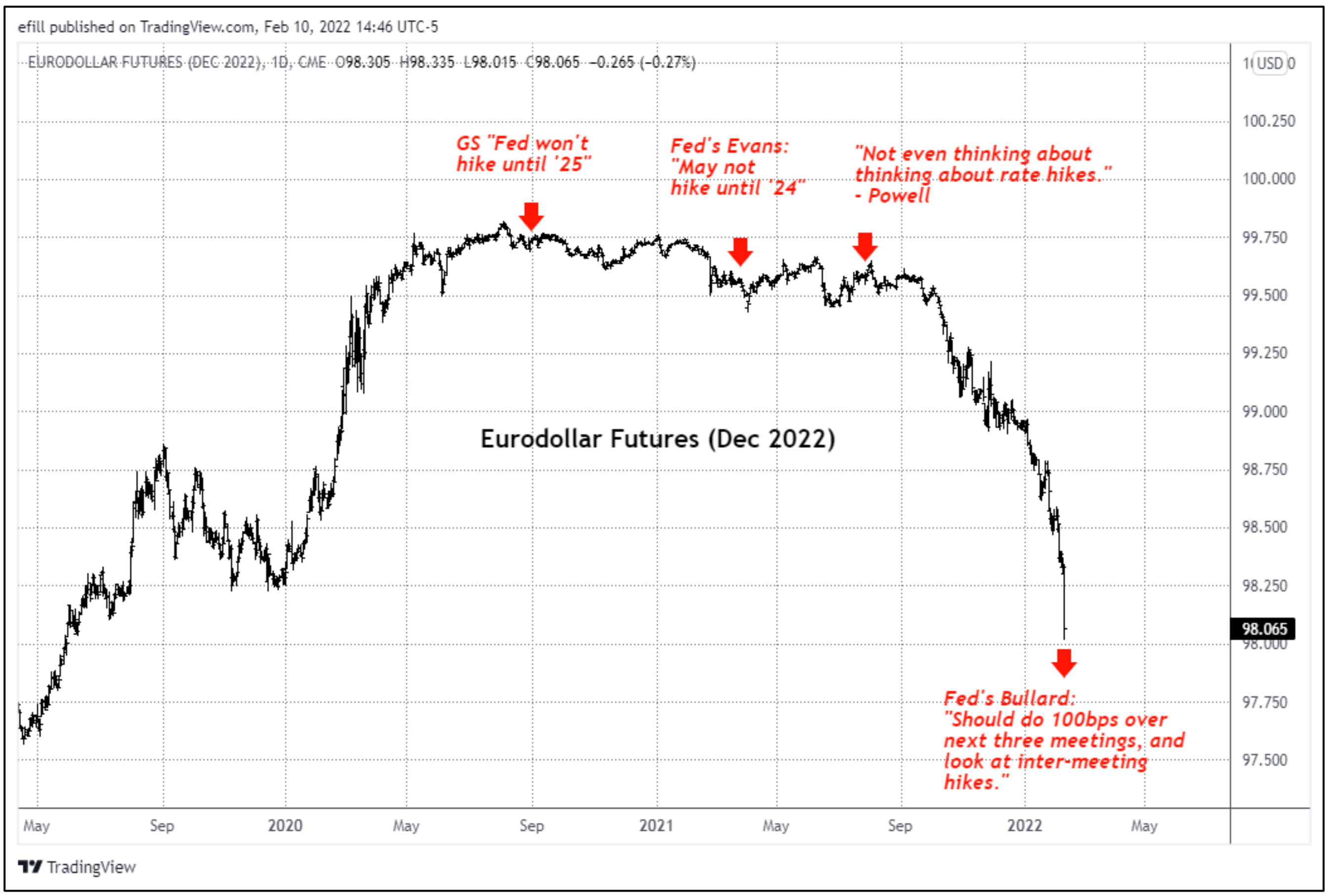
Stargazer
Asset Management

What to focus on in Global Macro for the week of February 14th, 2022

Macro Themes on the Radar:

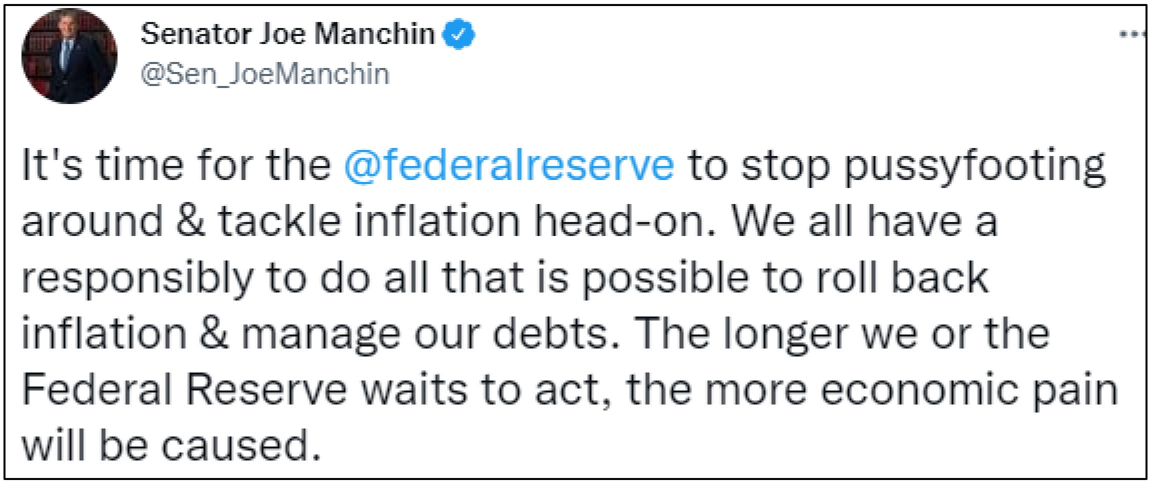
US Jan. CPI provided another rude surprise for markets and kept the pressure on the Fed to do something about it. With limited options, you pull the levers you have. Forward visibility at the moment is about 10-feet in terms of what comes next for geopolitics and the global economy. Volatility has continued as a result. The Fed has certainly found the will to tighten, maybe aggressively. However, remember it wasn't that long ago that Bullard's call for 100bps in hikes over the next six months would have been unimaginable.

