TOP DOWN CHARTS

Chart driven macro insights for investors

Weekly Macro Themes – 21 January 2022 - Volume 7, Edition 1

From the top down, here's the bottom lines:

1. Growth Scare: The global growth scare scenario is a credible and pressing risk this year.

2. China Macro: The PBOC is pivoting to stimulus as inflation tapers and the property downturn worsens.

3. EM vs DM: Bullish on EM equities in 2022 following the bashing in 2021.

4. EMFX: Bullish EMFX on cheap valuations, supportive macro, and much improved technicals.

5. EM Fixed Income: Bullish EM sovereign bonds given attractive absolute & relative valuations, positive expected real returns, and a supportive tactical setup (sentiment & technicals).

1. Growth Scare

TOP DOWN CHARTS

1. Growth Scare: multiple indicators point to a global growth slowdown

- The global policy pivot to tightening that kicked off last year has meant a transition for monetary policy from tailwind to headwind for growth.
- Pricing pressures logically lead to growth challenges by either choking-off demand, or spurring tighter monetary policy and higher bond yields.
- The lift in bond yields (borrowing costs) has already been substantial, e.g. US mortgage servicing cost indicator has gone up 45%.
- Global OECD leading indicators point to a loss of momentum.
- Tightening monetary conditions in EM and negative China credit impulse also reinforce the idea at a global level.
- Ultimately it is a test to see if the economy can stand on its own two feet after a stimulus driven rebound.
- Base case is that this is more of a mid-cycle slowdown and growth scare rather than the beginning of a full-blown recession – there are too many sources of upside e.g. capex/consumer/reopening.

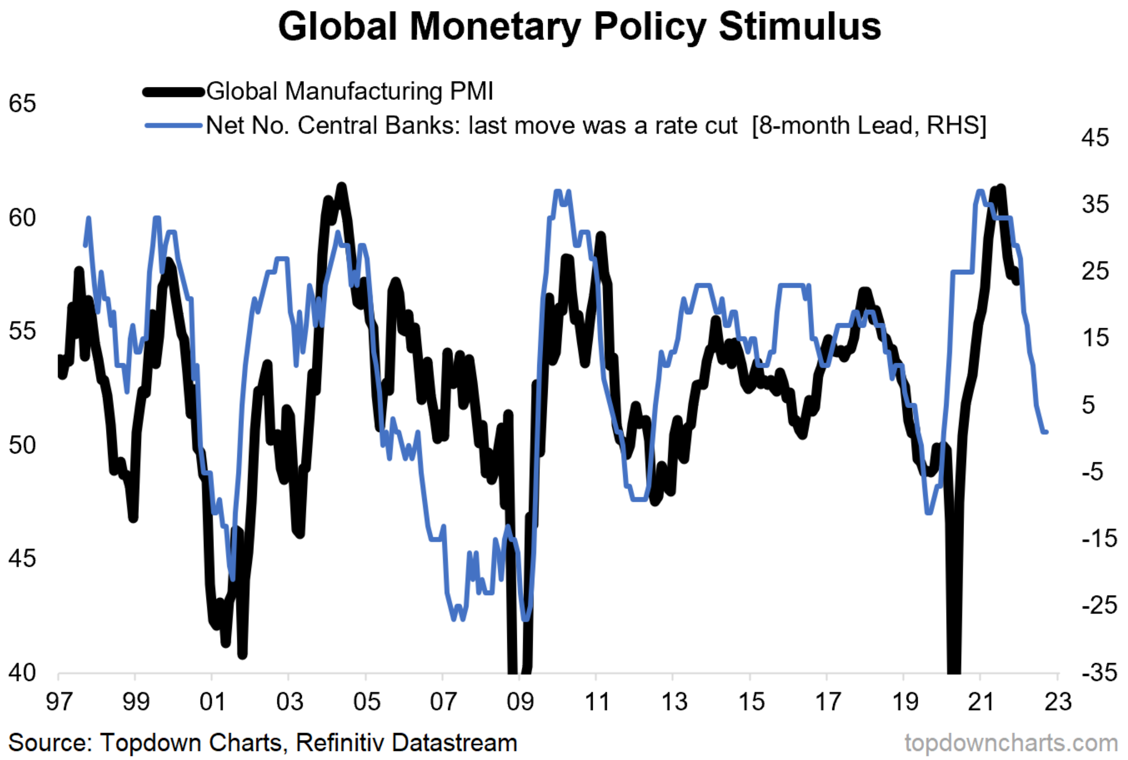
Bottom line: The global growth scare scenario is a credible and pressing risk this year.

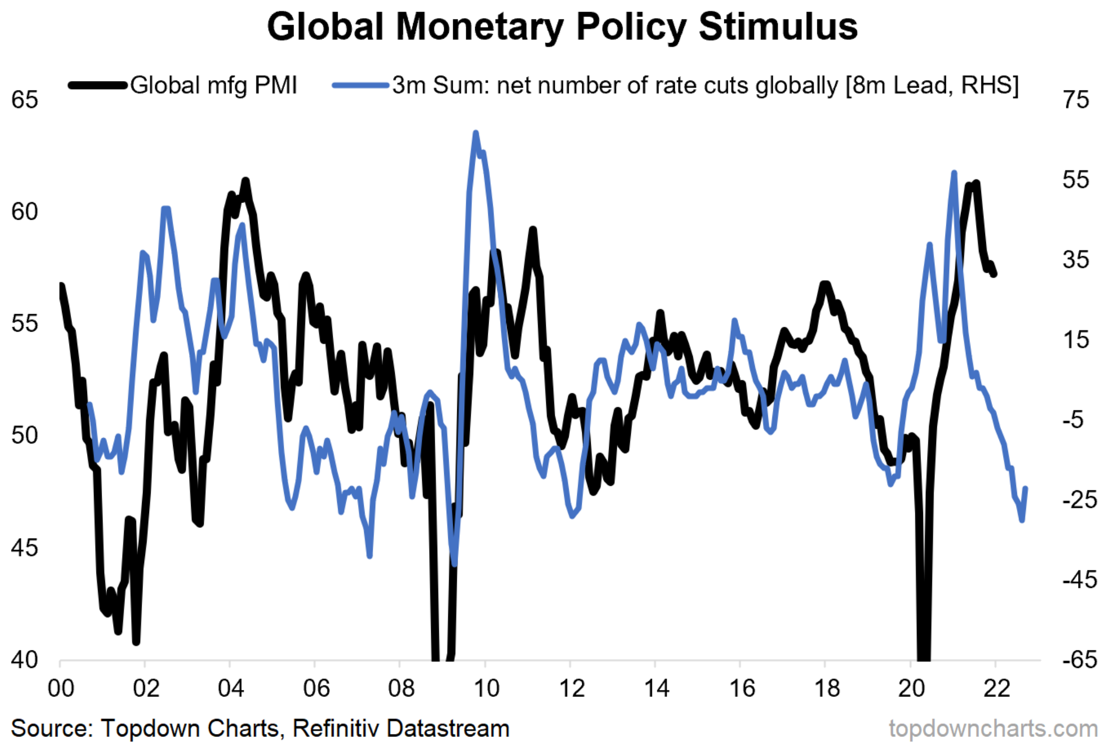
1. Growth Scare

TOP DOWN CHARTS

NOTE: in case you were wondering, I'm going to cover the current stock market correction that's underway in the Monday Markets Monitor once I get a bit more detail and data over the weekend.

But as for now, let's explore the "Growth Scare" scenario from the quarterly pack in a bit more detail. At a high level, the idea is that a bunch of leading indicators are pointing to a slowdown. First set of charts is the monetary policy trackers – the global policy pivot which I documented at length last year, as a minimum means less of a tailwind to growth, and ultimately tightening.

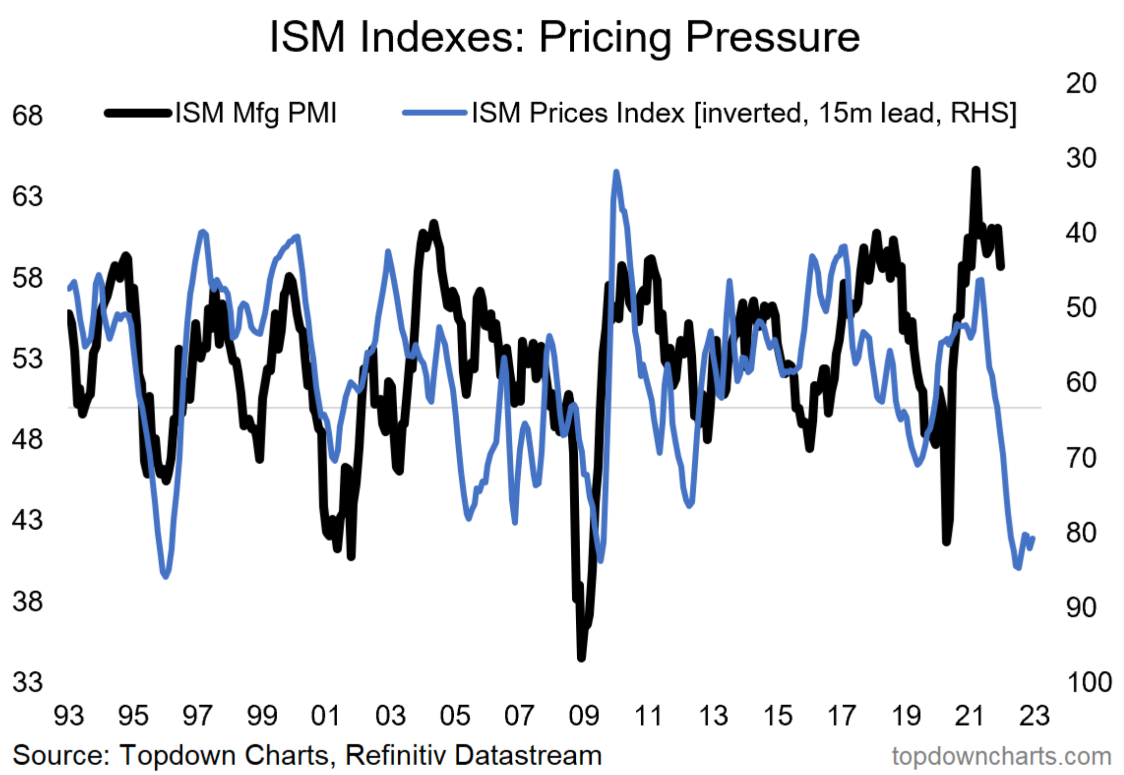


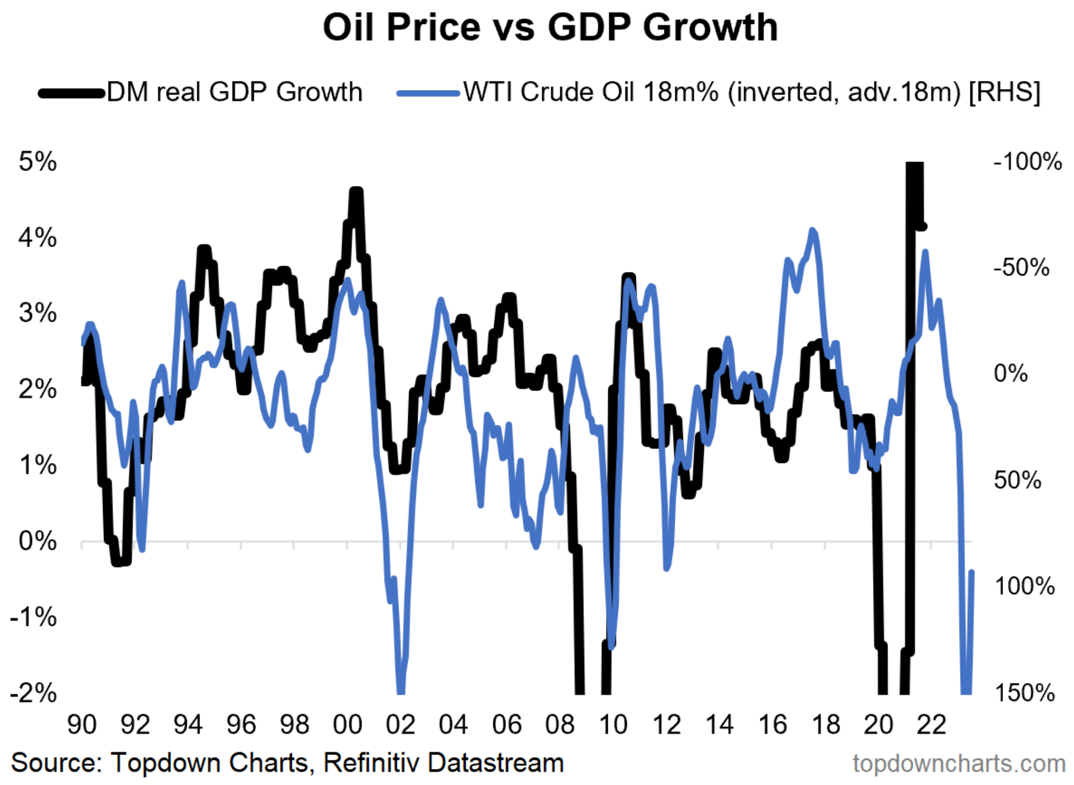


1. Growth Scare

TOP DOWN CHARTS

Closely tied up with the policy picture is pricing pressure. The path of the prices index in the PMIs and the 18m rate of change in crude oil prices suggest a dip in growth. The logic is that at a certain point if price rises become particularly acute then it can choke-off demand. But it's also closely linked with the previous 2 charts and the next 2 charts in that pricing pressures typically also mean tighter monetary policy and higher bond yields – clear headwinds to growth.

