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Asset Management

What to focus on in Global Macro for the week of September 21st, 2020

Macro Themes on the Radar:

On Wednesday the Fed formally adopted outcome-based forward guidance, declaring the conditions under which they would next hike rates:

"The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. In addition, over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities at least at the current pace to sustain smooth market functioning and help foster accommodative financial conditions, thereby supporting the flow of credit to households and businesses."

This of course gives them lots of wiggle room as "maximum" employment is hard to estimate and "moderately exceed" and of course "for some time" are clearly purposefully vague. Still, it is strong stuff if they really carry it out when inflation hits 2% and unemployment is back at the lows. For now, however, it just illustrates their commitment to keeping rates low. Things will get interesting if growth and inflation outperform expectations.

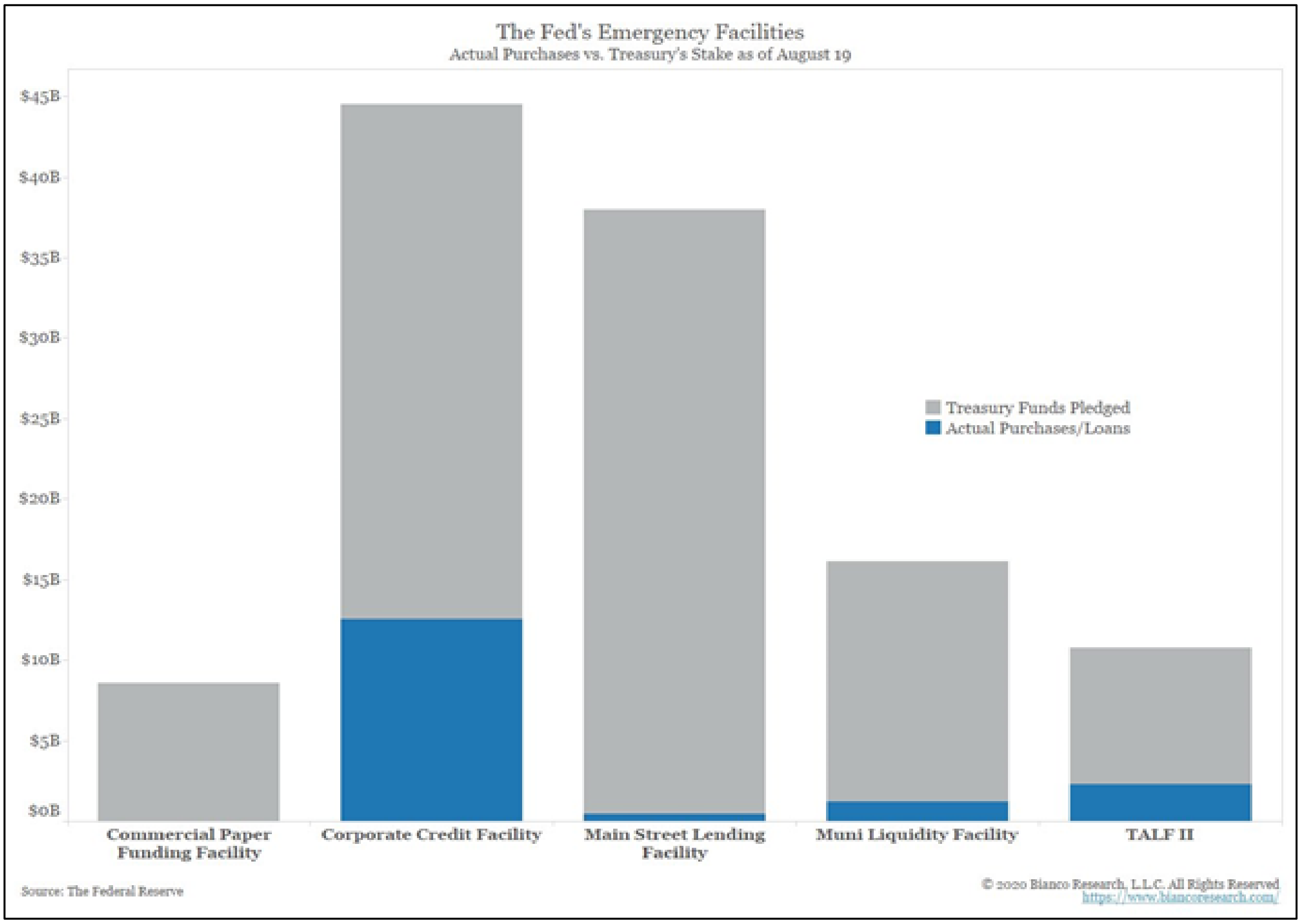
Markets have been happy to drink the Fed's liquidity and they have renewed their commitment to keep it coming both in terms of low rates and continued QE.

Having said that, it was also clear that the monetary policy toolbox is giving everything it can. Forward guidance is one of the last remaining options.

The emergency facilities that the Fed and the Treasury have put together have had mixed utilization so far. The following chart is a month old but not much has changed since then.

The Main Street Lending Facility in particular, has been a disappointment. Partially because banks have been reluctant to participate, but also because the desire to take on more debt has been minimal. PPP was essentially free money, but loans are a different story.

The Corporate Credit Facility has been the most effective and has had a very meaningful impact on the corporate bond market.

