



PROVIDING THE BIG PICTURE ON MACRO AND CREDIT SINCE 2009

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PLAN

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FIXED INCOME & FLOATING EXPENSES

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EXECUTIVE SUMMARY – 15TH OF NOVEMBER

MACRO THOUGHTS

- *"It is a way to take people's wealth from them without having to openly raise taxes. Inflation is the most universal tax of all." - Thomas Sowell*
- The US Consumer Inflation Report for October was "nasty", showing a 12% annualized rate of price change. It will get worse because of the surge in rental prices, a big component of US CPI. On this we agree with David Goldman from AsiaTimes - <https://asiatimes.com/2021/11/us-inflation-more-horrible-than-washington-admits/>
- Medical care and rent will be key inflation drivers in 2022, that's a given for US CPI.
- We posited last week in our conclusion that gold could start shining again. We think the moment has come and gold and silver precious metals could clearly benefit in the rebound.
- Energy woes are still there and will continue to weight on consumer sentiment. As such the significant fall in US consumer to the lowest since 2011 has to be watched very closely: University of Michigan Consumer Sentiment Index fell 4.9ppts to 66.8 in November a decade low.
- We get US retail sales very soon, October figures might still be good but rising inflationary pressure on the US consumer risks undermining retail sales in the month ahead.
- **BofA private client allocation:**
 - 66.0% stocks (new all-time high)
 - 17.0% bonds (new all-time low)
 - 10.4% cash (lowest since Sep'18)
- How do US dollars get "recycled then?" As described by Charles Gave recently, it used to be in US Fixed Income, now it seems to be in US Stocks. Fixed Income & Floating Expenses...

MACRO THOUGHTS

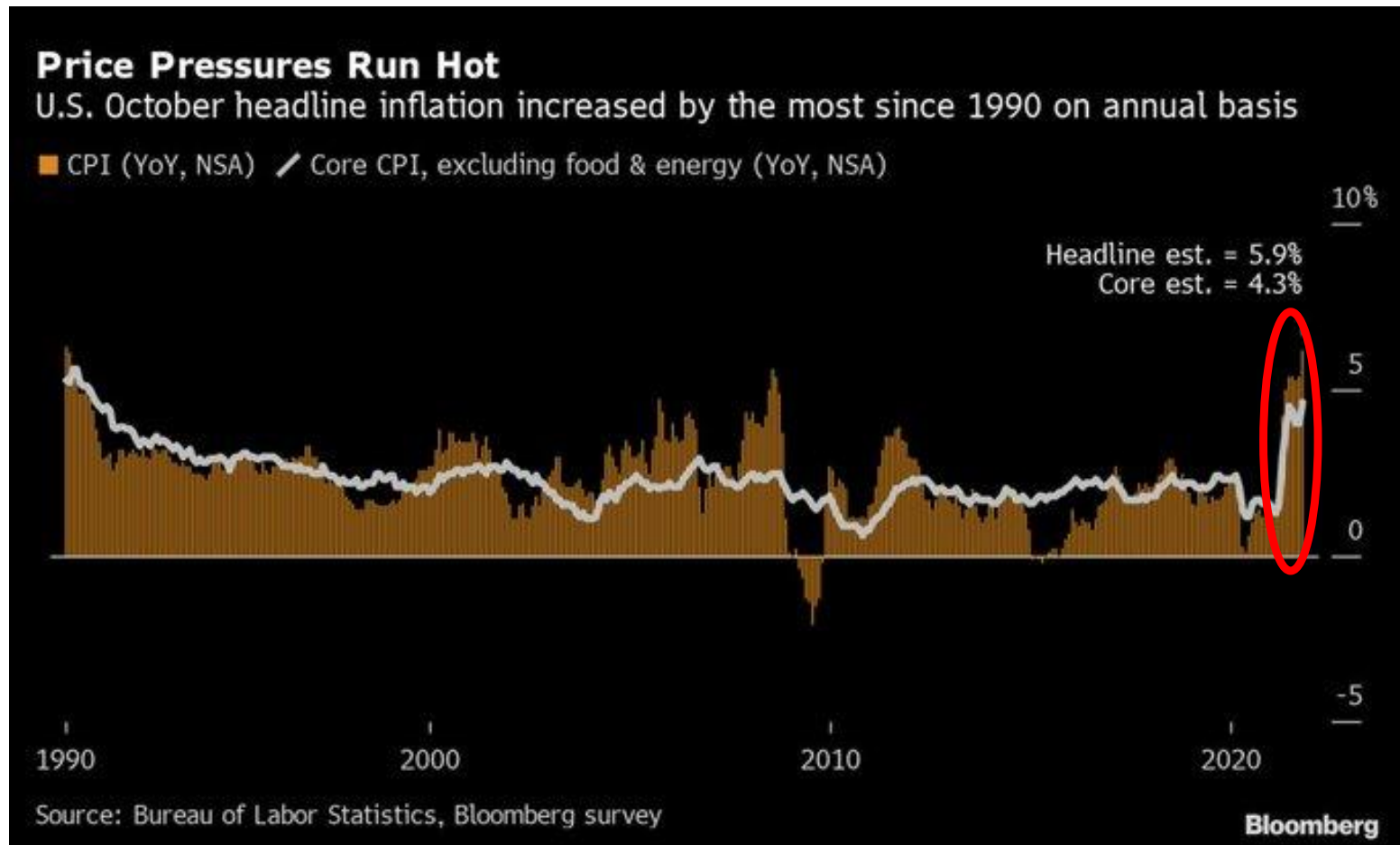
- **A little reminder in Macroeconomics**
- Robert Lucas argued that it is naive to try to predict the effects of a change in economic policy entirely on the basis of relationships observed in historical data, especially highly aggregated historical data. In essence the Lucas critique is a negative result given that it tells economists, primarily how not to do economic analysis:
- *"One important application of the critique (independent of proposed microfoundations) is its implication that the historical negative correlation between inflation and unemployment, known as the Phillips Curve, could break down if the monetary authorities attempted to exploit it. Permanently raising inflation in hopes that this would permanently lower unemployment would eventually cause firms' inflation forecasts to rise, altering their employment decisions. Said another way, just because high inflation was associated with low unemployment under early-twentieth-century monetary policy does not mean we should expect high inflation to lead to low unemployment under all alternative monetary policy regimes."* – Robert Lucas

MACRO THOUGHTS

- **A little reminder in Macroeconomics**
- In the 1970s, new theories came forward to rebuke Keynesian theories behind the Phillips Curve by monetarists such as Milton Friedman, such as rational expectations and the NAIRU (non-accelerating inflation rate of unemployment) arose to explain how stagflation could occur:
- *"Since the short-run curve shifts outward due to the attempt to reduce unemployment, the expansionary policy ultimately worsens the exploitable tradeoff between unemployment and inflation. That is, it results in more inflation at each short-run unemployment rate. The name "NAIRU" arises because with actual unemployment below it, inflation accelerates, while with unemployment above it, inflation decelerates. With the actual rate equal to it, inflation is stable, neither accelerating nor decelerating. One practical use of this model was to provide an explanation for stagflation, which confounded the traditional Phillips curve."* - source Wikipedia
- **The issue with NAIRU:**
- *"The NAIRU analysis is especially problematic if the Phillips curve displays hysteresis, that is, if episodes of high unemployment raise the NAIRU. This could happen, for example, if unemployed workers lose skills so that employers prefer to bid up of the wages of existing workers when demand increases, rather than hiring the unemployed."* - source Wikipedia

FIXED INCOME & FLOATING EXPENSES

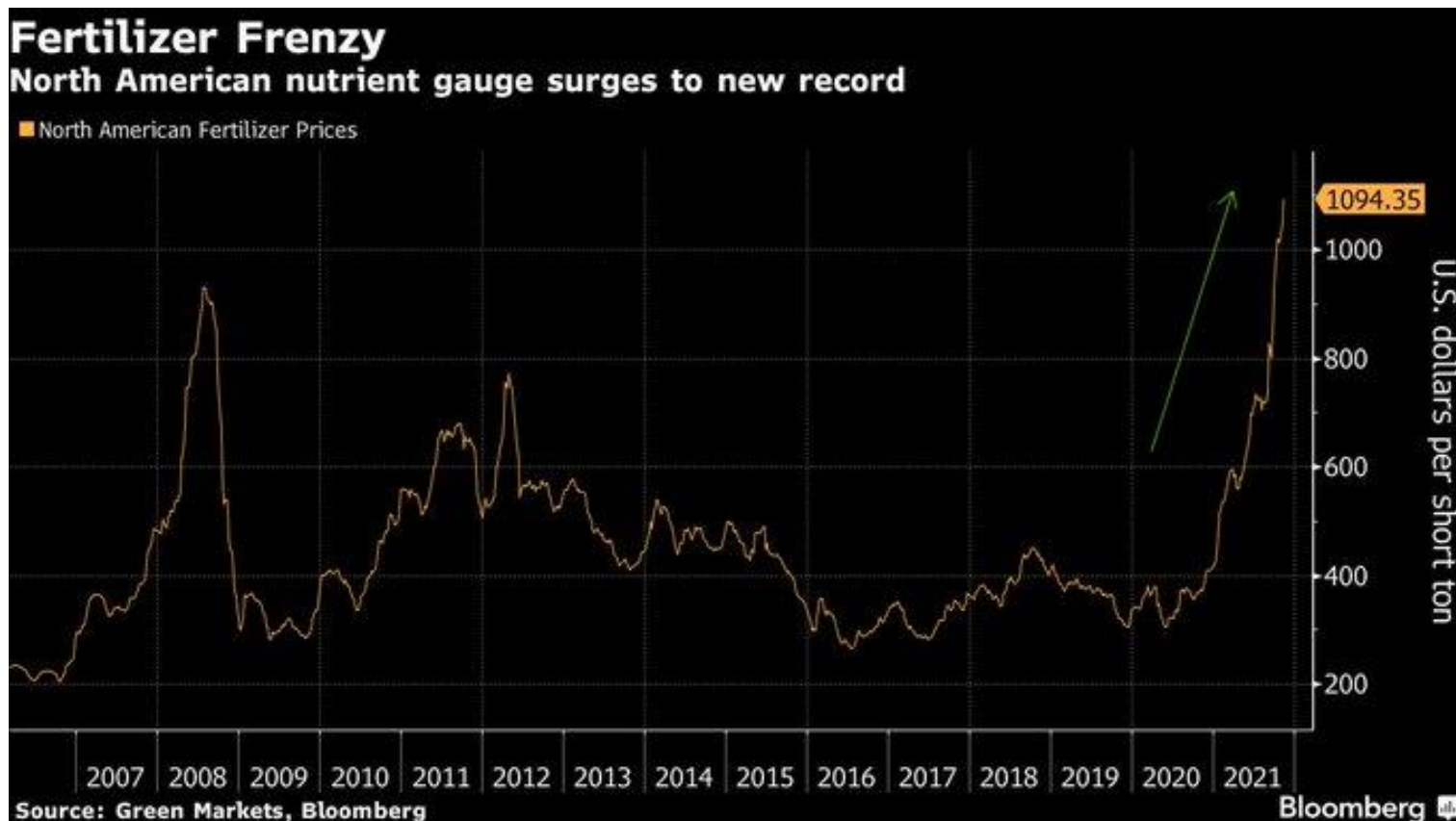
- Lawrence Summers suggested that outsize price gains are now becoming enduring as the U.S. economy suffers its fastest inflation since 1990



