Stargazer
Asset Management

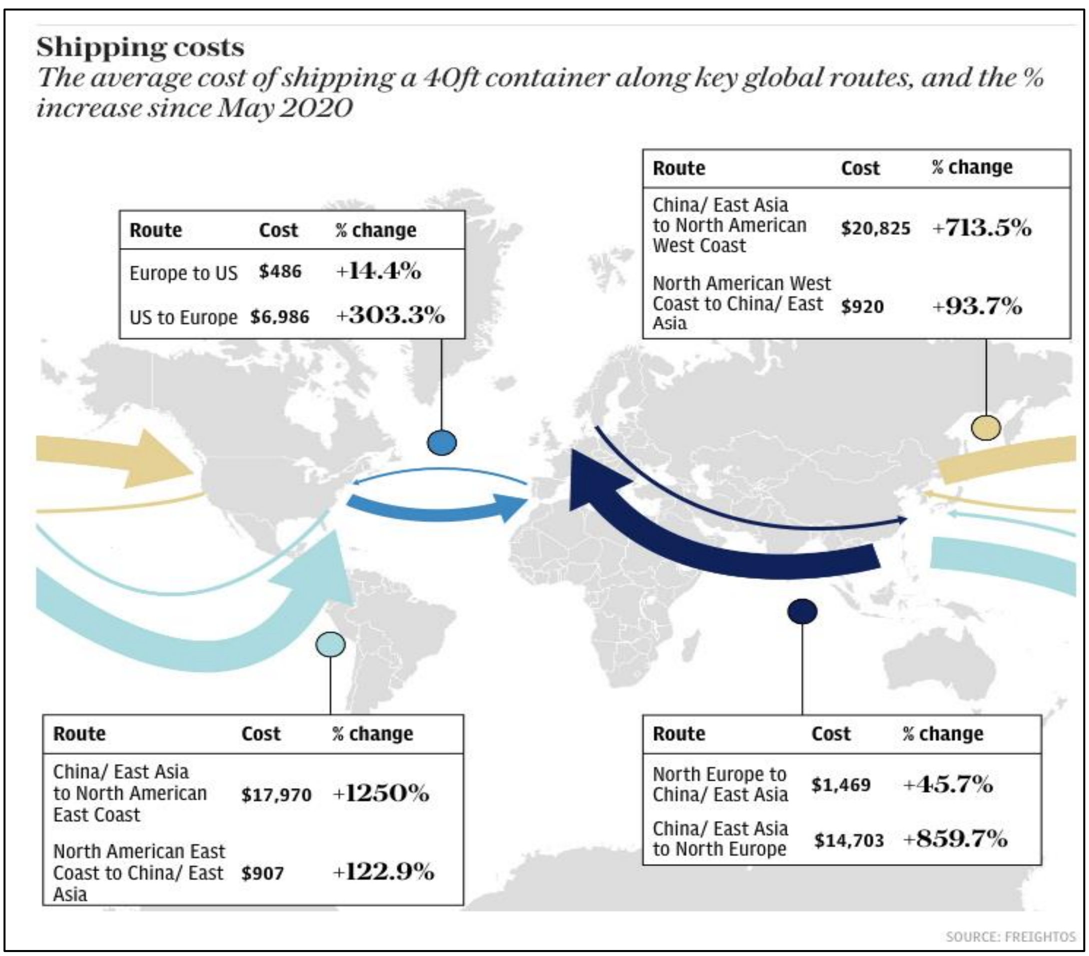
What to focus on in Global Macro for the week of October 18th, 2021

Macro Themes on the Radar:

The minutes made it pretty clear that barring disaster, the Fed will announce asset purchase tapering at the end of the next meeting on November 3rd. Markets are not only pricing a relatively quick taper, asset purchases are expected to have ended by the middle of next year, but they continue to bring forward rate liftoff expectations. It was only a few months ago that no hikes were expected until the end of 2023. Now nearly two hikes have been priced for the second half of 2022 and two additional hikes for 2023.

The curve is back to flattening, as front-end yields continue to rise while back-end yields have actually come off a little recently, as sooner hikes mean slower growth later.

Last week's slightly hotter than expected CPI, didn't help, nor did the nasty supply shock that continues to unfold. The media is flooded with news of overflowing ports and ships that are unable to unload their cargo. This is an interesting graphic that supports anecdotes of ships not bothering to get reloaded after unloading their previous cargo, adding to the container shortages in some areas. Some legs are paying 10-20x what the return leg pays.



