PROVIDING THE BIG PICTURE ON MACRO AND CREDIT SINCE 2009

Martin Tixier – Strategist

PLAN

CRACKS IN INFLATIONISM

1

EXECUTIVE SUMMARY – 19TH OF MAY

MACRO THOUGHTS

- *“Investors are impatient and they are also desperate for the 'next big thing,' and they are not paying attention to the fact that the 'next big thing' can be an economic crisis that they have created by being very irresponsible with their power.”- Carmen Busquets*
- We continue to think that Europe is in a very bad spot. ECB is in a worse position than the FED given the weight of energy in its imports and the weakening of the EUR currency making matters worse. We continue to believe the EUR is going towards parity with the US dollar and even weaker. We expect poor growth and growing social unrests.
- We still expect a "Carthaginian peace" deal between Russian and Ukraine. It refers to any brutal peace treaty demanding total subjugation of the defeated side. This is what Russia we think, will ask from Ukraine.
- Throughout 2021 we called for the risk of a stagflationary outcome in our OHM Research presentations. In that context “fixed income” must be avoided. More pain to come and corporate credit is already feeling the heat. Our credit canary aka US CCCs is starting to sing. Watch credit spreads as they will continue to widen significantly.
- Energy will continue to thrive. We recommended you coal stocks last year and GALP and SHELL. We continue to recommend going overweight Energy. Don’t forget gold and gold miners but add cautiously given Mack The Knife is still on its murderous rampage.
- ***Our usual reminder:*** For a bear market to ensue as we have repeated on numerous occasions, you need inflation to "accelerate". Past history has shown, what matters is the "velocity" of the increase in the oil prices, given that a price appreciation greater than 100% to the "Real Price of Oil" has been a leading indicator for every US recession over the past 40 years

MACRO THOUGHTS

- **Why our title Cracks in Inflationism?**
- "Inflationism" is a heterodox economic, fiscal, or monetary policy that predicts that a substantial level of inflation is harmless, desirable or even advantageous.
- The direct result of inflation is a transfer of wealth from creditors to debtors.
- "Inflationism" is a heterodox economic, fiscal, or monetary policy that predicts that a substantial level of inflation is harmless, desirable or even advantageous. Similarly, inflationist economists advocate for an inflationist policy. The contemporary Post-Keynesian monetary economic school of Neo-Chartalism advocates government deficit spending to yield full employment is attacked as inflationist, with critics arguing that such deficit spending inevitably leads to hyperinflation. Neo-Chartalists reject this charge, such as in the title of the Neo-Chartalist organization the Center for Full Employment and Price Stability. Also, a related argument is by Chartalists, who argue that nations who issue debt denominated in their own fiat currency need never default, because they can print money to pay off the debt similar to what we are hearing these days from the MMT supporters. Chartalists note, however, that printing money without matching it with taxation (to recover money and prevent the money supply from growing) can result in inflation if pursued beyond the point of full employment, and Chartalists generally do not argue for inflation.

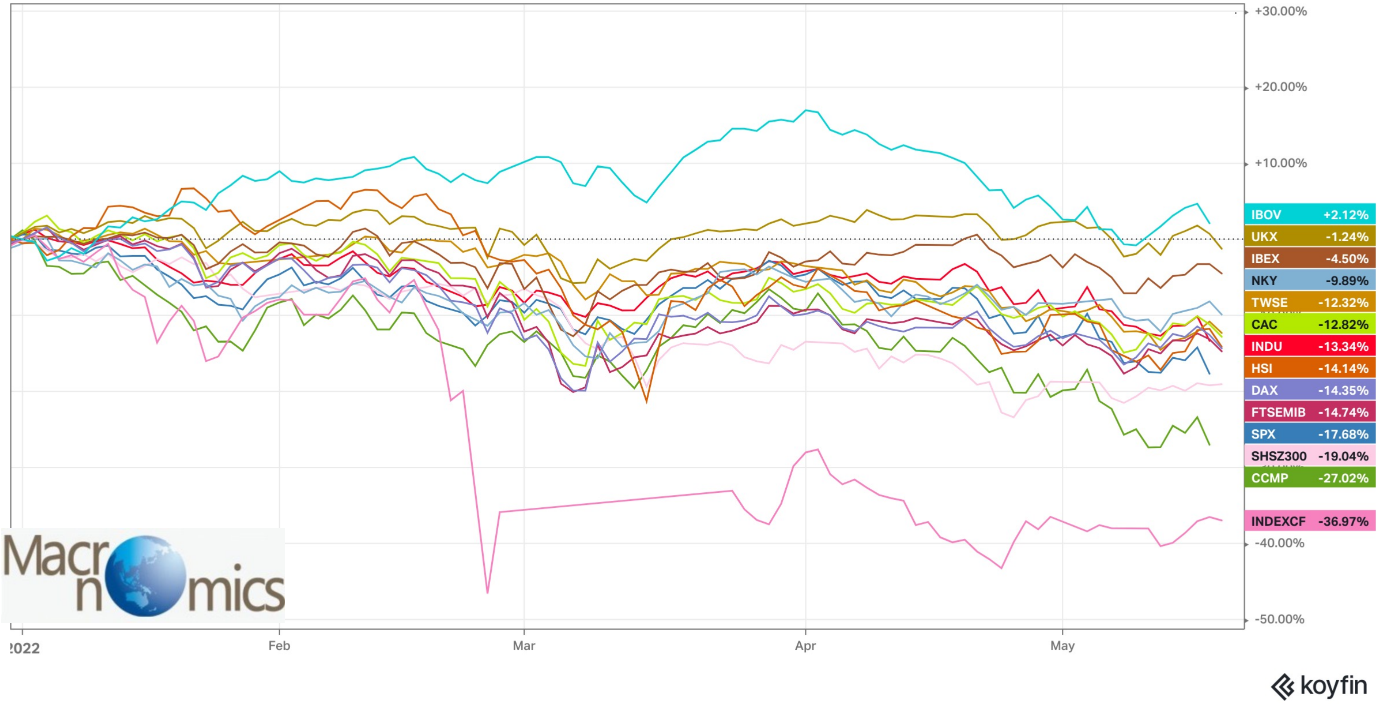
MACRO THOUGHTS

- It is also worth noting that Keynes described the inflation and economic stagnation gripping Europe in his book: The Economic Consequences of the Peace. Keynes wrote:
- *"Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some." [...]*
- *"Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose."*
- Keynes explicitly pointed out the relationship between governments printing money and inflation:
- *"The inflationism of the currency systems of Europe has proceeded to extraordinary lengths. The various belligerent Governments, unable, or too timid or too short-sighted to secure from loans or taxes the resources they required, have printed notes for the balance."*
- The direct result of inflation is a transfer of wealth from creditors to debtors - the creditors receive less in real terms than they would have before, while the debtors pay less, assuming that the debts would in fact have been repaid, and not defaulted on. Formally, **this is a de facto debt restructuring, with reduction of the real value of principal, and may benefit creditors** if it results in the debts being serviced (paid in part) rather than defaulted on.