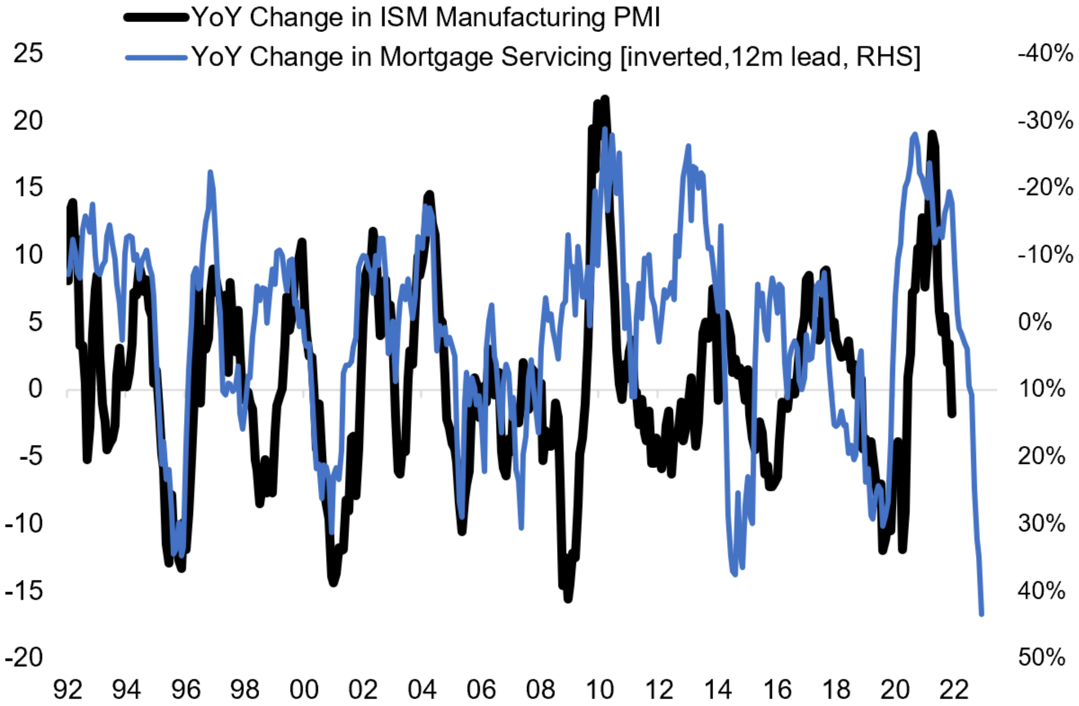




1. Growth Scare

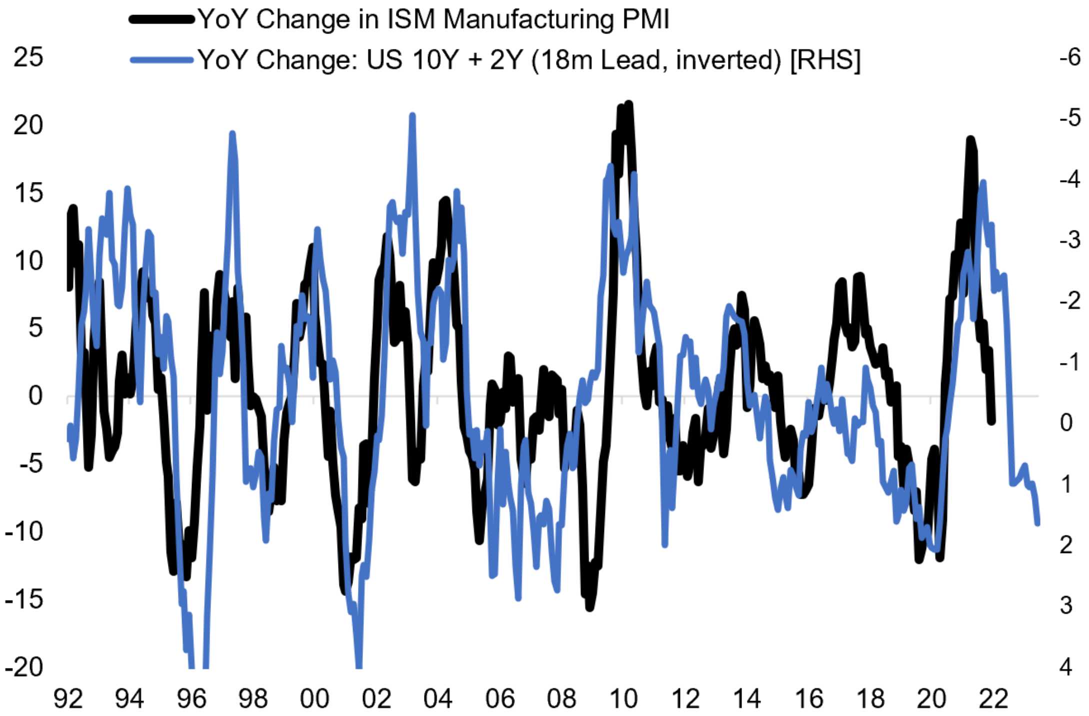
Indeed, if we look at how mortgage rates have come up (FHA effective mortgage rate at 3.77% vs the low of 2.98% early last year), along with surging house prices means the indicative mortgage servicing cost indicator has gone up 45% (!!). But it's not just housing, if we look at the rate of change in treasury yields we can deduce that already there has been a material uplift in funding costs basically across the board in so far as most rates price off treasuries + a premium.

Shifts in Borrowing Costs



Source: Topdown Charts, Refinitiv Datastream topdowncharts.com

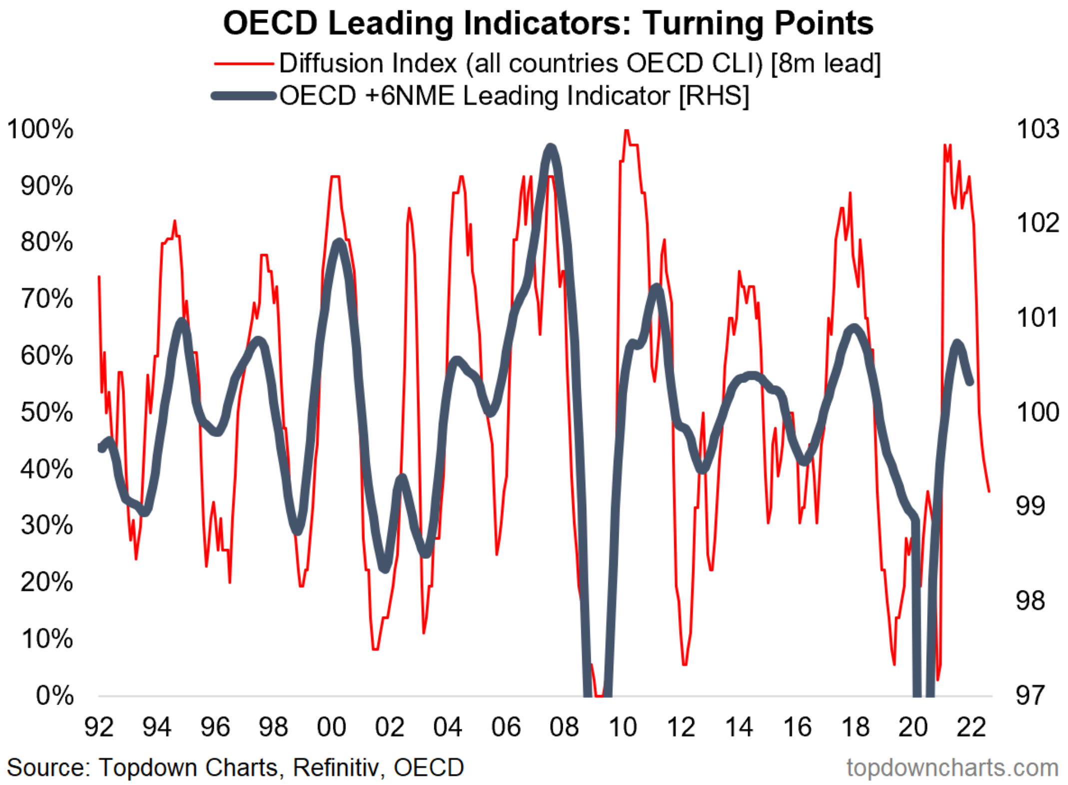
Bond yields set to become a headwind

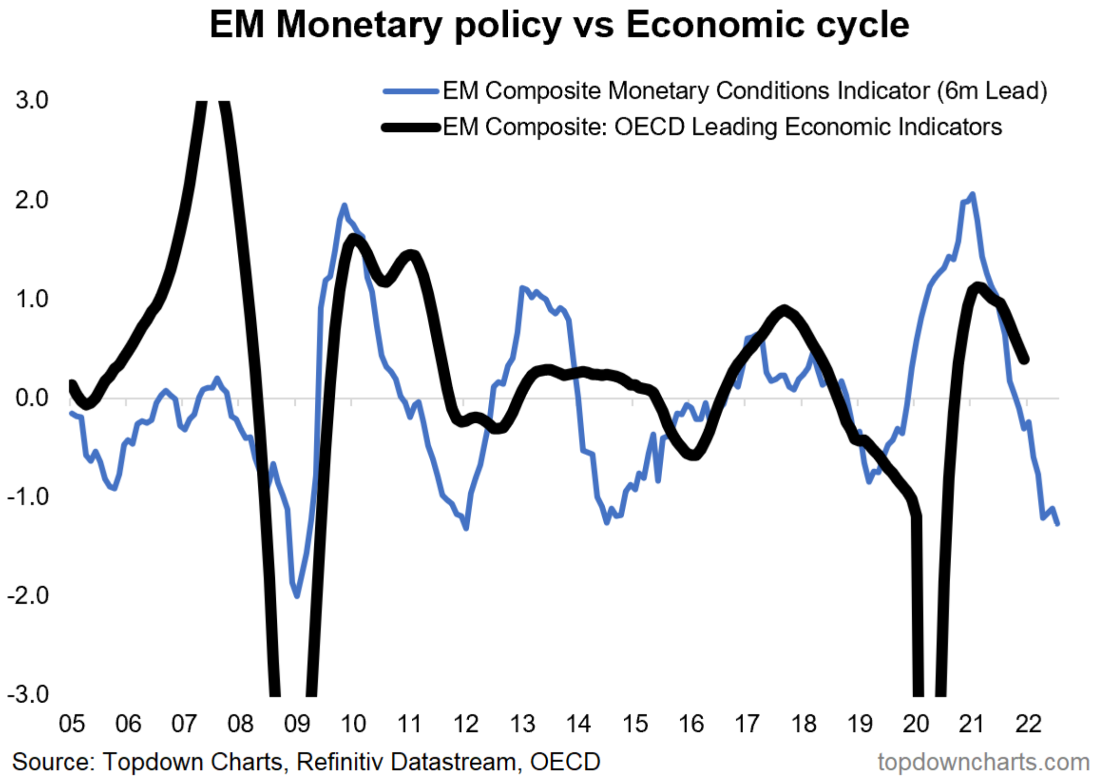


Source: Topdown Charts, Refinitiv Datastream topdowncharts.com

1. Growth Scare

Meanwhile elsewhere my somewhat odd indicator (you saw it here first), the diffusion index of all of the countries the OECD calculates its composite leading indicators for, is pointing to a loss of momentum in the recovery. At the moment my base case is that this is more of a mid-cycle slowdown and growth scare rather than the beginning of a recession – there are too many sources of upside e.g. capex/consumer/reopening. But as we also see with the tightening of monetary conditions in EM, there are a lot of pieces of evidence pointing to a drop-off in growth.

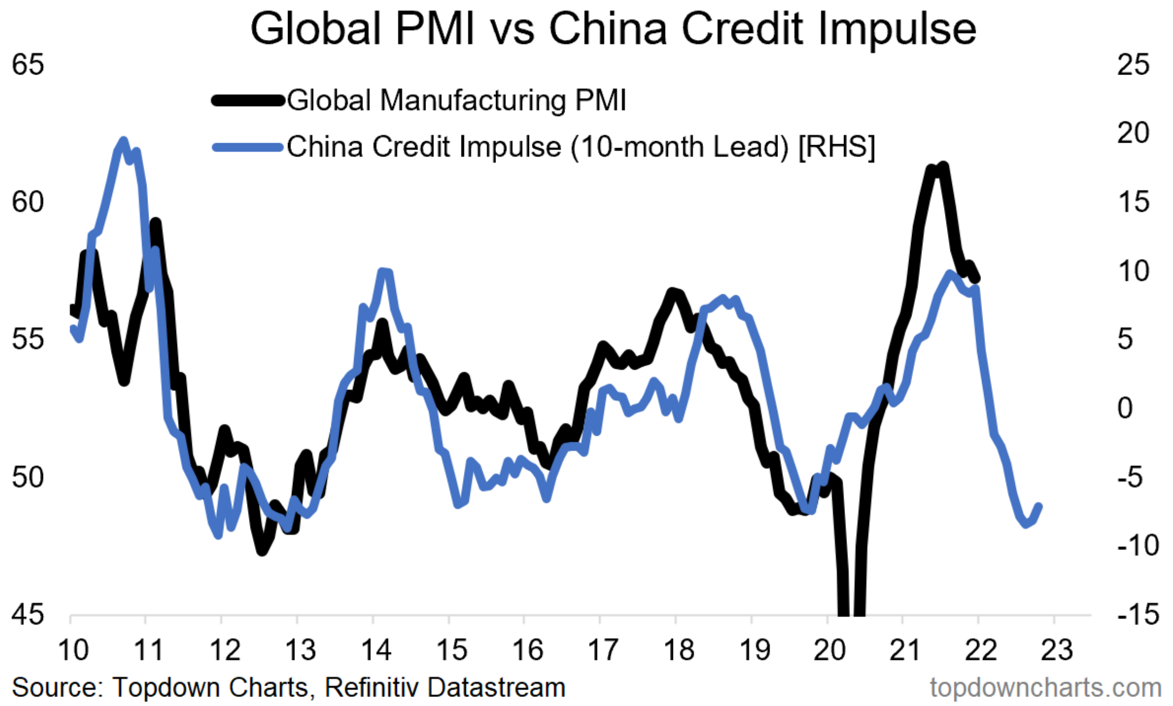


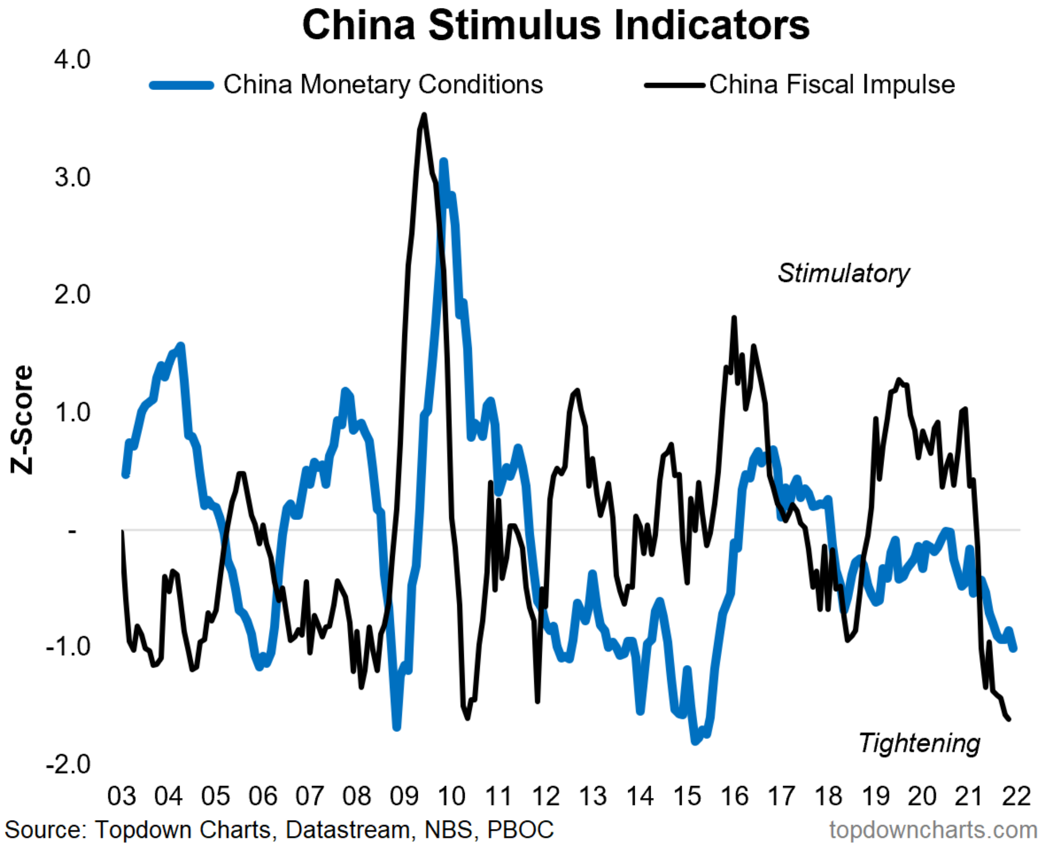


1. Growth Scare

TOP DOWN CHARTS

Lastly, the China credit impulse has been another widely talked about indicator pointing to a prospective global growth slowdown. Indeed, looking specifically at China my policy stimulus indicators have been showing both fiscal + monetary policy settings in contractionary mode in China --- hence in that respect it's arguably not as surprising then to see the softening of growth in China and the issues in the property market… and now also a policy pivot to easing. We carry on with this key theme in the next topic…..