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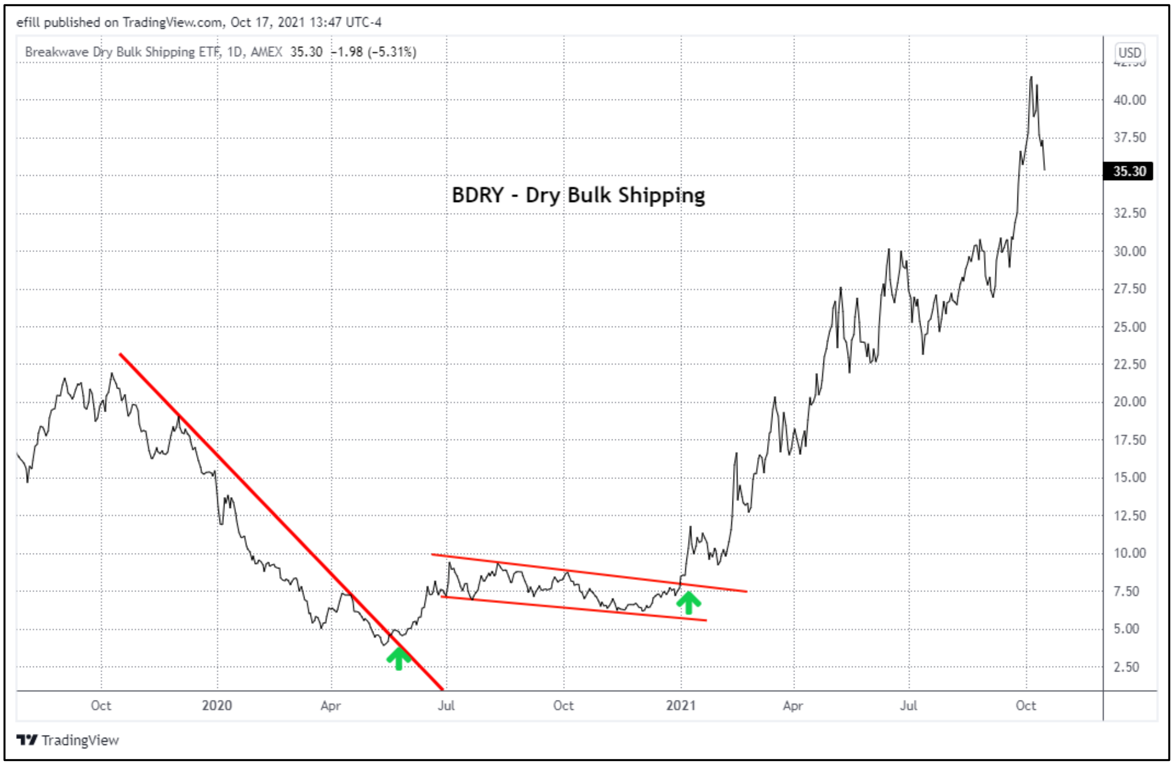
I have been watching Dry Bult Shipping for a sign that the top is in but while it has pulled back, it isn't clear if that was it or we are just seeing another pause.



China

As has been the case for a while, all roads lead to Beijing at the moment.

As Taiwan tensions continue to mount, there are some signs that at least the communications channels are re-opening between the West and China. Both the US and Europe have been re-engaging after months with very little communication between leaders. We will see what that yields.

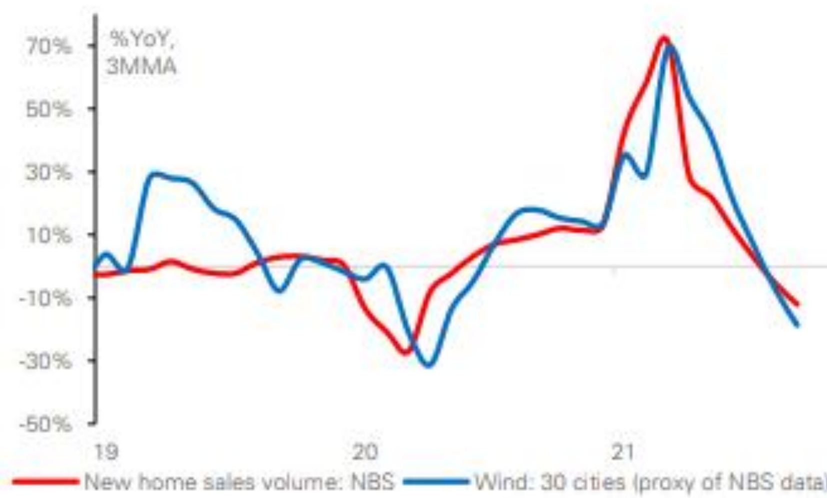
On the economic front, the PBoC has broken its silence on the property developers and last week stated that the situation was "controllable". Of course, market participants were quick to recall the Fed's "subprime is contained" comments as we headed for the GFC. In any case, the Chinese authorities continue to try and straddle their desire to reduce overall leverage and dampen/prevent bubbles while ensuring liquidity, economic growth, and stability.

That is an increasingly narrow landing strip as COVID continues to weigh and now an energy crisis ad to their troubles.

In the face of rising headwinds, the government is starting to push forward with more fiscal spending and some analysts are looking for a small rate cut next week.

Home sales and prices continue to fall, despite the government trying to expedite and streamline the mortgage process.

