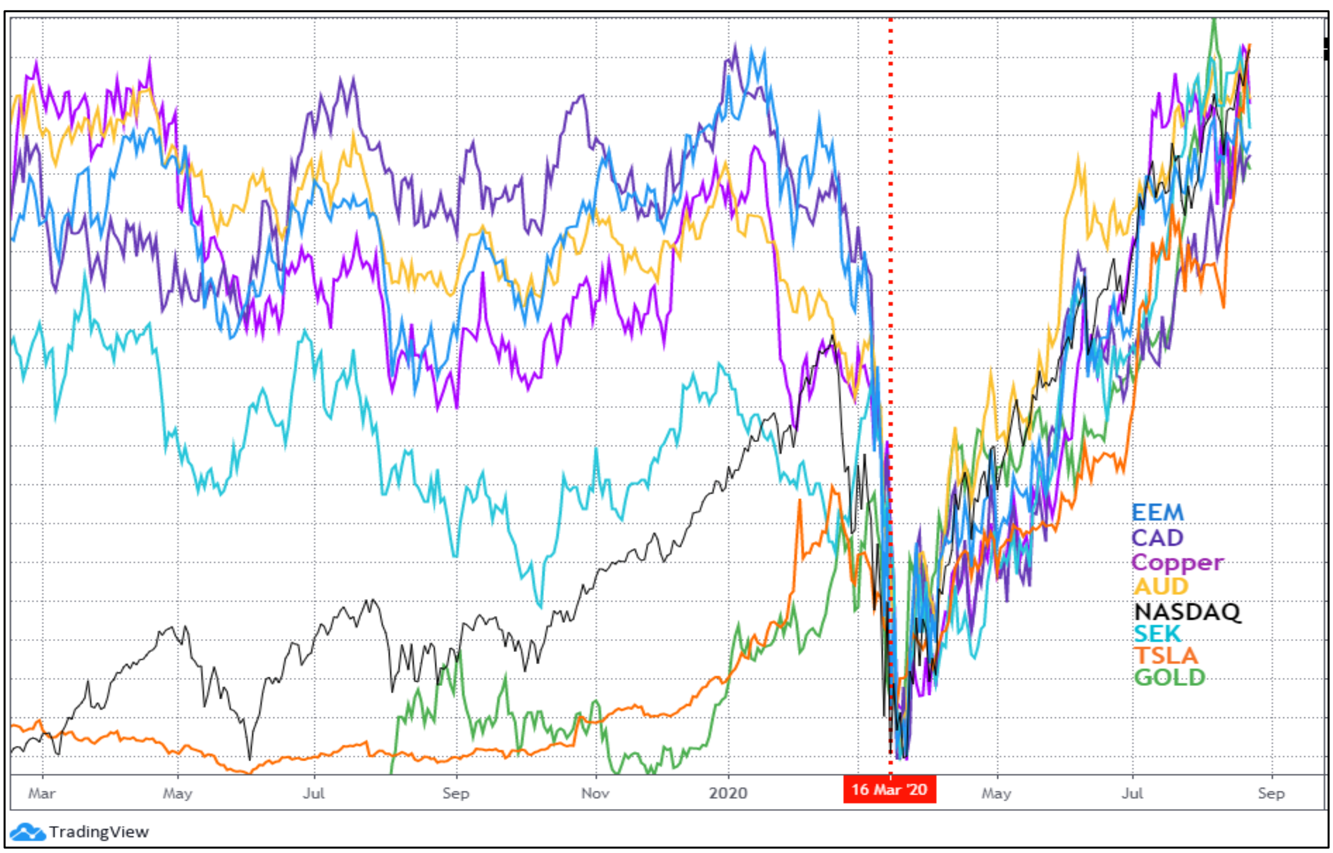
What to focus on in Global Macro for the week of August 24th, 2020

Macro Themes on the Radar:

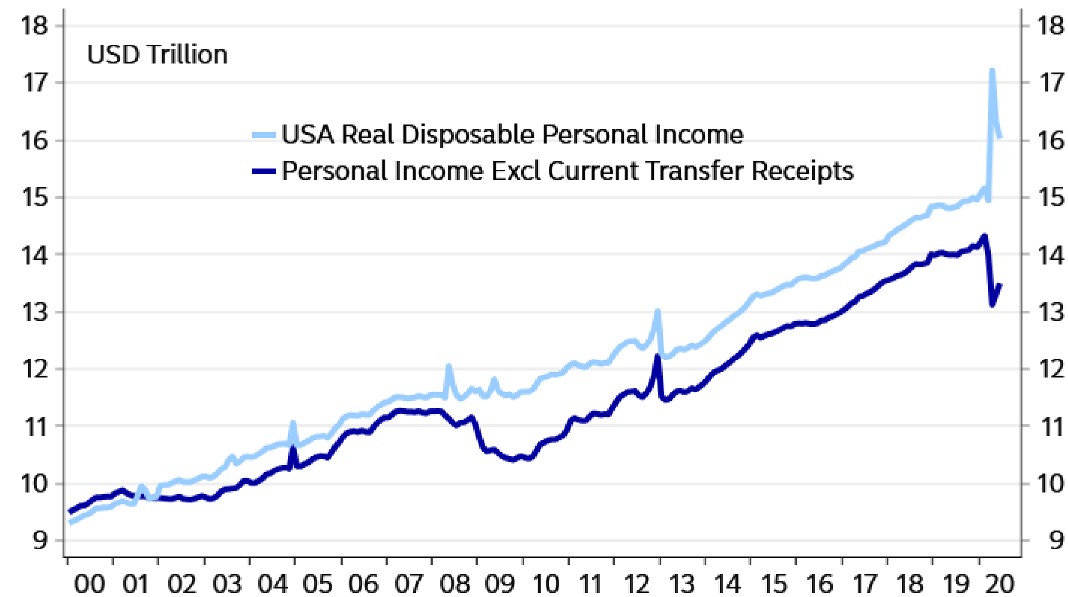
This week we have the Fed sponsored Jackson Hole symposium on the calendar. It will be held virtually this year, so the comments from sidebar discussions probably won't be as impactful as usual. Thursday's address by Powell has some headline making potential however, as he speaks about the long-awaited monetary policy framework review. Increasingly, it has become focused on the concepts of Average Inflation Targeting (AIT) and Yield Curve Control (YCC). AIT is most likely to make headlines this round, as the Fed moves towards incorporating a backward-looking component into its inflation target and forward guidance. Given that inflation has been below their goal for a while now, implementing AIT would mean that they let the economy run hot for longer than normal. This is the opposite of the Fed's unofficial opportunistic disinflation policy implemented post the Volker peak in interest rates and inflation expectations. These are some of the only remaining items in the monetary policy toolbox, if you exclude negative rates.

The Fed has certainly made a splash during the crisis. As they wheeled out one policy initiative after the other starting mid-March, and markets have responded. EVERYTHING turned at the same time. (This chart is meant to show direction rather than absolute or relative performance.)



The combination of aggressive monetary and fiscal policy has so far saved the day and made the current recovery in markets the fastest in history. Some of the most combustible parts of the economy have remained fire-proof under the torrent of liquidity. While uneven, net worth has held up well with higher equity and home values. The CARES act shielded the consumer…

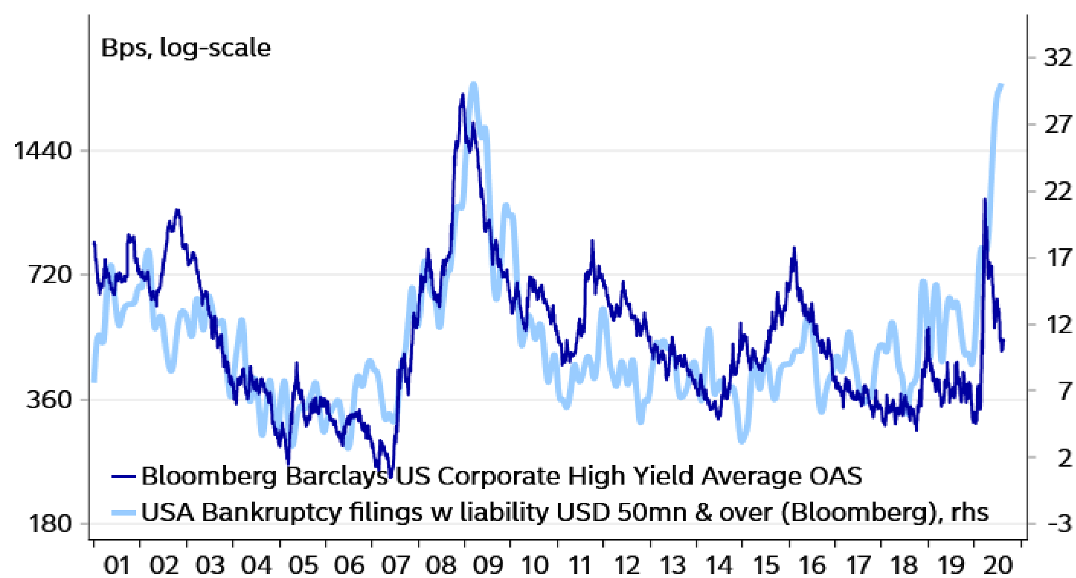
Chart 4. The crisis that increased disposable income