2 CRACKS IN INFLATIONISM

CRACKS IN INFLATIONISM

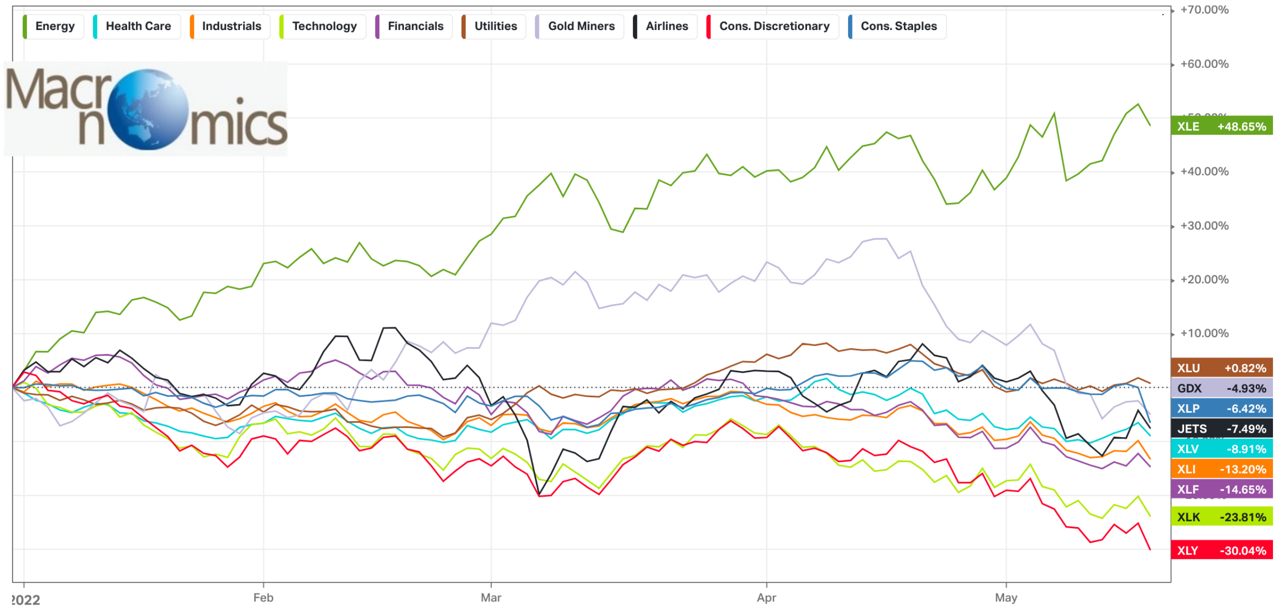
- Since our previous presentation Brazil's has regained its lead and is up by 1.2% YTD given "Mack The Knife" has put a dent in the surge of commodities. War in Ukraine has also taken its toll on the MICEX index in Moscow down 35% YTD. Hang Seng is down 12% YTD. Shanghai is down by 15% YTD with rising lockdowns. Overall a very weak tone with the NASDAQ down 27% in a bear market. Credit spreads have been as well weakening since the beginning of the year and weakening even more. Again not a good environment.



Graph source – KOYFIN - Macronomics

CRACKS IN INFLATIONISM

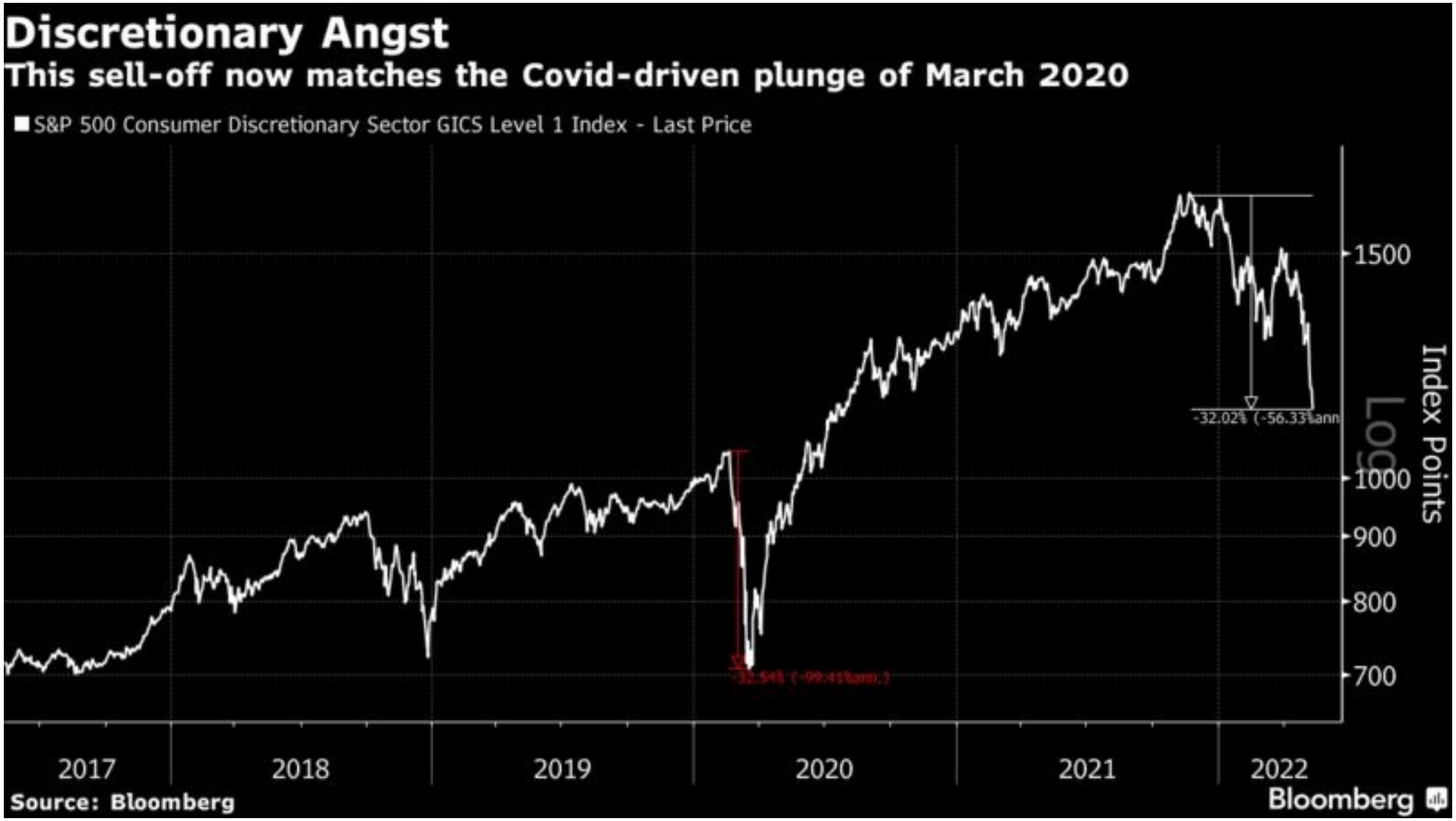
- **<u>US Sectors performance YTD:</u>**
- Energy (XLE) is still leading the pack +48.65% (it was up +42.78% YTD in our last presentation).
- Gold retraced due to Mack The Knife. Gold miners as well. We continue to like the sector (flat YTD) but until Mack The Knife finally calms down no reason to “buy the dip”.
- TECH is down by 23.81% YTD. Rising US yields is impacting “duration” trades.
- Consumer Discretionary is down by 30% YTD (last presentation down 28% YTD). Consumer Discretionary is in the cross-hair. As we said last time and we were right, more pain to come



Graph source – KOYFIN - Macronomics

CRACKS IN INFLATIONISM

- "The selloff for consumer discretionary stocks in the US is growing spectacularly. At 33%, the total drawdown is now almost exactly equivalent to the sector's fall in March 2020. So angst about the future of the economy appears to be back in full force: ." – Giorgio Mavroidis