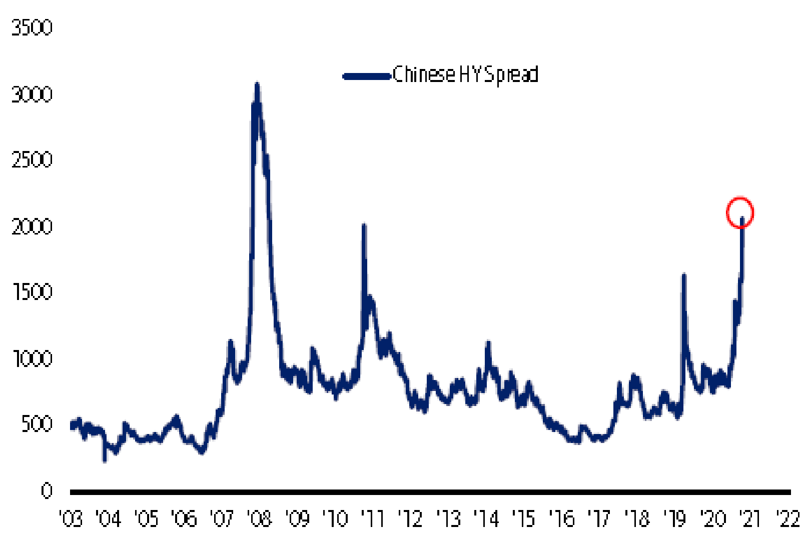
Figure 2: Over the past two months, the volume of new home sales has continued to decline, due to concerns over potential defaults at Chinese property companies



Source : Deutsche Bank, CEIC

The damage to Chinese HY bonds, radiating from the real estate sector, is meaningful.

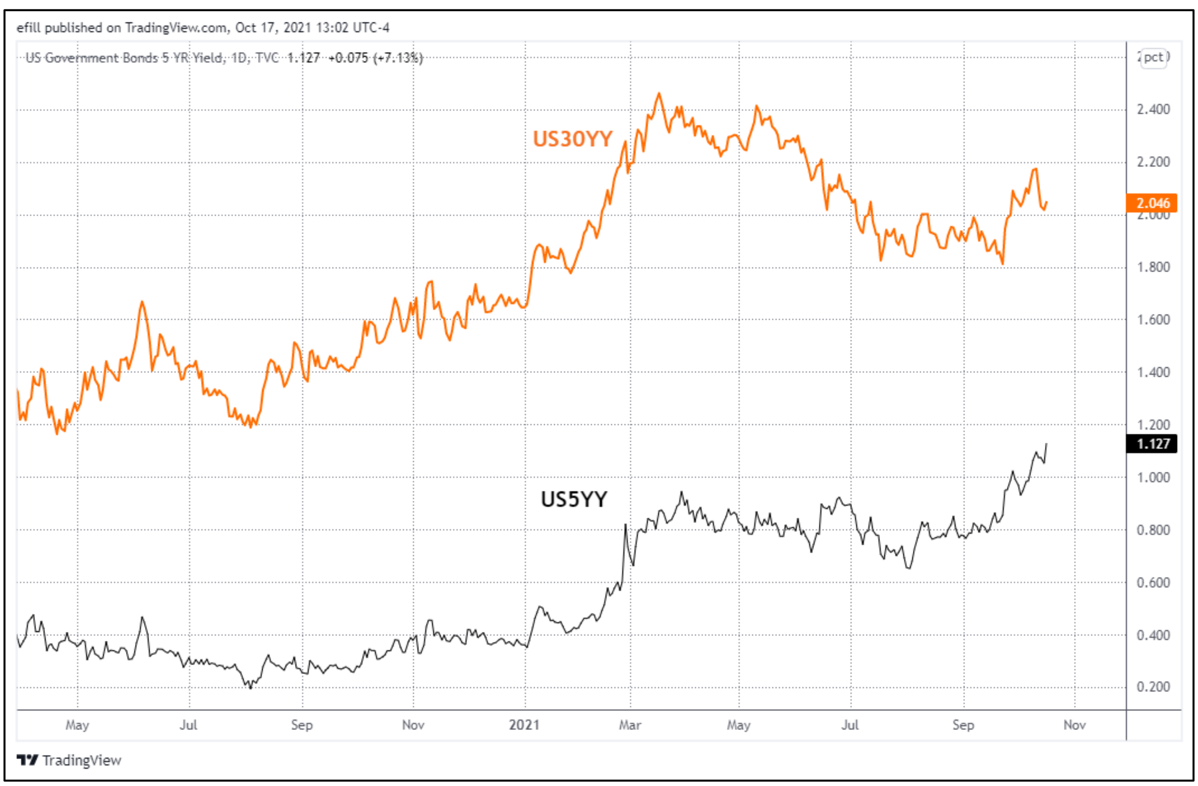
Chart 8: Chinese policymakers are not reacting to credit crunch
Chinese HY bond spread (bps)



Source: BofA Global Investment Strategy, Bloomberg
BofA GLOBAL RESEARCH

What to Focus on Now:

Treasuries - As tightening expectations are brought forward, all eyes are on the yield curve.



