JUNE 11, 2021

THE BEAR CASE

1,000 words – a 4 minute read.

Today's Musings come straight from this morning's notes for my BTV Open hit.

What is the UST bond market trying to tell us? Regular readers know I like to let the market tell me rather than me try to tell the market which usually results in me losing money.

The 10 yr. UST at 1.45% is certainly not telling us to fear embedded inflation though many still do; maybe it's telling us that its Goldilocks time but as an investor/advisor I don't get paid to believe in fables.

Maybe the bond market (together with what I think is a healthy pause in Commodities) is telling us to start to worry about a sharp slowdown in US growth, which is a much more worrisome Bear Case than a year of 3% US inflation.

I learned long ago that one should always have a bear case – the event/issue that will upend the bull case one normally leads with - so here's mine – what's yours?

Recall Covid's timeline of 1st in, 1st out and follow the leader logic. Well look at China, first in and out, growth clearly rolling over though its 10 yr. still yields over 3% and its FX has been strong. China's May CPI print surprised to the downside at 1.3% vs 1.6% consensus. While others focus on the much higher PPI #s, my old MS colleague Stephen Jen points out that these have been negatively correlated for years.

US growth is peaking as we speak – yesterday's inflation print will be the high as 2020 base effects wash out. Given its China's Centennial year I don't expect growth there to plummet but with both China and US growth slowing that's something to consider.

Maybe, as Macro Tourist Kevin Muir notes, it's the Manchin effect. Maybe Sen Manchin blocks passage of the Biden agenda, the Jobs & Family plans don't pass & the economy doesn't get that stimulus. Current estimates are for the US fiscal deficit to more than halve – yes halve next yr., from $3.4T in 2021 to $1.6T.

Significant US fiscal contraction coupled with a Fed that is leaning to taper rather than to ease further would suggest that 2022 US GDP & EPS estimates underpinning current US financial asset prices may need to be revised down leading to equity and USD weakness and further bond rally.

What about Commodities? It's tricky – I am quite bullish and expect a Commodity Super Cycle led mainly by demand for decarbonization (70% of global GDP now has emissions targets vs 30% just a few yrs. ago). JPM had some interesting work out this week showing that as US stock – bond correlations turn positive again that 60-40, Risk Parity funds etc. will need to look to Commodities as diversifiers – the Firm notes further that the stock – Comm correlation is close to zero suggesting that Comm are not only inflation hedges but also diversification vehicles - Commodities just might be the Boss.

Now to be clear this is a bear case I am just starting to contemplate. I am positioned for and continue to expect as a base case a move from a staggered global reopening to a synchronized global recovery as we exit 2021. TPW Advisory's global multi asset model portfolio positioning reflects this POV with heavy OWs to nonUS equity and Commodities as well as our thematic allocation.

As the ROW continues to recover I expect USD weakness & equity leadership to shift to Europe and increasingly to the laggards such as Japan and Latin America. Japan's LEI just hit a 7 yr. high while it has already had its Taper with the BOJ not buying any ETFs last month for the 1st time in 8 yrs. (stocks went up). Capital International notes that on a P/BV basis Japan equity sells at a 70% discount to the US and a 35% discount to Europe.

FX is the only major asset class yet to have a big move this year – I expect that to change in the 2H with EMFX the major beneficiary of USD decline. Our buddy Chase at Pinecone Macro showed an MXN chart this week titled "Blast Higher"; I agree and note that BRL and MXN = close to 20% of EMLC.

I remain of the view that the "testing time" will come late Summer, early Fall with Fed speak/meetings, clean econ data & clarity on the Biden policy agenda. In the interim Mr. Muir notes that equity volatility tends to go on vacation between beginning June and mid-July.

I do have two main takeaways: first, the USD is a loser in either scenario – if we get the synchronized global recovery US exceptionalism fades and ROW gets repriced higher. If the Bear case manifests, then for sure its dollar down. EMFX is the big winner, esp. in the former case.

Second, European equity is very well set up in either scenario. The ECB just raised its 2022 GDP forecast to 4.7% (note well above US 3.6% which may be at risk). Most importantly, Europe's Joint Recovery Fund (JRF) has yet to disburse a single Euro which should ensure that Europe's medium term outlook (2022- 2024) is the best of the Tri Polar World's three main regions: Asia, Europe & the Americas. Perhaps the idea that Europe can win the Decade of the 2020s is not a complete pipe dream.

Quick Crypto note – interesting how repeated rounds of Crypto Carnage are not hurting the digital pick & shovel space with BlockFi looking to raise another private round at a 70%, yes 70% premium since its last round a mere three months ago – BTC in contrast is down roughly 40% over the same period – private market bubble anyone?

I have been working on improving TPWA's flywheel in terms of moving from thought to analysis to expression. Consider this an early example of that process. Let me know what you think.

Enjoy the Tellimer sponsored 2H Outlook presentation as well as this Economist article on Climate. The latter will help you appreciate why Climate is the single biggest category in the TPW 20 – our 100% thematic global model portfolio.

TGIF!

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