Stargazer
Asset Management

What to focus on in Global Macro for the week of July 19th, 2021

Macro Themes on the Radar:

Next week's ECB meeting

Lagarde has been busy telegraphing that the upcoming meeting will include some "interesting changes and variations" to policy. Forward guidance on continued asset purchases and interest rate policy is likely to be central. "When we say that our response has to be especially forceful or persistent, I think persistent is precisely intended to signal that we will not prematurely tighten," she said to the Financial Times. Thursday's communication will be "clear, simple, crisp, to the point, and with as little jargoning as possible", Lagarde said. You can bet this will be very dovish stuff, including a discussion of how they will let inflation overshoot. Anticipating pushback from some ECB members, she has indicated that she neither has the expectation nor the illusion that decisions will be unanimous. The ECB already sat out the last economic cycle without getting in even one rate hike. Are we now heading for a second one? Europe is looking more and more like they are having the "Japanese experience" in terms of monetary policy.

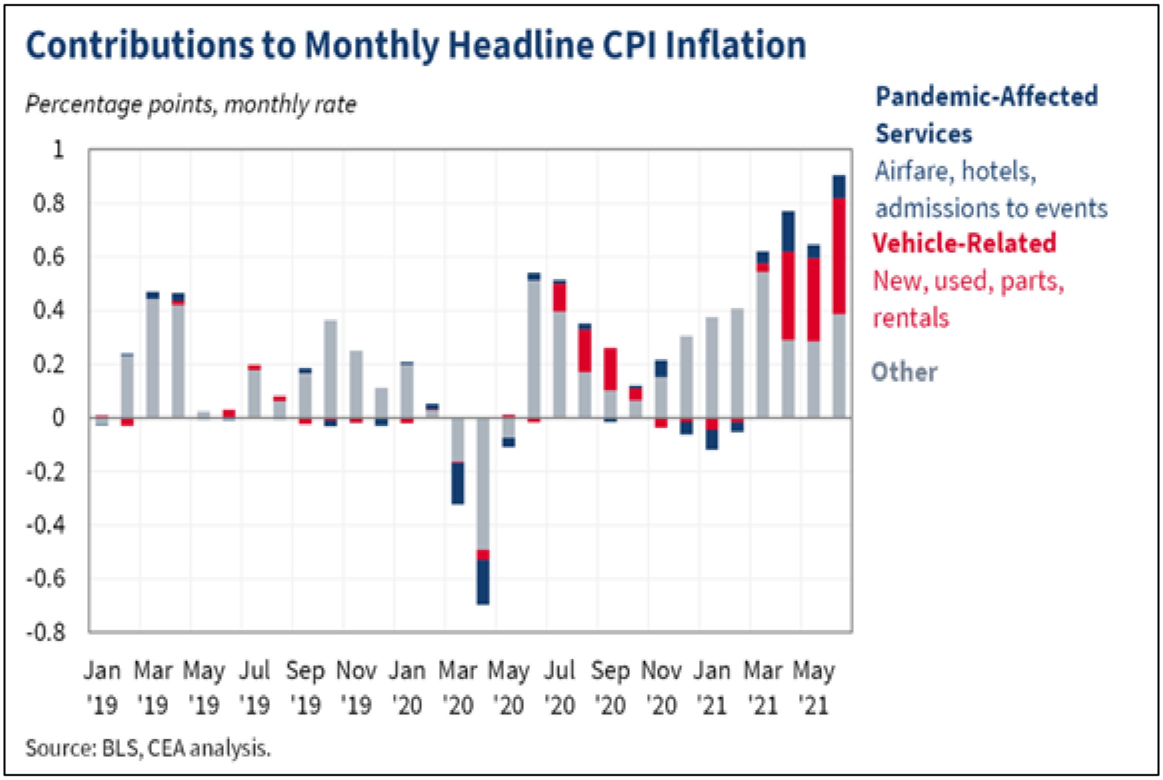
Fed

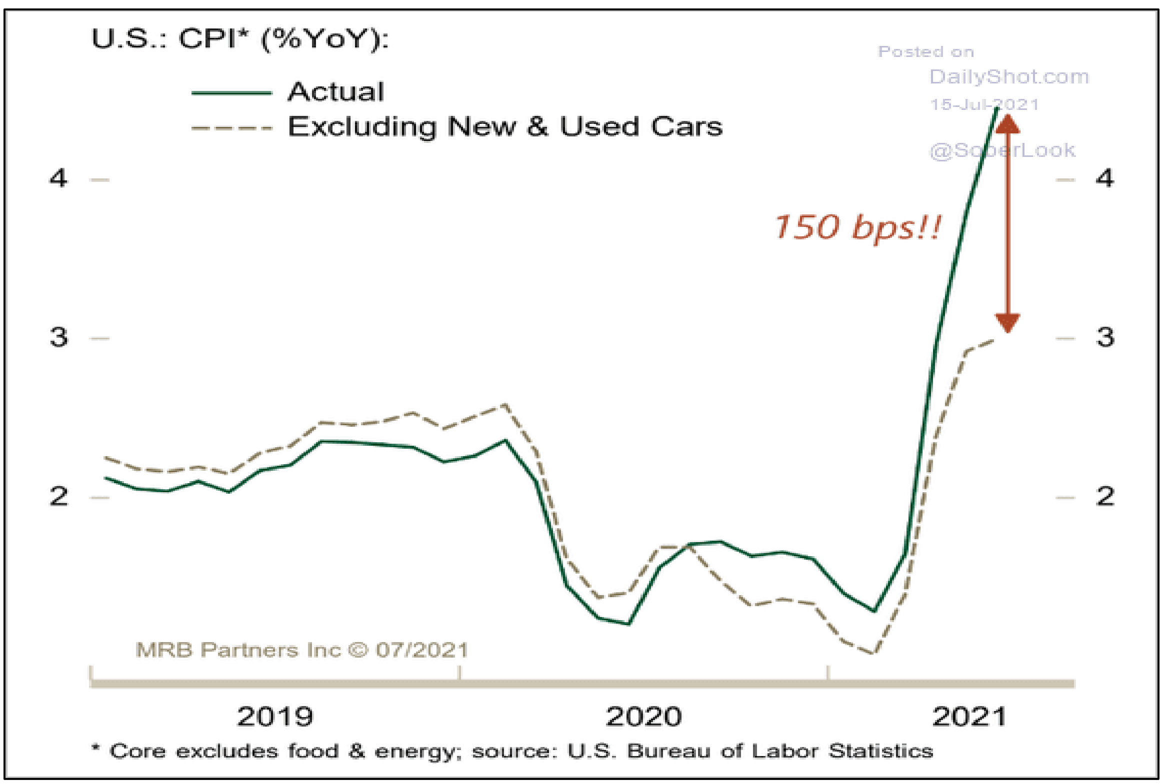
Chair Powell's congressional testimony last week largely brought more of the same. Yes, inflation "has increased notably and will likely remain elevated in coming months before moderating." Inflation has been "higher than expected and hoped for", but "we very much think that the price increases (for used cars, etc.) are temporary … and prices will begin to decline at some point." He indicated that we have not yet reached the Fed's benchmark of "substantial further progress" and that tapering was still "a ways off." He did confirm that they are talking about reducing asset purchases, but that any decision would be announced "well in advance". My bet is still that they announce the intention to taper at the end of the year, at the September meeting.