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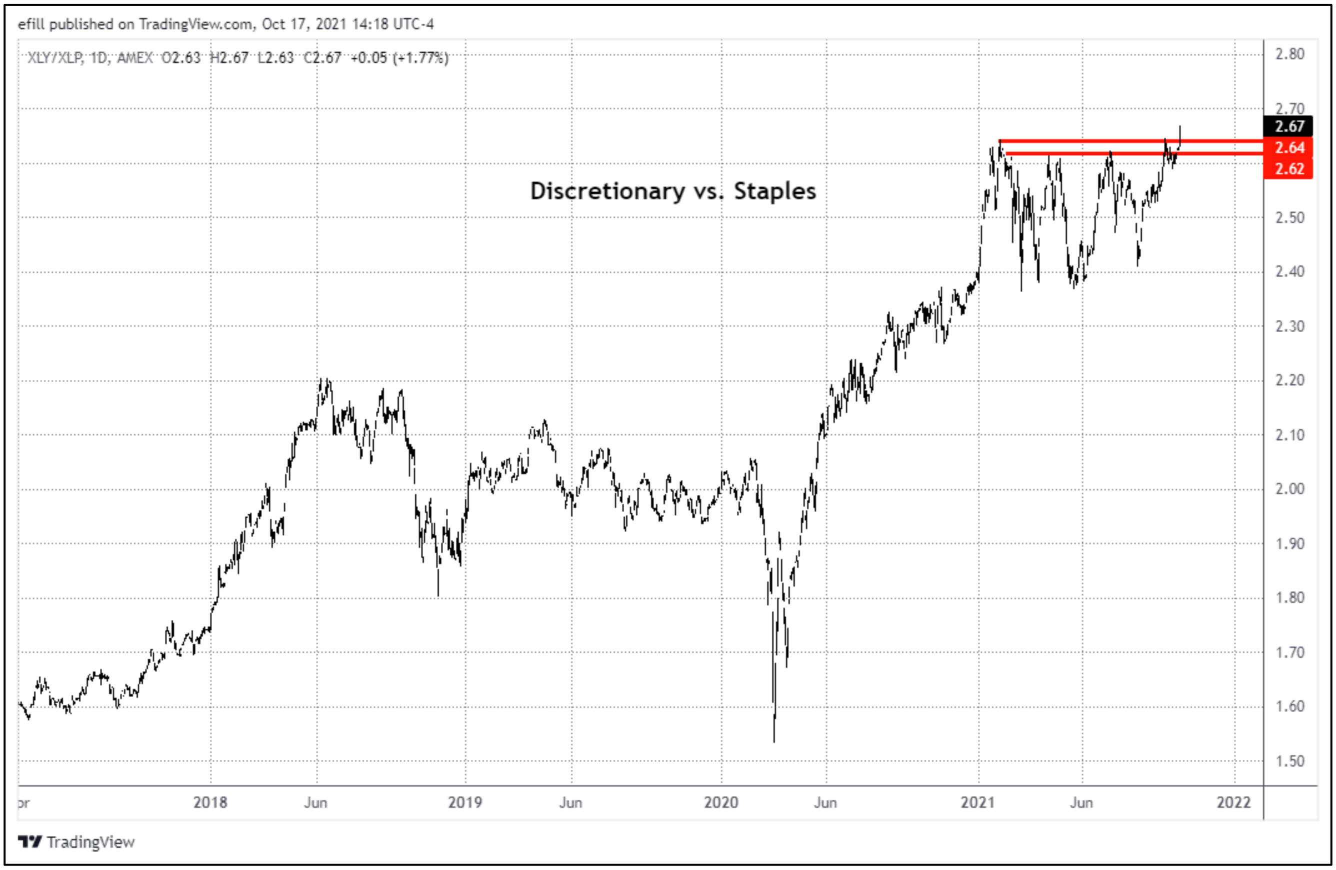
Equities

After multiple indices hit "inflation points" in recent weeks, they have all rallied back powerfully. So far, equities continue to hold up well given all the potentially negative narratives.

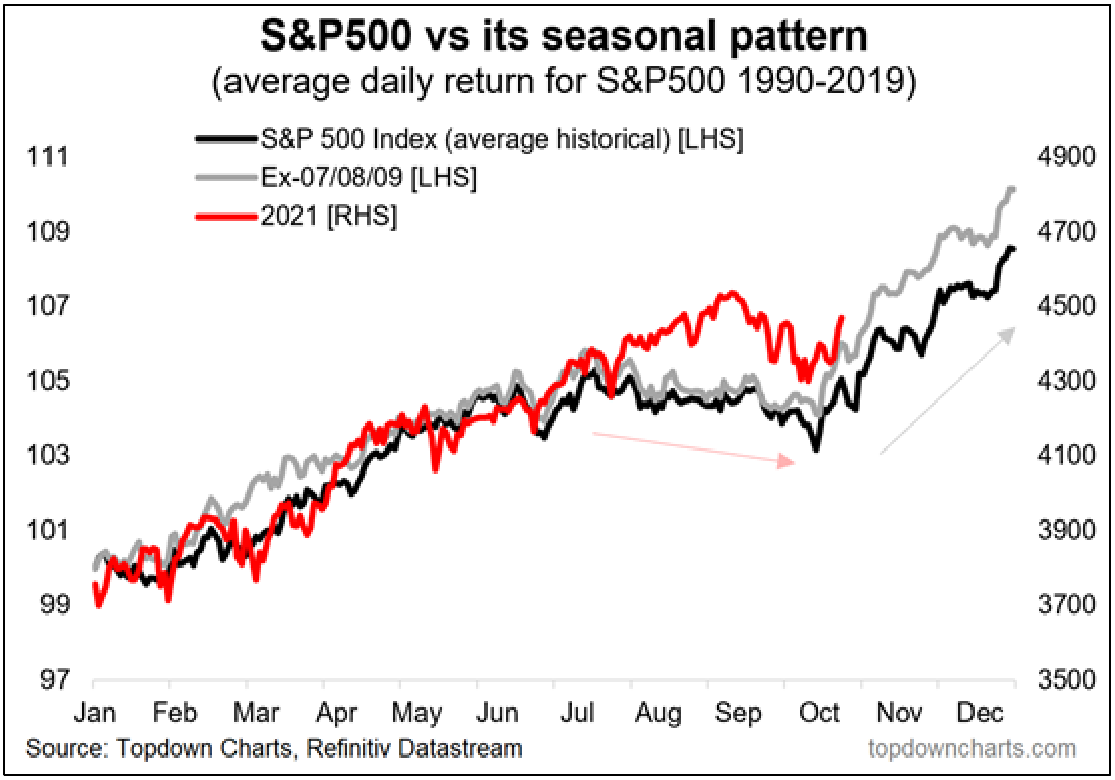
With daily new COVID cases down 50% from the recent highs and falling, people are pointing out that Discretionary is starting to break higher vs. Staples. It certainly is, although I would also note that AMZN, TSLA, and HD alone make up 46.5% of XLY's holdings these days.



