Stargazer
Asset Management

What to focus on in Global Macro for the week of March 9th, 2020

Macro Themes on the Radar:

Federal Reserve Bank of Boston President Eric Rosengren and Kansas City Fed President Esther George both spoke at a conference on Friday in New York.

Rosengren said the Fed may have more potency in the next crisis by buying a "broader range" of securities or assets given how low rates currently are. "There would be little room for the Federal Reserve to lower rates through large purchases of long-term Treasury securities, like it did to make conditions more accommodative in and after the Great Recession, if a recession occurred in this rate environment," he said.

George on the other hand, said she has many reservations about the Fed buying assets that are not Treasuries. "These effects, together with the perception that interest rates will remain at historically low levels for a prolonged period, can lead to a buildup of financial imbalances that ultimately pose risks to the real economy,"

The European Central Bank has been buying corporate debt and the Bank of Japan is buying equities via ETF's, but by statute, the Fed is currently limited in what it can buy.

Section 14 of the Federal Reserve Act limits open market purchases to obligations issued by or guaranteed by the U.S. government. The agency debt and mortgage-backed securities that the Fed purchased in the financial crisis were guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae.

As Rosengren acknowledged, the Fed would need an act of Congress to expand its authority to buy securities and assets. So, at least for the time being, his preference would be stimulus coming from Congress should it be needed

Both Rosengren and George were skeptical about the effectiveness of negative rates. (Thank goodness.)

If we remove a potential move to negative rates, and they may change their minds on this, the current toolbox includes the following:

- Rates back to zero.
- More "Not QE" via Repo and T-Bills
- Resumption of full QE –Treasuries and Mortgages again in the absence of an act of Congress. Potentially Equities and Corporate Bonds down the road.
- YCC (Yield Curve Control) in which they set a maximum yield for various Treasury securities along the curve. Most likely in the front end at least initially. This could be very controversial as the Fed will be increasingly seen as outright funding the deficit/debt.
- Forward Guidance and AIT (Average Inflation Targeting). These are really more of an accelerant once inflation gains traction than current stimulus.

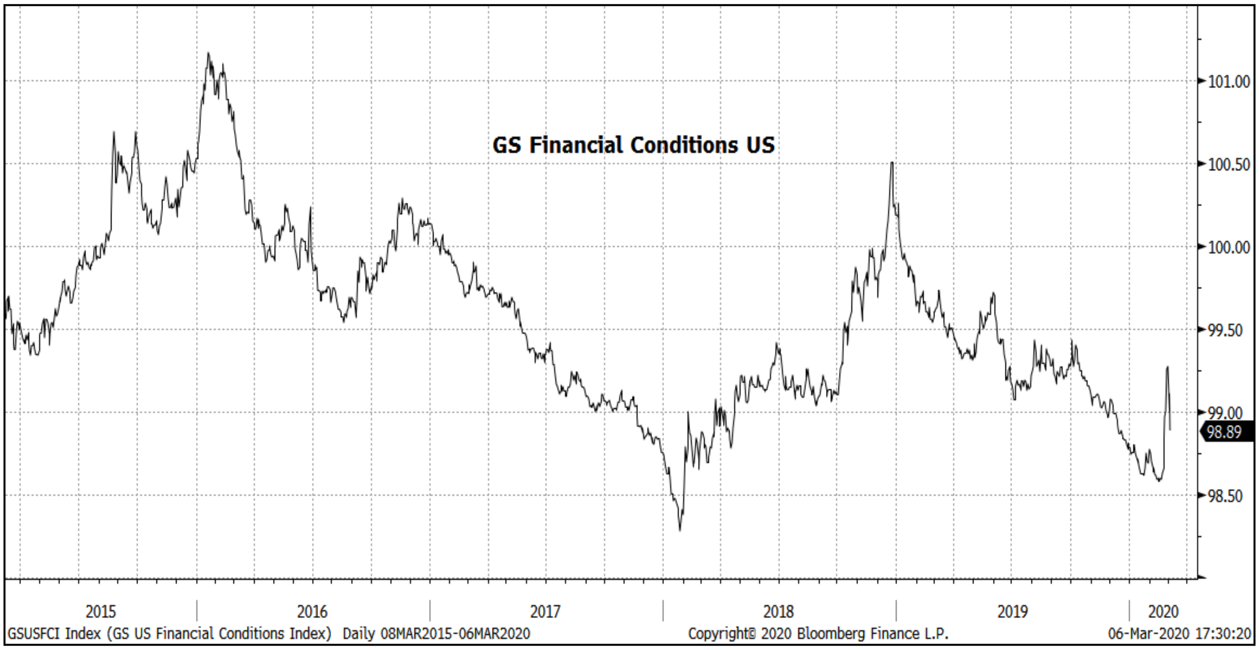
Initial fiscal stimulus seems to be coming via spending to control the coronavirus. Globally, we are north of 100bln announced so far. That is likely to climb.

Rosengren floated the idea automatic stabilizers, which offset economic fluctuations with a dynamic government budget, or infrastructure spending as possible policies.

"In a low-interest-rate environment, the obvious alternative to monetary policy in a downturn is to depend on fiscal policy shouldering a greater share of the burden for providing needed stimulus to the economy," Rosengren said.

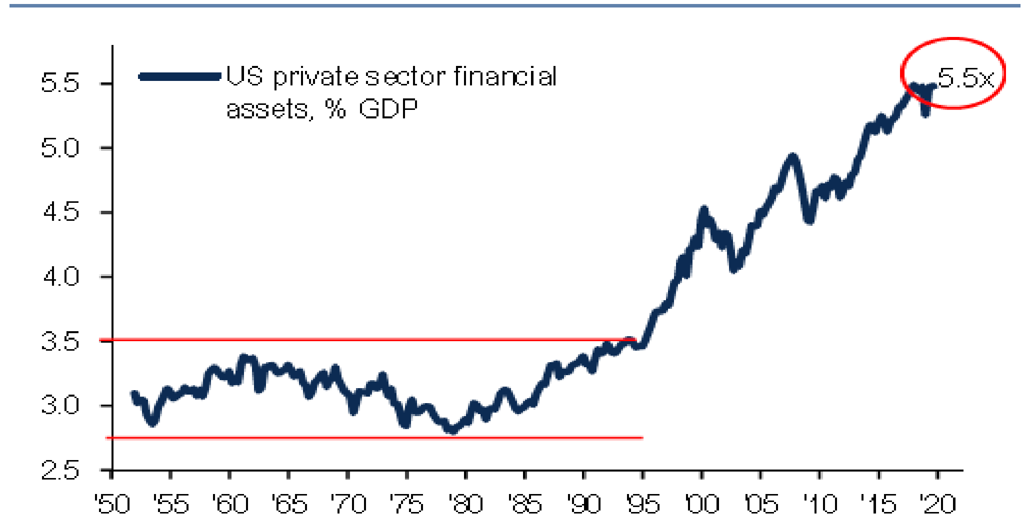
As of Friday, the markets had priced further substantial cuts at the March 17-18th meeting and again in June.

