Stargazer Asset Management

What to focus on in Global Macro for the week of March 15th, 2021

Macro Themes on the Radar:

ECB

The ECB decision was more forceful than the market expected; announcing that PEPP purchases would take place at a "significantly higher pace through to the end of Q2 than so far in 2021 (EUR53bn in Jan, EUR60bn in Feb). It remains unclear what “significantly higher” actually means since it was not defined. Will that deliver 67bn, 75bn, or 80bn? The idea is that they will review this new policy on a quarterly basis. If they go to 67 bn a month they can go for another year before they reach the top of the current PEPP envelope. Of course, making this a quarterly review, now introduces “taper risk” every quarter. Not to mention, that having now made a policy move, verbal intervention will have less impact as the market will want to see them put their money where their mouth is.

This seems to be halfhearted, YCC Lite. As the move in European bonds was largely triggered by the acceleration higher in US yields, the ECB is concerned that it does not yet reflect the fundamentals. However, going forward a slow move higher in yields should be tolerated, as long as they don’t outpace inflation expectations. There were a lot of questions during the press conference about how they actually measure favorable financial conditions. Lagarde went into a long explanation about how it is a holistic and multidimensional approach, that looks at both vertical and horizontal outcomes, examining the whole and all its parts simultaneously. Comical. It left the reporters wanting to ask the question again because other than making clear it was flexible, she gave them zip.

The ECB did upgrade its growth outlook and overall European markets liked the outcome.

Fed

The Fed is next on the docket, and we will hear from them on Wednesday. This is a big meeting with the potential for far-reaching and long-lasting impact.

As discussed last week, they have a number of issues to deal with and we will see how and if they are addressed.

- Will the SLR be extended? Some saying 500 bn plus in Treasuries for sale, if not.
- Effects of falling TGA on front end yields
- Jump in long-end yields
- Market bringing forward Fed Funds lift-off expectations
- Operation Twist 3.0?
- Steady as she goes, and all part of rising growth prospects, as long as inflation expectations are not negatively affected by yield jump?

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I would note that we now have Australia, Japan, and Europe all engaging in some form of yield curve control. The herd mentality of central bankers would make me believe that the hurdle for the Fed to also do so, is falling. Again, it is about financial conditions and I expect we will hear them comment on those. So far, while there is massive rotation going on, equities and credit spreads are holding in very well. The dollar has been higher primarily vs. negative yielders and to a lesser degree vs. everything else. Watch the dollar and not just yields, as it is the double whammy for tighter financial conditions if they both rise quickly.

If the market view on higher growth and higher inflation is correct, yields will continue to rise this year and the Fed will eventually be forced into a decision to either resist it or start talking about QE taper and eventual front-end lift-off. This will not be a low vol environment.

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

Yields

As BoA/ML points out, the US Treasury auctioned $255bn in debt over the past week, an amount larger than the annual GDP of Portugal or New Zealand. In 2021, the US government will spend approximately $879mn every hour. In other news, US 30-year yields just got back to their pre-pandemic levels.

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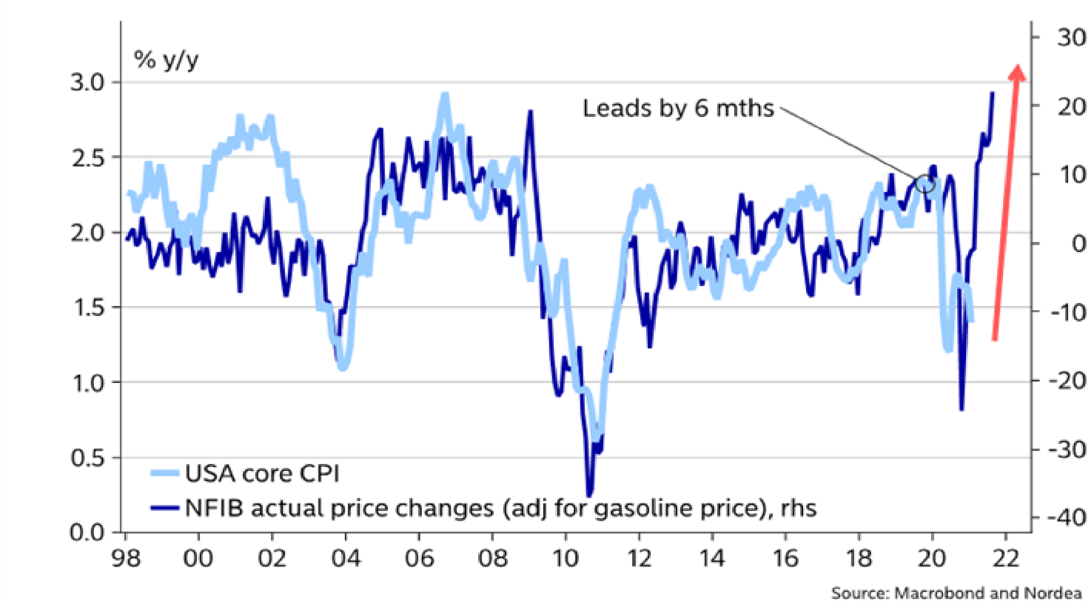
A widely acknowledged jump in inflation is very much expected in the coming months. Some and maybe even most of it is likely to be "transitory", as the CB's are already signally. However, if we suddenly find ourselves above the long-term inflation target the messaging will need to be very carefully delivered. It is so much easier to talk about AIT when it isn't actually in play.