2. China Macro

TOP DOWN CHARTS

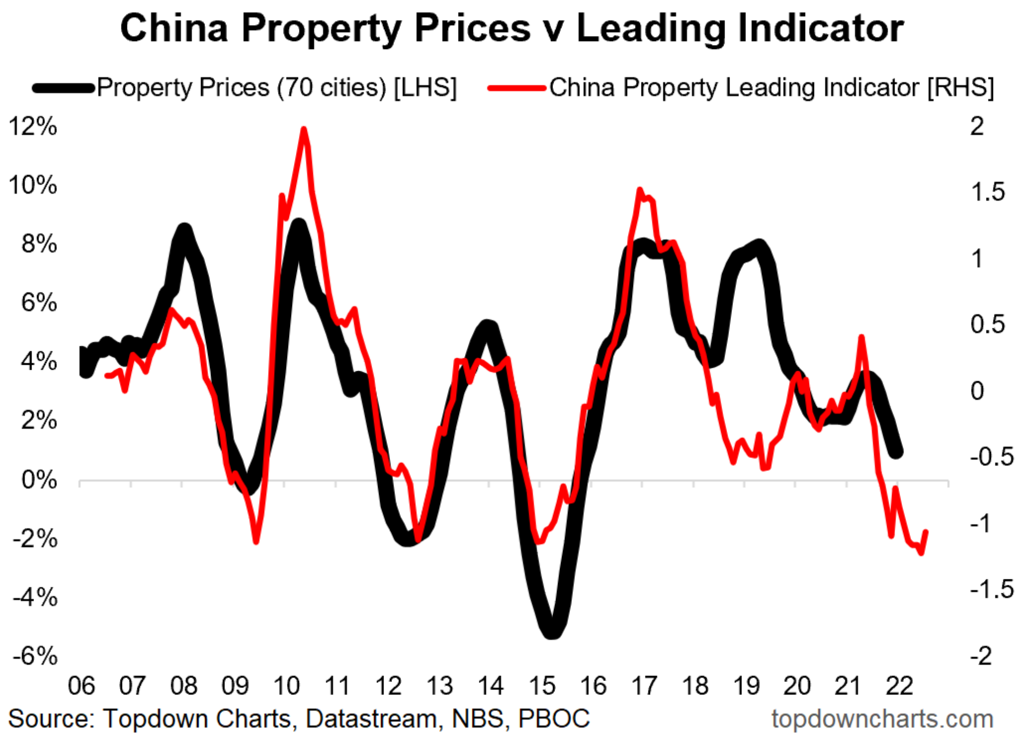
2. China Macro: another policy pivot… but this time to *easing*

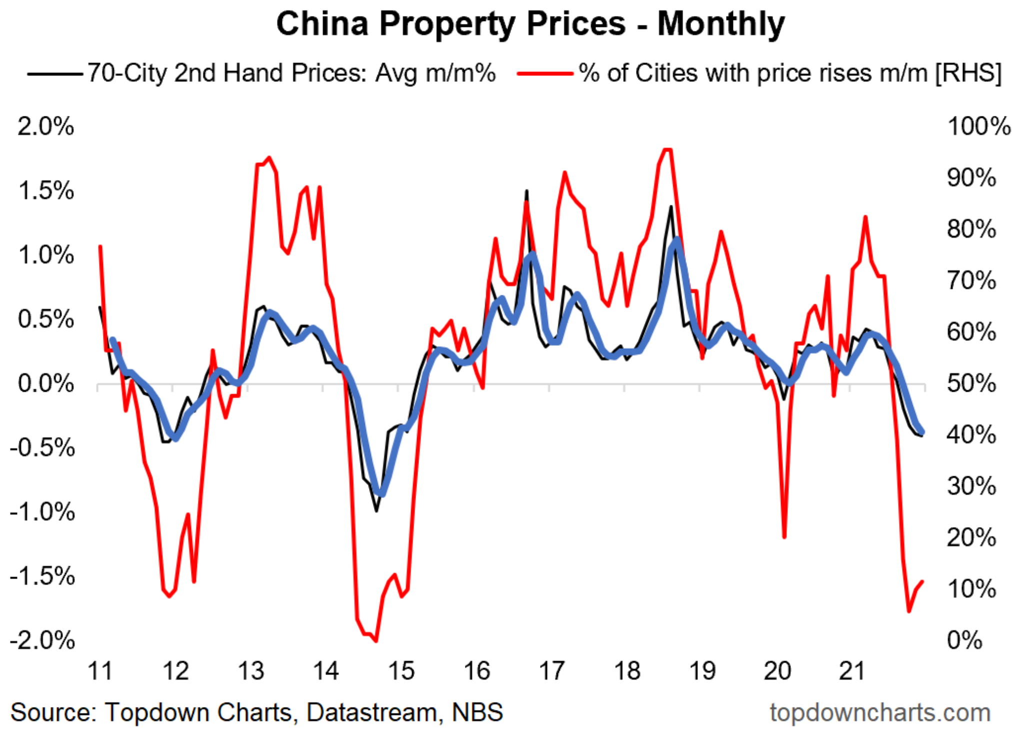
- China's property market downturn worsened into December, and the leading indicator points to things getting worse before it gets better.
- Inflation indicators in China appear to be peaking.
- These facts along with the point that 2022 is a critical political year for Xi Jinping make it clear the path of least resistance for macroeconomic policy is to pivot to easing.
- This is exactly what we've seen: the PBOC followed-up its 5bp cut in December with a 10bp cut this week: small moves yes, but very important signal.
- The pivot to easing should be bullish for China/EM equities and commodities, and likely sees CNY weakness (or at least a pause in its strong run).

Bottom line: The PBOC is pivoting to stimulus on the back of politics, peaking of inflation and a worsening property market downturn.

2. China Macro

The December data showed a worsening of the Chinese property market downturn. Monthly price changes ex-tier 1 were the steepest since the sharp downturn in 2014, and the breadth indicator shows price drops have been widespread across cities. Meanwhile the leading indicator (money supply, bond yields, property sector equities) points to an extension of the downturn at least through the first half of this year.

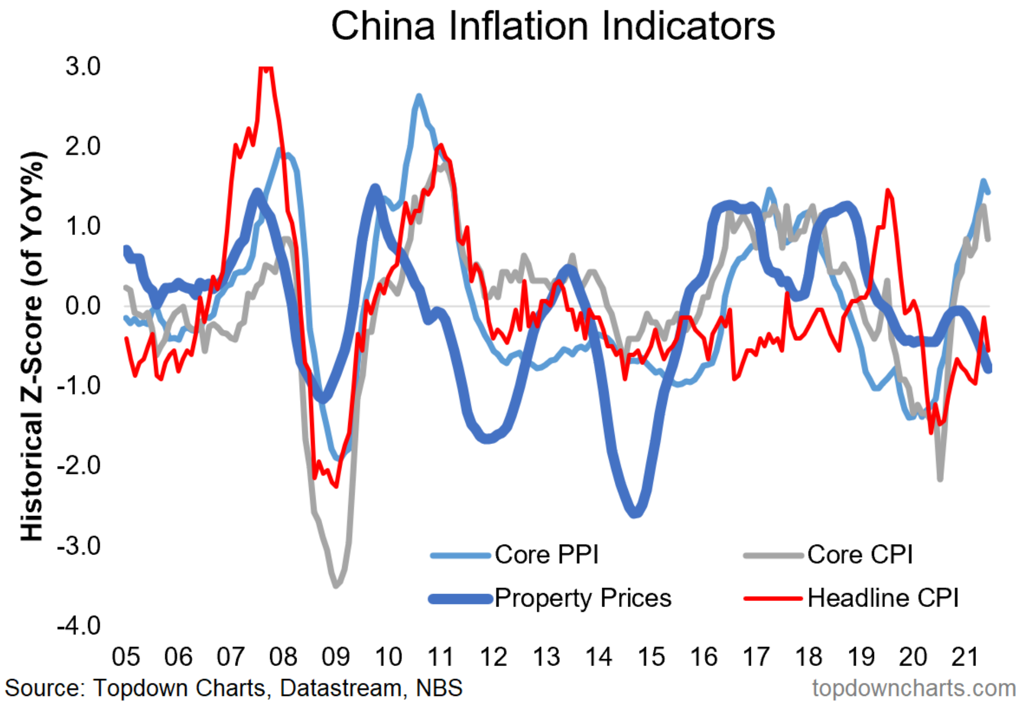


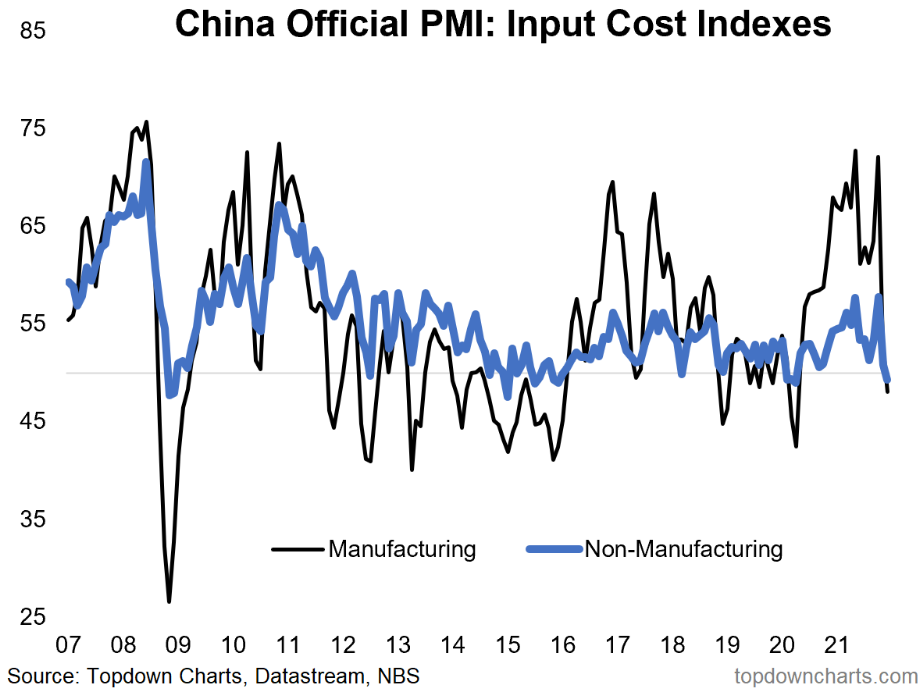


2. China Macro

TOP DOWN CHARTS

Also of significance aside from falling property price inflation, a number of inflation indicators have started to peak in China (i.e. core CPI/PPI), and the input cost indexes of the PMIs have sharply dropped off. So at this point we can observe a potential softening of inflation/pricing pressure, and a worsening property market downturn. Seasoned analysts of China macro policy (or for that matter, macro policy anywhere in the world) will note that this presents the ideal conditions for monetary policy easing... (not to mention: this year is the CCP's 20th Party Congress – effectively the election for the leader, where it is expected that Xi Jinping will secure his 3rd 5-year term – so we should expect policy actions consistent with reinforcing/underpinning growth and stability)