Source: Macrobond and Nordea

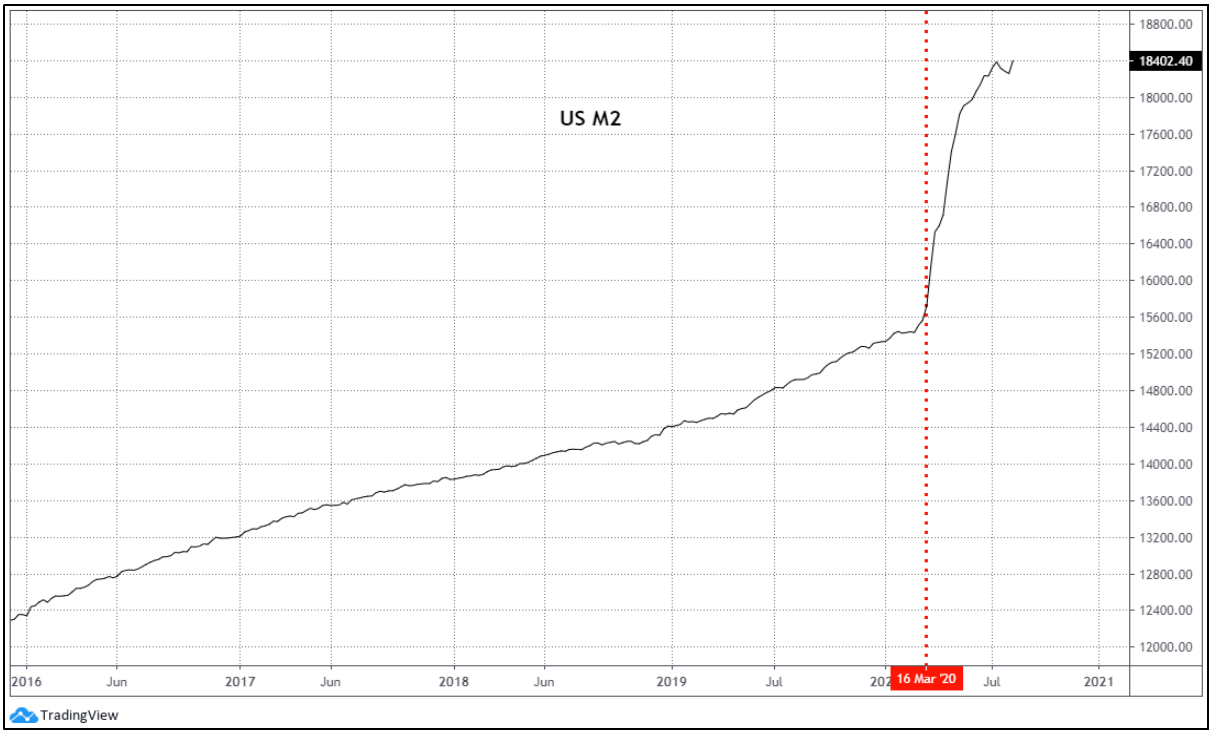
…while the unprecedented buying of corporate debt cut short the normal credit cycle.

Chart 1. The early decision to take over credit risk stopped the normal bankruptcy-driven collapse for corporate bonds

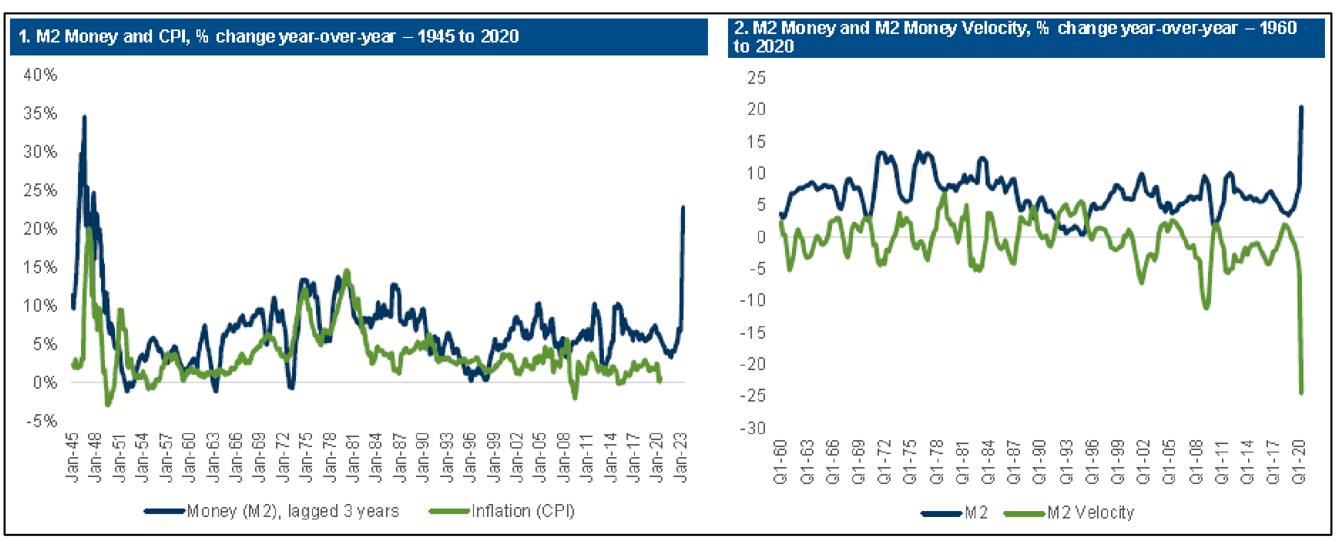


Source: Macrobond and Nordea

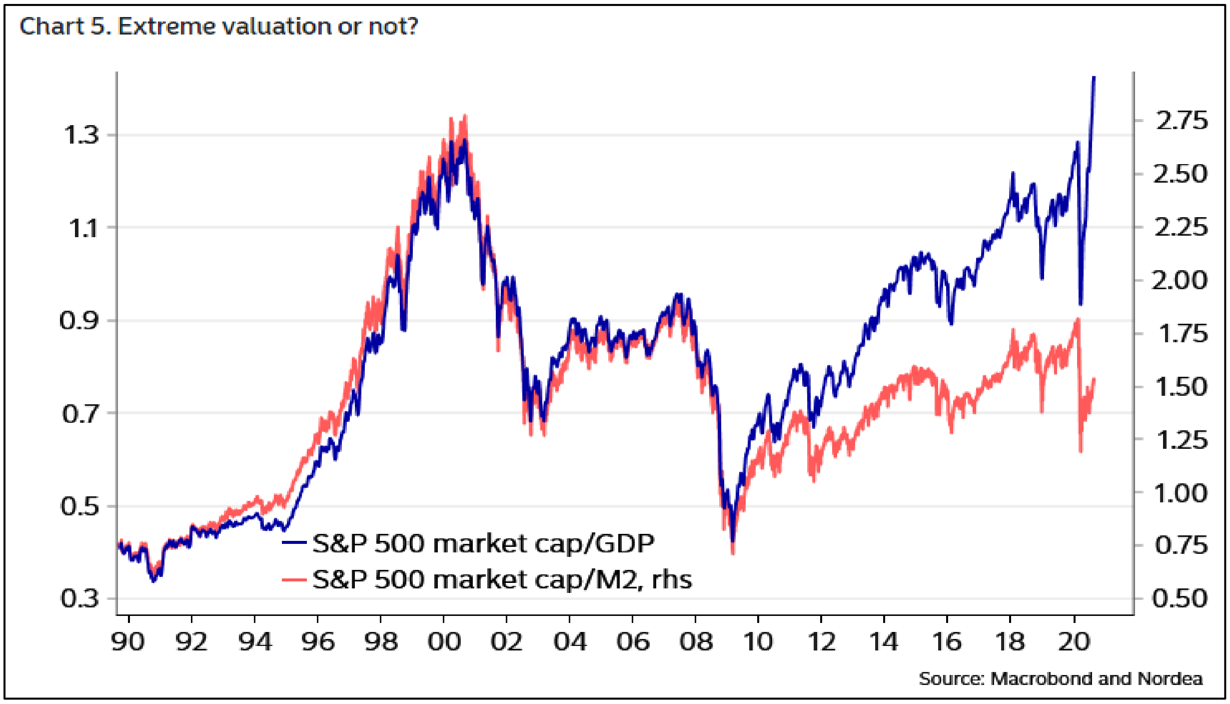
The combination of monetary and fiscal policy has sent money supply (we'll use M2) through the roof. I doubt it will be allowed to come crashing back down. This is a major development. Liquidity drives markets.