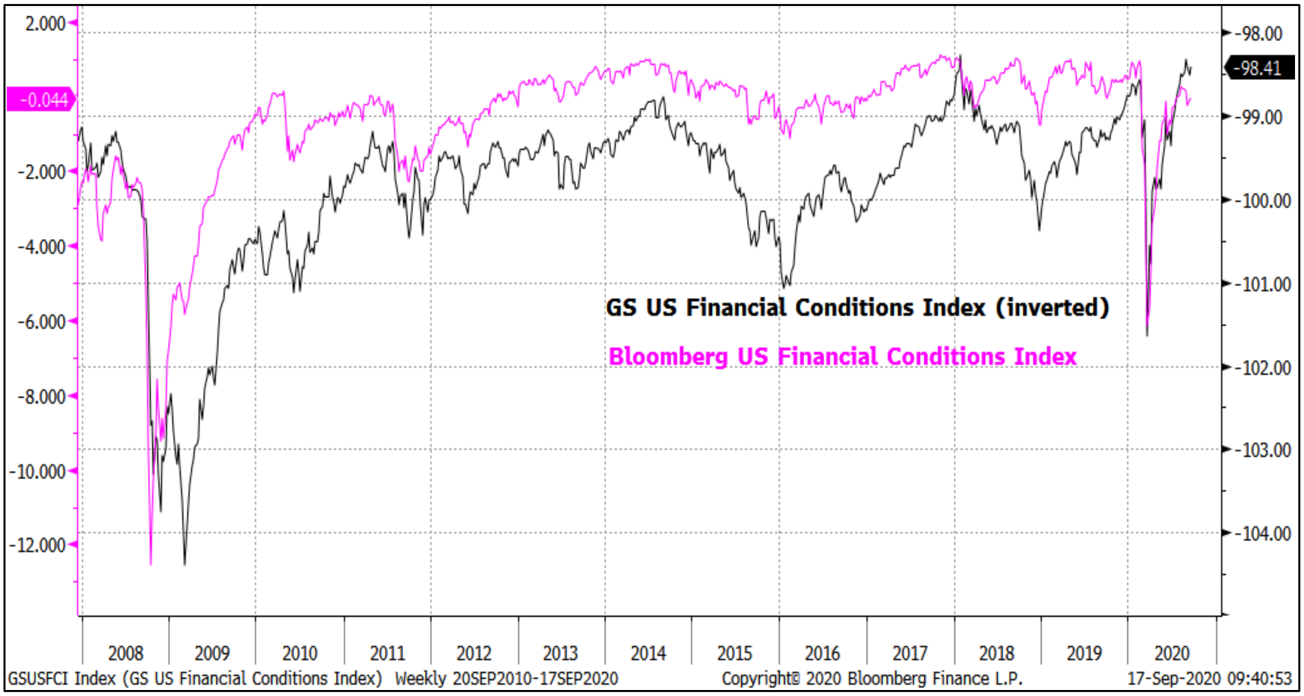


If the Fed really is committed to effectively raising both employment and inflation and then letting it run hot, they will have to keep financial conditions very easy.

That means:

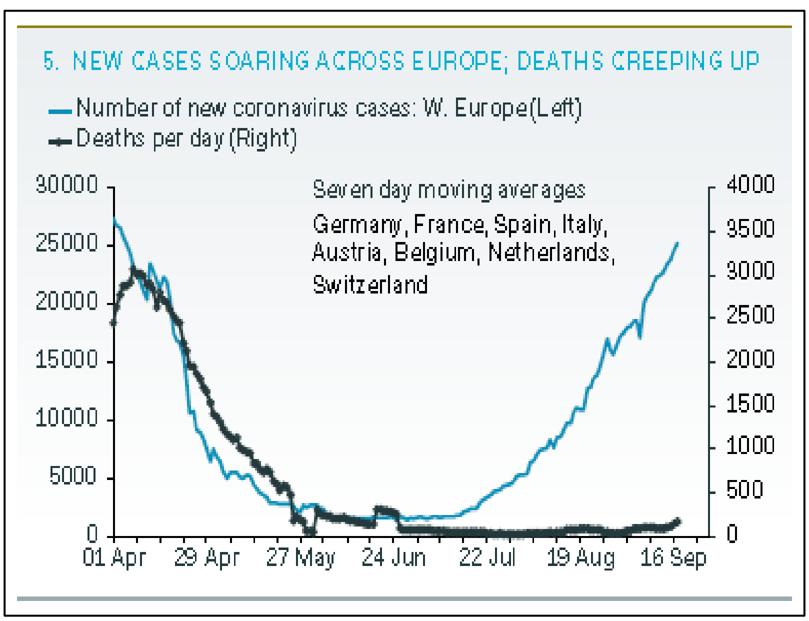
- Tight corporate credit spreads
- Lower USD
- Low rates and bond yields
- High or at least not falling equity prices

Given where we already are, it will be interesting to see if they can keep all those balls in the air.



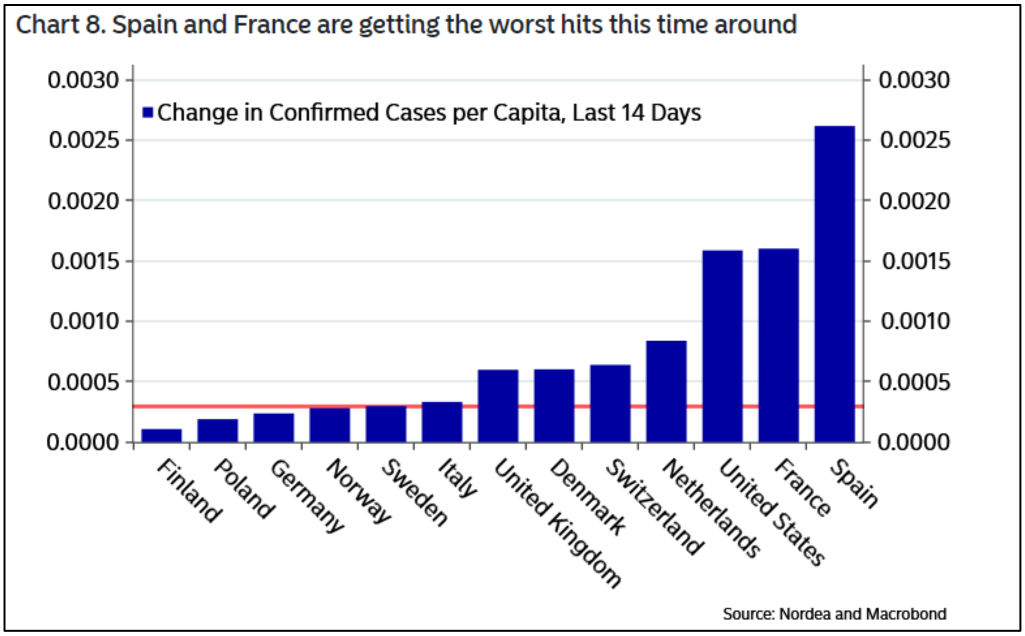
COVID

Europe is seeing a continued resurgence of cases. So far deaths per day are only rising slowly.



This trend towards lower fatality is being seen across the globe. Better therapeutics, a potentially less fatal strain, a higher percentage of young people among the infected and better isolation for the elderly all seem to be playing a role.

Spain and France are being hit hardest. (France now experiencing over 13,000 new infections daily.) But Denmark, the UK and the Netherlands are also seeing renewed spikes. Until we get a vaccine or greater herd immunity, COVID remains a story of rolling outbreaks.