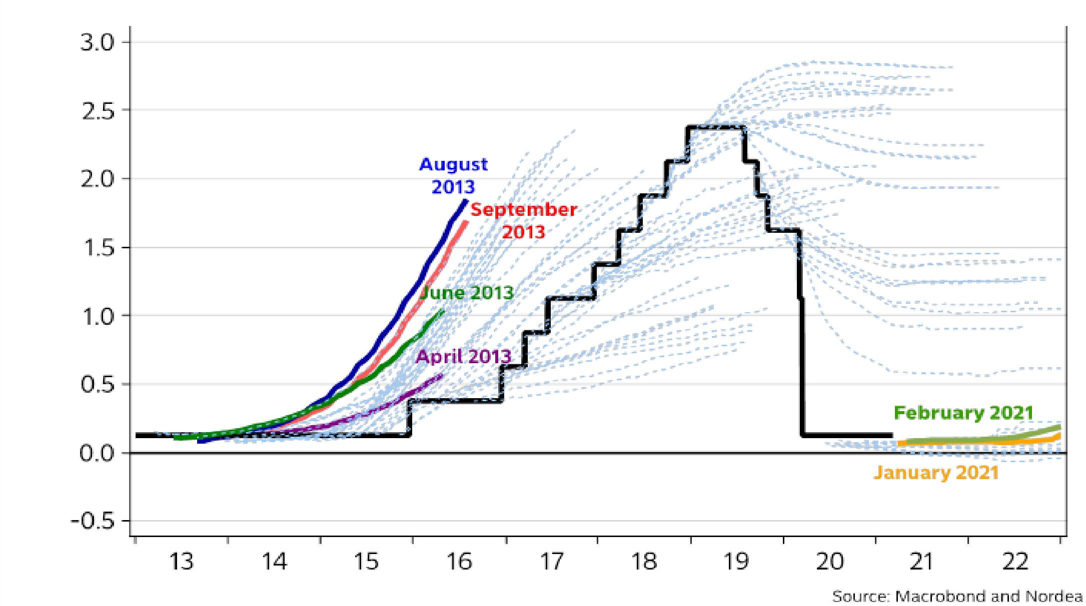
Chart 1. Brace yourself. Core inflation is coming



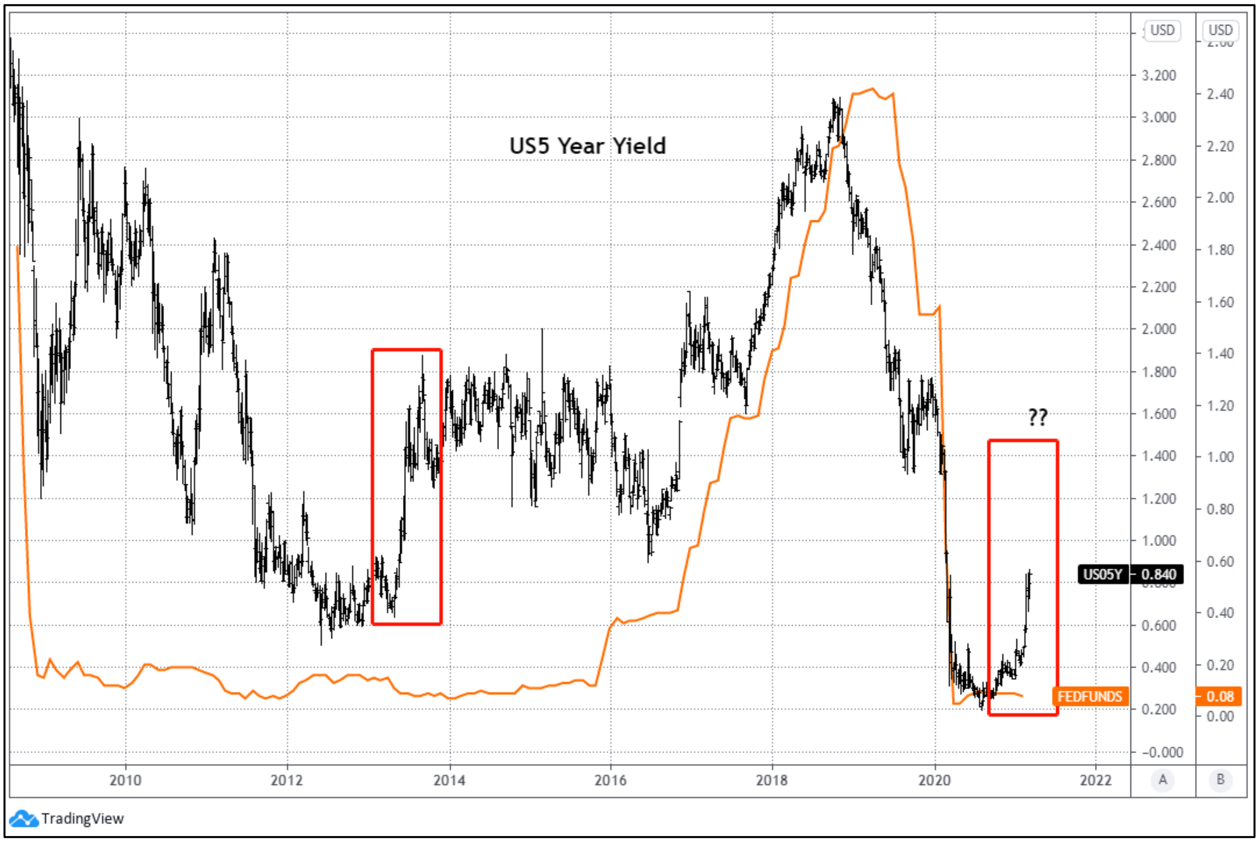
If they start to waffle or even signal a slow taper of QE on the horizon, it could be very hard for markets to separate that from Fed funds lift-off expectations.

This could certainly give us 2013 price action in Treasuries as hikes are priced.