Normally, this would start the countdown to higher inflation. So far, the plunge in the velocity of money has acted as a counterweight. Which one will prevail?

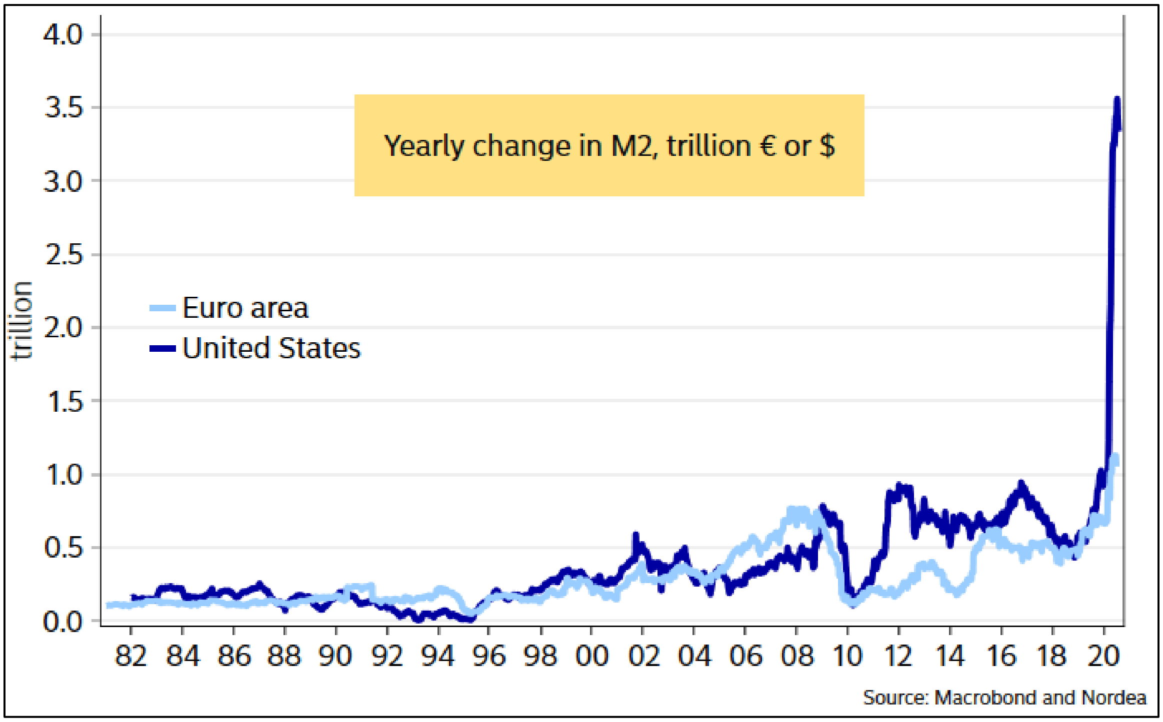


While contemplating the jump in M2, I came across this chart. It is not surprising that S&P market cap vs. GDP has exploded higher, given the price action in equities and the crash in GDP. However, I thought the S&P vs. M2 line was more interesting. It made me think of another chart… it looks strikingly like Euro Stoxx.

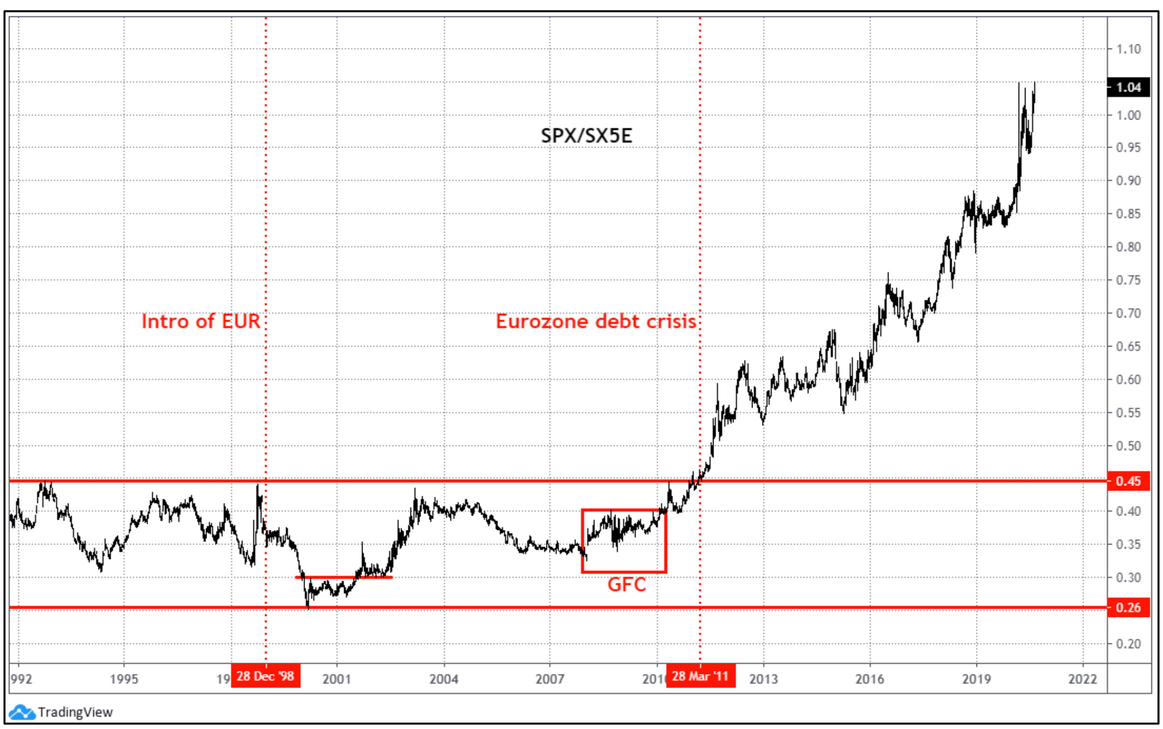


Here we have S&P500/M2 vs. Euro Stoxx. Is relative M2 growth a factor here?

The recent jump in US M2 has greatly outpaced M2 growth in Europe.



It is interesting to note that since early 2011 US M2 growth has almost continuously outpaced European M2. While relative earnings have certainly favored the US, relative M2 growth could also be a contributor to the US equity outperformance we have seen. Something to think about…