Graph source – Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- We have been sounding the alarm since last summer about “pitchforks risk rising. Are you paying attention now?
- Fertilizer prices keep soaring to unprecedented heights, signaling escalating costs for farmers and consumers around the world



Graph source — Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- U.S. consumer sentiment falls to the lowest since 2011.
- Higher inflation perceived to erode income (today & over the next year) & purchasing power, especially amongst older consumers

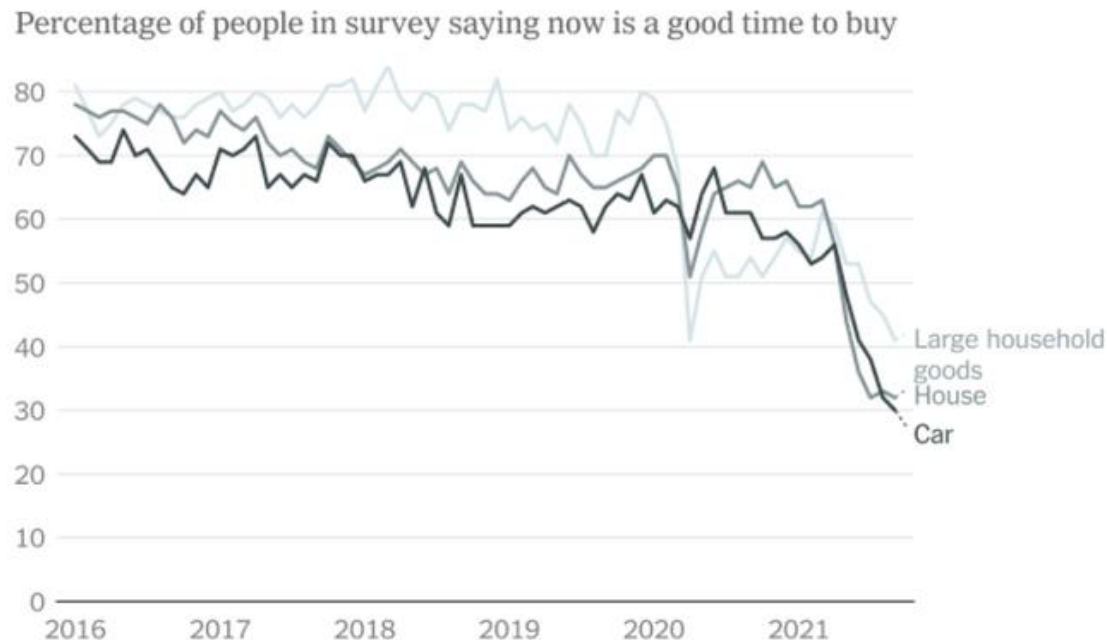


Graph source — Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- “Will rising inflation pinch US consumer spending? Next week's retail sales data for Oct looks encouraging: <https://bit.ly/3caORb3> but risk may rising in the months ahead” – James Picerno

Consumers Remain Resistant to High Prices



Source: University of Michigan Surveys of Consumers • By The New York Times

Graph source - James Picerno – NYT – University of Michigan - Twitter

*CPI rose 0.9% in Oct v 0.4% in Sept, est up 0.6%

CPI y/y rose 6.2% v est 5.9

1990 HIGH

*CPI ex. food/energy m/m UP 0.6%; est. up 0.4%; UP 4.6%; est. up 4.3%

*Food UP 0.9% in Oct v Sept 0.9%

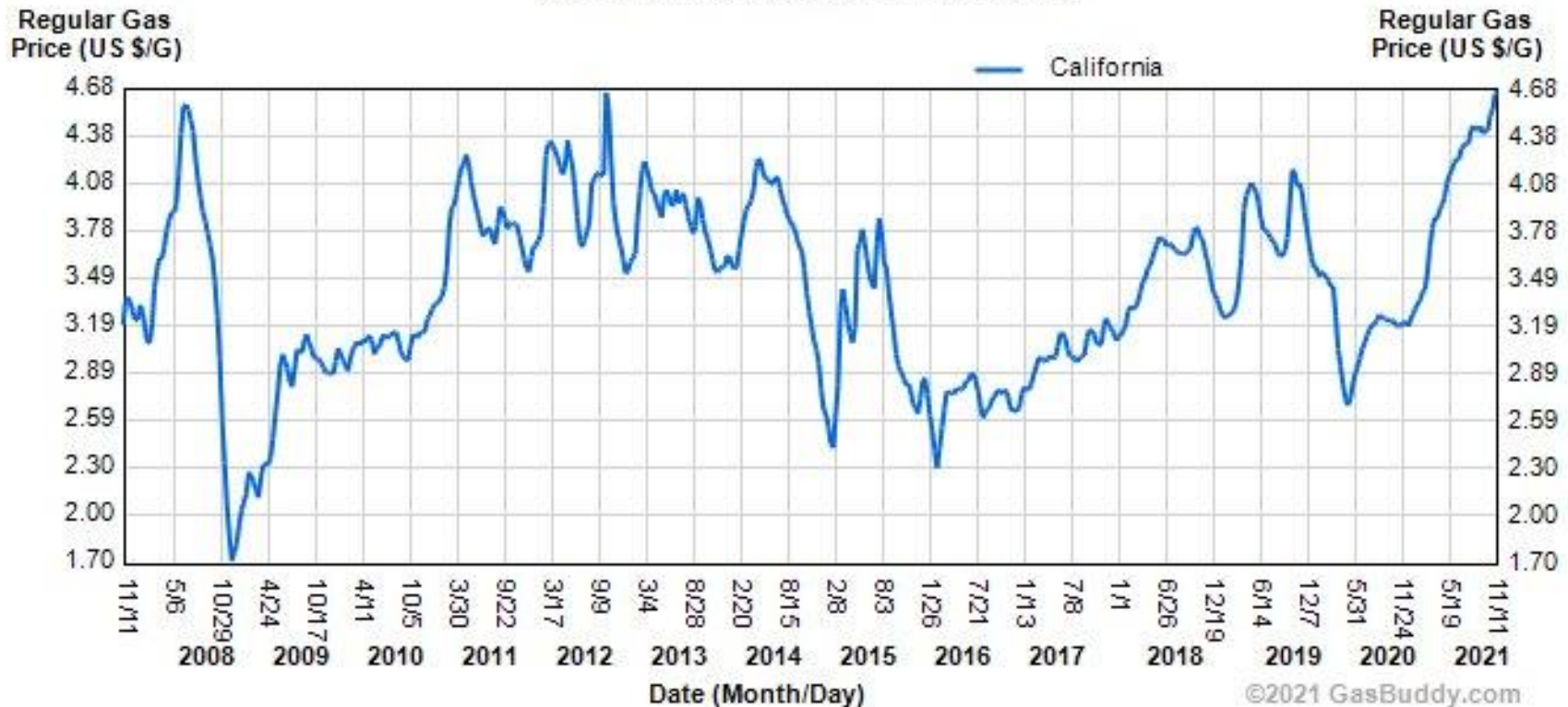
*Energy UP 4.8% in Oct. v 1.3% in Sept

*OER 0.4% v Sept 0.4%; up 3.1% y/y

FIXED INCOME & FLOATING EXPENSES

- “Average gas prices in California remain at all-time record highs, beating out both 2012 and 2008 records. \$4.68/gal today statewide average.” – Patrick De Haan