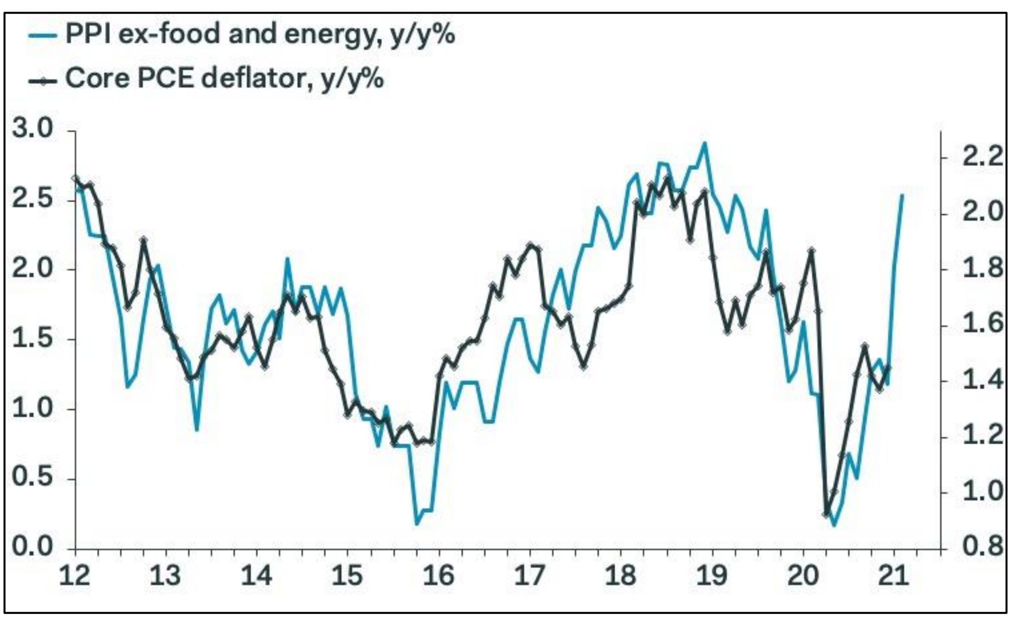
Chart 2. The taper tantrum in 2013 led markets to price in swifter rate hikes



Watch 5-years for continued repricing of lift-off. In the end, they didn't hike in 2013 as they reversed course and the markets were placated. This time we have a different set-up, however.



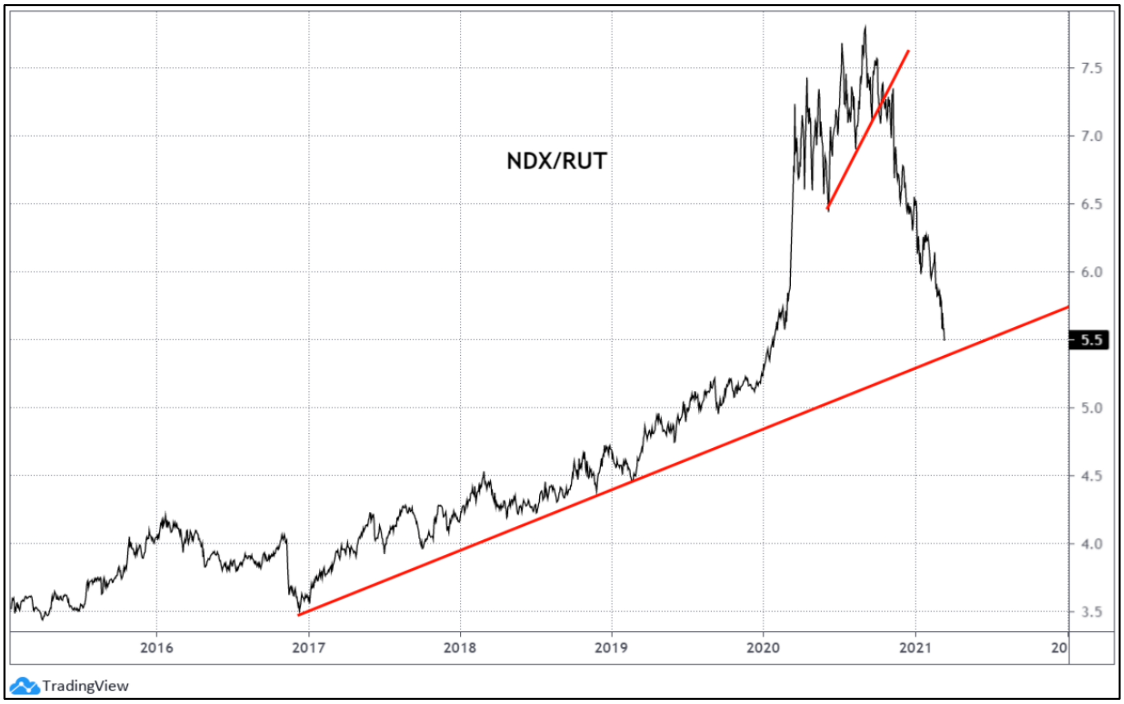
Base effects and strong demand now, with another wave of demand with full reopening.



Source: Pantheon Macro

Equities

All the reflation and growth-inspired rotation we are seeing has already resulted in a pretty epic reversal in the NASDAQ 100 vs. the Russell 2000. Deflation vs. Reflation.



Sharing many of the same big tech names, the move in the NDX vs. SPX has so far been more muted.

As you would expect, the equal weight version of the S&P vs. SPY shows the same de-rating of the dominant big tech names.

Europe

In keeping with the growth for value theme, Europe is getting interesting. The fundamentals have been scary and the vaccine missteps epic, but as a result investors have not been buying it… YTD flows.

Table 4: Net fund flows to global equities, $mn
Global equity flows by region

	Wk % AUM	YTD
Total Equities	**0.2%**	**278,464**
long-only funds	0.0%	70,967
ETFs	0.5%	207,429
Total EM	**0.6%**	**59,200**
Brazil	1.4%	512
Russia	-0.4%	-58
India	0.6%	-204
China	1.5%	17,244
Total DM	**0.2%**	**219,264**
US	0.2%	84,696
Europe	0.0%	1,288
Japan	0.0%	8,978
International	0.2%	120,947

