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What to focus on in Global Macro for the week of July 20th, 2020

Macro Themes on the Radar:

EU

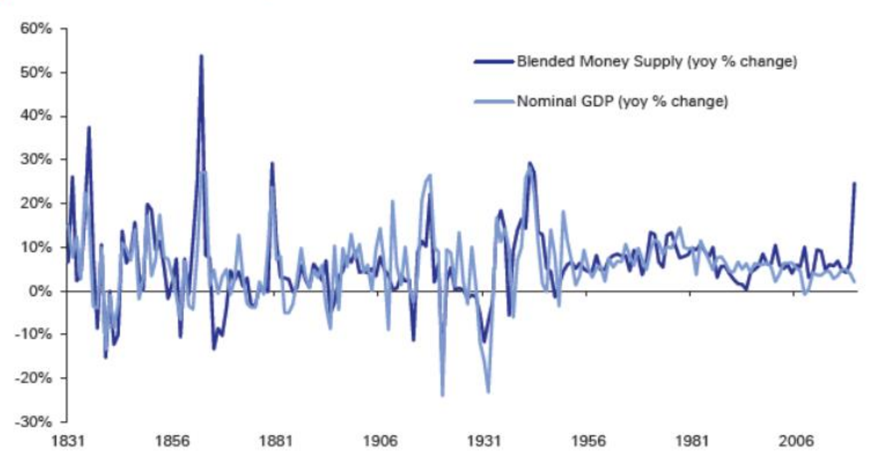
As expected, last week's ECB meeting and press conference were relatively unexciting. The ECB reaffirmed PEPP size at €1.35 trillion, running until at least June 2021. APP purchases continue at €20bn. No signs of slowing QE support. No changes to TLTRO or tiering.

With nothing new expected or delivered from the ECB, the market has been focused on the EU Recovery Fund negotiations that started on Friday as EU leaders met face-to-face in Brussels for the first time since the pandemic began. Now in day three of negotiations, the outcome is still uncertain and potentially deadlocked. The Dutch and their PM Mark Rutte stand at the center of the "frugals" as they oppose the current mix of loans and grants. They are demanding reforms be part of the grants and that their budgetary rebates be maintained. Either an agreement, or the failure to reach one could be a big deal for markets. So far on Sunday afternoon, we have no deal.

US

In the US, there is talk that the Fed is moving toward explicit inflation targeting. This would be part of a strengthened forward guidance campaign that would require a move to, and potentially above, the 2% inflation rate before the Fed would consider raising rates. The Phillips Curve is out… and with it, inflation forecasting. In its place we will likely see a refocusing on [actual inflation] as a policy trigger. At the same time, prospects for yield curve control continue to lurk.

Figure 1: Historically in the United States, nominal GDP growth has closely tracked money supply growth



Source : GFD, Deutsche Bank
Note: We've tried to use the broadest definition of the money supply available. This means it's a blend of currency in circulation (1831-1929), M1 (1930-1948), and M2 (1949-current). The Fed discontinued M3 in 2006 so we didn't blend that in historically.

As we approach the end of the month, if and in what form the $600 pandemic related boost to unemployment insurance will be renewed, remains an open question. With over 24m Americans still receiving this supplement the resolution will impact everything from consumer sentiment to retail sales. It is thought by some that the current boost is too high and is acting as a dis-incentive for people to go back to work. At the same there is a lot of political pressure to renew some type of special payment. Potentially this could mean that the supplement is cut back to $400 or even $200 rather than just allowed to expire.

What to Focus on Now:

Most of the factors that have helped stocks rally over the last few months are intact. Negative real rates, very generous fiscal and monetary policy and the tailwind of TINA in a low yield world, remain in place.

The fact that 77% of SPX stocks have a higher dividend yield than the US 10-year Treasury, serves to illustrates the "there is no alternative" argument for stocks.

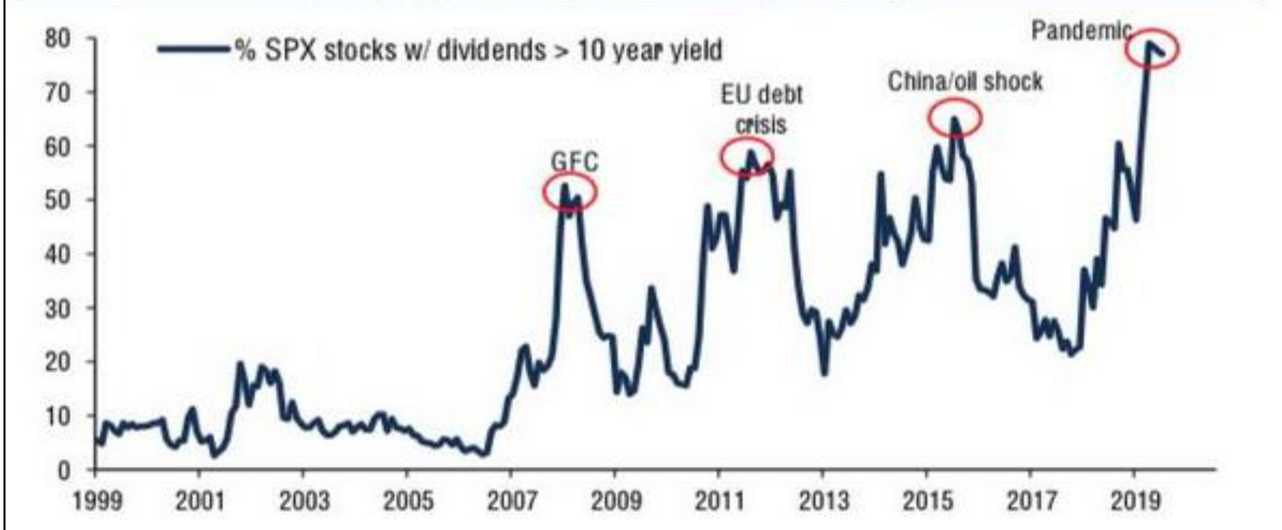
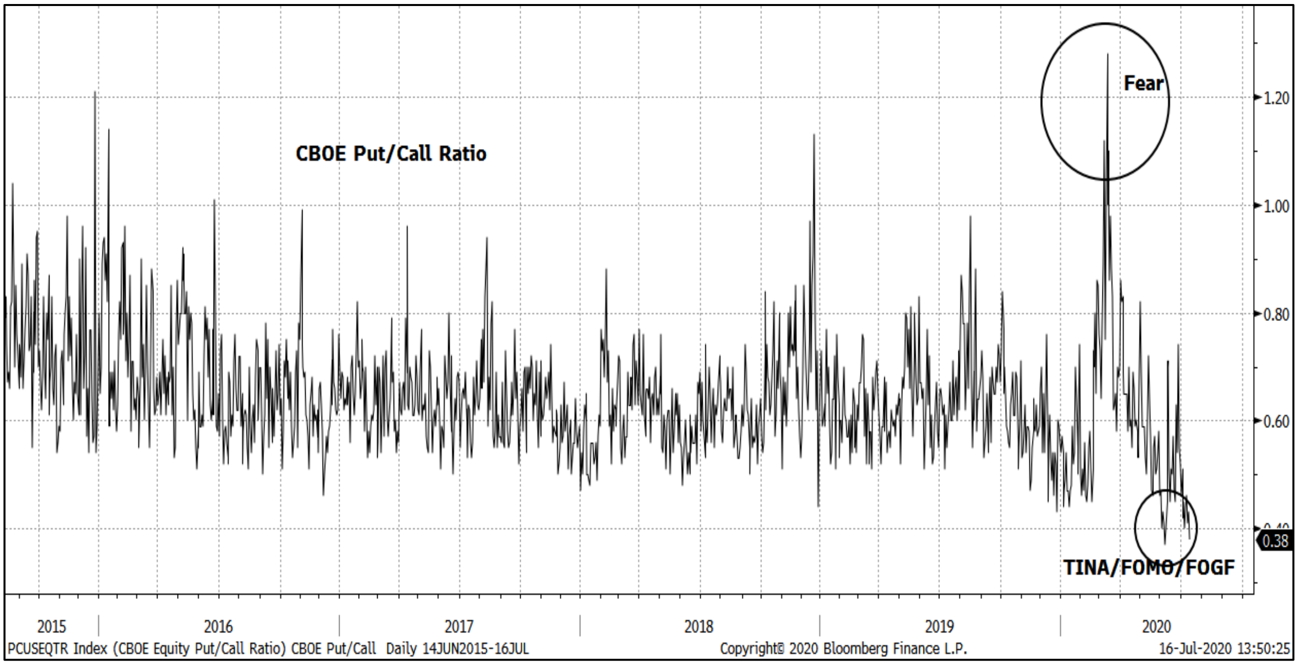