In under 18 months, GS has gone from no hikes until '25 to 7 hikes in '22. I doubt we get that.



With everything from the inflationary and geopolitical outcomes to earnings expectations in flux, I expect we will see the ground continue to shift in the coming months. Volatility is here to stay.

With the Biden administration being blamed for inflation and the mid-term elections approaching, even democrats are calling for rate hikes (ok yeah it is Manchin, but still).



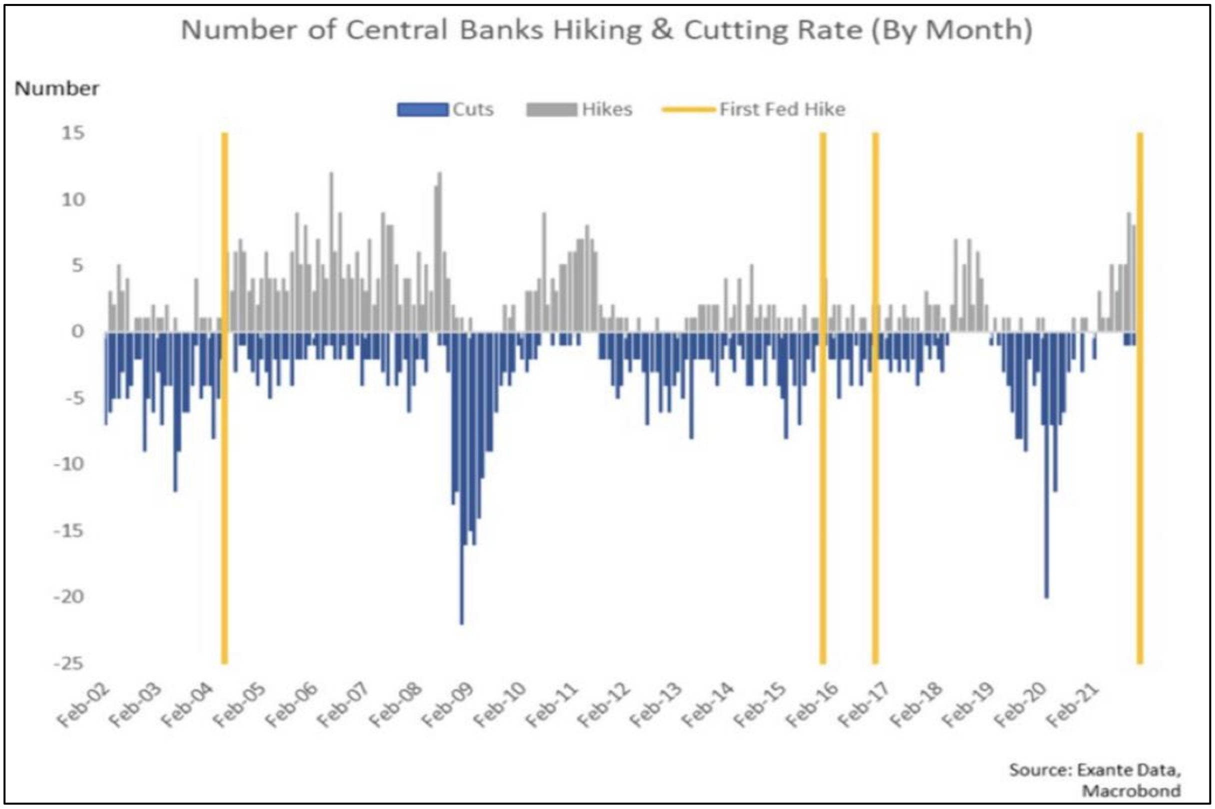
The market has been happy to front-load hikes but is clearly worried that the economy won't be able to handle too many hikes.

5's 30's and 2's 10's have been flattening. So has the Eurodollar curve, as ED4 is now only 23bps from ED12. Historically low for a hiking cycle that is yet to begin.

The market continues to worry that the Fed will be forced into a policy error, knowing how difficult it is to successfully engineer a soft landing for the economy.

The Fed's new framework, in which they don't hike unless inflation actually manifests itself, has combined with an initial view that it was more transitory than it has turned out to be. The result was always going to be a Fed that is slow to get going but then is filled with urgency. Urgency with no visibility is a tough spot to find yourself in.

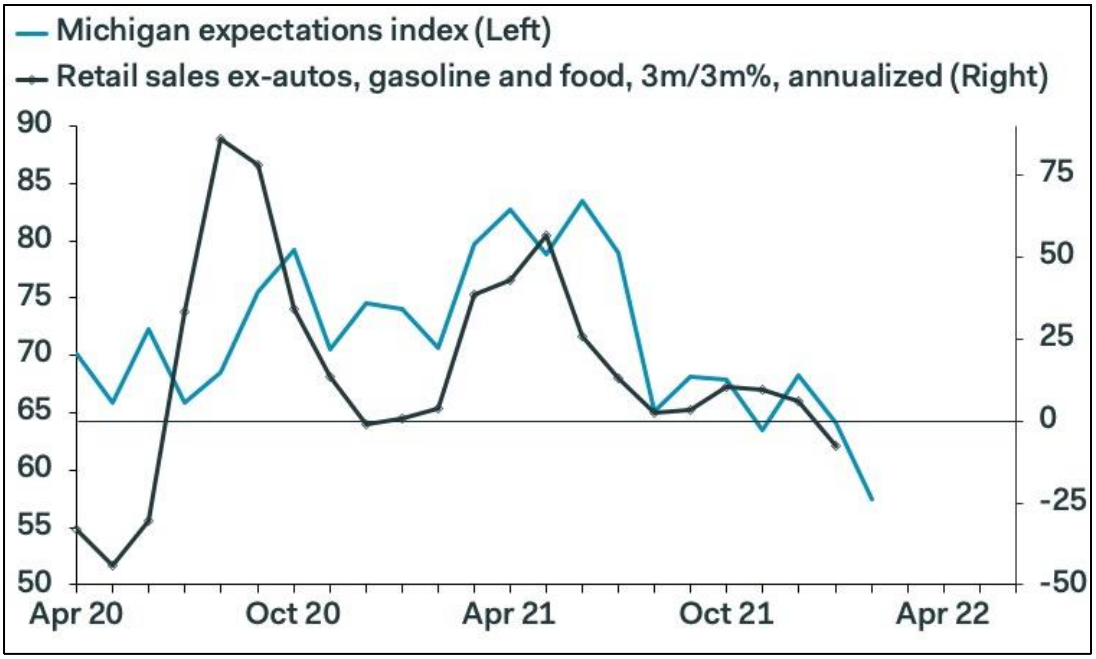
In this hiking cycle, the Fed has been slow to get going vs. other central banks...