Total Equities = Total EM + Total DM
Source: EPFR Global

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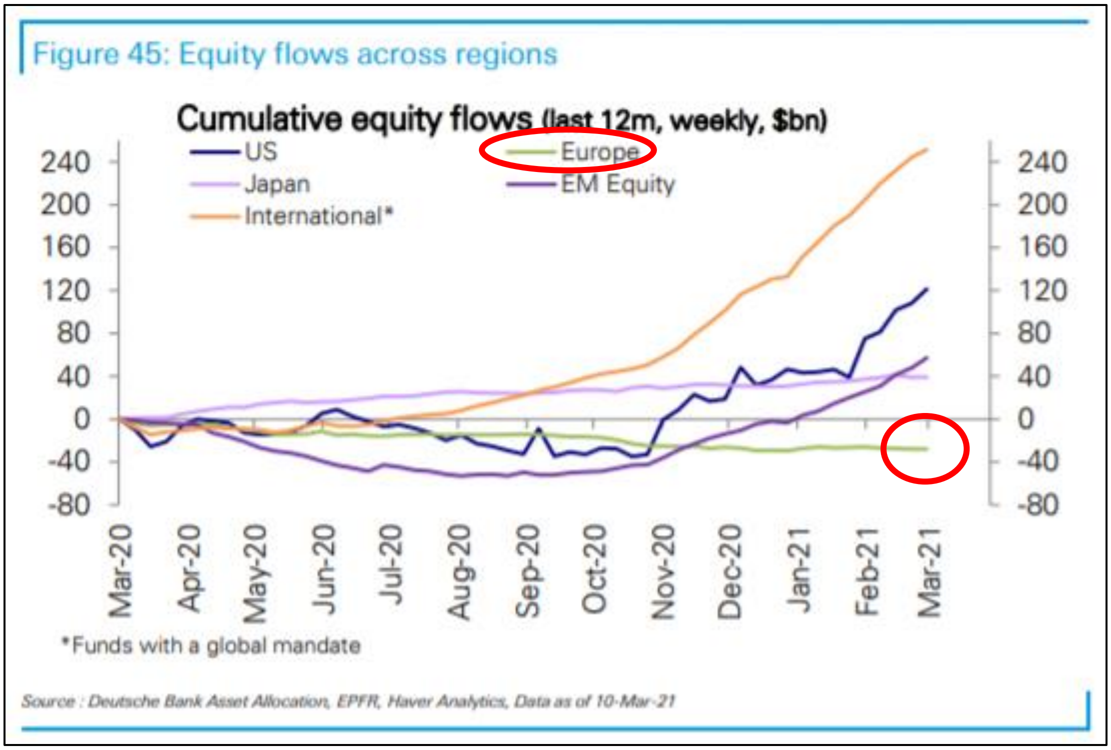
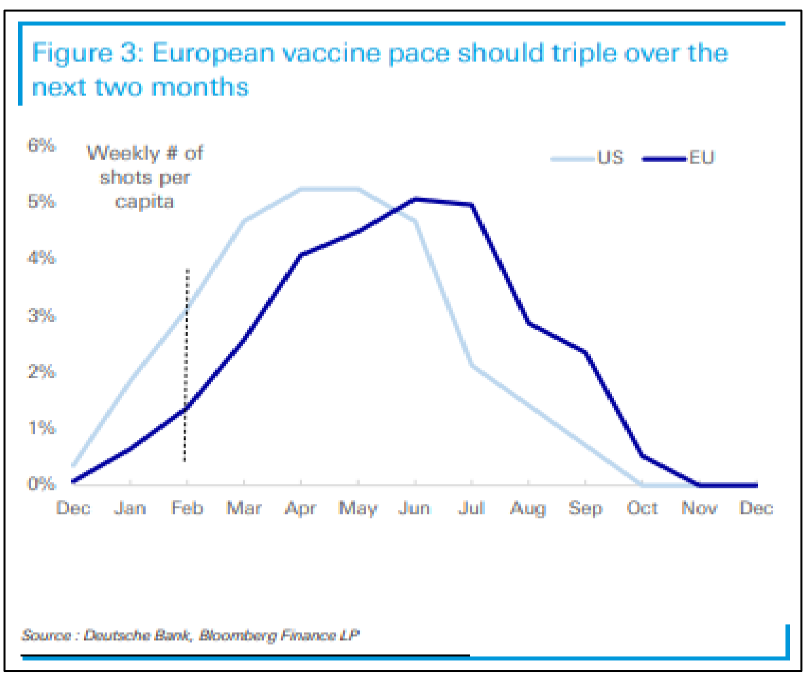
Nor do they already own it…

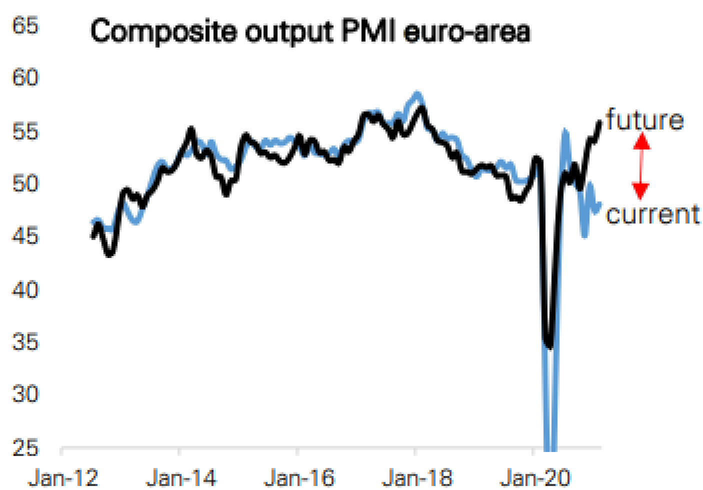


Currently, they have only vaccinated 1/3 as many as the US in % of population… but that is about to change.



With much harsher and more painful lockdowns, many still in effect, they have lots of pent-up demand.