Over the last week several Fed officials have mentioned the tightening of Financial Conditions as a concern. There are a number of versions of this index, even inside the Fed. I tend to like the Goldman Sachs version as it includes the USD which some of the others underweight. Generally, they all include Equities, Credit and Rates/Yields. With Rates/Yields falling, the USD (trade weighted) off the highs and Credit weaker but not yet in full blown retreat, the Fed's concern for Financial Conditions is in effect code for Equities.



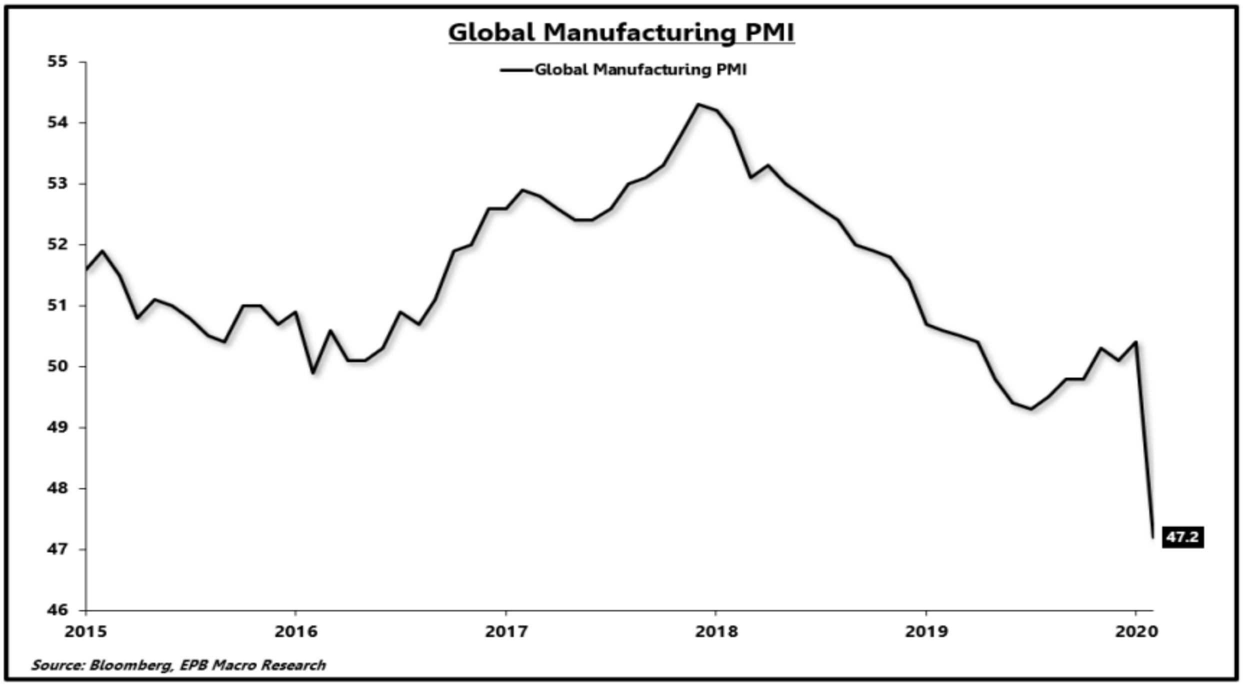
With Wall Street now 5.5X the size of Main Street (according to BoA/ML) I guess they have good reason to be focused on it.

Chart 8: Wall Street 5.5x size of Main Street



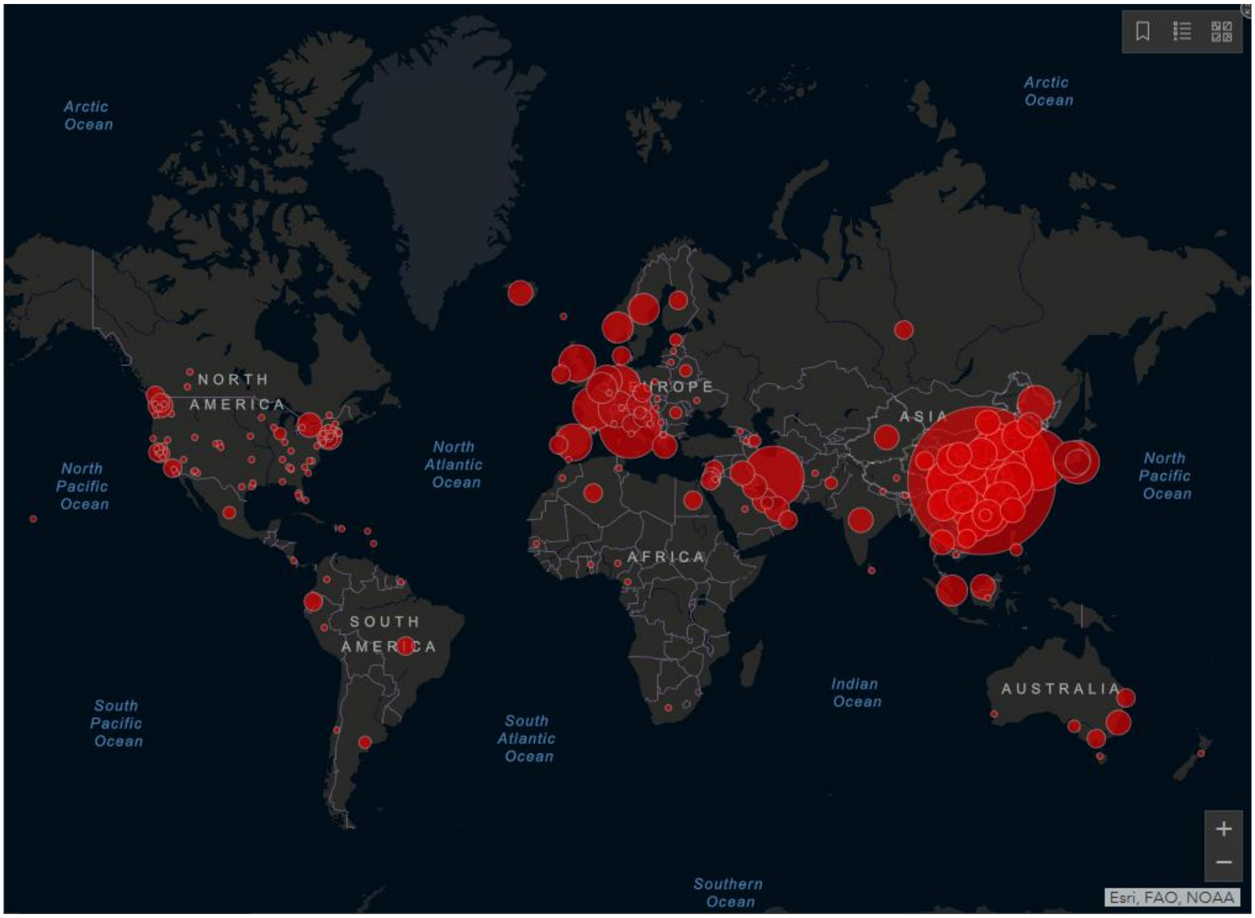
Source: BofA Global Investment Strategy, Haver; note private sector financial assets includes currency, deposits, equity shares, and other securities and does not include real estate.

While those saying "it is just the flu" battle with the Pandemic crowd, we really just don't know how this is going to break. In either case, a global recession of some sort, even if brief and with a V recovery, is becoming increasingly baked in. Led by China, and a rolling Demand/ Supply shock, Global Manufacturing PMI's have plunged.



