Weekly Macro Themes

End of Year Special Edition - 2019

"The End of Year Special Edition takes a different format to the usual weekly slide deck, and presents you with highlights, reflections, and some of the best charts of 2019. I sincerely hope you enjoy it!"
-- Callum Thomas, Head of Research and founder of Topdown Charts

Topdown foreword: What a year. It was almost a case of something for everyone… Bonds did well, equities did well, central banks pivoted from tightening to easing, economic confidence went from booming to recessionary, the S&P made new highs, gold broke out (then down), political risk weighed-in (both ways), and many markets just swung around through the range.

Looking forward, I would have to say 2020 is almost certainly going to be more binary than 2019. It's going to be a case of *either* bonds OR equities do well this time, not both. Those trading ranges are probably going to go out the window too. And the policy pivot is going to come home to roost. Noise levels will surely be as high as ever (and good charts will be as valuable as ever!).

For now, please enjoy this selection of charts which I have meticulously selected from reviewing all of the Weekly Macro Themes reports from the year 2019. As an exercise in reflection it's been personally rewarding and insightful, and I trust you will likewise get a lot out of this special edition.

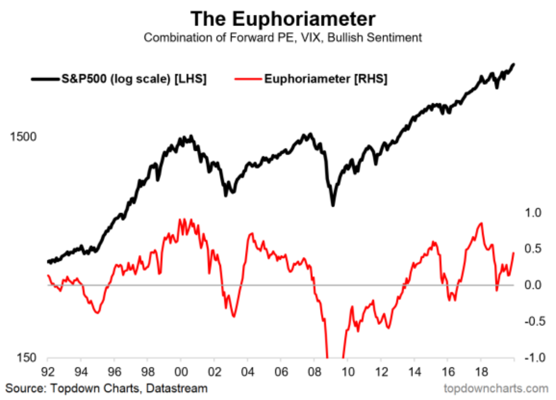
I look forward to catching up with you in the new year.

Section A. Charts That Worked

First up is a look at some of the charts and calls that worked particularly well during the year.

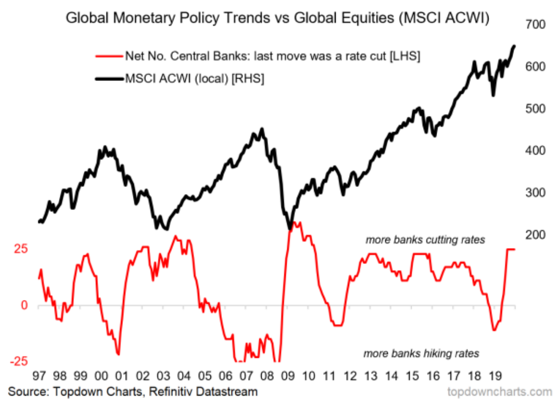
1. Back at the start of the year this was one of about a dozen sentiment/flows/positioning charts that helped lay out the bullish case for equities (along with the market breadth and valuations picture). Getting equities right this year was a key call, and the charts made it possible. (25 Jan 2019)

"The Euphoriameter combines the signals from the AAII II surveys, the VIX, and the forward PE ratio - basically a combination of market based and survey-based sentiment metrics. The key point is the high contrast between the start of 2018 (euphoria) vs the start of 2019 (dysphoria)."



2. This indicator helped identify how overzealous central banks drove global equity markets into a correction (and pushed the global economy to the brink). Subsequently it helped identify the global monetary policy pivot. (25 Jan 2019)

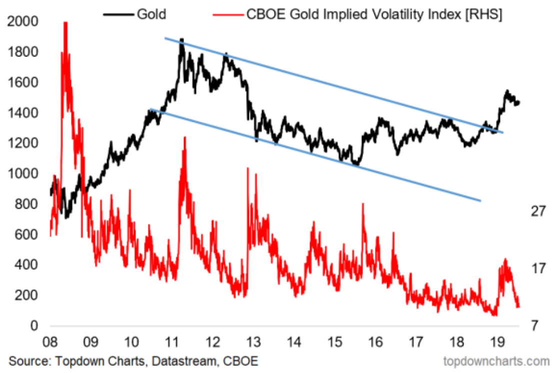
"the elephant in the room is monetary policy. Looking only at (this) chart you could pretty much say that the global equity market correction was driven by the transition to monetary policy tightening (banks hiking rates went from the minority to the majority) ... This is the part where we get to find out how sensitive the global economy really is to tighter (less easy) monetary policy. With the growth scare, perhaps a global pause/re ease is needed."



3. Gold (part 1): The first rumblings of the gold breakout showed up in this chart which helped identify the breach of the downtrend channel and the compression in implied volatility which preceded the surge in the gold price. (15 Feb 2019)

"the downtrend channel (from 2011), this is at risk of being breached to the upside (an upside breakout) - notably the near record-low in gold implied volatility means an upside breakout could end up being explosive since volatility crunches have a tendency to precede large moves."

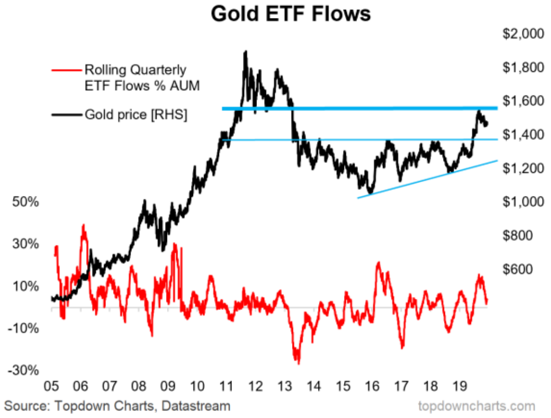
Gold price vs Implied volatility



4. Gold (part 2): the gold ETF flows chart was a key element in flipping bearish on gold (sentiment, positioning, flows, valuations became stretched, overhead resistance came into focus, and real yields rebounded off a key level). At the time that was quite a tough and lonely call to make - as the best ones often are. (6 Sep 2019)

"Add to that the crowded longs and heavy ETF inflows it's not hard to argue that gold takes a breather here at the very least. Indeed, it's entirely possible that gold could undergo a 10-15% correction (and still be in a secular bull market)."

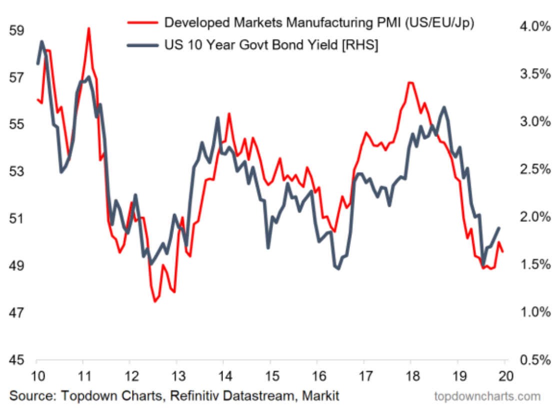
Gold ETF Flows



5. Treasuries (part 1): With the help of the PMI vs bond yield chart (and copper/gold, and copper vs CGBs) I highlighted the risk that bond yields would head lower – but it was with low conviction and I don't think I would have imagined that they would go as low as they did. I also hedged it with my view that valuations looked expensive and sentiment quite bullish. So I give more credit to the chart than myself on this one. (8 Feb 2019)

"Given the softer DM PMIs and falling copper/gold ratio, the macro pulse at the margin says there could still be a bit further to go towards the downside for bond yields."