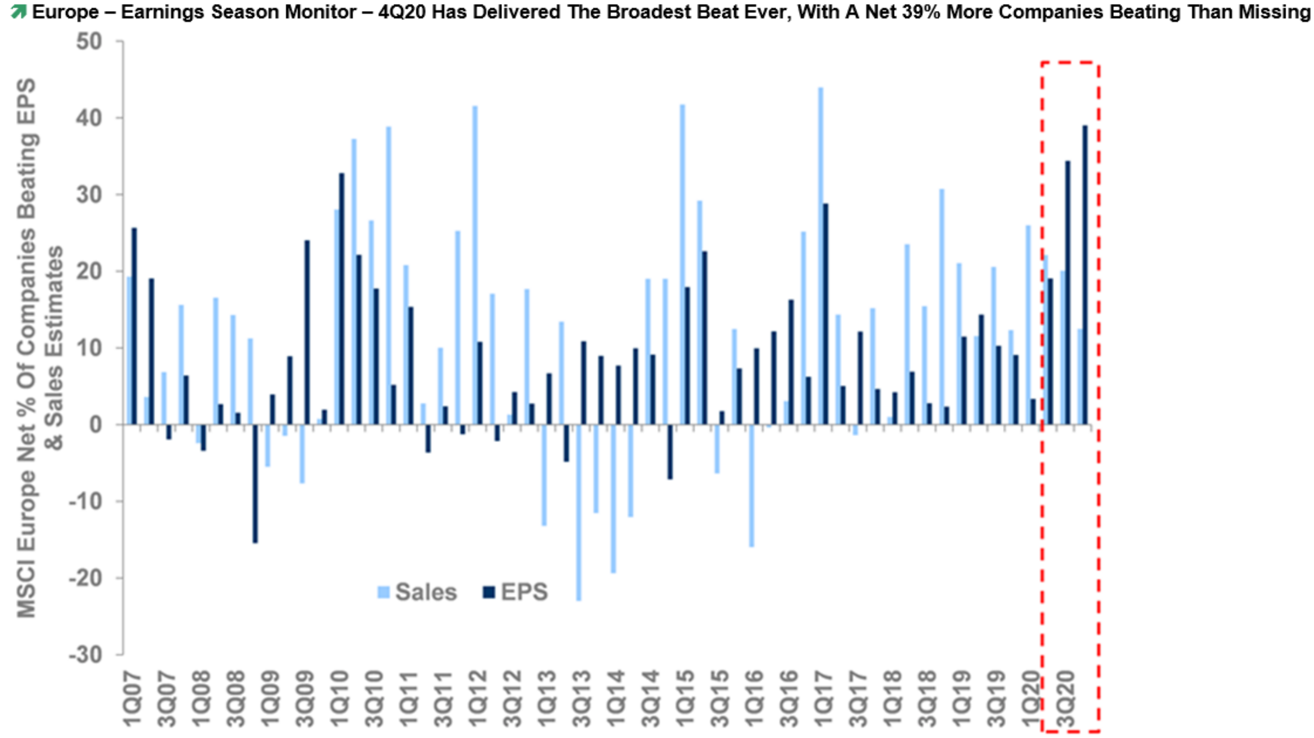
Figure 4: There is big pent-up demand in Europe too



Source : Deutsche Bank, Bloomberg Finance LP

In the meantime, earnings are actually improving…

Europe – Earnings Season Monitor – 4Q20 Has Delivered The Broadest Beat Ever, With A Net 39% More Companies Beating Than Missing

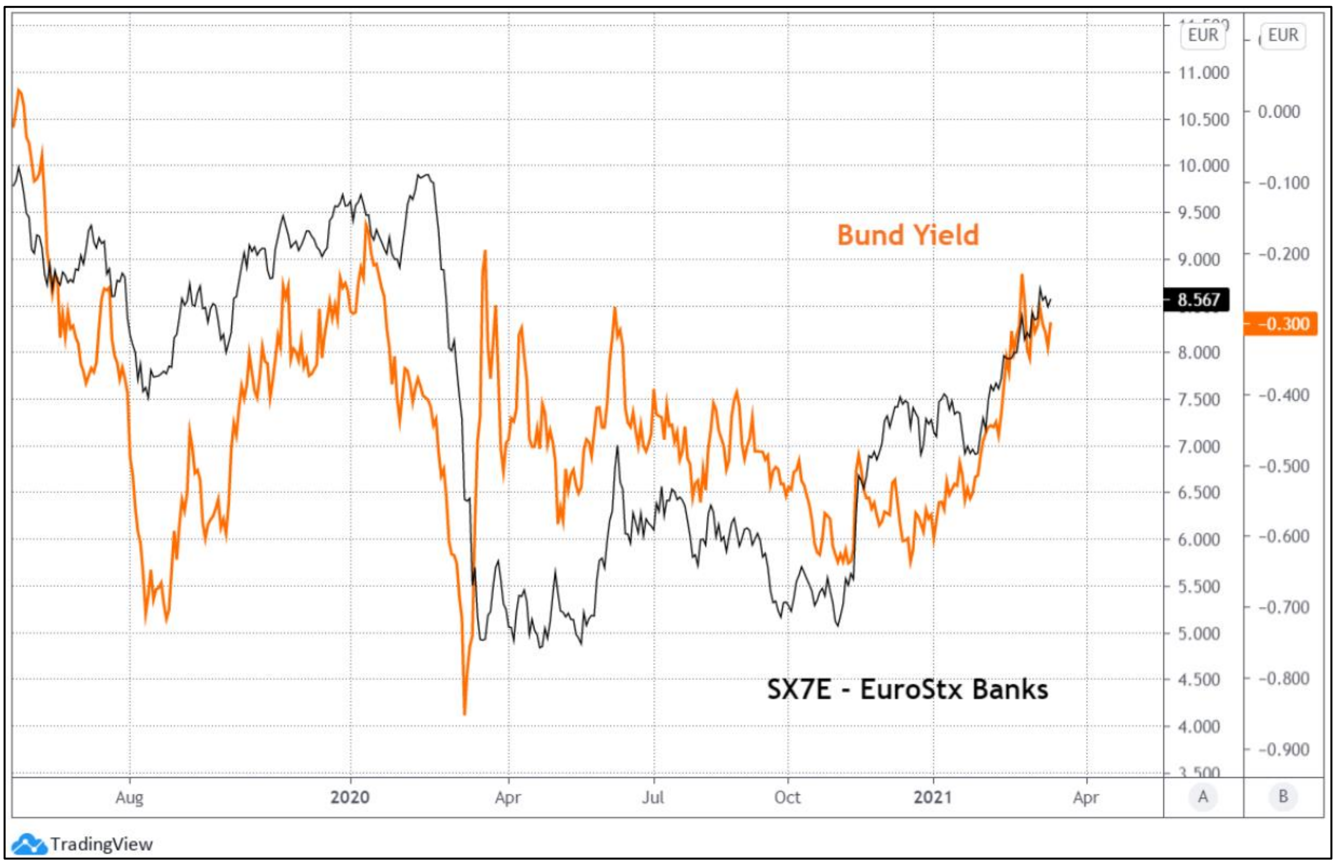


Source: MSCI, Bloomberg, Morgan Stanley Research Note: EPS beat / miss defined as +/-5% from consensus estimates