CPI

Inflation was in the news again last week as CPI exhibited further upside pressure. So far, however, pandemic-related factors are still big contributors, which continues to give the Fed cover, with 70% of investors in the transitory inflation camp.

Here are a few ways to look at that breakdown.





While those pandemic-related factors will calm down, and to some extent reverse, wage gains, once achieved, are unlikely to be reversed. For now, at least, those wage pressures persist.

Chart 10: Small business wage pressures at 40-year highs
Net % small businesses planning to raise wages in next 3 months

Source: BofA Global Investment Strategy, Bloomberg

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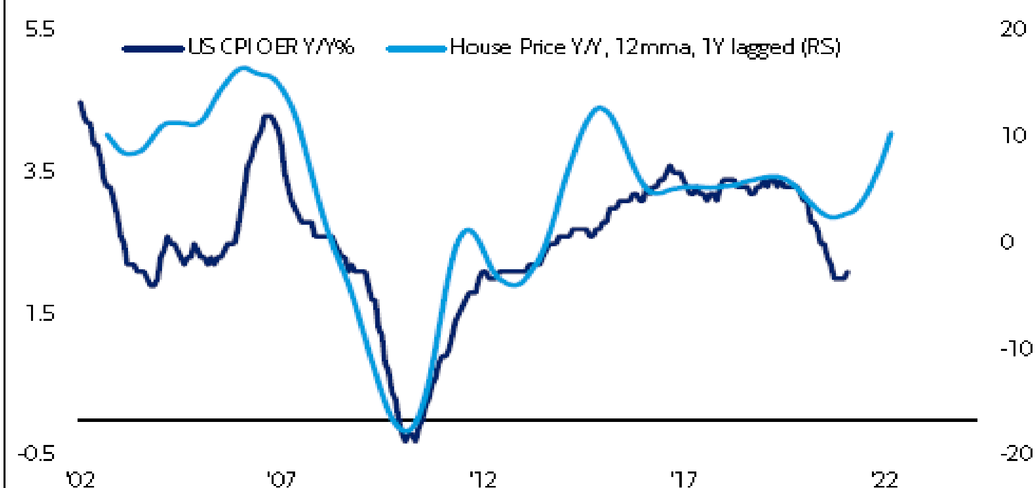
As discussed, the shelter component of CPI has yet to kick in.

Chart 9: Owner's equivalent rent (30% of core CPI) now rising
US CPI OER vs House Price (12mma, 1Y lagged)



Source: BofA Global Investment Strategy, Bloomberg

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H2 of this year will see some interesting effects, as some drivers of inflation subside while new ones engage. Also, in the media, there is the tendency not to differentiate between one-off price shocks and the ongoing process of inflation. They are not the same.

In any case, the move up in prices has certainly gotten the attention of consumers.

Chart 11: Survey of US consumers expects 4% inflation in NTM
Average inflation expectations for 1-year ahead

Source: BofA Global Investment Strategy, Bloomberg, Atlanta Fed
Note: average of 1-year ahead inflation expectations of NY Fed, Atlanta Fed, and UMich
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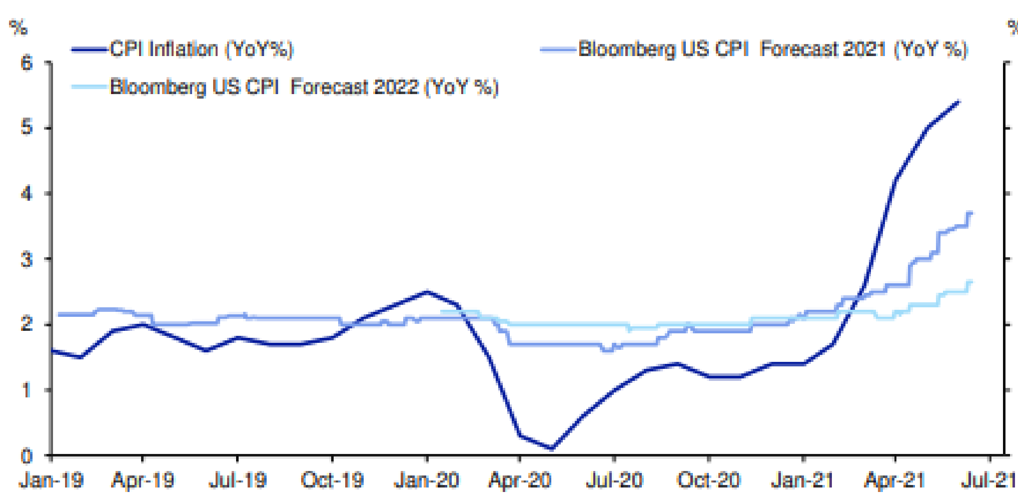
Even professional inflation forecasts for 2022 inflation have continued to rise. That would indicate that only part of the recent jump is being seen as near-term transitory. Q3 is likely to be very messy on the data front with potential fireworks in Q4 if employment improves materially.

Figure 1:US Headline CPI YoY versus Bloomberg Consensus Forecasts for FY 2021 and 2022 US CPI over the last 18 months.



Source : BLS, Bloomberg Finance LP, Deutsche Bank

This inflation heat-map from Nordea gives a nice breakdown of what we have been seeing.

Chart 10: A heat-map of inflation components in the US in YoY terms, %

	Jun/21	May/21	Apr/21	Mar/21	Feb/21	Jan/21	Dec/20	Nov/20	Oct/20	Sep/20	Aug/20	Jul/20	Jun/20
Core CPI	**4.5**	**3.8**	**3.0**	**1.6**	**1.3**	**1.4**	**1.6**	**1.6**	**1.6**	**1.7**	**1.7**	**1.6**	**1.2**
Household Furnishing and Supplies	3.4	3.7	3.2	2.8	2.3	2.4	2.9	2.9	1.9	2.1	2.6	1.5	1.3
Recreation Commodities	3.2	3.5	2.9	0.8	0.3	-0.2	-0.2	-1.0	-1.3	-0.8	-0.4	-1.3	-2.1
Education & Communication	-1.2	-1.4	-2.2	-4.9	-2.7	-1.9	-2.5	-4.3	-5.0	-6.0	-4.8	-4.3	-3.0
Televisions	7.6	4.5	2.6	-0.7	-0.5	-2.9	-4.9	-7.3	-10.4	-11.3	-12.5	-13.8	-15.1
Pets, Pet Supplies, and Pet Accessories	1.0	0.9	0.9	-2.7	-3.6	-3.3	-3.3	-3.6	-4.5	-2.9	-0.6	-3.3	-3.4
Apparel													
Apparel, Women's	5.2	4.2	-0.5	-5.4	-5.8	-5.5	-7.7	-8.5	-6.8	-8.9	-10.4	-10.4	-11.2
Apparel, Men's	1.5	3.3	1.0	-4.1	-5.0	-3.6	-2.6	-5.3	-7.9	-6.2	-4.6	-5.7	-4.8
Apparel, Infants' & Toddlers'	-0.5	3.1	1.7	-4.2	-6.8	-5.7	-5.4	-4.5	-7.6	-5.8	-2.8	-3.4	-5.0
Medical Care	-2.2	-1.9	-1.7	-2.4	-2.5	-2.3	-2.5	-1.1	-0.8	0.9	0.8	1.1	1.3
Transport													
New Vehicles	5.3	3.3	2.0	1.5	1.2	1.4	2.0	1.6	1.5	1.0	0.7	0.5	-0.2
Used Vehicles	45.2	29.7	21.0	9.4	9.3	10.0	10.0	10.9	11.5	10.3	4.0	-0.9	-2.8
Motor Vehicle Parts and Equipment	3.5	2.1	2.1	0.6	0.6	0.6	0.4	-0.1	0.5	0.6	1.2	1.6	0.7
Rental Cars	87.7	109.8	82.2	31.2	11.5	3.0	5.3	9.7	9.7	6.3	2.0	-3.4	-6.3
Airline Fare	24.6	24.1	9.6	-15.1	-25.6	-21.3	-18.4	-17.0	-20.0	-25.0	-23.2	-23.7	-27.2
Shelter													
Rent of Primary Residence	1.9	1.8	1.8	1.8	2.0	2.1	2.3	2.4	2.7	2.7	2.9	3.1	3.2
Accomodation	16.9	10.0	8.1	-7.6	-17.2	-13.3	-11.2	-12.7	-15.9	-15.0	-13.1	-15.3	-16.0
Owners' Equivalent Rent of Residence	2.3	2.1	2.0	2.0	2.0	2.0	2.2	2.3	2.5	2.5	2.7	2.8	2.8