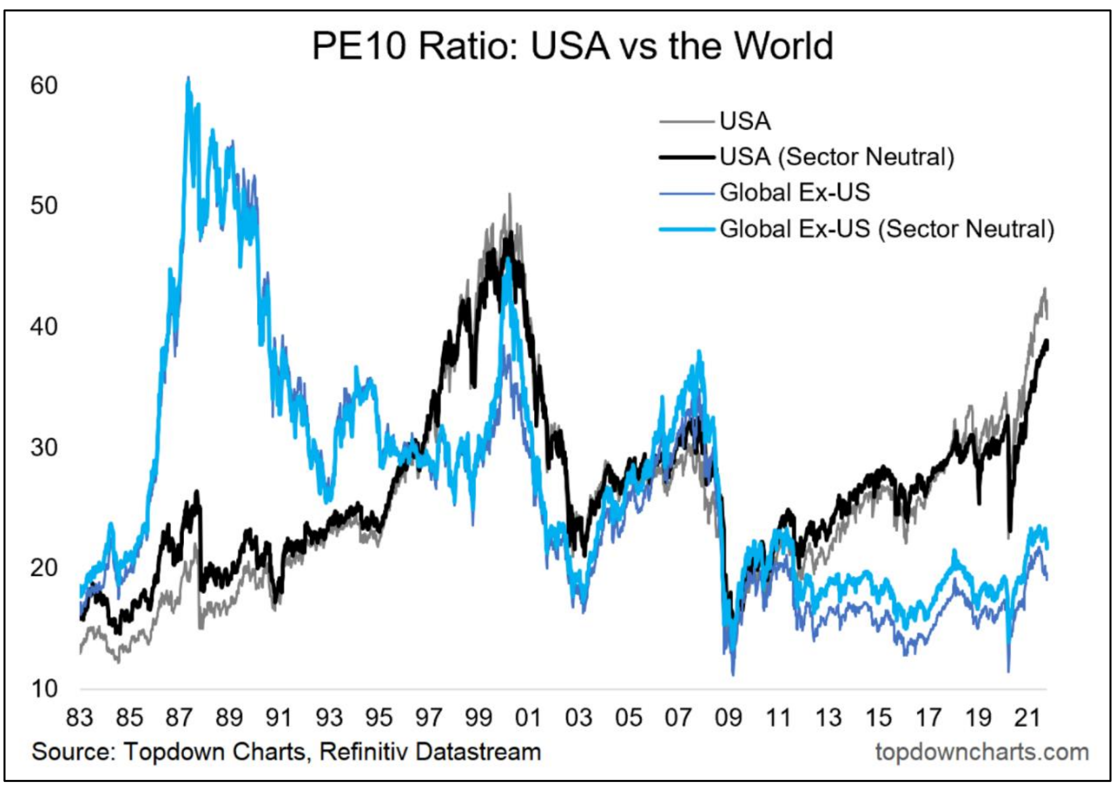
US retail sales and jobless claims have recently been better than expected, and the first look at earnings from the banks has been very good.

It will be very interesting to see what other sectors report as the impact of a negative supply shock and material shortages will be felt very differently from industry to industry.

The good price action overall is making people take another look at seasonal charts as they contemplate the likelihood of the traditional Q4 rally.



With the US expensive, there is lots of talk about Europe and EM being the best value now.



While Europe is up nicely on the year, in index terms, it has not been able to accumulate any outperformance vs. the US. The price action has not confirmed the relative value sentiment.