The next ten days will see plenty of potential for further Fed headlines.

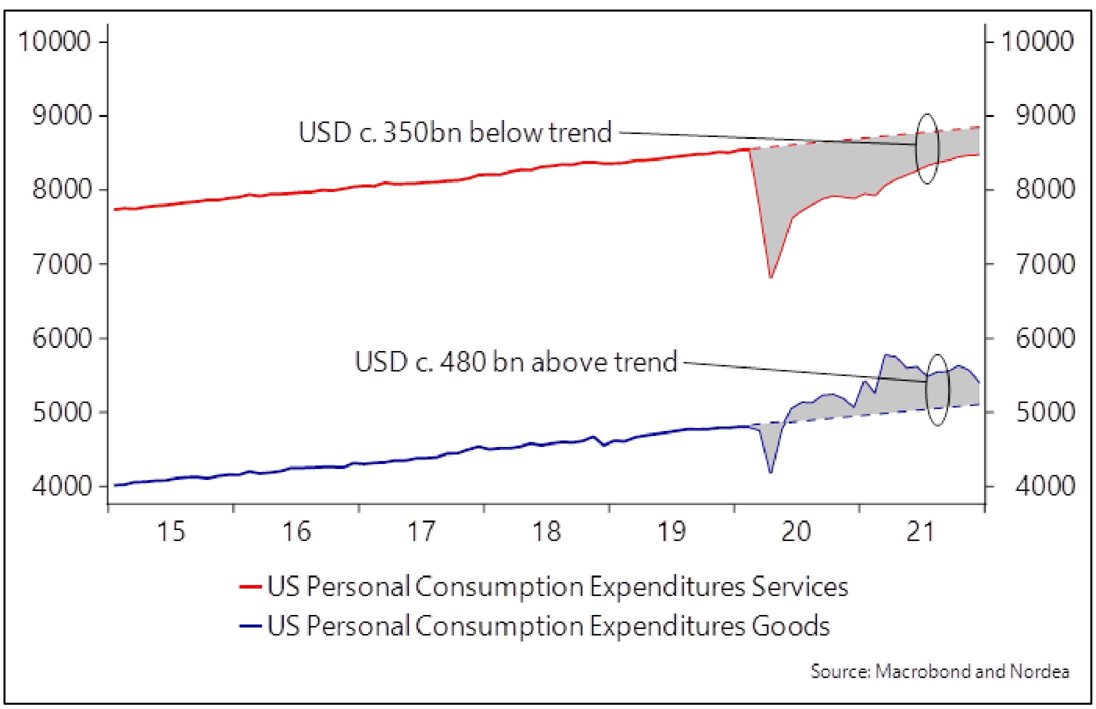
27) 02/14 08:30	Fed's Bullard speaks on CNBC			
28) 02/16 14:00	FOMC Meeting Minutes	Jan 26	--	--
29) 02/17 11:00	Fed's Bullard Discusses the Economy and Policy Outlook			
30) 02/17 17:00	Fed's Mester Speaks on Economic and Policy Outlook			
31) 02/18 10:45	Fed's Evans and Waller takes Part in Policy Panel at...			
32) 02/22 15:30	Fed's Bostic Takes Part in Moderated Q&A			
33) 02/24 11:10	Fed's Bostic Discusses Banking in a Digital Era			
34) 02/24 12:00	Fed's Mester Speaks on Economic and Policy Outlook			

Economically, many unknowns remain. Despite plunging COVID cases, rising energy and food prices are putting consumers in a bad mood.

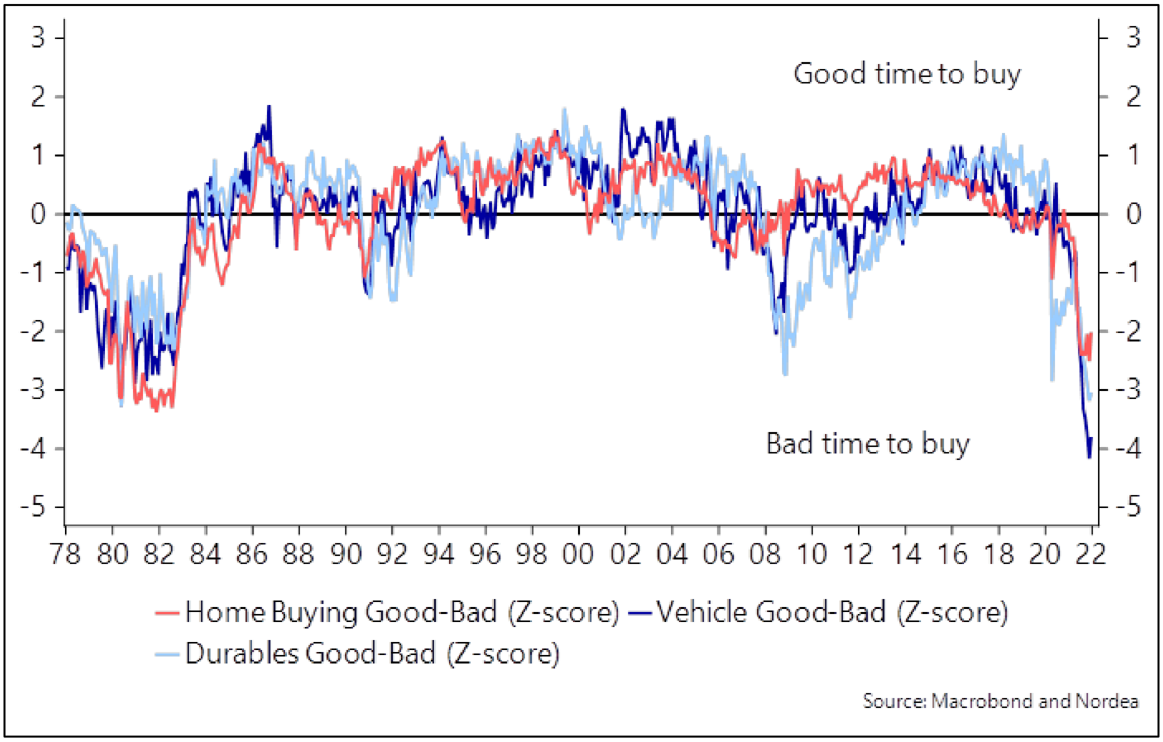


When and how US households' consumption will return to "normal" is uncertain.

