Stargazer
Asset Management

What to focus on in Global Macro for the week of December 14th, 2020

Macro Themes on the Radar:

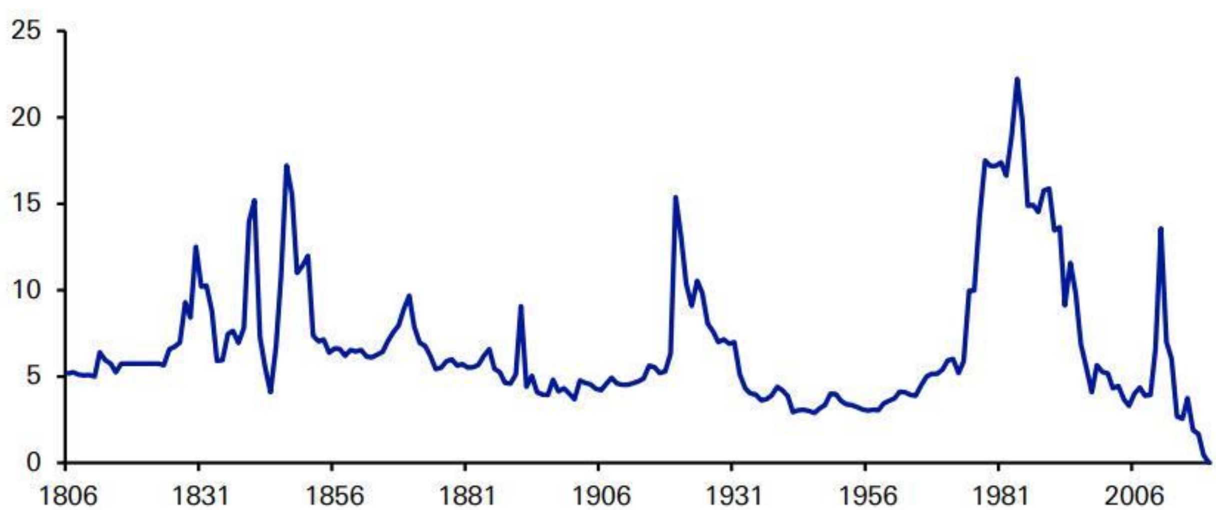
ECB

The results of last week's ECB meeting were more or less as expected. With high frequency data highlighting the risks of another deceleration in economic activity due to the latest lockdowns and virus spread, the ECB expanded its PEPP (pandemic emergency purchase program) by €500B, extending the duration of the PEPP through March 2022, and adjusting TLTRO's further by adding three more operations in 2021 and extending it by 12 months. No additional rate cuts.

At this pace, the ECB is set to own roughly 40% of the eurozone's sovereign bond market by the end of the year. (Fed owns around 22% in the US)

As you might expect, this additional commitment brought down peripheral bond spreads again. Portugal 10-year yields went negative for the first time as did Italian 5-year yields (10-year still at +55bps), while Greece 5-year is hovering at +5bps and German 10-year is now -65bps.

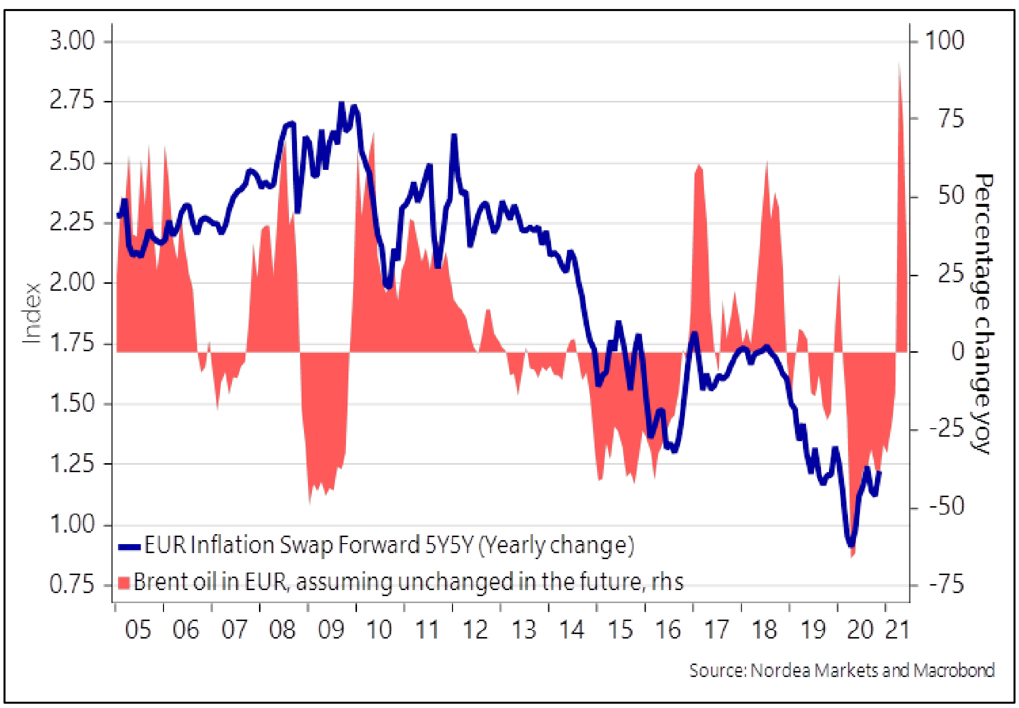
Figure 2: Annual Portuguese 10-year yield (and long-term proxies) using annual prints



Source : GFD, Deutsche Bank
Note: The data source uses many proxies to splice together an equivalent for 10yr yields before there was an official traded market.

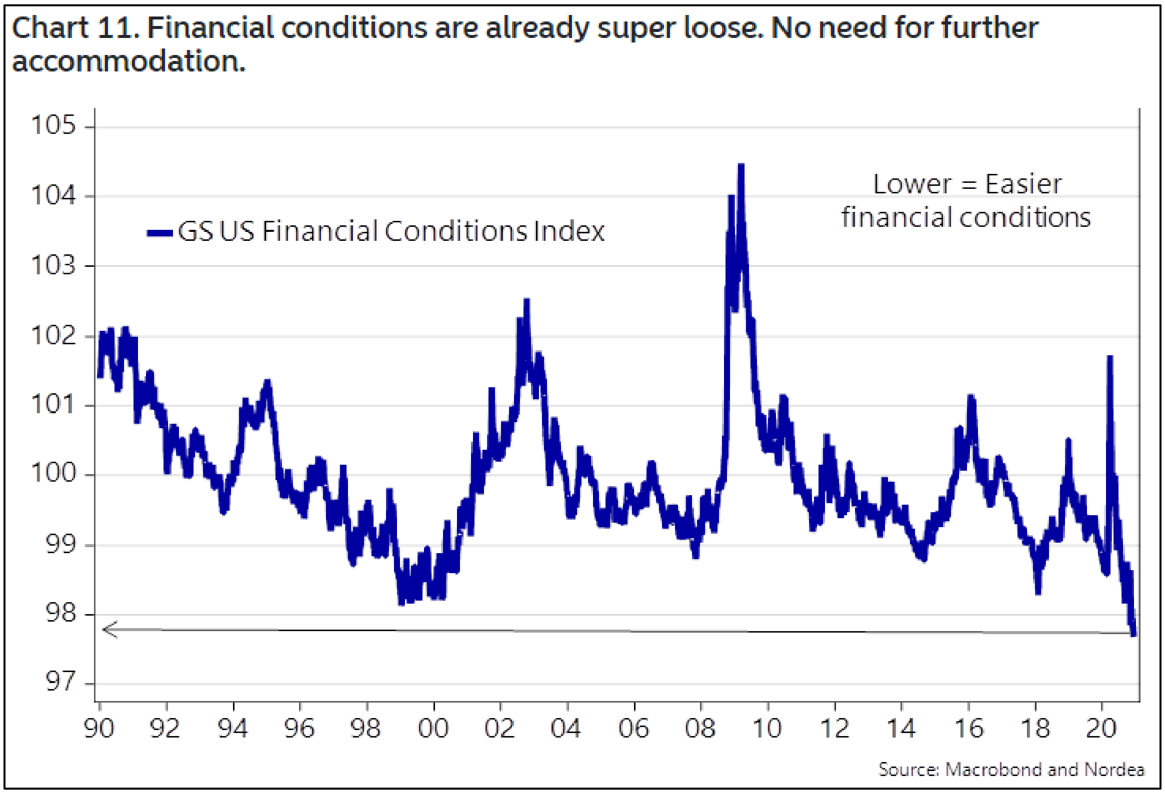
Not surprisingly this latest drop in yields has again swelled the amount of global debt with negative yields.

So far fear of renewed economic weakness and very low inflation rates make doing more of the same justifiable. However, by driving peripheral yields to zero or even negative levels, they are certainly stretching the rubber band. With widespread vaccine availability approaching, and some big base effects in things like oil likely to put upward pressure on headline inflation prints going forward; things that can move, like the EUR and equities, could get exciting.



Fed

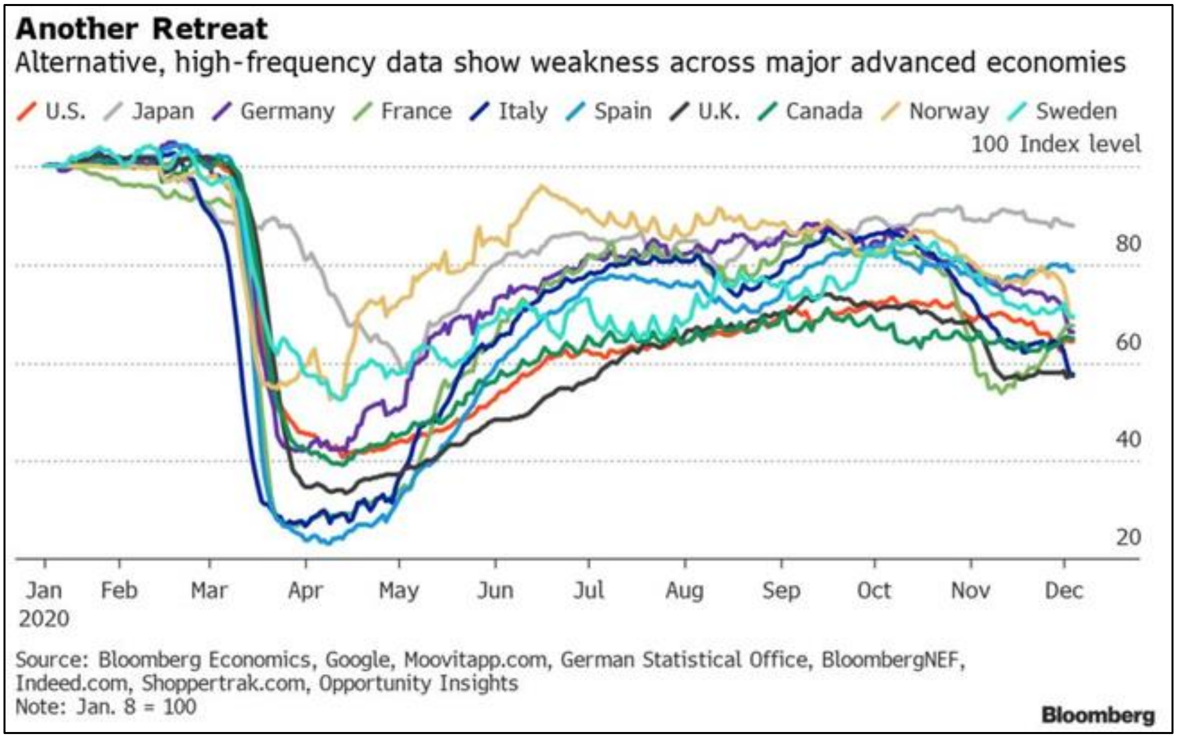
With the Fed's December meeting on the books for this week, markets will be watching for adjustments to the current programs. I don't expect much. Certainly, financial conditions are plenty loose.



What we could see is further guidance on what the size and duration of the asset purchases is likely to look like going forward. A premature rise in long-end yields seems to be increasingly on the mind of global CB's. The Bank of Canada recently decided to extend the maturity of asset purchases while cutting the pace of purchases. Some kind of new "operation twist" is increasingly likely in the US as well. If the Fed also decides to do some light "tapering" of current purchases, we might see at least a short-term revolt from the equity markets. At these valuations, that could lead to a sudden swoon. I think they won't want to be blamed for a pop in equity volatility at this point and would probably pass on the tapering option as a result.

With the ECB behind us, this week we have SNB, BoE, BoJ and of course the Fed on Wednesday.

In the near-term, the recovery has been put on hold as hospitalizations and deaths have hit new highs over the last few weeks.



The CB's may continue to add accommodation in dribs and drabs over the next few months. However, with the vaccines promising light at the end of the tunnel, maybe already by the end of the first quarter, their goal now is to get to the other side. With roughly 70% of hospitalizations occurring in those 65 and older, getting that 21% of the population vaccinated will make a huge difference for the medical system, reducing fear and allowing re-openings. With the potential for another round of fiscal stimulus in the US (maybe as soon as Monday) and an apparent Merkel brokered agreement with Poland and Hungary on rule of law issues regarding the Pandemic Recovery Fund, more fiscal spending is in the pipeline.

What to Focus on Now:

Goldilocks is being priced…

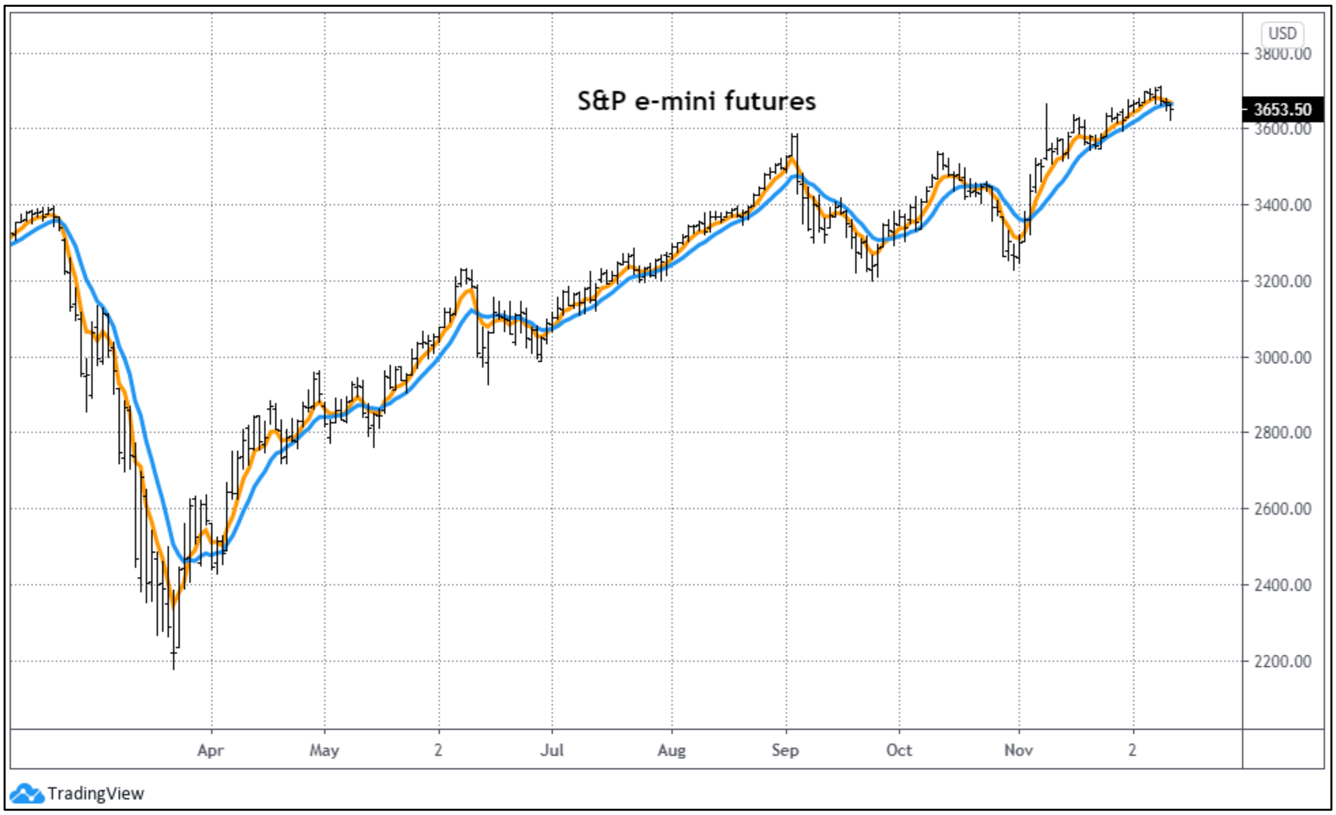
As noted over the last few weeks, sentiment is very bullish, and flows have been pouring into equities post the vaccine announcements.

The outlook is now for a big growth jump in 2021, and earnings expectations have been heading north as a result.

With policy makers in a panicky mood and looking to ignite reflation/inflation as a prescription for high debt and low nominal growth, the wind has certainly been at the markets back.

With a spectacular November behind us for equity markets, there are lots of people asking if maybe markets have priced too much too fast.

That is certainly possible in the near-term. Some of the short-term momentum indicators are now on the cusp of rolling over. With the move stretched as it is, these have increased importance since most of the other warning signs have been left in the dust by the recent run-up. However, while indicators like this give you some tools for shorter term momentum, they don't tell you much about the bigger picture.



To see a larger macro driven selloff usually something impactful needs to go wrong vs. expectations. This usually provides a "tell" of some kind if you are watching global markets.

The "tell" could be in anything from high beta EM currencies, to some equity sector that suddenly loses steam unexpectedly, or in interest rate and bond markets.

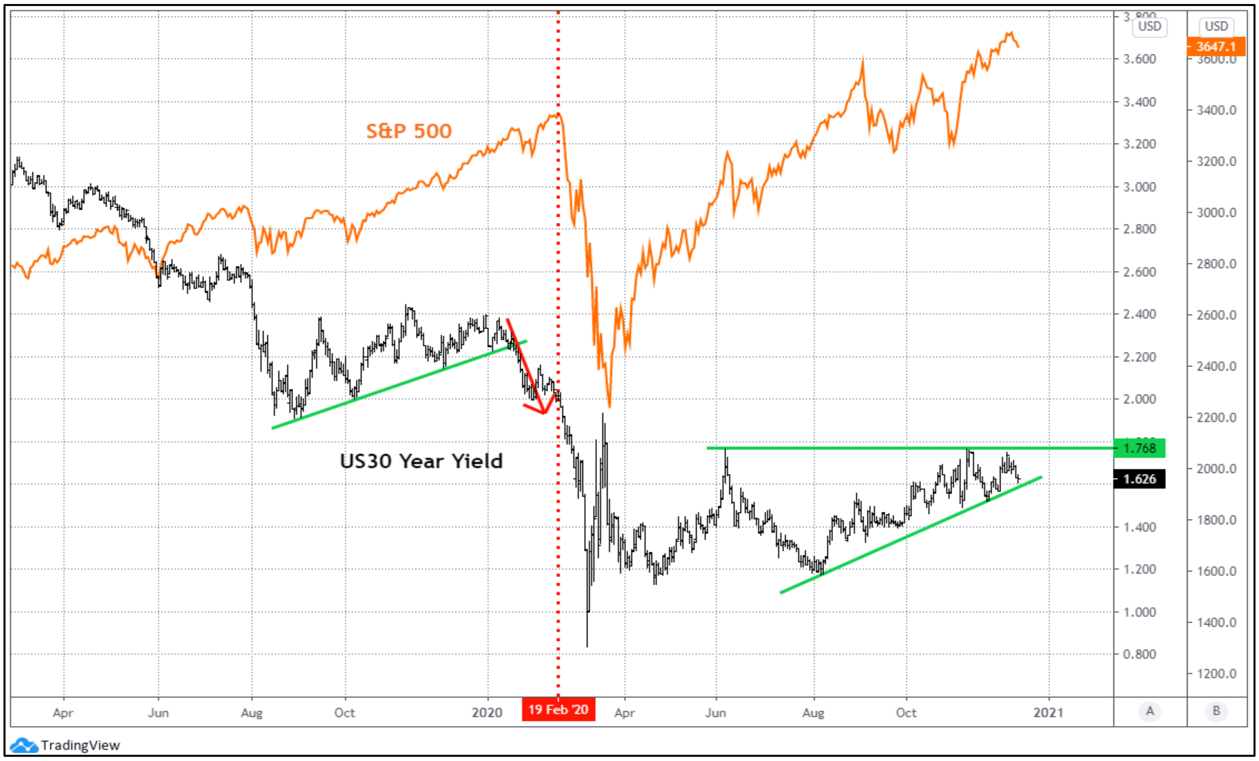
A recent example is the price action during the first few weeks of 2020, well before the equity market turned south.

Soon after the turn of the year, EM currencies started to fall, and EM equities started to underperform as the virus took hold in China. The dollar started to rally overall. A warning of a potential deflationary impulse coming.

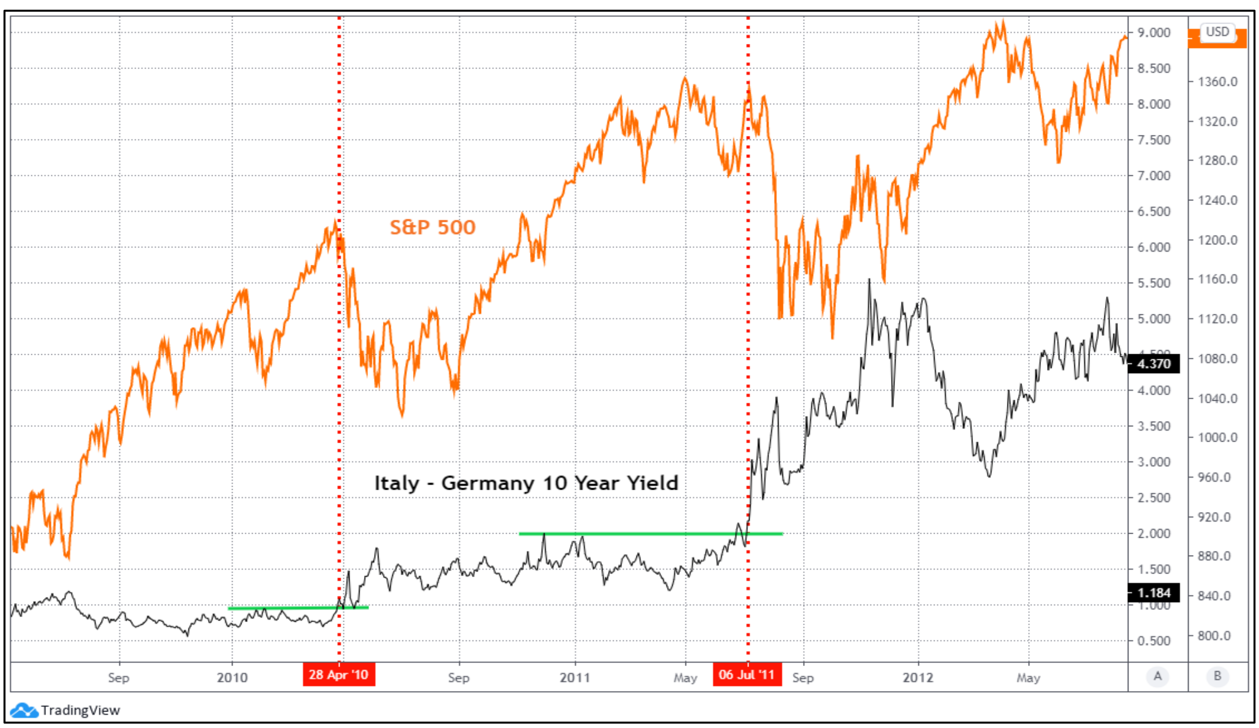
SGD headed south on China exposure.

So did South African ZAR on EM contagion.

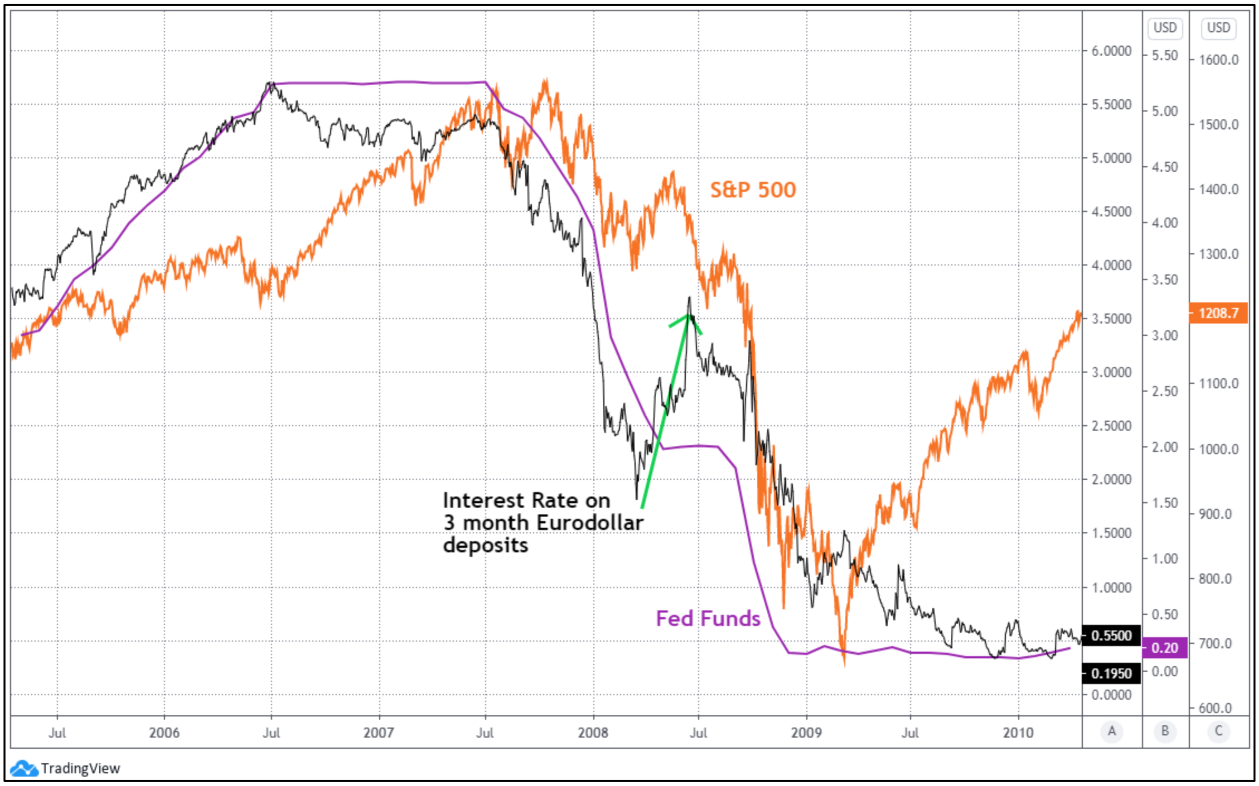
At the same time, US bond yields broke lower and accelerated to the downside.



Another example of these kind of macro "tells" and drivers was during the European debt crisis. While there was a lot of concern and debate about sovereign spreads building, it wasn't until the price action started that equities took notice.



A final and well-known example looks at 2008. While housing stocks had toped well over a year earlier and there was growing concern about subprime loans which had the Fed cutting and equities trading lower, it wasn't until intra-bank lending cost exploded that the real debacle started to come into focus.



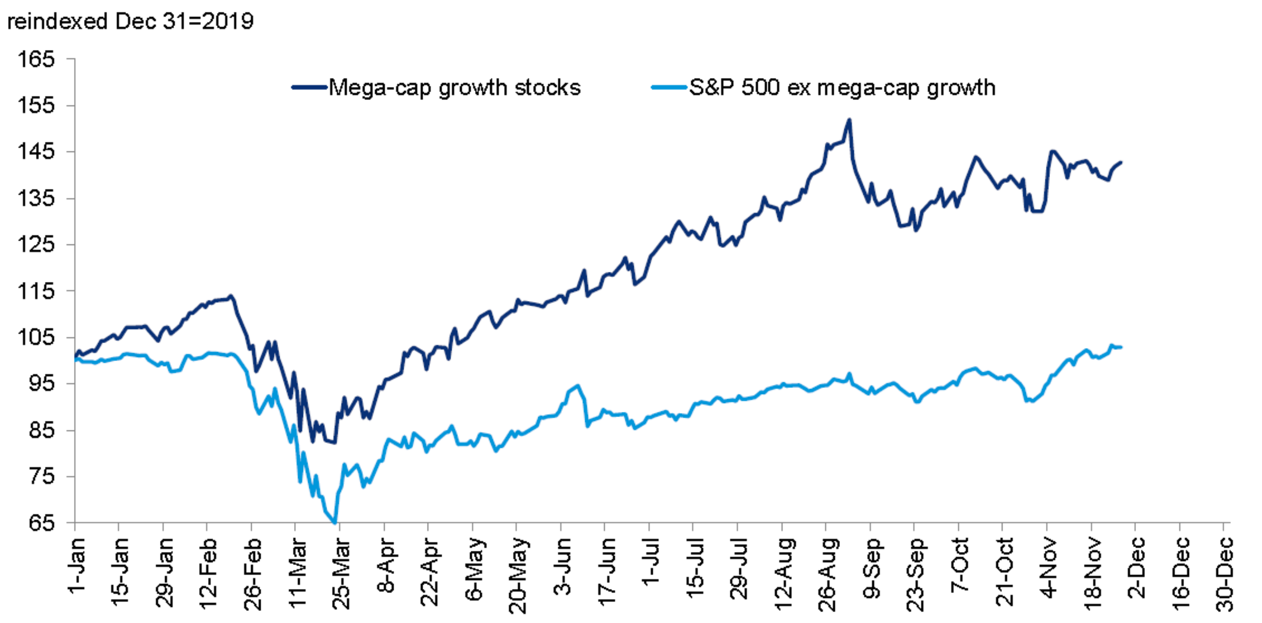
So, what could go wrong here, and what can we watch for indications that something unexpected/new is unfolding?

- Watch bond yields. After being stuck, a break higher or lower will rock the status quo and inject instability into the markets. The CB's have smothered bond market volatility and a break in either direction now will mean something new is being priced. Can runaway money supply growth cause inflation earlier than anyone expects?
- Watch the USD. If reflation/inflation expectations continue to grow but bonds are not allowed to reflect that because of negative interest rates and yield curve control, the USD could be the only open valve. In that case, look for the recent fall to accelerate. If on the other hand USD starts to rebound (especially if bonds rally) it will be reflective of concerns that the reflation story is losing ground.

Something else to watch, is the dominance and size of US big-cap tech and the large role in US equity indices. With such a large profile in the markets, it is worth thinking about whether meaningful rotation can be accomplished without increased volatility.

The tech story has been a good one, and inflows understandable given the backdrop. However, now the stocks are expensive, and positioning is large and concentrated.

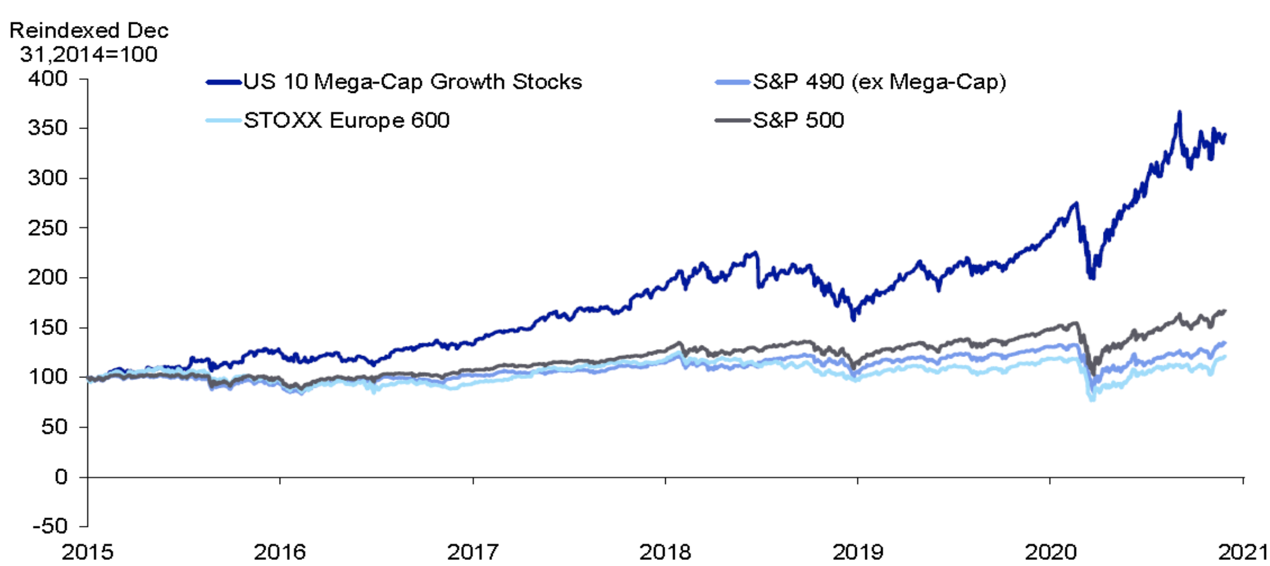
S&P 500 mega-cap growth vs others (re-indexed, Dec 31 2019=100)



Source: Bloomberg Finance LP, DB Global Research

US outperformance has been a technology story.

Outside 10 mega-cap growth stocks, the S&P 500 market cap tracks much closer to the Stoxx 600 in USD terms



Source: Bloomberg Finance LP, Deutsche Bank

We should know soon if tech can hold here and power on, or not.

After five months in a range, a number of these stocks have patterns that should be resolved soon, one way or the other.

The recent rotation into the Russell 2000 stocks has been dramatic. Leaving the NASDAQ nearly unchanged since September while the Russell has gained 20+%

An impressive sprint for the Russell vs. the S&P as well over the last 6 weeks. Often a move like this would be fed and accompanied by higher Treasury yields. Not this time, at least not yet.

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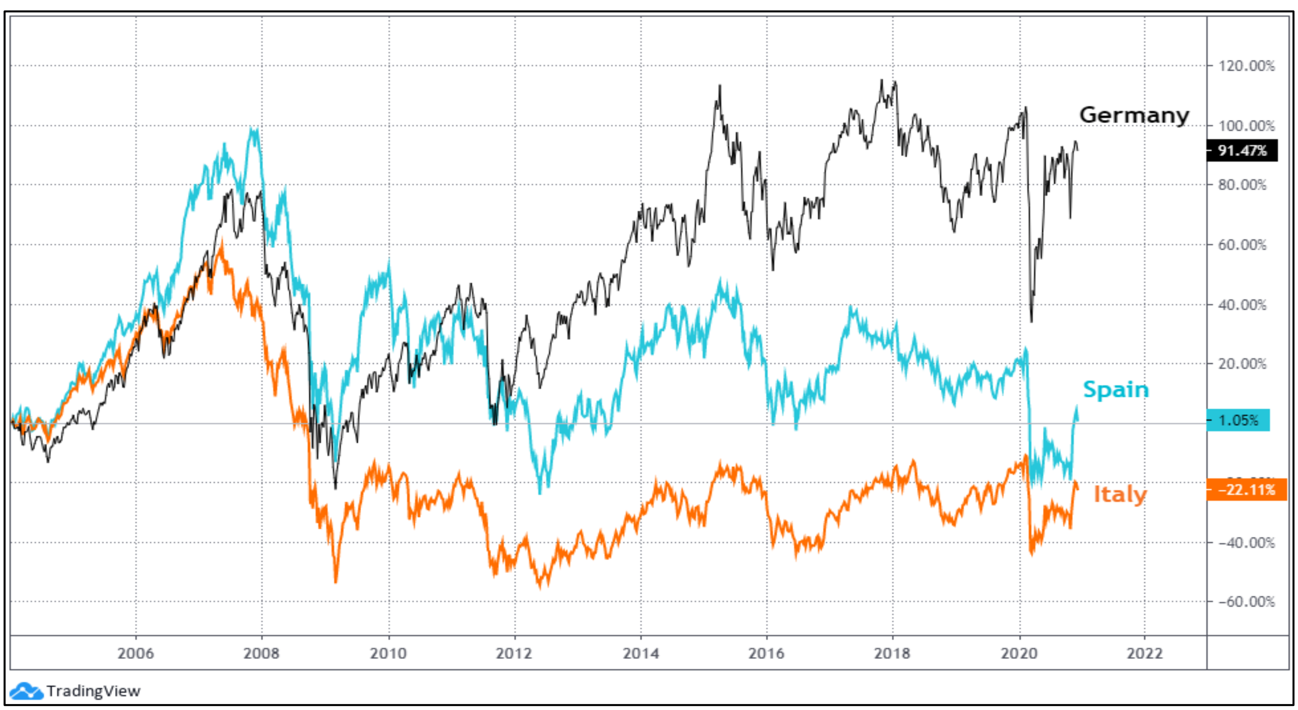
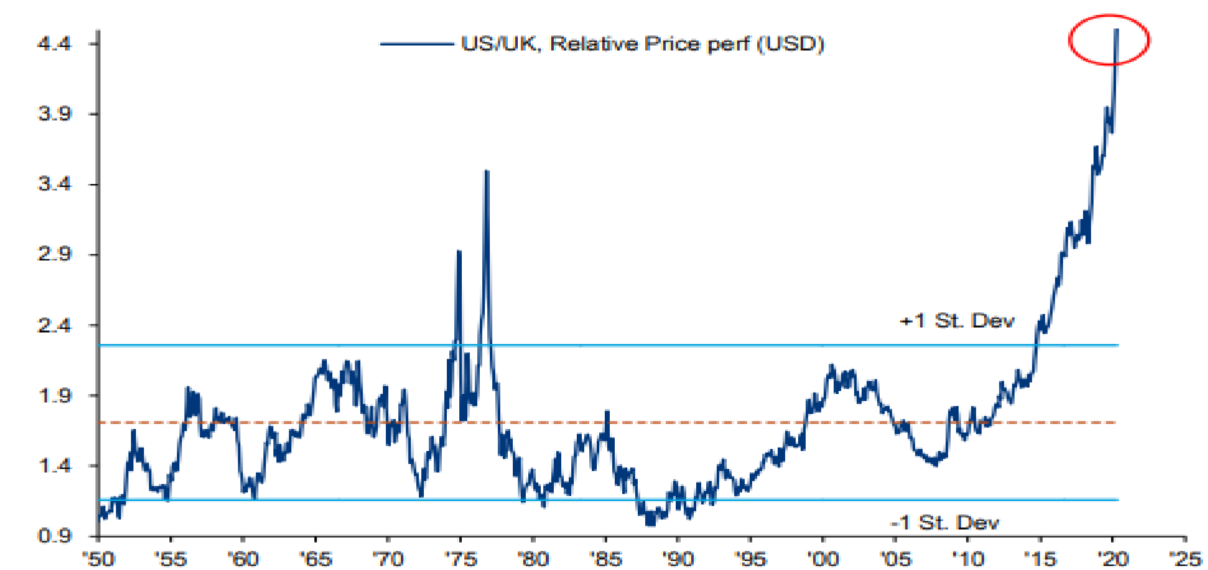
Europe saw some big outperformance on the initial vaccine news but has had a hard time keeping up with the US more recently. I'm watching this one for a confirmation that the global rotation trade is taking hold here as well.

While Spain and Italy have had big pops in their equity indices recently, in the bigger picture they are still some of the worst performers. Lots of potential if they can ever reach escape velocity.



The UK stands out as the king of underperformance with Brexit hanging over it for the last few years. Aside from Brexit related growth concerns, UK equities have a lot of natural resource exposure and technology is only 1% of the FTSE100 vs. 25% of the S&P500. Clearly, there have been good reasons, but still worth keeping an eye on given the low exposure investors have.

Chart 41: US vs. UK equities, relative price performance (USD)



Monthly data
Source: BofA Global Investment Strategy, Global Financial Data, Bloomberg

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EM is taking another run at kicking off increased outperformance. A weaker dollar supports EM.

FX – Waiting for USD acceleration to the downside. A rally could precipitate or go hand in hand with an equity stumble.

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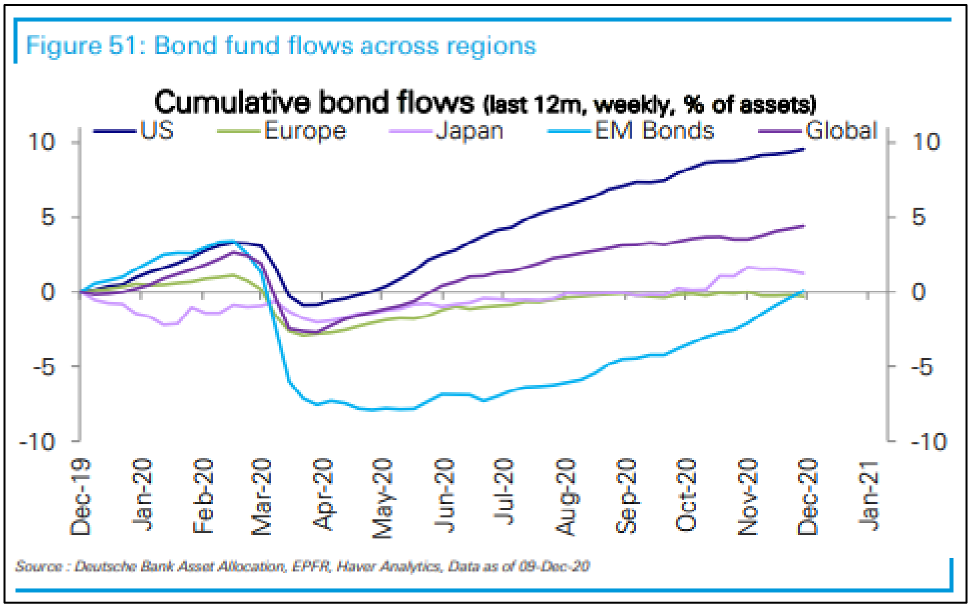
GBP – stuck at a big level, Sterling continues to struggle, as the never-ending Brexit ordeal drags out. I still think it is a buy on further weakness OR on a break higher.

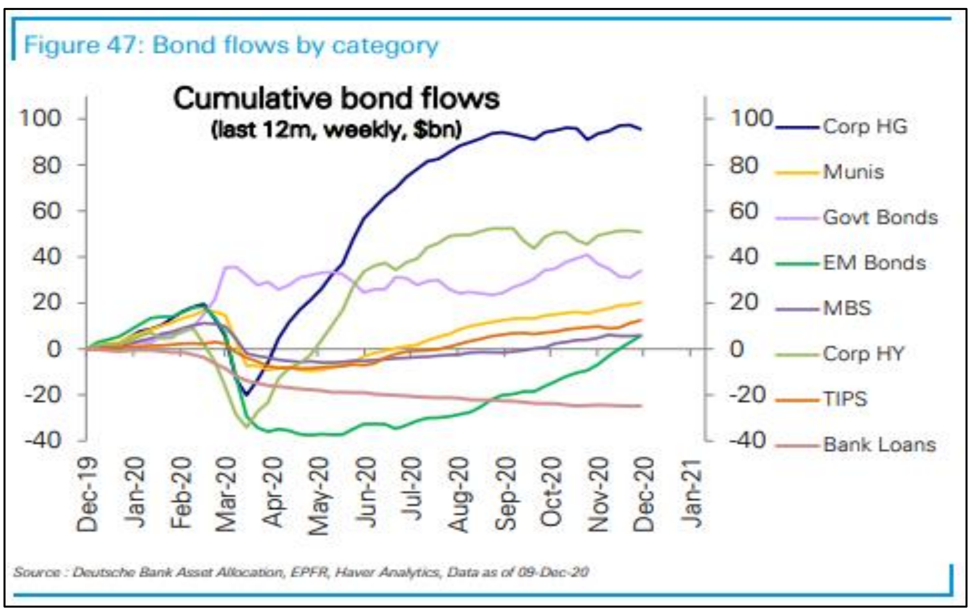
AUD – With EM, Copper and Iron Ore still zooming, AUDUSD could still have room in a weak USD environment.

EUR – With the ECB behind us and further rate cuts unappealing, USD will be the driver of the EUR. Any further extension of the move may have to wait for the Fed meeting this week, however.

Bonds

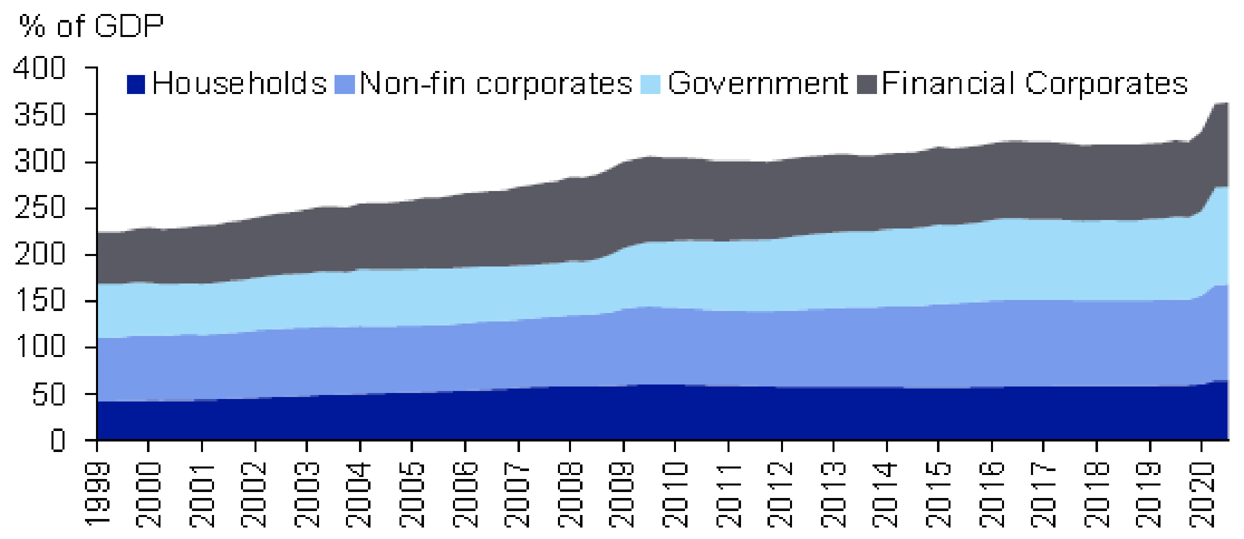
Global bond flows have been strong this year. Given NIRP in other DM countries it is no surprise the US has benefited. Higher available yields and Fed support, have made corporate bonds attractive.



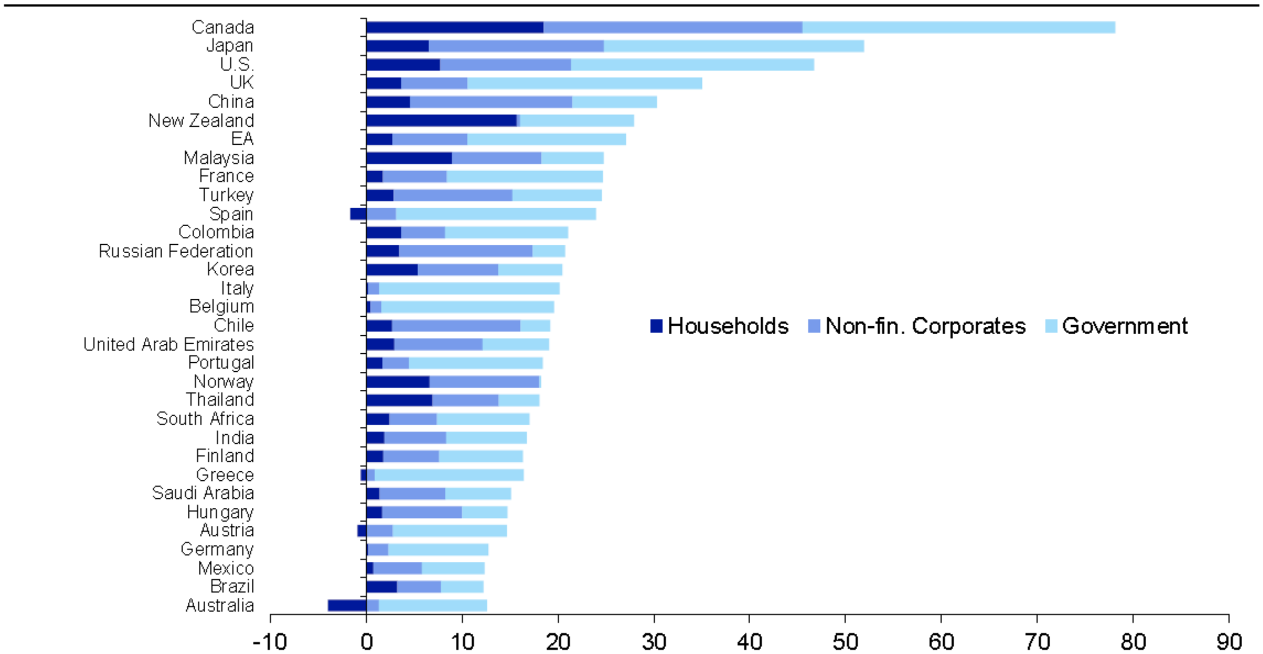


The “bond vigilantes” of the 90’s are long gone, beaten down by persistently low inflation and CB’s that are now increasingly absorbing huge amounts of government debt. COVID has increased global debt dramatically but CB’s have removed a good portion of that supply. They continue to push investors out the risk curve as global debt increases. It is a game of musical chairs, but for now the music continues.

Global sectoral debt (% of GDP).. Even higher in 2021 and beyond…



Change in debt-to-GDP, between Q4-2019 and Q3-2020

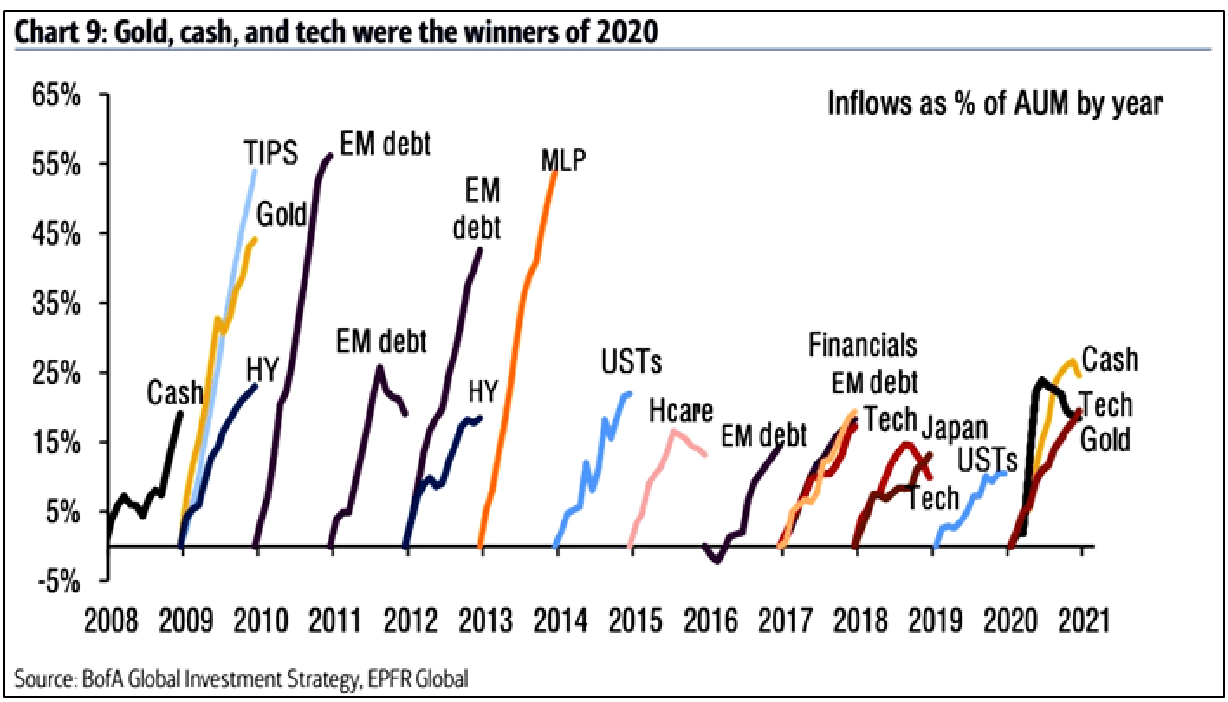


Source: IIF, Deutsche Bank

At the moment, whether it finally matters one day, is almost beside the point. For now, the ability to continue pumping money into the economy without there being any consequences, in terms of being able to borrow at reasonable rates, will guarantee that the behavior continues. If anything, the yields have become more "reasonable". Again, watch bond yields for a "tell" that greater volatility is coming.

Gold – Technically Gold remains in no-mans-land.

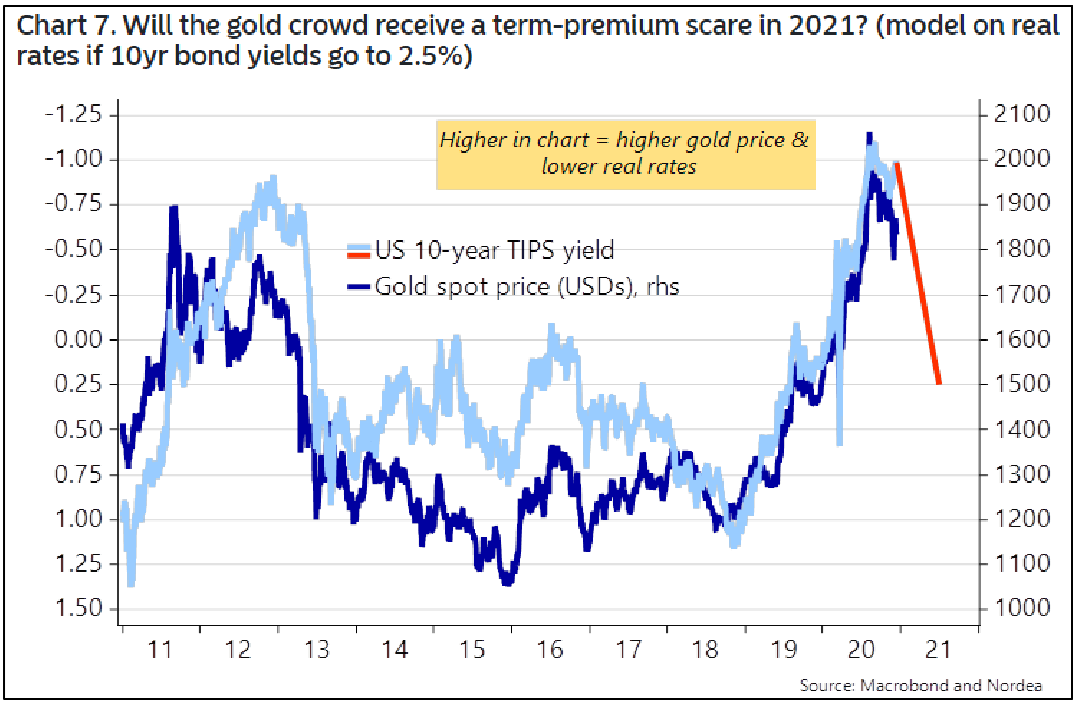
There were large inflows in 2020, followed by at least a partial liquidation over recent months.



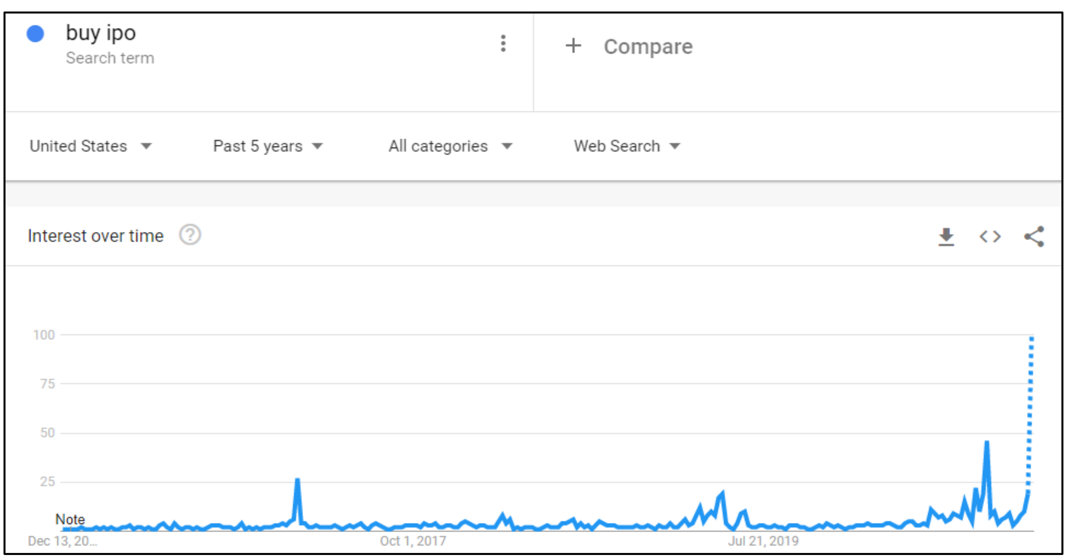
The precious metals with a greater industrial use, such as Silver and Platinum, still look interesting and have a few potential catalysts for higher prices. However, Gold is more of a safe haven, and plays by somewhat different rules, as a result.

The ideal scenario from here would be that bond yields are firmly held down by CB's as they seek to let inflation run hot, and that as a result the USD accelerates to the downside.

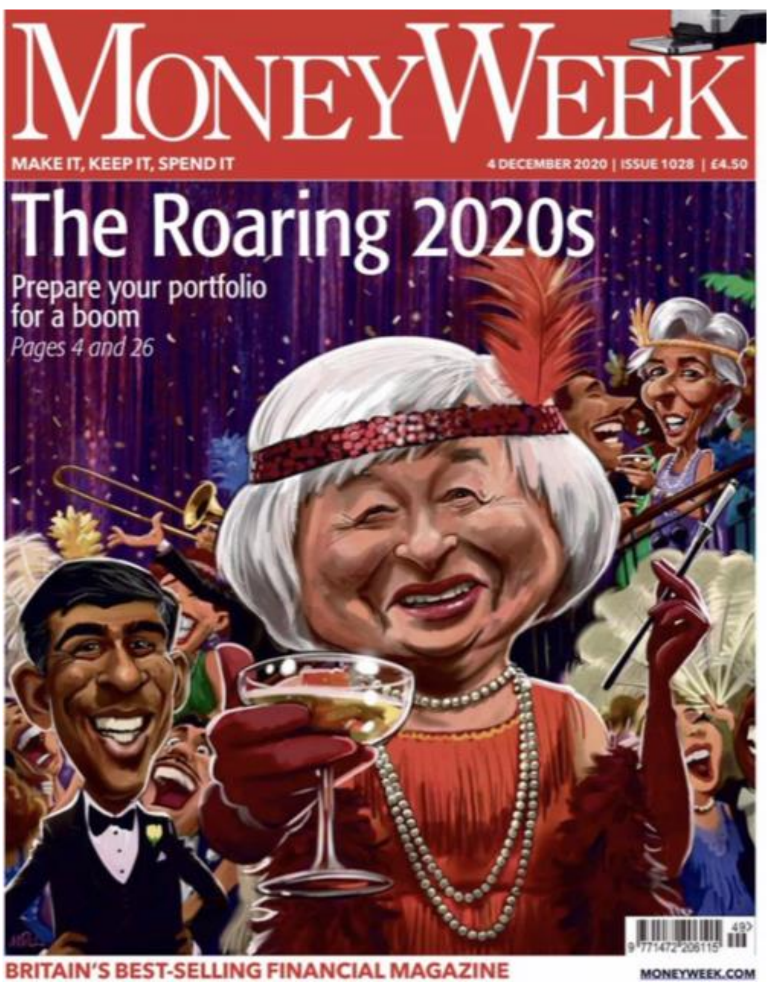
Potentially very damaging, would be a quick rise in long end bond yields that dampens inflation expectations.



Other stuff... All the recent IPO excitement has not escaped retail investors. Google Trends...



And then there is this… hmm. You don't get that cover at the bottom.



Central Banks have been very busy making the alternatives to equities unappealing. Investors have not fully re-loaded yet, and a successful change of leadership could open further upside, but it is time to make sure you are watching for "tells".

The real party pooper would be disappointing growth with inflation surprising to the upside.

On the Data front, Fed and PMI’s are the big ones this week.

Important Macro Data Releases and Events for the Week

Monday 12/14/2020

- Tankan Large Manufacturing Index (Q4) Forecast: -15, Prior: -27 (Sunday NY)
- RBA Meeting Minutes
- Retail Sales YoY (Nov) Forecast: -, Prior: 4.3%

Tuesday 12/15/2020

- Industrial Production MoM (Nov) Forecast: 0.3%, Prior: 1.1%
- BoC's Governor Mecklem SPEECH

Wednesday 12/16/2020

- Markit PMI's for most of Europe
- Retail Sales Control Group (Nov) Forecast: 0.1%, Prior: 0.1%
- Retail Sales MoM (Nov) Forecast: -0.4%, Prior: 0.3%
- Markit Manufacturing PMI (Dec) Forecast: 55.8, Prior: 56.7
- Markit Service PMI (Dec) Forecast: 56.5, Prior: 58.4
- Markit PMI Composite (Dec) Forecast: -, Prior: 58.6
- FOMC Economic Projections
- **Fed's Interest Rate Decision and Monetary Policy Statement/Press Conference**

Thursday 12/17/2020

- SNB Interest Rate Decision and Monetary Policy Statement
- BoE Interest Rate Decision and Monetary Policy Statement

Philly Fed Manufacturing Survey (Dec) Forecast: 20, Prior: 26.3

Housing Starts and Building Permits for (Nov)

Initial Jobless Claims Forecast: - , Prior: 853k

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 776k

Continuing Claims Forecast: - , Prior: 5.757m

BoJ Interest Rate Decision and Monetary Policy Statement

Friday
12/18/2020

IFO - Business Climate (Dec) Forecast: 90.5, Prior: 90.7

IFO - Current Assessment (Dec) Forecast: 89.3, Prior: 90

IFO - Expectations (Dec) Forecast: 92.8, Prior: 91.5

Retail Sales MoM (Oct) Forecast: 0.2%, Prior: 1.1%