Chart 1: There is no alternative
Percentage of S&P 500 companies paying dividends greater than the 10-year Treasury yield
Source: BofA Research Investment Committee, Bloomberg

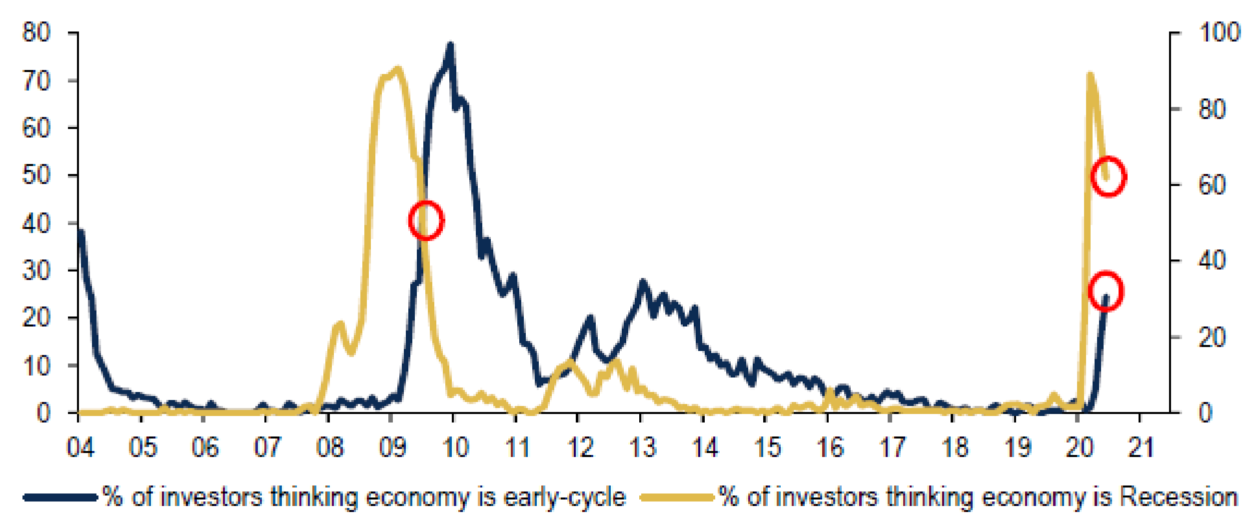
Momentum and "fear of missing out" has taken things like the put/call ratio back to extremes.



Last week saw the release of the July BoA/ML's Global Fund Managers Survey... I thought it was very instructive on how people are positioned and what sentiment that reflects. Obviously, a lot of concentrated consensus positioning can result in a big move in the markets, if the mood changes.

Investors are still very cautious, but sentiment is improving.

Exhibit 3: FMS expectations of "early recovery" vs "recession" better measure of macro belief



Source: BofA Global Fund Manager Survey

However, investors also think US equities are already overvalued.

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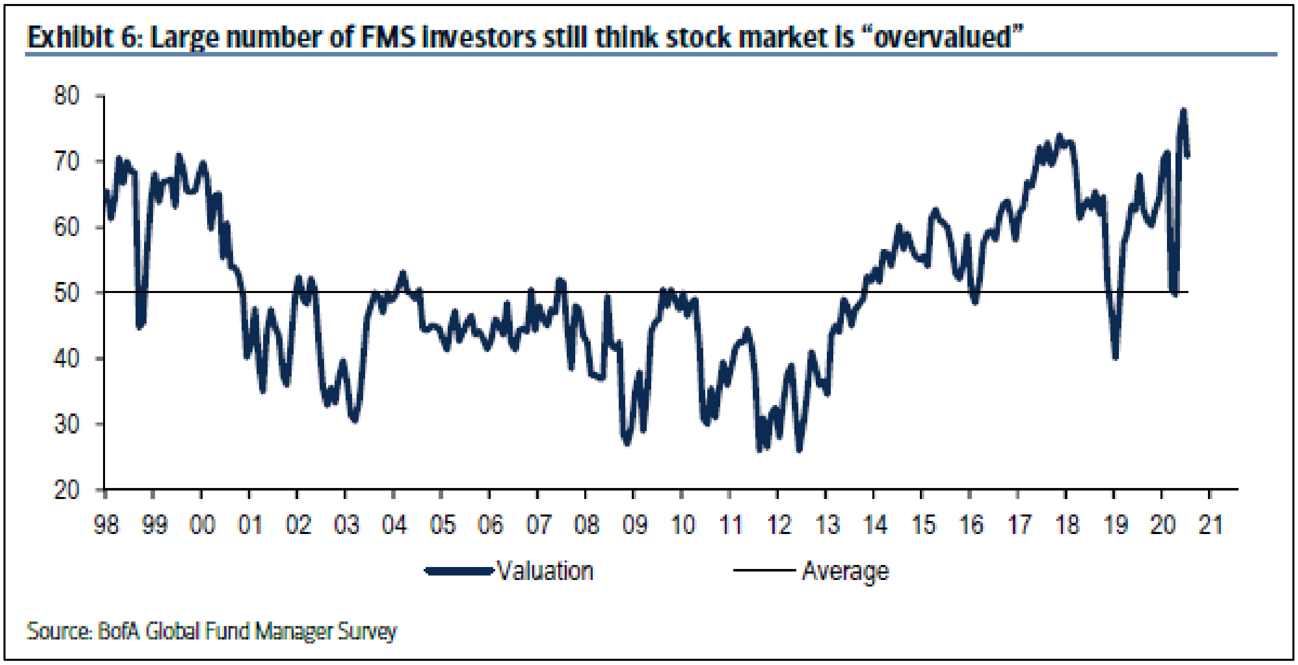
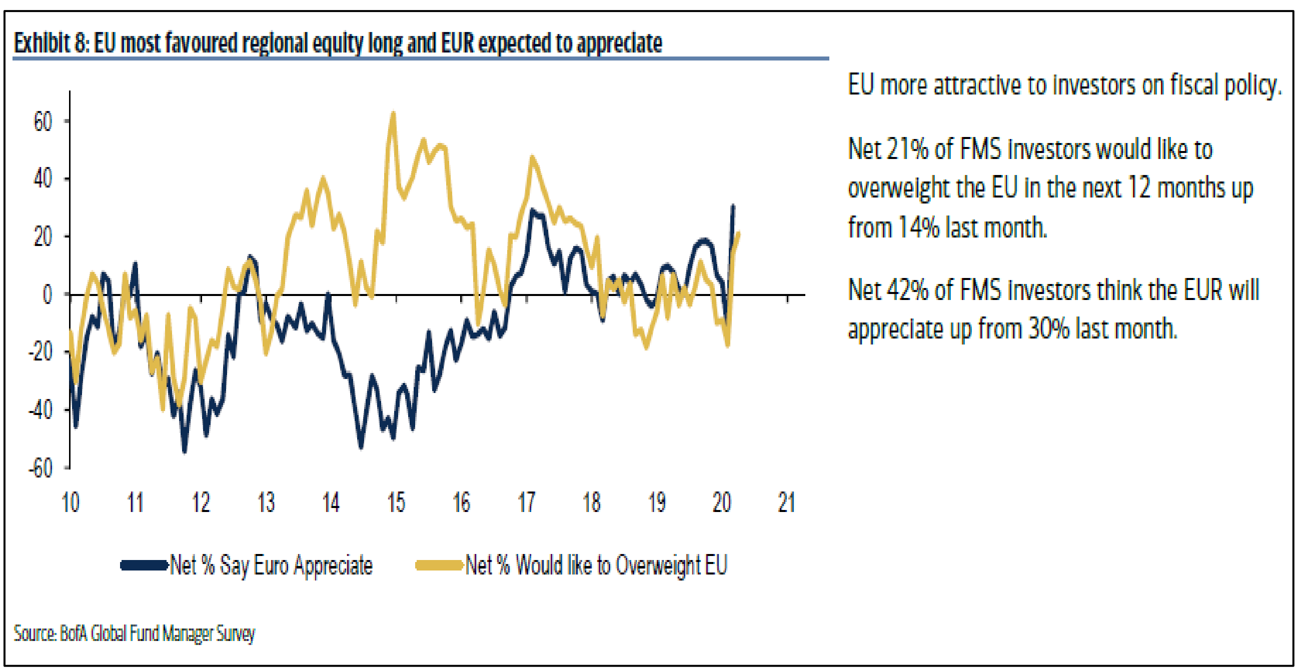
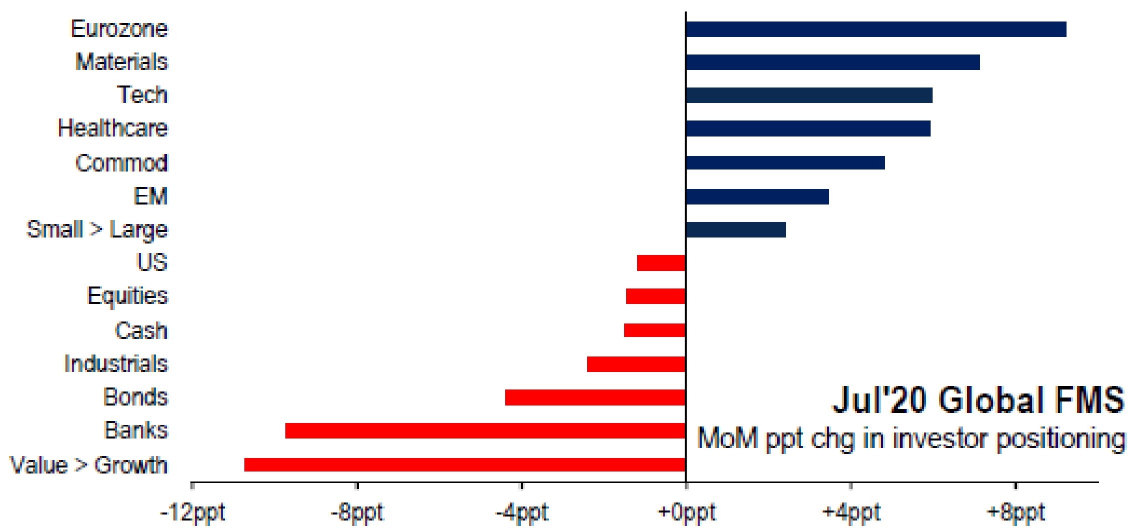


With a strong fiscal policy and a better current virus backdrop, they are increasingly starting to look to Europe.



Yes, they have started buying Europe, but overall there is still no love for long underperforming "value" in the US…

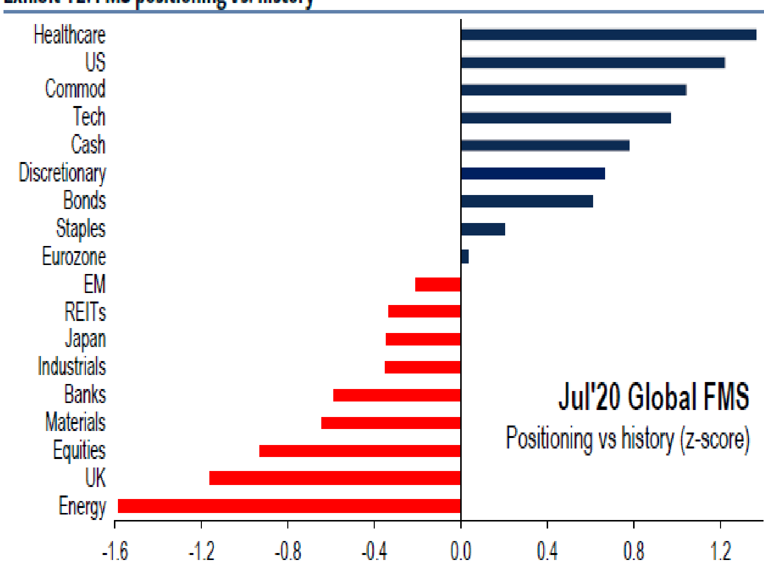
Exhibit 11: Europe most favored but global banks saw biggest drop and no love for value



Source: BofA Global Fund Manager Survey

Overall, US healthcare and technology are still heavily owned.

Exhibit 12: FMS positioning vs. history

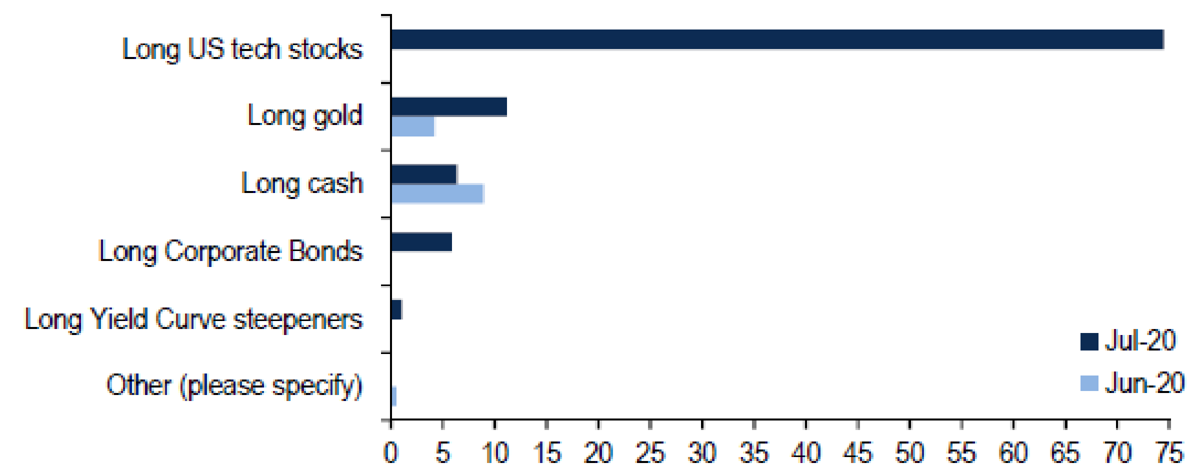


FMS investors increased their net exposure to their favorite overweights (technology and pharma) and moderated their underweight in materials.

Source: BofA Global Fund Manager Survey

Not only are survey respondents positioned for "growth" and "defense" … they think everyone else is as well.

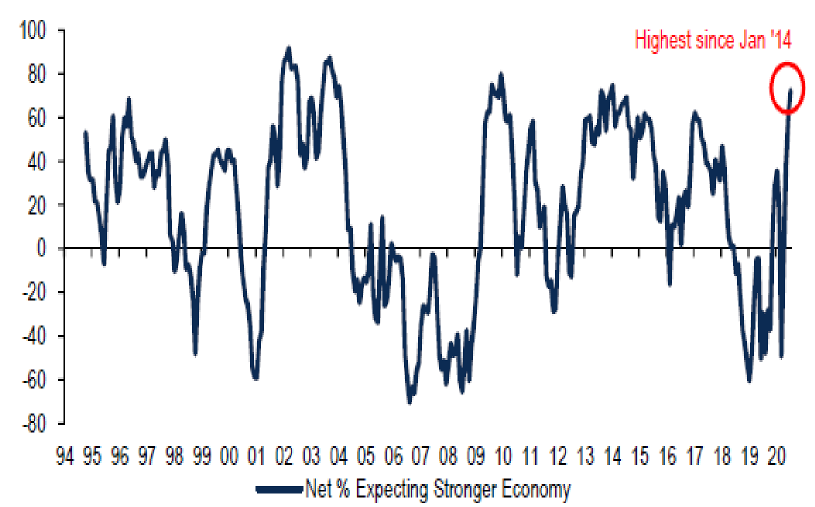
Exhibit 29: What do you think is currently the most crowded trade?



Source: BofA Global Fund Manager Survey

However, at the same time they think that the global economy should continue to improve … significantly.

Exhibit 25: How do you think the global real economy will develop over the next 12 months?

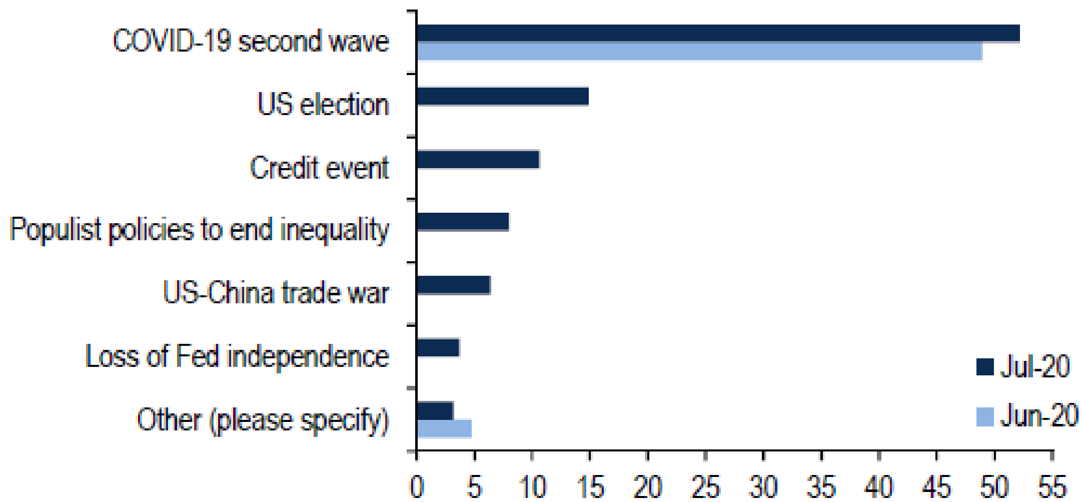


July FMS shows investors raised global growth expectations by another 11ppt to net 72%, highest level since Jan'14; 36% of respondents expect the global economy to get 'a lot stronger', the highest figure recorded (going back to Oct'94)

Source: BofA Global Fund Manager Survey

Risks are seen to remain centered around COVID, with politically generated tail risks filling in most of the other line items. Fair enough given the current situation in some states.

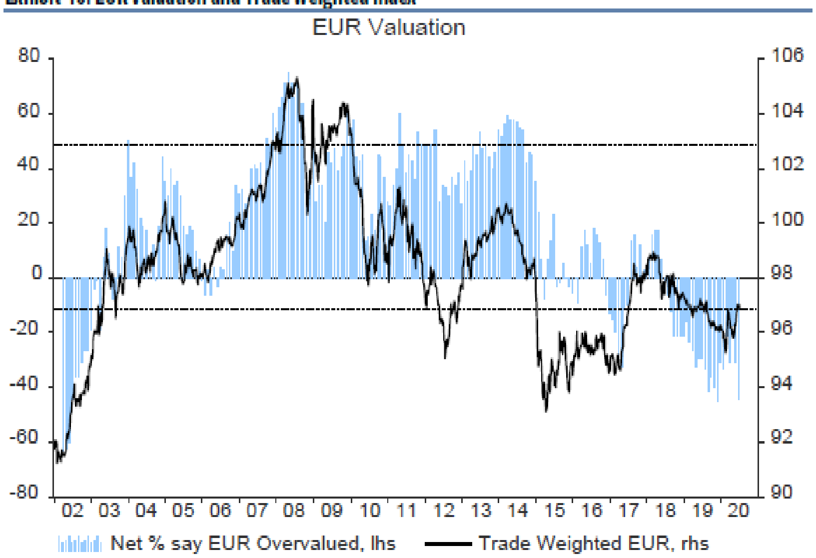
Exhibit 28: What do you consider the biggest "tail risk"?



Source: BofA Global Fund Manager Survey

With regard to currencies, investors think the EUR is cheap… (again, we probably need a meaningful EU Recovery Fund deal to get another leg higher I would guess)

Exhibit 40: EUR valuation and Trade weighted Index



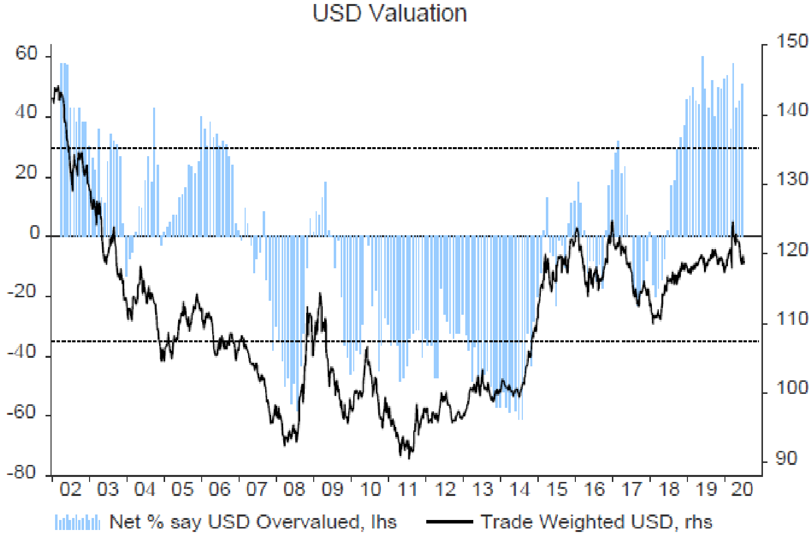
Net 44% FMS investors say EUR is cheap, the most since Dec '19.

Current valuations are 2.1 stdev below the long-term average.

Source: BofA Global Fund Manager Survey

and that the USD is expensive.

Exhibit 41: USD Valuation and Trade weighted index



Source: BofA Global Fund Manager Survey

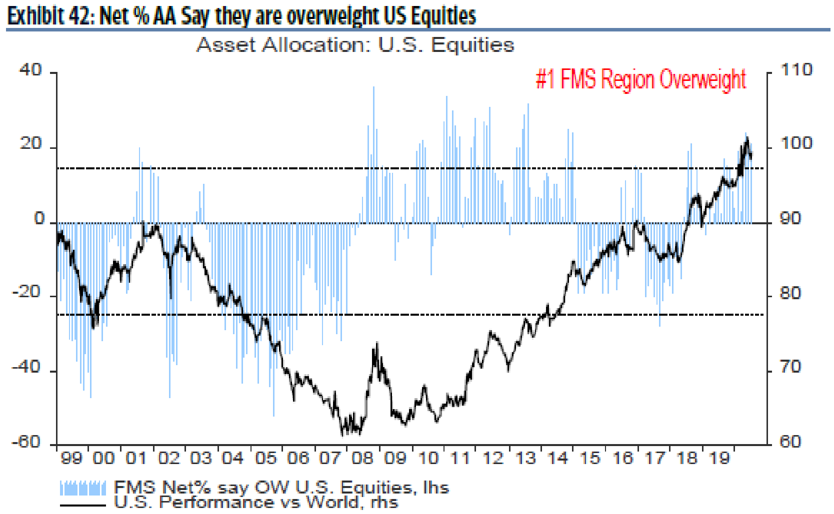
Net 51% FMS investors say the US$ is overvalued, up 6ppt MoM.

Current valuations are 1.7 stdev above the long-term average.

They remain very long the US (and fair enough given the outperformance of returns and earnings we have seen).

Investor Regional Equity Allocation

Exhibit 42: Net % AA Say they are overweight US Equities



Source: BofA Global Fund Manager Survey

Allocation to US equities declined 1ppt to net 21% overweight but remains #1 FMS region this month.

Current allocation is 1.2 stdev above its long-term average.

And are just now, after a big jump, getting back to average long-term allocation to Europe.

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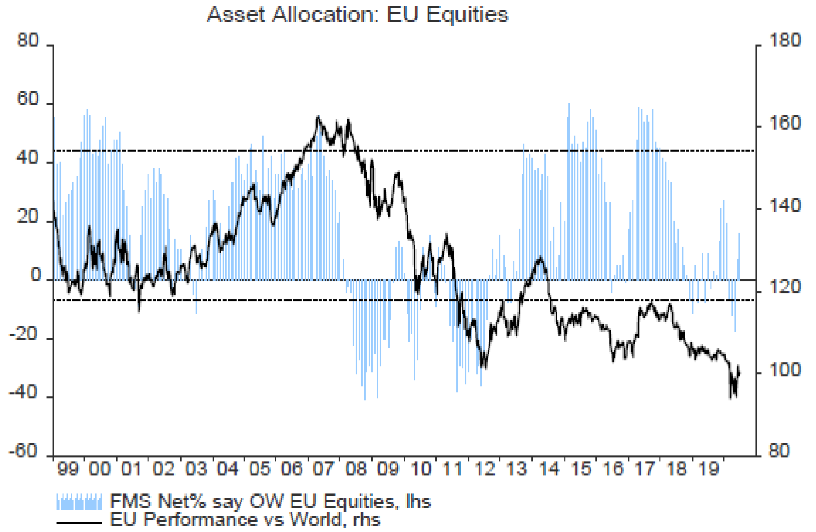
Exhibit 43: Net % AA Say they are overweight Eurozone Equities



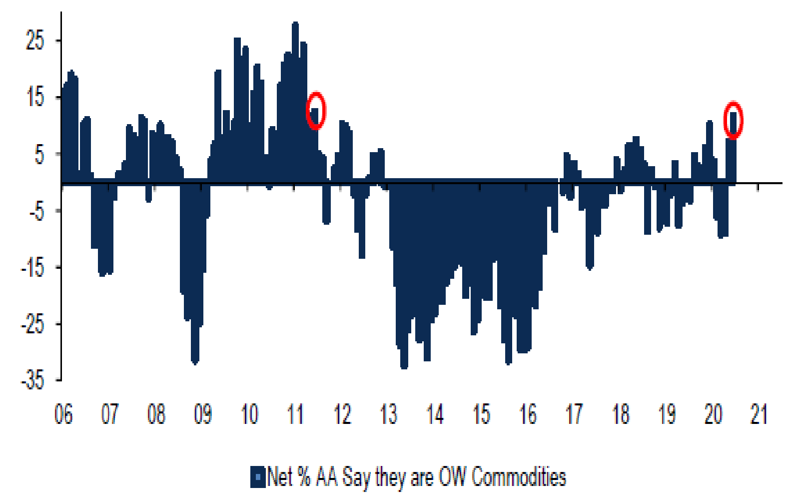
Source: BofA Global Fund Manager Survey

Allocation to Eurozone equities increased 9ppt to net 16% overweight, the largest increase in net weighting of any region this month.

Current allocation is at its long-term average.

Rhyming with their view on the USD, rate expectations and the potential for Central Banks to "let it run hot", the allocation to commodities is rising…

Exhibit 9: Highest overweight in commodities since July '11



Source: BofA Global Fund Manager Survey

Asset allocation: equity allocation low, bond allocation high relative to past 10 years but commodities highest since July '11. Net 12% of FMS investors say they are overweight commodities.

To sum up the survey…

Institutional investors are long US tech and healthcare but think US equities are overvalued.

They think global growth should improve but are not really positioned for it.

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Recently they have starting to move a little, … the buying of Europe and Commodities is picking up. EM would be an obvious addition if capital really starts to be redeployed.

A falling USD is probably required for this shift to continue or accelerate. So far it has fallen a bit but has failed to achieve a clear break.

If it does go, it could go hand in hand with the long-awaited shift from "growth" to "value". Both within the US and on a global scale.

There is a lot of ammo (given current positioning) to move prices if we do get the shift.

What is the evidence that the timing is now? Other than the above-mentioned flows…

Well it is building… Let's take a look at some charts.

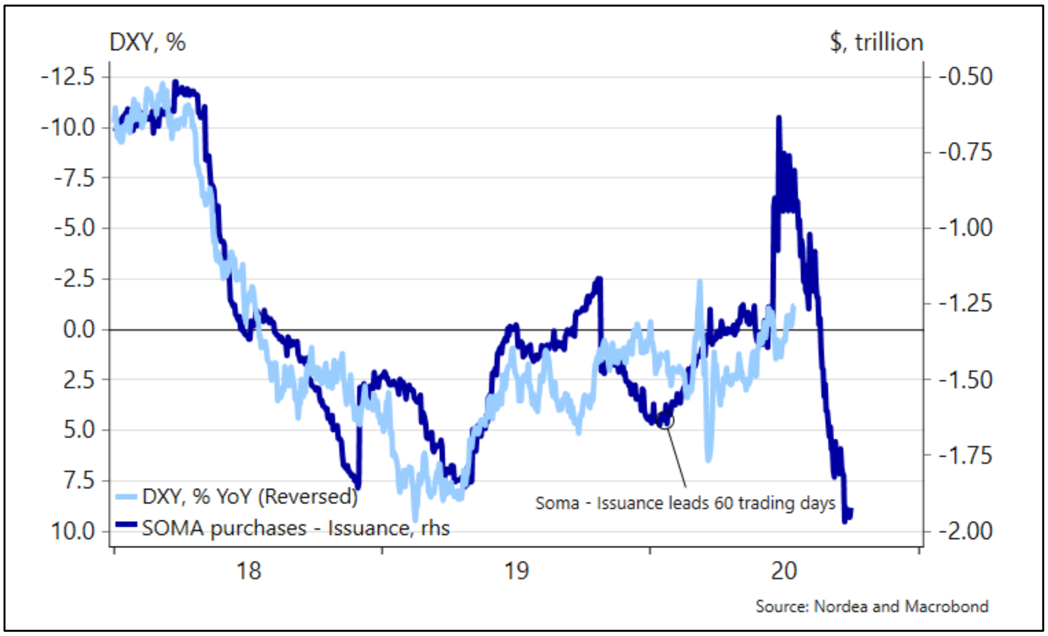
Top in Growth vs. Value?