Graph source - Bloomberg - Twitter

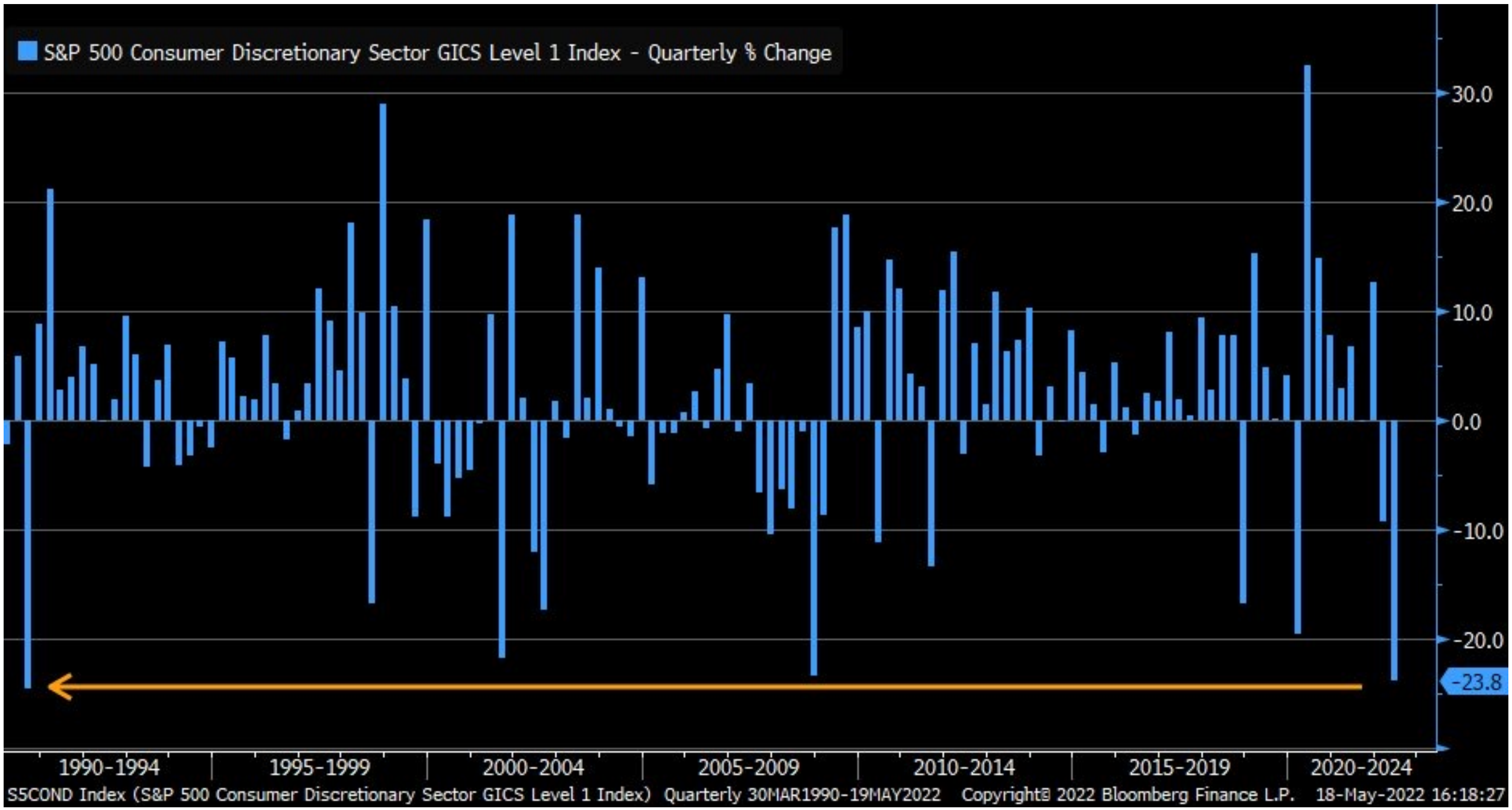
CRACKS IN INFLATIONISM

- Consumer Discretionary is down by 32% YTD (last presentation down 28% YTD). Consumer Discretionary is in the cross-hair. As we said last time and we were right, more pain to come. Europe has further down to fall, US as well.

Graph source – TradingViews - Macronomics

CRACKS IN INFLATIONISM

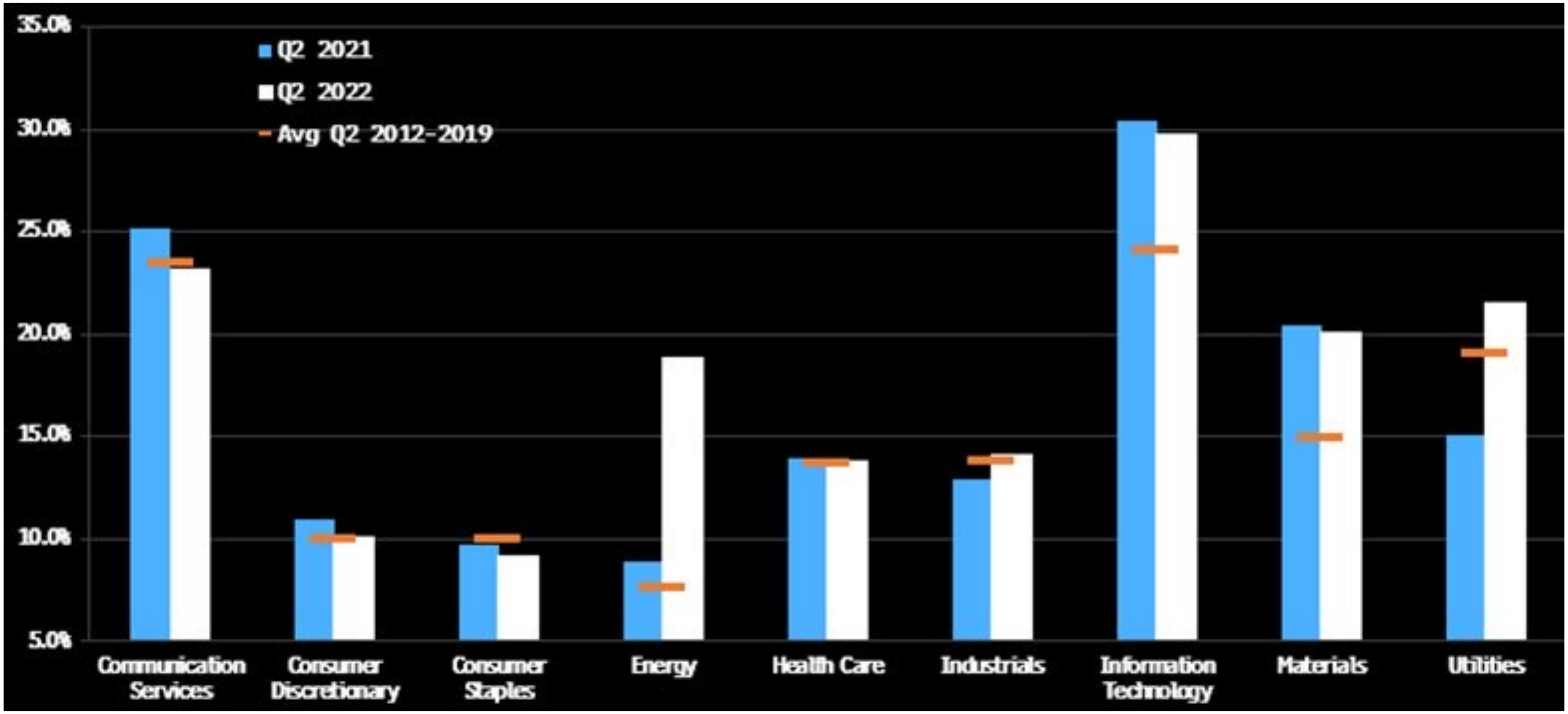
- “Off Target: S&P 500 Consumer Discretionary sector is having its worst quarter since 1990” – Liz Ann Sonders



Graph source - Liz Ann Sonders - Bloomberg - Twitter

CRACKS IN INFLATIONISM

- "Margin forecasts keep weakening, particularly for the consumer stocks. More than half of S&P 500 consumer staples and discretionary companies are projected to have a lower operating margin in 2Q year-over-year, with Amazon.com, Starbucks and GM among the worst-hit." – Gina Martin Adams



Graph source - Gina Martin Adams - Bloomberg - Twitter

CRACKS IN INFLATIONISM

- S&P 500 Consumer Discretionary sector top holdings
- Consumer discretionary stocks have gotten a lot cheaper but it's hard to see a catalyst for valuation expansion given rising rates and inflation pressure this group most among S&P 500 sectors.
- We continue to see more headwinds as a whole on the sector with rising fuel and gasoline prices for the US Consumers.