Governments are faced with a choice, outbreak or recession. If you slowly roll out measures as the media and popular outcry increases, you probably get both. In China, they opted for what they hoped would be relatively severe but short-lived economic pain as they attempted containment. That approach is of course much harder the more open and democratic the nation. For all the criticism of the Chinese handling of the virus, Europe and the US have been even slower to react. Really, they never had the option to do what China did.

In either case the containment attempts are all but over in practical terms; that window has closed. We are now moving on to managing the outbreak.



Policy going forward will focus on slowing the spread, with three goals in mind. 1) Don't overwhelm the medical system with a huge number of severe cases all at once. 2) Gain time as we wait for the vaccine. 3) Minimize the lasting economic impact.

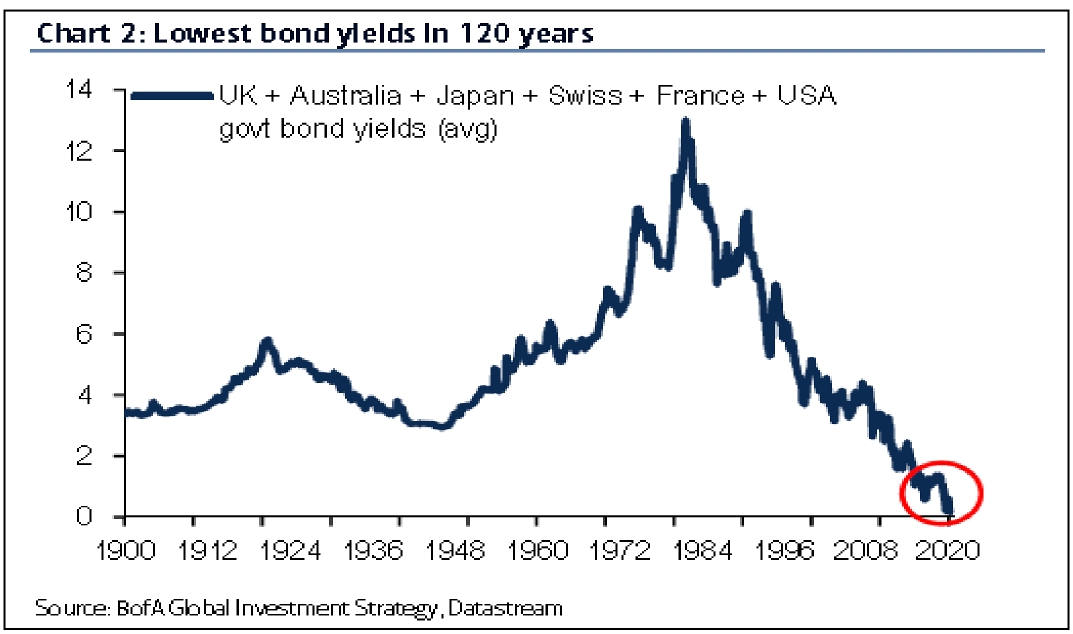
The good news is that the actual death rates are likely much lower than the 2-3% being reported. South Korea, has been testing huge numbers of citizens, including those who are asymptomatic, and the current death rate looks to be below 1%. The average age of death is 80.

On Sunday, Italy expanded its "Red Zone" to include 16M people in Northern Italy vs. 50K.

The Fed is taking the situation seriously, but I suspect largely reacting to the equity markets. Inter-meeting cuts are obviously rare. Here are the previous 7 that we have seen over the last 20+ years. These emergency cuts have almost always brought at least a bounce. Is this a '98 scenario, or the start of something more lasting? That is the question being debated.

Contact: efill@stargazerfunds.com / +1.203.219.3649

Over the last 40 years, the Fed has never cut more than three times in a row without a recession. This was cut #4. However, with so many “never happened before” inputs, we face a forecasting jungle. For example, we have never seen low global bond yields…



- Very low or negative policy rates
- Few monetary policy options

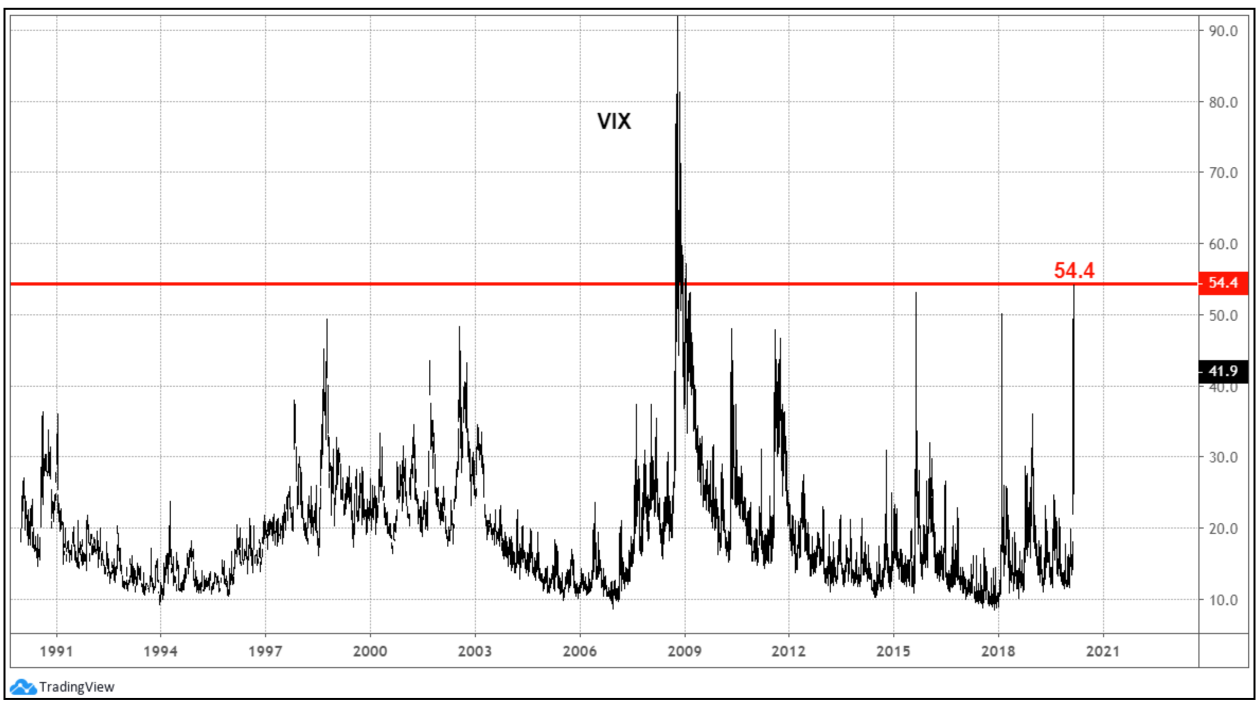
- Pandemic risks
- High US deficit given the point in the cycle (low unemployment)
- High global debt levels
- Huge US outperformance vs. rest of world
- Growth vs. Value extreme only seen during '99.

Now throw in: Trade, foreign policy uncertainty and US election uncertainty, and we are faced with an environment in which volatility is likely to stay higher than what these markets have become accustomed to.