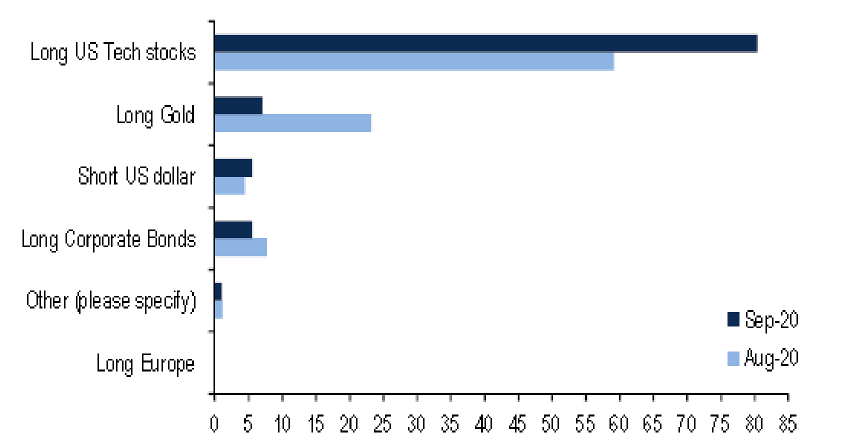


What to Focus on Now:

It has been a tough September so far for equities. After reversing August's big gains, we are now at critical levels in many global indices. US outperformance (led by big Tech) is being challenged.

Investors have been plowing into tech for the last few months…

Exhibit 21: What do you think is currently the most crowded trade?

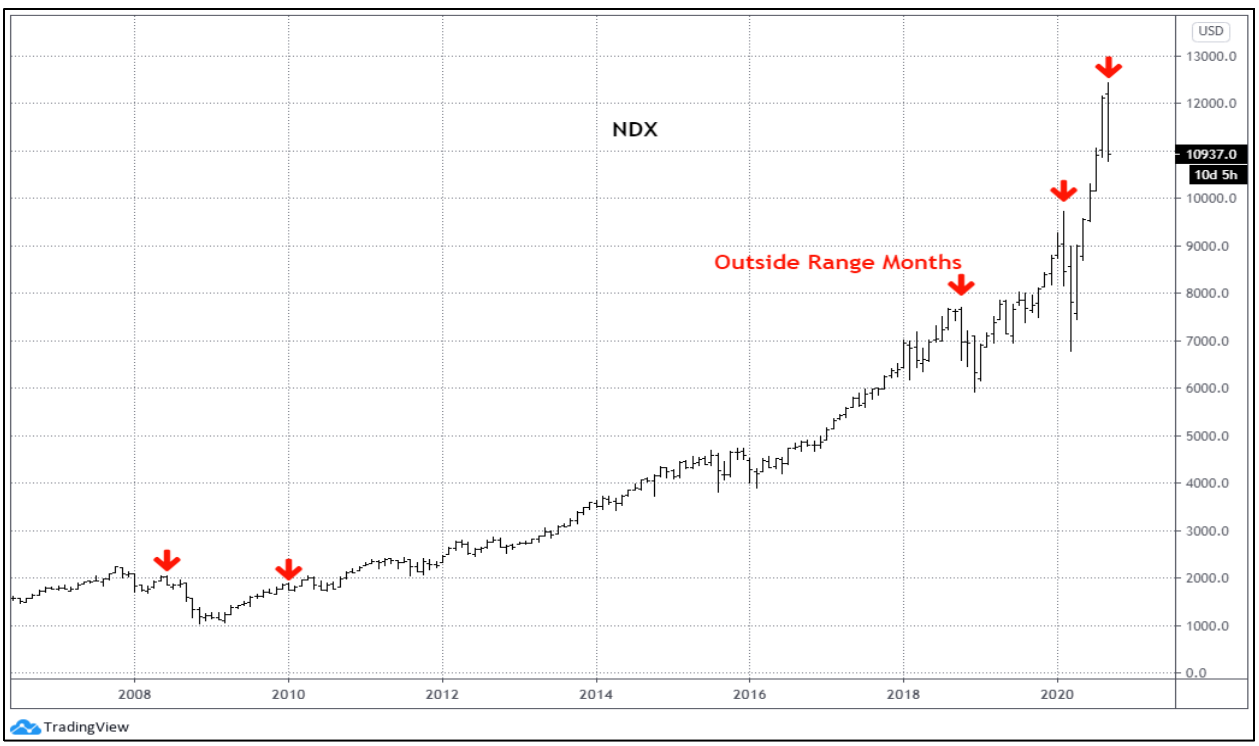


Source: BofA Global Fund Manager Survey

Most crowded trades in Sep '20:

1. Long US tech (80%) – strongest consensus view ever.
2. Long gold (7%).
3. Short US dollar (6%).
4. Long Corporate Bonds (6%).

Price action and valuations were getting extreme, but FOMO is powerful. Add to that the huge amount of options buying in tech and the resulting gamma shorts for market makers and we had the makings of a blow-off. The ugly reversal has created some interesting charts. The NDX has put in a rare monthly reversal pattern so far (of course the month isn't over yet). Generally, an outside range month like this means we are in for at least a few months of sideways, potentially further downside.



Relative performance of the NASDAQ vs. the world ex-US also has an outside range month down.

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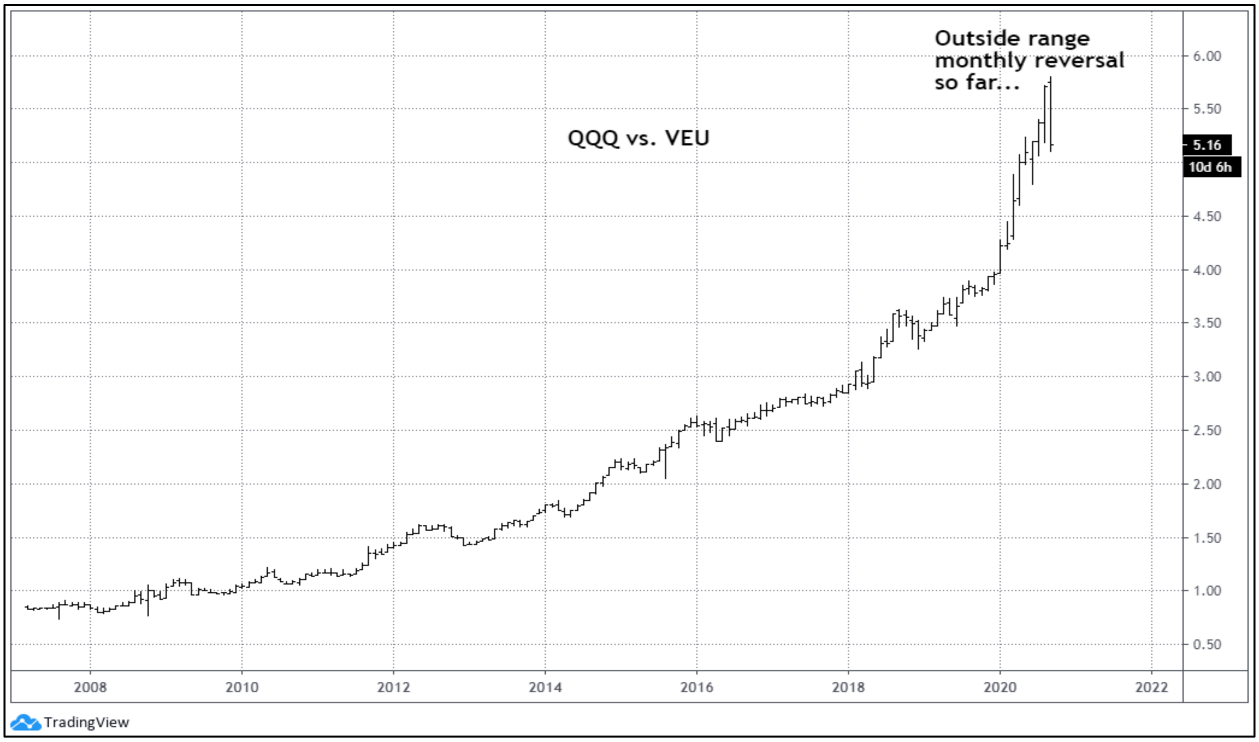
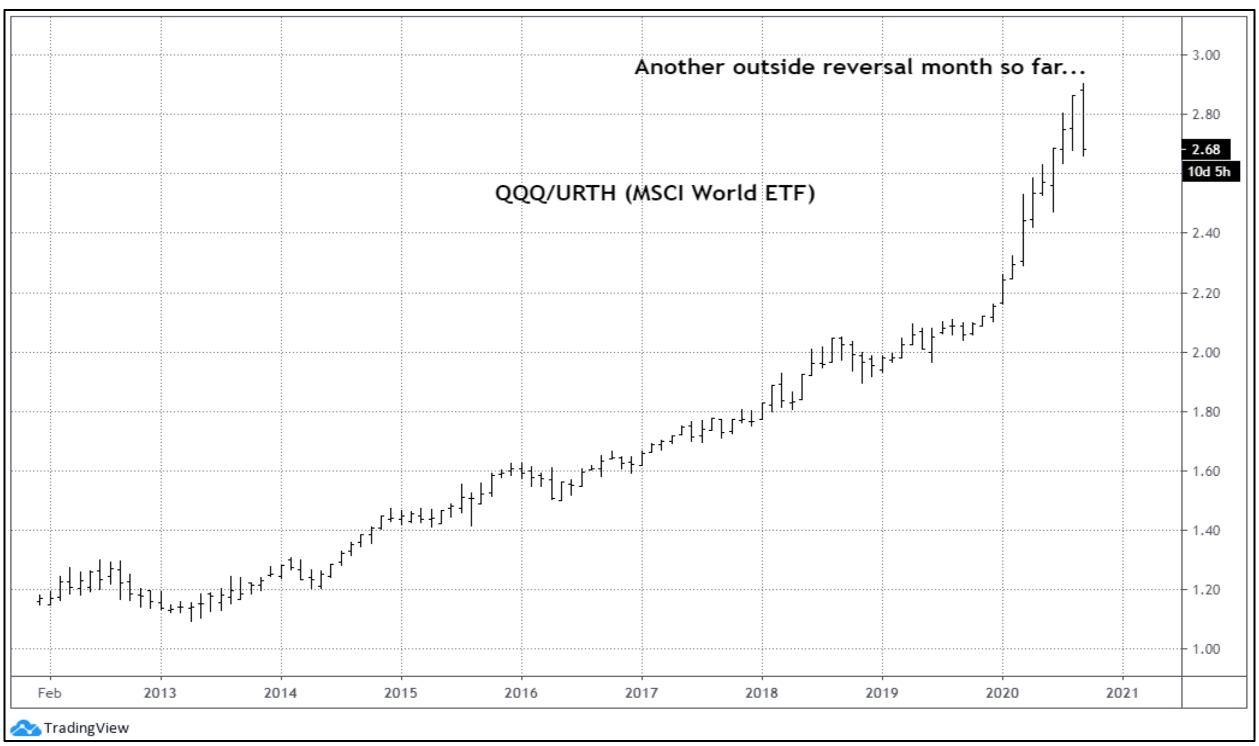


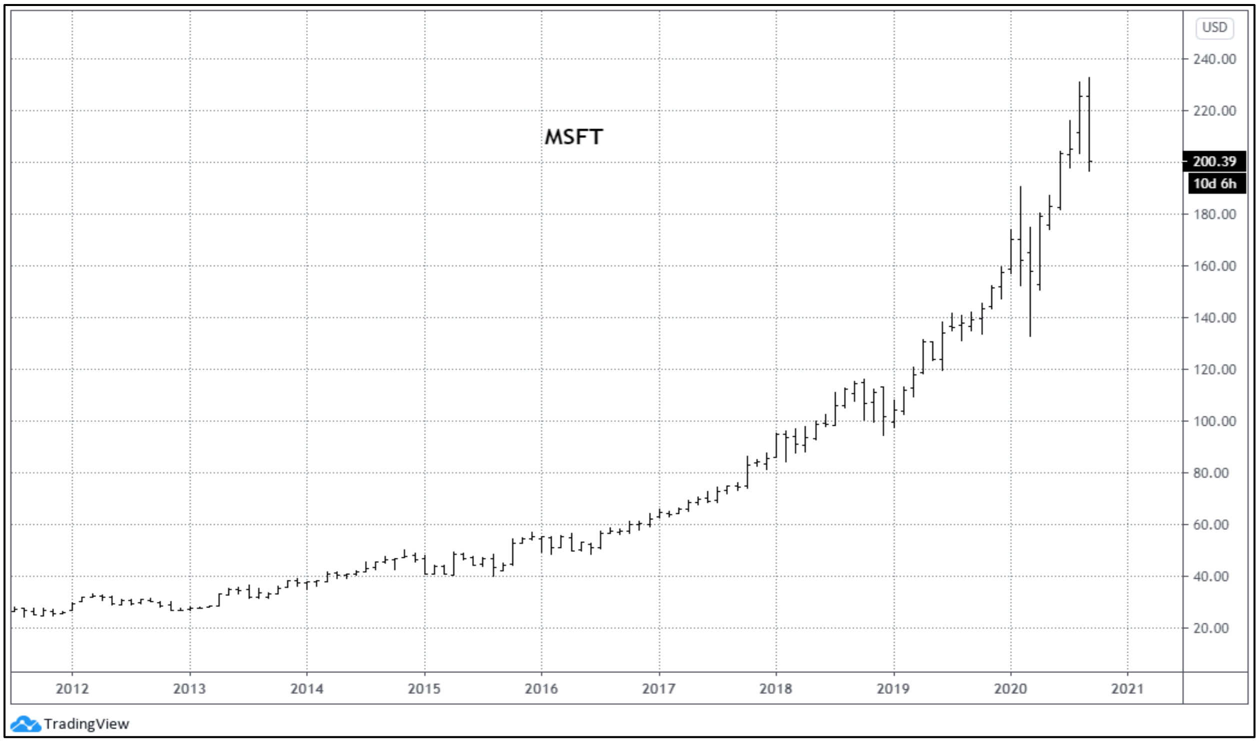
As does the NDX vs. the MSCI World ETF.