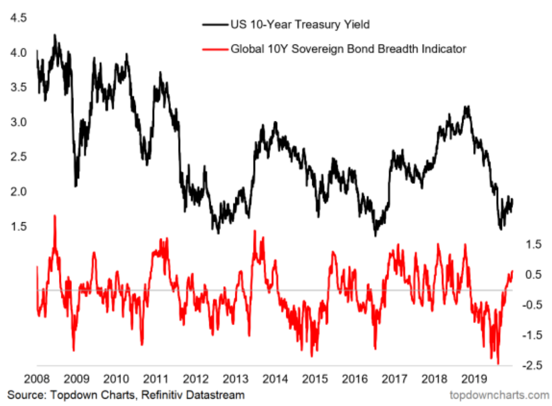
DM PMI vs Bond Yields



6. Treasuries (part 2): "overbought & overvalued". Though I could say that they were overvalued for much of the year, the missing link was the tactical indicators needed to round out and finesse that view. This composite global sovereign bond breadth indicator put in the most extreme overbought signal in recent history. (9 Aug 2019)

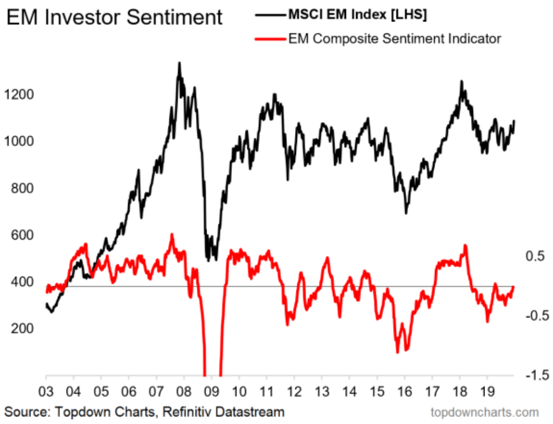
"The composite global 10-year sovereign bond breadth indicator is lighting up as extreme overbought for government bonds. Aside from being overbought, on my indicators US treasuries are now extremely overvalued. The composite valuation signal is now at a record level"

Global 10-Year Sovereign Bond Breadth



7. I turned bullish EM equities late 2018, and reaffirmed that call in January this year, a key part of this (along with cheap valuations, and supportive technical/macro indicators) was my composite sentiment indicator. At the time it was giving an extreme bearish reading – which I look at as a bullish contrarian signal. This helped in raising conviction at the bottom in absolute terms for EM equities. (18 Jan 2019)

"moving on to investor sentiment, the composite sentiment indicator has fallen further, this tends to be a contrarian bullish signal"

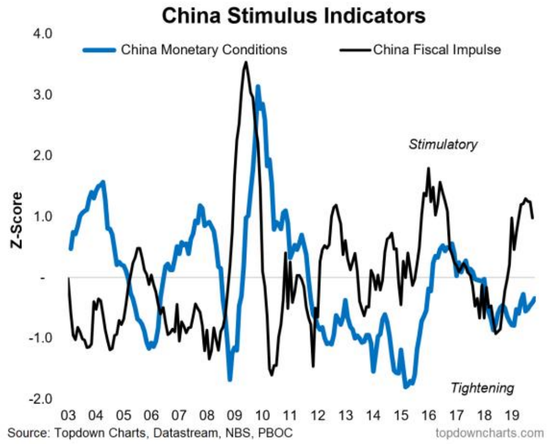


8. I talked about this one in the 2018 End of Year Special Edition as one to watch in 2019, but also highlighted it alongside what I thought would be a downturn in property that should have helped the case (more on that in the charts for 2020). In any case, this is one of those situations where if valuation gets cheap enough it can speak louder than the prevailing narrative/noise. (22 Feb 2019)

"looking at the chart of China A share valuations, there's a lot of room to move before they revert to the long-term average (let alone get back to expensive)"

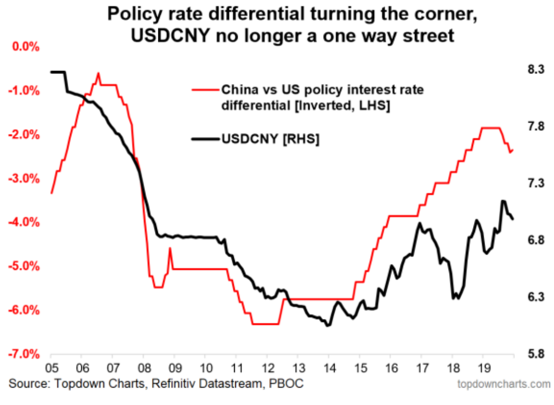
9. This one worked in so far as the tightening of monetary and fiscal policy indicators flagged the weakening macro pulse in China. Subsequently it also helped identify how although they had been doing some fiscal stimulus to help prevent growth from slowing too much, they had clearly been holding back on monetary stimulus. (18 Jan 2019)

"moving on to the policy puzzle for China, clearly the inarguable softening in the China macro picture incrementally puts pressure on policy makers to shift to a more forceful stimulus stance - something that has not been forthcoming yet as shown by my China stimulus indicators. Hence economic policy uncertainty is understandably at a record high for China. For me, the question of more forceful stimulus is 'when' not 'if'."



10. Back in January, USDCNY was trading around 6.8, it later peaked just below 7.2. To the extent that this chart helped flag the risk of devaluation, this chart certainly 'worked'. (18 Jan 2019)

"one caution I would add is the USDCNY is not out of the woods Indeed, if they opt for further and more aggressive monetary stimulus this will most likely add to devaluation pressures and that's the type of thing that would not sit well with Asian FX or EMFX (and hence remains a key downside risk to the bull case there)"

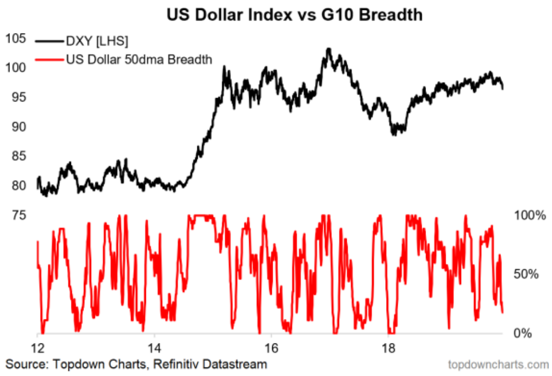


Section B. Charts That Didn't Work

Of course, it wouldn't be complete without a look at some of the charts that didn't work (or shall we say the ones that worked "less well!").

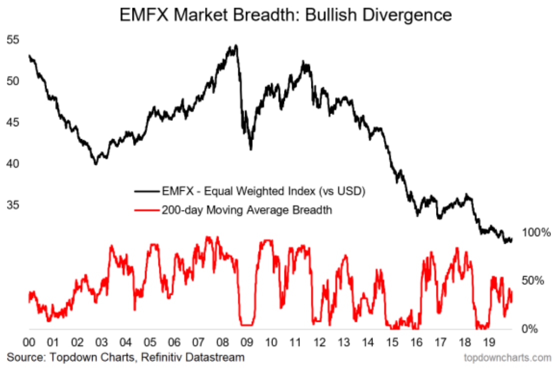
1. After (correctly) turning bullish on the US dollar in early 2018 I decided to abandon the bullish view early this year as market breadth indicators began to rollover (along with what I saw as unsustainable macro and rates divergence between the US and the rest of the world). I would say I was right to abandon the US dollar bull call since the DXY didn't go up much, but to the extent that meant being bearish was wrong as the US Dollar traded in a tight but uptrending range with many false breaks in either direction. (18 Jan 2019)

"market breadth is rolling over for the US dollar against G10 currencies. Looking at the recent history of 50dma breadth and further history on the 200dma breadth chart, this type of breakdown in breadth often shows up around the start of a major move and/or trend change. This is enough to abandon my previously bullish USD view"



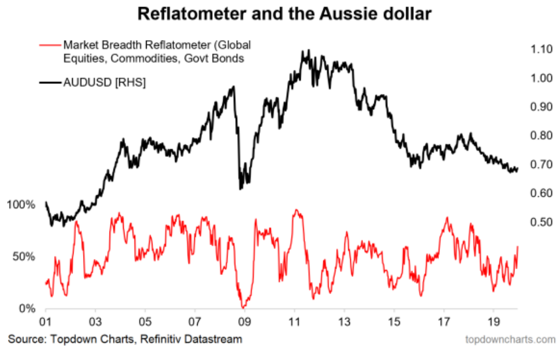
2. In many ways the other side of the coin so to say, I highlighted the bullish case for EMFX early in the year as the valuation, market breadth, and intermarkets seemed to line up. I was initially right, but ultimately wrong (albeit I did change the view later in the year). I would say though the outlook is much better going into 2020 (valuation, market breadth, macro). (18 Jan 2019)

"Looking specifically at EMFX market breadth, the 200dma breadth indicator has spiked in recent weeks from washed out levels, and the EMFX index has stirred from very tight range trading. This previous compression in price volatility is just the type of thing that can set the scene for an explosive breakout. The action in Asian FX and EM Equities breadth appears to be confirming the case for a turnaround here, so this is definitely one to have on the radar."



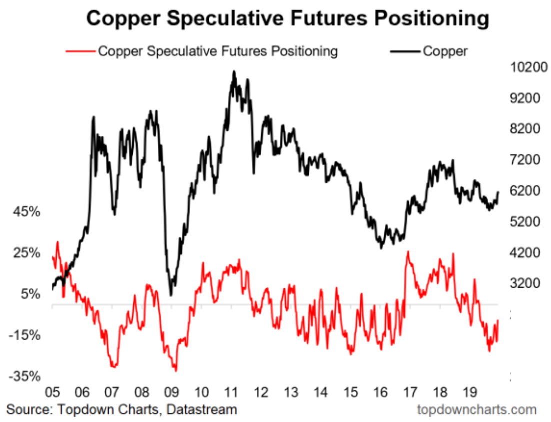
3. I turned bullish too early on AUDUSD partly due to the initial rebound in this indicator (along with improved valuations and contrarian sentiment signals). The domestic (RBA rate cuts) and USD resilience stymied that call. (19 Apr 2019)

"Typically the Aussie marches to a similar tune as China/EM/commodities/general risk appetite. The chart below of the reflatometer (200-day moving average breadth for global equities, commodities, and sovereign bonds [inverted]) has turned up significantly and this is typically a bullish sign"



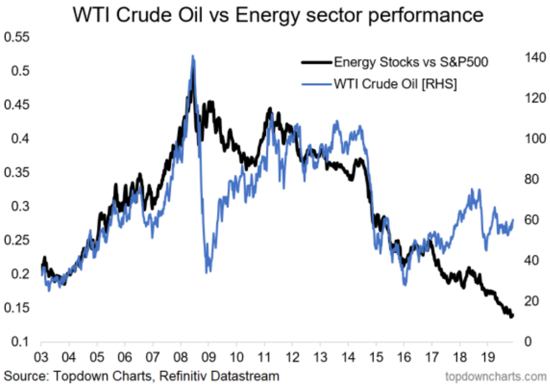
4. Similarly I got too excited with the initial rally in Copper, but that's looking better now. (22 Feb 2019)

"After bouncing off support, copper is starting to show signs of life (and possible short squeeze)"



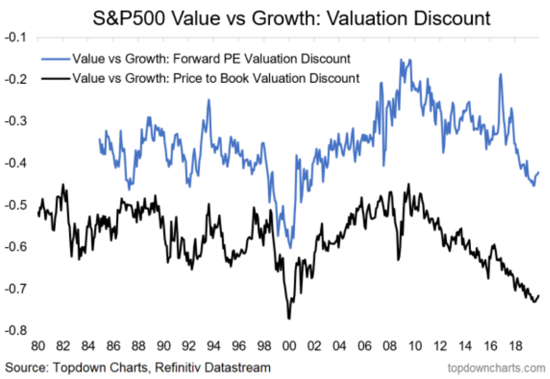
5. Energy stocks relative performance never caught back up to oil. Maybe the oil price needed to go higher, maybe all of those companies happened to be poor quality, maybe the rise of ESG has disproportionately punished the sector, maybe the hurdle of strong tech stocks is too high, or maybe it just needs more time. Either way it is one in the "yet to happen" pile. (22 Feb 2019)

"Should the bullish scenario play through for oil, energy stocks could be a key beneficiary after lagging substantially, and trading to still quite low absolute and relative valuations."



6. The value of value stocks: many similarities to the previous one, value stocks failed to gain the upper hand against growth stocks, albeit you could say there was at least a shot across the bows with the momentum meltdown. Not to be discouraged, I've got another chart on this in the ones to watch for 2020 section later in this report as some macro catalysts loom. (1 Mar 2019)

"value is cheaper than usual vs growth (or said differently, the most expensive stocks are trading more expensively than usual compared to the bottom end of town). It could take time, but logic says this tilts the odds in favour of value outperforming growth"

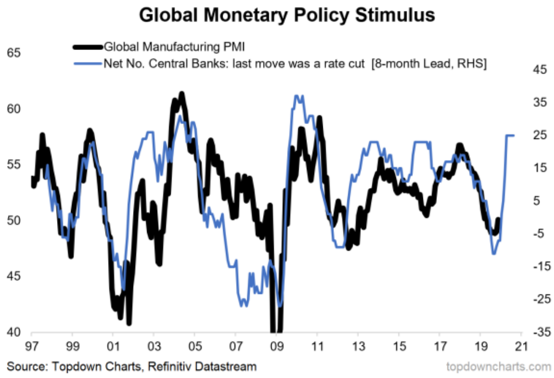


Section C. My Favourite Charts

These are some of my favourites – mostly ones I simply enjoyed coming up with (some of my favourite moments are designing a new chart/indicator which brings a completely new perspective or insight).

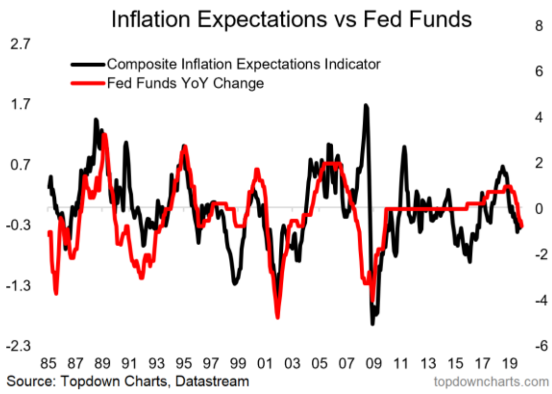
1. One that quickly became (in)famous (especially given the prevailing sentiment at the time). Time will tell whether it will be one for section A or B in next year's End of Year Special! (30 Aug 2019)

"the net number of central banks in rate cut mode against the global manufacturing PMI: it seems to operate with about an 8-month lead; not a perfect track record but pretty good, and it's pointing to a decent rebound later this year/early next year."



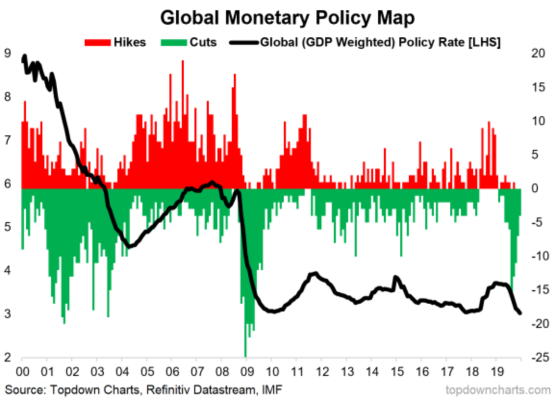
2. This was one of the new sets of indicators I built this year, and one of the first insights it helped generate was presenting a harbinger that the Fed needed to pivot back to rate cuts given the collapse in inflation expectations. (29 Mar 2019)

"Looking at the all-indicators composite inflation expectations indicator, it seems to line up fairly well with the direction of the Fed funds rate (YoY change), thus the easing in inflation expectations arguably justifies a more dovish stance."



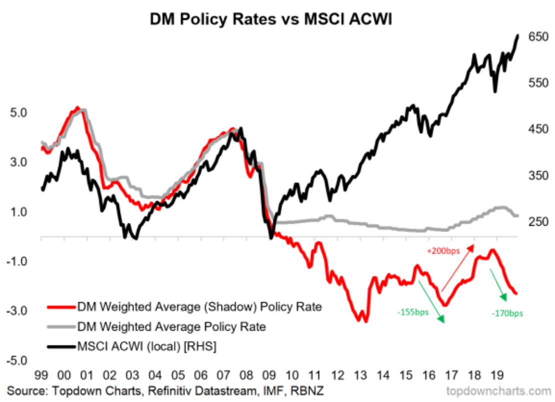
3. The Global Monetary Policy Pivot: this chart remains one of my favourites, and was a feature in last year's End of Year report as it helped pick up on the mass migration of central banks to tightening – which as it turns out in hindsight was probably a mistake. (1 Mar 2019)

"As promised, the global monetary policy map chart is going to be a regular feature this year. Predictably, after 9 months of exclusive hikes and no cuts by the 37 central banks we track, February brought a return of the cuts, and a fair dealing of dovish declarations - hinting that this could just be the start of a wider pivot in policy"



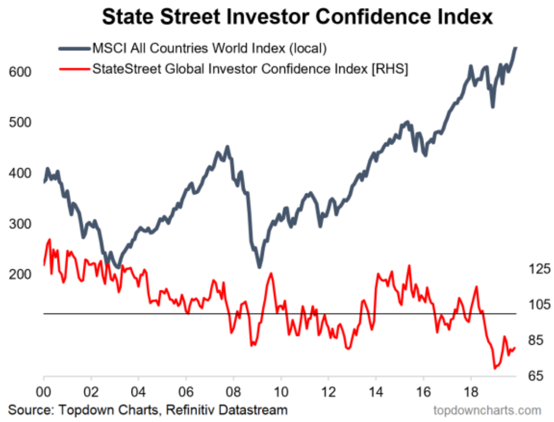
4. Another monetary policy chart, this one tracks the weighted average policy rate for DM central banks, but uses "shadow rates" (which factor in the impact of QE). The shadow composite tells a bit more than the headline rates. (31 May 2019)

"looking at the developed markets composite policy rate with shadow rates subbed in the weighted average policy rate has fallen [170] bps from the previous high (this followed 200 bps of effective tightening by DM banks). Interestingly, it declined by 155 bps in the wake of the 2015/16 corrections - which you could argue helped pave the way for the echo bull market of 2016/17. Further easing and follow-through on the policy pivot will be helpful for risk assets,"



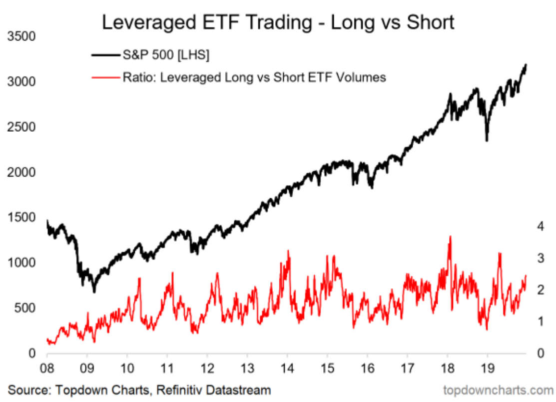
5. This one was useful both initially in terms of helping confirm the bottom in global equities, but also subsequently in showing how institutional investors basically sold the bottom, sold the rebound, and remained underweight. It's one of the reasons why I remarked that a lot of investors were offside to my 2020 global economic rebound thesis (which I developed later in the year, but before the October breakout). (1 Feb 2019)

"As you can see with the chart, the global (investor confidence) index dropped to a record low which indicates massive de-risking"



6. Another relatively new addition to the stable of charts, a tracker of leveraged ETF trading volumes, this one yields quite interesting tactical (contrarian) insights at extremes e.g. around the Dec/Jan market lows, and subsequent rebound. As you might guess it's shot up again recently… (25 Jan 2019)

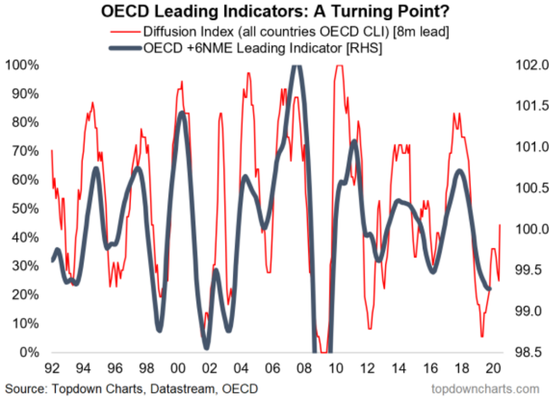
"On trading action, we can see the ratio of levered long vs short ETF value-traded (basically a gauge of demand for leveraged long relative to leveraged short product) plunged to multi-year lows around the market bottom (in contrast to a record high in Jan 2018 …if only I had this chart back then!)"



Section D. Charts to Watch in 2020

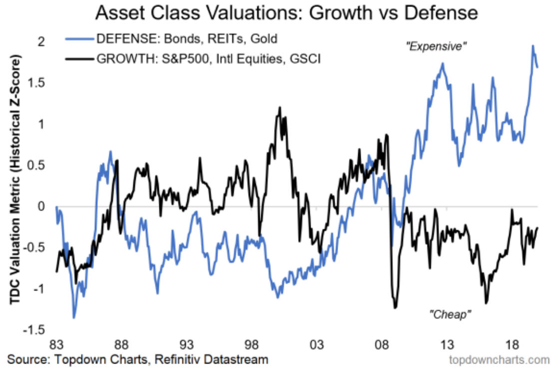
As interesting and sometimes amusing as it is to look back, as investors we get paid for looking forward, and there's a few existing trends and themes that will remain front of mind and be key to keep on the radar in 2020. Following is a selection of the key charts and indicators I will be watching in the new year.

1. A turning point in the global economic cycle: 2019 basically saw a global manufacturing and export recession. Yes Recession. I have a growing list of leading indicators pointing to a recovery in 2020, and the below is one of them. The diffusion index of OECD leading indicators has made a clear turnaround after reaching a decade low. I will be watching for a turn up in the main global indicator (and for the diffusion index to continue to edge higher/stay higher).

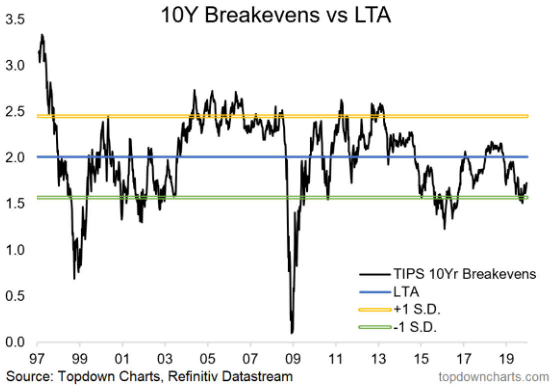


2. A big part of the 2020 recovery thesis is the global monetary policy pivot. Not many have noticed, but EM have been particularly aggressive in easing policy (and they have the most traditional policy ammunition). Given some of the cycle indicators have already begun to stabilize for EM I have a stronger degree of confidence that we will see a cyclical upturn across emerging economies in the coming months and quarters.

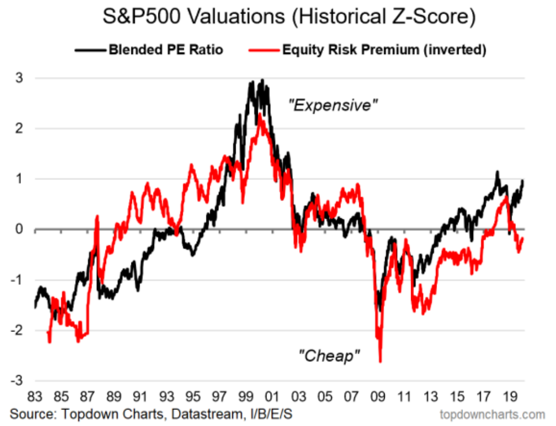
3. Growth Assets vs Defensive Assets: says it all in terms of where investors have been positioned, and it tells you that defensive assets may not necessarily be "safe" given such expensive valuations. Indeed, a global economic rebound could well make defensive assets a source of risk, rather than a hedge of risk.



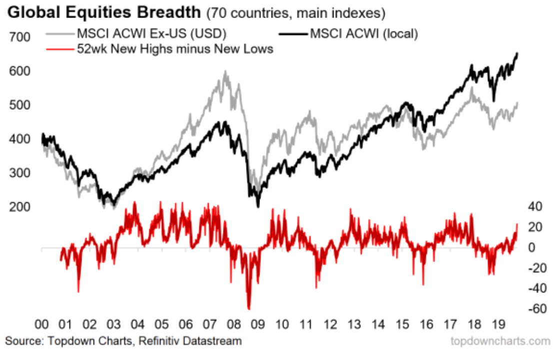
3. TIPS breakevens look cheap, and should rebound if we get better growth. This will also tend to put upward pressure on bond yields (i.e. nominal yield = real yield + inflation expectations).



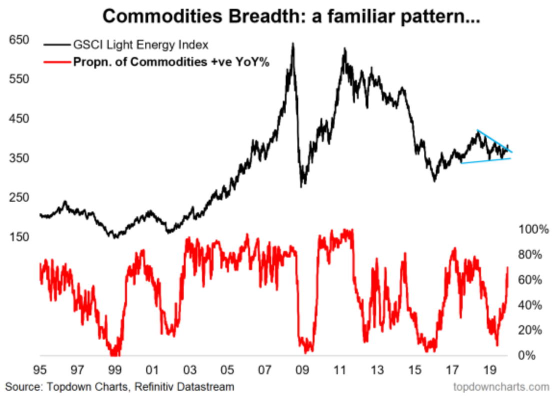
5. The downside of higher yields is that all else equal it will squeeze the ERP, which in contrast to absolute valuations, still looks cheap/attractive.



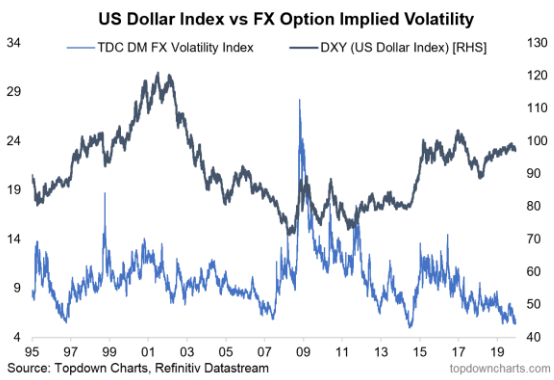
6. As for Global Equities, it looks like we're in a new cyclical bull market (based on a fairly familiar and reliable global equity market breadth signal).



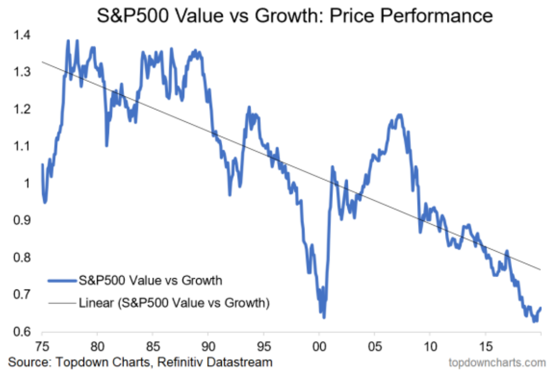
7. Commodities (at an asset class level) have also seen a familiar market breadth pattern emerge, which points to a cyclical bull market (lines up with relatively light positioning, cheap valuations, and a prospective better macro backdrop).



8. One key piece of the puzzle for commodities is the US dollar, and while I continue to maintain a bearish bias there, one thing I am very mindful of is the crunch in FX volatility. Typically crunches in volatility like this tend to be resolved in a violent fashion: that is, it could be a harbinger of a large/rapid move (agnostic of direction). So, will 2020 bring a return of volatility for the US dollar?



9. Value vs Growth: the investment strategy graveyard is littered with failed calls for a turnaround in the performance of value vs growth stocks. But I think we could be close to the much awaited and much forecast turning point. Relative value between the two cohorts is at the lowest point in 20 years, and in terms of macro catalysts, higher bond yields, better growth, and higher commodity prices will help the sectors that are slightly over-represented in value vs growth.

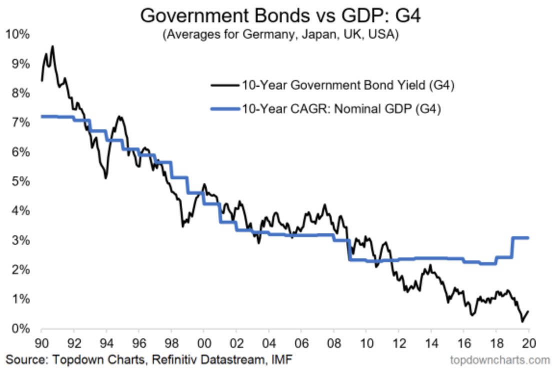


10. Last but not least, this chart shows Chinese property price growth vs China A-shares. It's a useful chart for China watchers and global investors in general, but it's of particular interest now because property price growth is rolling over, and that could be good news for China A-shares. Because the marginal speculative investment dollar in China is basically trapped in the country, you tend to see this succession of chasing one hot asset after another. Thus, we could start to see a rotation effect between property and stocks in China, and that (along with cheap valuations, easier monetary policy, better global growth, and a trade deal/truce) could drive a potentially explosive new bull market in China A-shares.

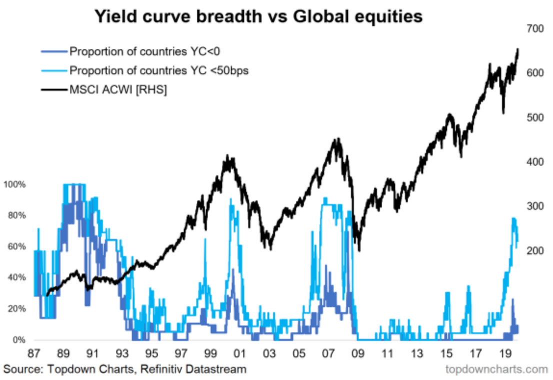
Section E. Honourable Mentions

Those charts worthy of mention but not quite fitting in the previous categories.

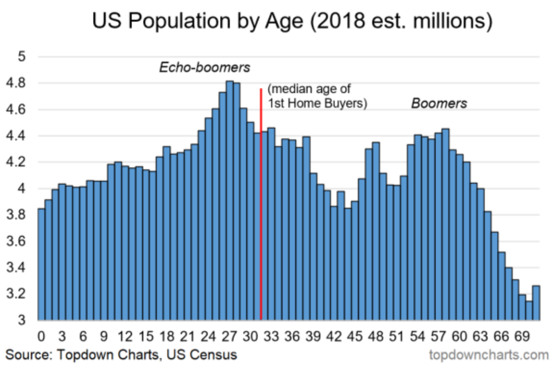
1. DM bond yields look low relative to nominal growth (n.b. GDP would need to fall 20% in one year to close that gap – my guess is it's *not* GDP that does the heavy lifting to close this gap…).



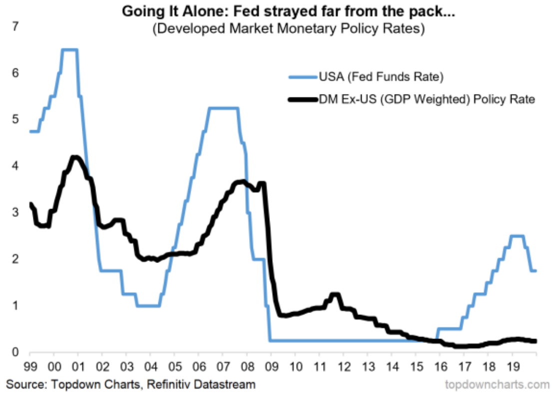
2. As bullish as I am on global growth and risk assets, this chart does make me wonder. But then again, maybe it actually *is* different this time.



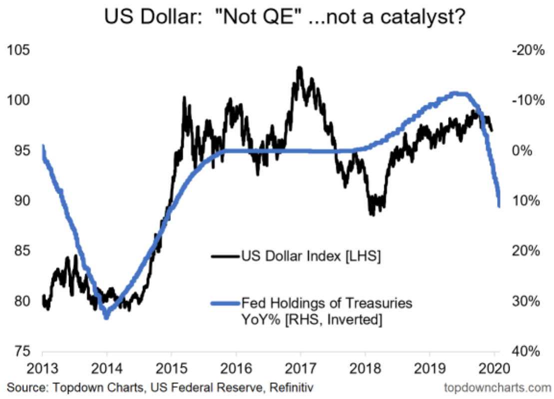
3. OK (echo)Boomer: usually demographics are the domain of the bears, but here's a bullish story: the first wave of echo-boomers (kids of Boomers) are about to reach prime first-home-buying age.



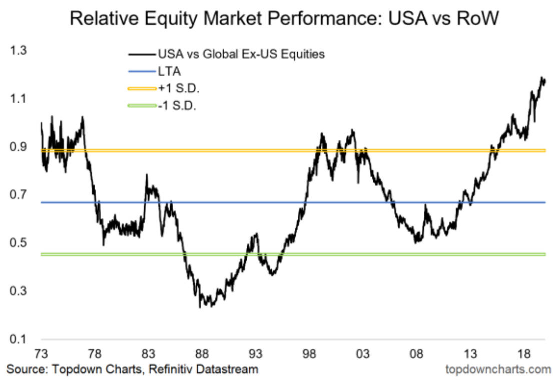
4. Arguably the Fed strayed too far from the pack with its 2017/18 rate hiking cycle. It now has the most room to move, and given the importance of relative yields for exchange rates, this could have key (bearish) implications for the US dollar.



5. We are told it's "not QE", so it makes you think: is it also *not* a catalyst to a weaker US dollar…?



6. While it tends to take a few years to fully turn the corner, a possible weaker US dollar would help get things moving in the USA vs RoW equities relative performance line. Global ex-US are cheaper, and have materially higher medium term expected returns. You tend to see circa 10-year cycles of relative performance, and we just reached the end of another one of those cycles.

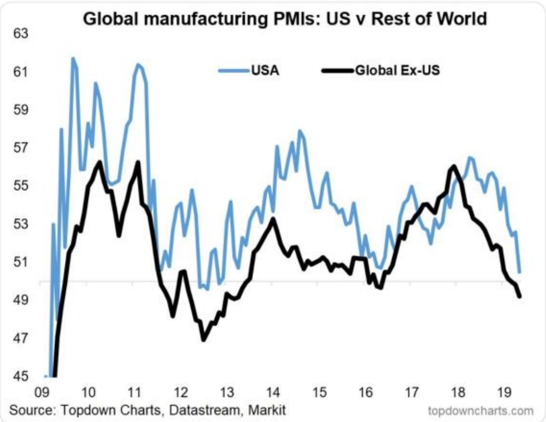


Section F. People's Choice Charts

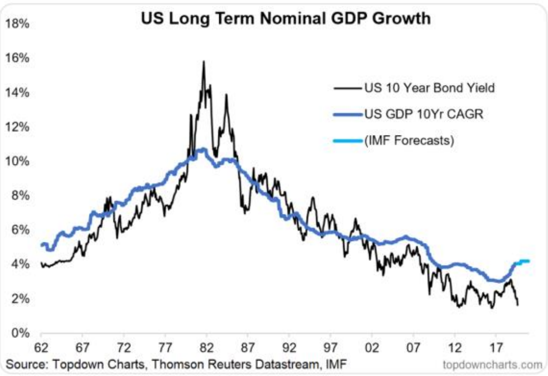
In this section I defer to our followers on Twitter (@topdowncharts) for the most popular charts based on views and engagement. These charts are not updated to the latest in contrast to those in the previous sections (helps explain why folk were so interested in them at the time – as always, just email me if you want to see any of these or others updated, or if you had any questions in general).

P.S. be sure to follow us on Twitter and let me know if you ever want a shout out or retweet for your business

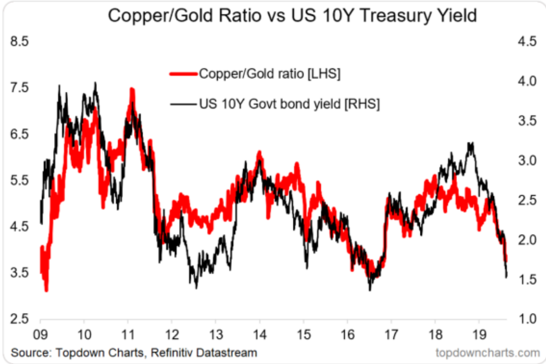
1. Manufacturing PMIs -- USA vs the Rest of the World: "So, I guess now we have the answer as to whether the US can go it alone..."



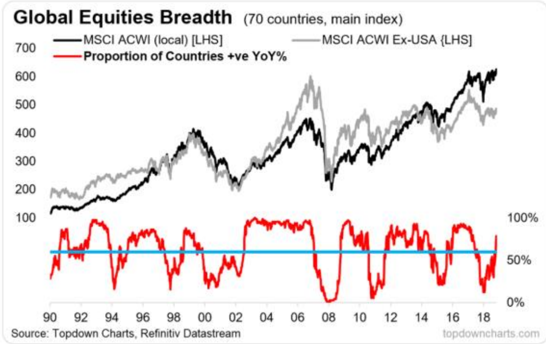
2. This one rattled some cages, it was close to the bottom in yields when I tweeted it out, and on my personal account I quote-tweeted "Bonds are overvalued." – the amount of abuse and pushback I received (in hindsight) was really informative. It's not the first time I've received really important sentiment type information from Twitter, indeed with the following I have I can usually get a fairly good feel for where the market is positioned.



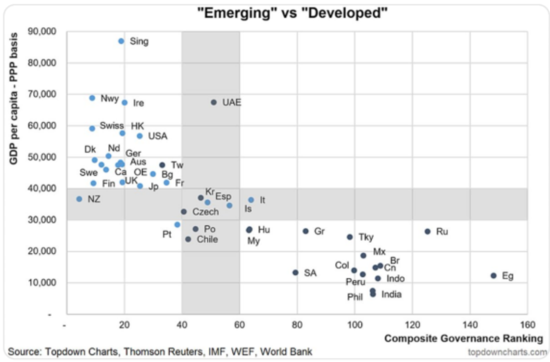
3. There wasn't actually that much controversy around this one, but about a couple of weeks after I put it out the Copper/Gold ratio actually bottomed along with bond yields.



4. "Global Equities: The New Bull Market". As noted in section D, it looks like a new cyclical bull market is underway. Folk liked this idea.



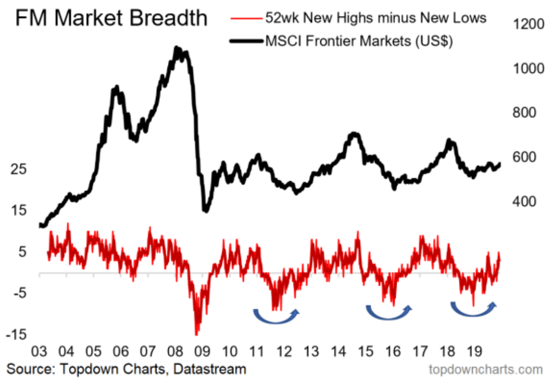
5. EM vs DM: "Useful visual for when people ask about the difference between developed vs emerging markets". Quite an interesting chart which makes use of my composite country governance ranking indicators.



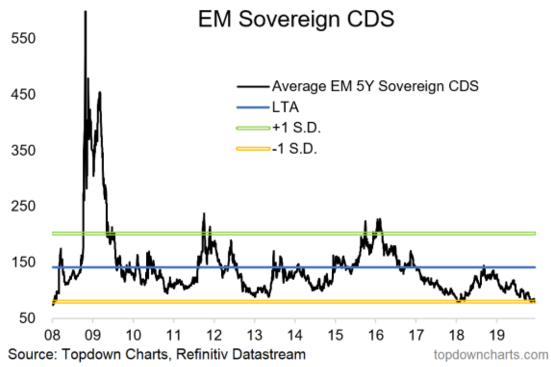
Section G. New Coverage

This section provides a brief look at some of the new areas of coverage initiated over the year.

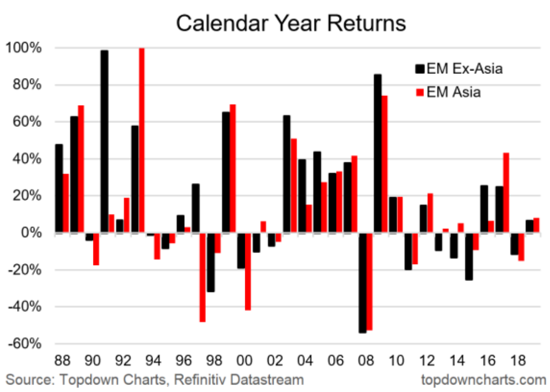
1. Frontier Markets: as part of including frontier market equities in the Capital Market Assumptions, the initial indicator build-out included this interesting breadth chart below which has a rather familiar pattern showing up.



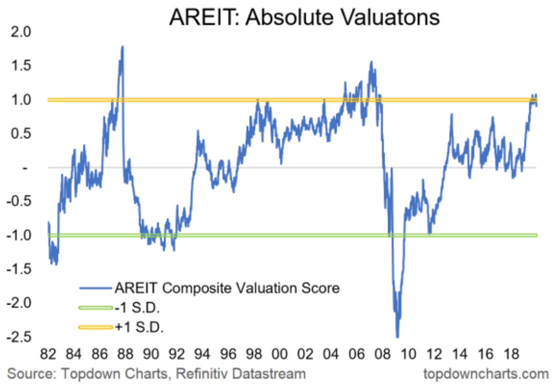
2. EM Sovereign Bonds: interesting to see how EM sovereign risk pricing has relaxed, a lot.



3. EM Ex-Asia Equities: here's a bit of visibility on the swings in relative performance within EM.

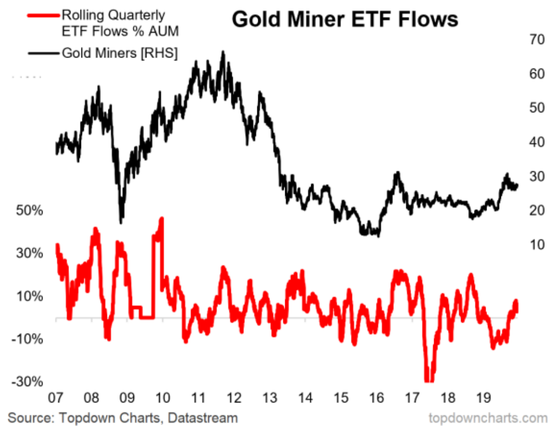


4. A-REITS: (Australian REITs – for my Aussie & Kiwi clients); expensive like their global peers.



5. Global Shipping Stocks: pure-play shipping stock index is pricing in a rebound in global trade.

6. Gold Miners: for a brief moment there, gold miners were a contrarian play (given ETF flows).



Report by Callum Thomas, Head of Research at Topdown Charts

About Topdown Charts

Topdown Charts provides chart-driven research across a global multi-asset universe. The key offering is the Weekly Macro Themes report which has been designed specifically for multi-asset portfolio managers, active asset allocators, and macro-driven fund managers. The perspective is that of a buyside strategist and the key deliverables of the report are: investment idea generation, top-down global macro insights, risk management input, and asset allocation research.

Research Process and Framework

Research Process

Valuation

Valuation as a common anchor in the thesis
- Identify and develop valuation indicators
- Monitor for extremes (where the best opportunities are found)
- Explore the relative value case (no asset exists in a vacuum)

Cycle

Cycles are a constant across time and markets
- Identify the core cyclical/monetary drivers for the asset class
- Develop and monitor indicators and key data points
- Clarify how asset prices evolve across the cycle

Tactics

Round out the idea with tactical guidance
- Tactical indicators aid in idea generation + implementation
- Apply disciplined and sensible technical analysis techniques
- Look for extremes in sentiment, flows, and positioning

Key Beliefs

- Risk = owning an asset which is overvalued, overowned, overbought and out of time.
- Risk also = underexposed to assets which are undervalued, unloved, oversold, and turning around.
- See things as they are: avoid forecasting, be data-driven yet be unapologetically forward looking.
- Must define/frame key risks and drivers for a given asset class.
- Know what indicators/charts to watch and monitor (and strive for constant innovation/improvement).
- Aim = put the odds in your favour.

Key Objectives and Scope of Research

Really there are 3 key objectives that we aim to deliver: **risk management input** (investors tend to disproportionately punish permanent loss of capital vs rewarding exceptional performance), **idea generation** (but exceptional performance is still critical!), and help our clients **gain perspective** (which not only helps them in managing money, but also communicating with their clients and stakeholders).

Risk Management
- Rule 1 of investing: don't lose money.
- What do we need to be paying attention to?

Idea Generation
- Engage multiple factors to find the best ideas.
- Create unfair advantage for our clients through superior research.

Gain Perspective
- Stay focused on the signal, not the noise.
- Inform our clients with cutting-edge studies.

Investment Universe

Equities
- ❑ Regions/Countries
- ❑ Sectors/Industries
- ❑ Styles/Factors

Alternatives
- ❑ Commodities
- ❑ Currencies
- ❑ REITs, MLPs

Fixed Income
- ❑ Government bonds
- ❑ Corporate credit
- ❑ Inflation linked

Topdown Charts -- What we do:

We work with portfolio managers to help make their job easier. The aim is to make the service look and feel like having an extra investment strategist on the team.

Core Institutional Service

The core institutional service is aimed at multi-asset portfolio managers and investors requiring top-down input in their process: who want something a little bit different, and share a similar philosophy and affinity for our chart-driven research approach.

The core service includes:

-Regular research reports (see below for a full listing)

-Help with questions and requests (either about the reports or in general)

-Use of the charts (e.g. in your own reports and presentations)

The Reports

Weekly Macro Themes: Core report, featuring 5 ideas/topics each week spanning investment ideas, risk management input, and meaningful macro insights.

Global Cross Asset Market Monitor: Key developments across the major asset classes and markets, a chart/focus of the week, pack of standardized charts.

Monthly Chartbook: Contains a summary of key views (short & medium-longer term) across asset classes, how that maps to a model TAA guide, collation of the most important charts for active multi-asset investors, and capital market assumptions.