XLY US Equity | Export ▾

1) Profile | 2) Performance | 3) Holdings

7) Top Fund Hlds | MHD »	Net Fund
11) Amazon.com Inc	19.688%
12) Tesla Inc	18.714%
13) McDonald's Corp	5.652%
14) Home Depot Inc/The	5.418%
15) NIKE Inc	4.631%
16) Lowe's Cos Inc	4.092%
17) Target Corp	3.229%
18) Booking Holdings Inc	2.760%
19) Starbucks Corp	2.655%
20) TJX Cos Inc/The	2.098%

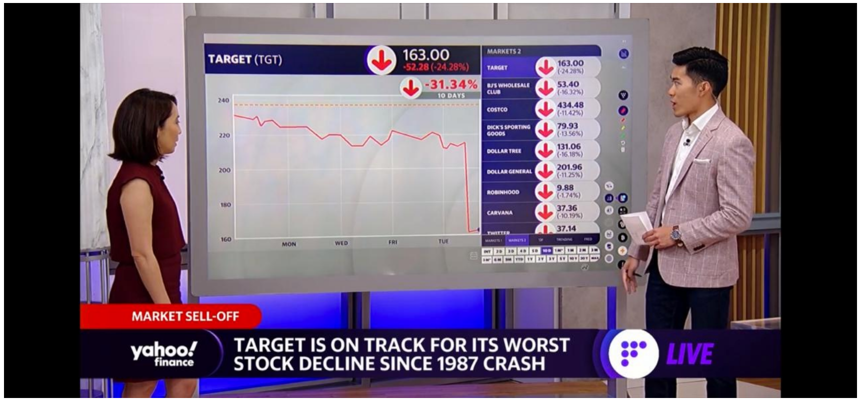
Graph source -- Bloomberg - Twitter

CRACKS IN INFLATIONISM

- The market has been pricing a recession for a while
- $WMT and $TGT just confirmed it with their worst daily returns since 1987

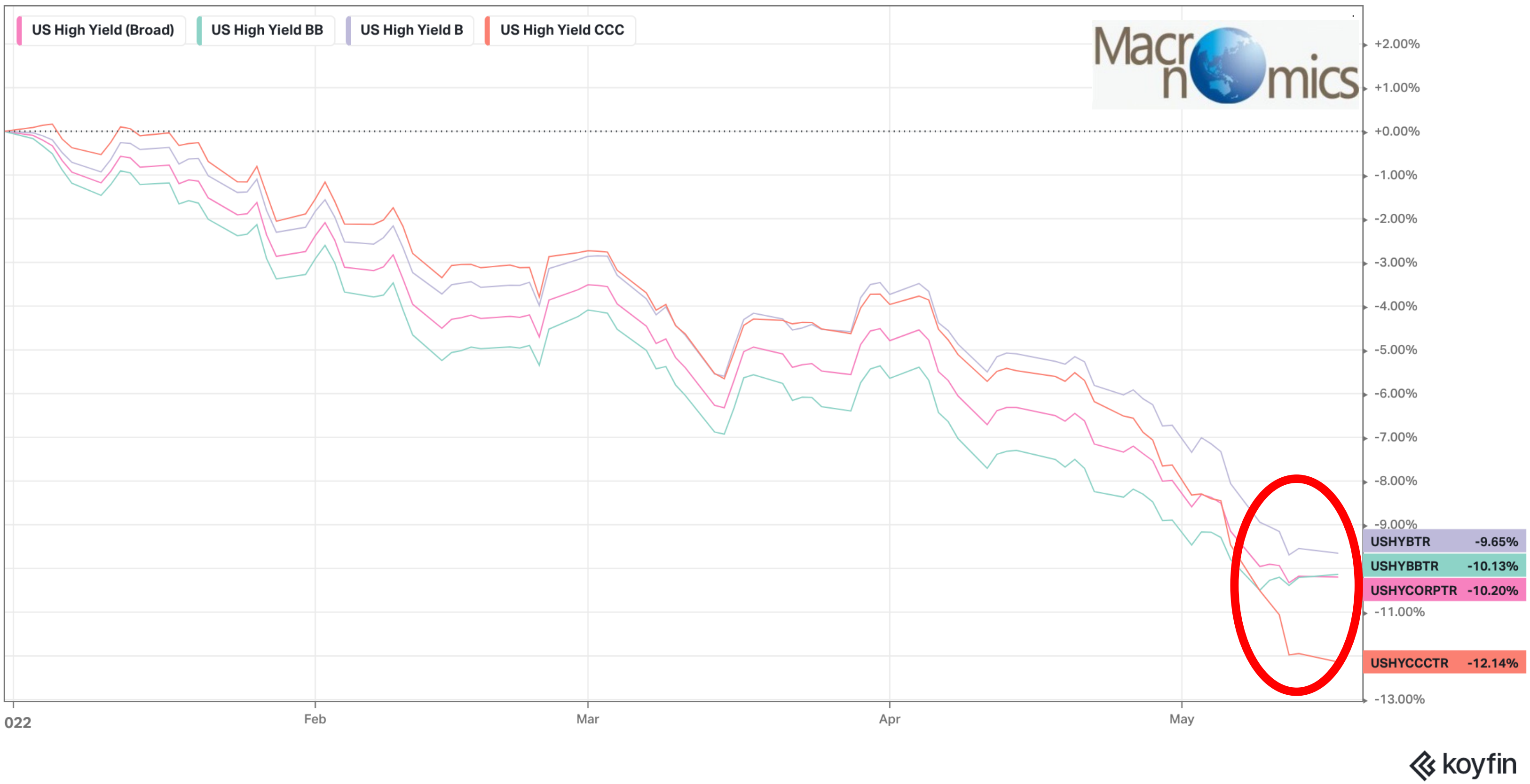
- **Returns YTD:**
  - - Consumer discretionary $XLY -30%
  - - Retail $XRT -30%
  - - Homebuilders $ITB -28%
  - - Financials $XLF -19%

- "Softish landing" not happening
- Utilities and Energy sectors are the least affected by inflation and interest rates.
- This continues to be what is needed to be played investment wise in the unfolding “stagflationary” scenario.