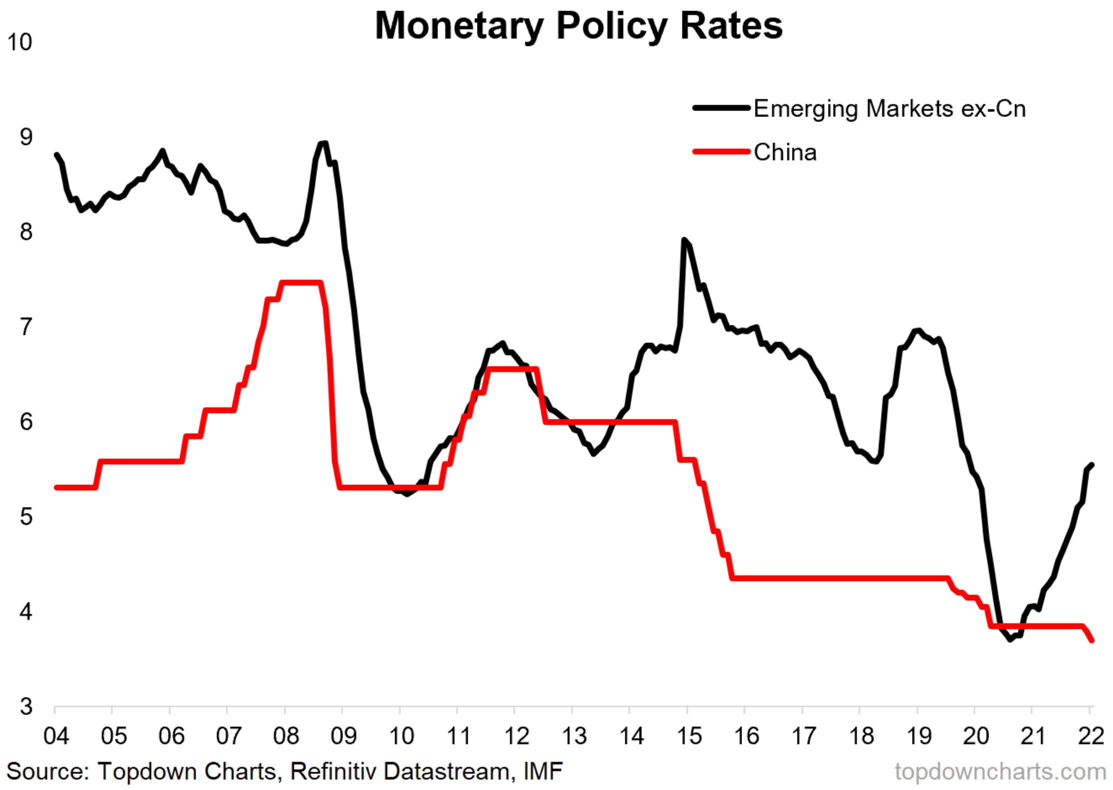




2. China Macro

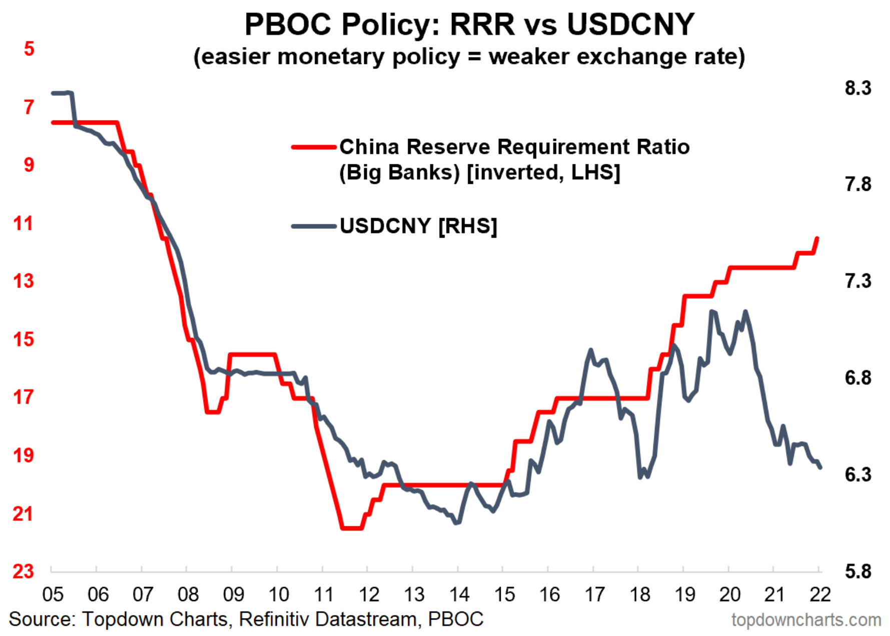
TOP DOWN CHARTS

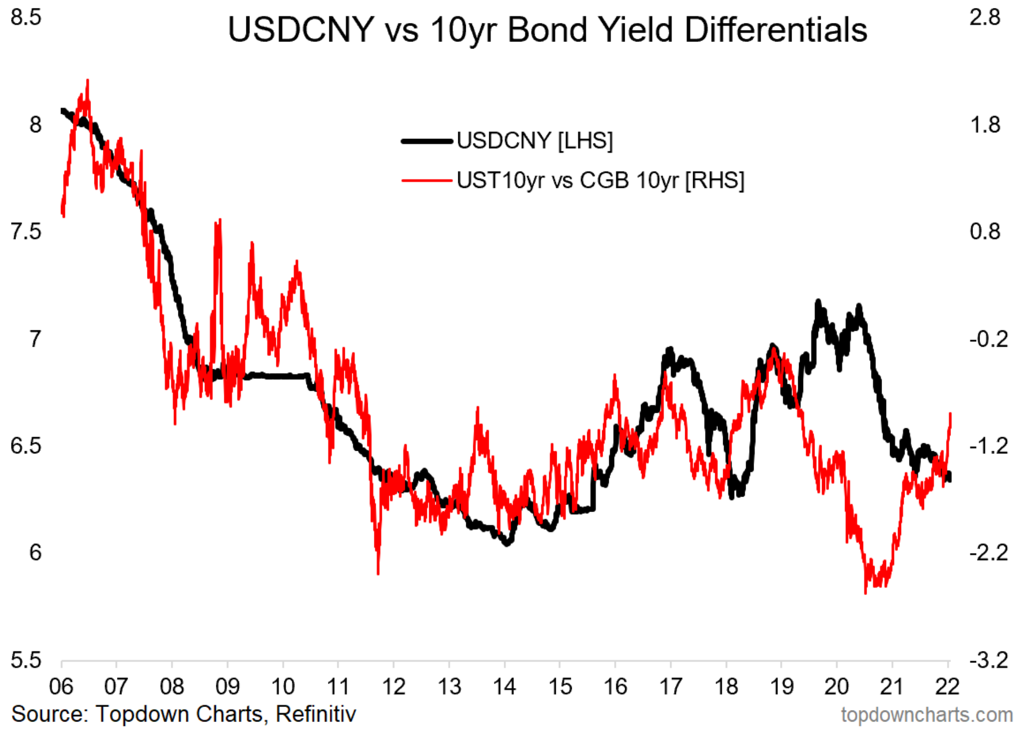
And that's exactly what we're seeing, the PBOC has pivoted from its neutral/hawkish stance (they opted for relative forbearance on stimulus during the pandemic – and in hindsight could afford to do so given the extent of stimulus unleashed around the rest of the world!). This week the PBOC followed-up its 5bp cut in December with a 10bp cut to 3.7%. Small moves, yes, but the signalling aspect is critical. Ironically also it continues the trend of "China zigging while the rest of the world is zagging" e.g. just as the Fed moves to hike rates, the PBOC is kicking of a rate cut cycle.

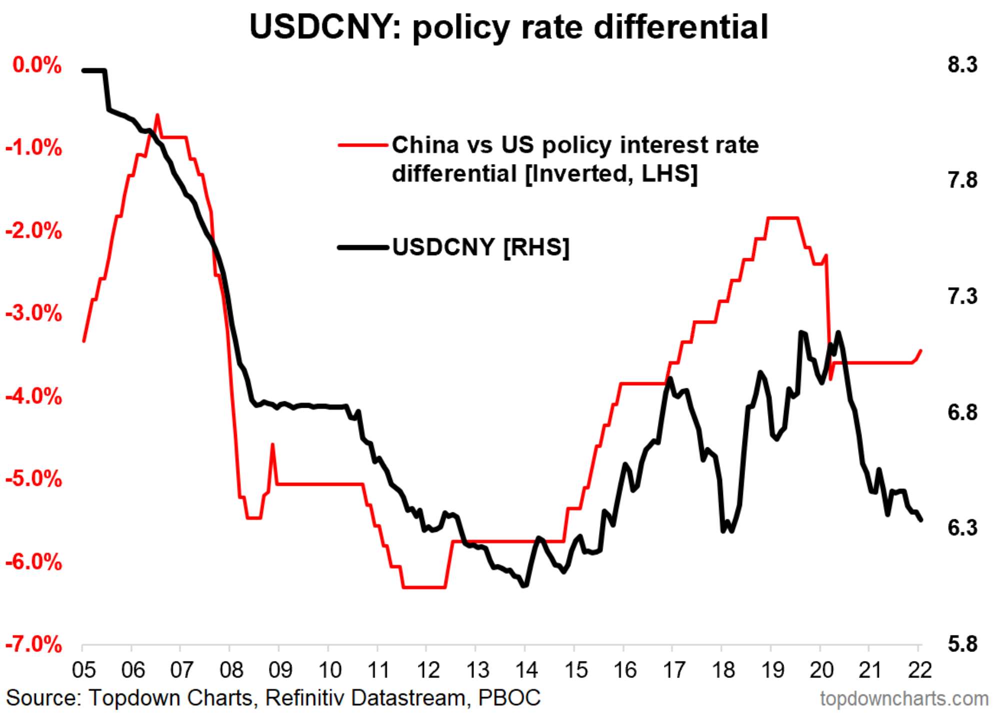


2. China Macro

The pivot to easing by the PBOC should be bullish for China/EM equities and commodities. But one aspect to note is that typically such policy divergence gets resolved through the FX markets, and that should mean ultimately a weaker CNY or at least a pause in the relative strength of the CNY seen over the past 18 months.







3. EM vs DM

TOP DOWN CHARTS

3. EM vs DM: Bashed in 21, bullish in 22

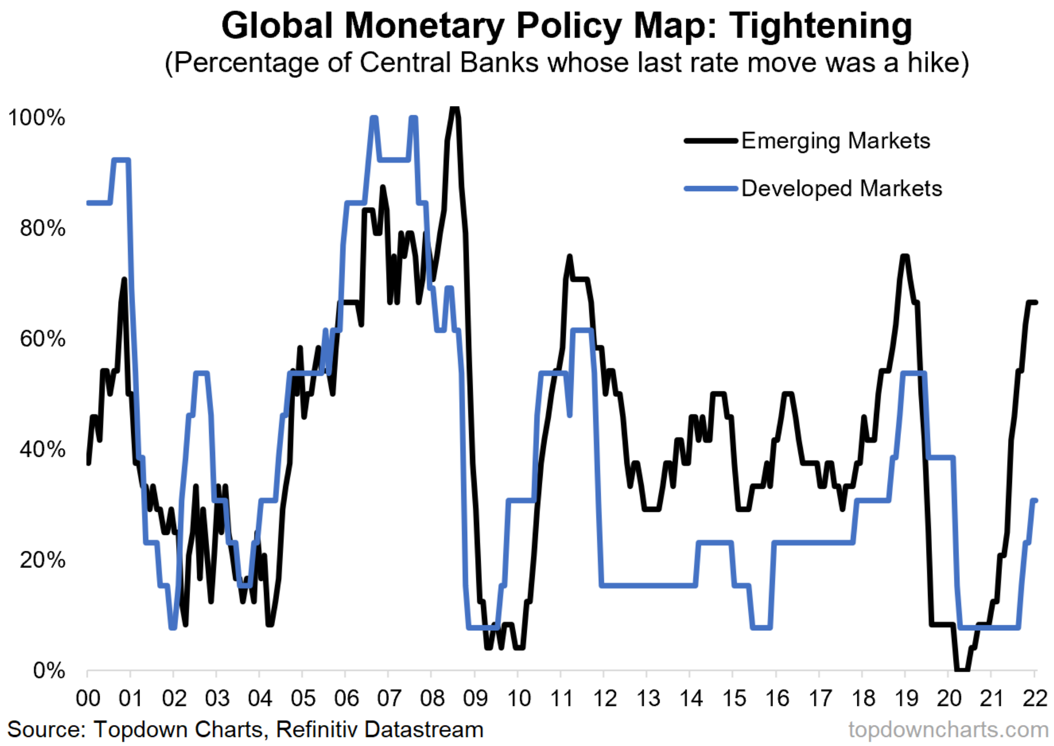
- EM equities lost ground in absolute + relative terms last year as a majority of EM central banks pivoted into rate hike mode.
- Arguably EM are further down the track than DM, which are set to step away from stimulus, and as such EM may be better positioned on a relative basis.
- The valuation backdrop supports that notion, with a mild valuation gap between EM and developed ex-US and a wild valuation gap for EM vs USA.
- Positioning has been significantly pared back, with ETF market share (implied allocations) at a record low, and surveyed allocations substantially lower.
- Sentiment indicators have also undergone a major reset from record high optimism last year to now basically neutral – a bull market correction?
- Overall, remain bullish medium-term on EM, cautiously lift the risk-watch (but continue to monitor), and favour EM vs DM (especially vs US).

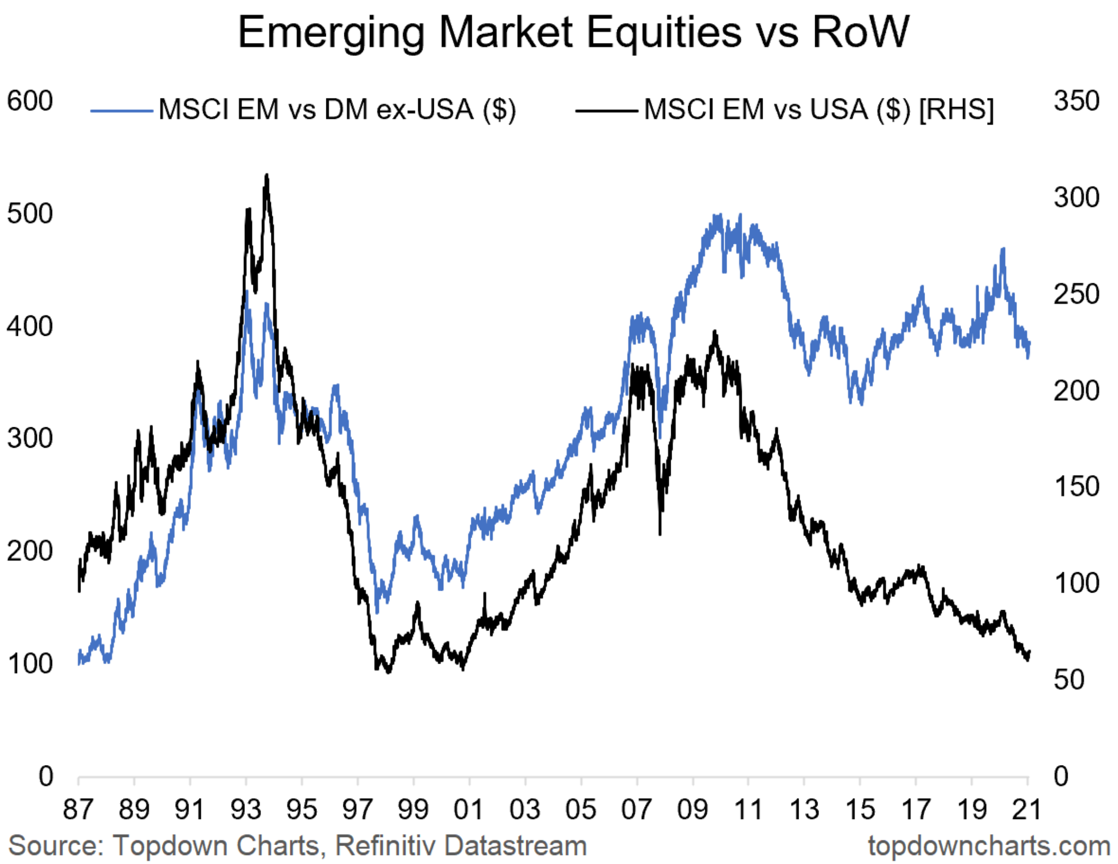
Bottom line: Bullish on EM in 2022 after a bashing in 2021.

3. EM vs DM

TOP DOWN CHARTS

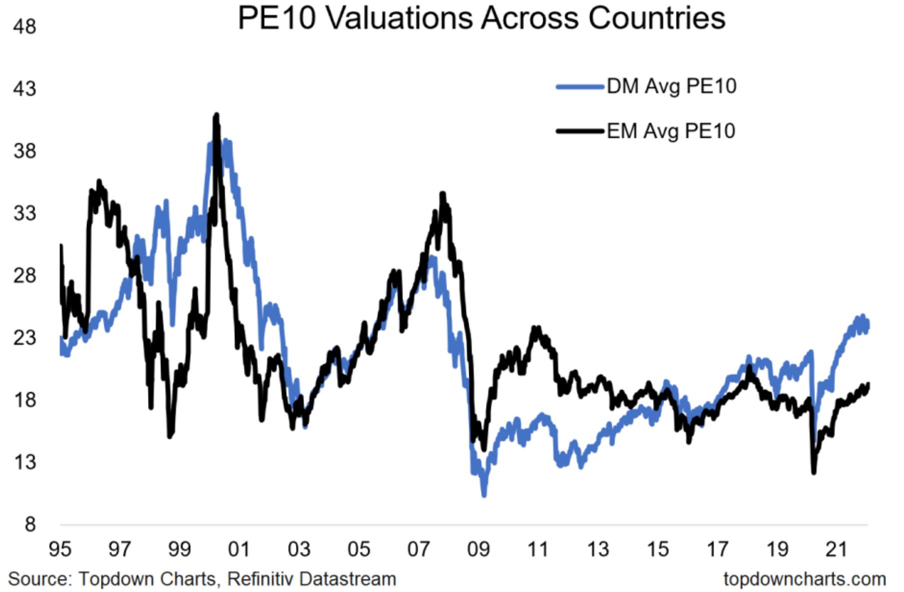
EM equities went backwards in 2021 both in absolute and relative terms – extending their long-term downtrend vs US equities and back to the bottom of the range vs developed ex-US. There were a few things going on, but policy was clearly a big part of it. As noted previously China had already been relatively tight/neutral on policy while fully 2/3rds of EM central banks pivoted into rate hike mode. This puts EM further down the process than DM, and potentially at an advantage as DM central banks step away from stimulus.

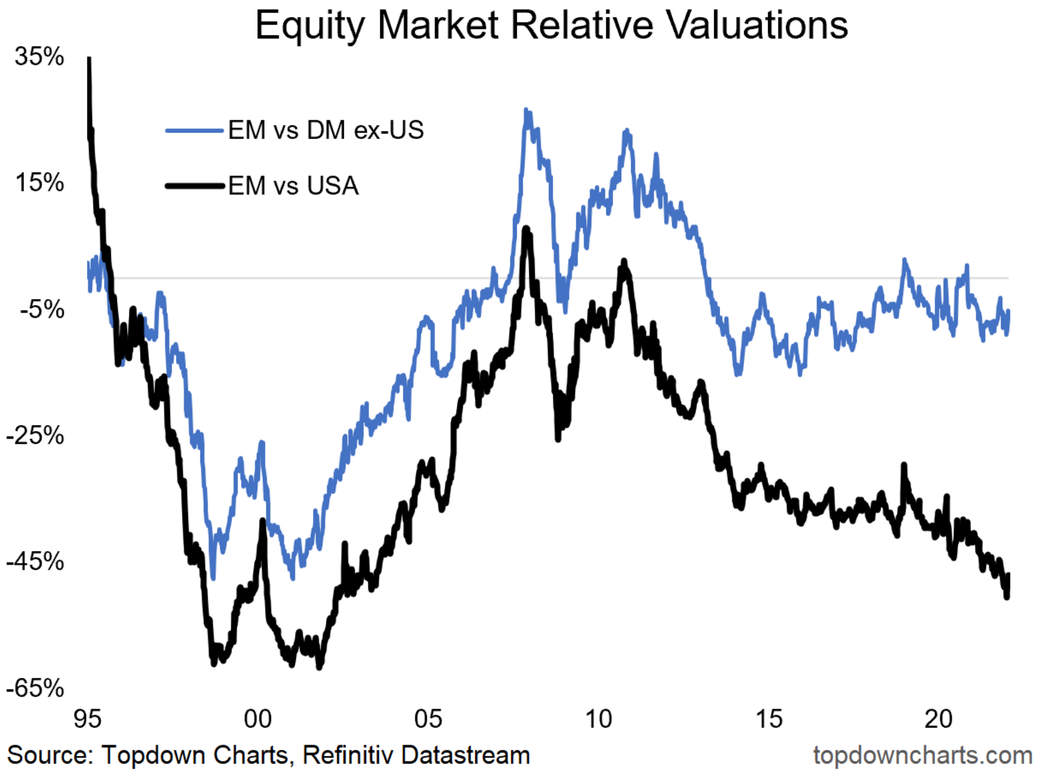


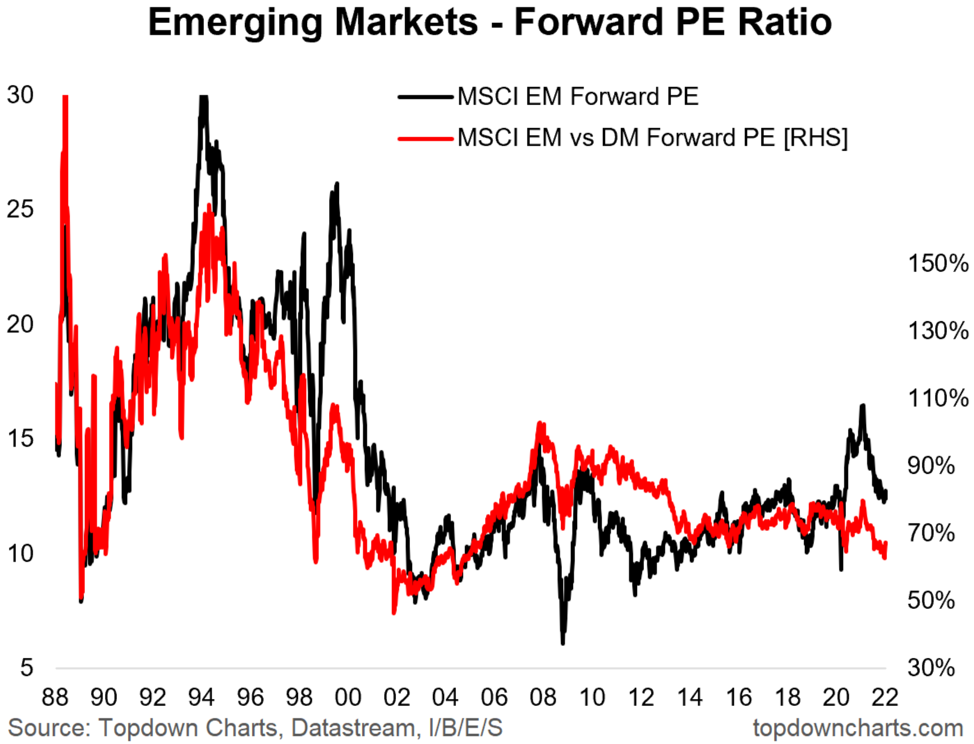


3. EM vs DM

Indeed, the lackluster performance by EM has opened up a mild valuation gap vs Developed ex-US and a wild valuation gap vs the US. The broad composite relative valuation chart below shows this clearly, and it is confirmed in the PE10 and forward PE chart. I would note that absolute valuations are about neutral, but clearly there is a relative value case here.

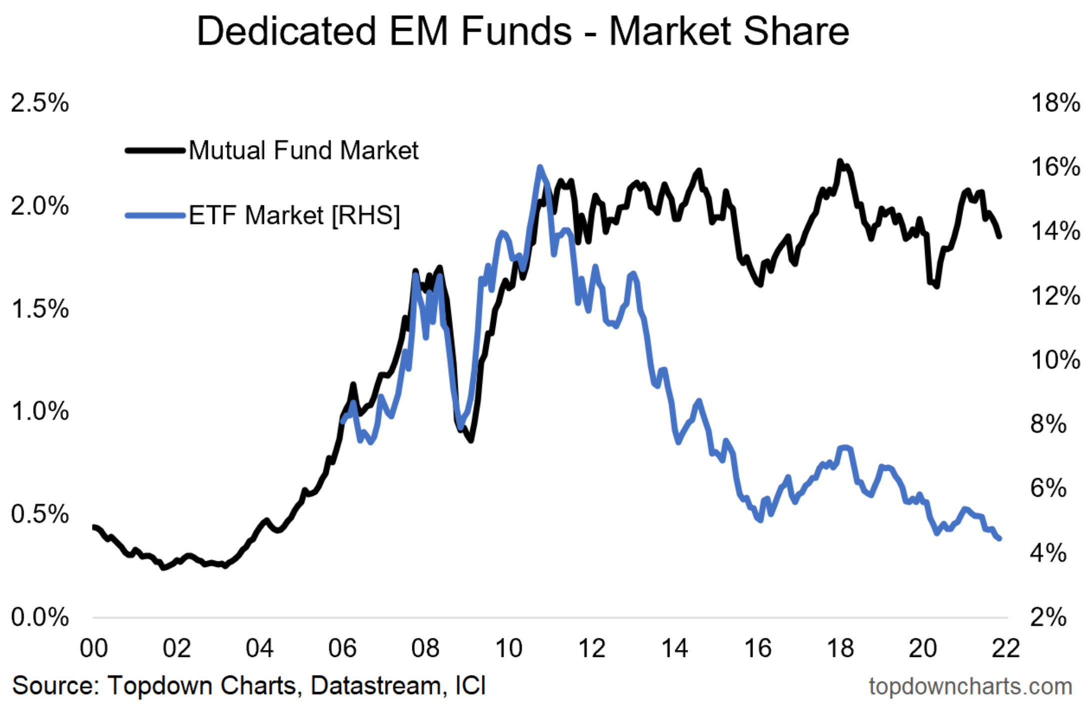


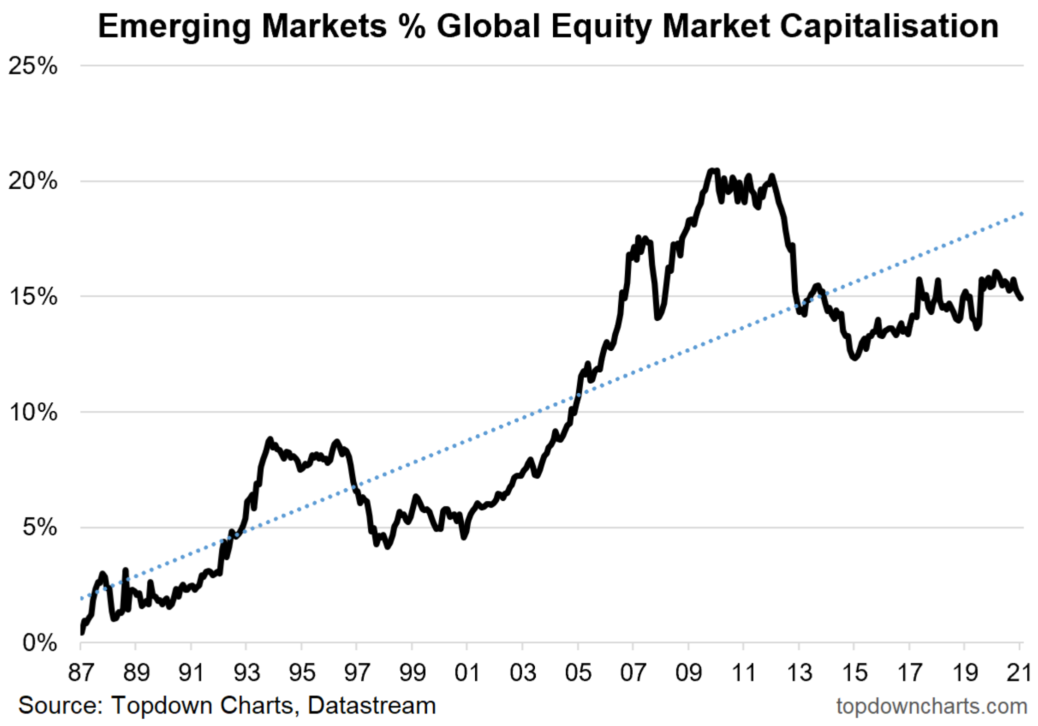




3. EM vs DM

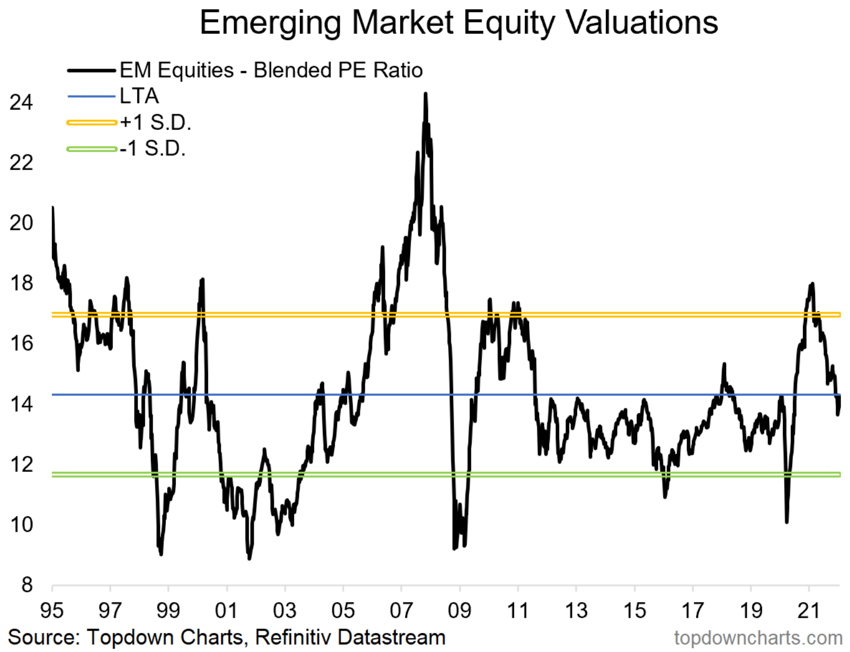
On a similar note, implied positioning by investors in EM funds has pulled back to the average of the past decade in the mutual fund space, and in the ETF space is actually at a record low (and fund manager surveys show EM allocations slightly net-underweight). Likewise, EM market cap share of global equities has gone sideways the past 8 years and is well down off the peak, below trend, and substantially below EM share of global GDP. So in a way this reinforces the case for EM vs DM, or certainly shows the shift in popularity of EM now vs a decade ago.

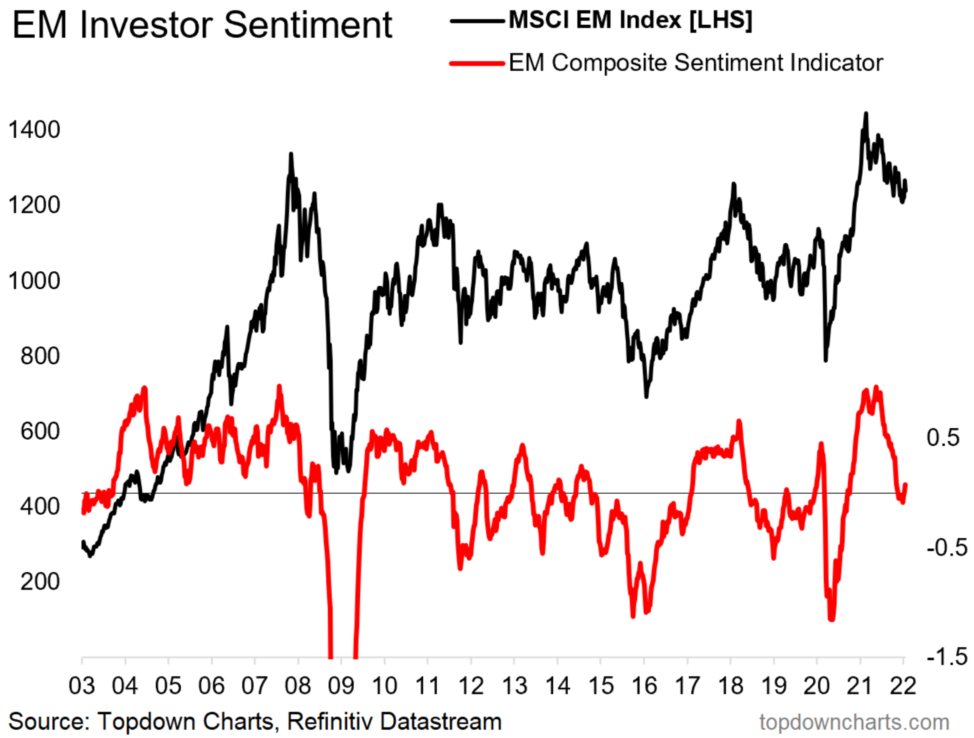


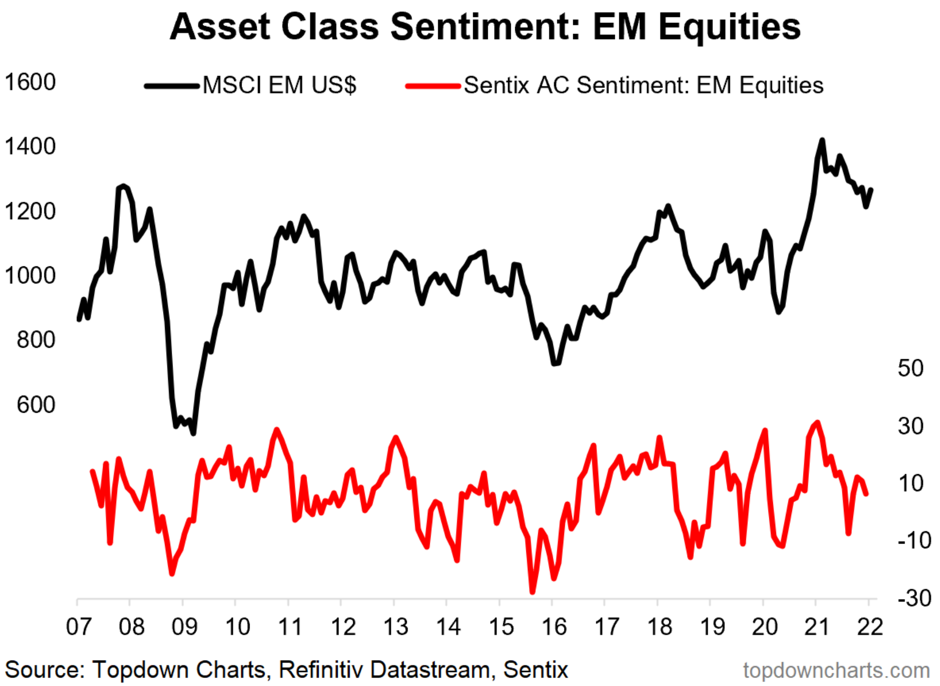


3. EM vs DM

Finally, on a similar note the EM composite sentiment indicator reset back to neutral from a record high (and is turning up?), and sentix asset class survey is also back to neutral – also down from an all-time high. So there has been a clear and resolute reset in sentiment – not quite down to outright pessimism where a strong contrarian signal would be generated, but consistent with a bull market correction. Also of note is the reset in the blended PE as price tapered, EPS recovered.







4. EMFX

TOP DOWN CHARTS

4. EMFX: stability, strength, and sentiment…

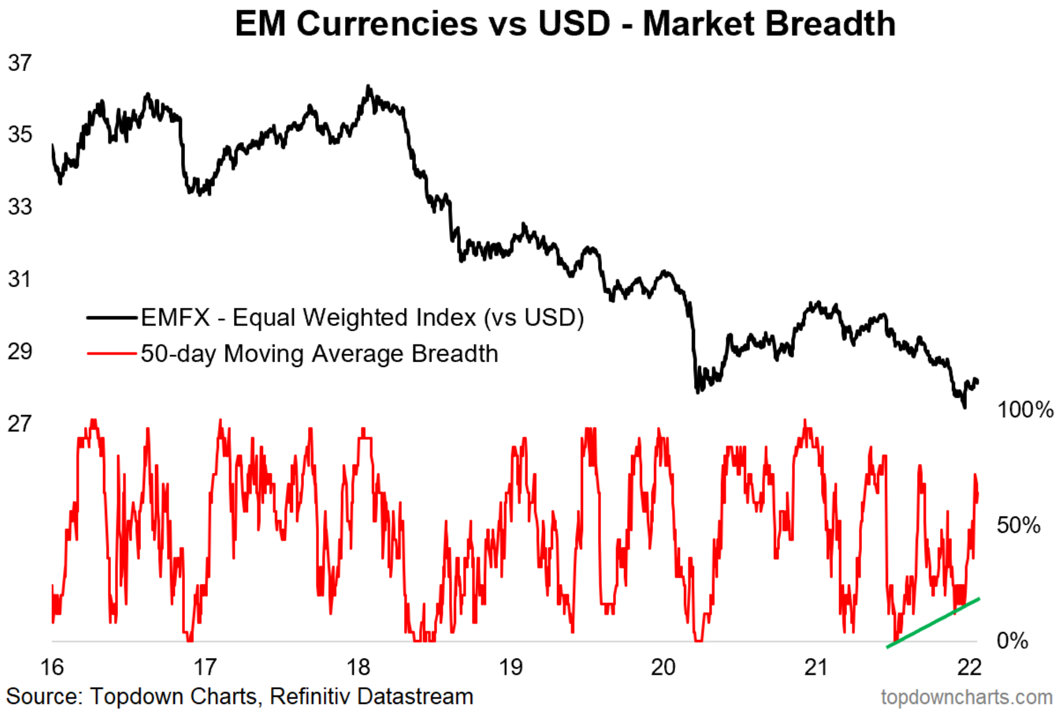
- The equal weighted 25-currency EMFX index has begun to stabilize after losing ground much of last year.
- We are seeing bullish divergence on the 50dma breadth chart, and oversold signals in the 200dma breadth chart.
- Valuations remain materially cheap, renewed commodity strength should help, and EM central bank rate hikes should encourage yield/carry-trade flows.
- On the other side of the coin, the US Dollar sees vanishing yield support, slight overvaluation, mixed technicals, and crowded longs/consensus bullishness, and hence consistent with the bullish EMFX view the US Dollar outlook is bearish.

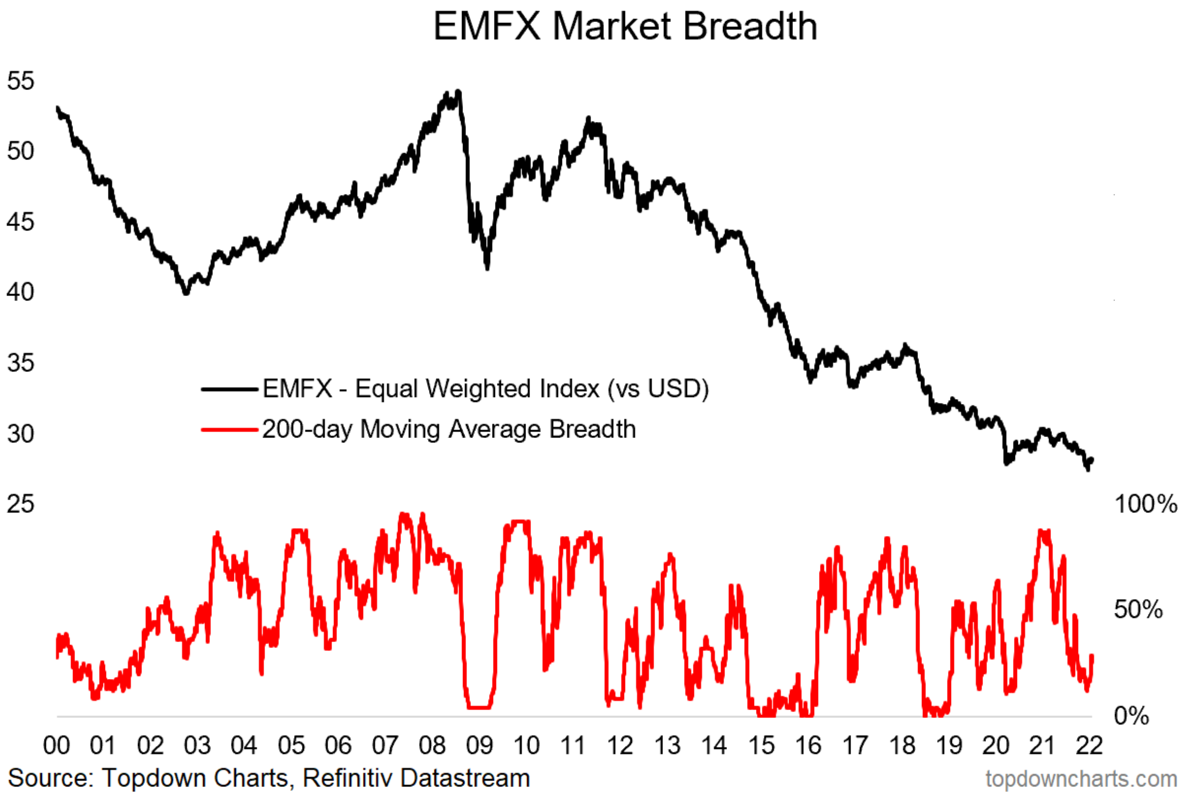
Bottom line: Bullish EMFX on the basis of cheap valuations, supportive macro (commodities and interest rates), and much improved technicals.

4. EMFX

TOP DOWN CHARTS

EMFX appears to be finding some stability in the new year, with my equal-weighted 25-currency (vs USD) index rallying off the lows and putting in a bullish divergence signal on the 50dma breadth chart. Also of note is the 200-day moving average breadth indicator is turning up from oversold levels – all up indicating perhaps at least a pause to the weakening trend seen last year.

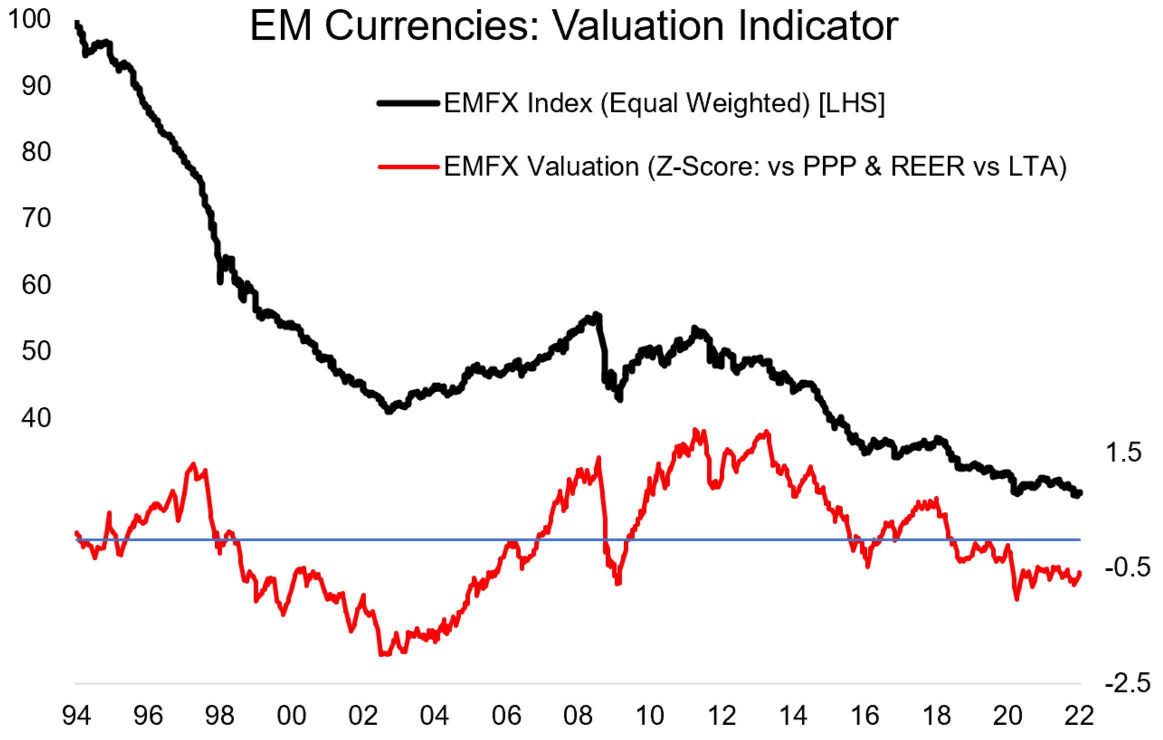




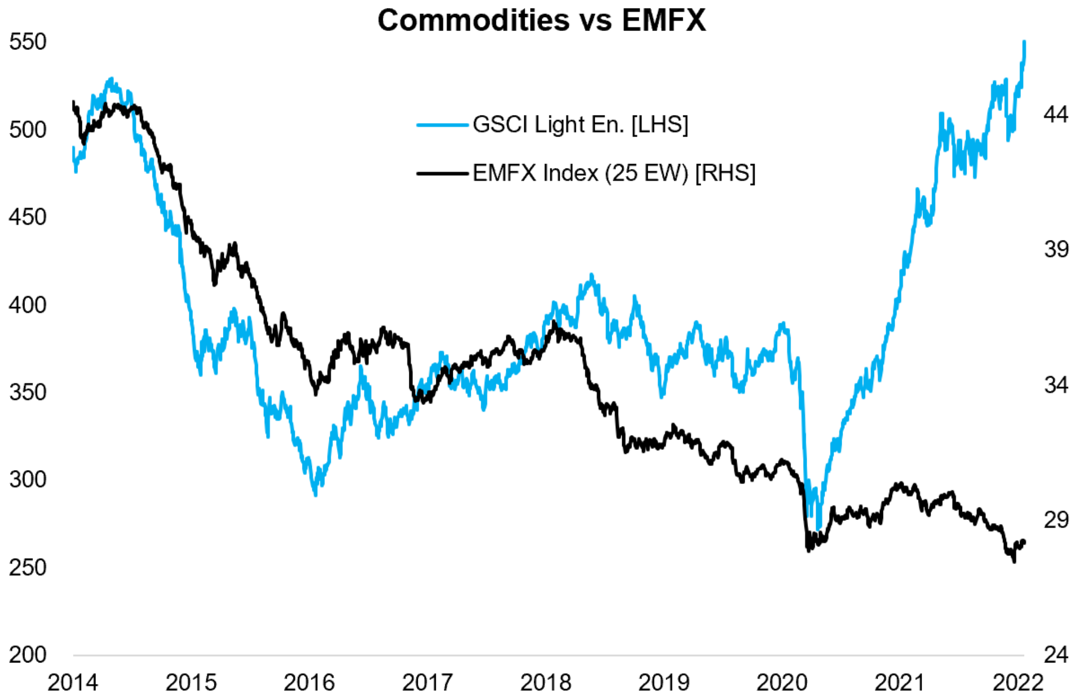
4. EMFX

TOP DOWN CHARTS

Zooming out, valuations are still on the cheap side – which helps tilt the medium-term bias to the upside. Also of note is the renewed strength in commodities, which should at the margin be bullish for EMFX. Finally, as mentioned previously EM central banks have been busy hiking rates, which at a certain point should help attract speculative/carry-trade flows in search of higher yields.



Source: Topdown Charts, Thomson Reuters, BIS, IMF topdowncharts.com

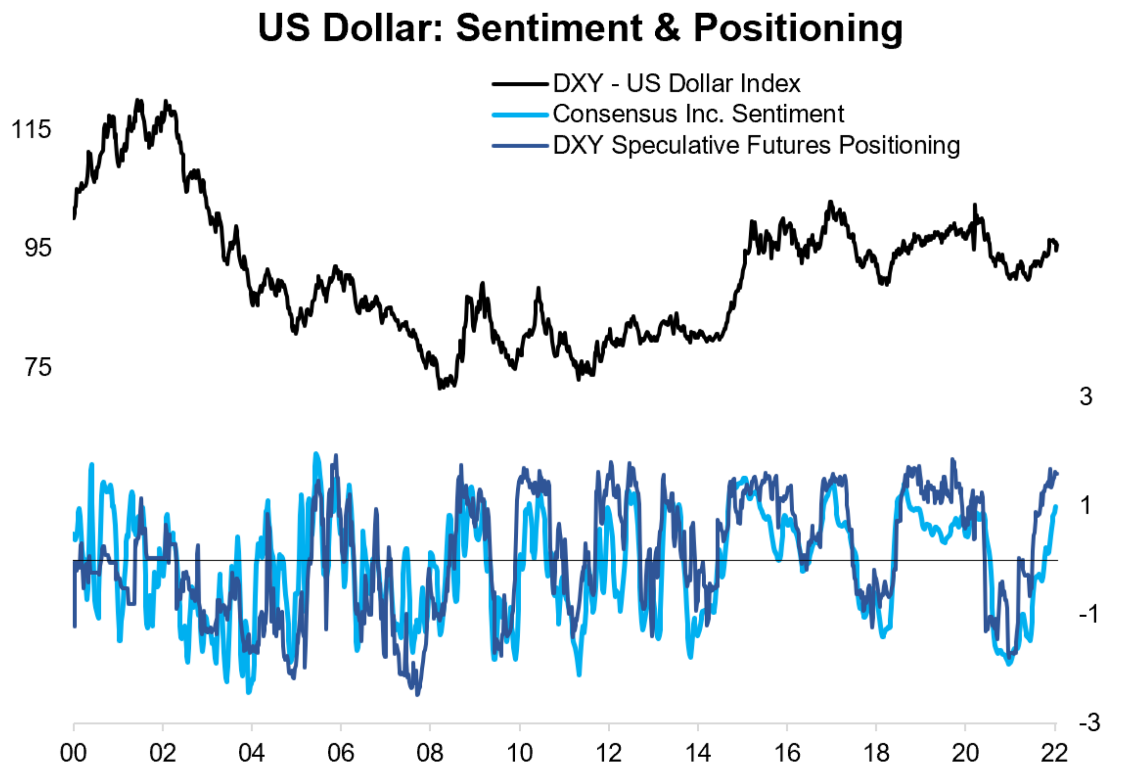


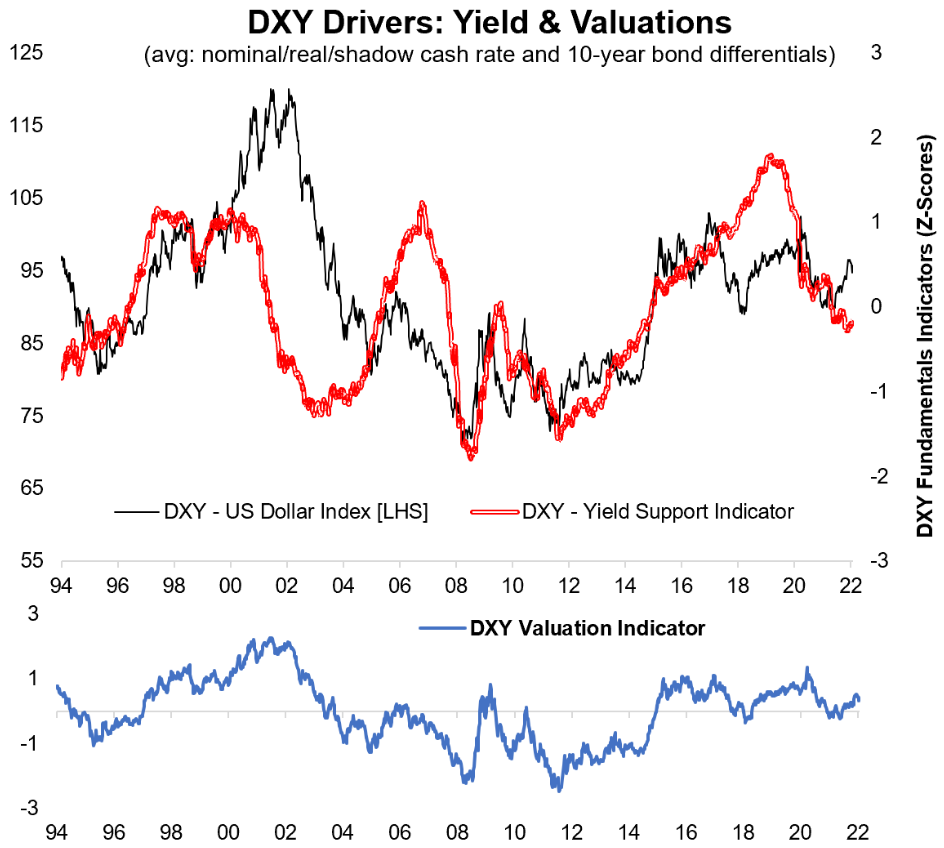
Source: Topdown Charts, Refinitiv Datastream topdowncharts.com

4. EMFX – US Dollar Aspect

TOP DOWN CHARTS

On the "other side of the coin" so to say, the US dollar outlook remains bearish given vanishing yield support, slight overvaluation, mixed technicals (e.g. the DXY seems to be stumbling at the upper resistance level), and a flip in the market over the past year from crowded shorts to now crowded longs and increasingly consensus bullish sentiment on the outlook. So from a medium term and tactical standpoint it is consistent with the constructive view on EMFX.