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

We have a weird mix of inputs at the moment. On one hand, the Fed is buying, on average, $336m bonds every hour, while the government spends $875m an hour (BNY calculation). Retail sales were better than expected, but consumer sentiment is lower, as inflation drives down future spending plans.

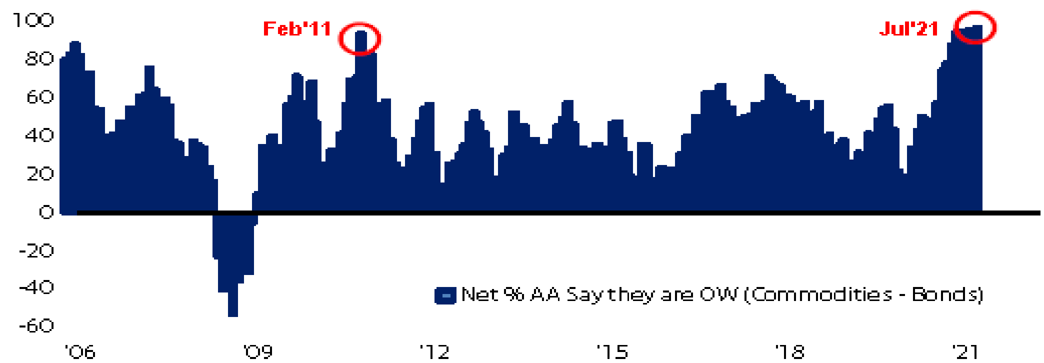
Markets are still largely positioned for growth and inflation, but the rotation back out of value and into big cap growth has been brutal in equities. Both bonds and the dollar have remained well supported. COVID concerns are back globally.

Global growth is increasingly de-synchronizing. While some central banks are already reducing policy accommodation, others, China, in particular, are again increasing liquidity provision.

The second half of the year is likely to be much more complicated than the first, as growth and policy differentiation grows. Some countries will get a glimpse of what the post-V recovery "new normal" looks like, while others continue to struggle with recovery.

Positioning and Sentiment

Chart 16: FMS global commodities vs bonds allocation at all-time highs
Net % AA Say they are OW Commodities minus Bonds



Source: BofA Global Fund Manager Survey

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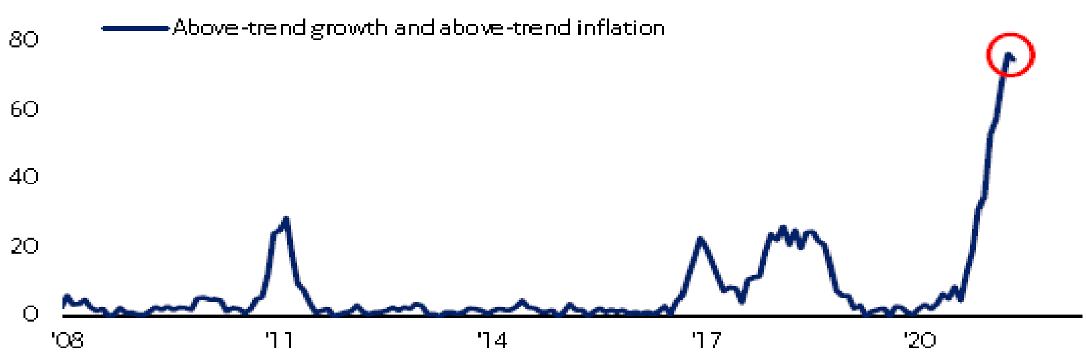
Chart 4: Peak Boom
Growth and inflation expectations



Source: BofA Global Fund Manager Survey

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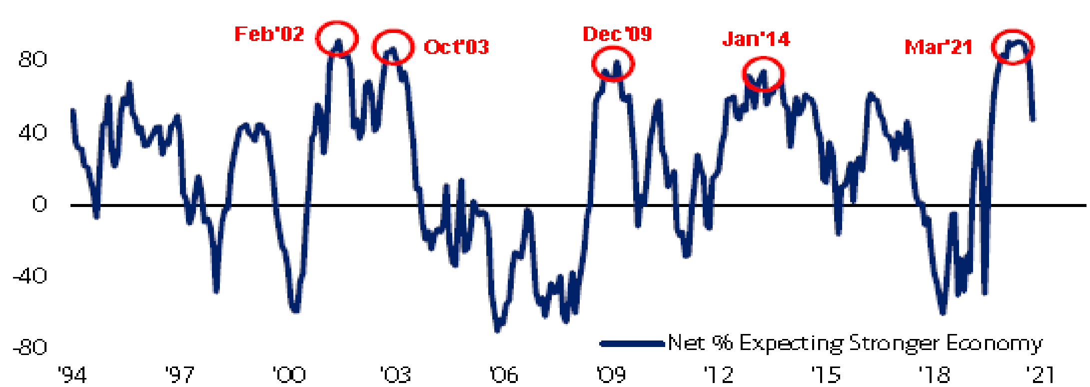
Chart 2: FMS economic expectations have peaked
Net % Say Global Economy Will Improve