CRACKS IN INFLATIONISM

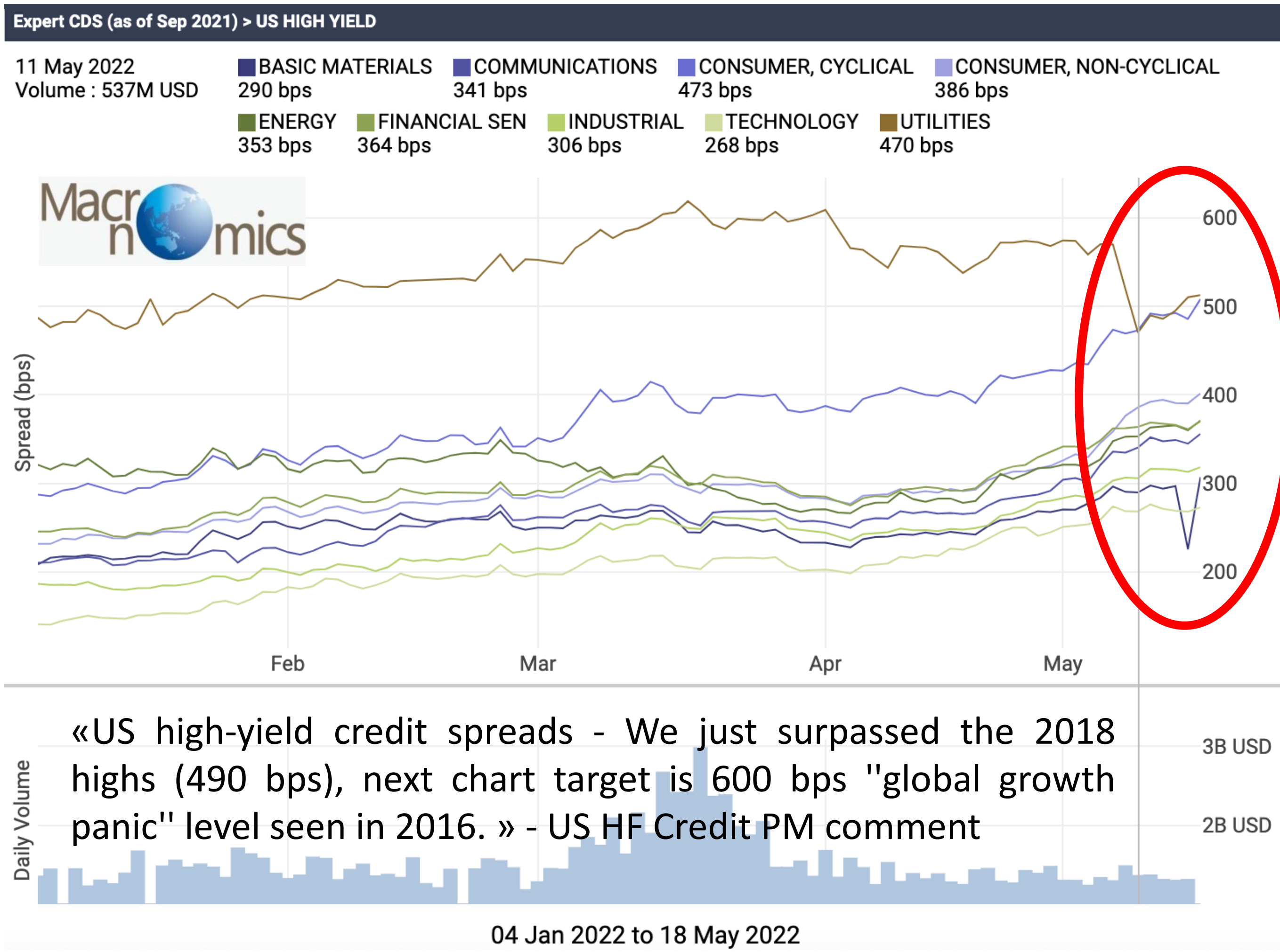
- High beta US High Yield is in negative territory.
- Bond volatility affected high beta due to the FED and rising "real yields"
- CCCs are now down more than BBs. We are starting to see weakness in credit, which is never a good sign. Watch this space. US CCCs down 12% YTD. More pain coming.



Graph source – KOYFIN - Macronomics

CRACKS IN INFLATIONISM

- We are starting to see weakness in credit, which is never a good sign. Watch this space.

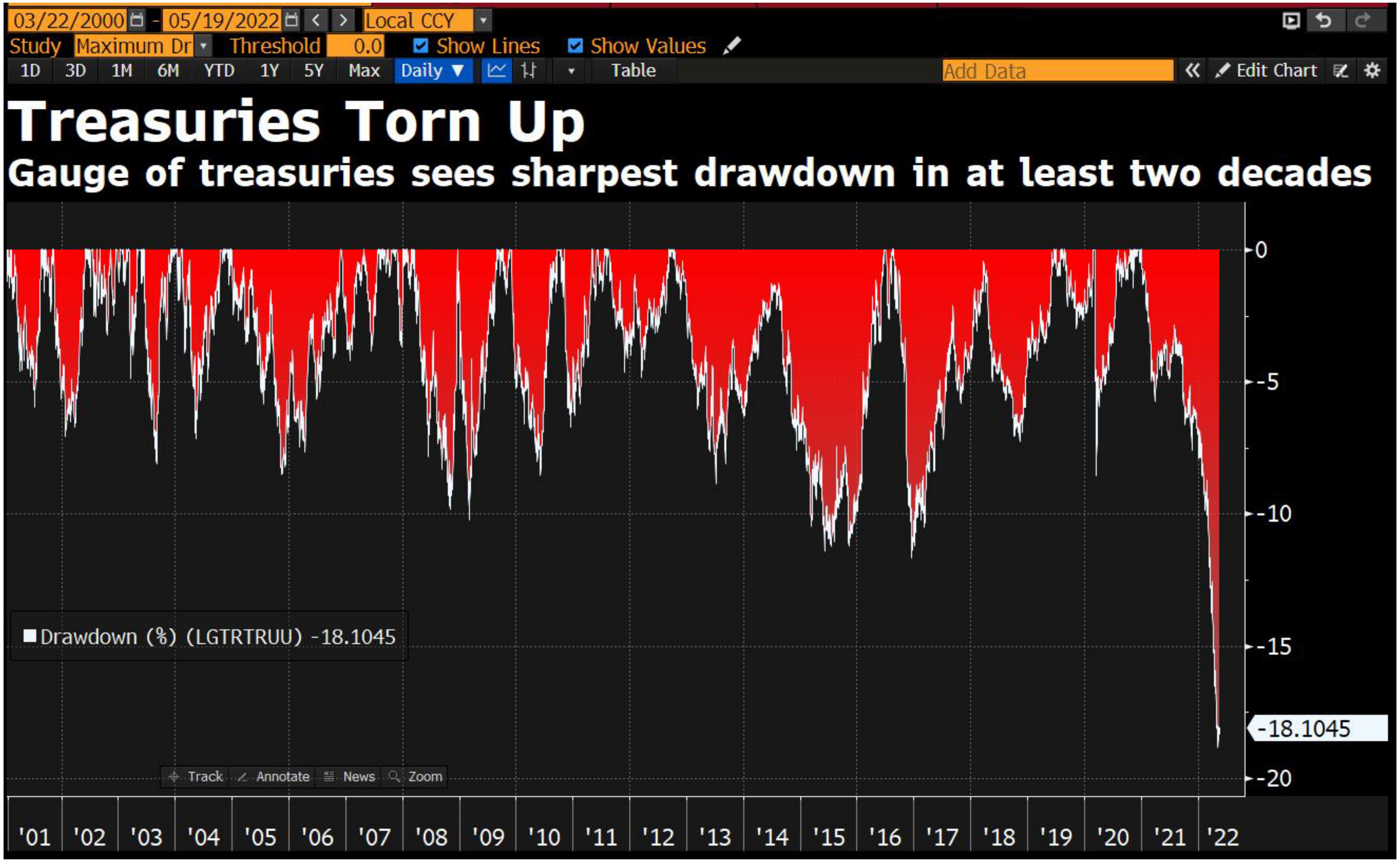


«US high-yield credit spreads - We just surpassed the 2018 highs (490 bps), next chart target is 600 bps ''global growth panic'' level seen in 2016. » - US HF Credit PM comment