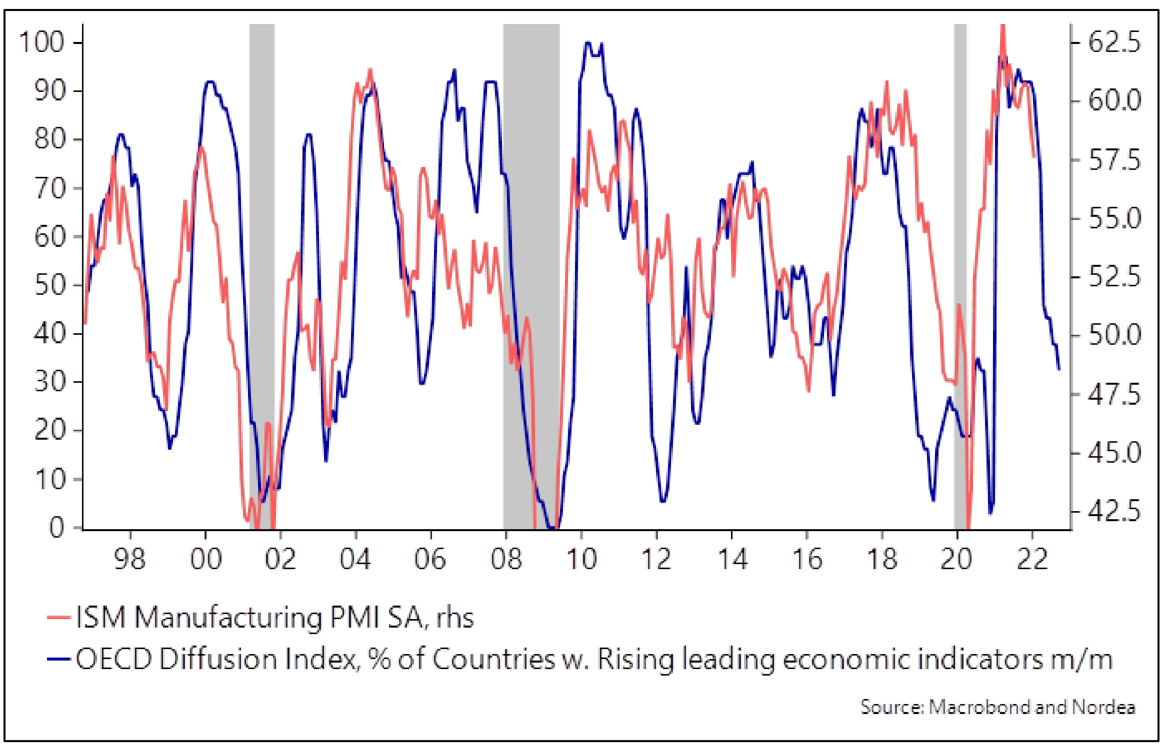
Over time, and as COVID fades, durable goods should fall back to trend and services pick up.



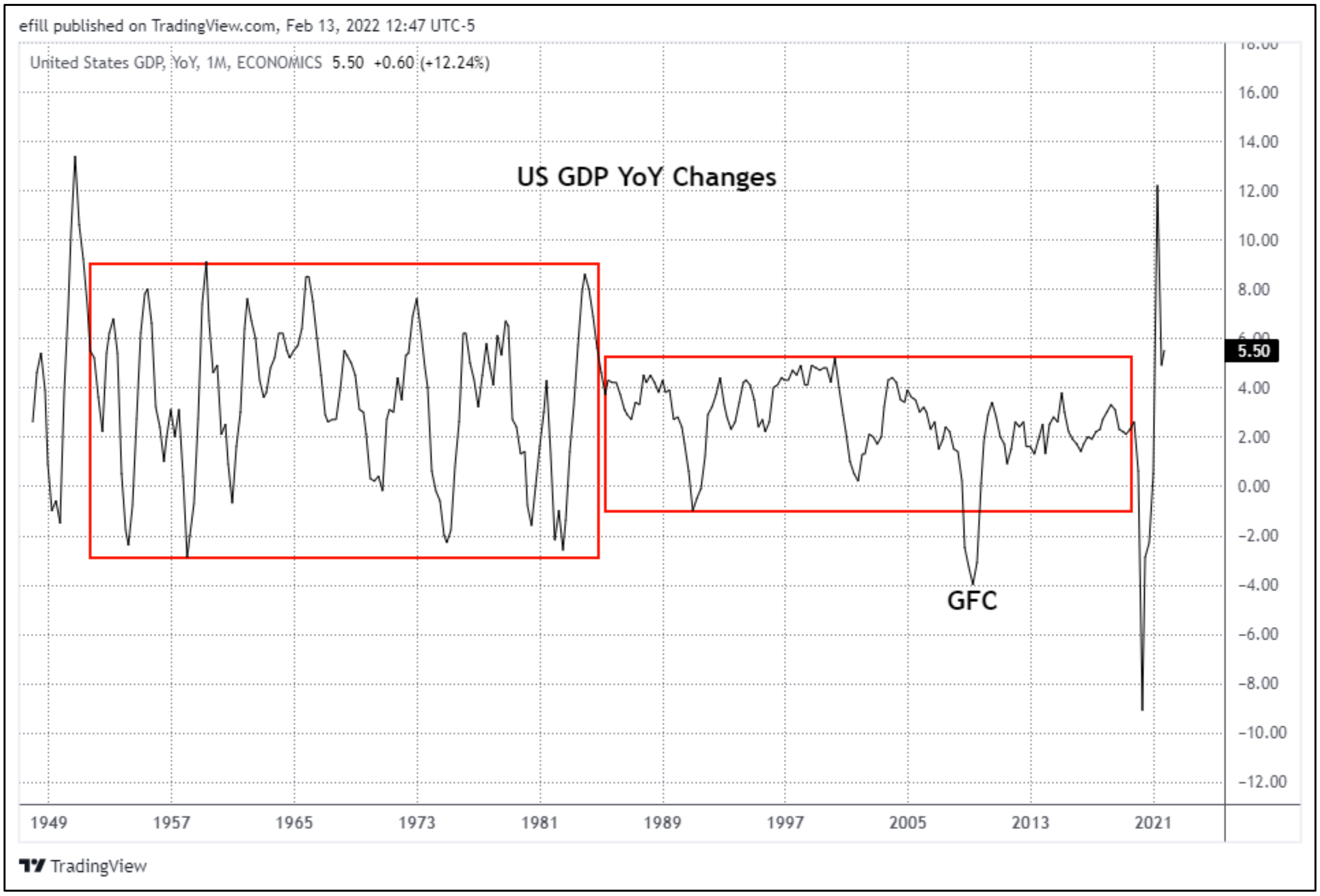
High prices and lower real wages have started the process as the University of Michigan Index prints the worst-ever sentiment for buying durable goods.



Global activity has been showing signs of slowing and global leading economic indicators have been softening.



With inflation an issue for the first time in decades, don't' be surprised if the relatively low volatility in GDP we have seen since the mid-80's is over. A disinflationary backdrop allowed central banks to always swoop in and save the day. The GFC was the exception as the deflationary forces unleashed by the credit bubble were hard to deal with.



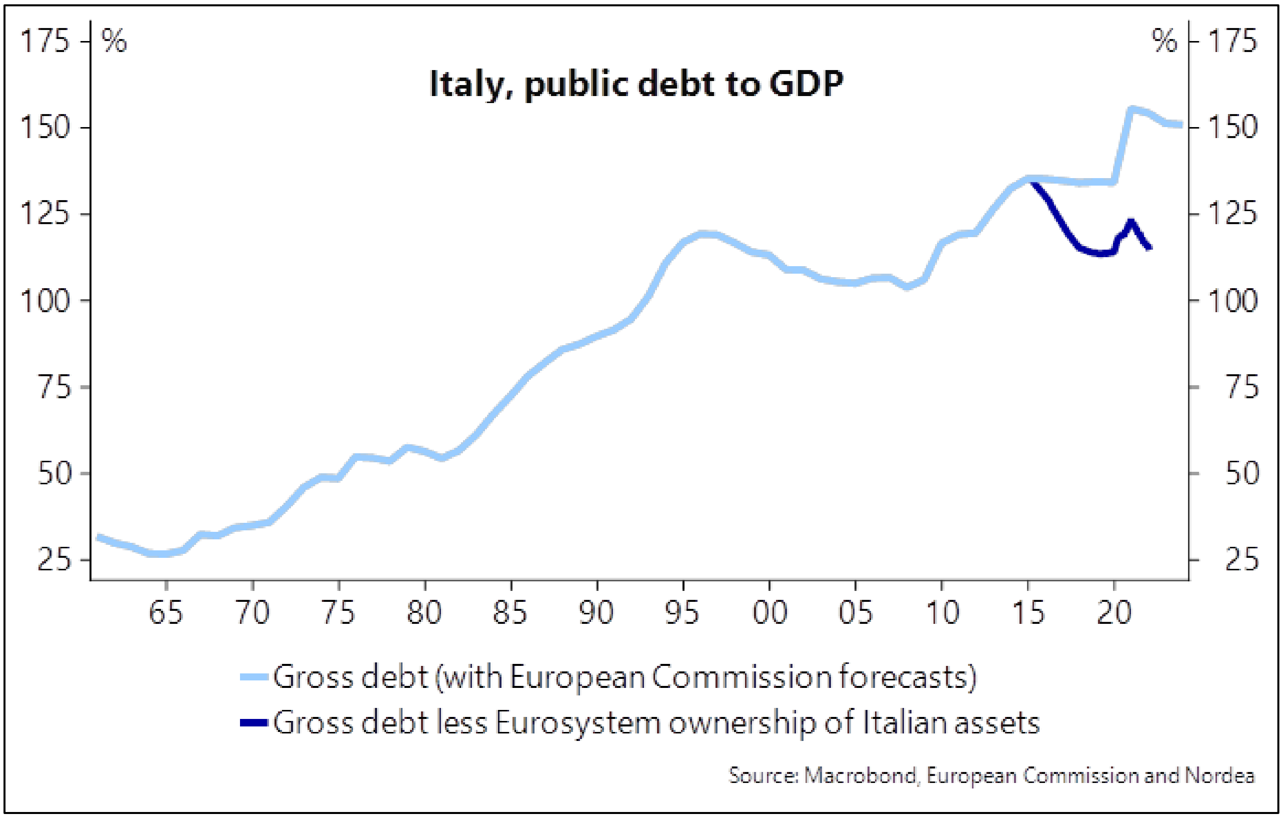
ECB

After the multi-standard deviation move in eurozone rates and bond yields, the ECB started to push back last week. President Lagarde indicated that markets need to be cautious that they aren't getting ahead of themselves. As discussed last week, the ECB is in a very difficult position given their inflation mandate, as they again face an inflation jump largely driven by energy. The Ukraine situation is of course part and parcel of that issue.

The market has priced a fair number of hikes, following the US path.

The ECB also continued to face the problem of peripheral spreads, something the US doesn't need to contend with. QT remains very unlikely anytime soon, and we will see to what extent an end to asset purchases is possible. They may reach a point where they are forced to continue asset purchases even as they slowly raise rates. That is something they have so far said they would not do. We will see.

Here Italy is again the one to watch. Italian debt-to-GDP is now stabilizing around 150%. The amount of Italian bonds that the central bank bought during the pandemic is roughly equal to the total increase in Italian debt during that period.