5. EM Fixed Income

5. EM Fixed Income: finally fixed income is starting to look good somewhere…

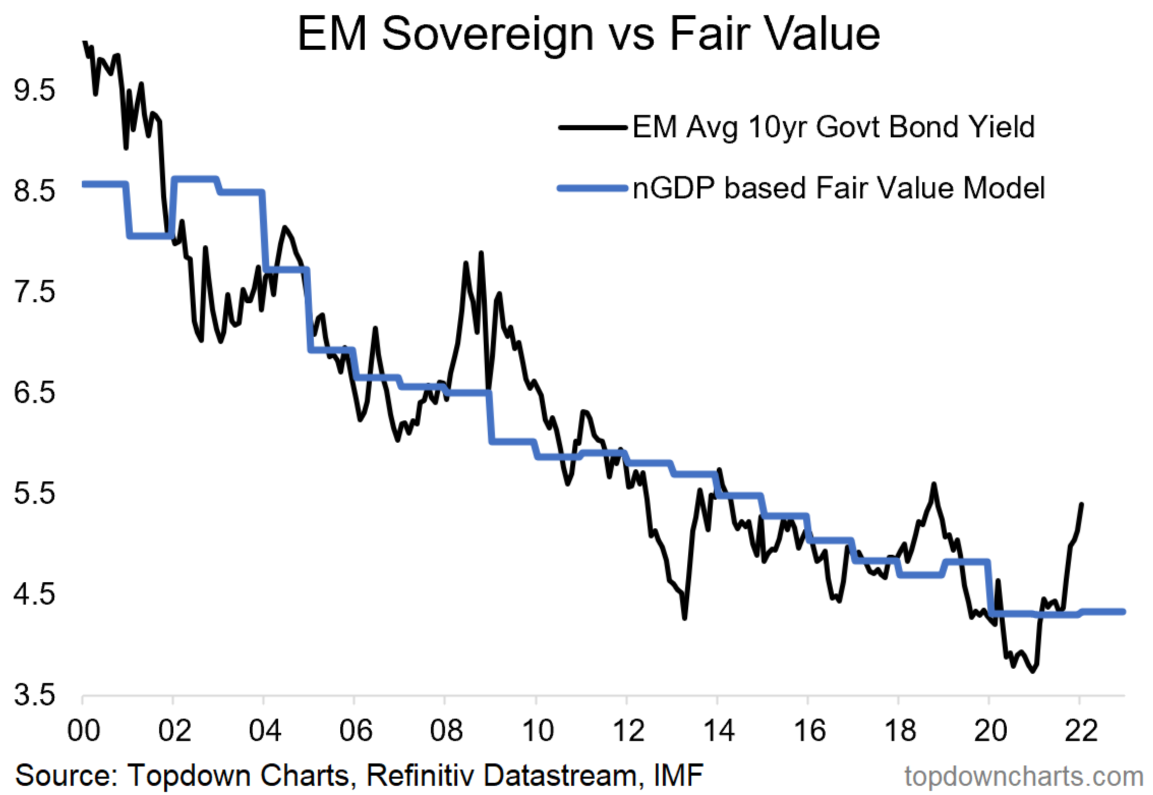
- Following the sharp backup in EM government bond yields, absolute valuations are tracking at the cheapest in 12-years.
- Relative value is also compelling, with the spread to US at the upper end of the range and near an all-time high vs developed markets.
- The longer-term expected return estimates show a positive yield spread even after adjusting for expected inflation and FX effects.
- Tactical indicators are also supportive with EM sovereign bond breadth oversold (+minor bullish divergence), and sentiment fairly washed out.
- Finally, the constructive view on EMFX outlined in the previous topic also adds to the bullish tactical case for EM local currency government bonds.

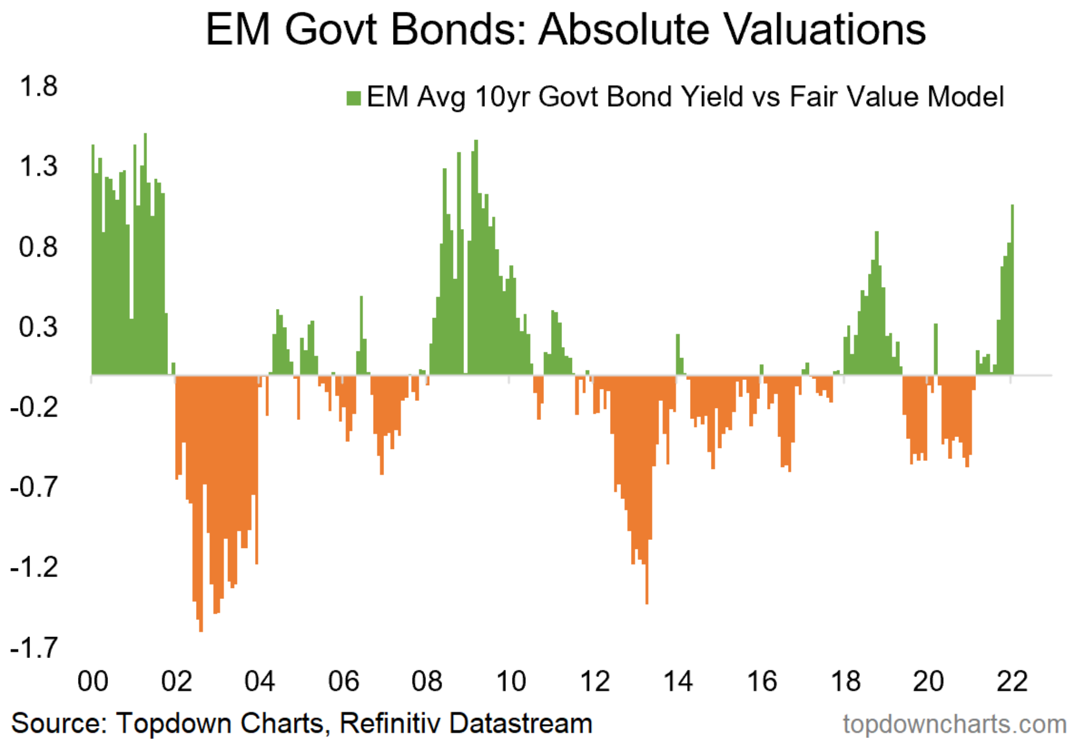
Bottom line: Bullish EM sovereign bonds on the basis of absolute & relative valuations, positive expected real returns, and a supportive tactical setup (sentiment & technicals).

5. EM Fixed Income

TOP DOWN CHARTS

As briefly noted in the quarterly pack, EM sovereign bonds are starting to look attractive after a particularly sharp backup in yields. At present the average EM 10-year government bond yield is tracking at a 12-year high vs the fair value model (i.e. looks very cheap in absolute terms).





5. EM Fixed Income

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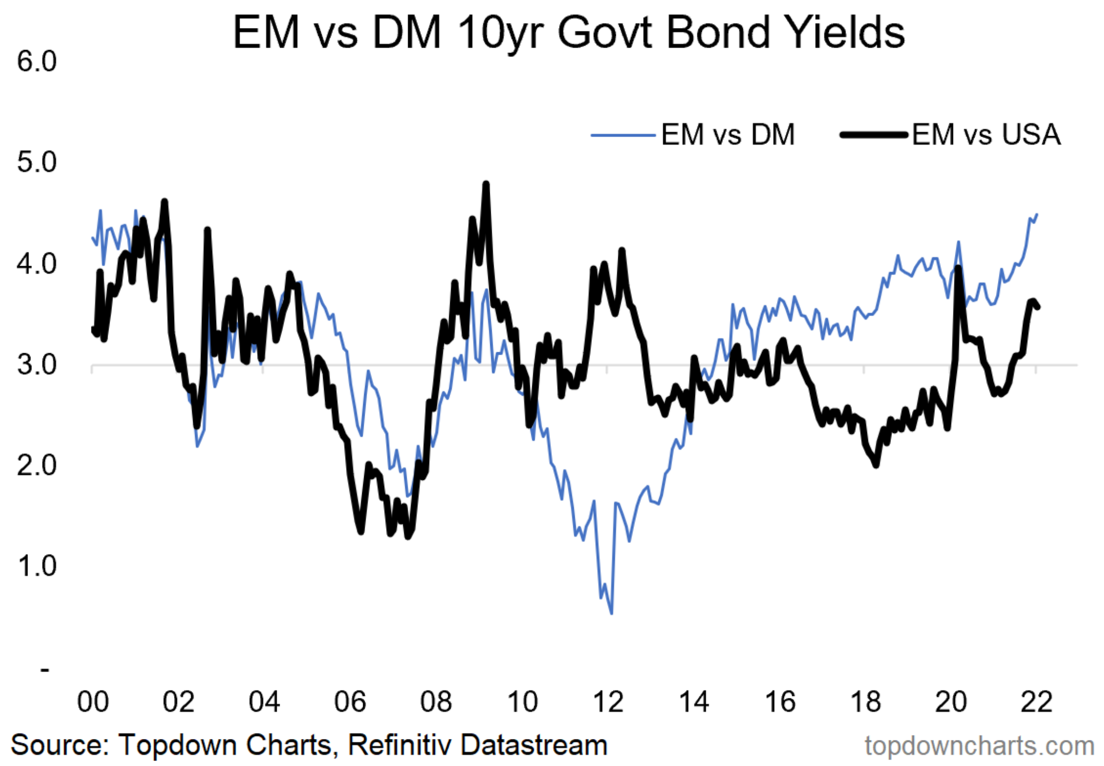
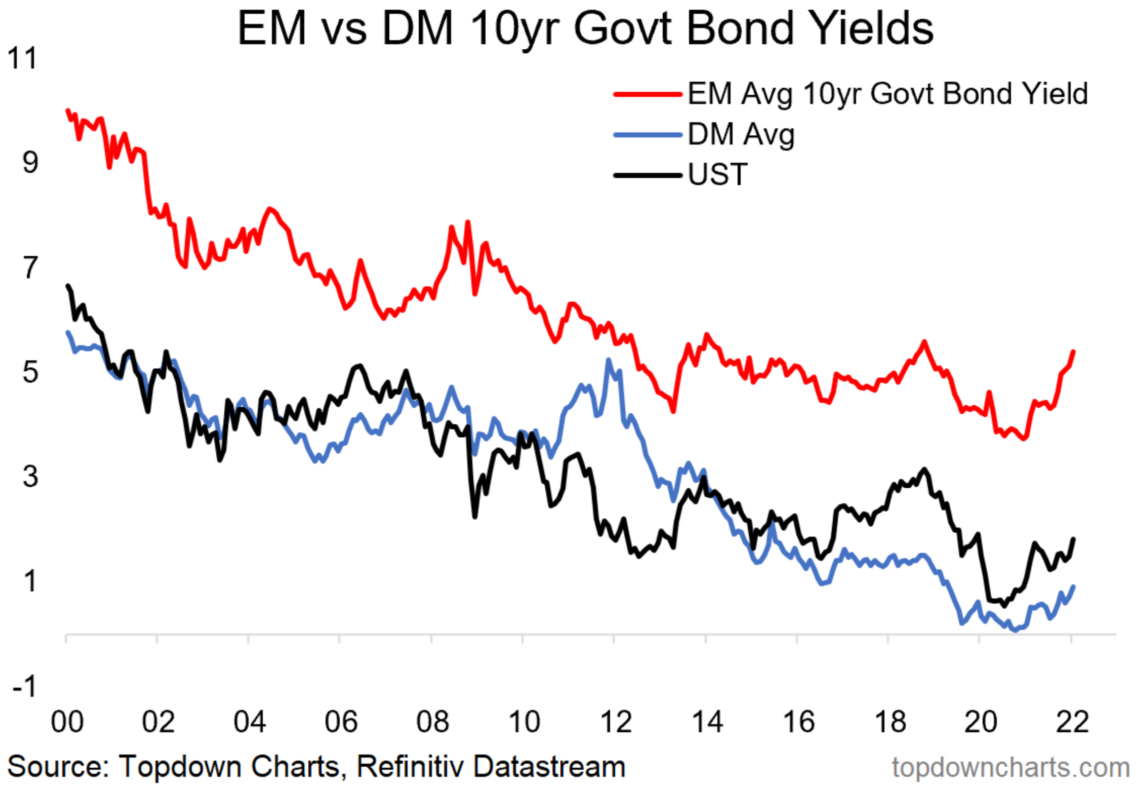
Similarly, from a relative value standpoint, the spread between EM and US government bond yields is at the upper end of the range, and the spread to the rest of developed markets is just shy of an all time high. In other words, there is a substantial yield pickup on offer in EM vs DM govt bonds.