Source: BofA Global Fund Manager Survey

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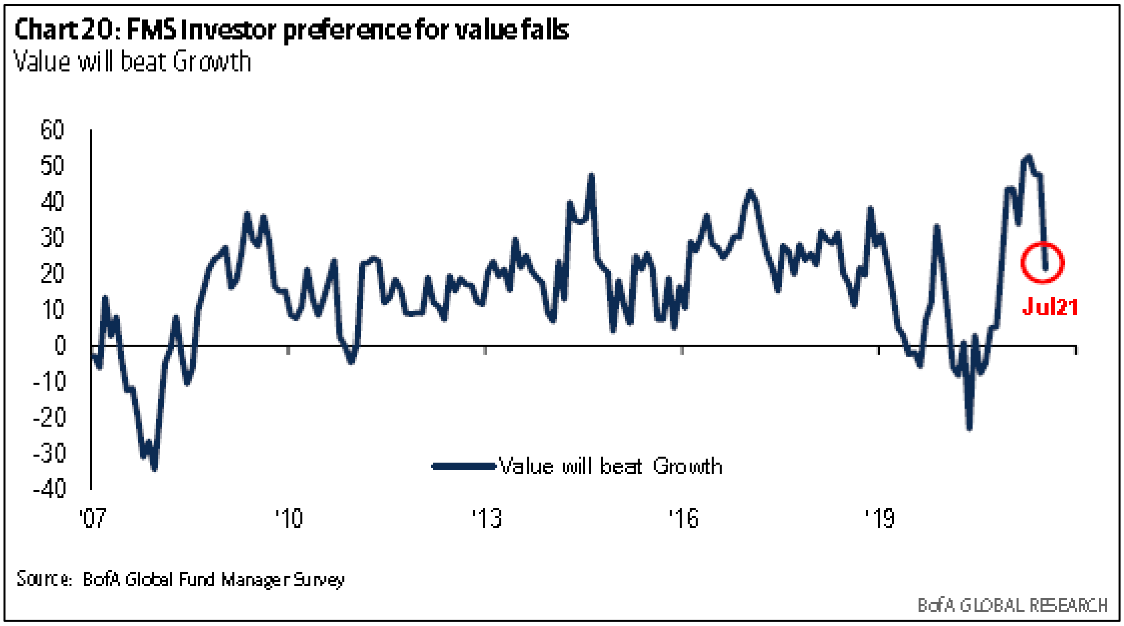
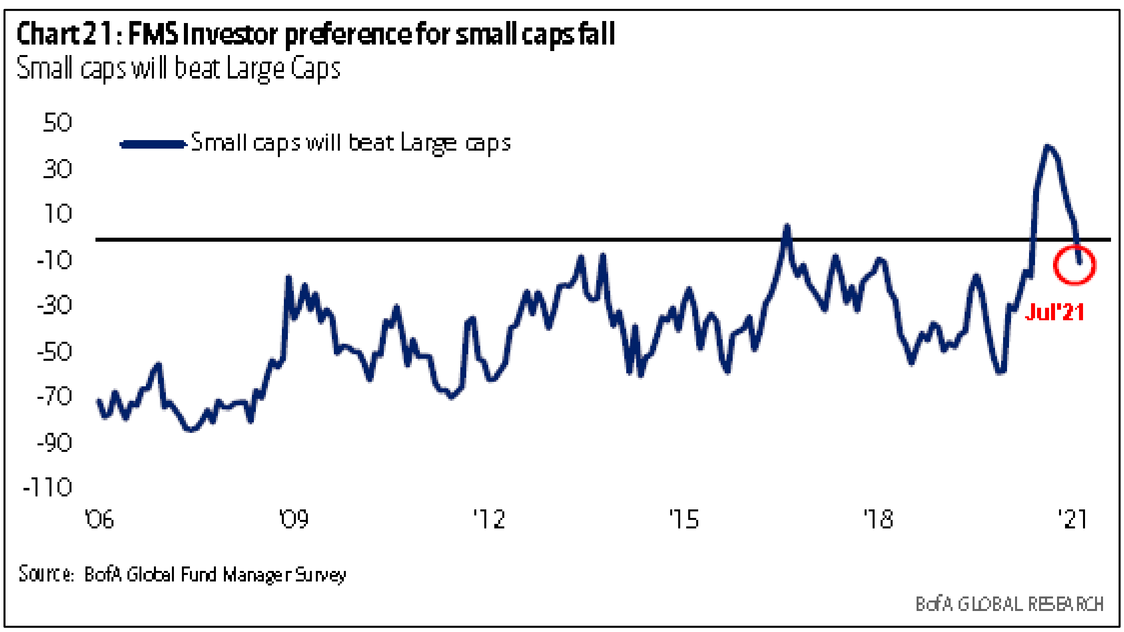
As a result…



And…



The switch from growth to value has been reversing and is now playing out as a classic move from the periphery to the center (safe haven), as Soros would describe it.

We are seeing it on a relative basis inside the US but also on a global scale, as big cap US growth outperforms everything else again.

Things like QQQ/IWM have now reached my target window. This move will need to slow and reverse soon, or we risk a continued run back to the September 2020 highs.

The World ex-US

China's growth has been increasingly in focus as they try to straddle support for the real economy on one hand and their fear of igniting or feeding real estate and financial bubbles on the other.

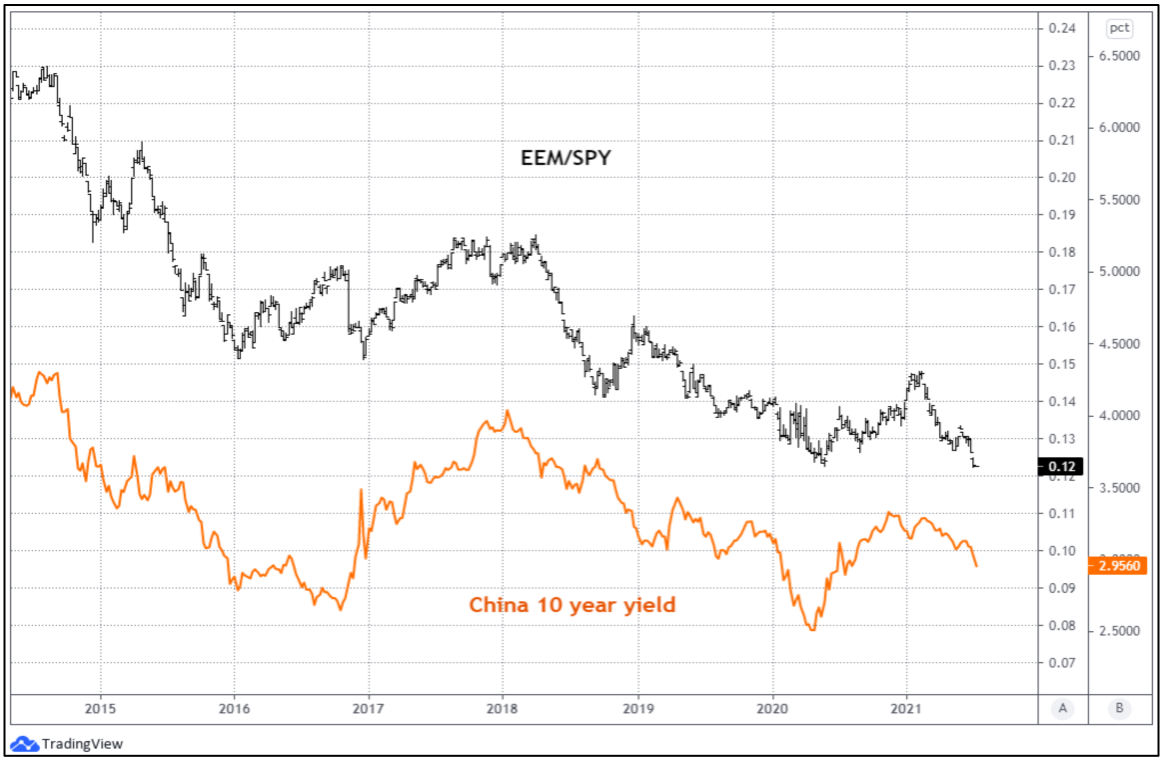
The recent RRR cut is likely only the start as they usually are not one-off's, despite the PBoC saying this isn't the start of a new easing cycle. It will be important to watch for further easing moves and potentially even a rate cut down the road.