Graph source – DATAGRAPPLE - Macronomics

CRACKS IN INFLATIONISM

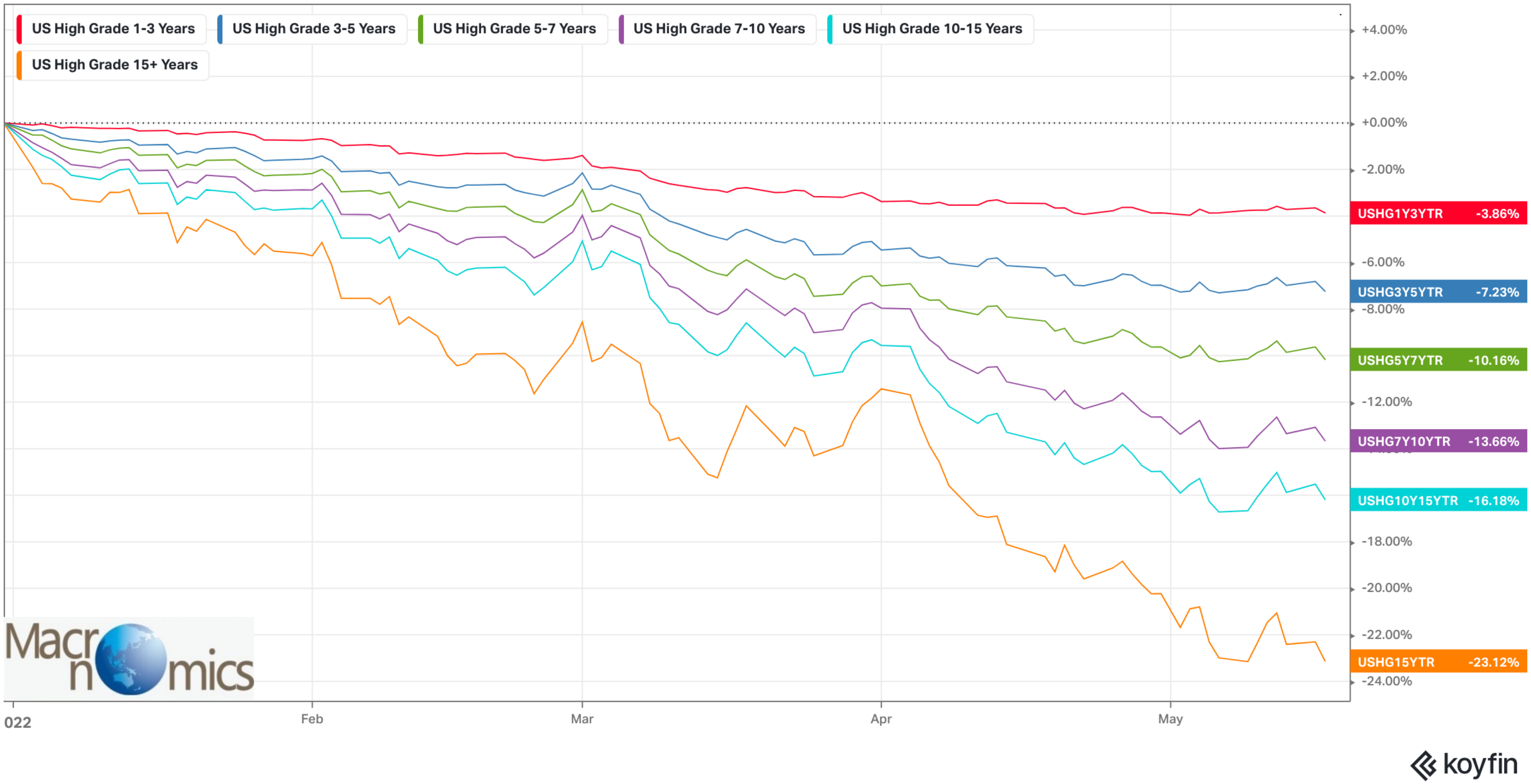
- The selloff in US treasuries is pretty spectacular. If you think the only blood spilled as been in equities that is.



Graph source - Bloomberg - Twitter

CRACKS IN INFLATIONISM

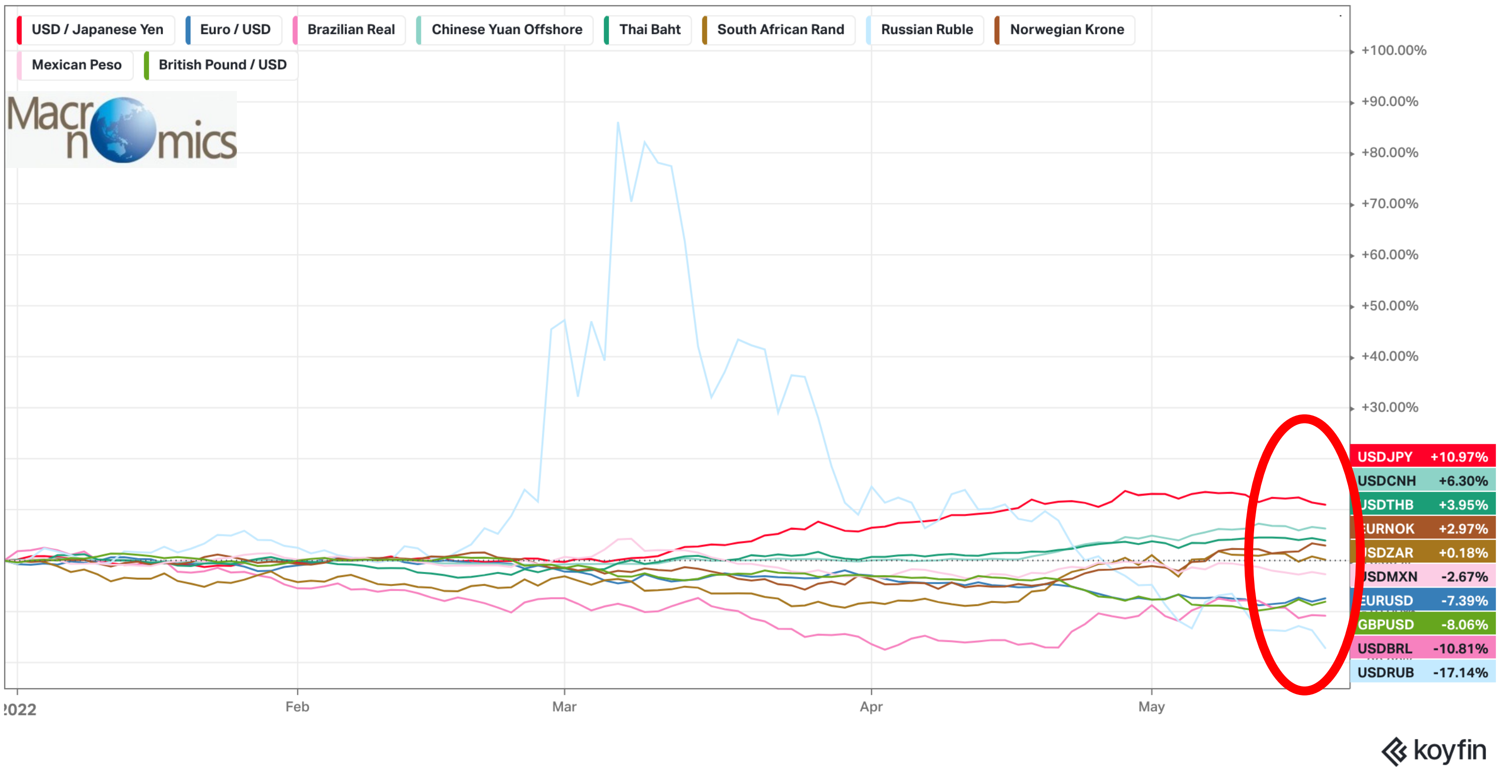
- You know by now that we continue to dislike fixed income in an inflationary environment. Overall rising real yields in conjunction with global sovereign yields weight heavily on Investment Grade. Convexity is starting to bite and fast. Long end is down 23.12% YTD!