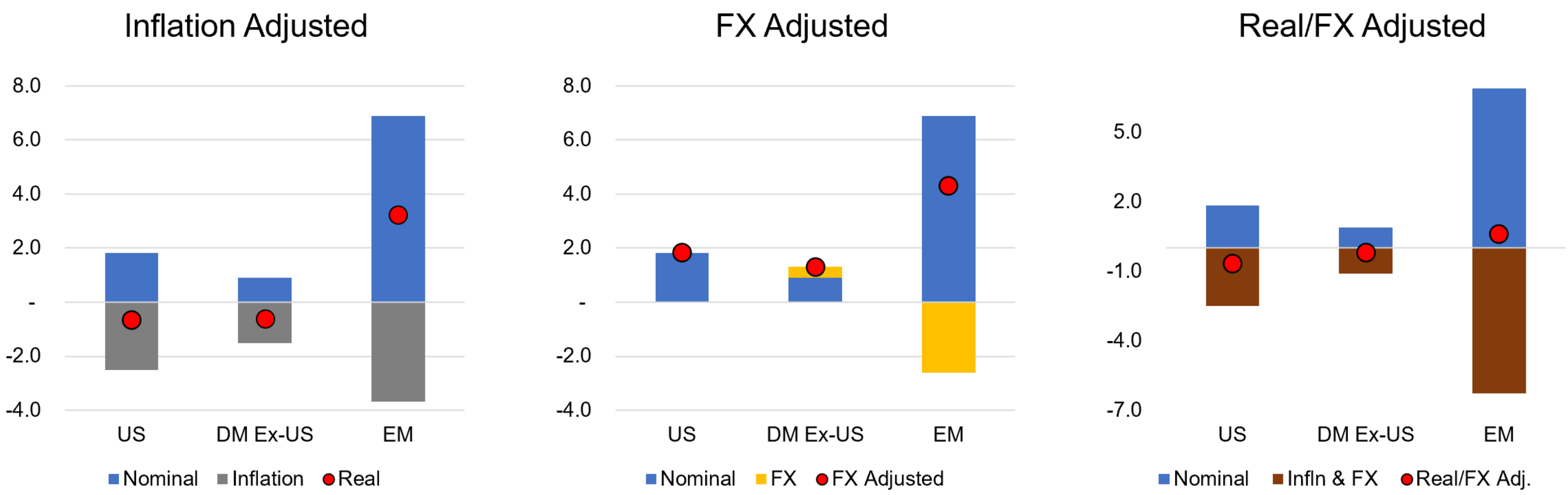




5. EM Fixed Income

TOP DOWN CHARTS

From an expected returns/buy-and-hold standpoint we do need to factor in expected inflation and FX (hedging) effects – to that end, we do find that the average government bond yield premium for EM remains positive even after making those adjustments.

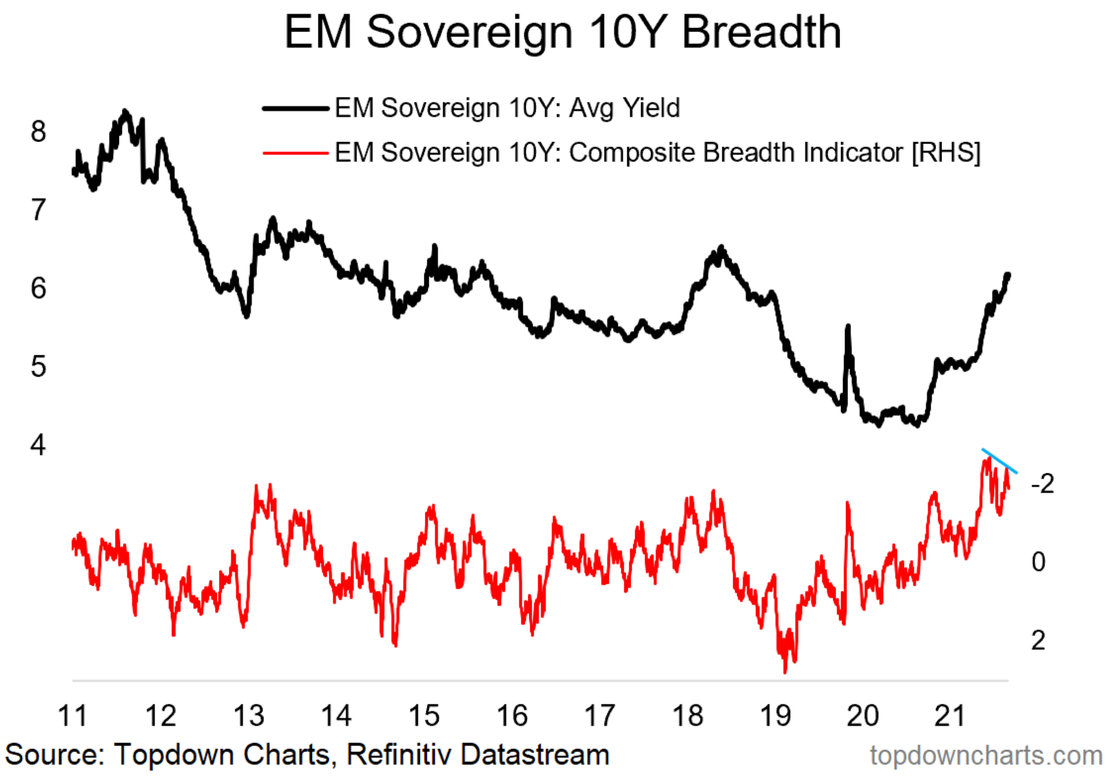


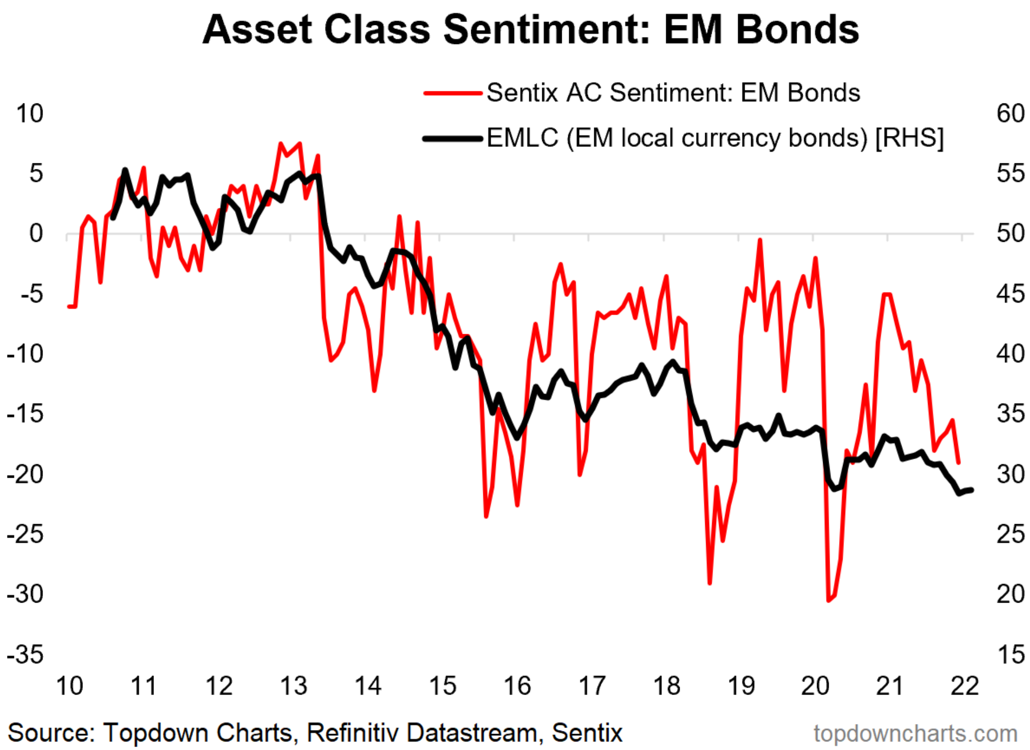
Source: Topdown Charts, Refinitiv Datastream, IMF, WEF, World Bank

topdowncharts.com

5. EM Fixed Income

Lastly, I wanted to also highlight that the composite breadth indicator for EM sovereign yields is looking oversold, and even has put in a tentative bullish divergence (lower high in the indicator vs higher highs in yields – bullish divergence because yield = opposite of price). Also of note is the significant washout in investor sentiment on EM bonds. So it looks like the tactical outlook lines up with the valuation/strategic case.





Ideas Inventory – OPEN/CURRENT THEMES AND IDEAS

TOP DOWN CHARTS

Date	Category	Subject	Topic	Direction	Timeframe	Conviction	Comments/Notes	Updates
21 Jan 2022	**Idea**	Bonds	EM Sovereign	Bullish	12-18m	Med.	WMT: absolute + relative value, supportive sentiment & technicals	
21 Jan 2022	**Idea**	FX	EMFX	Bullish	12-18m	Low	WMT: supportive valuations, macro, technicals	
21 Jan 2022	**Macro**	Economy	Global	Down	6-12m	Med.	WMT: multiple leading indicators point to a "Growth Scare"	
19 Nov 2021	**Risk**	Comdty	Ind. Metals	Bearish	3-6m	Low	WMT: place on risk-watch given weak technicals/sentiment/macro risks	
24 Sep 2021	**Idea**	Bonds	US Treasuries	Bearish	3-6m	Low	WMT: technicals, sentiment, macro, valuations, policy	29 Oct 2021: reduce conv.
17 Sep 2021	**Idea**	Equities	Gold Miners	Bullish	1-3m	Low	WMT: (relative to S&P500) valuation, sentiment, positioning, technicals	12 Nov 2021: reiterate
27 Aug 2021	**Idea**	Equities	US Small Caps	Bullish	6-12m	Low	WMT: capitulation in positioning/flows, reset in relative value	15 Oct 2021: maintain
23 Jul 2021	**Macro**	Capex	Global	Up	1-3yrs	Med.	WMT: expect capex to rebound, esp. commodities + infra/climate	10 Dec 2021: reiterate
7 May 2021	**Macro**	Policy	Global	Hawkish	1-3yrs	High	WMT: switch to hawkish given turn in interest rates cycle + inflation risk	10 Dec 2021: reiterate
9 Apr 2021	**Macro**	Tax	Global	Up	1-3yrs	High	WMT: anticipate stall/turn (up) in global corporate tax rate trends	17 Sep 2021: raise conv.
19 Mar 2021	**Idea**	Equities	Defensive Value	Bullish	1-3yrs	Low	WMT: (relative) increasingly cheap relative valuations	20 Dec 2021: maintain
16 Jan 2021	**Macro**	Inflation	Global/US	Up	12-18m	High	WMT: mix of short/medium-term factors present clear upside risk	10 Dec 2021: maintain
21 Aug 2020	**Idea**	Equities	Energy Stocks	Bullish	1-3yrs	Low	WMT: cheap valuations, contrarian signals, + rel. vs gold/miners	14 Jan 2022: maintain
21 Aug 2020	**Idea**	Equities	UK Equities	Bullish	12-18m	Med.	WMT: cheap valuations, consensus underweight, tactical indicators	24 Sep 2021: maintain
22 May 2020	**Idea**	Equities	Europe vs US	Bullish	12-18m	Low	WMT: relative valuations favor Eurozone	29 Oct 2021: maintain
15 May 2020	**Idea**	Equities	Global Banks	Bullish	12-18m	Med.	WMT: cheap valuations, improving technicals/macro outlook	15 Oct 2021: maintain
8 May 2020	**Idea**	FX	US Dollar	Bearish	1-3yrs	Low	WMT: long-term cycles, fading yield support, fiscal outlook, sentiment	21 Jan 2022: maintain
10 Apr 2020	**Idea**	Equities	EM	Bullish	12-18m	Low	WMT: Still some relative value, but risks more mixed now	21 Jan 2022: maintain
10 Apr 2020	**Idea**	Equities	EM ex-Asia	Bullish	12-18m	High	WMT: relative value, implied allocations below avg., oversold, FX	10 Sep 2021: reiterate
10 Apr 2020	**Idea**	Equities	Eurozone	Bullish	12-18m	Med.	WMT: relative value, pessimistic sentiment, policy (fiscal+monetary)	29 Oct 2021: maintain
27 Mar 2020	**Idea**	Equities	Global Ex-US	Bullish	3-5yrs	Low	WMT: cheap valuations (absolute & relative), expected return differential	14 Jan 2022: maintain
27 Mar 2020	**Idea**	Equities	Value vs Growth	Bullish	3-5yrs	Low	WMT: value cheaper than usual vs growth, techs + macro drivers +ve	15 Oct 2021: maintain
20 Mar 2020	**Idea**	Comdty	Commodities	Bullish	3-5yrs	Low	WMT: underinvestment in supply, global capex/demand outlook	14 Jan 2022: maintain

Ideas Inventory – CLOSED/PAST THEMES AND IDEAS

TOP DOWN CHARTS

Date	Category	Subject	Topic	Direction	Timeframe	Conviction	Comments/Notes	Updates
30 Jul 2021	**Risk**	Equities	EM	Bearish	1-3m	Low	WMT: place on risk-watch given suite of risk indicators "orange flags"	21 Jan 2022: lift risk watch
10 Apr 2020	**Idea**	Equities	Frontier	Bullish	12-18m	Low	WMT: strategic +MT case good, but ST mixed.	13 Dec 2021: move neutral
9 Oct 2020	**Idea**	Comdty	Gold	Bearish	12-18m	Low	WMT: maintain medium-term bias: valuations, real yields, macro	12 Nov 2021: move neutral
9 Jul 2021	**Idea**	FX	Safe Haven FX	Bullish	3-6m	Med.	WMT: value reset, positioning signal, technicals look bullish	22 Oct 2021: close (neutral)
13 Mar 2020	**Idea**	Equities	Global	Bullish	12-18m	Low	WMT: risks clearly shifted, but not enough to flip outright bearish yet	20 Aug 2021: move neutral
6 Mar 2020	**Macro**	Capex	Commodities	Down	12-18m	Med.	WMT: Comdty Capex rolling over: key variable for LT AC view	23 Jul 2021: reverse
14 Aug 2020	**Idea**	Bonds	US Treasuries	Bearish	6-12m	Low	WMT: ST mixed (sentiment/techs), bearish MT on macro/value	9 Jul 2021: move neutral ST
16 Apr 2021	**Idea**	Comdty	Gold	Bullish	1-3m	Low	WMT: bullish technical and sentiment signals	18 Jun 2021: change to bear
10 Apr 2020	**Idea**	Equities	US Small Caps	Bullish	6-12m	Low	WMT: n.b. *no more relative value*, but cyclicals + cycles positive	28 May 2021: change to neutral
19 Feb 2021	**Macro**	Policy	Global	Neutral	12-18m	Med.	WMT: mon.policy outlook switching to neutral -- increasingly hawkish	7 May 2021: change to hawk
20 Mar 2020	**Idea**	Bonds	TIPS B/E	Bullish	12-18m	Low	WMT: *no longer cheap* but links to recovery and inflation theme	9 Apr 2021: change to neutral
11 Sep 2020	**Idea**	Comdty	Agri/Grains	Bullish	12-18m	Low	WMT: low capex, supply disruption, sentiment/positioning, SOI	19 Mar 2021: change to neutral
6 Mar 2020	**Macro**	Policy	Global	Dovish	12-18m	High	WMT: "Global Policy Pivot Part 2" - expect new big wave of stimulus	19 Feb 2021: change to neutral
27 Mar 2020	**Idea**	Equities	GLIF	Bullish	12-18m	Low	WMT: oversold technicals, cheap absolute & relative valuations	5 Feb 2021: close (neutral)
26 Jun 2020	**Risk**	Equities	EM	Bearish	1-3m	Low	WMT: mindful of O/H resistance, EMFX divergence	9 Nov 2020: alert lifted
26 Jun 2020	**Idea**	Equities	Gold Miners	Bullish	12-18m	Med.	WMT: short + longer term technicals setup in gold + miners rel.	9 Oct 2020: close (bearish)
17 Apr 2020	**Idea**	FX	AUDUSD	Bullish	12-18m	Low	WMT: cheap valuations, IRDs +metals turned, ~~crowded shorts~~	4 Sep 2020: close (neutral)
13 Apr 2020	**Idea**	Equities	Gold Miners	Bullish	1-3m	Med.	GMM: rel perf. near breakout; technicals & sentiment bullish	26 June 2020: replace (LT)
27 Mar 2020	**Idea**	REITs	US REITs	Bullish	12-18m	Low	WMT: oversold, rel val cheap, but abs val not, some uncertanties/risks	15 May 2020: close (neutral)
24 Feb 2020	**Risk**	Equities	EM + S&P500	Bearish	1-3m	Med.	GMM: bearish divergence for EM equities, S&P500, +EMFX breakdown	27 Mar 2020 (implied closed)

n.b. The Ideas Inventory was only launched in early 2020 (so ideas older than that are not included).

“WMT” = Weekly Macro Themes (ideas from this report)

“GMM” = Global Markets Monitor (ideas from the market themes section of the Monday report)

Thanks for reading...

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