Do leading economic indicators start to pick up as continued policy easing is discounted?

I continue to watch what Chinese yields are doing.

As noted last week they have tended to lead US yields in recent years. They also seem to be a good indicator of how the world, ex-US, is doing.

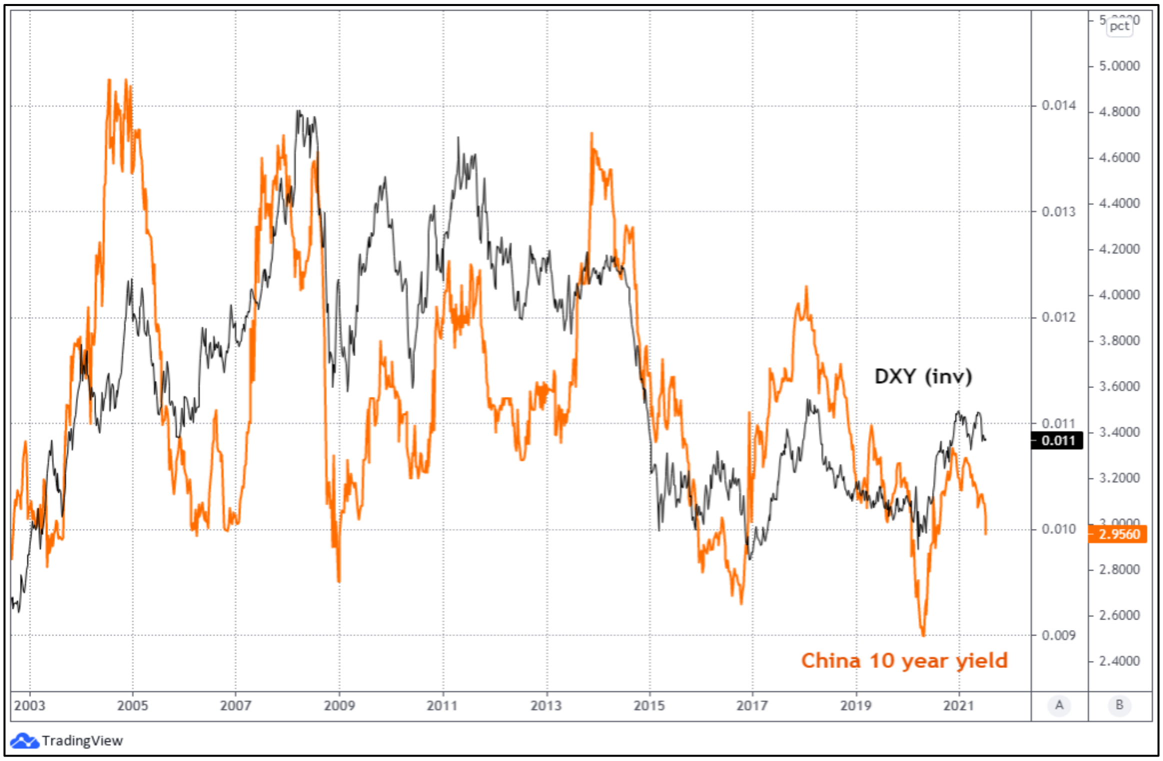
Falling China 10-year yields have gone hand-in-hand with US outperformance in equities.


EEM/SPY
China 10 year yield
0.24
0.23
0.22
0.21
0.20
0.19
0.18
0.17
0.16
0.15
0.14
0.13
0.12
0.11
0.10
0.09
0.08
0.07
pct
6.5000
6.0000
5.5000
5.0000
4.5000
4.0000
3.5000
2.9560
2.5000
2015
2016
2017
2018
2019
2020
2021
A
B
TradingView

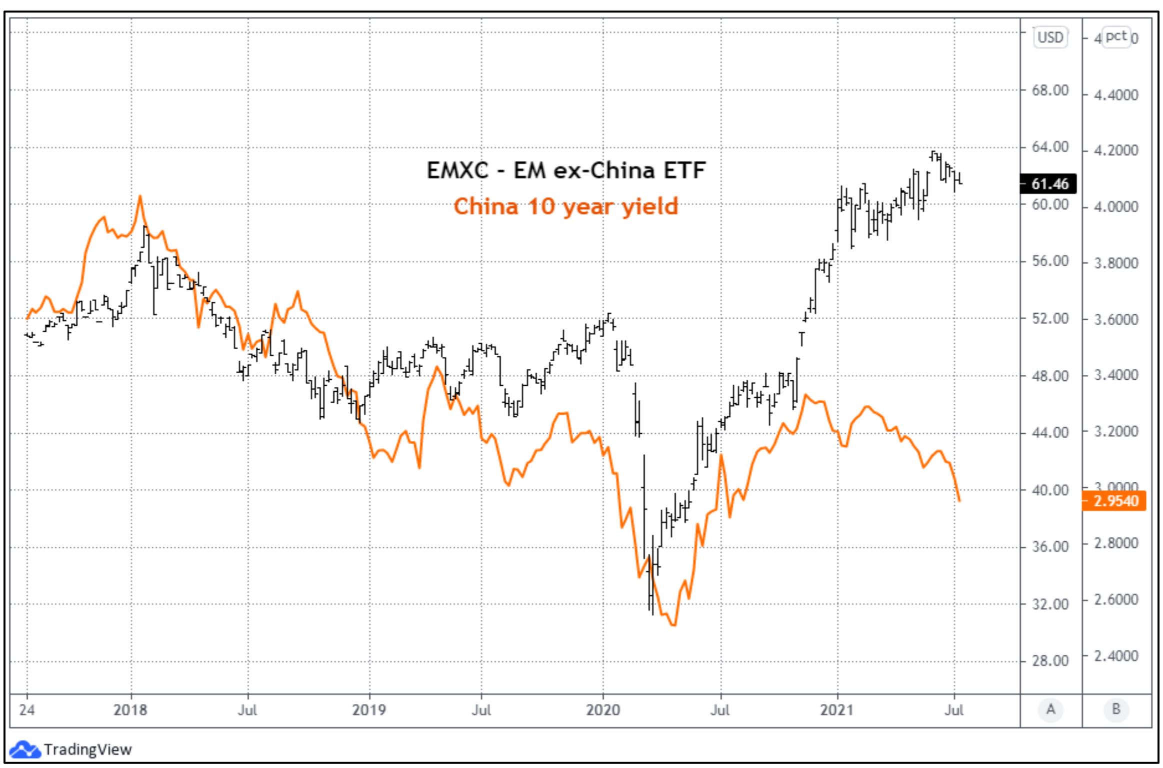
And in FX.