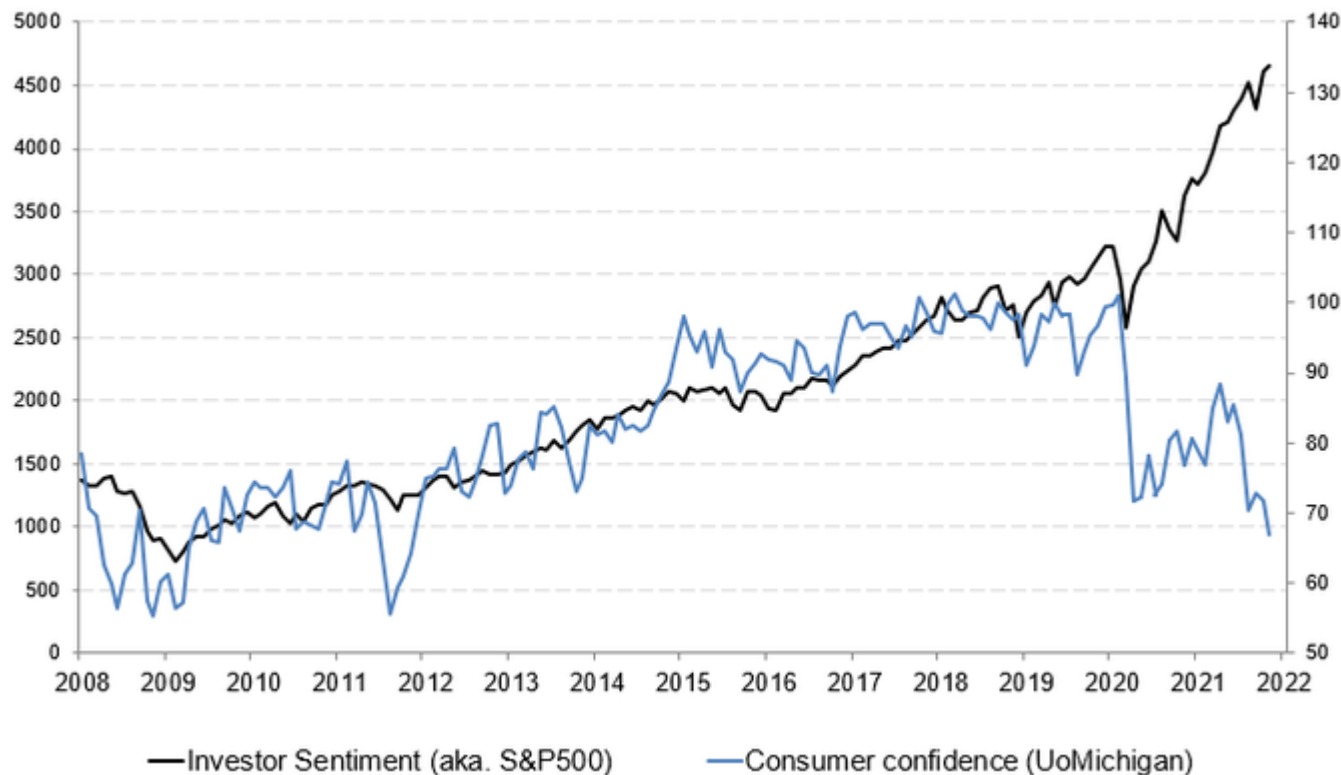
168 Month Average Retail Price Chart



Graph source Patrick De Haan - Twitter

FIXED INCOME & FLOATING EXPENSES

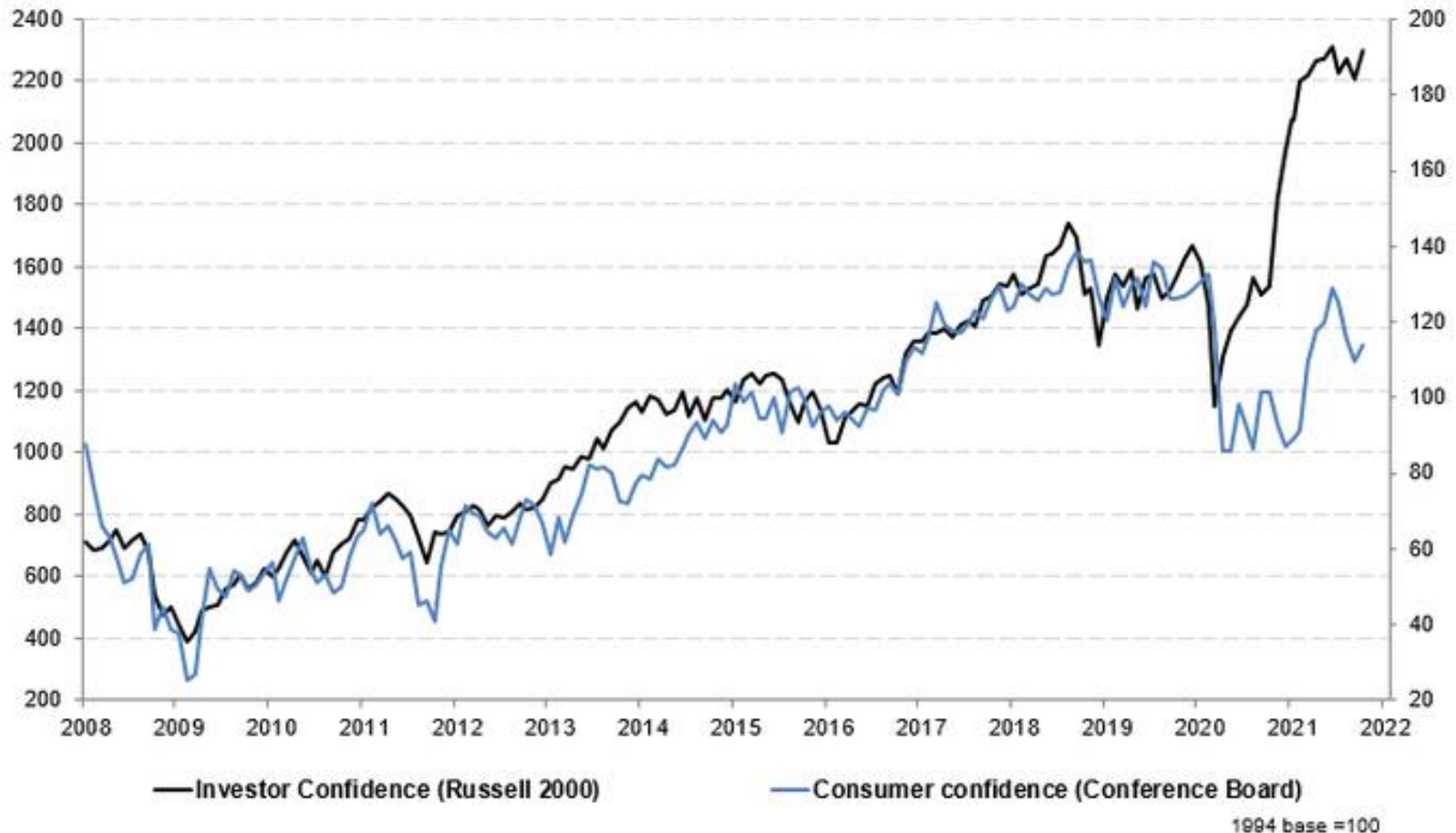
- Consumer sentiment is diverging from investor sentiment - asset price inflation is one thing, but surging consumer price inflation is another thing when it comes to the consumer.
- US consumer & investor sentiment has never been as diverged as it is now. Mind the gap.



Graph source - @takis2910 – Twitter

FIXED INCOME & FLOATING EXPENSES

- More direct comparison of consumer & investor sentiment is Conference Board vs. \$RTY (Russell 2000).



Graph source - @takis2910 – Twitter

FIXED INCOME & FLOATING EXPENSES

- New York City apartment market is on fire and median rent in Manhattan rose 18% y/y in October to \$3,382 (largest annual increase in a decade); per Samuel Miller, preference for higher-end apartments drove rents higher.



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- If rents are rising fast, guess where US CPI will be going next?
- So no inflation will not be “transitory”.

Outpaced

Rents for class B apartments have increased faster this year

■ Class A ■ Class B



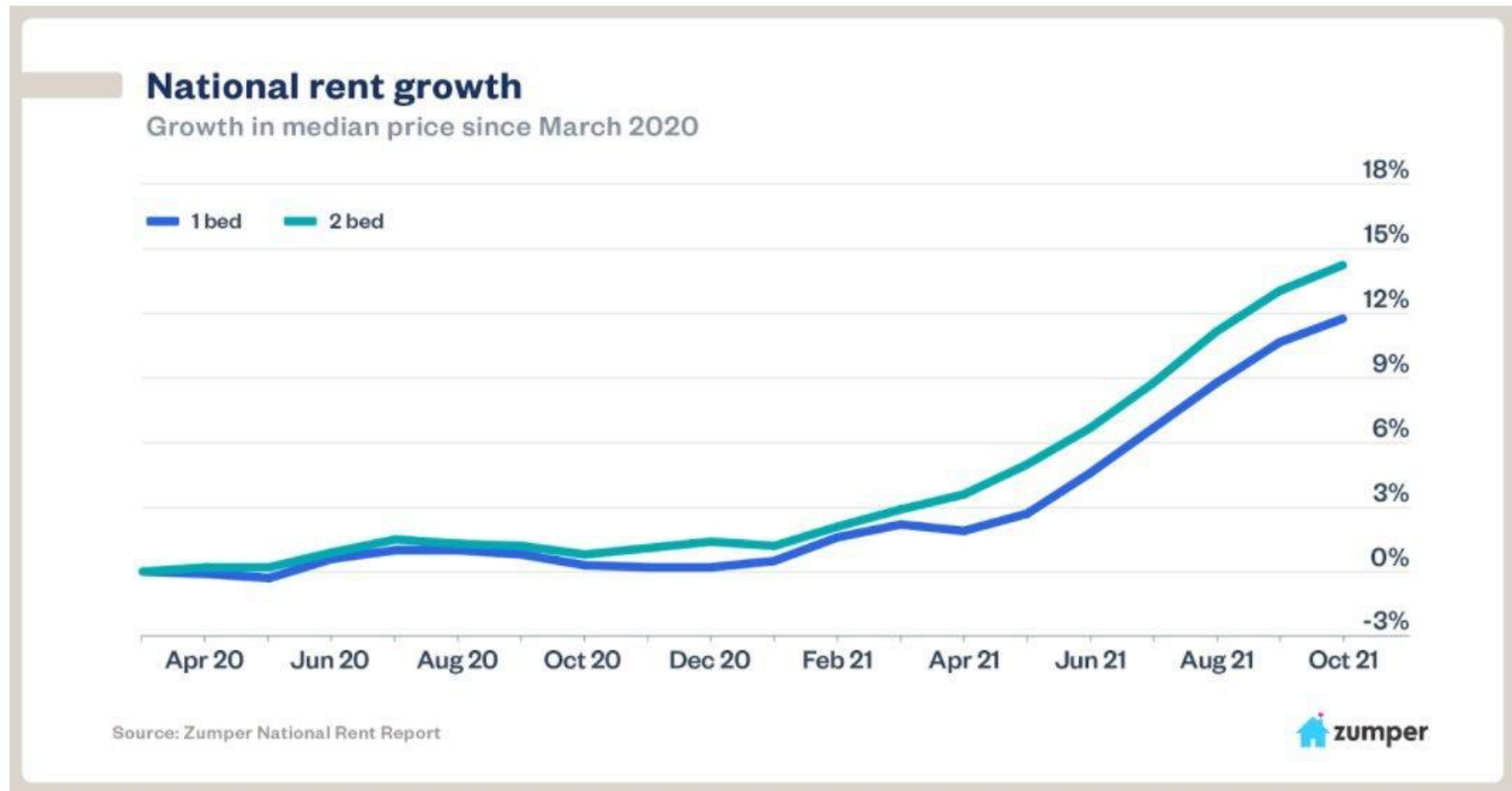
Source: Zumper

Note: Rate of change from March to October 2021

Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- Rents are on an upward trajectory so for the US consumer, it doesn't look that good going forward on top of rising energy prices and healthcare.



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- U.S. 10-year breakeven rates have risen to the highest since 2006.



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- Billionaire Investor Ray Dalio warns inflation is driving down real wealth: "Some people make the mistake of thinking that they are getting richer because they are seeing their assets go up in price without seeing how their buying power is being eroded."



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

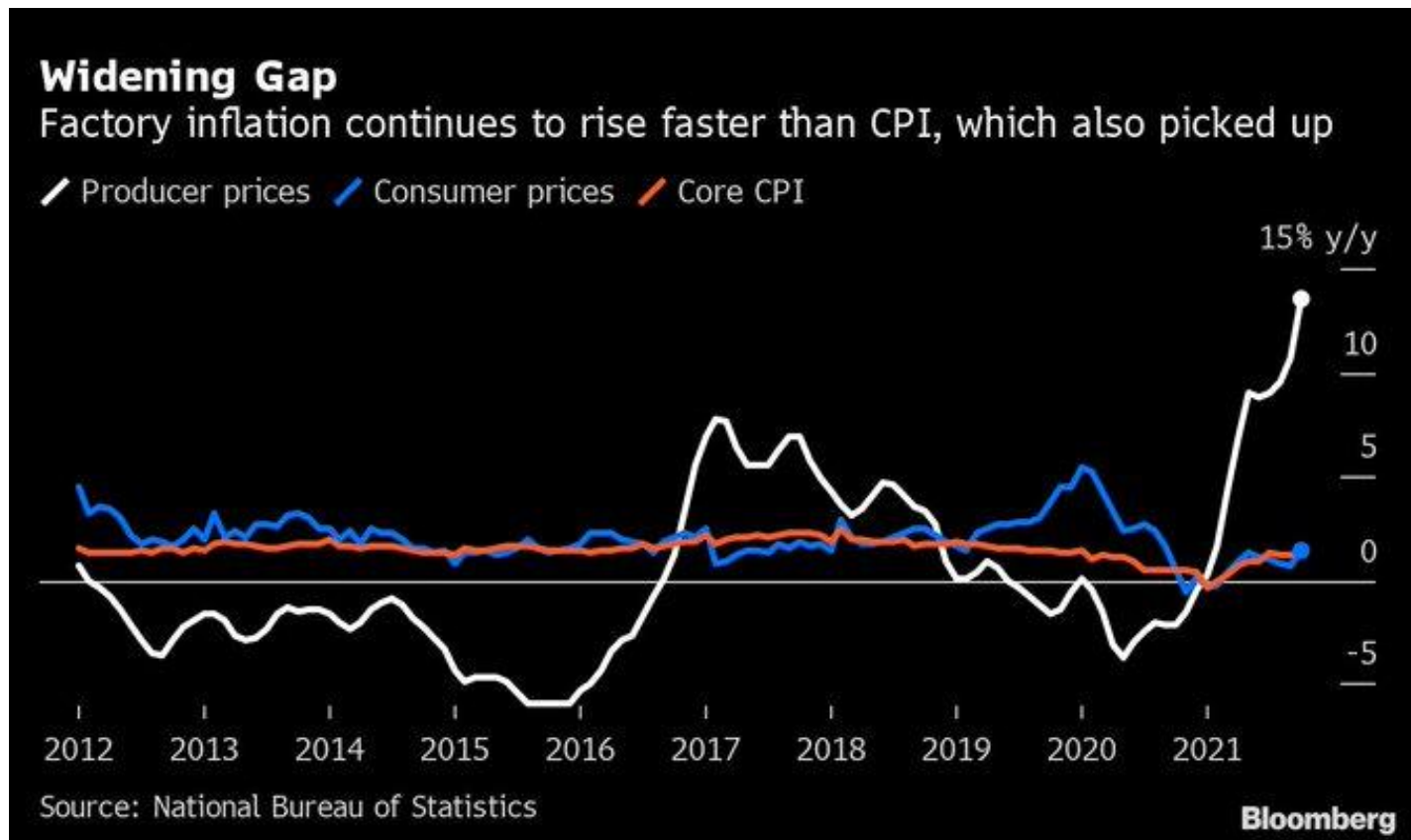
- In Germany inflation pressure keeps rising. Selling prices in wholesale trade rose by 15.2% in Oct YoY, highest since March 1974 after the 1st oil crisis (+15.8%). Wholesale inflation mainly driven by increased prices for raw materials and intermediate products.
- The ECB has a problem...



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

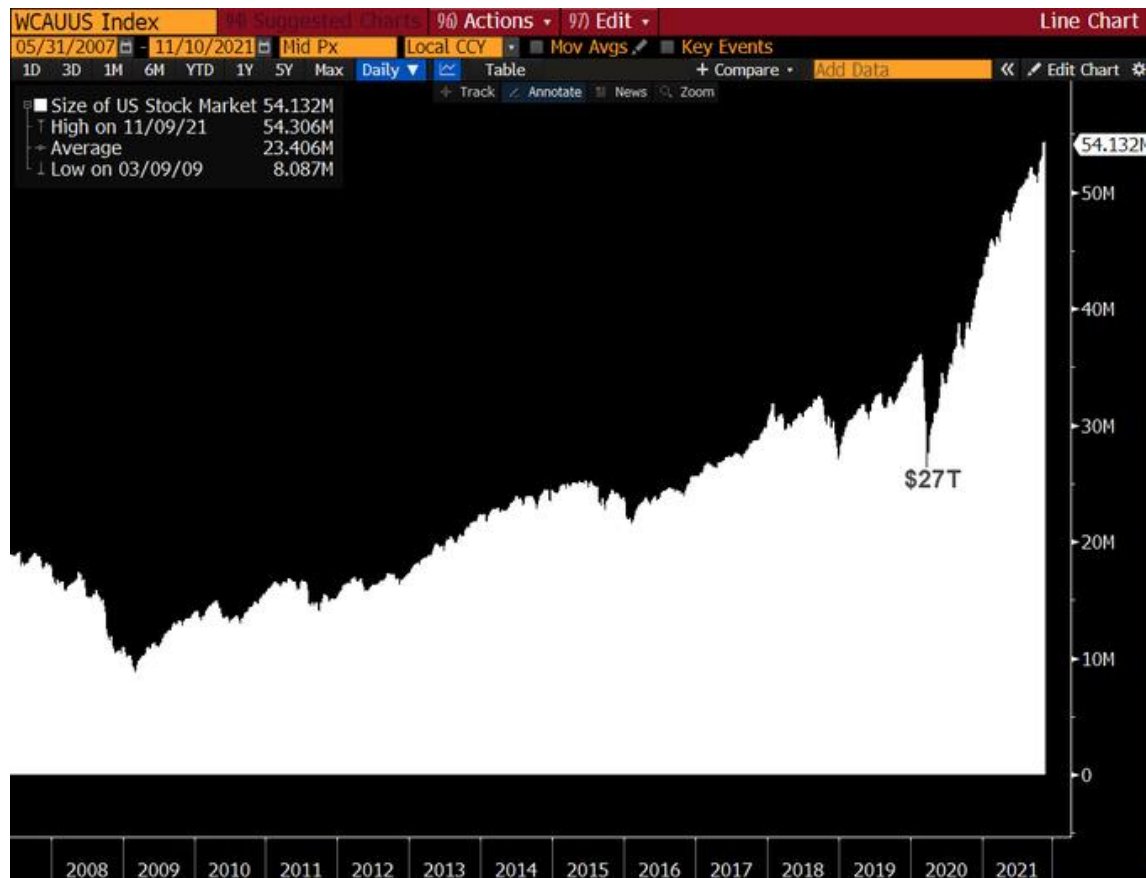
- China's PPI climbed 13.5% YoY, hitting fastest pace in 26 years & beating the median forecast for a 12.3% gain, data from National Bureau of Statistics showed Wednesday. The consumer price index rose 1.5%, fastest pace since September 2020 & above projected 1.4% gain.



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- The U.S. stock market is now \$54T, up from \$9T in 2008 and up from \$27T just 20 months ago.
- QE does wonders on “asset prices”.



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- “S&P 500’s real earnings yield has plunged to its lowest on record ... at -2.3%, surpasses prior low of -2.1% in 1974” – Liz Ann Sonders.
- The Money illusion in full display...



Graph source – Liz Ann Sonders - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

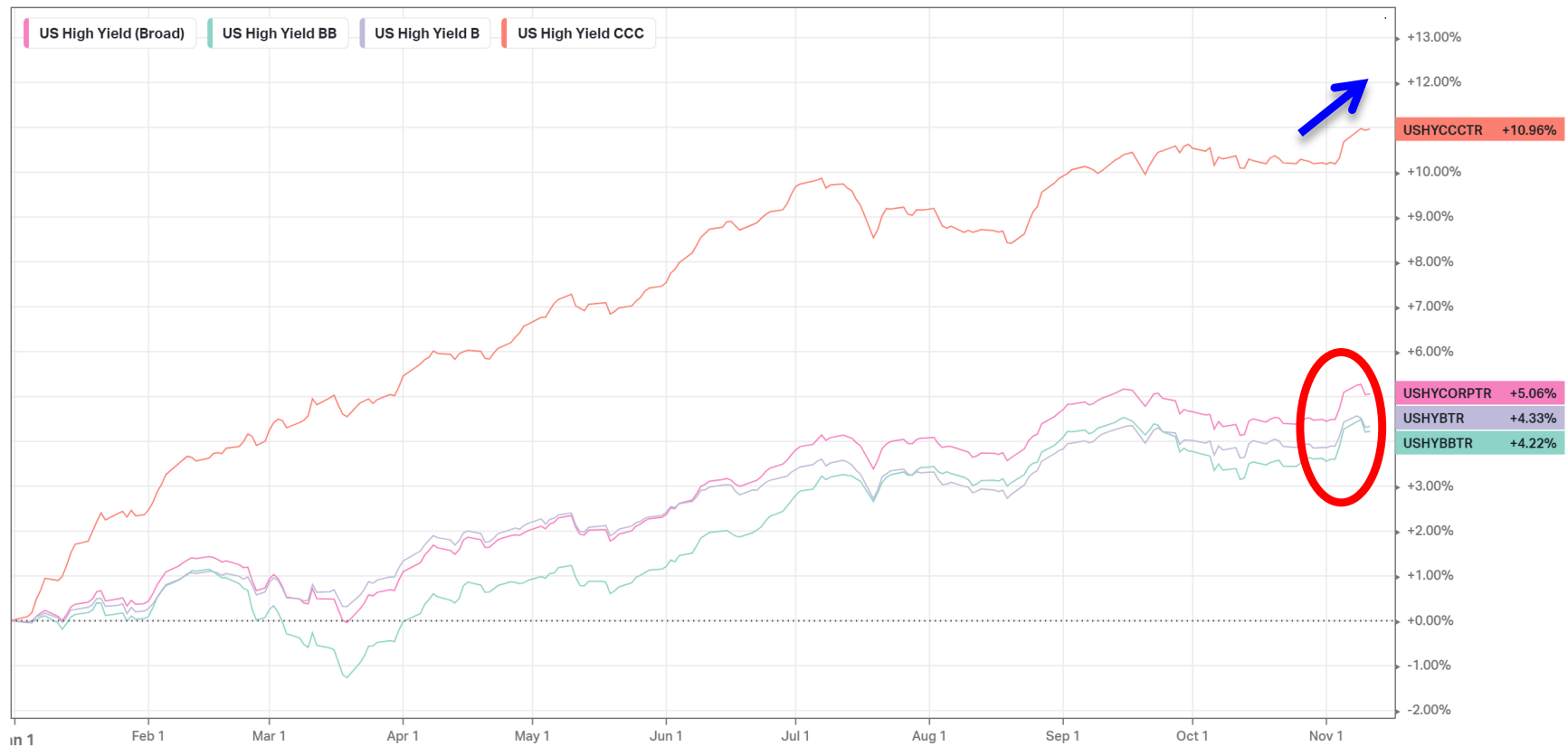
- 'The current "patient" approach is beginning to look totally inappropriate. On a real basis, we have the lowest real fed funds rate in history, at a time when inflation is its highest in 30 years.' - John Authers



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- High beta US High Yield continue to benefit from the rise in oil prices. For US High Beta and CCCs it has been a very good year so far.



koyfin

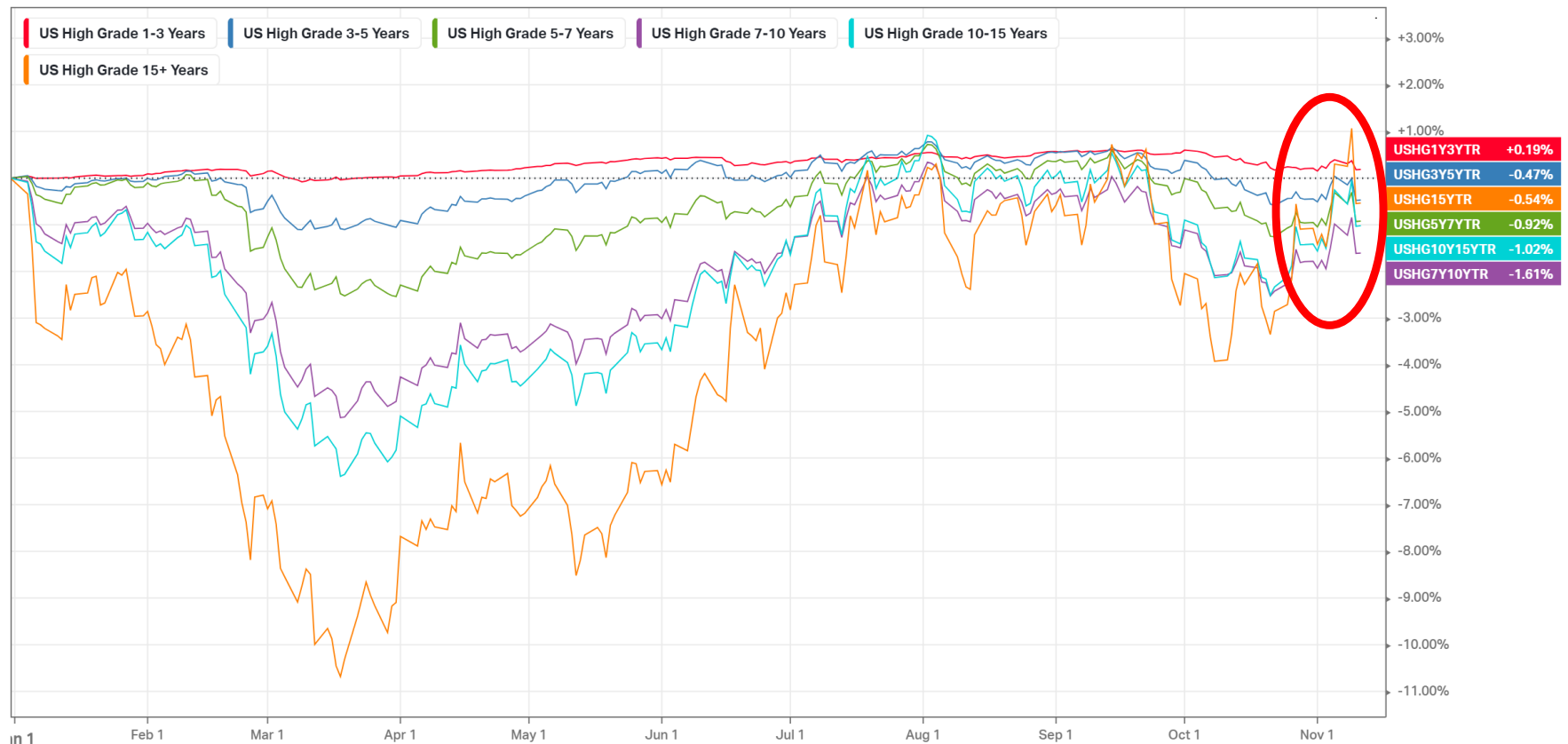
Graph source – KOYFIN - Macronomics

Private and Confidential November 2021

macronomics

FIXED INCOME & FLOATING EXPENSES

- The continuation in Government bonds volatility continues in that context to weaken the YTD performance of convexity exposed asset such a US Investment Grade bonds. No change from last week.