With a 7-year average duration, higher rates will take some time to materially raise the carrying cost and remember that in practice the interest paid to the central bank on their holdings is returned to the government as “central bank profits”. The ECB maintains that their asset purchases are not “monetary financing”, since the debt is bought in the secondary market rather than directly from the government.

If inflation remains relatively high even as the pandemic fades there will be rising tensions again inside the ECB. So far, federalization of debt and a common Treasury still looks like a distant prospect and may require yet another crisis to move forward.

In the meantime, there remains the conundrum that yields held down by negative front-end policy rates are making it very difficult to attract buyers.

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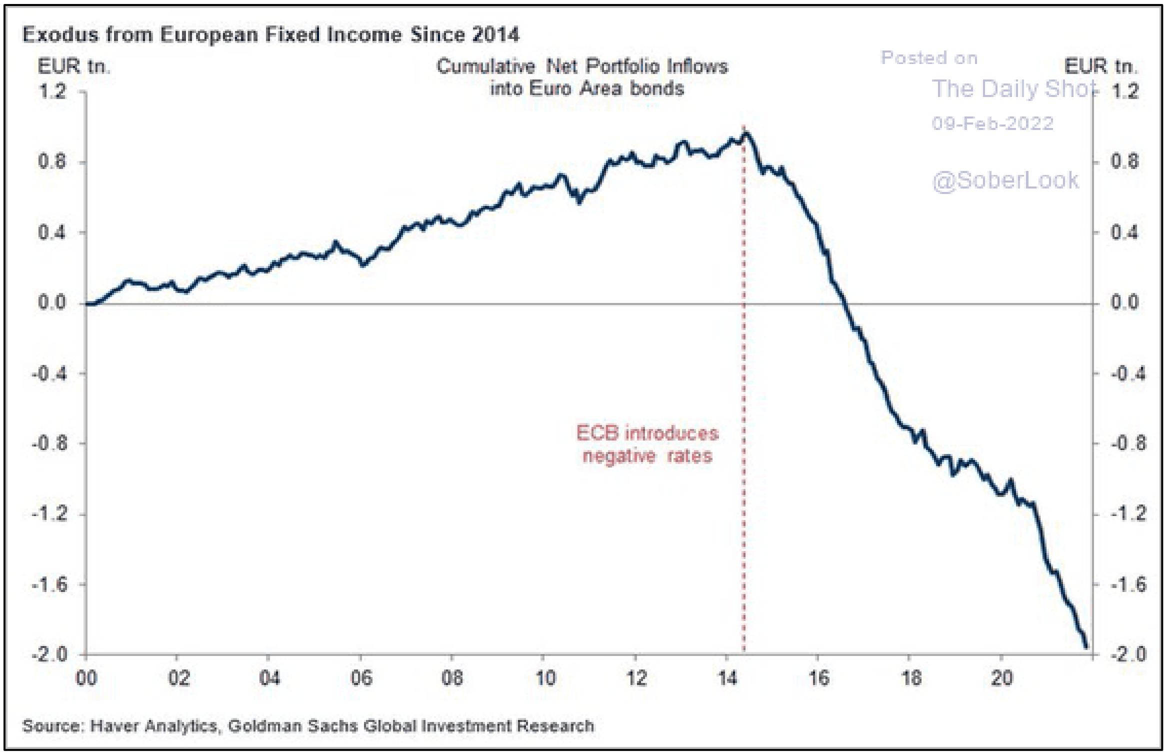
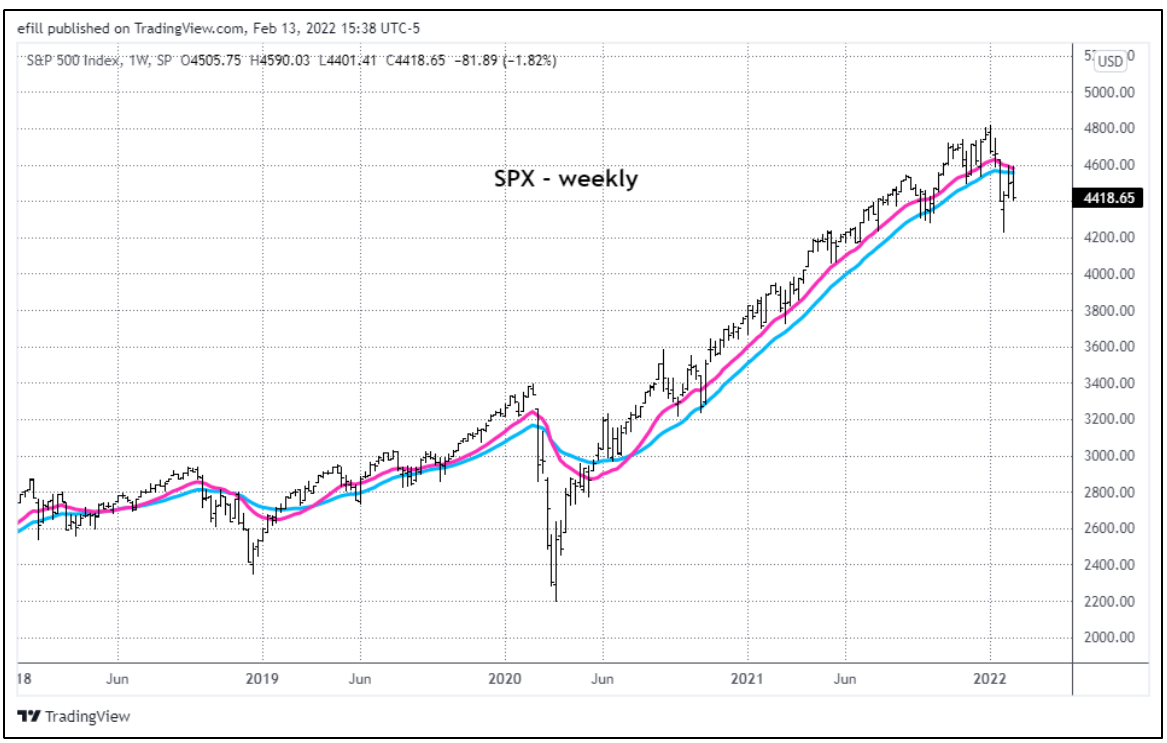


What to Focus on Now:

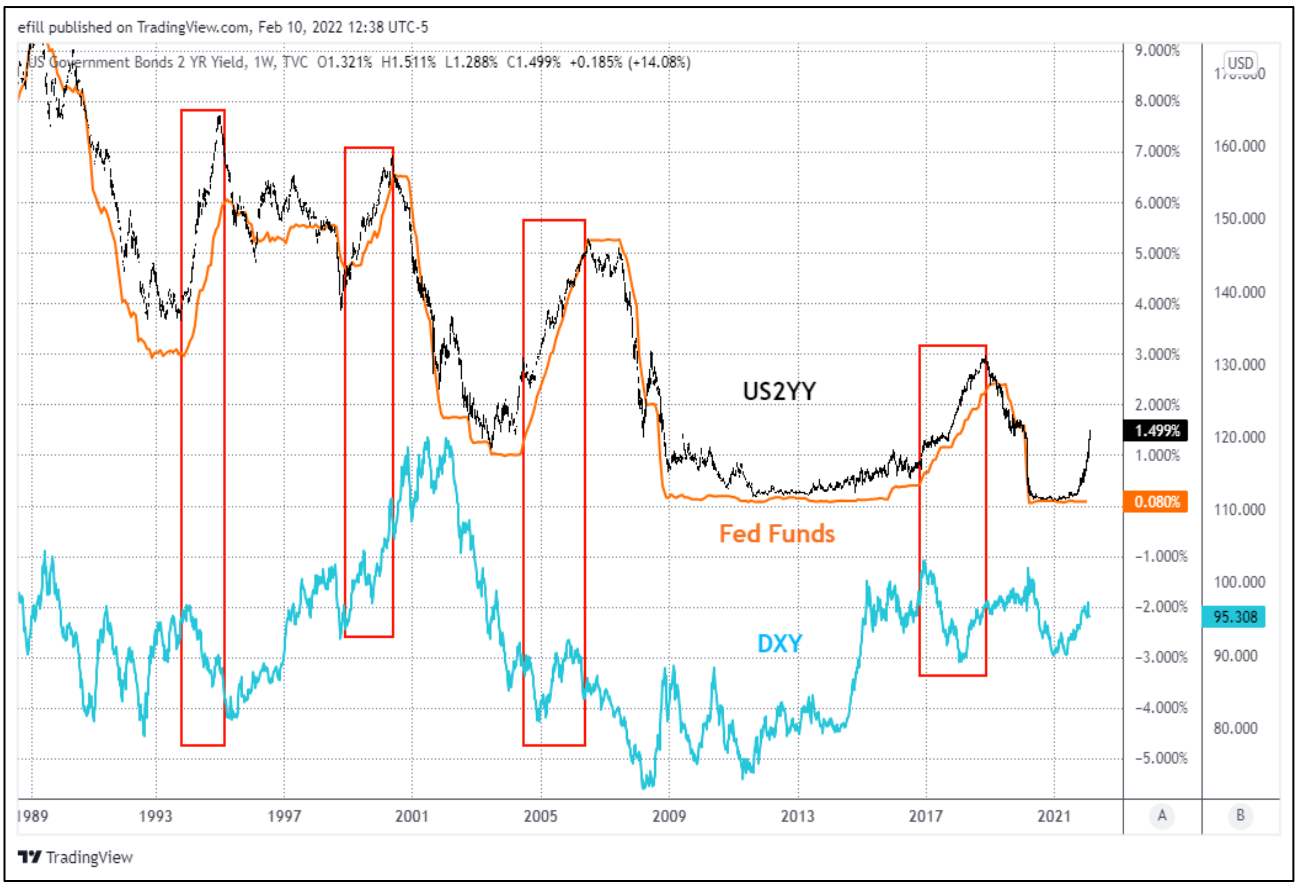
Markets continue to ask themselves to what extent the Fed can protect risk assets in a high inflation environment. After last week's drop momentum remains vulnerable.



With the Ukraine invasion outcome likely to overshadow most other news items, markets are coiled across asset classes for more volatility.

FX

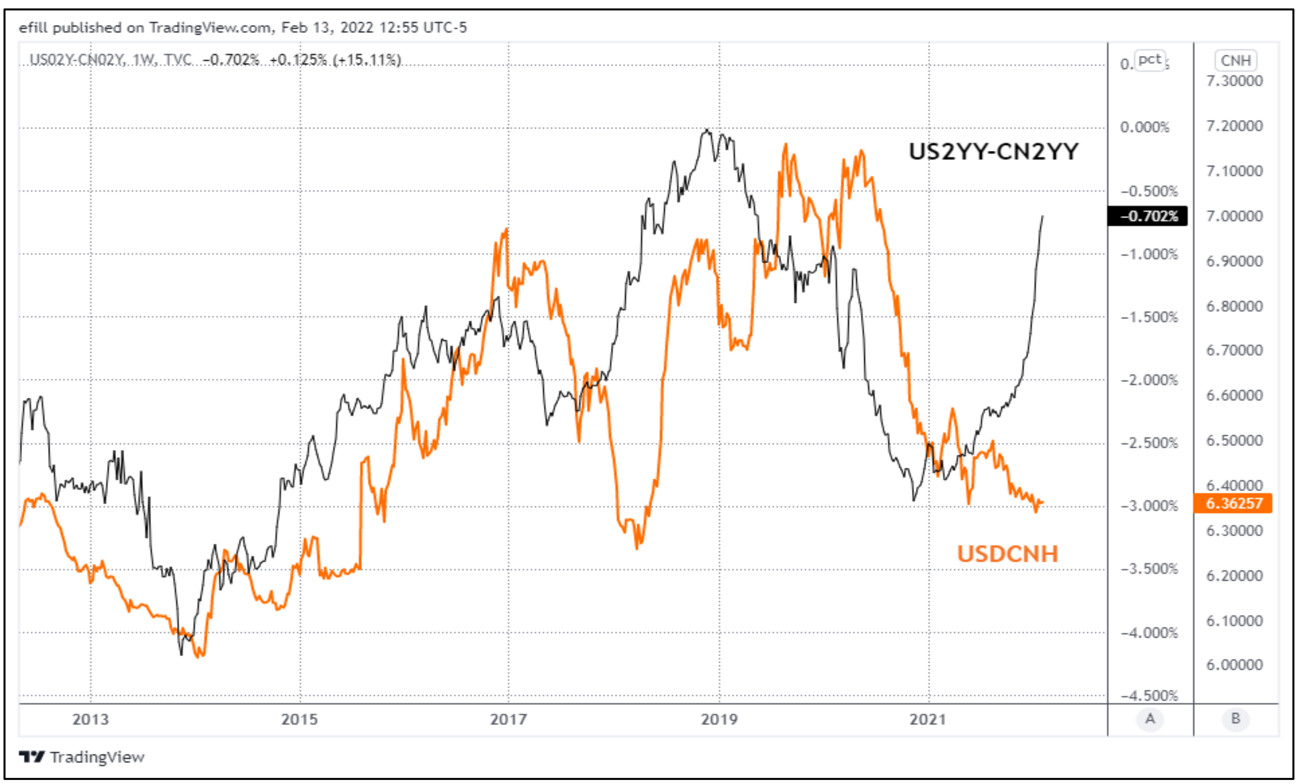
In three of the four last hiking cycles, the dollar initially fell. Only to later rally back as the tightening progressed and financial conditions became more restrictive. The tightening into the 2000 equity peak was the exception, as large flows continued to come into the US, the leader in terms of both equity market performance and global growth, at the time.