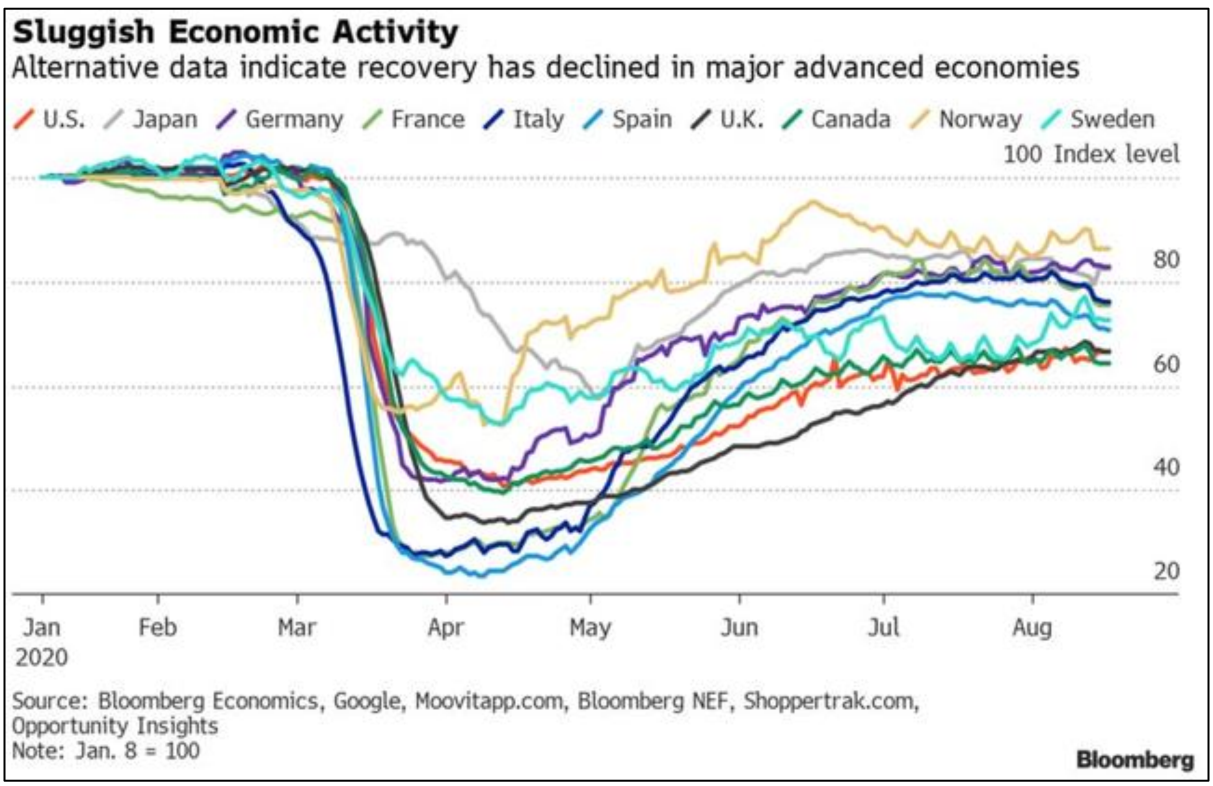


As Milton Freedman famously said: "Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output." If applied to financial assets, it could be meaningful during a time when M2 growth and corporate buybacks in the US occurred at a much higher rate than in Europe.

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

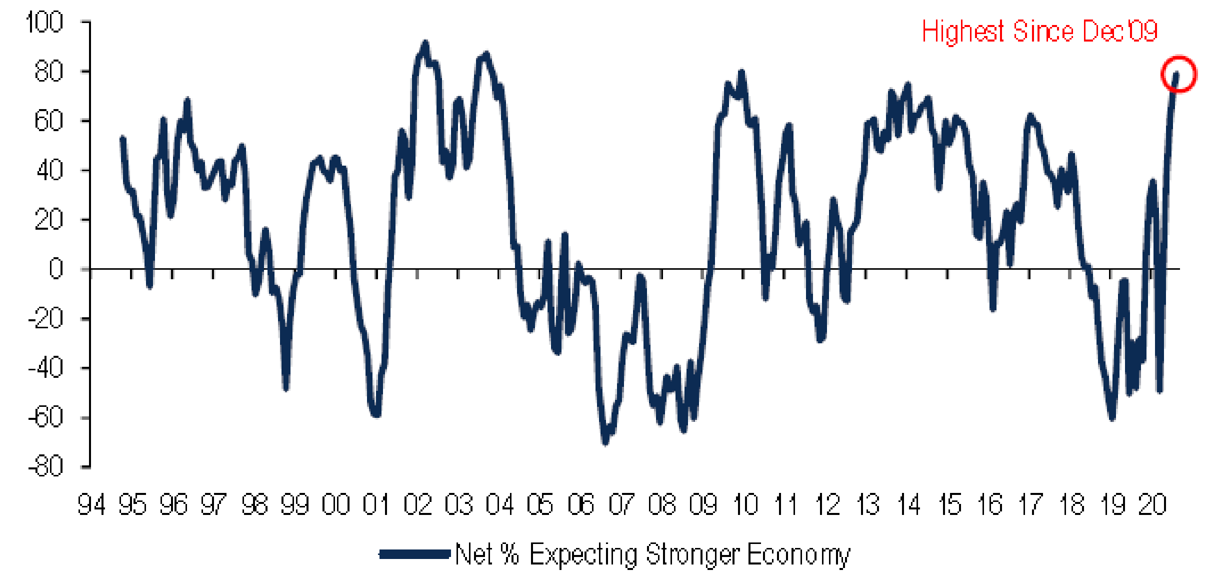
Economy

While many of the traditional but lagging data-points are still recovering off the shutdown lows, high frequency data has slowed over the last 6 weeks.



Yet broadly speaking, market participants are the most bullish on global growth that they have been since December 2009.

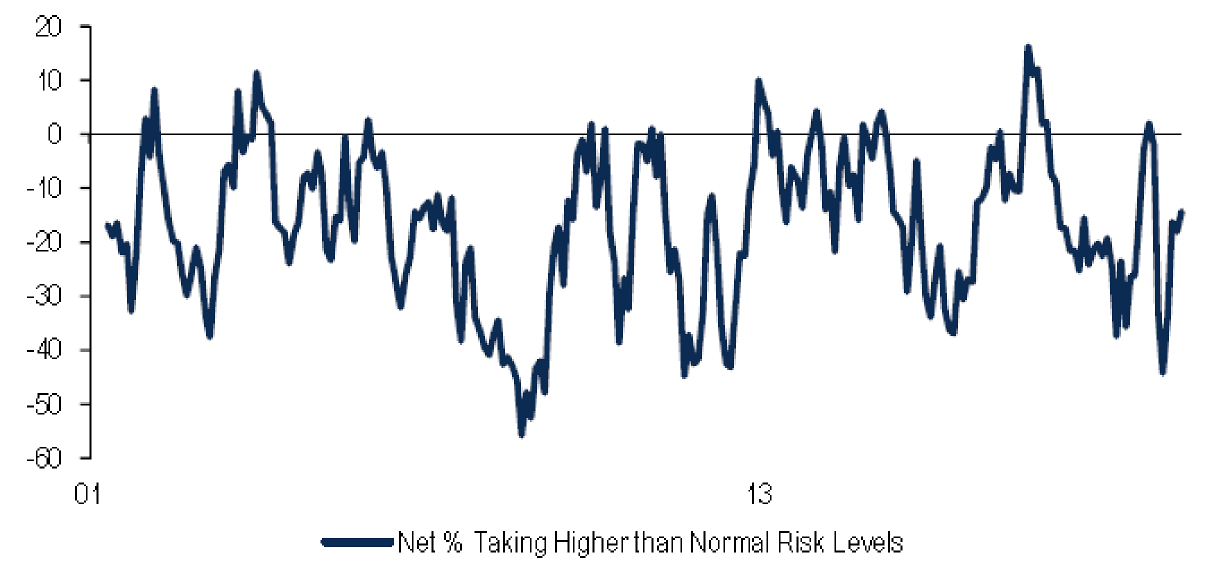
Exhibit 24: How do you think the global real economy will develop over the next 12 months?



Source: BofA Global Fund Manager Survey

However, in such an uncertain environment they remain relatively cautious.

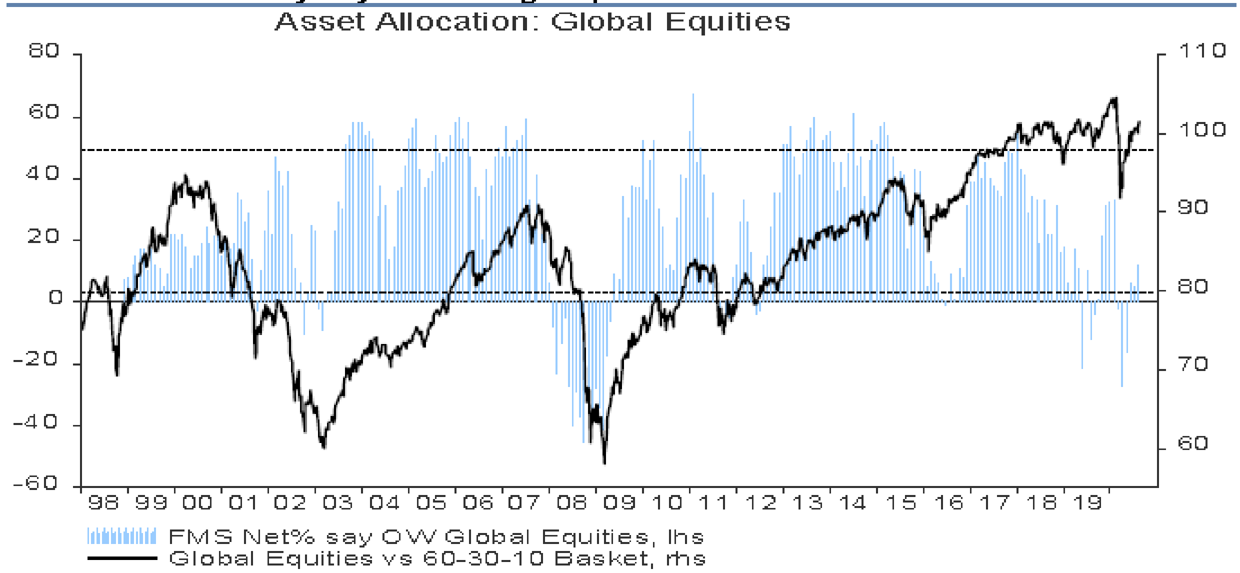
Exhibit 29: What level of risk do you think you're currently taking in your investment?