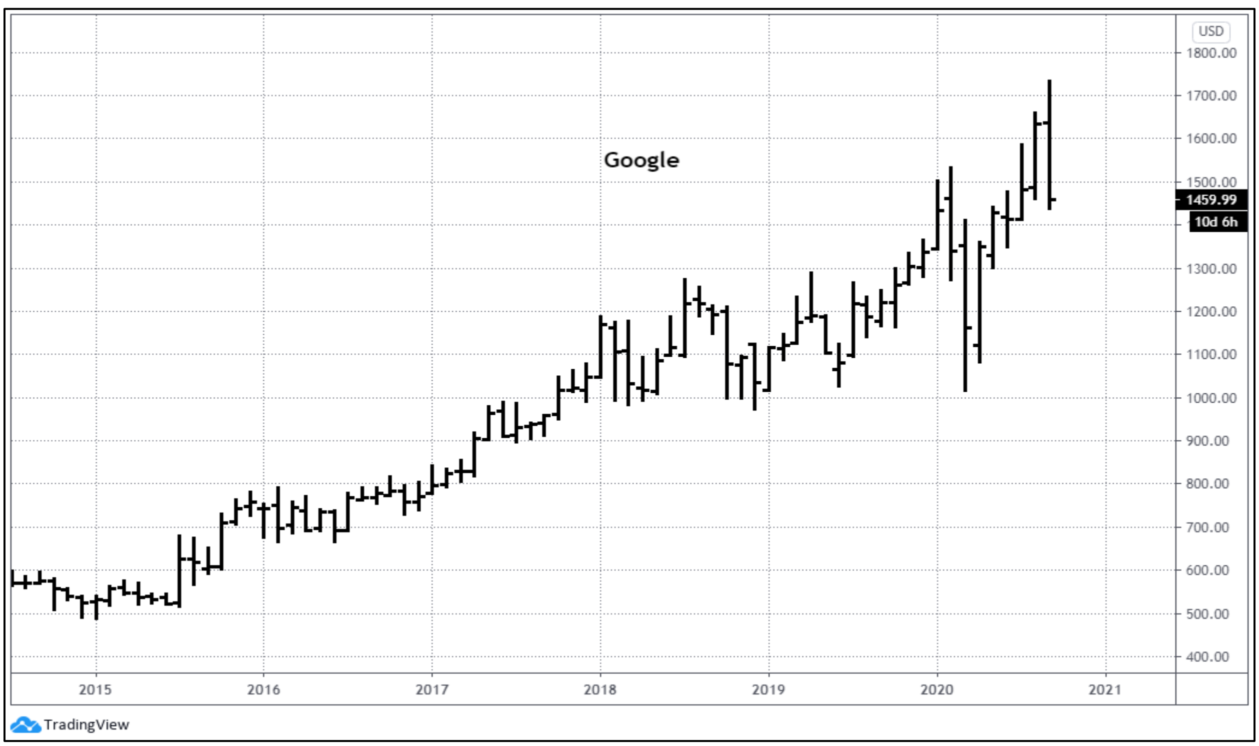
It isn't surprising that the FAANG + MSFT looks similar, given the big tech roundtrip in prices over the last six weeks.

Or that many of the components do as well… AAPL

as well as Microsoft…



and Google



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Semiconductors have an outside month as well, and the daily chart is hanging at precarious levels.

Given these cracks in the rally, it is noteworthy that so far, the VIX is unimpressed.

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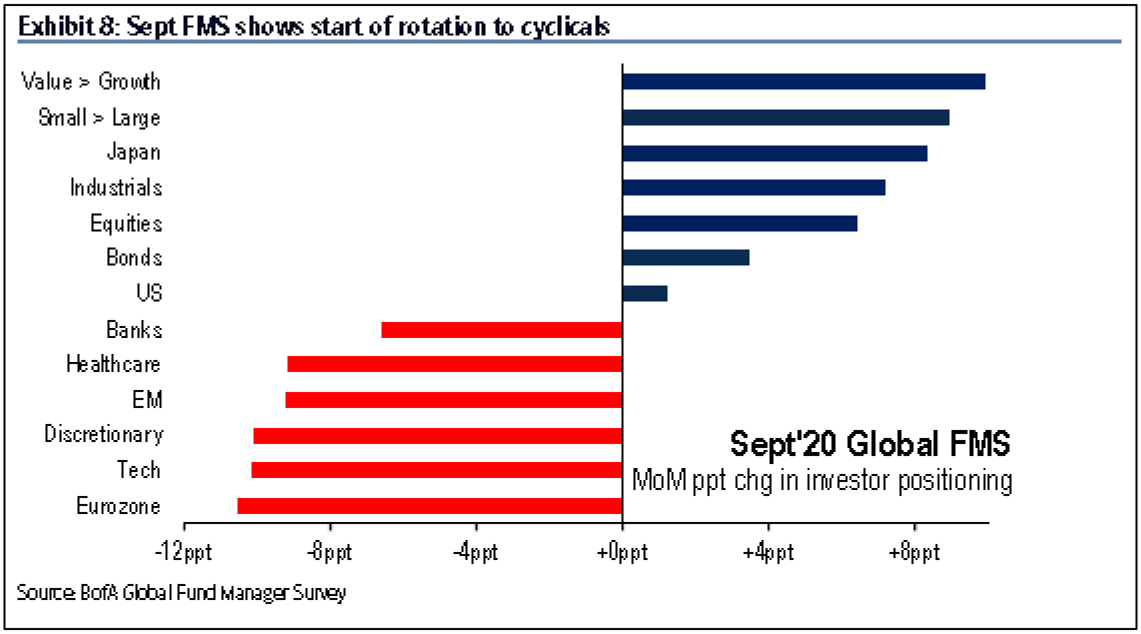
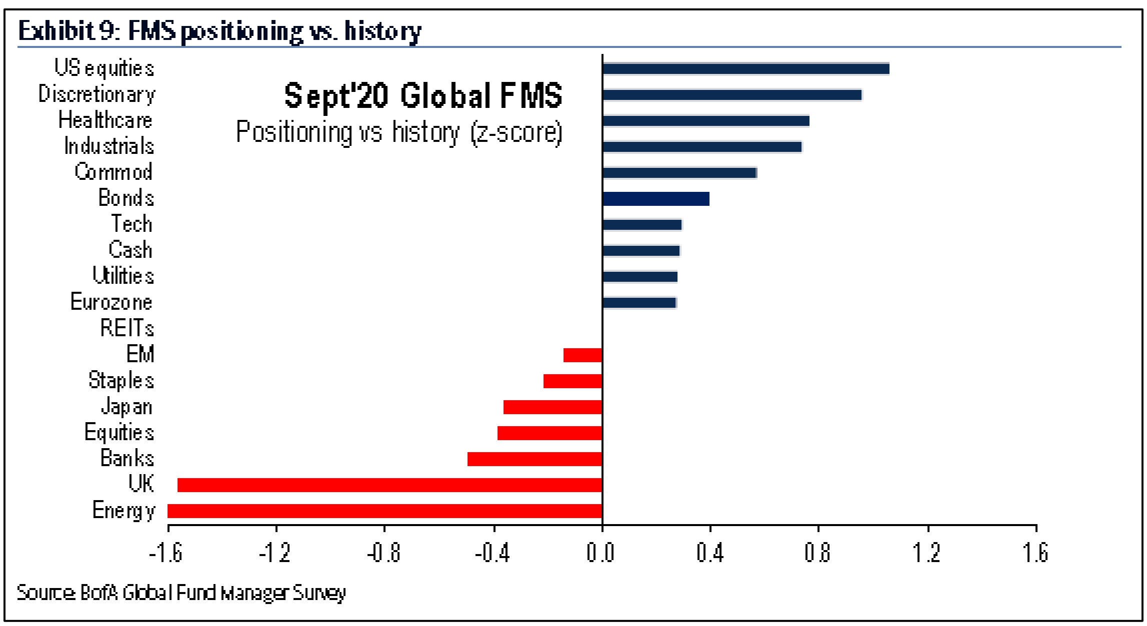
The market read seems to be that while tech is off the boil, it is more a reflection of rotation into other sectors and styles rather than a potential top in equities. The hope is that we are starting a cyclical rotation and that potentially a benign change of leadership can take place. Out of tech, healthcare and big caps and into value and small caps.

The Russell is definitely starting to perk up vs. the S&P and we have a big level just above in terms of relative performance vs. the S&P. Against the NDX it has some real potential as well.

The flows are starting to show the shift…



Although positioning could have a long way to go. So far, still no love for Banks or Energy.



Global flows into equities overall had picked up recently.

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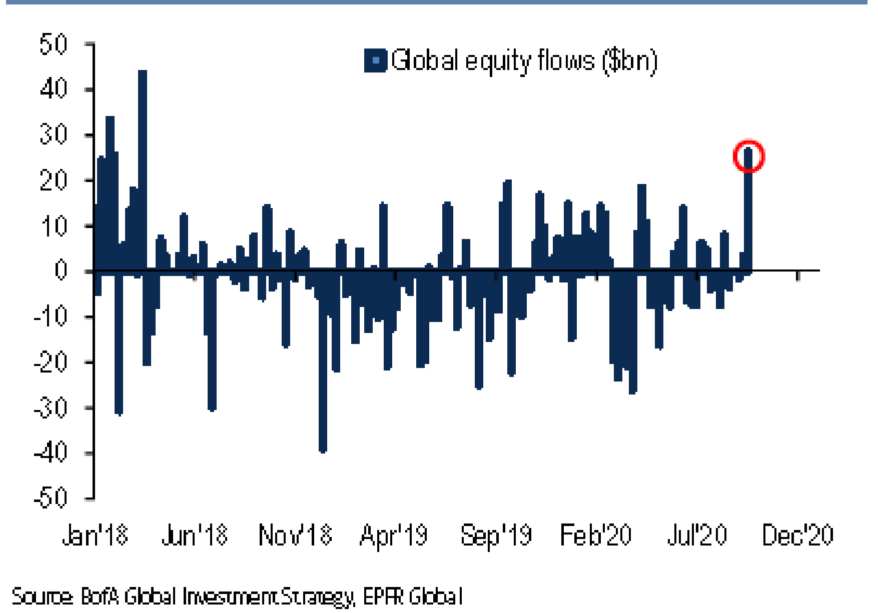
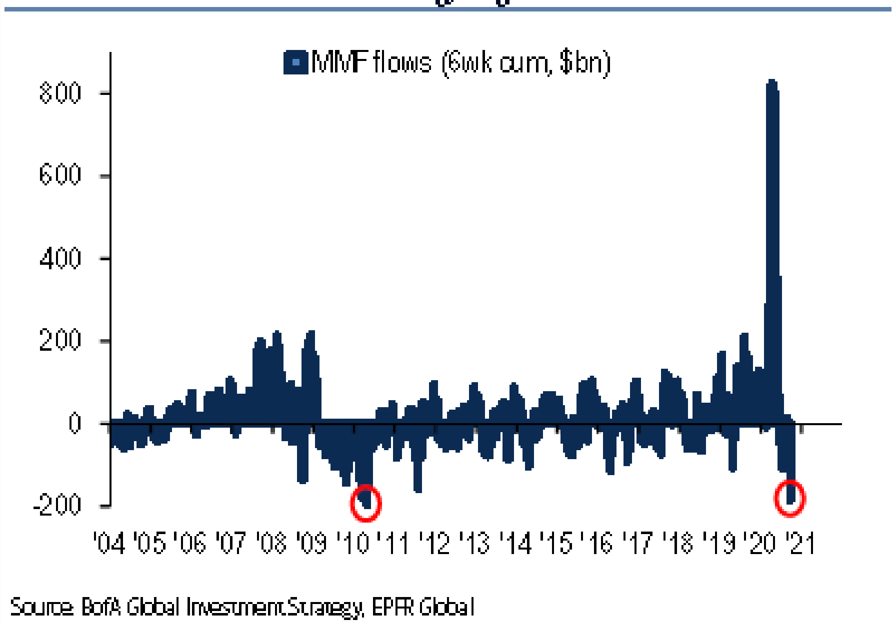
Chart 3: Frenzy into global stocks funded by dash from cash



Source: BofA Global Investment Strategy, EPFR Global

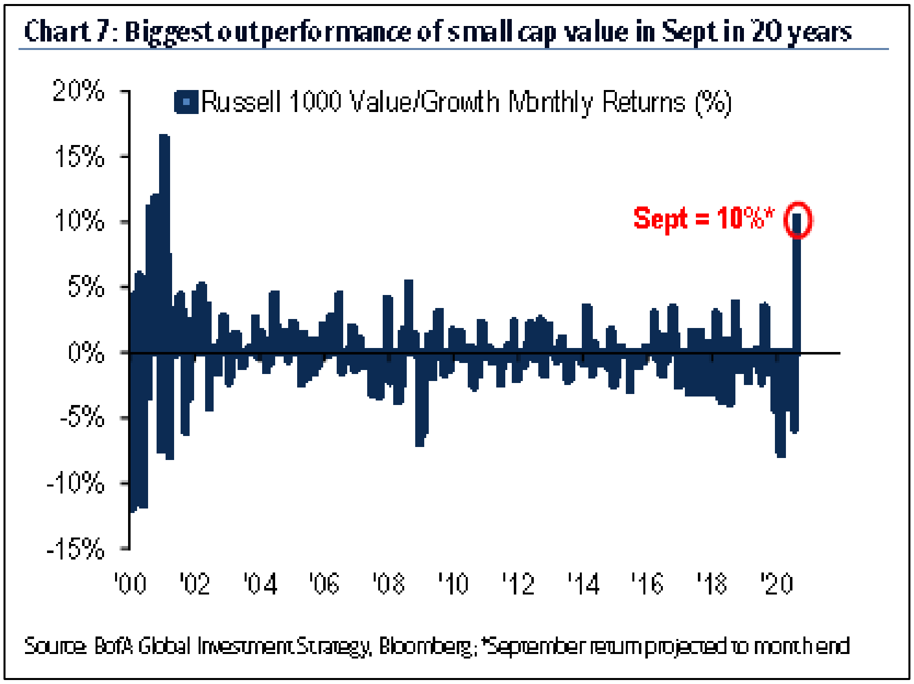
As money left the safety of money market funds.

Chart 5: Dash from cash accelerating, largest since 2010



Source: BofA Global Investment Strategy, EPFR Global

However, it is increasingly finding its way into Value stocks.

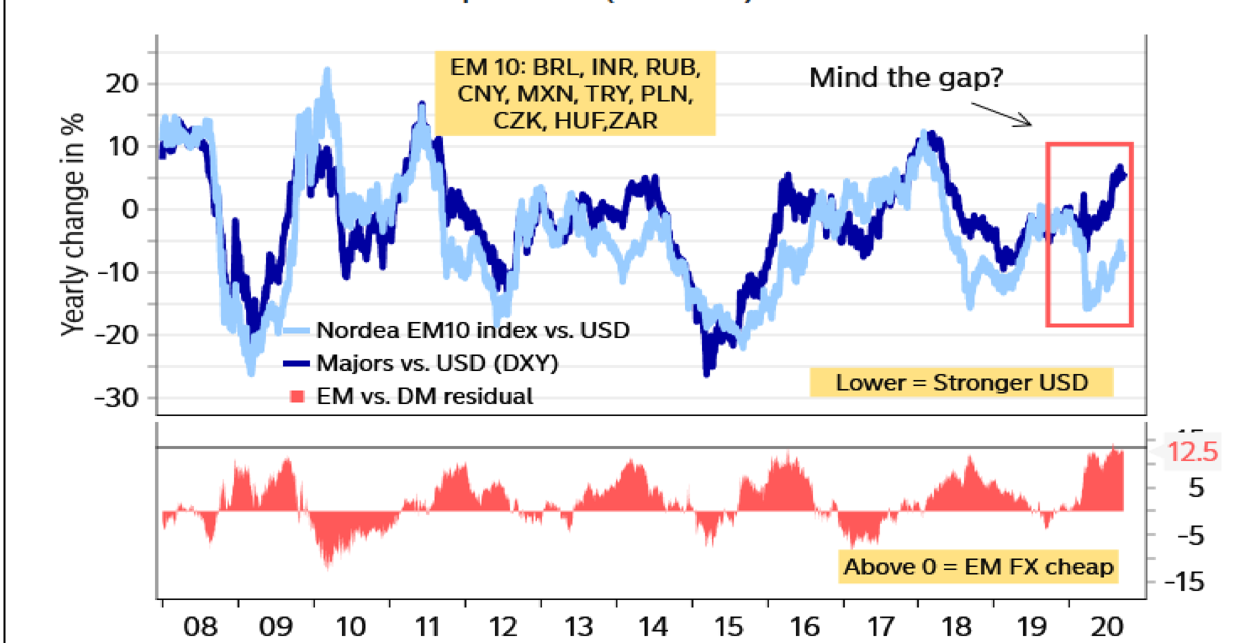


Over the last couple of days, we have seen growth stocks fall and value fall less. The big question is, can we rotate and change leadership away from the high-flying tech stocks without taking down the entire market? I think volatility is set to pick up here in equities.

So far, the rotation has been largely inside the US with regional shifts being shunned. Having said that, EM is starting to perk up on a relative performance basis. Continued USD weakness and China economic strength would help turn the trend.

In a benign rotation with continued USD weakness, EM potentially has upside.

Chart 9. EM FX still looks cheap vs EUR (and USD)



Source: Macrobond and Nordea

EuroStoxx have gone sideways now for nearly four months. I would be careful if the recent lows come out.

The EUR heavy Dollar Index is the same price it was nearly two months ago.

