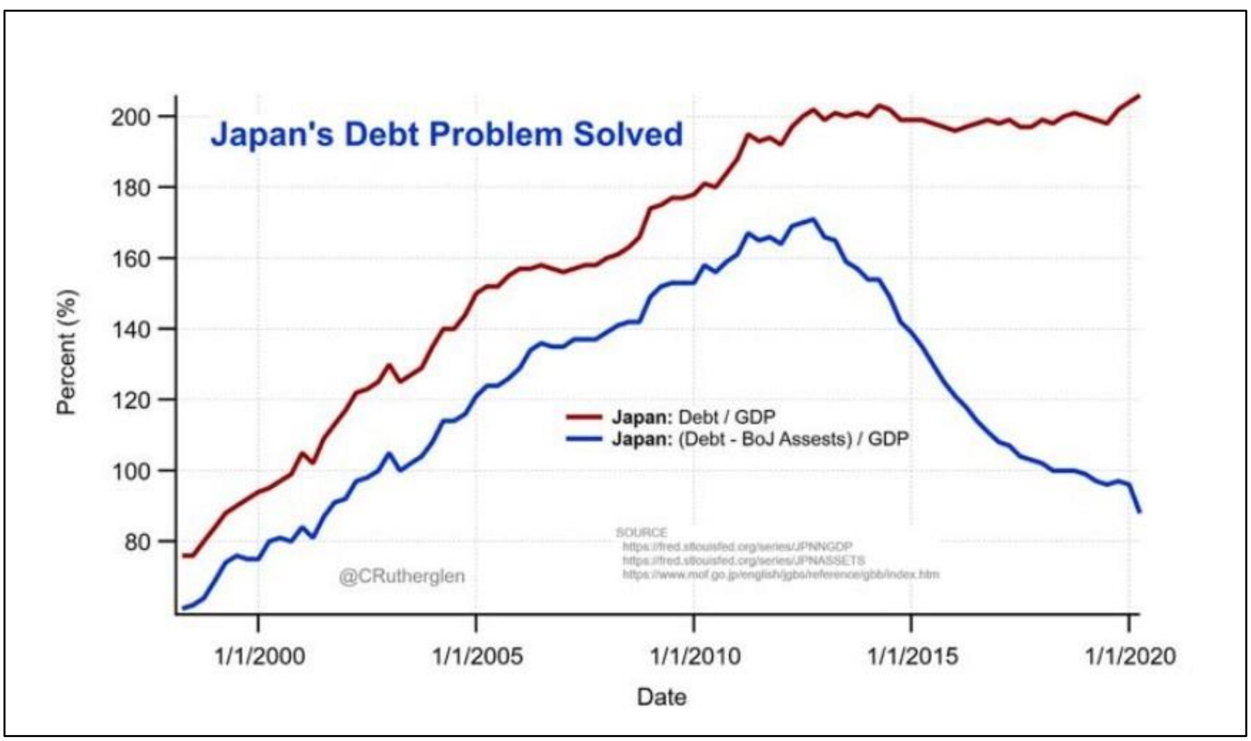
The combination of QE and NIRP in some countries has created major dislocations and tested the limits of what makes sense in free markets.



It is well known that there is nearly $18Trl in debt globally with negative yields. That is not just sovereign paper but extends well into the corporate sector in Europe. Rather than crowding out, the combination of NIRP and QE is crowding investors in, despite the huge government issuance.



Central banks are not just keeping rates down but absorbing supply. Problem solved.



Stargazer
Asset Management

So far, with inflation still low and rates stuck at zero (or negative) bond markets have played ball. We have seen only a relatively minor increase in yields, especially given the jump in inflation expectations. <u>Watch bond markets for confirmation OR failure and then, how the CB's react.</u>

Stargazer
Asset Management

Disclaimer

This document and its contents are confidential to the person(s) to whom it is delivered and should not be copied or distributed, in whole or in part, or its contents disclosed by such person(s) to any other person. Any party receiving and/or reviewing this material, in consideration therefore, agrees not to circumvent the business proposals explicitly or implicitly contained herein in any manner, directly or indirectly. Further, any recipient hereof agrees to maintain all information received in the strictest confidence and shall not disclose to any third parties any information material to the opportunity contained herein and, upon review hereof, agrees that any unauthorized disclosure by any party will result in irreparable damage for which monetary damages would be difficult or impossible to accurately determine. Recipients recognize, and hereby agree, that the proprietary information disclosed herein represents confidential and valuable proprietary information and, therefore, will not, without express prior written consent, disclose such information to any person, company, entity or other third party, unless so doing would contravene governing law or regulations. This document is an outline of matters for discussion only.

This document does not constitute and should not be interpreted as advice, including legal, tax or accounting advice. This presentation includes statements that represent opinions, estimates and forecasts, which may not be realized. We believe the information provided herein is reliable, as of the date hereof, but do not warrant accuracy or completeness. In preparing these materials, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources.