Spyglass Macro

Global Macro Advisory for Active Investors

What to focus on in Global Macro for the week of August 8th, 2022

Well, last week's strong employment report and the wave of pushback we have seen regarding the pricing of a Fed pivot, has ended any discussion of a Fed slowing its roll for the time being

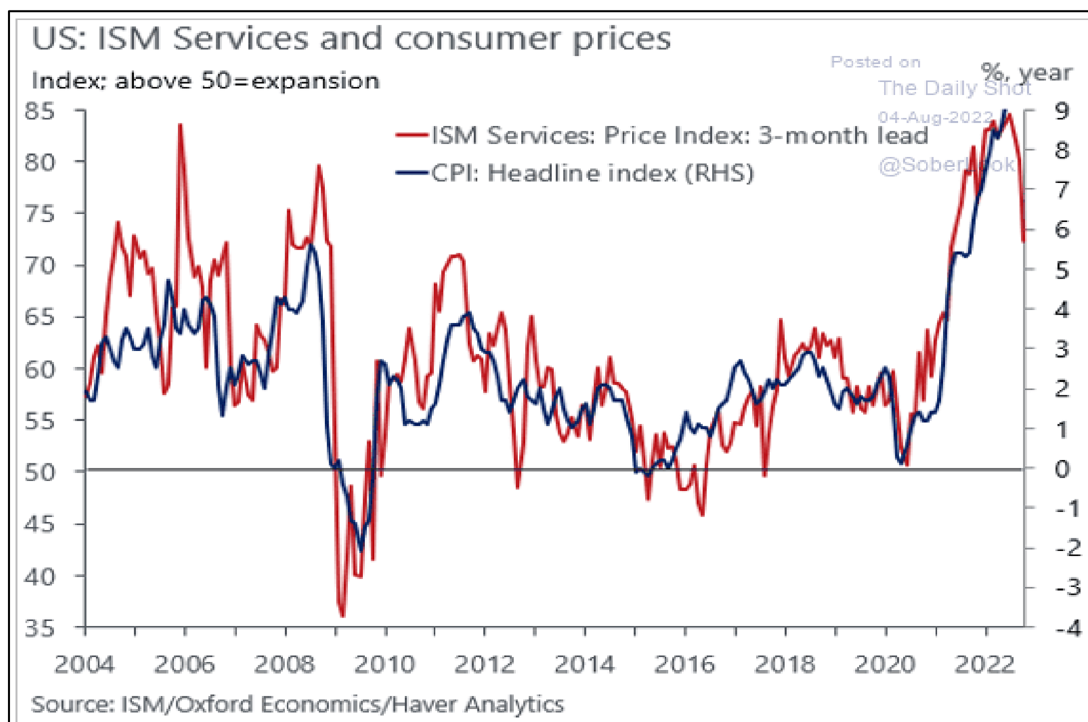
A few of many quotes:

- KASHKARI: 2023 RATE CUTS SEEM LIKE 'VERY UNLIKELY SCENARIO'
- BULLARD: SHOULD GET TO 3.75%-4% RATE THIS YEAR
- MESTER: HAVEN'T SEEN ANYTHING SUGGESTING INFLATION LEVELING OFF
- DALY: MARKETS ARE AHEAD OF THEMSELVES ON FED CUTTING RATES IN 2023

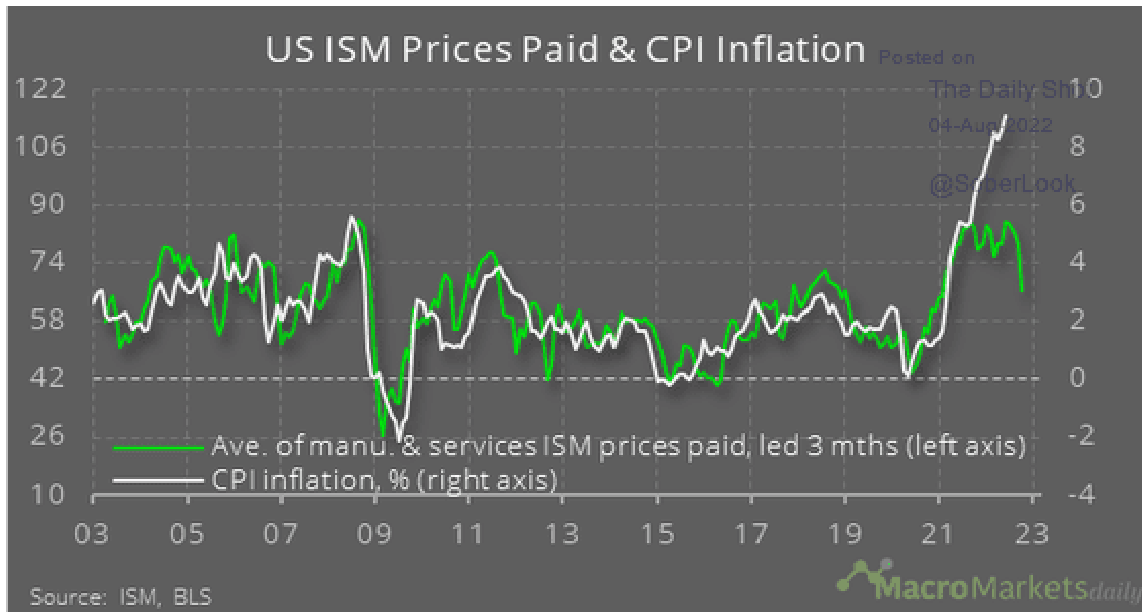
In the meantime, US data is mixed. Manufacturing isn't showing much of an uptick and if anything is showing that at least some demand destruction is taking place. The service sector has however remained resilient. In fact, the Service PMI increased 1.4 points to 56.7 in July, still firmly in the expansion zone. A big driver of the stronger than expected employment report was the jump in restaurant and bar employment which jumped 74,100 – the largest in five months.

In addition, there are signs that price pressures are starting to ease as the ISM Services Prices component had the biggest drop since 2017. Falling commodity prices are likely feeding into this already.

Eventually, we should see that feeding into headline CPI.



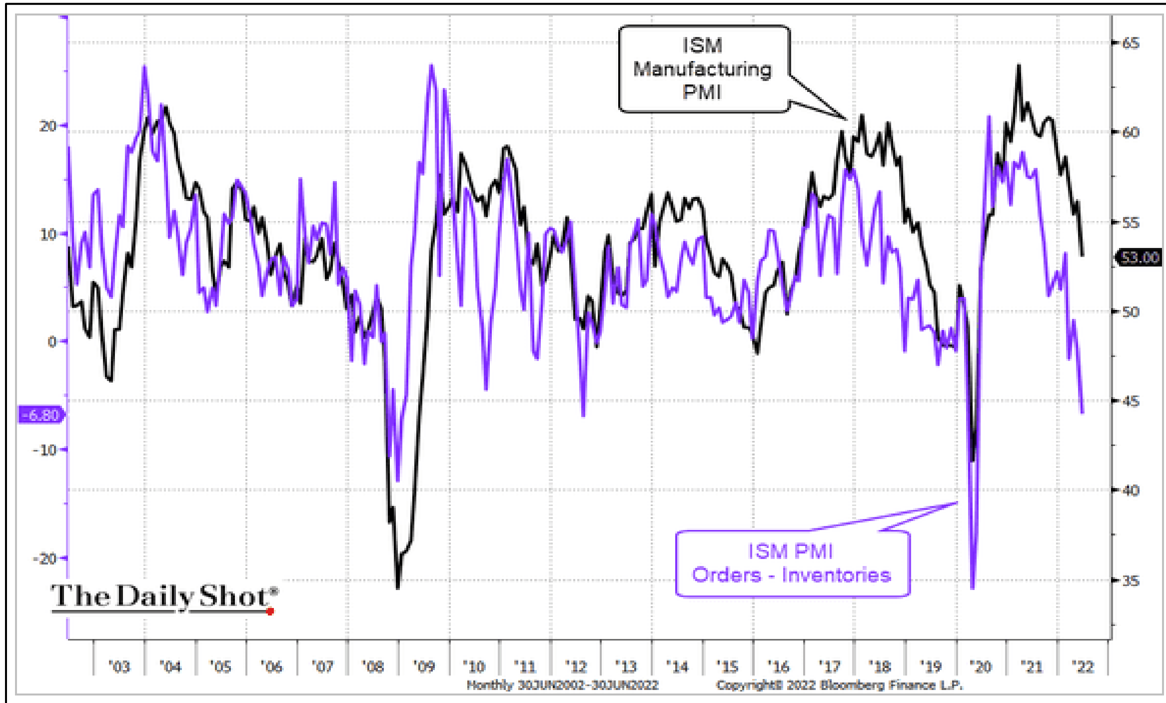
The combined manufacturing & service prices paid show an even larger divergence from CPI building.



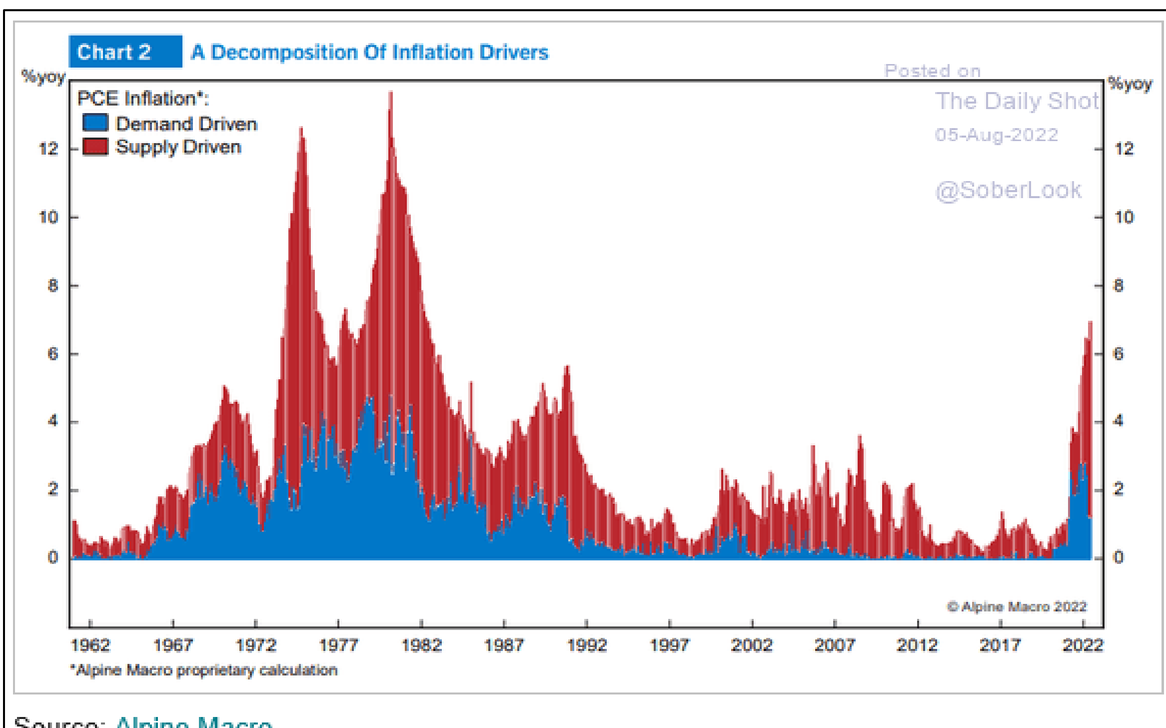
The one item in the recent employment numbers that does show we are starting to eat through the demand for labor, was the 605,000 drop in job openings, to 10.7 million. This was concentrated in retail and wholesale trade. However, there is still a big buffer vs. job seekers.

Housing has been softening quickly, and consumer credit has been expanding at a near-record pace. Here is the Fed's Consumer Credit (Total Change SA).

However, so far, the drop in manufacturing surveys has not yet affected overall economic activity. Having said that, further Manufacturing PMI weakness is likely, in the coming months.



We are definitely seeing demand destruction in global manufacturing but less in services. At the same time, supply chain drivers remain in focus.

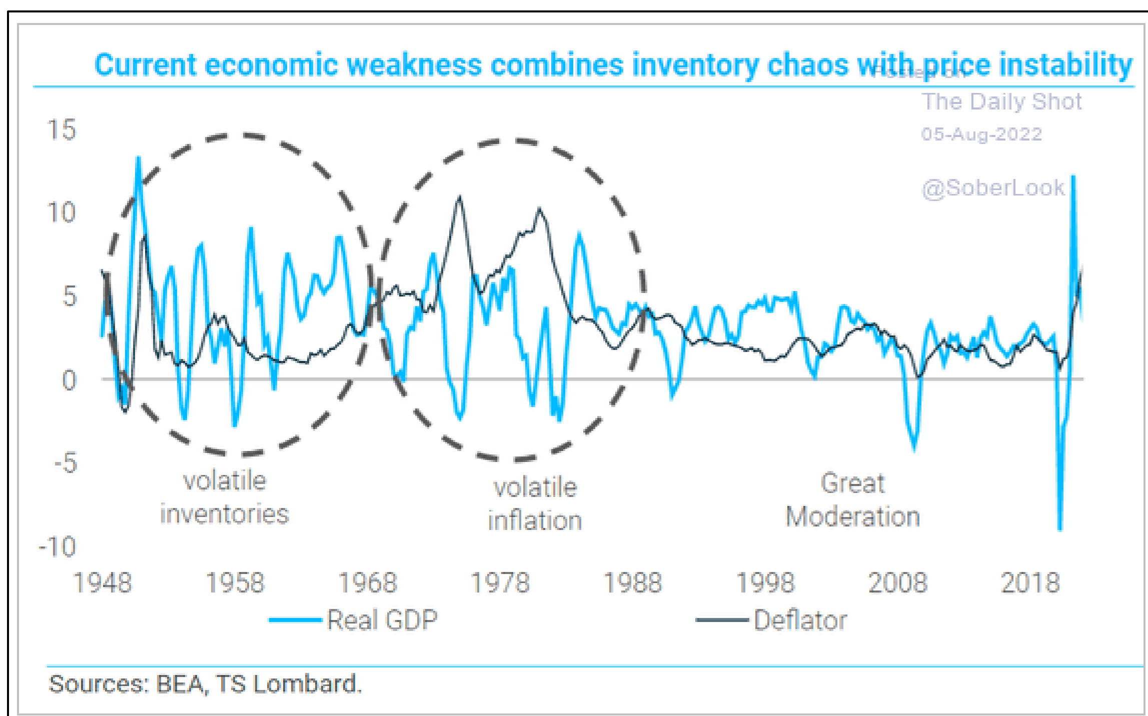


Source: Alpine Macro

However, here too there are growing signs of improvement. Inventories are rising and delivery times, and backlogs, are now falling rapidly

The big questions remain, when inflation does roll, how long will it last, and what will the state of the economy be at that point?

This goes back to the discussion from last week about what regime we are in post COVID.



Are we currently just experiencing a series of one-offs delivered by COVID, or have we entered a new regime that includes on-shoring of production and de-globalization, energy shortages due to poor policy, and global geopolitical instability?

CS's Zoltan Pozsar did a nice job summing up the issue in a recent note:

"… do you see inflation as cyclical (a messy re-opening after COVID, exacerbated by excessive stimulus) or structural (a messy transition to a multipolar world order, where two great powers are challenging the might and hegemony of the US). If the former, inflation has peaked. If the latter, inflation has barely started, and could actually be understood as an outright instrument of war."

What regime we are in is very important for the interest rate/equity relationship.

For example, after the Asian crisis and LTCM yields and stocks went up and down together, as the markets feared a deflationary environment.

However, post the GFC, the continued and relentless flood of global liquidity pushed up equity prices and the correlation to yields was much looser.

Now, if we have a higher-for-longer inflationary backdrop, we could very well return to the relationship that existed from the 70s to the mid-90s, in which stocks would be under pressure when yields rose but would lift when yields peaked.

This could also have big implications on the "yield curve signal". Potentially muddying the waters vs. very clean signals in 2000 and 2007.

Here are some current market charts that stand out to me… The Russell is looking interesting.