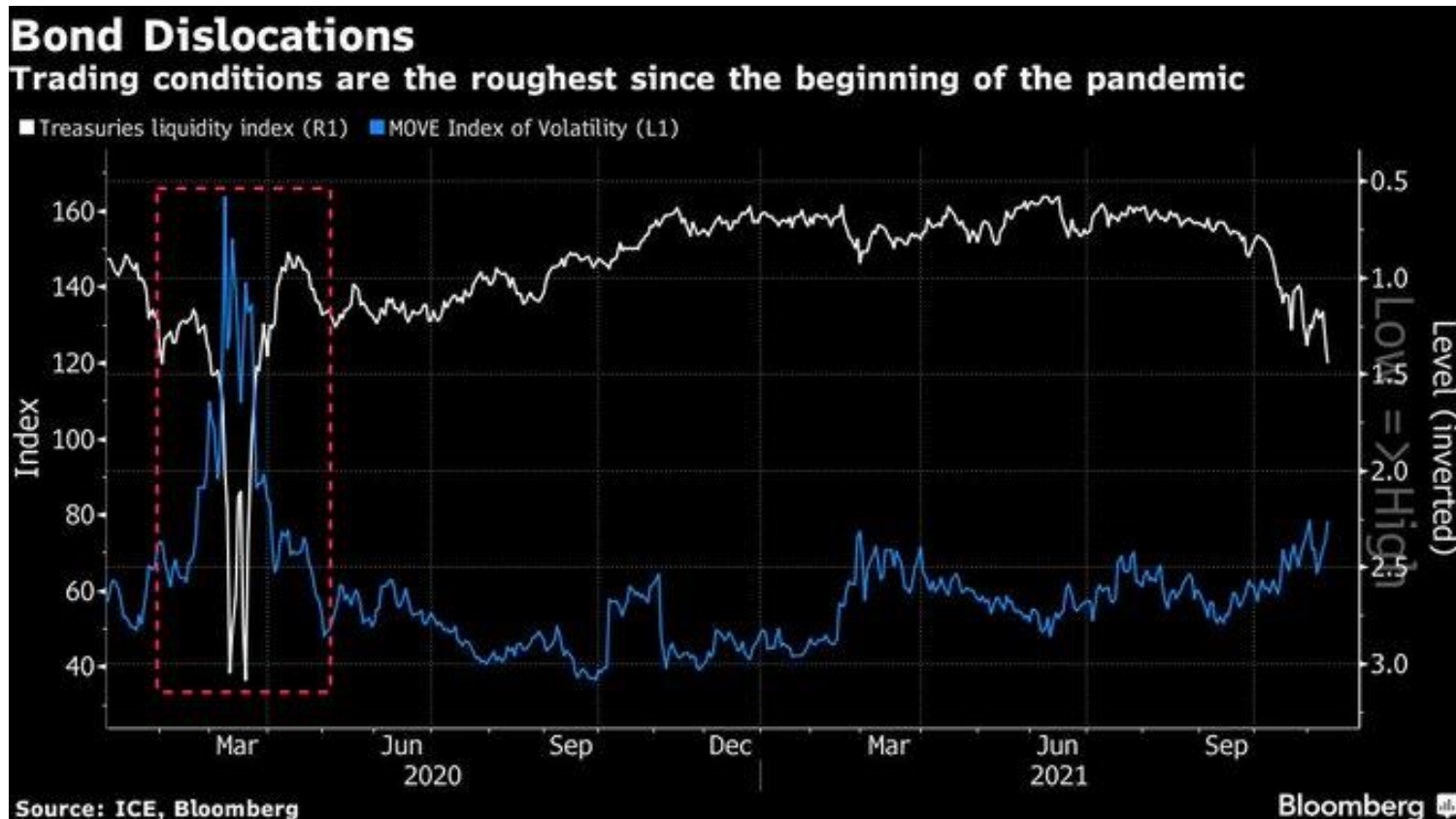


Graph source – KOYFIN - Macronomics

koyfin

FIXED INCOME & FLOATING EXPENSES

- “Signs have emerged in the U.S. Treasury market of a vicious cycle in which reluctance to participate in the market impairs liquidity, making large price swings even more likely.” – Bloomberg
- Less liquidity means more volatility in the fixed income space. Watch out.



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- Implied volatility in U.S. yields has risen to near the highest since April 2020.
- Given the leveraged nature of Risk Parity fundsn how long until it spills onto equities volatility?



Graph source - Bloomberg - Twitter

FIXED INCOME & FLOATING EXPENSES

- Implied stock volatility has generally been falling.
- So all in all money is flowing into stock from outflows in fixed income



Graph source - Bloomberg - Twitter

ARE SOME CENTRAL BANKS TRAPPED?

- The famous Taylor rule thinks the FED funds rate should be above 6.5%.
- Is the FED behind the curve?



Graph source - Bloomberg - Twitter

ARE SOME CENTRAL BANKS TRAPPED?

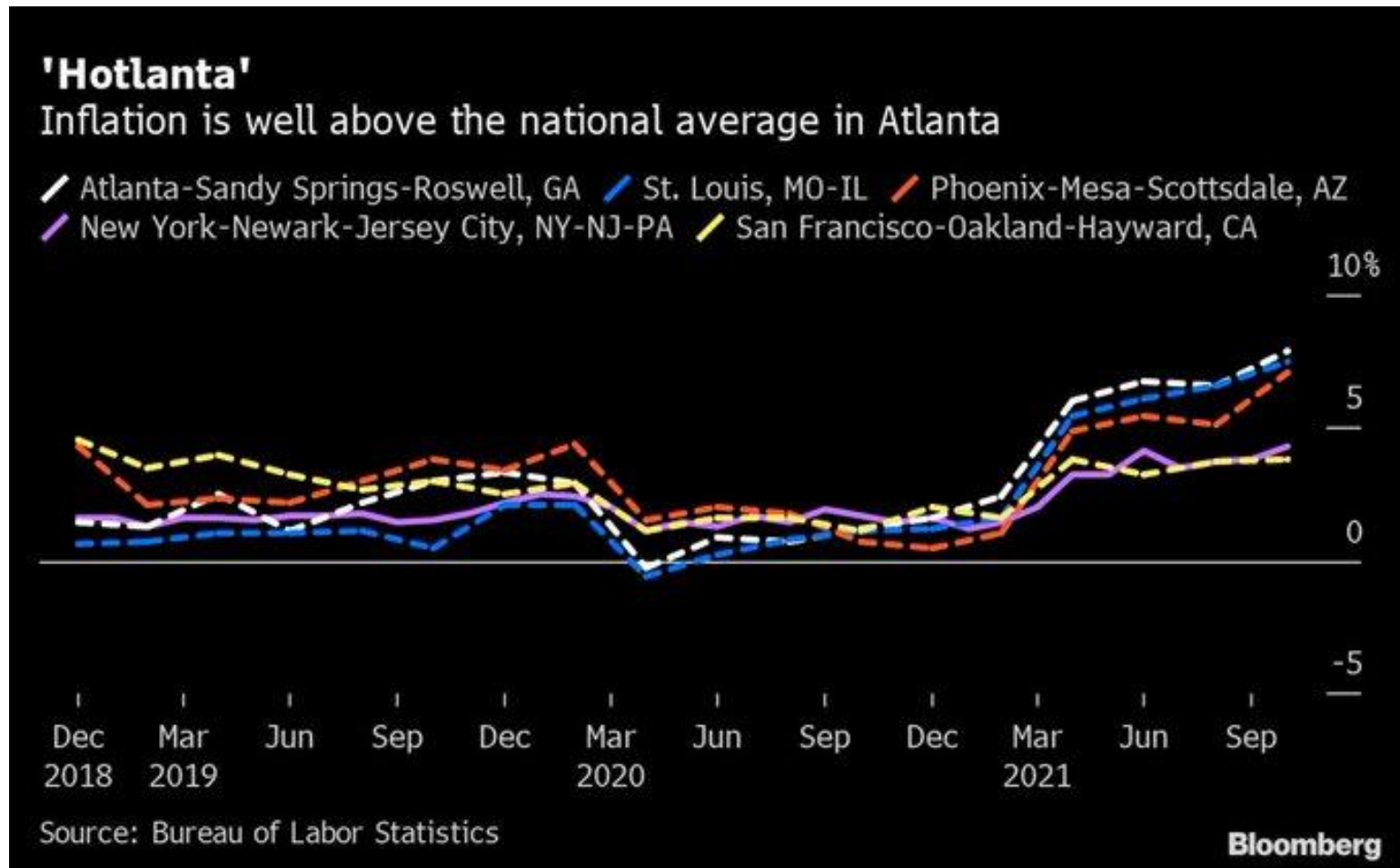
- US 5-year inflation swaps are now at a three-decade high.



Graph source - Bloomberg - Twitter

ARE SOME CENTRAL BANKS TRAPPED?

- Inflation in Atlanta is double what it is in San Francisco



Graph source - Bloomberg - Twitter

ARE SOME CENTRAL BANKS TRAPPED?

- “Gold miners finally staging a relative breakout vs. the S&P 500?” – Julien Bittel CFA
- It certainly looks to us this way.

Gold Miners (GDX US) vs. US Equity (SPY US)



Graph source - Julien Bittel CFA - Bloomberg - Twitter

ARE SOME CENTRAL BANKS TRAPPED?

Here's a breakdown of price increases in the latest CPI report:

- Gasoline: +49.6%
 - Gas Utilities: +28.1%
 - Used Cars: +26.4%
 - Meats/Fish/Poultry/Eggs: +11.9%
 - New Cars: +9.8%
 - Electricity: +6.5%
 - Overall CPI: +6.2%
 - Food at home: +5.4%
 - Food away from home: +5.3%
 - Transportation: +4.5%
 - Apparel: +4.3%
 - Shelter: +3.5%
- For much of this year, rising inflation has been bad news for gold. Now it's giving the metal a shot in the arm.
 - No wonder in Thematic ETF land Gold Miners are up 6.23% over the week but still 9.25% down YTD