There have been a number of false starts for this trade over the last few months. Maybe we face another one, but the set-up is better than it has been, and I think the probability of a more meaningful move is higher this time.

The dollar is a critical component. Further weakness would validate the shift. Here is the Deutsche Bank Trade Weighted USD … just barely holding in. Other trade weighted USD charts look similar.

There has been some concern that the fall in the Fed's balance sheet over the last few weeks would retard USD weakness. However, the primary driver of the fall, which has been decreased

FX swap line usage, is a sign of a receding USD shortage and therefore, potentially dollar bearish. Another concern people have expressed is that Fed QE has not been keeping up with Treasury issuance and that the result is a USD drain from the system (especially given the jump in the TGA account). Fair enough, we will have to see if it matters or is drowned out by other capital flows. Feels like a tipping point for the dollar one way or the other.



Last week saw a big price reversal in various relative performance charts… As you know, the driver of equities has been the FAANGM stocks. These charts would say that the timing for a turn in that relative performance could be now. Perhaps a bigger question is what does that mean for markets overall? Can a leadership change occur with a bullish backdrop? Again, I think a lot will depend on what the dollar tells us about the back story.

Either way the reversals last week are very interesting from a technical perspective. This type of set-up is typical of a trend that is running out of steam.

Here Europe (VGK) vs. NASDAQ 100 (QQQ)… but if no agreement on the EU Recovery Fund, it could be short lived.

If we drill down a little into the US, it becomes clear that even the NASDAQ vs. the SPX may be seeing the start of a reversal.

The different weights of the big cap tech names that have been driving the US equity rally have made the NDX outperformance this year striking. First sign of a turn, or at least a pause?

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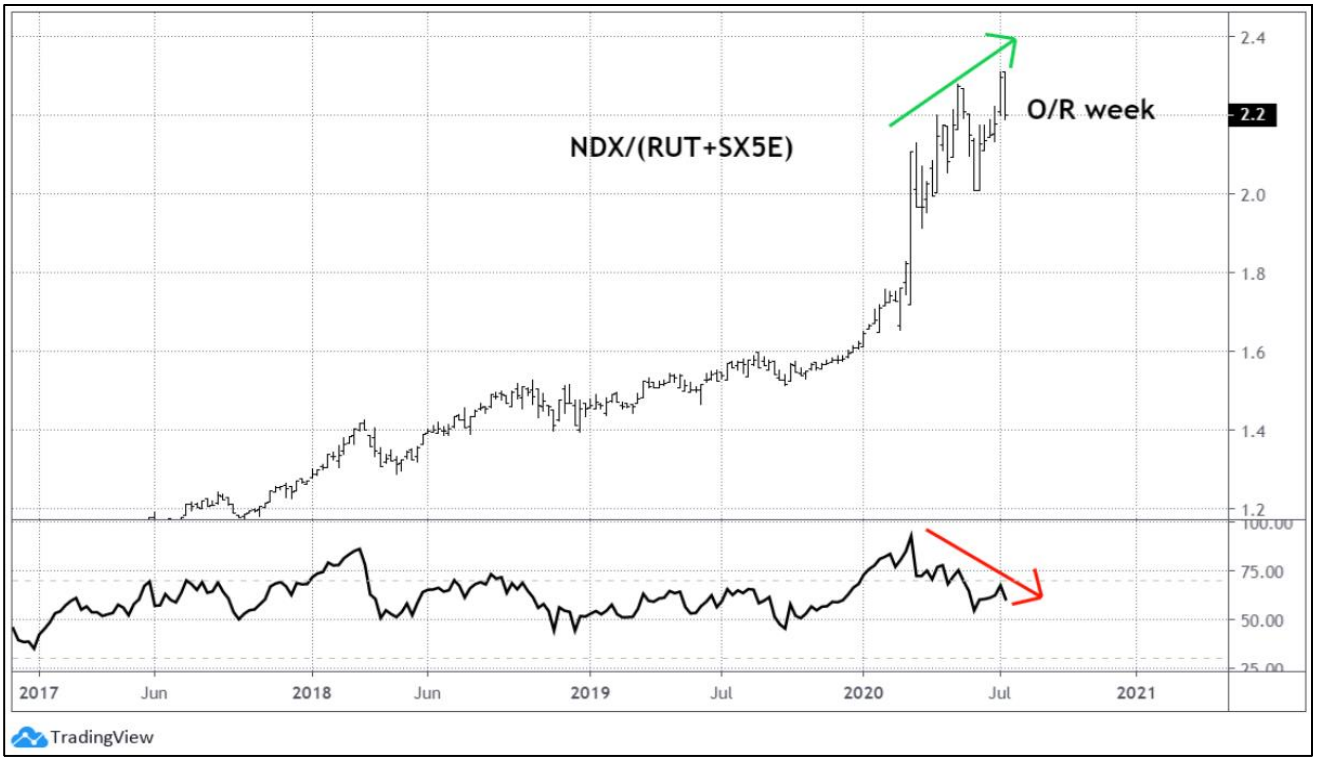
Another potentially interesting way to look at the global Growth vs. Value trade is via this combination of NASDAQ vs. Russell and Euro Stoxx. Reversal pending?