Source: BofA Global Fund Manager Survey

As a result, they are still not highly positioned in global equities.

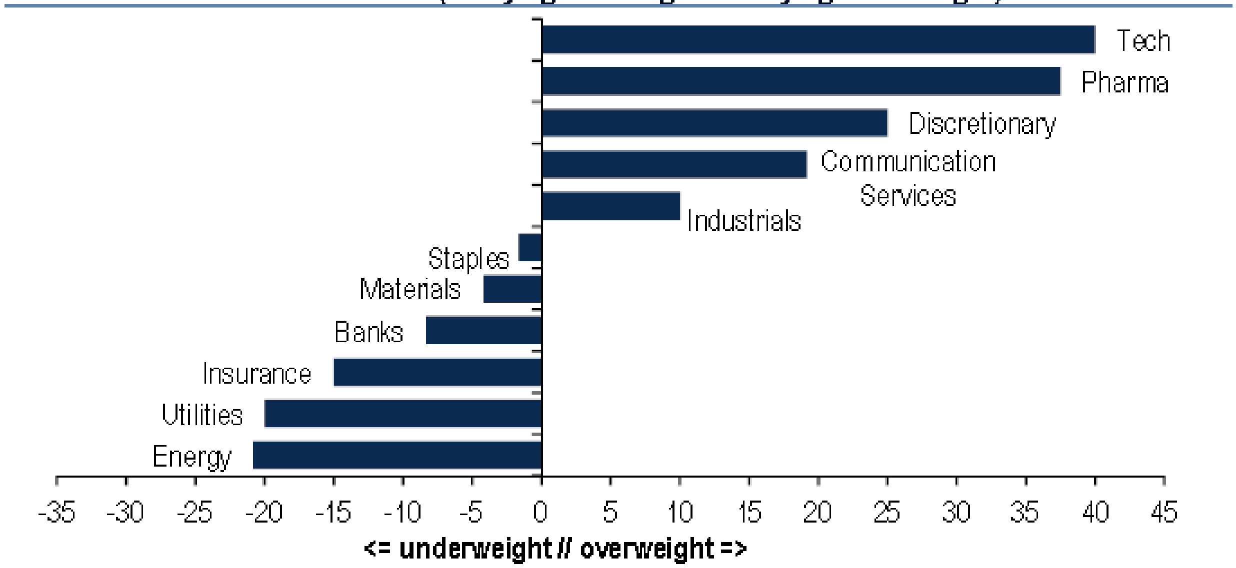
Exhibit 33: Net % AA Say they are overweight Equities



Source: BofA Global Fund Manager Survey

However, as you might expect, what they do have is in the market leaders … US Tech remains king.

Exhibit 46: Global sector sentiment (% saying overweight - % saying underweight)



Source: BofA Global Fund Manager Survey

As most asset classes have gone up together, everything now feels expensive to investors. (Back to the first chart in the piece.)

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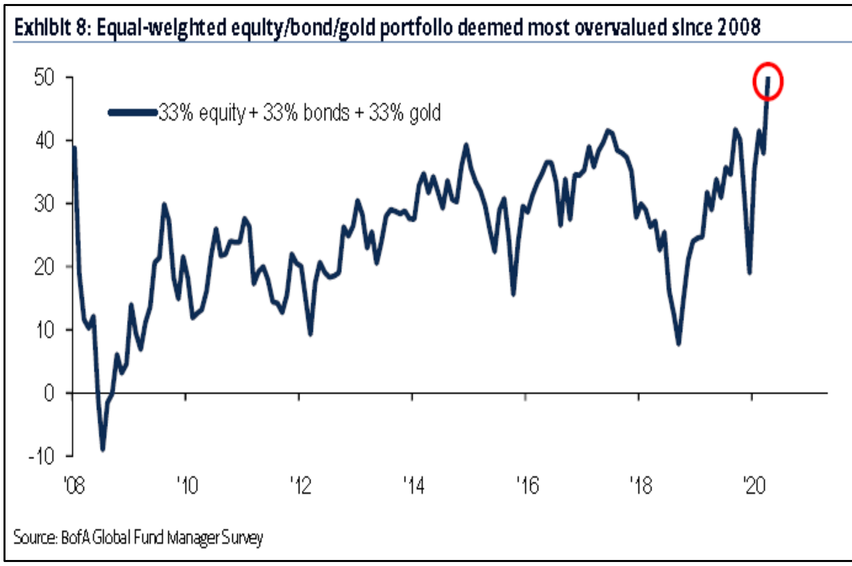
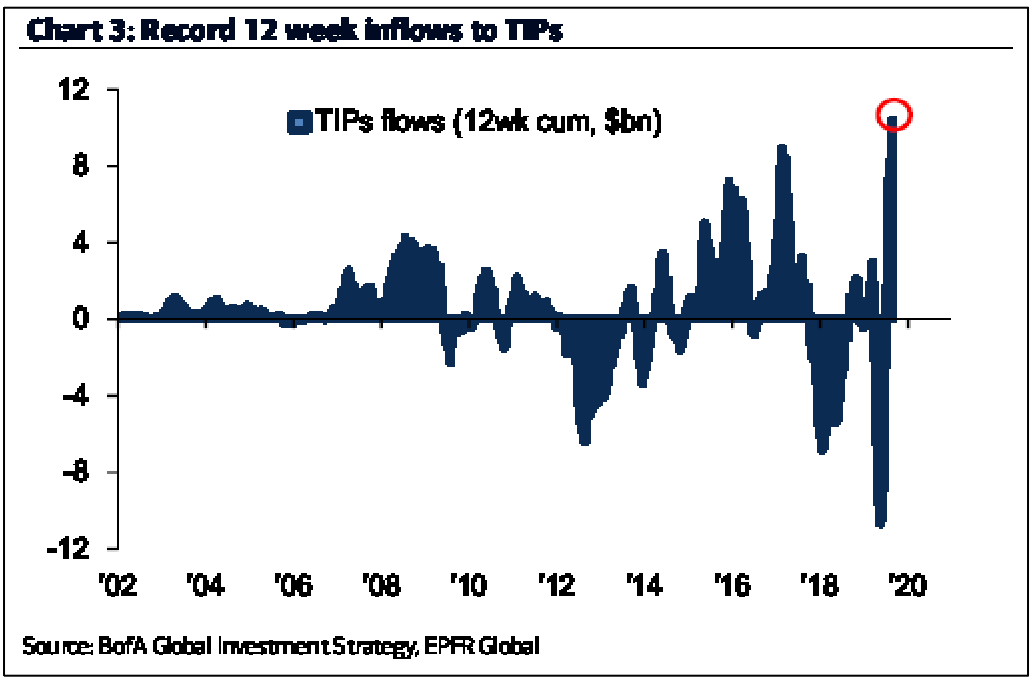
Watch for asset classes to potentially again diverge. If/when that happens, decisions will need to be made, resulting in a potentially dramatic shift in flows.



FMS investors believe assets are overvalued; for example an equal-weighted equity/bond/gold portfolio deemed most overvalued since 2008.

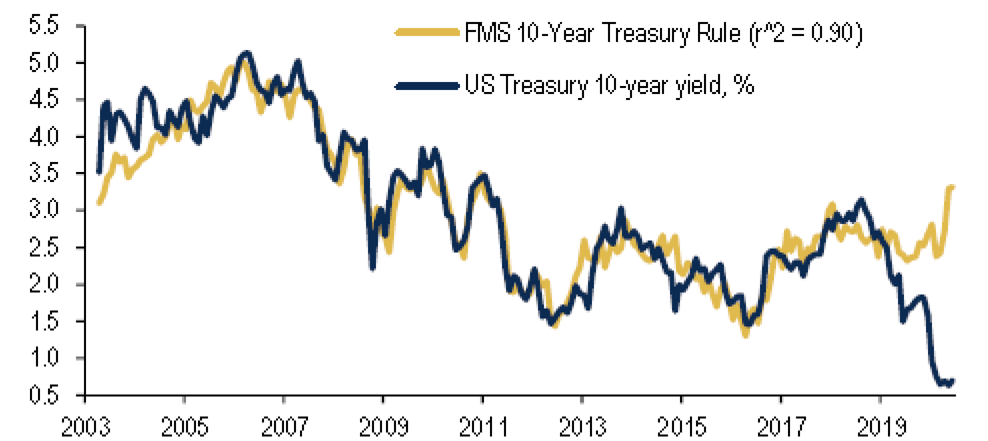
Yields

Inflation expectations have recovered from the shutdown lows and investors are starting to wonder if we will get a pop as the Fed seems intent on letting the economy run hot. TIPS have seen strong in-flows.



However, as discussed last week, bond yields remain suppressed. The spread to countries with NIRP, Fed forward guidance and the fear of YCC, have all played a part in holding down US long-end yields. This BoA/ML model gives an estimate of where 10-year Treasury yields "should be" historically, given other inputs.

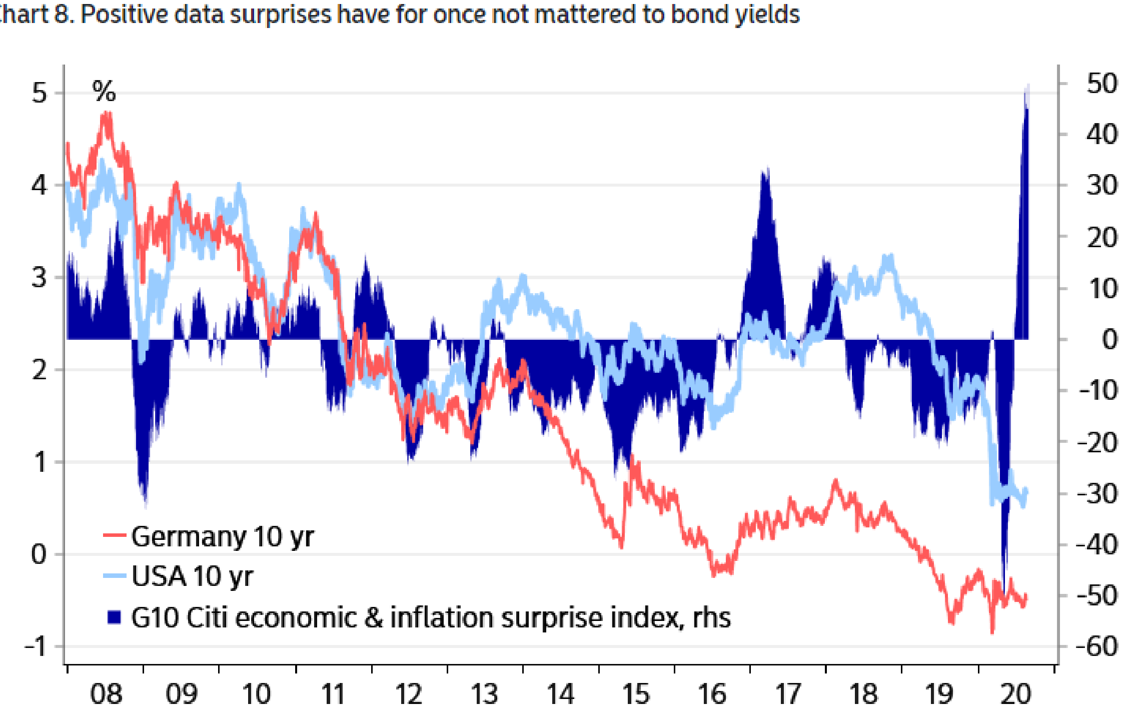
Exhibit 18: BofA Global FMS 10-Year Treasury Rule



Source: BofA Global Investment Strategy, FMS, Bloomberg

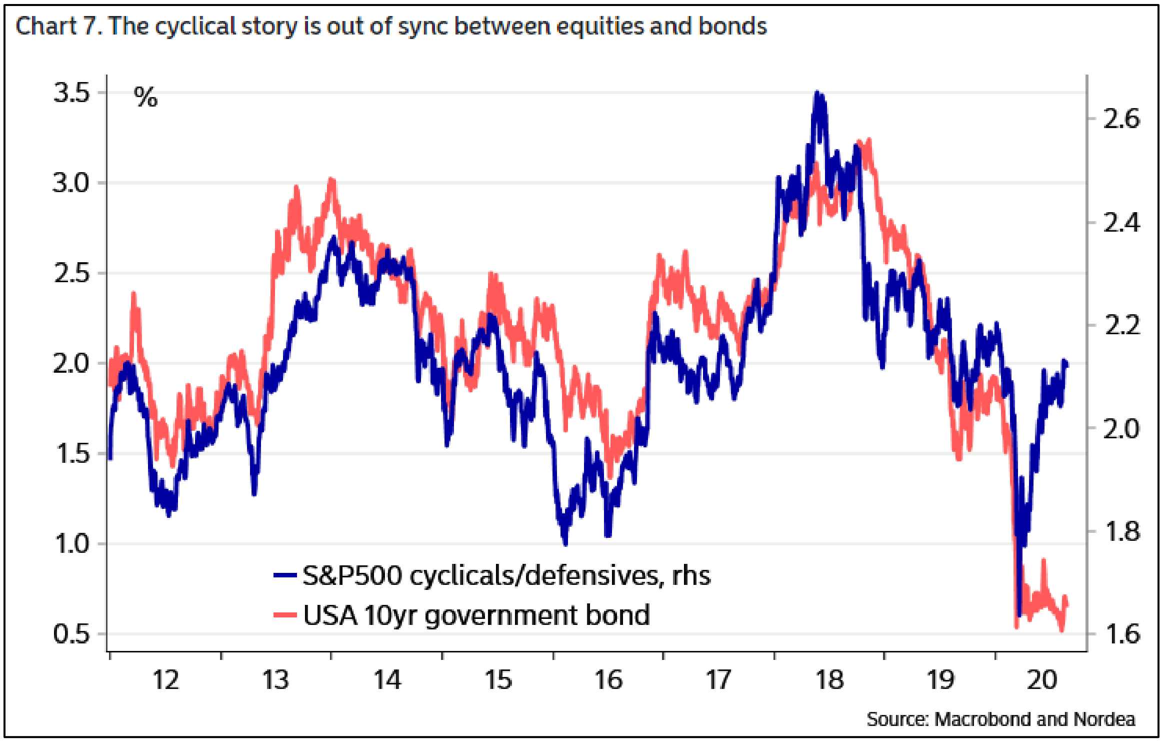
The positive data surprises we have seen post re-opening have had little effect on global government bond yields so far.

Chart 8. Positive data surprises have for once not mattered to bond yields

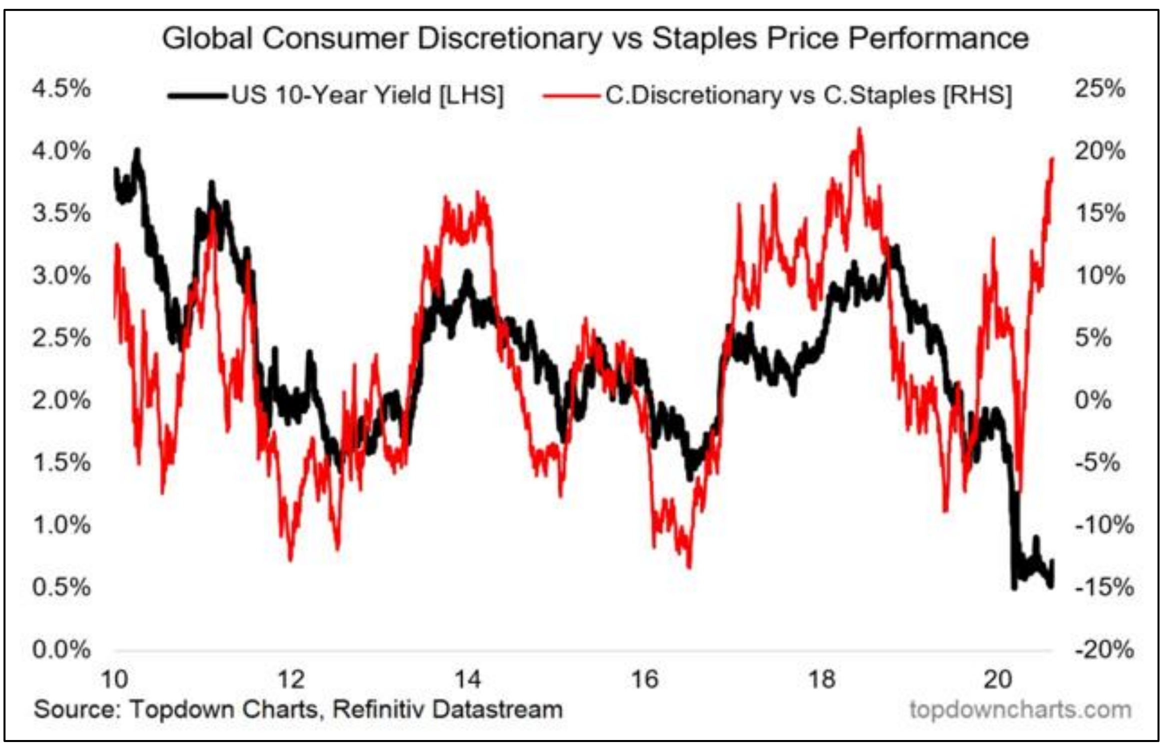


Source: Macrobond and Nordea

The recent outperformance of Cyclical vs. Defensive equities remains at odds with bond yields…



… as does the performance of Discretionary vs. Staples.



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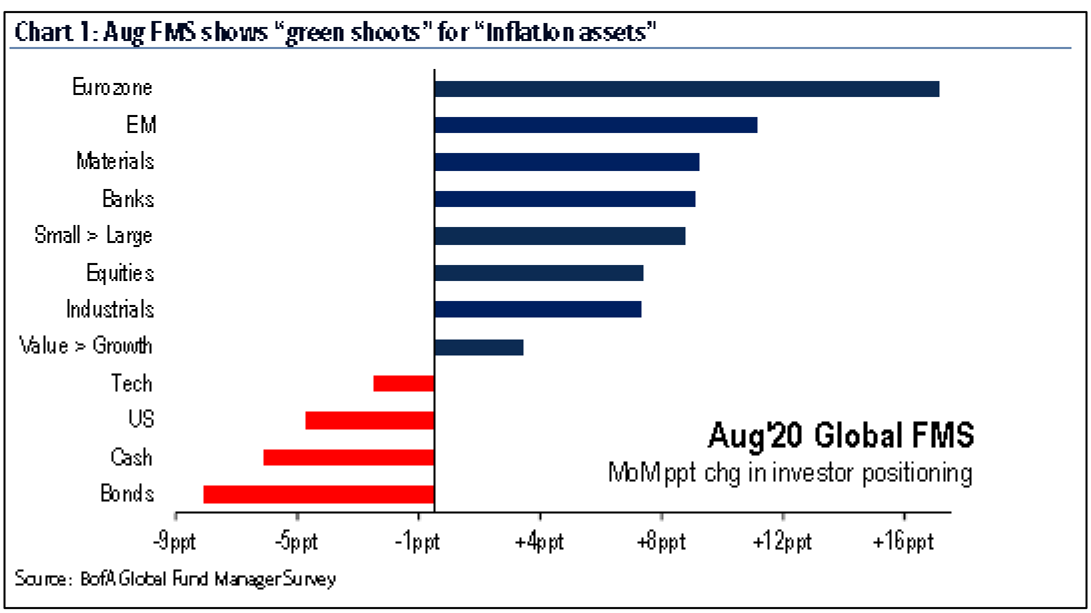
In the meantime, I'm watching for signs of a break. A renewed move higher in yields could get interesting.

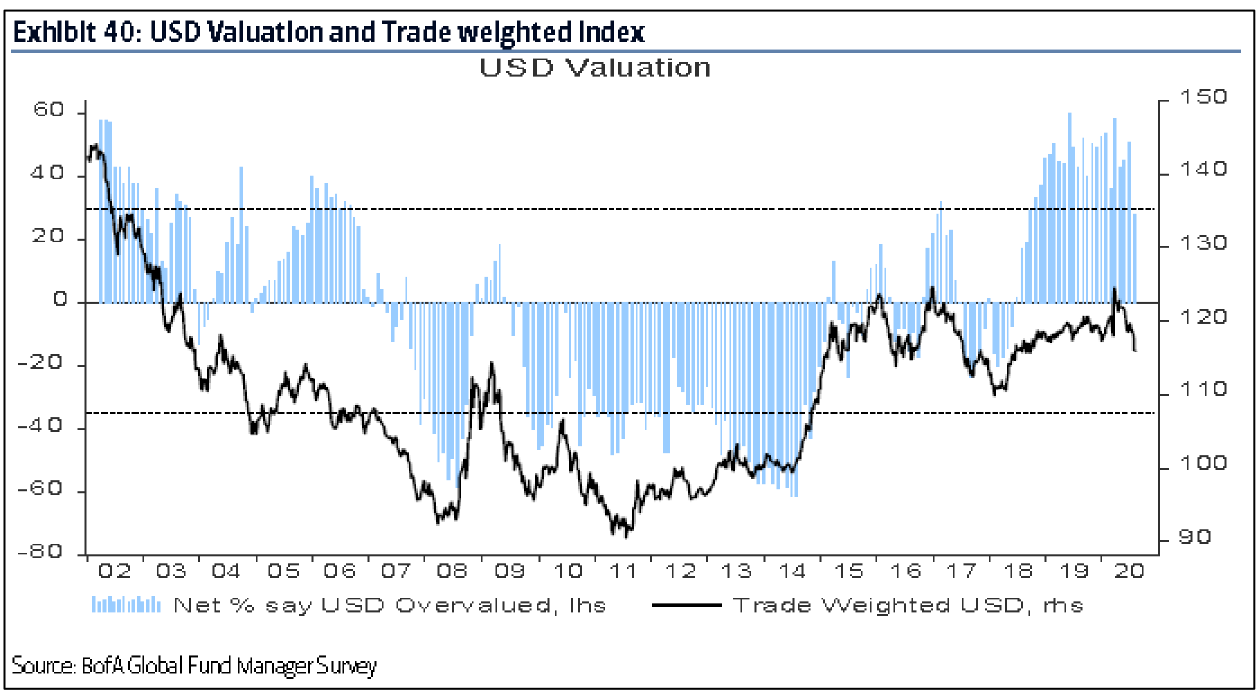
USD

The dollar debasement / reflation theme has become increasingly reflected in the flows.

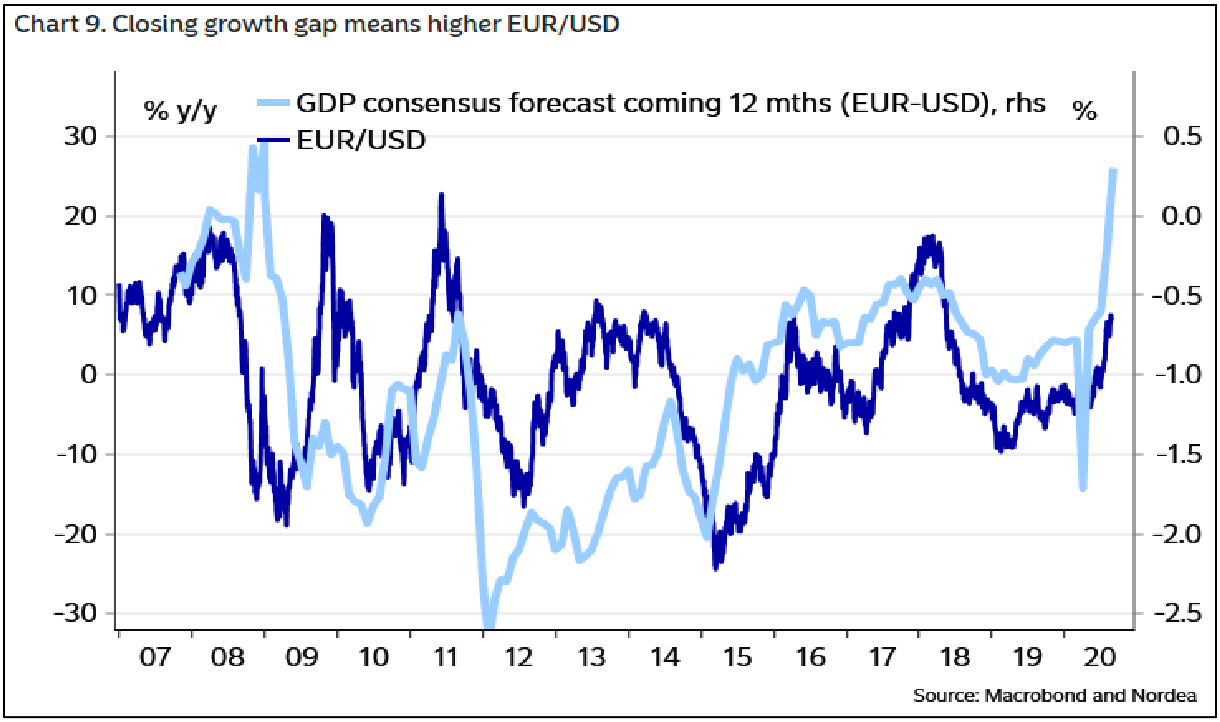


Yet for now the US continues to outperform via the Tech leaders and relative liquidity. We will see if the flows are followed by price action or if the price action causes an unwind of the flows.