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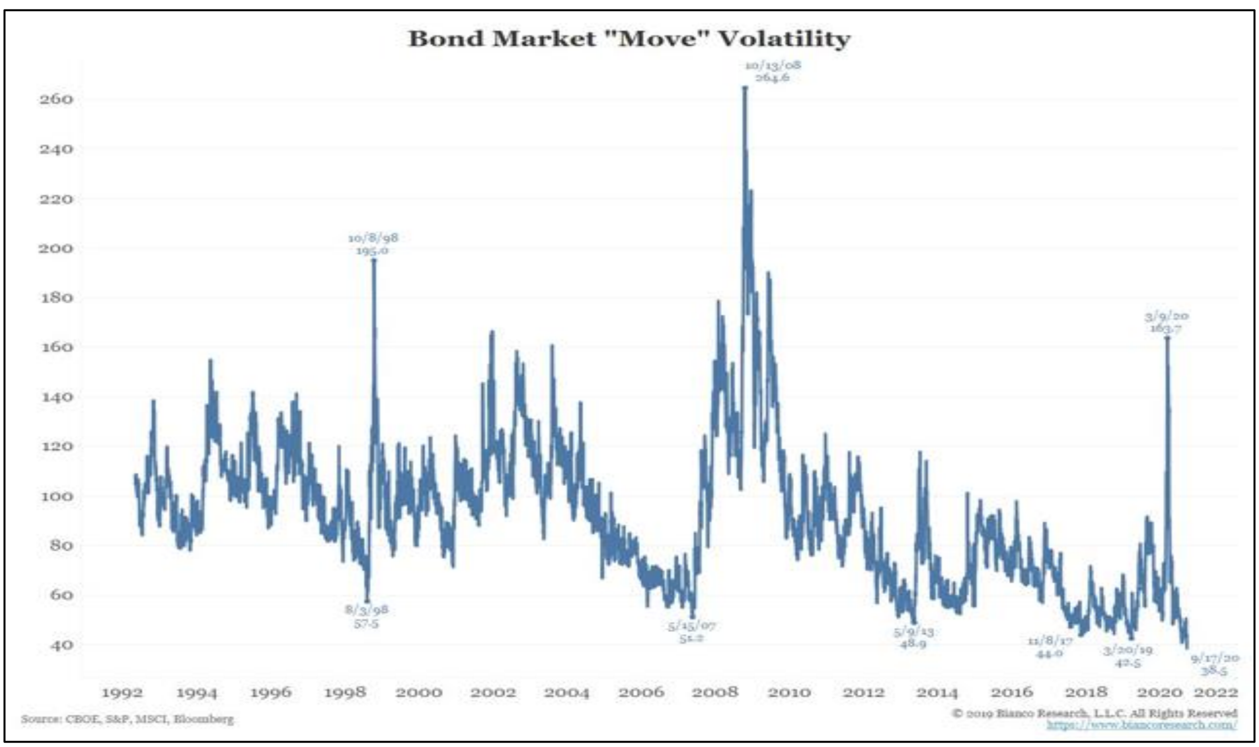
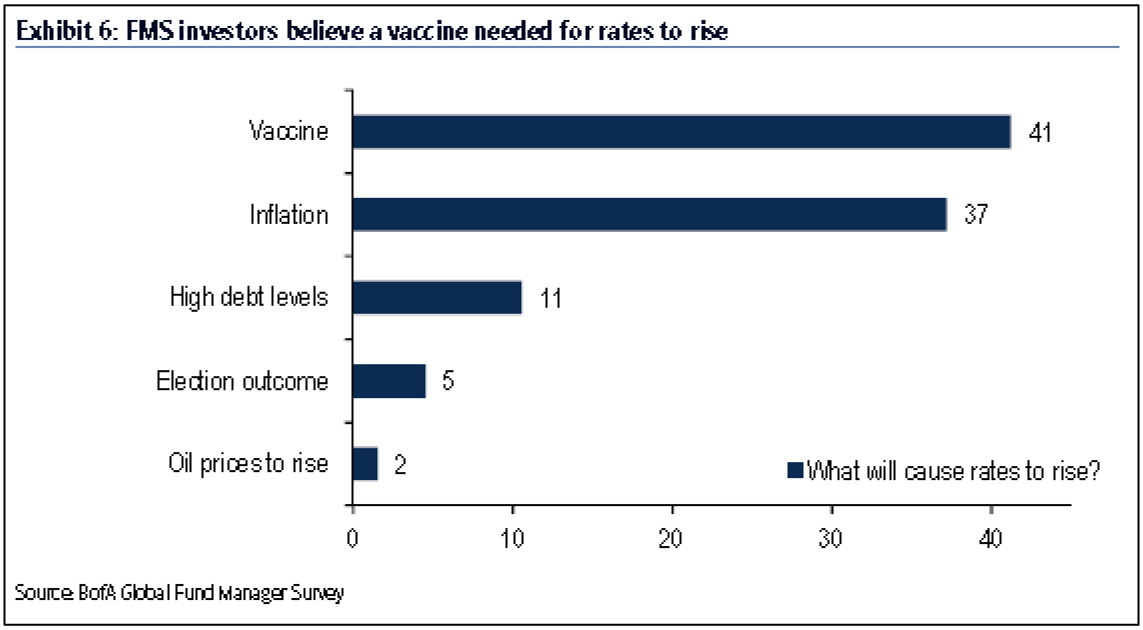
Not to be outdone in the boring department, Bonds have been stuck between better economic data, large deficits and potential reflation on one hand and zero front end rates at home and negative front-end rates abroad on the other.

Bond market volatility is scraping all-time lows as a result.



It was interesting to note that in the recent BoA fund managers survey, the absence of a vaccine came in as the top hurdle to higher rates. Its availability would presumably give the reflation trade wings. Can we infer that the Fed's "strong forward guidance" will only matter post vaccine?



If the Fed is serious about AIT you can expect this to break higher…

For now, Gold has been working off its over-bought condition. So far it has held in well. What happens if equities head south? A lot will depend on what the USD does. I think an interesting trade is equity downside and gold upside.

<u>Lots of Fed speakers this week not to mention testimony from both Powell and Mnuchin in front of Congress.</u>

Important Macro Data Releases and Events for the Week

Monday 9/21/2020

- Chicago Fed National Activity Index (Aug) Forecast 1.95, Prior: 1.18
- **Fed's Powell SPEECH**
- Fed's Brainard SPEECH
- Fed's Williams SPEECH

Tuesday 9/22/2020

- BoE Governor Bailey SPEECH

	Existing Home Sales MoM (Aug) Forecast: 5.98m, Prior: 5.86m
	Consumer Confidence (Sep) Forecast: -14.7, Prior: -14.7
Wednesday 9/23/2020	Gfk Consumer Confidence Survey (Oct) Forecast: -1, Prior: -1.8
	Markit Manufacturing, Service and Composite PMI's for EU and rest of Europe
	Markit Manufacturing PMI (Sep) Forecast: 53.1, Prior: 53.1
	Markit Service PMI (Sep) Forecast: 54.7, Prior: 55
	Markit PMI Composite (Sep) Forecast: -, Prior: 54.6
	Housing Price Index MoM (Jul) Forecast: 0.5%, Prior: 0.9%
	Fed's Mester SPEECH
	Fed's Chair Powell testifies
	Fed's Quarles SPEECH
	BoJ Monetary Policy Meeting Minutes
Thursday 9/24/2020	SNB Interest Rates Decision and Monetary Policy Assessment
	EU Economic Bulletin
	IFO - Business Climate (Sep) Forecast: 93.8, Prior: 92.6
	IFO - Current Assessment (Sep) Forecast: 89.5, Prior: 87.9
	IFO - Expectations (Sep) Forecast: 98, Prior: 97.5
	Initial Jobless Claims Forecast: 850k, Prior: 860k
	Initial Jobless Claims 4-week ave. Forecast: 944k , Prior: 912k
	Continuing Jobless Claims Forecast: 13.194m, Prior: 12.628m

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Fed's Chair Powell testifies

Treasury Sec Mnuchin SPEECH

New Home Sales MoM (Aug) Forecast: 892k, Prior: 901k

BoE Governor Bailey SPEECH

Fed's Williams SPEECH

Friday 9/25/2020

Durable Goods Orders ex-Transportation (Aug) Forecast: 1.2%, Prior: 2.6%

Durable Goods Orders ex-Defense (Aug) Forecast: 0.1%, Prior: 10.1%

Durable Goods Orders (Aug) Forecast: 1.5%, Prior: 11.4%

Non-Defense Capital Goods Orders Ex-Aircraft (Aug) Forecast: 1.9% Prior: 1.9%

Fed's Williams SPEECH