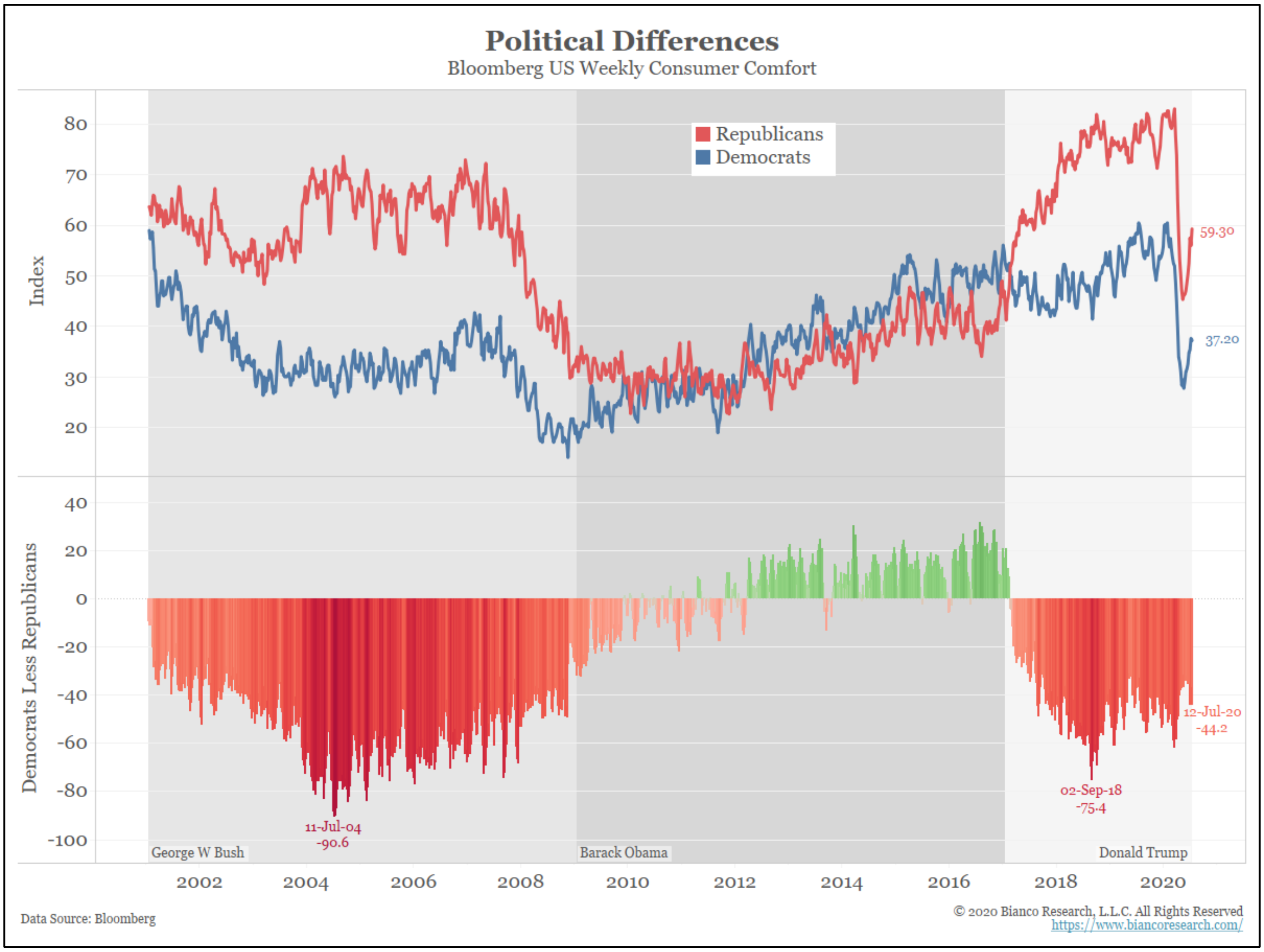


Could it all just amount to another quick retracement in the trend, like we saw back in May when everyone got very excited about a turn towards Value? I would say the technical setup is better now, but let's see.

In any case, I think there is still good reason to look for ways to have some structurally long volatility/gamma trades. I expect that volatility will remain higher than what we saw during the last five years as the power that governments can exert on markets and the economy has shifted away from central bankers to fiscal policy makers. With CB's now out of bullets other than as providers of leverage for government lending programs don't expect that balance of power to shift back anytime soon. Here is a great interview with Russell Napier in which he discusses some of this and what it could mean going forward.

Chart of the week

I thought this was an interesting one from Bianco Research… disagreement on the state of the economy when you break down the Bloomberg's weekly consumer comfort index by political affiliation.



Important Macro Data Releases and Events for the Week

Monday
7/20/2020

- RBA Meeting Minutes
- RBA's Governor Lowe SPEECH

Tuesday
7/21/2020

- Chicago Fed National Activity Index (June) Forecast: -, Prior: 2.61
- Retail Sales MoM (May) Forecast: 21%, Prior: 19.1%

Wednesday
7/22/2020

- Consumer Price Index Core YoY (Jun) Forecast: 0.9%, Prior: 0.7%

	Housing Price Index MoM (May) Forecast: -, Prior: 0.2%
	Existing Home Sales MoM (Jun) Forecast: 4.79m, Prior: 3.91m
	NAB's Business Confidence QoQ (Q2) Forecast: -8, Prior: -11
Thursday 7/23/2020	Gfk Consumer Confidence Survey (Aug) Forecast: -4.5, Prior: -9.6
	Initial Jobless Claims Forecast: -, Prior: 1.3m
	Initial Jobless Claims 4-week ave. Forecast: - , Prior: 1.375m
	Continuing Jobless Claims Forecast: -, Prior: 17.338m
	Commonwealth Bank Manufacturing PMI (Jul) Forecast: 55.1, Prior: 51.2
Friday 7/24/2020	Markit Manufacturing PMI (Jul) Forecast: 48.3, Prior: 45.2
	Markit Service PMI (Jul) Forecast: 50.4, Prior: 47.3
	Markit PMI Composite (Jul) Forecast: 50.3, Prior: 47
	Markit Manufacturing PMI (Jul) Forecast: 49.5, Prior: 47.4
	Markit Service PMI (Jul) Forecast: 51, Prior: 48.3
	Markit PMI Composite (Jul) Forecast: 51.1, Prior: 48.5
	Markit Manufacturing PMI (Jul) Forecast: 51.3, Prior: 49.8
	Markit Service PMI (Jul) Forecast: 50.2, Prior: 47.9
	Markit PMI Composite (Jul) Forecast: -, Prior: 47.9
	New Home Sales MoM (Jun) Forecast: 0.7m, Prior: 0.676m

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