Although the percentage is falling with the dollar, investors still see the USD as overvalued.



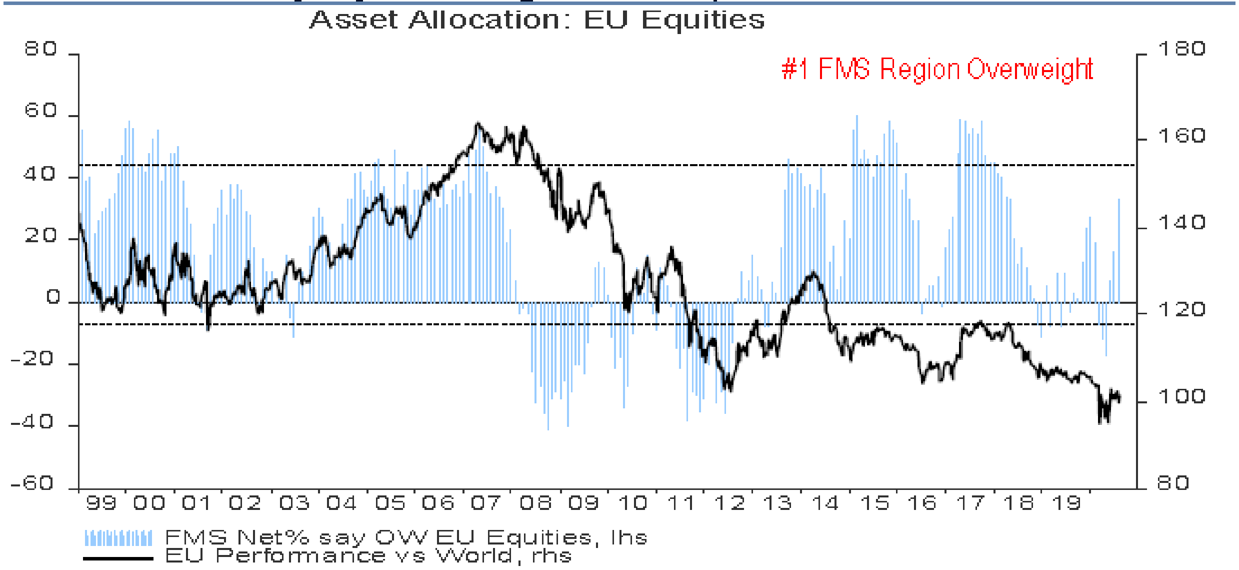
Many believe that European GDP will outperform the US over the next year. Hints of those expectations being met or missed will matter.



For the moment the dollar selloff has hit a big level and I continue to expect a pause or retracement in the near-term…

… especially vs. the EUR, as people are now positioned in both the currency and equities.

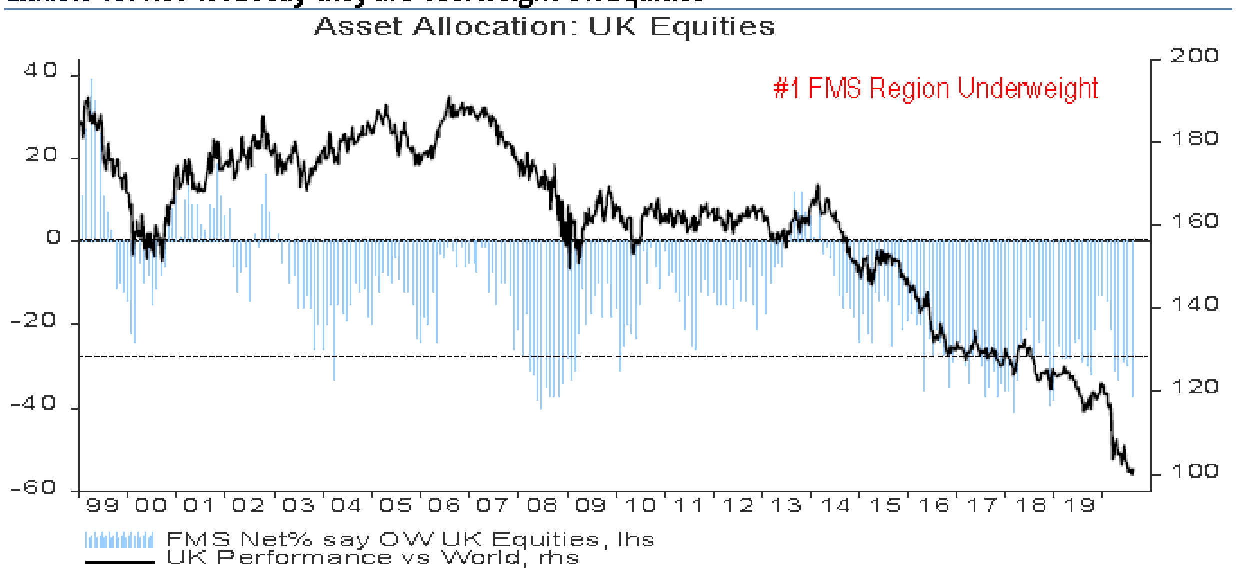
Exhibit 42: Net % AA Say they are overweight Eurozone Equities



Source: BofA Global Fund Manager Survey

If we can get some closure on a Brexit deal during the upcoming negotiations (any deal will do at this point), the UK is worth watching. It has had very poor relative performance and continues to be a big under-weight.

Exhibit 45: Net % AA Say they are overweight UK Equities



Source: BofA Global Fund Manager Survey

Watch the currency for hints of new in-flows.

Important Macro Data Releases and Events for the Week

Monday
8/24/2020

Chicago Fed National Activity Index (Jul) Forecast: -, Prior: 4.11

Tuesday
8/25/2020

GDP w.d.a. Forecast: -11.7%, Prior: -11.7%

Housing Price Index MoM (Jun) Forecast: -, Prior: -0.3%

S&P/Case-Shiller Home Price Index YoY (Jun) Forecast: 4%, Prior: 3.7%

New Home Sales MoM (Jul) Forecast: 0.75m, Prior: 0.775m

Consumer Confidence

BoC's Schembri SPEECH

Wednesday
8/26/2020

Durable Goods Orders ex Transportation (Jul) Forecast: 2%, Prior: 3.4%

Durable Goods ex Defense (Jul) Forecast: -, Prior: 9.5%

Durable Goods Orders (Jul) Forecast: 3.3%, Prior: 7.6%

Non-Defense Capital Goods Orders ex Aircraft (Jul) Forecast: 2.3%, Prior: 3.4%

BoC's Wilkins SPEECH

BoE's Haldane SPEECH

Jackson Hole Symposium

Thursday
8/27/2020

Core Personal Consumption Expenditure QoQ (Q2) Forecast: -, Prior: -1.1%

Personal Consumption Expenditure Prices QoQ (Q2) -, Prior: -1.9%

Initial Jobless Claims Forecast: .925m, Prior: 1.106m

Initial Jobless Claims 4-week ave. Forecast: -, Prior: 1.17575m

Continuing Jobless Claims Forecast: 15m, Prior: 14.844m

GDP Annualized Q2 Forecast: -32.5%, Prior: -32.9%

GDP Price Index Q2 Forecast: -, Prior: -2.1%

Fed's Chairman Powell SPEECH

BoC's Governor Macklem SPEECH

Jackson Hole Symposium

Friday
8/28/2020

Gfk Consumer Confidence Survey (Sep) Forecast: 2, Prior: -0.3

Consumer Confidence (Aug) Forecast: -15

Business Climate (Aug) Forecast: -, Prior: -1.8

Stargazer
Asset Management

Harmonized Index of Consumer Prices YoY (Aug) Forecast: -, Prior:0

Core PCE - Price Index MoM (Jul) Forecast: 0.4%, Prior: 0.2%

Personal Income MoM (Jul) Forecast: -0.2%, Prior: -1.1%

Personal Spending (Jul) Forecast: 1.5% Prior: 5.6%

Chicago PMI (Aug) Forecast: -, Prior: 51.9

Michigan Consumer Sentiment Index (Aug) Forecast: 72.8, Prior: 72.8

BoE's Governor Bailey SPEECH

Saturday
8/29/2020

Non-Manufacturing PMI (Aug) Forecast: -, Prior: 54.2

NBS Manufacturing PMI (Aug) Forecast-, Prior: 51.1

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