Here is Morgan Stanley's commentary to go with the chart:

"Earnings season in Europe has delivered a strong positive surprise relative to consensus estimates, with continued signs of a strong EPS recovery in 2021. There was a strong breadth of beats with 59% of companies beating EPS estimates by 5% or more, while 20% have missed, giving a 'net beat' of 39% of companies. Also, weighted earnings are on track to come in 17% ahead of consensus, with the median stock beating by 8% too. The breadth of sales beats has been much narrower than that of EPS, with a net 13% of companies beating sales estimates, which suggests a beat on margins. Furthermore, the team highlight a number of key themes emerging from this earnings season: (1) Dividends and Buybacks; (2) Financials Dividend Momentum; (3) Margin Expansion; (4) Value beating Growth on EPS; (5) Reflation in focus; and (6) Inflation likely to pick up."

Yes, European equities have been performing for the last few weeks, largely led by financials given the move up in long-end yields.



However, the broader indices are now at very interesting levels.

To be fair, growth in Europe has been slow for many years now and equities and positioning reflect that fact. In some countries like Italy, real GDP is lower than 20 years ago. However, all that is already in the price. If the US growth for value switch has global legs, Europe is washed out value with no sponsorship. Every dog has his day.

Euro Stoxx at the top of the range… watch for the break.


Euro Stoxx 50
EUR
4800.0
4600.0
4400.0
4200.0
4000.0
3873.2
3833.4
3831.8
3600.0
3400.0
3200.0
3000.0
2800.0
2600.0
2400.0
2200.0
2000.0
1800.0
1600.0
2006
2008
2010
2012
2014
2016
2018
2020
2022
TradingView

France too…


CAC40
EUR
7600.000
7200.000
6800.000
6400.000
6157.673
6033.760
5600.000
5200.000
4800.000
4400.000
4000.000
3600.000
3200.000
2800.000
2400.000
2000.000
1600.000
1995
1998
2001
2004
2007
2010
2013
2016
2019
2022
TradingView

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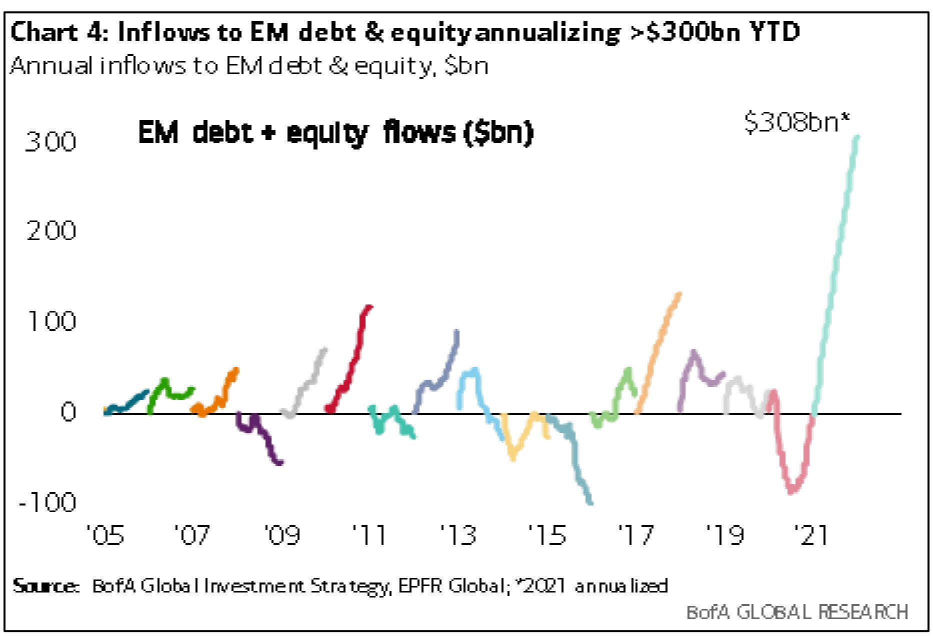
Is the end of COVID pain about to mean explosive tourism and travel? We are back near pre-COVID levels already, so some of it already being priced, but taking out early 2020 highs has resulted in big jumps in many markets.

EM – Interestingly, EM has seen almost the opposite in terms of interest and flows. Competitive bond yields, the prospects for global reflation and, risking currency values have been attracting large capital flows.



I'm not bearish EM unless financial conditions do meaningfully tighten, i.e. higher yields and higher USD. It also isn't the start of that party. Notice what it did when the early 2020 highs came out.