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

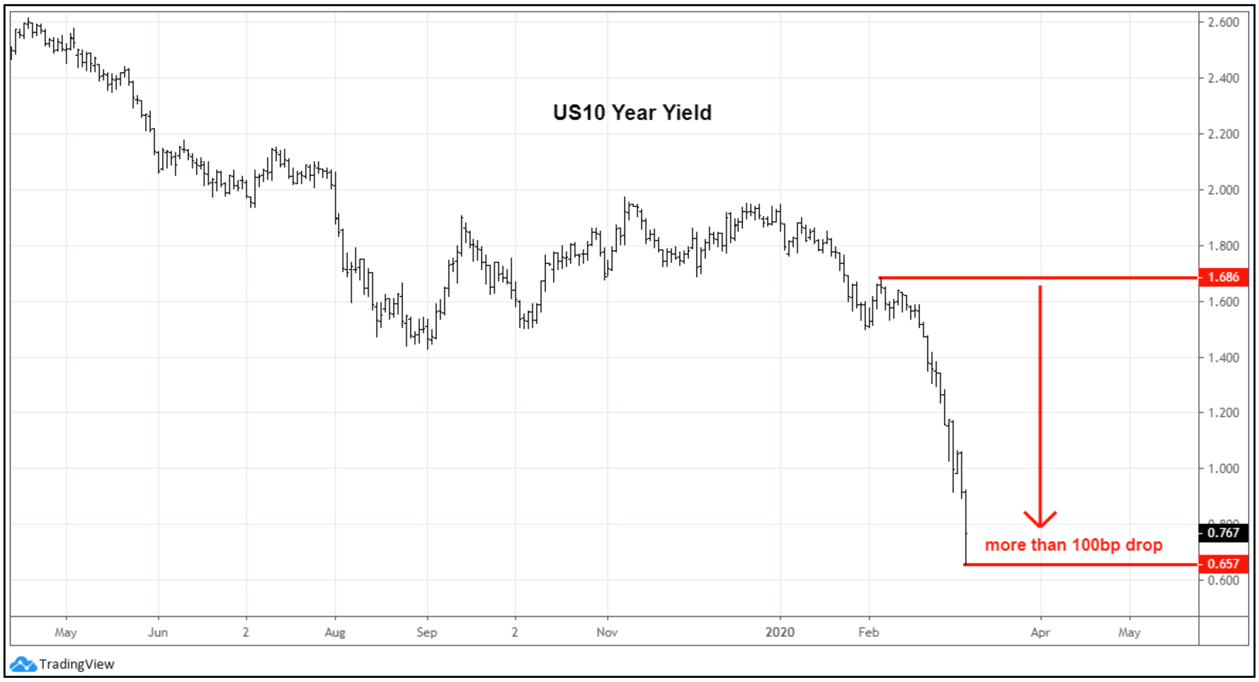
Volatility and price spikes have become increasingly extreme over the last two weeks.

Friday saw the highest VIX print outside of the GFC, before equities rebounded into the close.

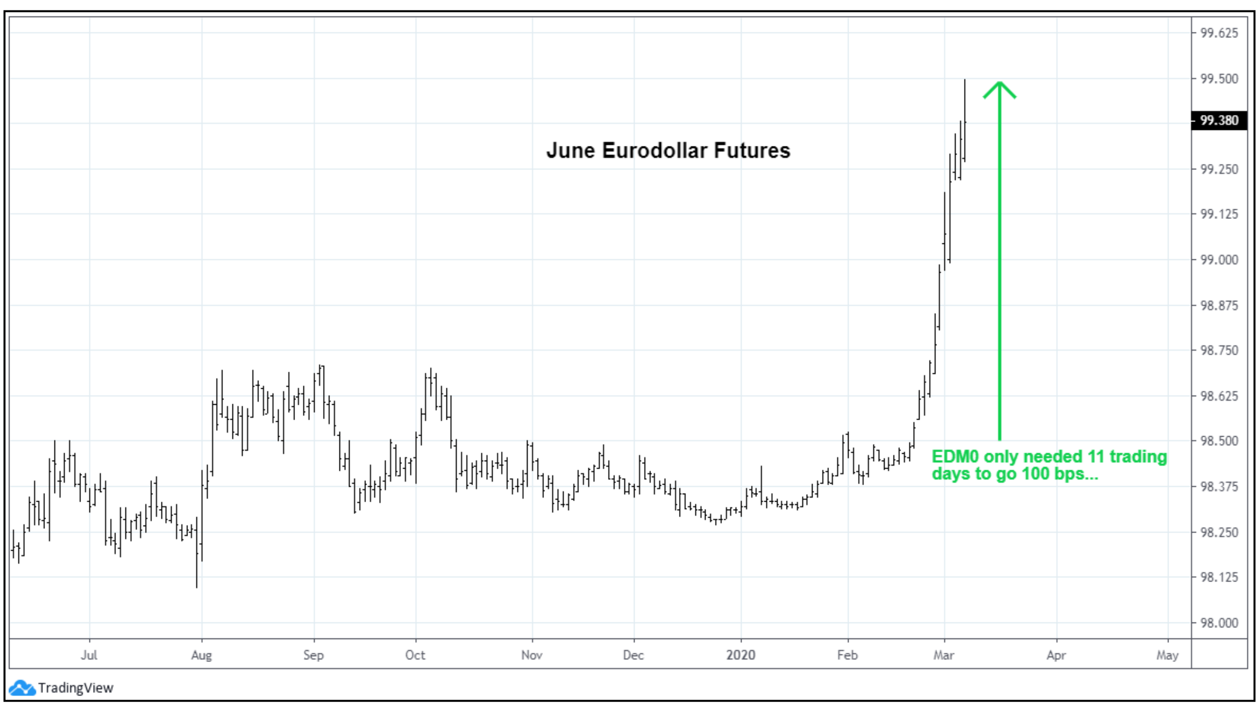


The move along the entire interest rate curve has been nothing short of spectacular.

In the last month, US 10-year yields have fallen 100 bps.