CNHUSD
China 10 year yield
USD
0.16000
0.15800
0.15600
0.15400
0.15200
0.15000
0.14800
0.14600
0.14400
0.14200
0.14000
0.13800
0.13600
0.13400
0.13200
0.13000
0.12800
0.12600
0.12400
pct
5.2000
5.0000
4.8000
4.6000
4.4000
4.2000
4.0000
3.8000
3.6000
3.4000
3.2000
2.9560
2.8000
2.6000
2.4000
014
2015
2016
2017
2018
2019
2020
2021
2022
A
B
TradingView

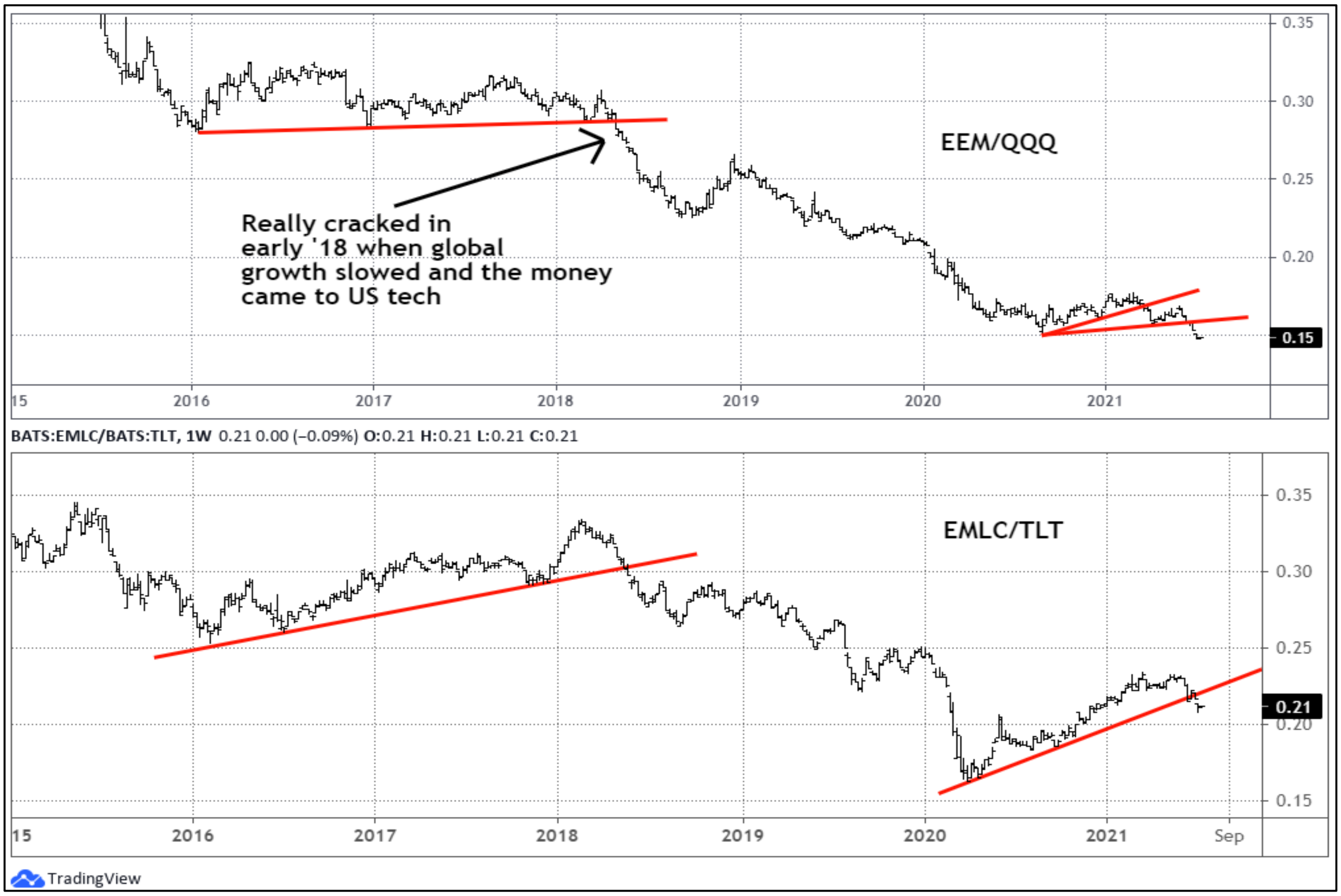
Not just vs. CNH and CNY either… Dollar Index (inverted)



A stronger overall USD is rarely good for EM in general. At the risk of over-stating the China yield story, ex-China EM is looking increasingly vulnerable.



The current US outperformance theme and bond/FX price action are reminiscent of what we saw in 2018. Both EM equities and EM bonds underperformed as markets started to worry about growth.



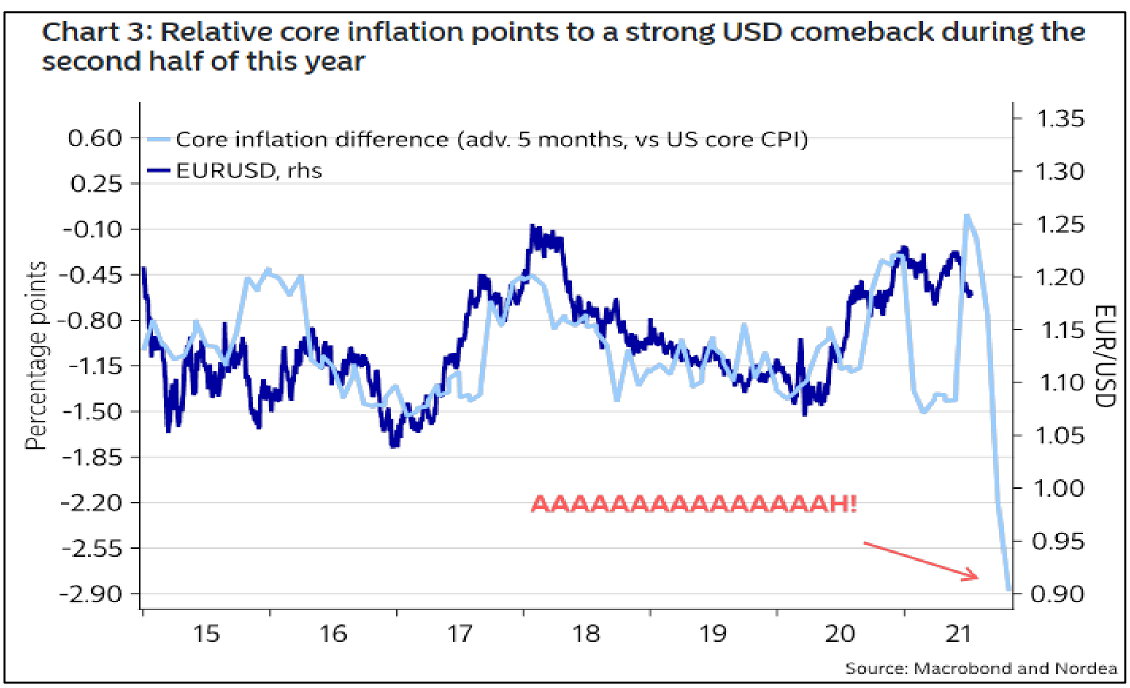
What happens next in these markets will be very important for US investors. Underperformance in EM and now increasingly in Europe (both of which have had meaningful positioning), can drive money to the US and continue to support "safe" US stocks.