It continues to be a similar story for EM this year…

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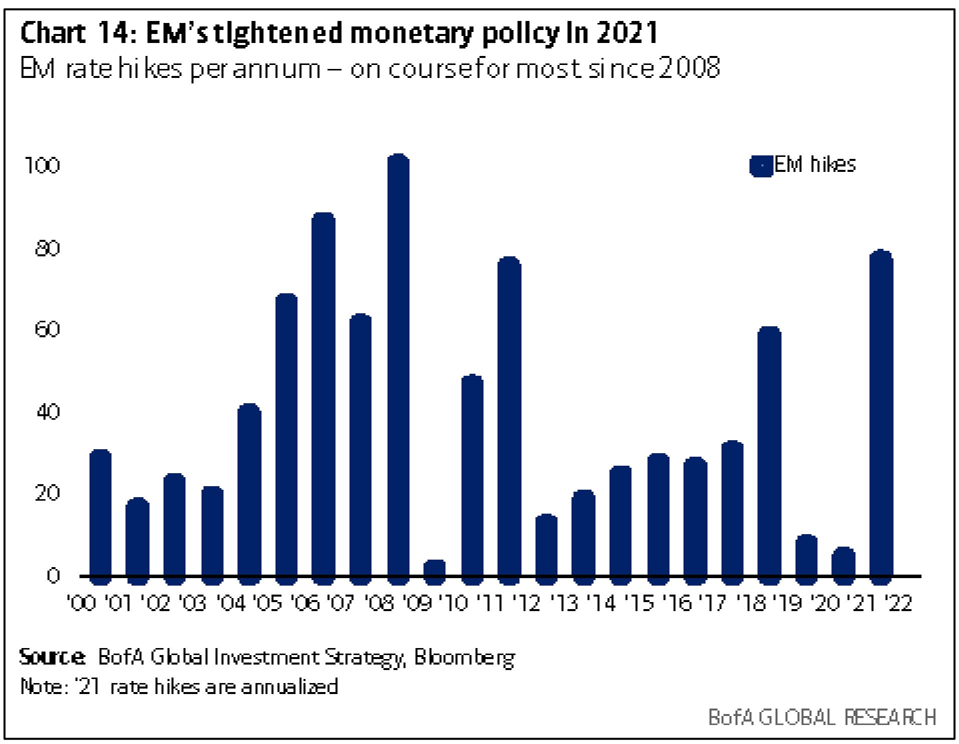
That's is the case even if you take out China. Here is EM ex-China vs the S&P500.

With high commodity prices and rising inflation, EM CB's have been tightening. It will be worth watching how their economies react.



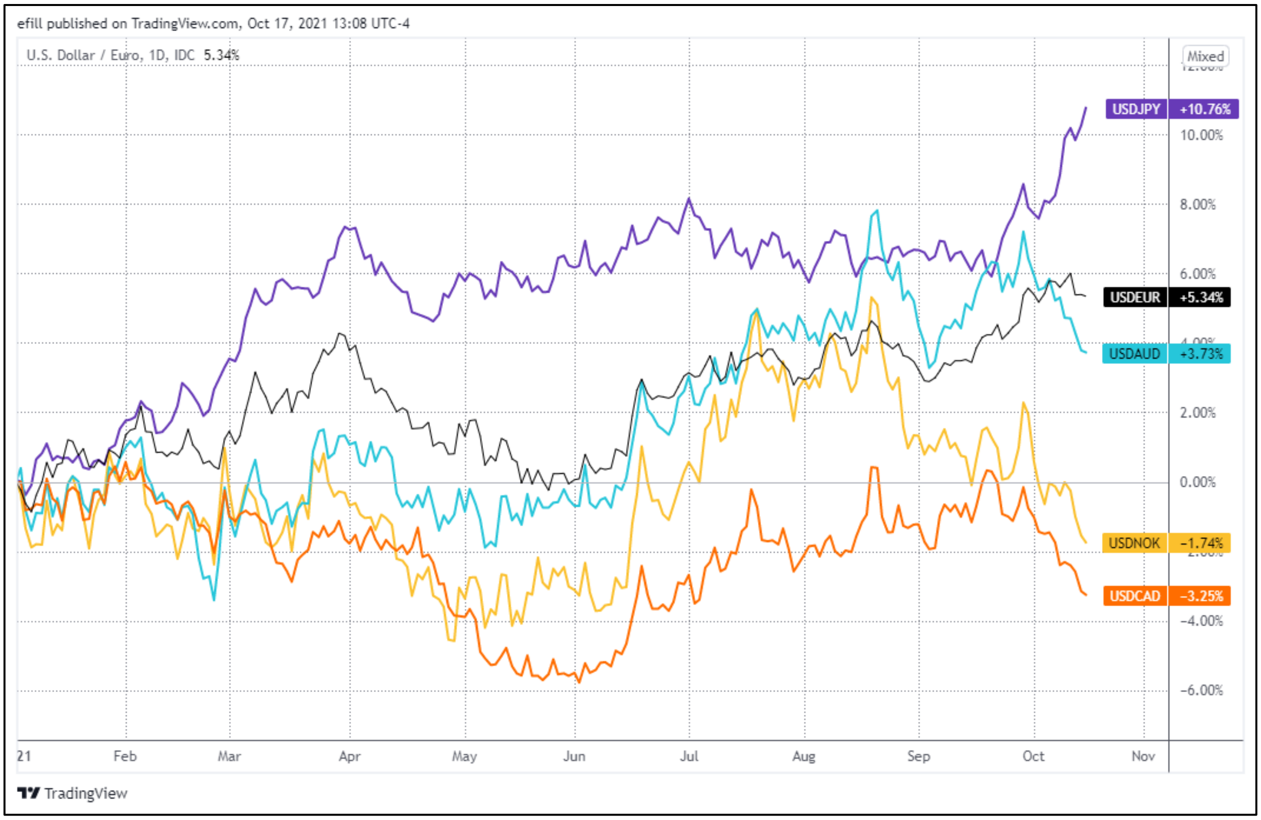
The ratio of commodities vs. EM is now as overbought as it has been in nearly fifteen years. Perhaps understandable given the global supply shock and China story, but that is a very unstable situation.