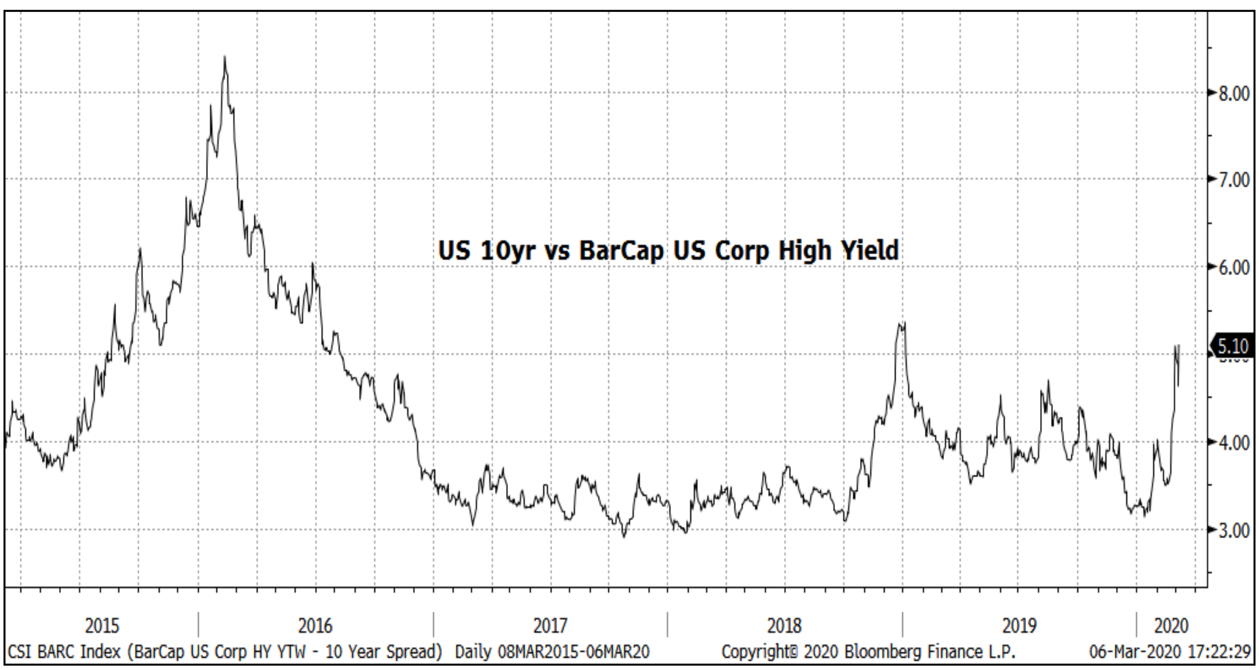
3-month Eurodollars have exploded as Fed cuts are quickly priced…



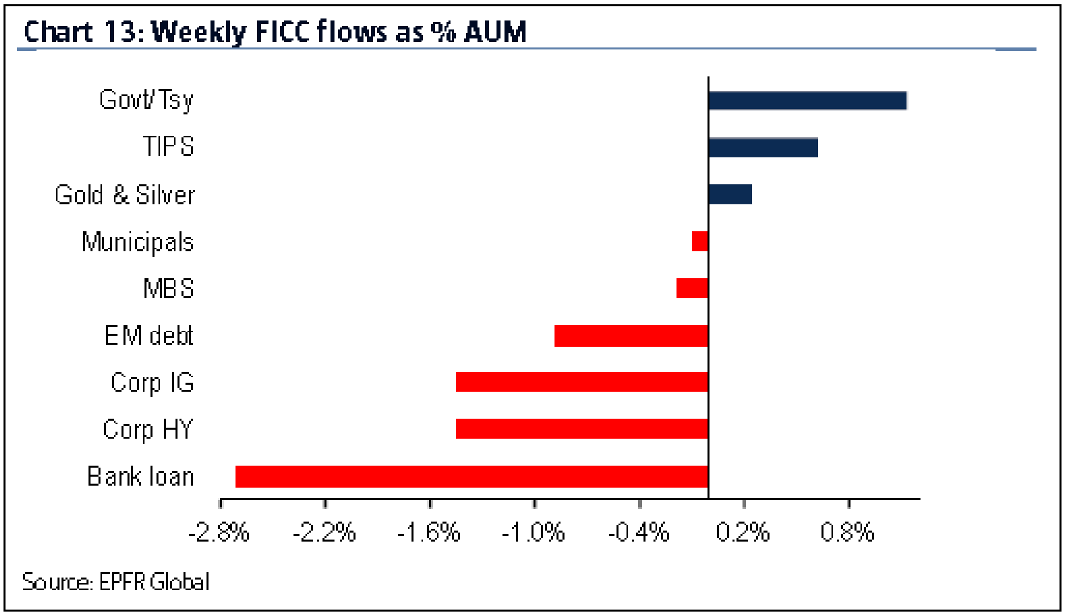
TLT – which reflects 20+ year treasury holdings, has reached very overbought levels. Only rarely (see ’11) does price push on much from here, but again it’s a world “never before” so it certainly could.

Credit has cracked a bit, but if things keep on as they have been, that may only be starting.

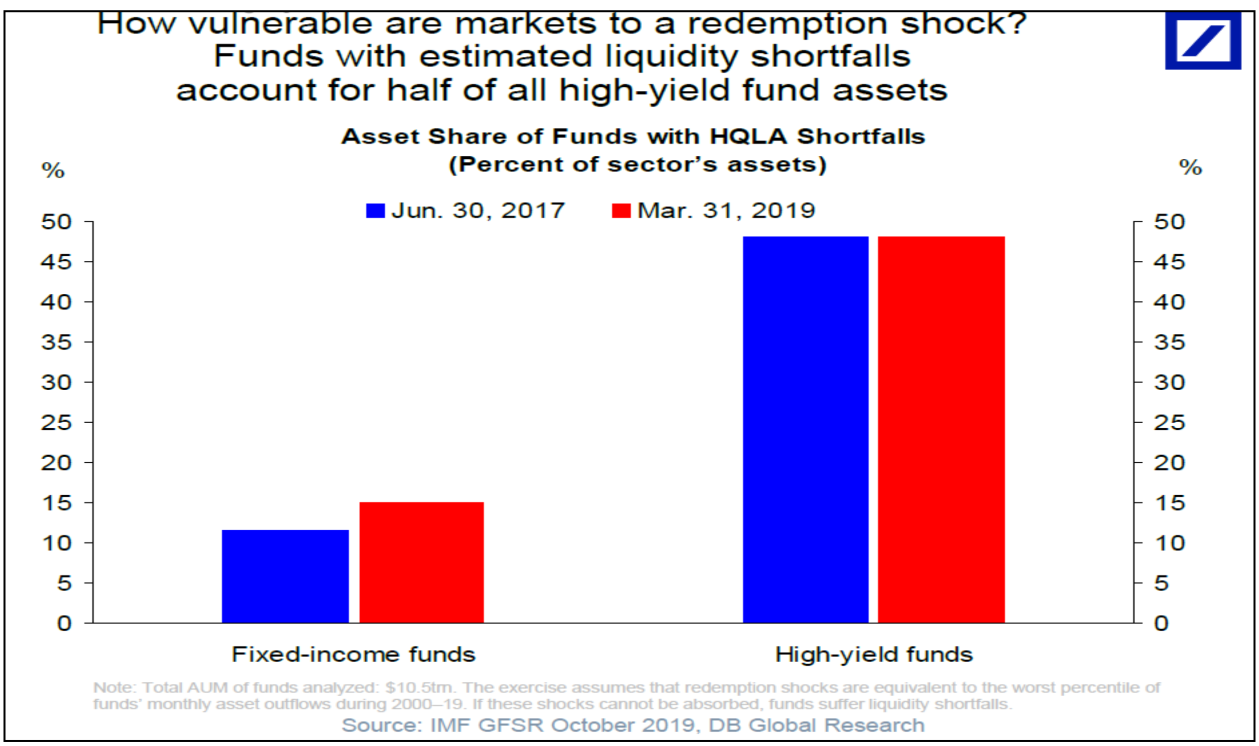
Spreads are starting to move. The fall in oil prices isn't helping the highly leveraged components of the energy sector.



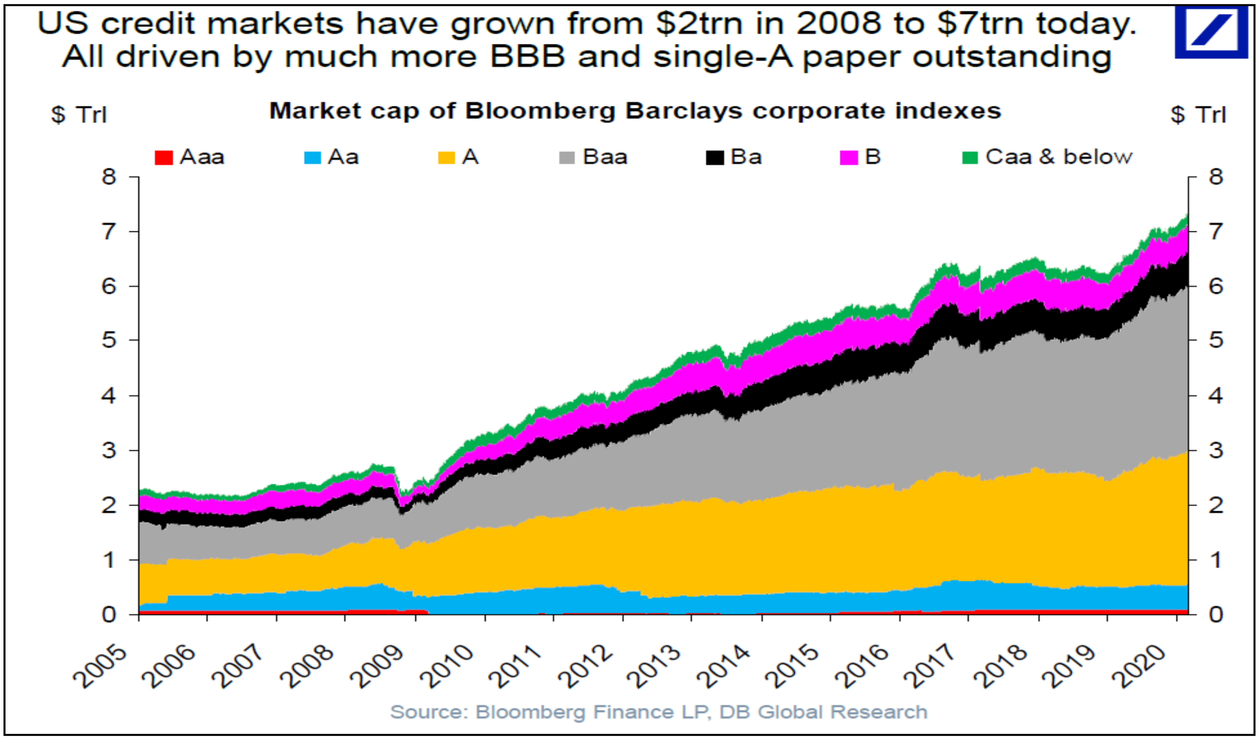
The outflow from credit into Treasuries has been picking up.



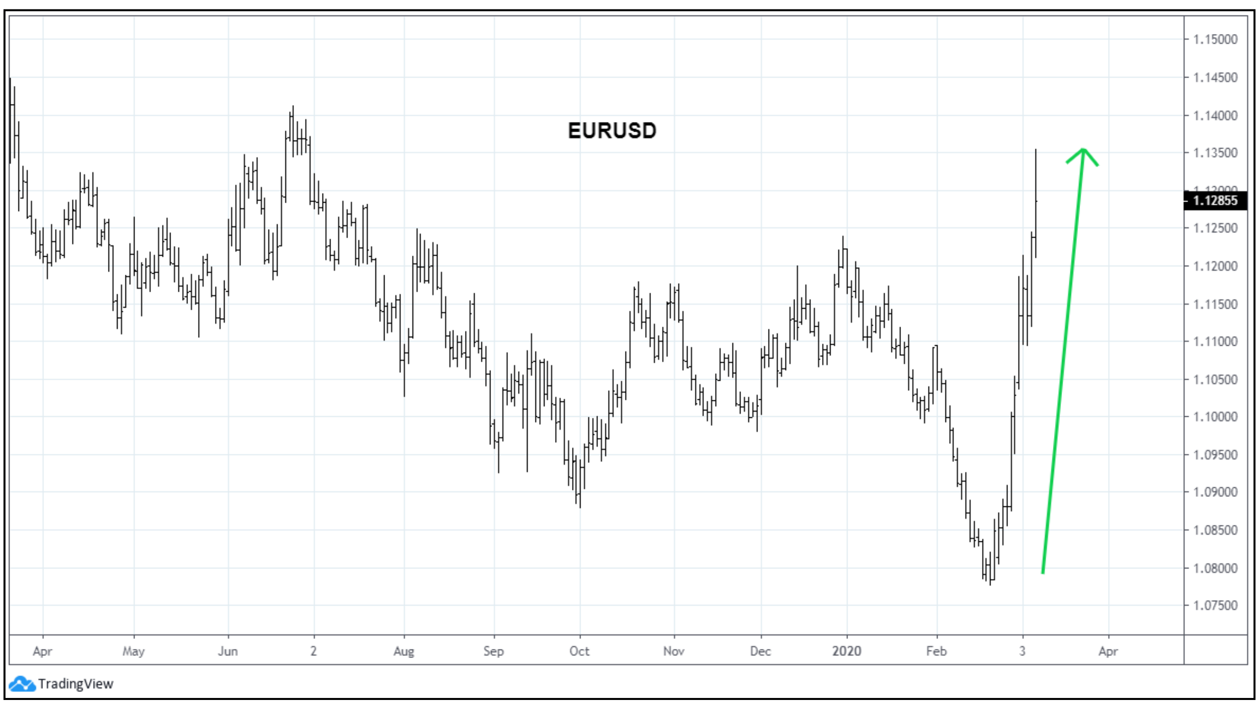
A couple of interesting credit market charts follow… liquidity could be an issue.



With much of it on the cusp of investment grade.

