JULY 9, 2021

BRAIN MELT = OPPORTUNITY

1120 words, a 4 minute read.

Maybe it was the long 4th of July weekend (all that socializing after 18 months without) or the strong 1st H of the year (record for US financials, Energy, near 25 year best for EU banks) or the weather (I was rained on 5 days in a row personally) but whatever the cause there seems to be a collective brain melt going on in global financial markets.

Maybe it's the Dueling Dualities as investors toggle between bull case and bear between inflation fears and slow growth concerns, between the Delta variant spread and the vaccine production surge (my bet for most important tactical issue).

It is a confusing period with little in the way of recent history to guide investors; a sub 1% drop in the S&P after a record run of day after day ATHs sparks media hyperventilating about down markets and what it signals for the global economy. After such a run an S&P pullback is healthy.

Here in the US, travel related segments are close to O/S (JETS) even with travel surging in both the US and Europe, while long term UST (TLT) and growth stocks (QQQs) are O/B. AGG is right at its 200DR level while TLT just broke above its 200D resistance level – let's see if it holds.

UST have rallied 8 days in a row & are due for a reversal. On the other side of the ledger, EMFX is down 10 of last 11 trading days while Asia Pacific equity is down 7 of last 8 days. Technical levels remain important in the current environment because both humans and machines can track them. 10 year UST 200 DR is at 1.23%.

For all the hype most financial assets have been range trading for months; it's the rotations underneath that have been tricky. After a great 1H run for Value and Cyclicals as rates rose and bonds sold off the reverse has happened over the past few weeks - now that move is extended.

Range trading reflects investor confusion about peak growth vs global expansion, Fed tapering vs a Fed unable to raise rates, Delta Variant vs synchronized global expansion etc. If Fed taper was really the fear then all this slowdown talk should alleviate it right? Somehow it doesn't feel that way. Credit is trading fine while Defensive equity sectors are not seeing any big bid. Just another "pothole"….

Here's the TPWA 3 step approach: Step One - Keep Calm and Carry On. Or as Bob Marley sang "So when you're riding through the ruts don't complicate your mind". Step Two – recognize what's happening. Step Three – take advantage of the opportunity.

With Asia the epicenter of globe growth concerns as the Delta variant surges and Japan decides no spectators at Olympic events, it's worth noting two things: first, the A$ /Y cross – a noted global growth proxy, is now quite O/S and closing in on 200d support at 80.9. Second, China is on the case, having just reduced its RRR by 50 bps and injecting liquidity into the system ahead of Q2 GDP. Tactically that supports global risk assets, strategically it does raise the question of why the about face.

While China has passed peak growth (Q1 GDP +18% y/y) it is still likely to report Q2 GDP growth of 8% or so y/y and Q/Q growth of 1.2% which is quite decent. Peak growth does not = no growth… as I noted in last week's monthly. The question is from peak growth to what: 6-8% in China, 3-4% in US? That would be fine.

The EC just raised Europe's 2021 GDP growth estimate again to 4.8% while Europe is likely to grow faster than the US in 2022 and 2023 as its recovery plan unfolds. Yet, EU stocks fell 2% on the news that the ECB would be very slow to remove accommodation - why? I don't know.

Yesterday's US open might have been it for the recent pullback as the selling was close to record levels (TICK Rule); judging from our model portfolios, the vast majority of holdings closed above their open price. Today's robust open and the extended nature of both bonds and growth stocks would suggest we are closer to the end than the beginning of this counter trend rally.

We updated our model portfolios this week for clients of TPWA's Model Portfolio Delivery Service (MPDS). We decided to take advantage of the opportunity provided by recent weakness to play offense adding to long term holdings in the Climate space as well as China growth (down 30% from high, O/S and trading at 15% discount to 10 yr. average valuation). Funding came from long duration US debt which just hit a new 52 week high.

On the Climate side the action keeps coming fast and furious. China just put its top regulatory body in charge of ensuring it meets its Climate objectives; it is likely to formalize its ETS this month. Europe is updating its ETS as well while California just asked its residents to cut water consumption by 15% y/ty to cope with a record drought. It's not inconceivable to me that over time water starts to be priced on a scarcity value basis along the lines of Carbon. Let's see if the G 20 meet includes any climate news along with the (VG) global tax update.

Our global multi asset model portfolio now incorporates ten distinct thematics including Water & Carbon while our TPW 20 model remains 100% thematic. StoneX notes that inflows to thematic ETFs rose 5x in 1H y/y to $150B while the # of thematic ETFs rose 4x in last 5 years. Thematics is the new global macro alpha hunting ground - one the big institutions have not yet started to fish in (and they will) along with Commodities.

Playing offense with solid technical support and a robust and unchanged global macro outlook feels right. Even in the Covid speed era it is highly unlikely we are close to the end of this cycle – economic growth or earnings wise. Keep in mind the average G7 growth cycle is 5 years… we are still in year one.

Let's see what earnings bring – US banks start us off and with US consumer demand for credit booming (up 39% y/y and up 11% over 2 yrs.) and the lock up on dividends and buybacks lifted it should be a good start to what will be a blockbuster earnings season. As always focus forward as the first glimpses into 2022 should start to manifest.

Here's another dueling duality – a short week that felt awfully long – TGIF!

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