This can further support the USD and even mean continued bond buying. Eventually, however, those other markets will need to at least stabilize on a relative basis, or we end up with a negative feedback loop of a consistently rising USD AND rising bonds, which is generally not a good backdrop for equities overall. We have had a taste of that in recent days.

This next chart actually captures much of the above-described scenario… It shows non-US equities with foreign currency exposure vs. longer-dated US Treasuries. The maximum down-move happens when these equities go down, while the USD rallies AND Treasuries rally.

Have we run out of steam here?

FX – I thought this was an interesting, if sensationalist, chart to ponder. Core inflation surprises to the upside in US but to the downside in EU. The result is a wider policy gap between Fed and ECB after a lag. USD goes up.



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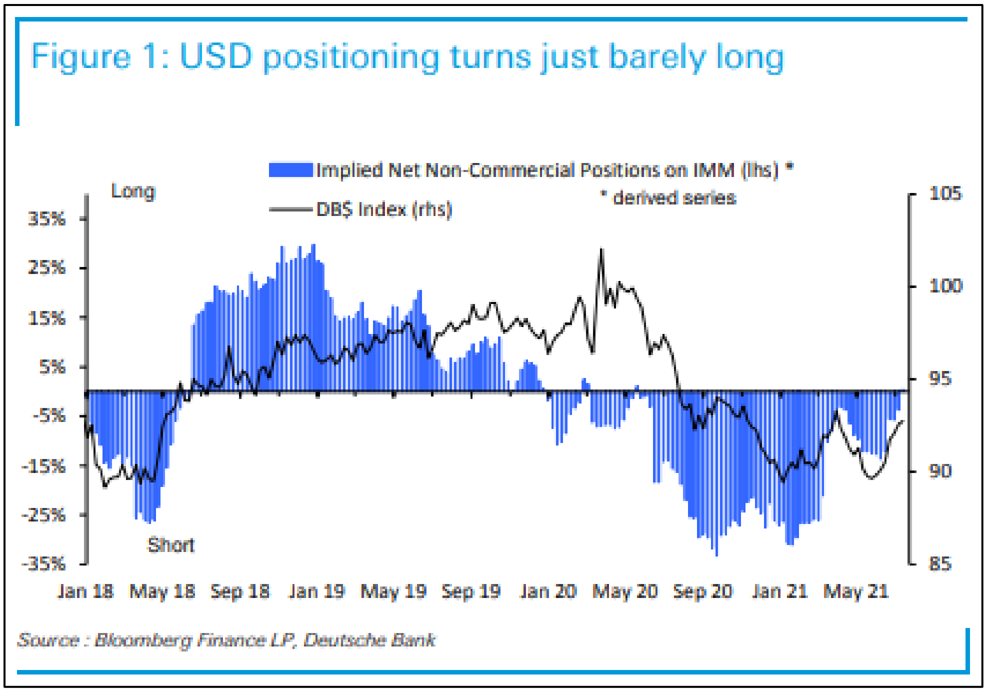
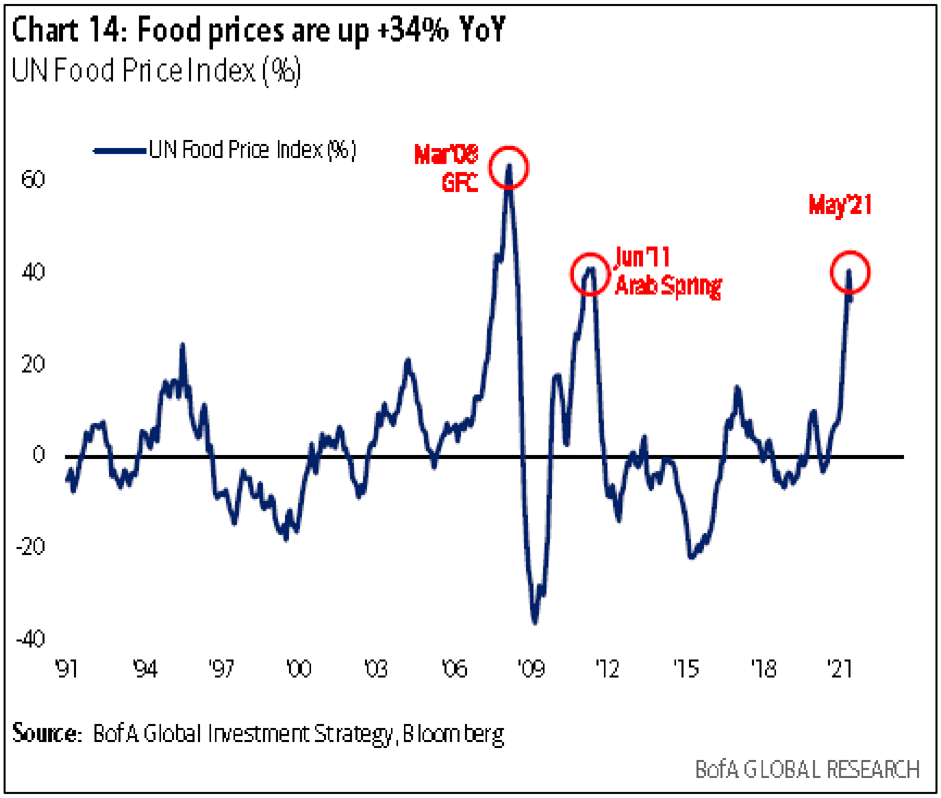
USD positioning is now back to essentially flat.

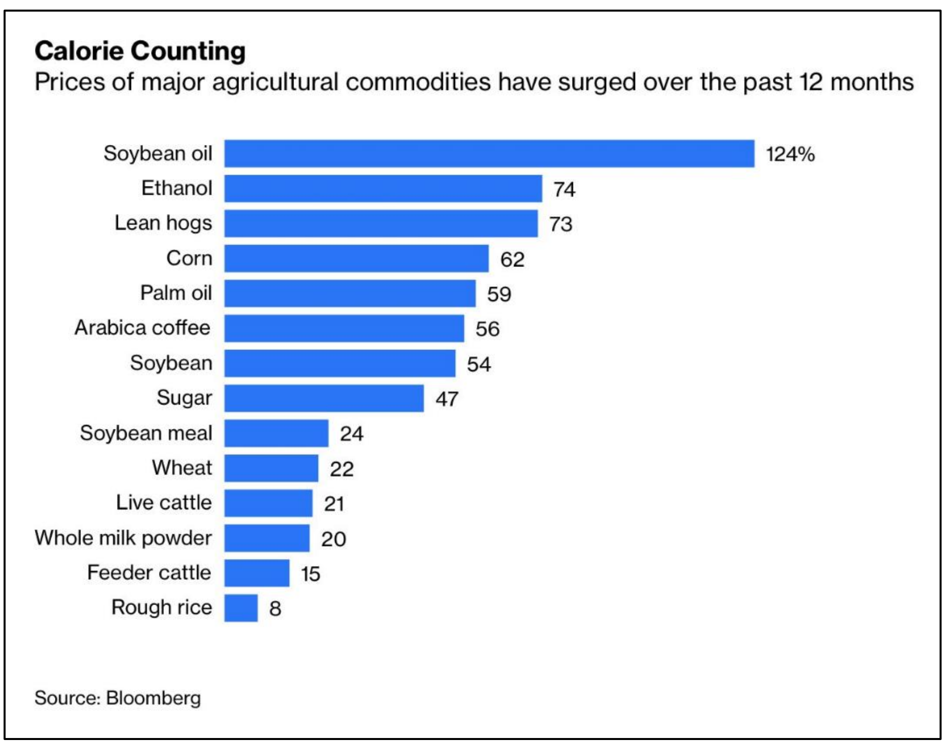


With the Dollar Index right at the top of the range we are primed for a move… fail or break higher. Soon.