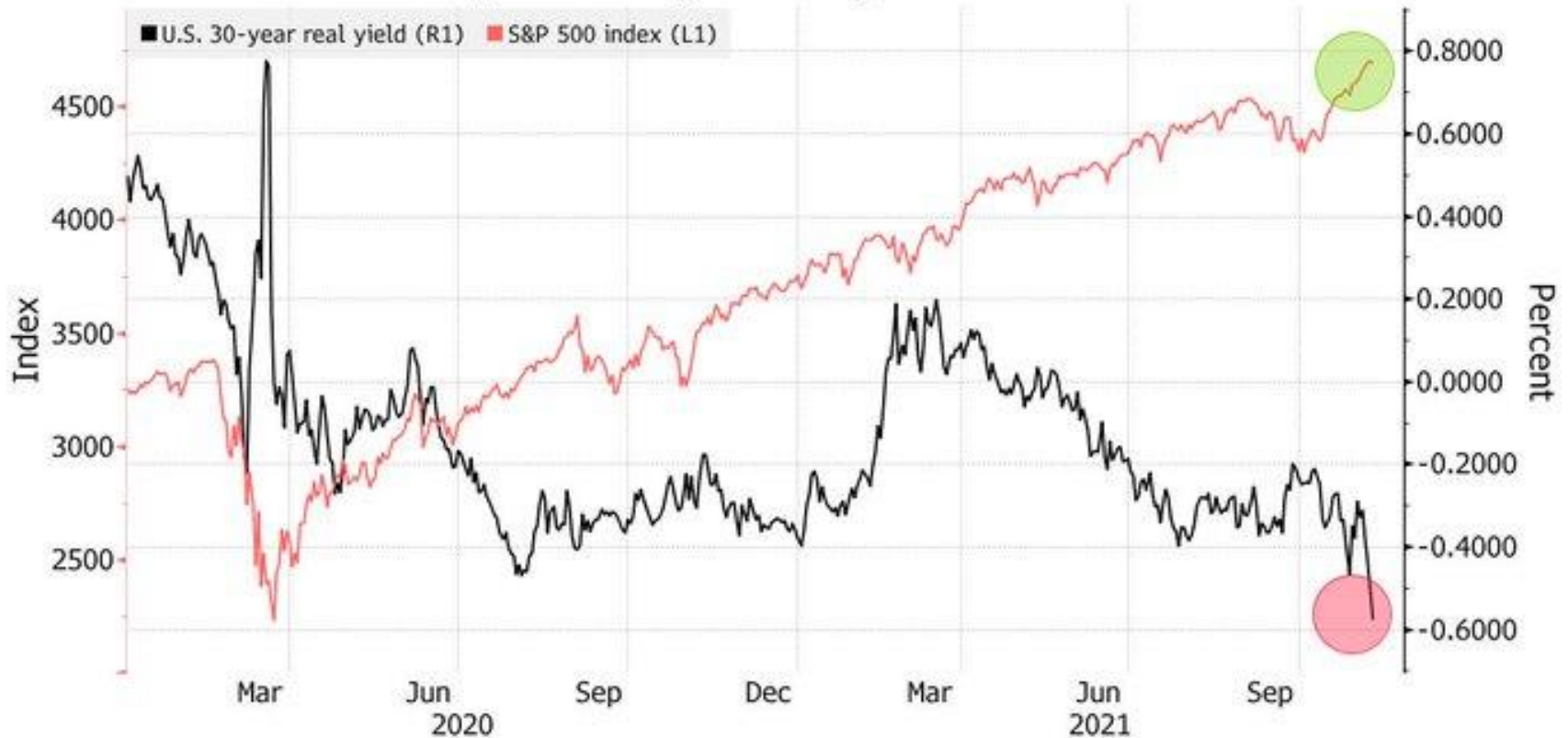
Graph source - Bloomberg - Twitter

FOOD FOR THOUGHTS

- Risk Binge or a Bubble? Signals From Real Yields Split Investors - Bloomberg

Separate Ways

U.S. stocks hit all-time highs as 30-year real yields set record low



Source: Bloomberg

Bloomberg

Chart source - Bloomberg - Twitter

FOOD FOR THOUGHTS

- "The average yield for the high-yield bond index has remained below 4% for much of this year, hitting record lows in July, according to Bloomberg data. But, it's been on an upward trajectory as of late, closing at 4.03% as of Monday." - Bloomberg

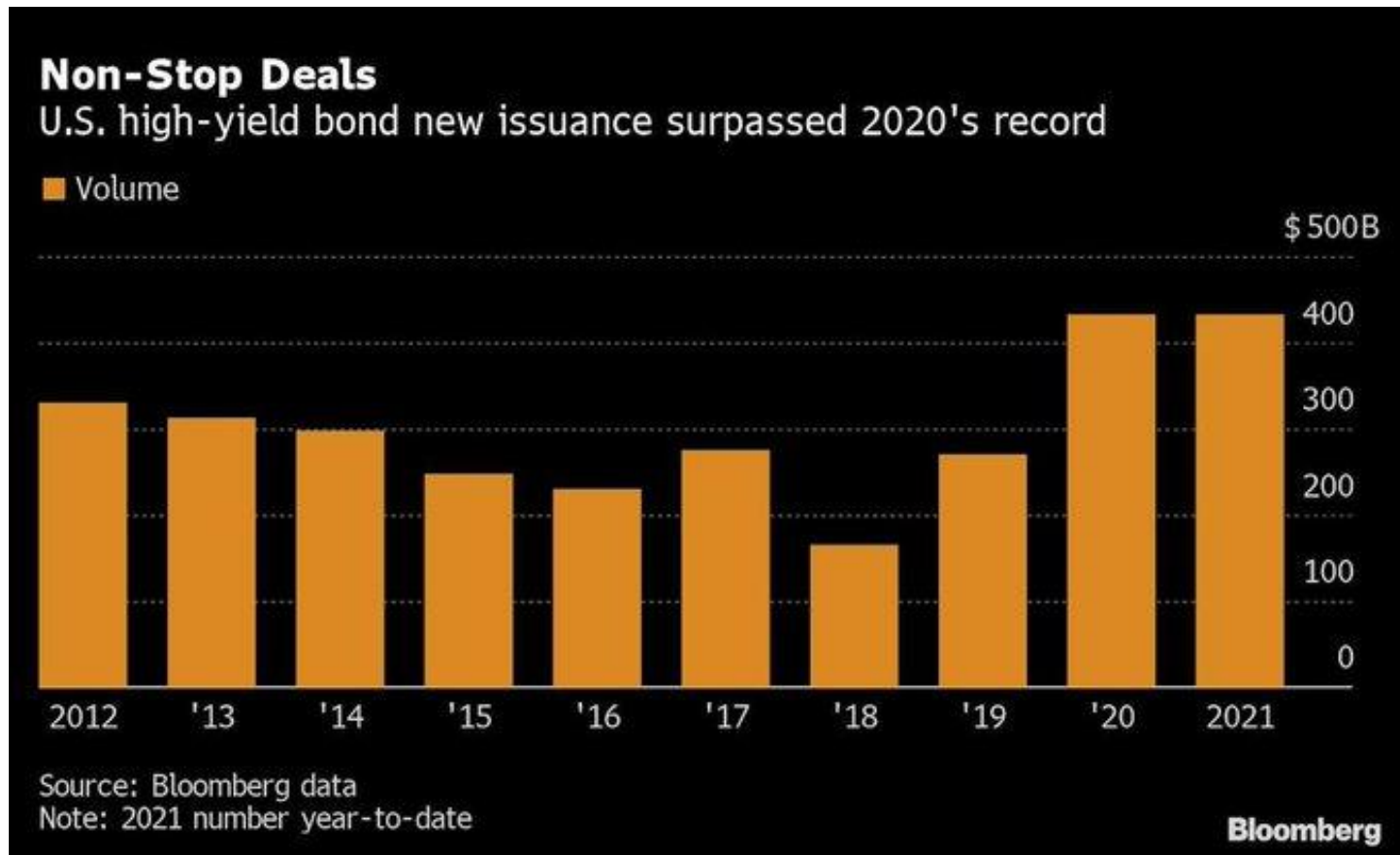


Chart source - Bloomberg - Twitter

FOOD FOR THOUGHTS

- Is VALE completely oversold / undervalued equity given it is the number 1 iron ore miner in Americas and number 1 nickel producer globally?
- Nickel and cobalt may need 20-times current production to meet demand
- Lithium prices aren't the central cost in batteries, depending on the battery it's Nickel or Iron ore.



Graph source – Seeking Alpha

- We have this 2.6x FY2022 EV/EBITDA, 18.05% FCF yield
- We are turning positive on the name as it seems to us a nice contrarian bet.

FOOD FOR THOUGHTS

- Glencore (blue line) is up by 57.90% YTD versus VALE SA (red line) down 21.90% YTD.
- Both have similar market capitalization now : \$64.8 bn vs \$61.4bn



Graph source – MarketScreener

FOOD FOR THOUGHTS

- Glencore (blue line) versus VALE SA (red line) over the last two years.
- VALE SA used to outperform Glencore by a significant margin.



Graph source – MarketScreener

FOOD FOR THOUGHTS

- From a profitability perspective, VALE appears to us deeply “oversold” but, given new restrictions linked to COVID resurgence that seems to already affecting the Chinese economy, for some it might be too early to call the bottom in Iron Ore prices which would no doubt benefit VALE SA.

VALE SA:

- Its Gross Profit Margin (TTM) is 61.16% versus a sector median of 30.39% (source Seeking Alpha).
- Its Net Income Margin (TTM) is 31.65% versus a sector median of 8.25% (source Seeking Alpha).