FX

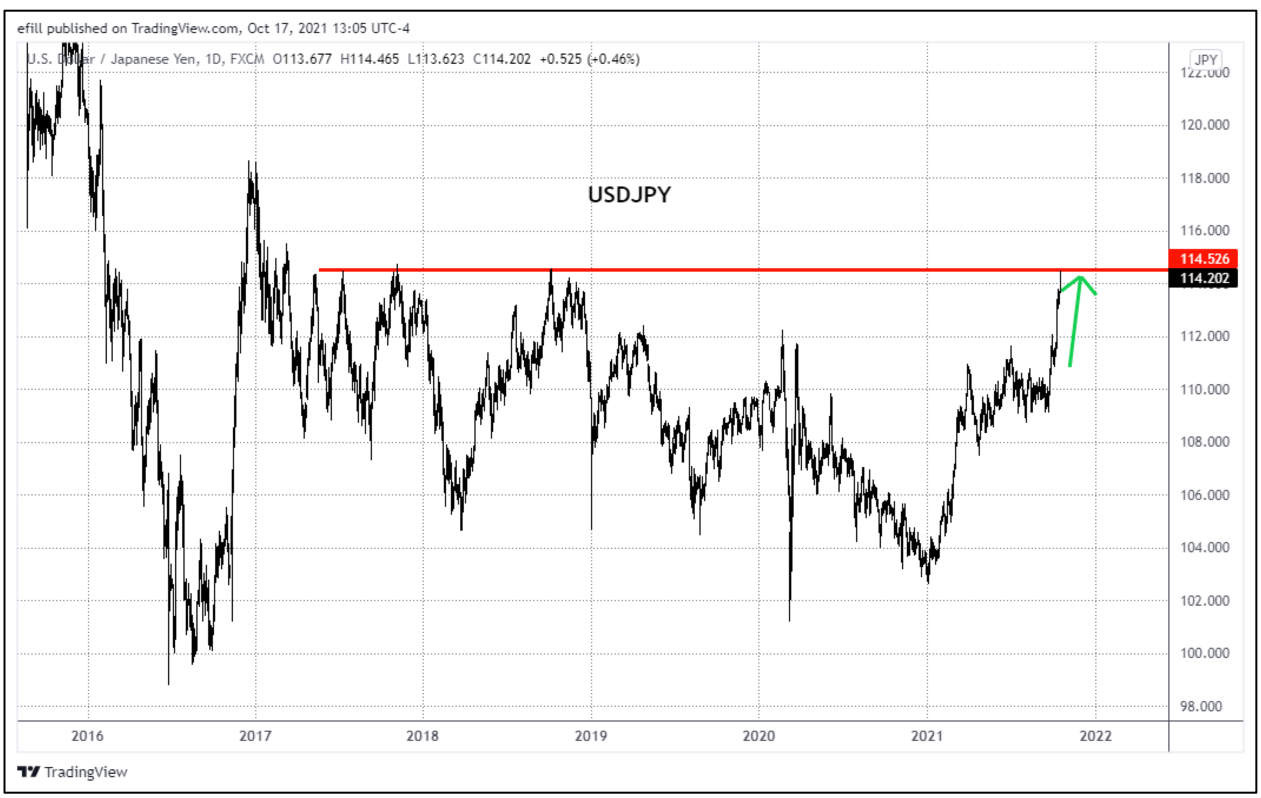
After a long slumber, FX is coming to life. Currencies are being differentiated by inflation, central bank policy, and growth expectations.

The result has been that overall USD strength is giving way to more idiosyncratic stories that are driving up commodity related currencies but are a headwind to some of the zero or negative yielding G7 currencies where central banks are expected to be the slowest to hike. Add in China linkages and continued COVID restrictions / relative re-opening and there is a lot going on in the cross-currency pairs.

The below chart illustrates some of this dispersion as the dollar strengthens against JPY on one hand but weakens vs. currencies like NOK and CAD on the other.



USDJPY has had a big jump after it broke its very tight ranges. Now at the next big level…



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Some of the Yen crosses look particularly interesting on the longer-term charts as they challenge big levels.