We will see if that develops again. Until Ukraine invasion fears were again stoked on Friday, EM had been holding up well, despite a challenging global interest rate environment. BRL, ZAR, KRW, THB continue to be interesting, but of course, a Ukraine calamity could derail that.

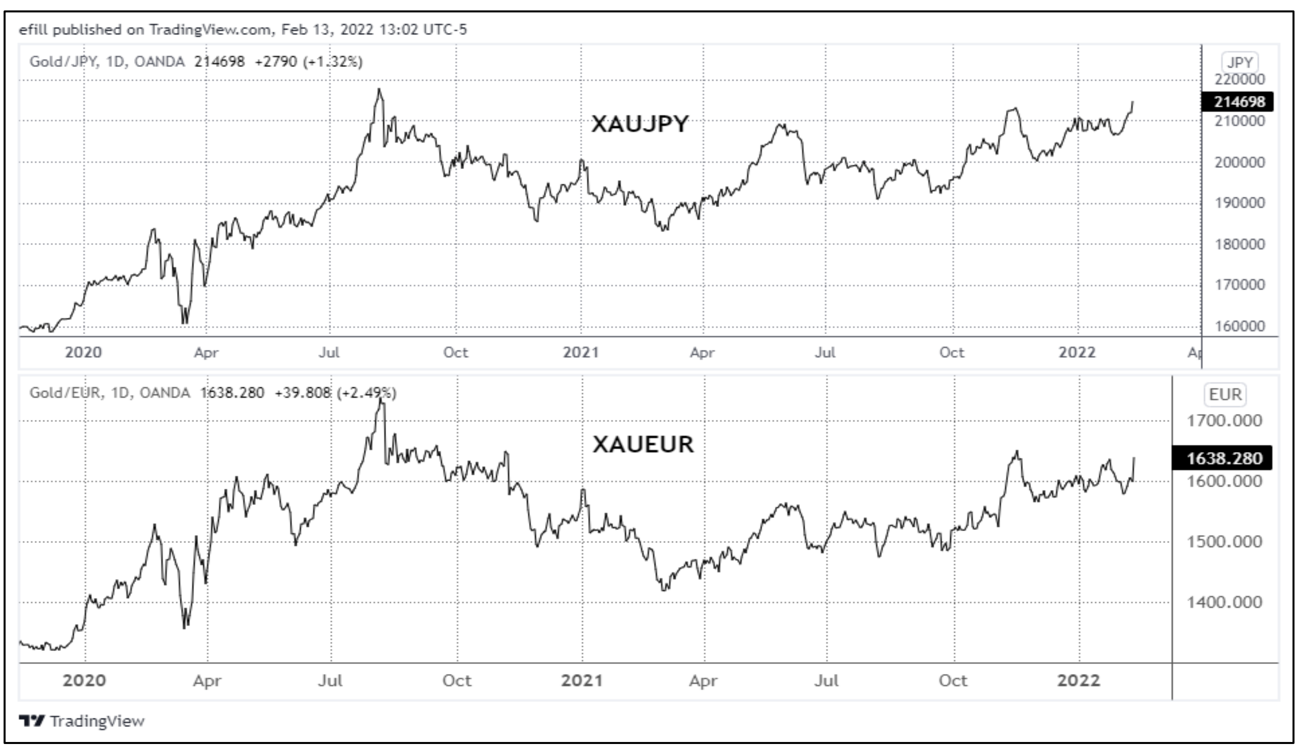
Not surprisingly, the EUR took the brunt of Friday's Ukraine fears. Many other USD crosses were only marginally stronger.

So far, the higher US rates have not hurt currencies like CNH.



Oil – The narrative remains strong. However, we are getting into the price territory where things start to break in the global economy. Is that what the divergence with CAD is starting to tell us?

Gold – The Ukraine news on Friday, drove Gold above key levels. With rising real yields and a still relatively firm USD, the fundamentals have been difficult for Gold. However, the price action needs to be respected and we have hit my inflection point trigger, from which prices tend to fail or accelerate. It has certainly been lifting vs. other currencies so maybe it surprises vs. USD too.



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For all the talk, Gold vs. Bitcoin is basically where it was early last year.

This week's scheduled data will likely be overshadowed by geopolitics…

Important Macro Data Releases and Events for the Week

Monday 2/14/2022 — RBA Minutes

Tuesday 2/15/2022 — Employment Data

GDP (Q4)

PPI (Jan)

CPI (Jan)

Wednesday 2/16/2022 — CPI (Jan)

Retail Sales (Jan)

CPI (Jan)

FOMC Minutes

Thursday 2/17/2022	Building Permits (Jan)
	Housing Starts (Jan)
	Initial Jobless Claims
	Initial Jobless Claims 4-week average
	Continuing Jobless Claims
	Philly Fed Manufacturing Survey (Feb)
Friday 2/18/2022	Retail Sales (Jan)
	Retail Sales (Jan)

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