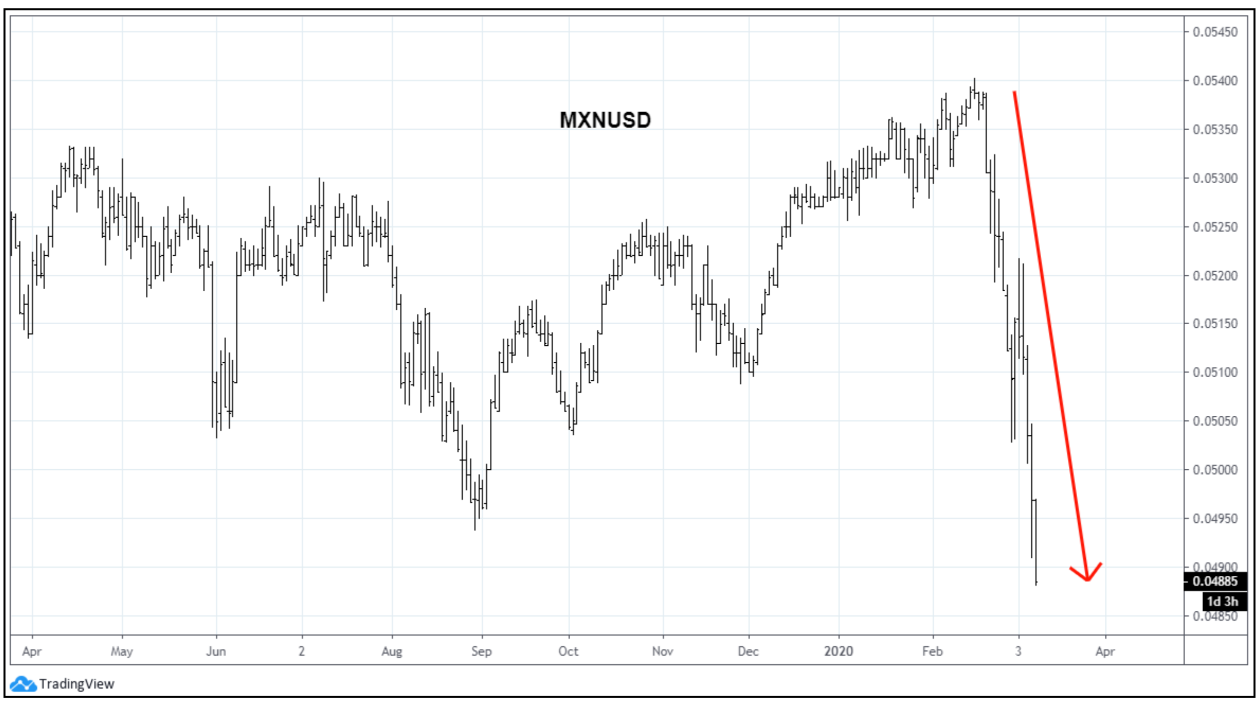


Many of the DM currencies have strengthen vs. the USD … Like EUR



AND Yen...

While in EM, it has been quite the opposite story ... MXN



And BRL…

With signs that China may have turned the corner on the virus spread, currencies with the closest link to China have actually started to recover a bit. Like SGD…

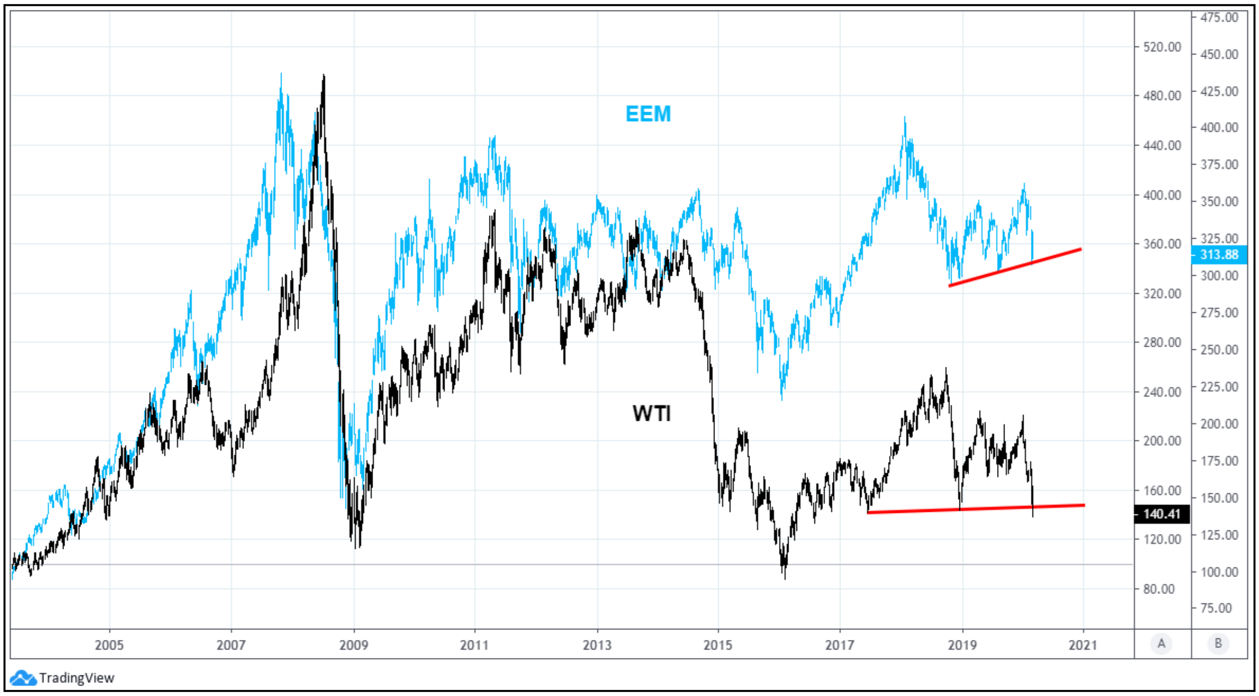
KRW

Oil

With the failure of the OPEC talks in Vienna on Friday, we have been launched into an Oil price- war as Russia goes after US Shale and Saudi Arabia goes after Russia. Oil is expected to open down huge and ME equity markets are getting crushed out of the gate.

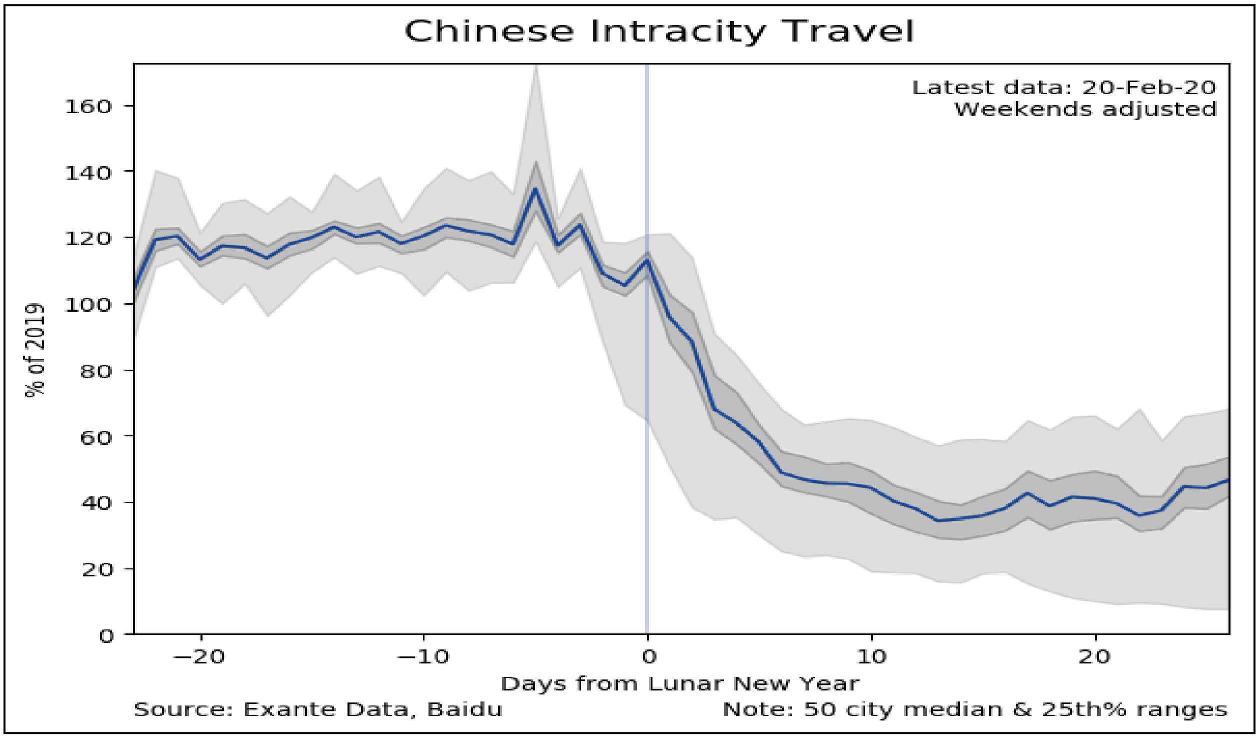
Although the magnitude of EM's link to oil seems to have been reduced in recent years, the direction of the oscillations is still correlated. The dollar is part of this dynamic as well. Usually I would say the recent downward pressure on the USD vs. Developed Markets would be somewhat supportive but with the current crisis footing in markets, USD/DM and USD/EM are diverging.