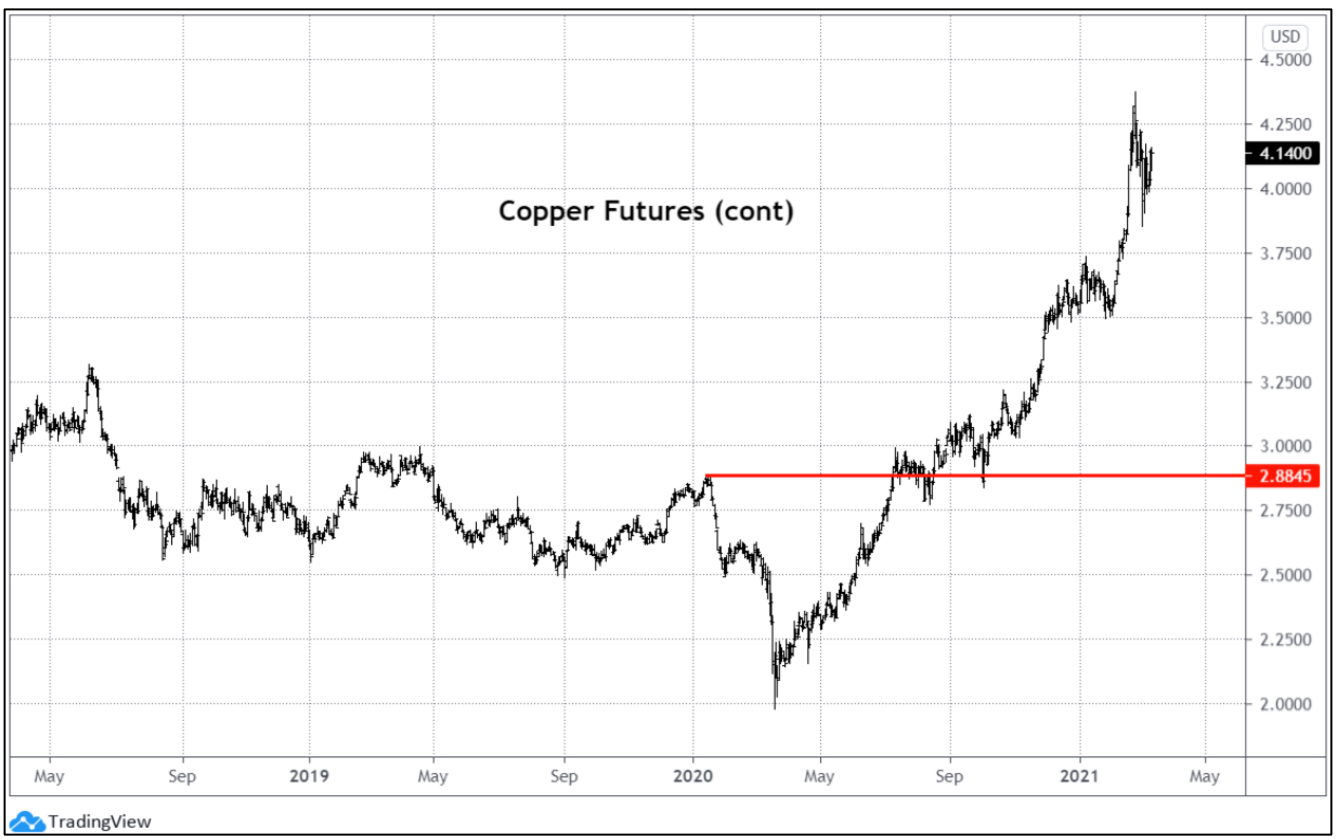
FX - In some ways, FX is a Fed play here. If yields keep rising and they don't react, it could mean USD higher and financial conditions tighter until they do react. How they react will matter, a lot. The closer they get to real YCC the worse for the dollar. In the meantime, the jump in things like USDCHF and USDJPY is unwinding some of the dollar short positioning.

Figure 13: CTA allocations in FX (long USD)

Source : Deutsche Bank Asset Allocation, Bloomberg Finance LP, Data as of 11-Mar-21

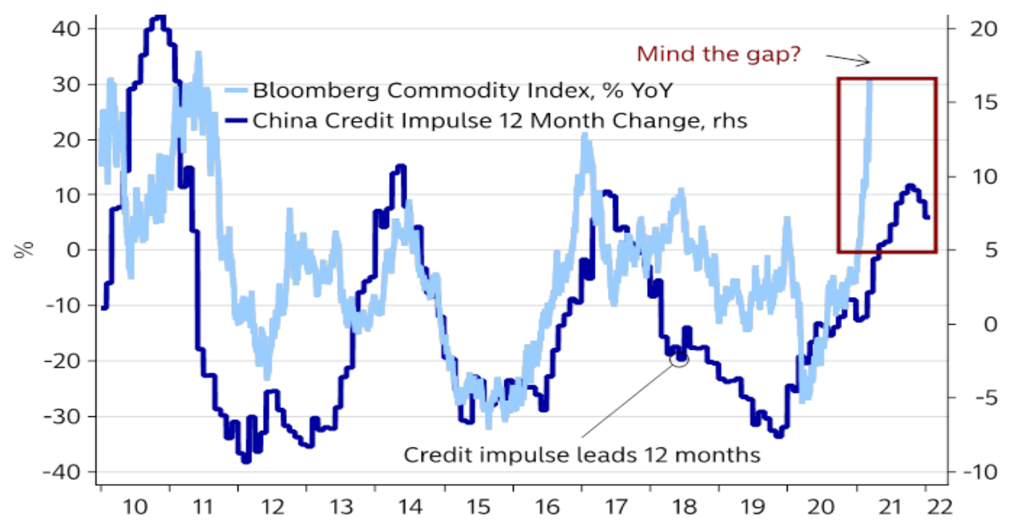
Although on a trade-weighted basis it is still substantial.

Commodities - Industrial commodities have been running very hot. Things like copper…