Commodities – A few unrelated observations.



With global food prices rising, some are pointing to the fact that in the past political turmoil in EM has at times coincided with sharp price jumps. High prices can create scarcity for the people, increasing the propensity for protests. The current situation in places like Cuba, South Africa and Colombia is seen as lending anecdotal support for that idea. I can see the allure of this argument but am less certain to what extent it has actually been a meaningful driver.

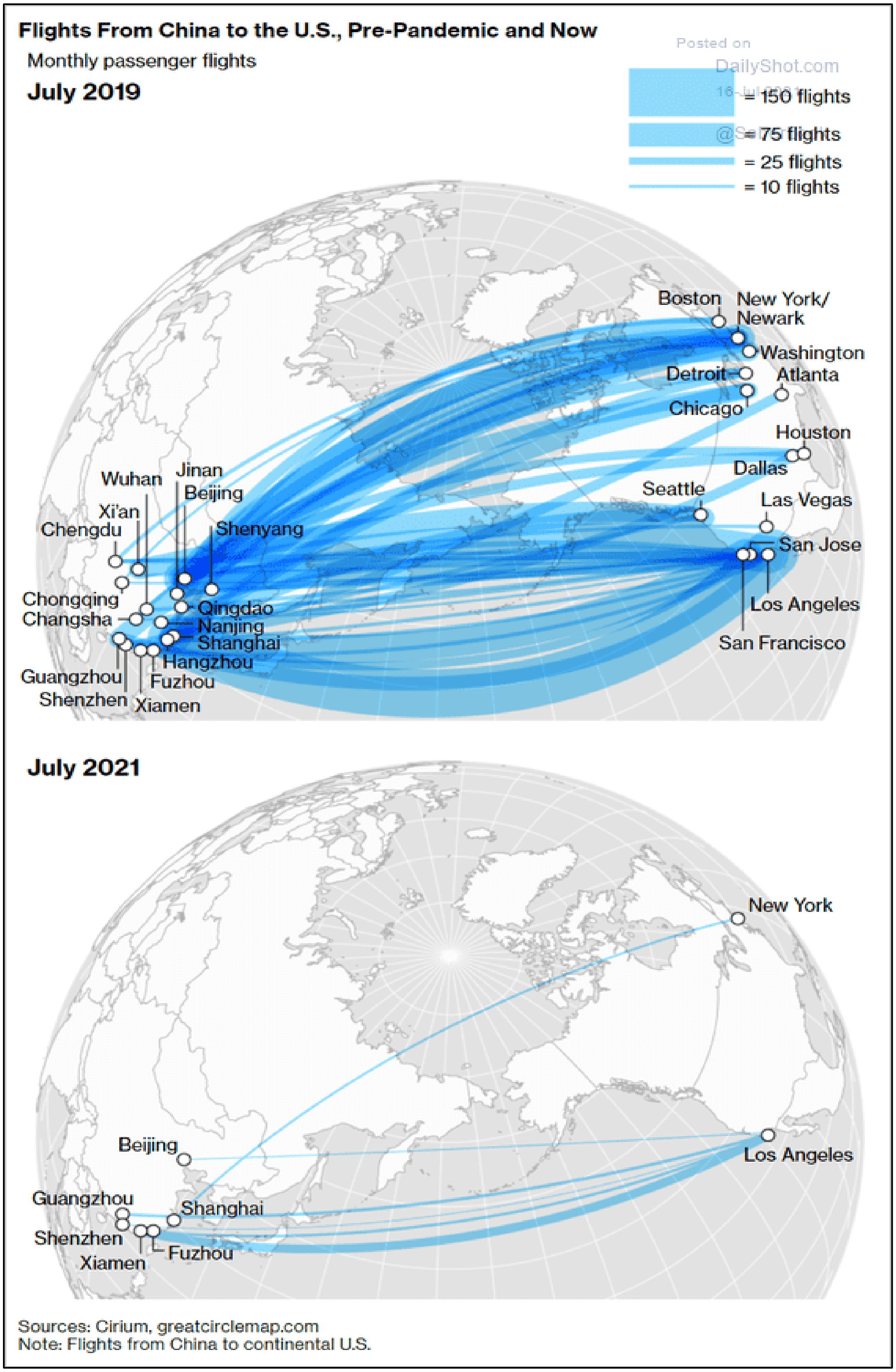


Because of its global importance as a food source, I would keep an eye on rough rice, which so far has been very well behaved.

I hate to circle back to the China yields story again, but they have tended to also lead commodities over the last decade…

Just because this is the commodities section… This break in the direction of travel is interesting. They tend to re-correlate. Not a comment on relative cheapness, because of scaling, just direction.

Chart of the week … While I'm sure largely a residual of COVID, this is pretty amazing.



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This week's main macroeconomic highlights will be the ECB meeting on Wednesday and flash PMIs from the largest European economies and the US at the end of the week. The Federal Reserve will be in a blackout period ahead of its July meeting, so the ECB and its new average inflation targeting framework will be front and center on Thursday. In the US, Senate Majority Leader, Schumer, has scheduled a vote on the bipartisan infrastructure package as he tries to get the bill done ahead of the August break.

Important Macro Data Releases and Events for the Week

Monday
7/19/2021

PBoC Interest Rate Decision (Monday night ET)

Tuesday
7/20/2021

ECB Bank Lending Survey

Building Permits MoM (Jun) Forecast: 1.7m, Prior: 1.683m

Housing Starts MoM (Jun) Forecast: 1.592m, Prior: 1.572m

Wednesday
7/21/2021

Nothing of note

Thursday
7/22/2021

ECB Interest Rate Decision and Policy Statement/ Press Conference

Initial Jobless Claims Forecast: 350k, Prior: 360k

Initial Jobless Claims 4-week average Forecast: -, Prior: 382.5k

Continuing Jobless Claims 3.128m, Prior: 3.241M

Chicago Fed National Activity Index (Jun) Forecast: -, Prior: 0.29

Consumer Confidence (Jun) Forecast: -2.5, Prior: -3.5

Friday
7/23/2021

EcoFin Meeting

Markit Flash PMI's from across Europe

Markit Manufacturing PMI (Jul) Forecast: 62, Prior: 62.1

Markit Services PMI (Jul) Forecast: 64.8, Prior: 64.6

Markit PMI Composite (Jul) Forecast: -, Prior: 63.7