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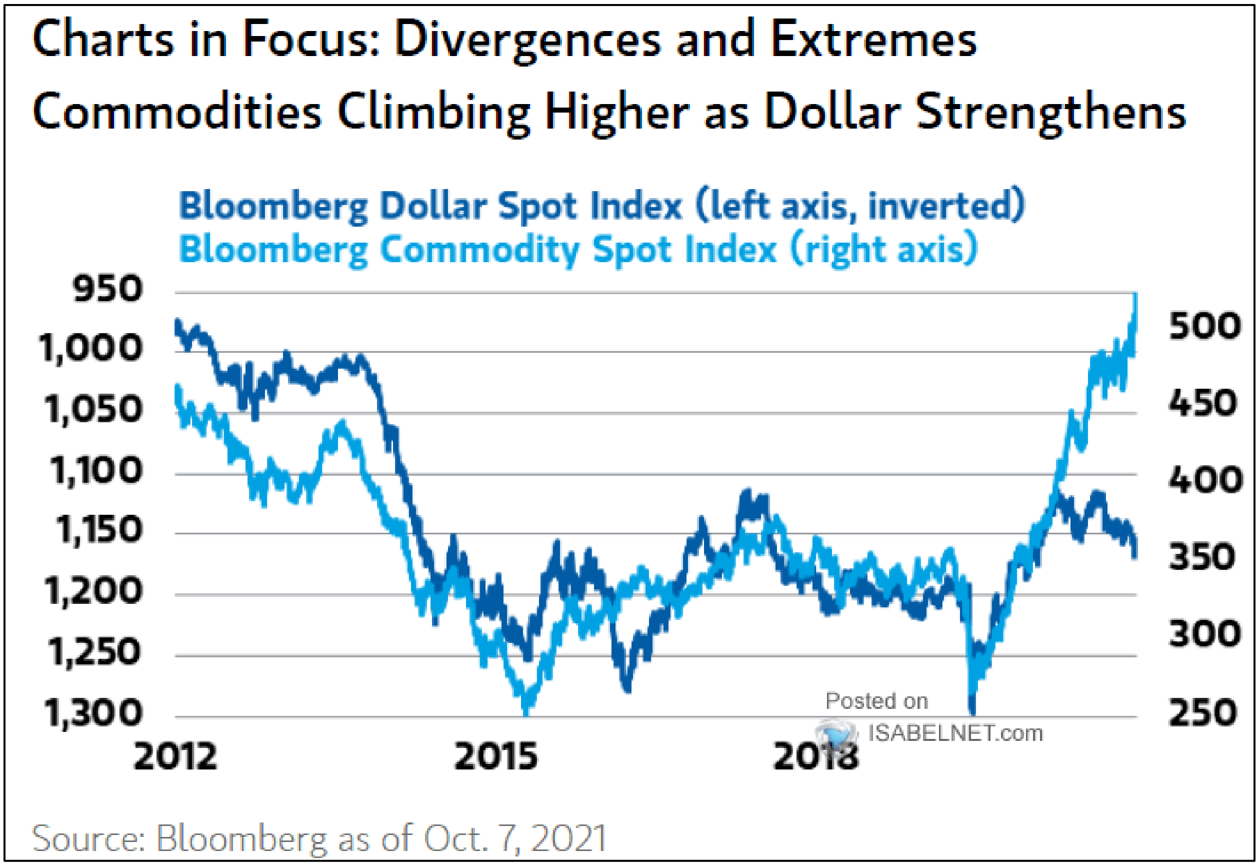
With industrial metals trying to get another leg higher going, after recent consolidation, precious metals remain at the mercy of the yield/dollar combination. While the performance vs. USD remains unimpressive, Gold was showing some promise more broadly vs. currencies like the EUR and JPY.

After punching through the top of the range vs. EUR we got a quick reversal lower. It looks like the engagement party has been canceled, at least for now.

In the meantime, Nickel is back at the highs, Aluminum just keeps going and Copper jumped last week. Even poor Platinum is off its lows and trying to get back in the game.

Finally, the divergence between commodities and the dollar during this move continues to stand out. If it is purely a function of the supply shocks generated by bottlenecks and shortages, does that make this commodity run more or less durable? When people talk about the 1970's inflationary environment, one of its key facets was a dramatic and continued weakening of the USD. We just have not had that… at least not so far.



Next week markets will be focused on earning, with 78 of the S&P 500 reporting, Q3 GDP from China and flash PMIs for October. There are also a number of central bank speakers that could deliver headline bombs.

Important Macro Data Releases and Events for the Week

Monday
10/18/2021

GDP YoY (Q3) Forecast: 5.1%, Prior: 7.9%

Retail Sales YoY (Sep) Forecast: 3.3%, Prior: 2.5%

Fed's Quarles speech

Tuesday
10/19/2021

Building Permits & Housing Starts

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Fed's Bowman and Waller speeches

Wednesday
10/20/2021

PBoC Interest Rates Decision

PPI Sep)

CPI (Sep)

BoC CPI (Sep)

Fed's Beige Book

Thursday
10/21/2021

European Council Meeting

Philly Fed Manufacturing Survey (Oct) Forecast: 26, Prior: 30.7

Initial Jobless Claims Forecast: -, Prior: 293k

Initial Jobless Claims 4-week average Forecast: -, Prior: 334.25k

Continuing Jobless Claims, Prior: 2.593M

Consumer Confidence (Oct)

Friday
10/22/2021

Markit flash PMIs from across Europe (Oct)

Markit flash PMI (Oct)

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