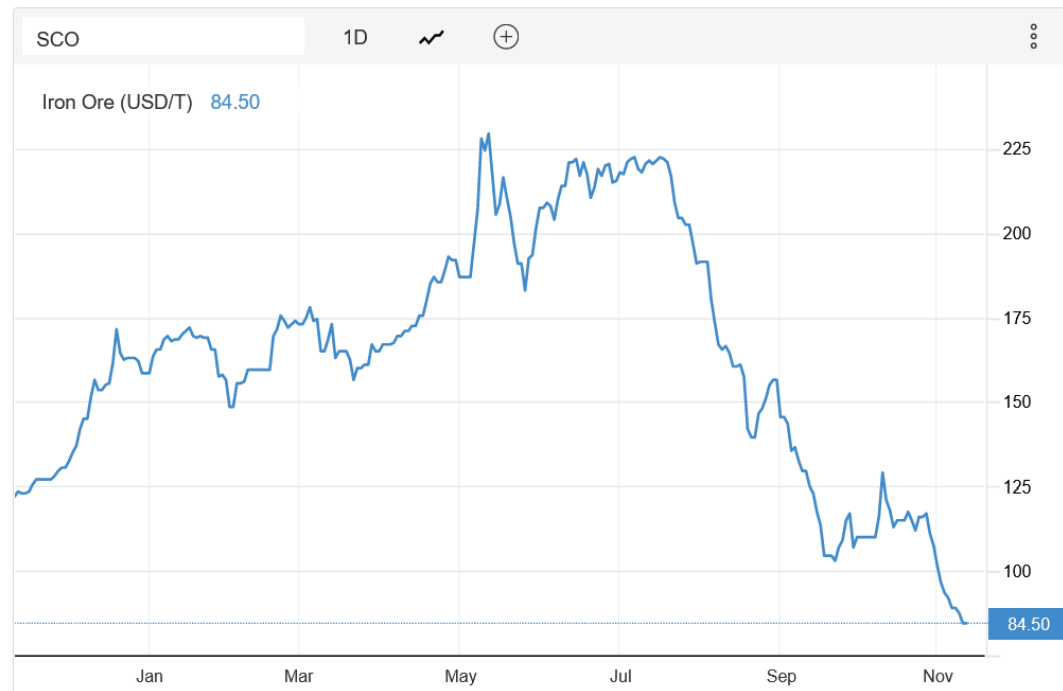
Graph source – Bloomberg Twitter

- Nonetheless we like beaten up, oversold stocks such as VALE SA though it might seem a little bit too early to pull the trigger. We do think it is one to watch closely.

FOOD FOR THOUGHTS

- Iron Ore price looking as well “oversold” thanks to fears of a big Chinese “slowdown”.
- Iron ore bust has been spectacular, falling 2/3 over the past 6 months.
- And the discount for lower 58% grade ore has blown out from <10% to about 30% over the period, presumably on the combination of 1) soaring coking coal prices and 2) emissions reduction throttling in China.

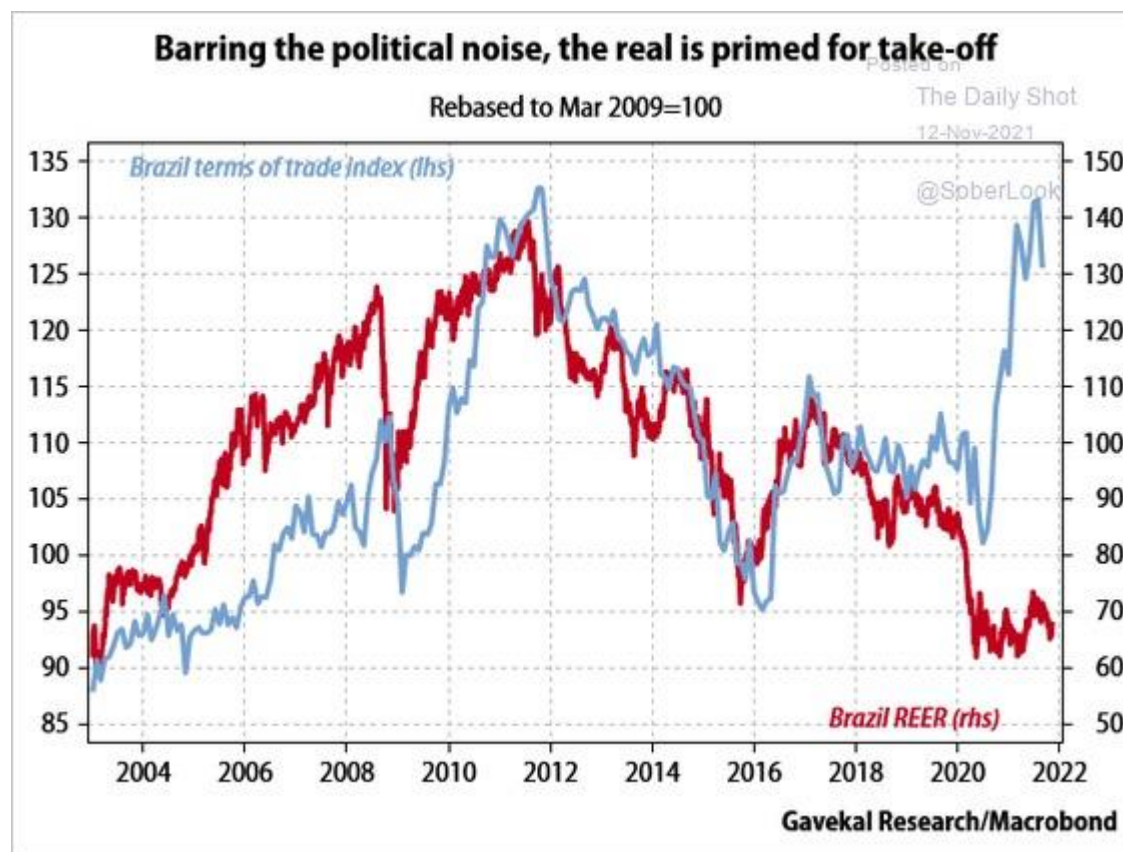
Iron ore with 63.5% iron content for delivery in Tianjin extended its downward momentum to below \$90 per metric tonne, the lowest since May 2020 on weak industrial demand from China due to curbs on steel production. After enforced constraints on steel production in 2021, China ordered steel mills to lower output during the winter season and ahead of the Winter Olympics in Beijing. Moreover, the Chinese property sector remains under pressure as Beijing tightens credit lines and Evergrande's difficulties spark contagion for other Chinese property developers. Capacity utilization rates of 163 blast furnaces at mills across China plunged 66.17% from the previous week to 62.39% in the first week of November, data from Mysteel consultancy showed. Weekly steel consumption in the world's top metals consumer also dipped, down 2.3% from the previous week, according to Mystel. Meanwhile, official data showed China's iron ore imports fell 4.2% in October for a second straight month of decline.



Graph source – Twitter

FOOD FOR THOUGHTS

- No other EM currency is as beaten up as the Real, taking into account sky-high terms of trade due to elevated commodity prices.
- 12-month rate differential on Brazil is now in the double digits at 11.1%.



Graph source – SoberLook – Gavekal - Twitter

5 CONCLUSION

CONCLUSION

- Harpex index is falling a bit but not enough yet in comparison to the Baltic Dry Index (bulk cargo), this will continue to put pressure on prices and corporate margins. We continue to watch the Harpex index very closely for cues on global trade.
- We continue to like the “uranium” play.
- Gold is getting a bid. We start liking it again, and Silver and Precious Metals miners as well!

Theme ↕		Day ↕	Week ↕	Month ↕	Year ↕	# Assets ↕
Cannabis	•	▲ 5.92%	▲ 10.80%	▲ 7.14%	▲ 18.89%	15
Gaming & esports	•	▲ 0.00%	▲ 7.36%	▲ 13.96%	-	3
China tech	•	▲ 1.08%	▲ 6.91%	▲ 6.78%	-	15
Gold miners	•	▲ 0.28%	▲ 6.23%	▲ 6.64%	▼ -9.25%	6
Solar	•	▲ 0.00%	▲ 4.02%	▲ 12.61%	▲ 33.20%	11
Uranium	•	▼ -0.28%	▲ 3.38%	▲ 5.93%	▲ 162.55%	2
Clean Energy	•	▲ 0.68%	▲ 3.23%	▲ 8.76%	▲ 14.86%	18
Lithium & Battery tech	•	▼ -0.06%	▲ 2.55%	▲ 13.75%	▲ 93.56%	10
Cloud computing (SaaS)	•	▲ 0.00%	▲ 2.24%	▲ 6.54%	▲ 44.32%	17
Cyber security	•	▲ 1.39%	▲ 2.18%	▲ 8.57%	▲ 54.39%	1

Table source – CMC Markets - Optp Thematic ETF Screener

CONCLUSION

- Overall it is hard for us to become bearish looking at what is happening in the credit space, yet, the ongoing volatility in the fixed income space is a cause for concern and so is the ultimate impact rising inflation will have on future consumption.
- As per our food for thoughts, we like contrarian trade which offers good value and VALE SA seems to us to be ticking a lot of boxes.
- In similar fashion the recent rebound in gold prices is very supportive for a more significant rebound in gold miners. As such we are as well turning more positive on this sector.
- That's all for now. Don't hesitate to reach out / comment. Happy trading to all !

BIOGRAPHY

- **MARTIN TIXIER** is the author and founder of the blog “Macronomics” (<http://macronomy.blogspot.com>) launched in December 2009 and focusing on Macro trends in general and credit in particular. His blog was in the top 20 economic blogs in the United Kingdom (<http://uk.labs.teads.tv/top-blogs/economy>) and receives around 20,000 views per month.
- Mr. Tixier has served as Senior Fixed Income Investment Specialist in the asset management industry for CANDRIAM, a leading pan-European multi-specialist asset manager managing €80B AUM at end of December 2014
- Mr. Tixier was awarded the highest accolade for a Six Sigma project in 2006 for Bank of America where he worked 7 years in various positions. He won the coveted Best of Six Sigma Award (top 15 projects out of 1500 submitted globally).
- Mr. Tixier graduated from the top ranked ESSEC BBA as well as ISC in Paris where he obtained a Master degree in Business Engineering and International Trade. Martin is a certified CISI Level 3 FCA (Financial Conduct Authority) in Regulation, Securities and Derivatives and also has the ACI Dealing Certificate with distinction and is as well as a certified Six Sigma Green Belt.
- Mr. Tixier has also been lecturing at IAE Lille, Toulouse Business School and ESAM Paris for post graduate students dealing on the subject of banking regulations and accounting practices and the role of credit in the economy as well as interest rates and credit trading strategies.