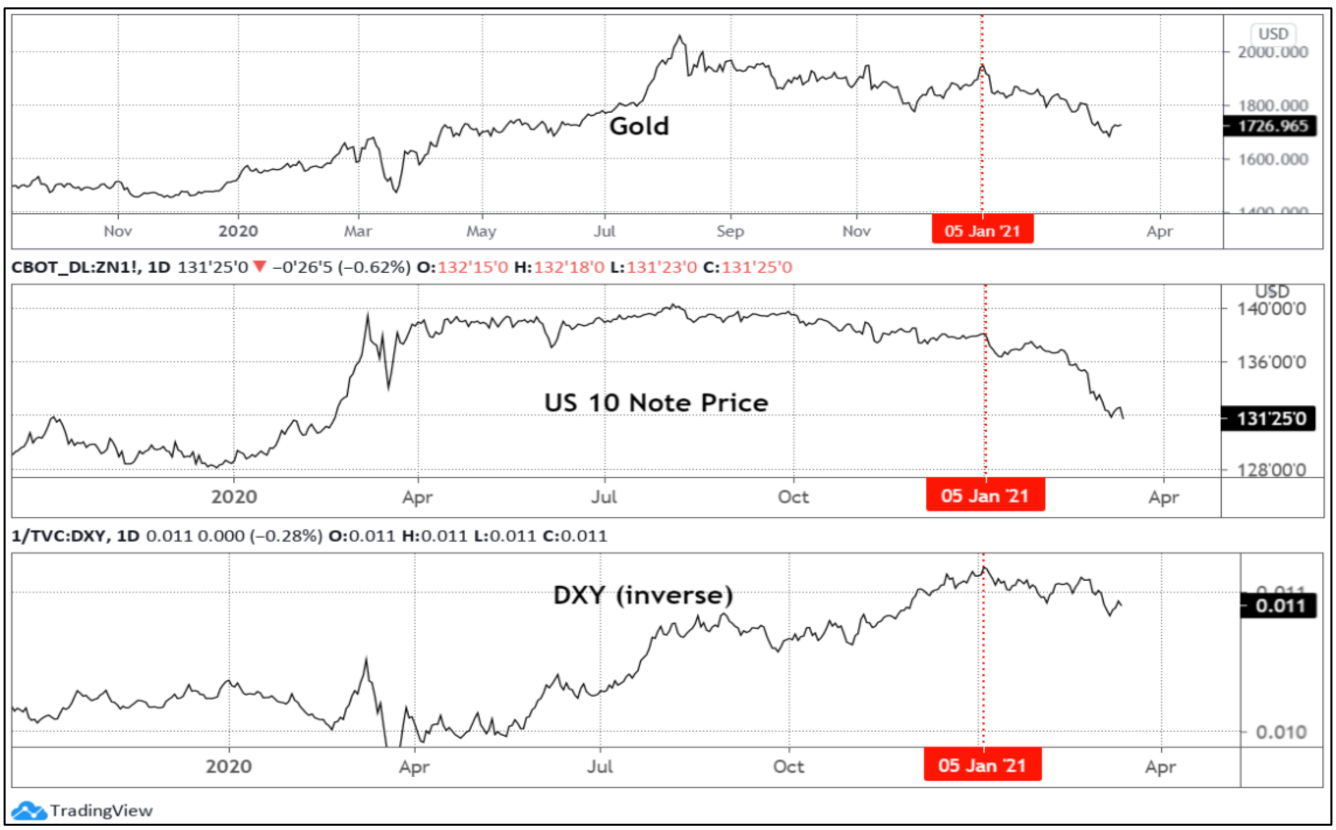


However, come the second half of the year there are signs that China credit could start to have an effect. Not now… but one not to forget about. Yields and dollar developments could add to this depending on how it all plays out.

Chart 5. China's credit cycle is rolling over, which could be a warning signal for H2-2021



Gold has had a hard time with the combination of higher yields pushing up longer-term real rates and the USD's recent rally.



Last week we got to a big level and held… let's see. Both Gold and miners are trying to stabilize… maybe.

The zoomed in GDX chart has got my attention … although it still has some work to do to get me excited.

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Thought this was interesting… then and now:

Table 1: 365 days later from when WHO announced global pandemic…
Key market and macro driver levels pre-Covid, during Covid, and today

		Pre Covid	Covid Low/High	Now
Macro	US PMI	51.1	41.7	60.8
	US CPI (YoY%)	2.5	0.1	1.7
	China PMI	50.2	35.7	50.6
	US Payroll (k)	315	-20679	379
Market	US 10yr Treasury (%)	1.51	0.54	1.54
	IG spread	99	401	104
	HY spread	338	1087	363
	Oil ($/bbl)	60	20	70
	Gold ($/oz)	1680	1471	1723
	Bitcoin ($)	10389	4904	57664
	S&P500 ($)	3373	2237	3939

Source: BofA Global Investment Strategy, Bloomberg

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Important Macro Data Releases and Events for the Week

Sunday
3/14/2021

- Industrial Production YoY (Jan) Forecast: 30%, Prior: 7.3%
- Retail Sales YoY (Jan) Forecast: 32%, Prior: 4.6%

Monday
3/15/2021

- RBA Meeting Minutes
- Industrial Production YoY (Jan) Forecast: -5.3%, Prior -5.3%

Tuesday
3/16/2021

- EcoFin Meeting
- ZEW Survey - Economic Sentiment (Mar) Forecast: 65.1, Prior: 69.6
- ZEW Survey - Current Situation (Mar) Forecast: -62, Prior: 67.2
- ZEW Survey - Economic Sentiment (Mar) Forecast: 74, Prior: 71.2
- Retail Sales Control Group (Feb) Forecast: -1.2%, Prior: 6%

Retail Sales MoM (Feb) Forecast: -0.5%, Prior: 5.3%

Wednesday
3/17/2021

CPI Core YoY (Feb) Forecast: 1.1%, Prior: 1.1%

30-year Bund Auction

Building Permits MoM (Feb) Forecast: 1.75M, Prior: 1.886 M

Housing Starts MoM (Feb) Forecast: 1.57 M, Prior: 1.58 M

CPI Core YoY (feb) Forecast: 1.4%, Prior: 1.6%

Fed Interest Rate Decision and Monetary Policy Statement / Press Conference

Thursday
3/18/2021

BoE Interest Rate Decision and Monetary Policy Statement

Initial Jobless Claims Forecast: -, Prior: 712k

Initial Jobless Claims 4-week average Forecast: -, Prior: 759k

Continuing Jobless Claims -, Prior: 4.144 M

BoJ Interest Rate Decision and Monetary Policy Statement / Press Conference

Friday
3/19/2021

Producer Price Index MoM (Feb) Forecast: 0.7%, Prior: 1.4%

Retail Sales MoM (Jan) Forecast: -2.5%, Prior: -3.4%

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