Keep an eye out for further potential EM downside (below is indexed to 100). Although that may be complicated given the high exposure ETF's like EEM have to greater China.

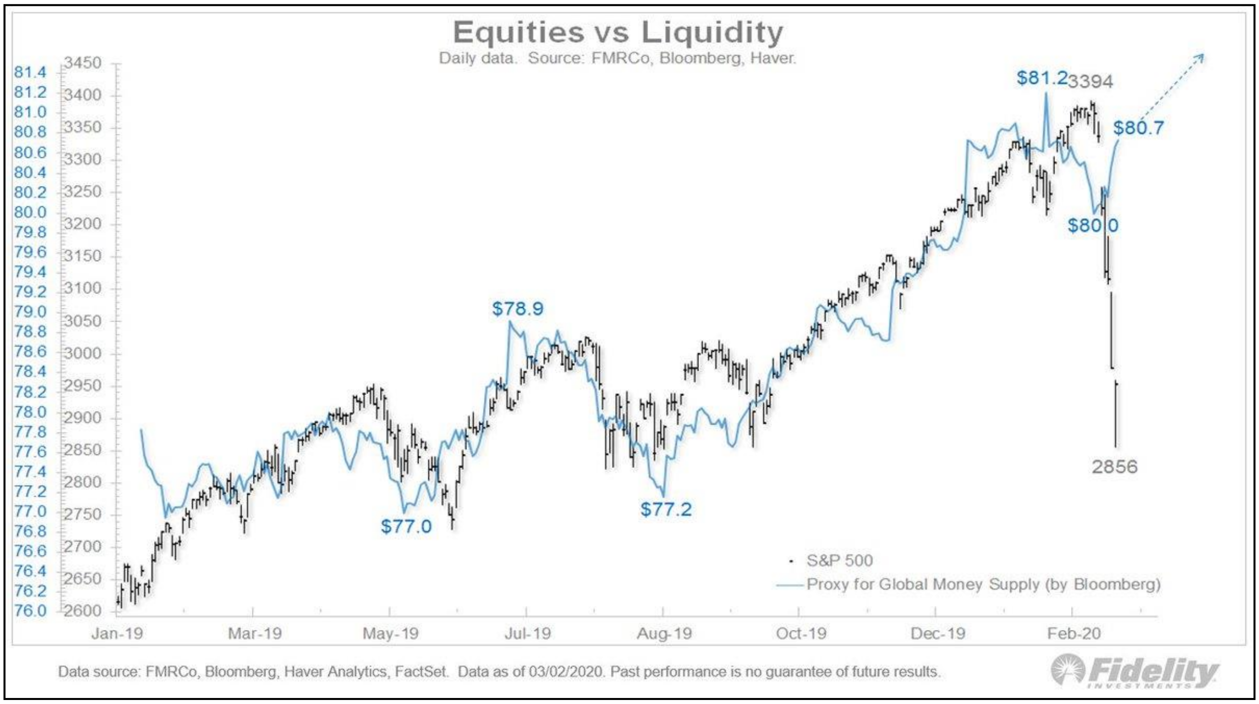


As mentioned last week China has started to outperform as hopes for a rebound (and no doubt official support for equities) has grown as the number of new cases falls.

At least some stability is returning.



For the US equity market, the virus brought a sudden narrative break that ended the notion that only liquidity matters. The big question remains… will we go back to that when things calm down or will the impact of liquidity continue to be overwhelmed by global growth concerns?



Data source: FMRCo, Bloomberg, Haver Analytics, FactSet. Data as of 03/02/2020. Past performance is no guarantee of future results.

<u>Actionable Trades and Developments:</u>

<u>Equity Indexes:</u> Short small DAX

<u>Fixed Income:</u> Sold EDM0 calls too early. Wondering if 10's and 30's now overdone. That might be first place we see if the situation is turning the corner.

<u>Commodities:</u> Nothing at the moment. Gold still doing its thing.

<u>Currencies:</u> Short CAD and started buying some volatility in GBP and EUR which is still very cheap.

This week's data must be taken with a grain of salt again given how fast things are moving. Sunday saw Q4 Japanese GDP come in even weaker than the preliminary data. The ECB on Thursday will be eagerly awaited. The Fed is the following weak with a two-day meeting on the 17-18th.

Important Macro Data Releases and Events for the Week

Monday
3/9/2019

- Industrial Production s.a. MoM (Jan) Forecast: 1.5%, Prior: -3.5%
- Trade Balance s.a. (Jan) Forecast: 15.4B, Prior: 19.2B
- Housing Starts s.a. YoY (Feb) Forecast: 205K, Prior: 213.2K

Tuesday
3/10/2019

- CPI YoY (Feb) Forecast: 4.9%, Prior: 5.4%
- GDP s.a. QoQ (Q4) Forecast: 0.1%, Prior: 0.1%
- GDP s.a. YoY (Q4) Forecast: 0.9%, Prior: 0.9%
- RBA's Debelle **SPEECH**
- Westpac Consumer Confidence (Mar) Forecast: -0.4%, Prior: 2.3%

Wednesday
3/11/2020

- Manufacturing Production YoY (Jan) Forecast: -3.3%, Prior: -2.5%
- CPI ex Food& Energy MoM (Feb) Forecast: 0.2%, Prior: 0.2%
- CPI ex Food& Energy YoY (Feb) Forecast: 2.3%, Prior: 2.3%

Thursday
3/12/2020

- Industrial Production s.a. MoM (Jan) Forecast: 1.2%, Prior: -2.1%
- PPI ex Food & Energy YoY (Feb) Forecast: 1.7%, Prior: 1.7%
- Initial Jobless Claims Forecast: 215k , Prior: 216k
- Initial Jobless Claims 4-week ave. Forecast: - , Prior: 213k
- Continuing Claims Forecast: 1.723m, Prior: 1.729m
- **ECB Rate Decision and Monetary Policy Statement**

Contact: efill@stargazerfunds.com / +1.203.219.3649

Friday 3/13/2020

Harmonized Index of Consumer Prices YoY (Feb) Forecast: 1.7%, Prior: 1.7%

Michigan Consumer Sentiment Index (Mar) Forecast: 97, Prior: 101

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.