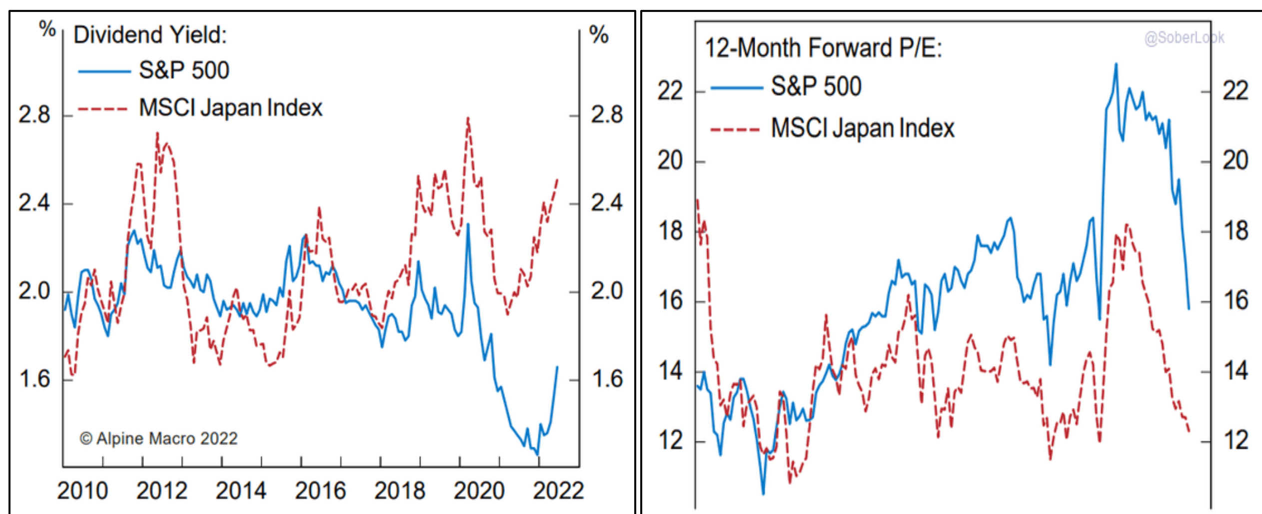
At least on a relative basis. A good part of it may be the sudden resurgence of the underperforming biotech components.

IWM looks like it is heading for new highs vs. DM world ex-US.

The Nikkei also looks like it is worth watching at these critical levels. The nominal Nikkei has held in well, as you might expect given the JPY depreciation.

Relative to the S&P you could argue that it is cheap.

Having said that you have gotten what you paid for in terms of global equity valuations over the last decade+.



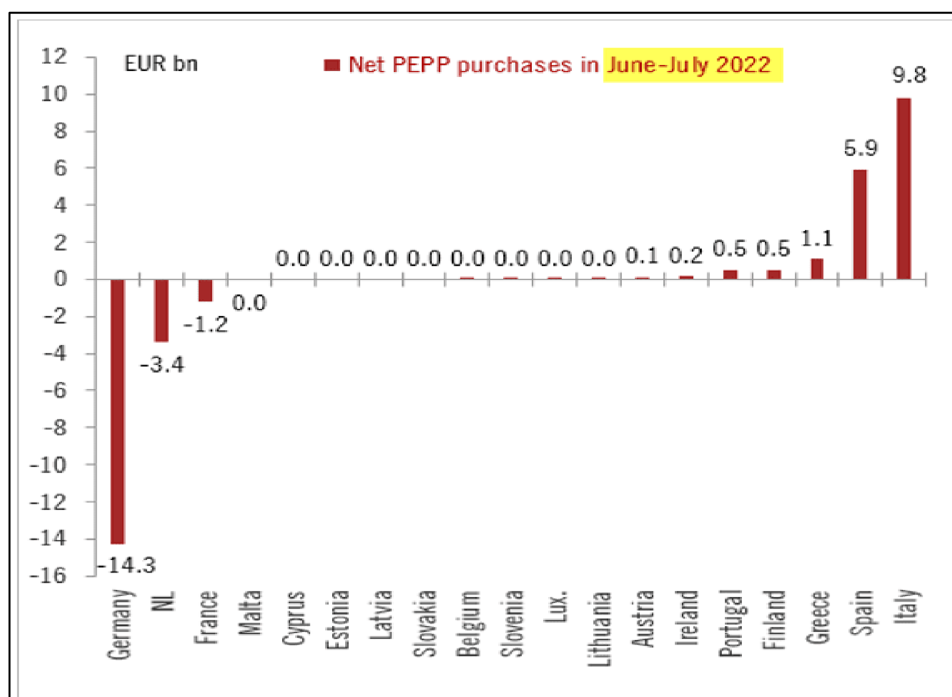
The dollar vs. DM held support this week. However, I think USDBRL has further room to fall.

EWZ has done nicely. The first stop should still be 31.50. Having said that we are more than halfway there.