Graph source – KOYFIN - Macronomics

CRACKS IN INFLATIONISM

- RUB against the USD has not only recovered from its low but is now up 17% vs USD.
- BRL is up by more than 10.81% YTD against the US dollar. Both equities and FX are standing out.
- The US Dollar index has breached the 100 level while the JPY is experiencing more pain. We still like shorting the JPY via ETF YCS. It's down 10.95% YTD vs the USD



Graph source – KOYFIN - Macronomics

CRACKS IN INFLATIONISM

- The dollar index, which tracks the greenback against six major peers, edged 0.16% lower to 103.63, after a 0.55% jump in the previous session. Preeminent haven currency the yen slid, with the dollar adding 0.48% to 128.845 yen after a 0.86% tumble on Wednesday.
- There has indeed been some respite recently coming from Mack The Knife.
- The dollar index is up around 8% since the start of the year, and in a note Tuesday, Deutsche Bank said the “safe haven” risk premium priced into the greenback was now at the “upper end of extremes,” even when accounting for interest rate differentials.
- No wonder our preferred Yen short via ETF YCS took a breather.

CRACKS IN INFLATIONISM

- Given our stagflationary stance, you now understand our chosen title. Inflation is indeed running hot and cracks in the narrative are starting to show up through credit markets.

- Difficult to see a reversal until Mack The Knife stops its rampage. For cues watch the US Treasury Notes 10 year yield.

- You should:
    - Continue to short EUR vs USD.
    - On our Short JPY vs USD via ETF YCS (up 25.42% YTD) Time for a pause.
    - Continue to short European Consumer Discretionary
    - Reduce your exposure to European Credit: Investment Grade in General and European High Yield in particular.
- With inflation hitting levels not seen for four decades, short sellers should focus on consumer discretionary names. Remember US CPI will continue to run hot for the coming months with a big risk coming from rising rents which are a big component in the composition of the US CPI.
- Favor the Energy sector and Utilities sector as a “defensive” play.

CRACKS IN INFLATIONISM

- Japan is facing headwinds hence the rapid depreciation of the Japanese yen over the US dollar. The ETF YCS enables you to play the depreciation game. We like this short but right now it might stay in a range. As such we are NEUTRAL for now.

Graph source –Trading Views - Macronomics

CRACKS IN INFLATIONISM

- In the current high energy prices context and with the burst of the ESG bubble making "Coal" look enticing again. We continue to like the sector. BTU is highly volatile but can continue to deliver outsized gains in the current context. We continue to like both names.
- BTU YTD is +90% YTD. Again BTU is highly volatile. You might prefer ARLP to sleep at night… (YTD +38%). We continue to like both names.

Graph source –Trading Views - Macronomics

CRACKS IN INFLATIONISM

- Nasdaq, ETH and BTC are moving in synch. It all depends now on the trajectory of the Fed. Duration assets are suffering as real yields matter in the end. Rising US 10 year yields present a threat to the crypto darlings. More downside in our opinion going forward. Still our scenario.

Graph source –Trading Views - Macronomics

CRACKS IN INFLATIONISM

- BTC and MSTR (Microstrategy) are moving in synch. Given MSTR is a leveraged play on BTC, we view it as its second derivative. As such the prospects do not look good for the CEO and his company, him being a big crypto fan. No change in our opinion.

Graph source –Trading Views - Macronomics

CRACKS IN INFLATIONISM

- Gold has been spanked by Mack The Knife (+1.69% YTD), yet some miners such as RGLD and GOLD are more resilient than others. We continue to like the sector nonetheless.
- In the current state of the world we continue to view very positively gold and gold miners given inflationary pressure and high level of geopolitical uncertainties but for now real yields matters and in true Gibson Paradox, gold has reacted accordingly, to the downside that is.

Graph source –Trading Views - Macronomics

CRACKS IN INFLATIONISM

- Luxury sector good smacked down big time in 2022. Asian markets remain the hot spot for French luxury brands. Continuous worries relating to Chinese lockdowns on COVID issues will continue to weight on the sector. As well if we are indeed facing a downturn, this will impact the luxury sector as a whole. Avoid for now and we are not that convinced by the most recent small bounce. Hermès s less “travel” dependent than LVMH. **AVOID**

Graph source –Trading Views - Macronomics

CRACKS IN INFLATIONISM

- TECH in US and much more in Asia have been seriously beaten down. US Tech's path is depending on the Fed's normalization path. Asia TECH while enticing from a valuation perspective we continue to remain underweight as indicated in our previous presentation. **Avoid** for now.

Graph source –Trading Views - Macronomics

CRACKS IN INFLATIONISM

- GALP vs SHELL. SHELL is taking the lead but we continue to like both names. GALP has been overall more volatile than big player SHELL. We continue to like both names.

Graph source –Trading Views - Macronomics

CRACKS IN INFLATIONISM

- Some shipping stocks are still doing very well. EDRY, GLNG are still climbing, SBLK as well is doing ok and so is GRIN. See our presentation of the 28th of April for an overview