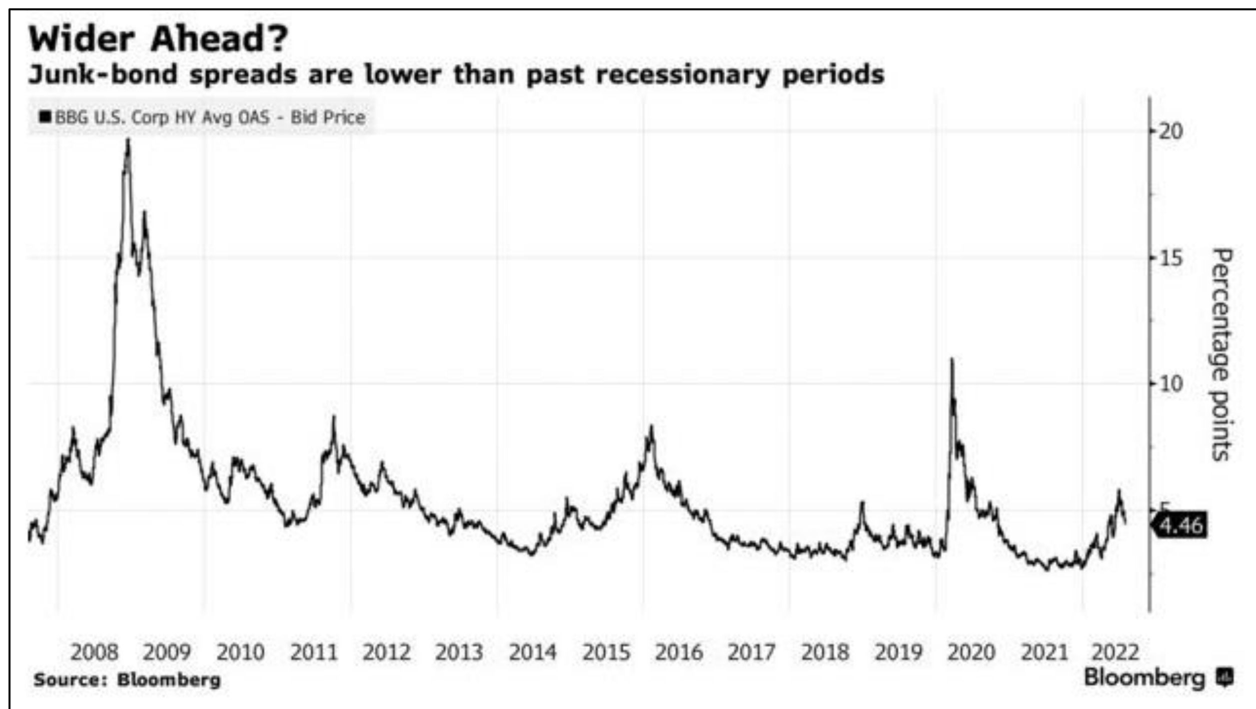
Falling real yields last week helped Gold. I was surprised it held up given Friday's reversal.

German yields have plunged over the last few weeks, but Italy has kept pace, and then some.

Here is the explanation: The ECB has had its own operation twist going to achieve those results. This is a taste of what policy is likely to look like going forward.



On the US credit side, it is worth noting that junk-bond, in aggregate, have held in better than might be expected. Yes, equities have rallied and Treasuries off the lows means people had started looking to add back some FI exposure. However, current spreads are not indicative of what one might expect given the economic challenges and recession fears. But as Bloomberg pointed out in an article last week: "Much of the recent compression in spreads is because of energy debt, which has performed better than the broader high-yield market this year as oil prices have risen… may "be skewing expected default rates lower for the broader market, and in turn, giving investors a bit more optimism in buying high-yield broadly."



It is all about CPI next week… Good luck!

Important Macro Data Releases and Events for the Week

Monday
8/8/2022

No data of note

Tuesday
8/9/2022

US Nonfarm Productivity and Unit Labor Costs (Q2) Prel.

CPI and PPI (Jul)

Wednesday
8/10/2022

HICP (July)

CPI (Jul)

Thursday
8/11/2022

PPI (Jul)

Initial Jobless Claims

Initial Jobless Claims 4-week average

Continuing Jobless Claims

Friday
8/12/2022

GDP (Q2) Prel.

Industrial Production (Jun)

Michigan Consumer Sentiment Index (Aug) Prel.

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