Graph source –Trading Views - Macronomics

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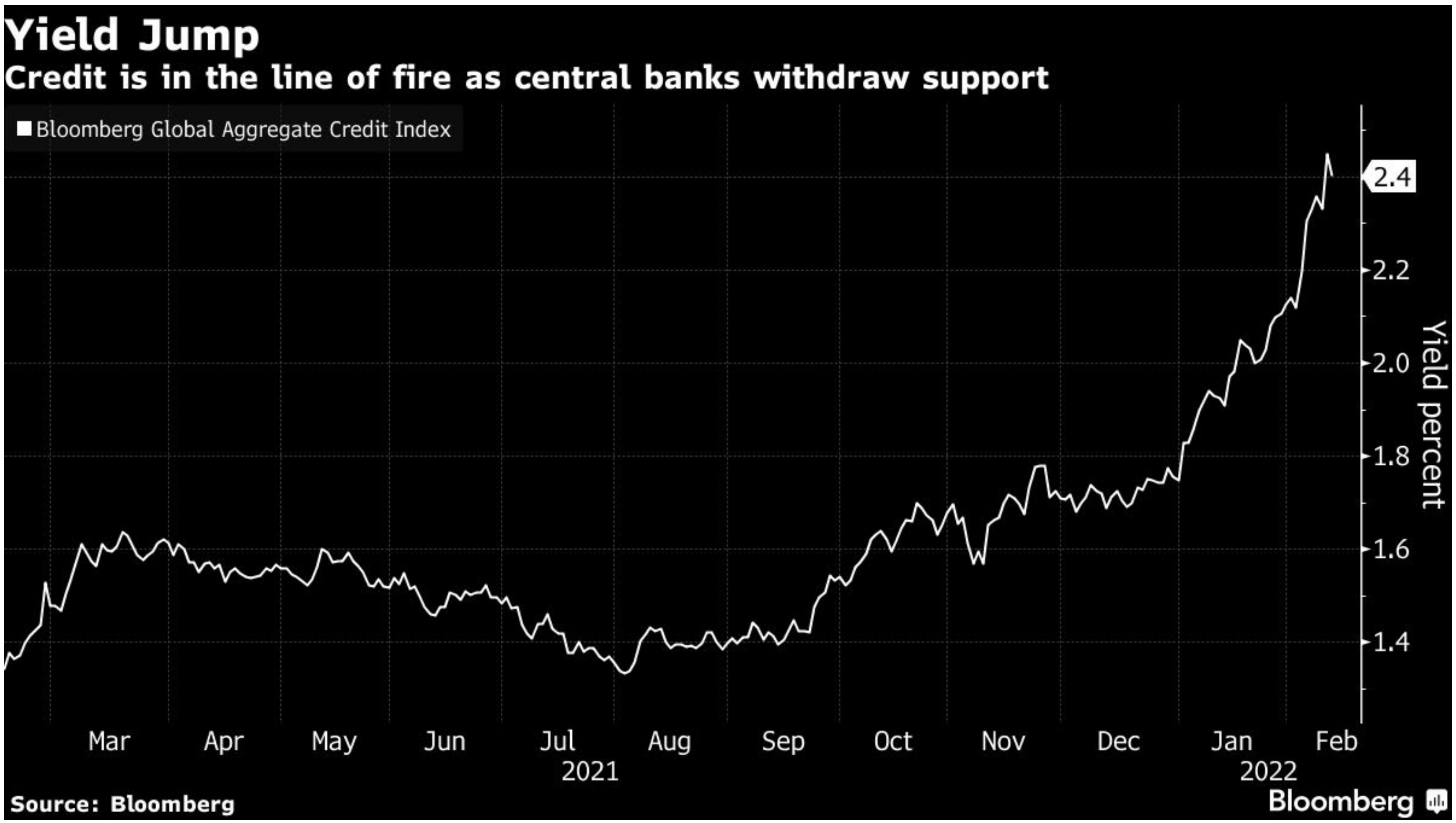
CREDIT ALWAYS MATTERS

CREDIT ALWAYS MATTERS

- In our book a deterioration of credit spreads is always a significant matter, regardless of the endless optimism spin by equities investors.
- We therefore always focus on the deterioration of financing conditions to ascertain an acceleration of potential defaults.
- As such the US CCCs being the weakest rating bucket, act as a “credit canary”. While it doesn’t scream total panic yet, we do see continuous rising dispersion as well as tightening of financial conditions.
- Us company Carnival just sold $1 billion of debt yielding 10.5%, vs the 6% yields on similar debt the company sold 7 months ago. “It’s a little bit of a head scratcher that they would issue debt in the high-yield market that has been less favorable for new issuance” – Bloomberg
- Spreads on US High Yield bonds have kept widening in the face of growth scares, even though many companies don’t have to raise money and are staying out of the market.

FOOD FOR THOUGHTS

- "Sell what you can!" That's credit investors' mood now amid an environment of rising rates and political tensions, according to a BofA survey.
- The net overweight position in investment-grade debt fell to 16%, the lowest since February 2019.



Graph source –Bloomberg - Twitter

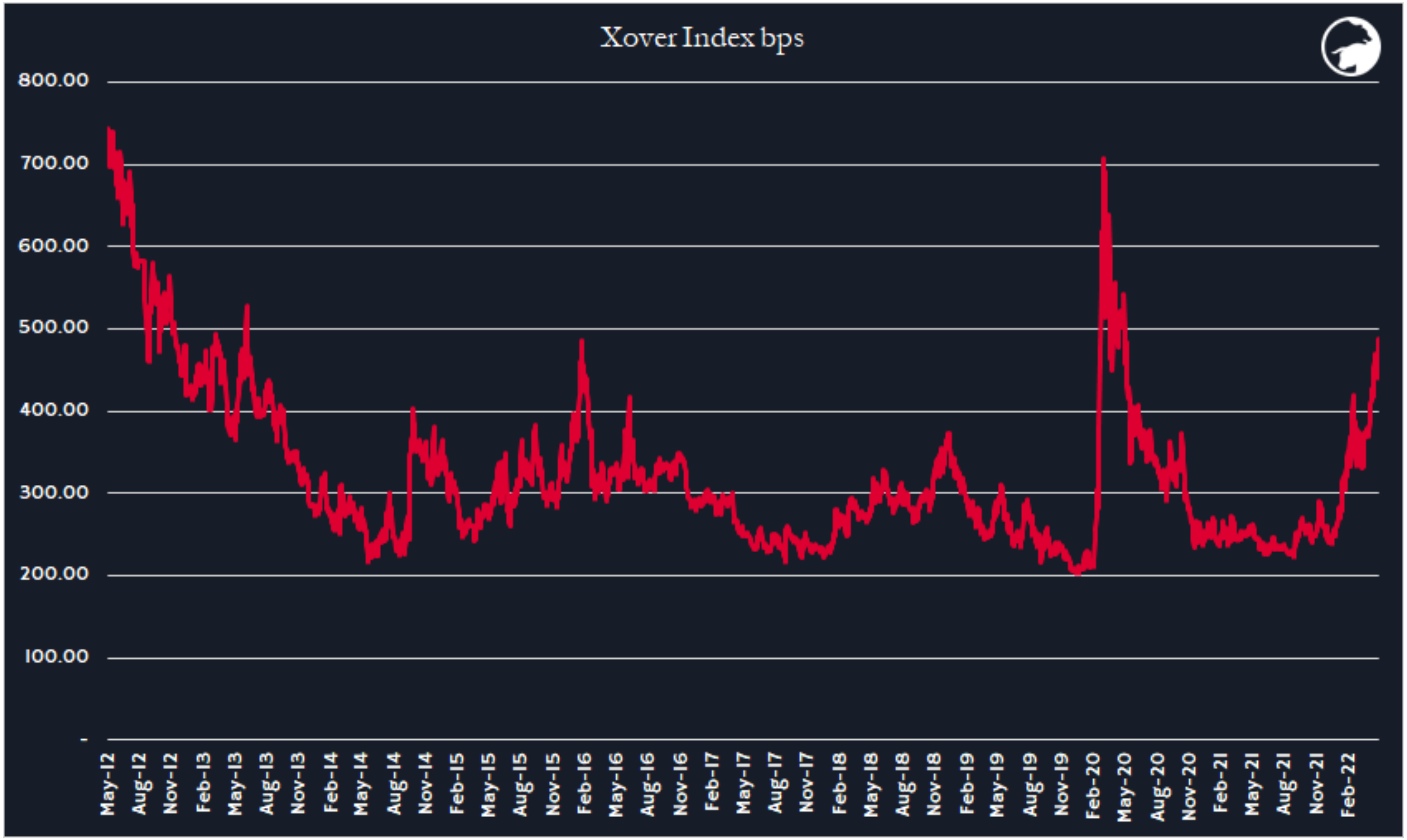
CREDIT ALWAYS MATTERS

- “The Bloomberg U.S. Financial Conditions index is about the most negative since May 2020.” – Lisa Abramowicz

Graph source –Lisa Abramowicz - Bloomberg - Twitter

CREDIT ALWAYS MATTERS

- "Xover on the up - 500 here we come?" – EuroHighYield
- The below charts depict the CDS index gauge for European High Yield, namely the Itraxx Crossover 5 year index.



Graph source –EuroHighYield - Twitter

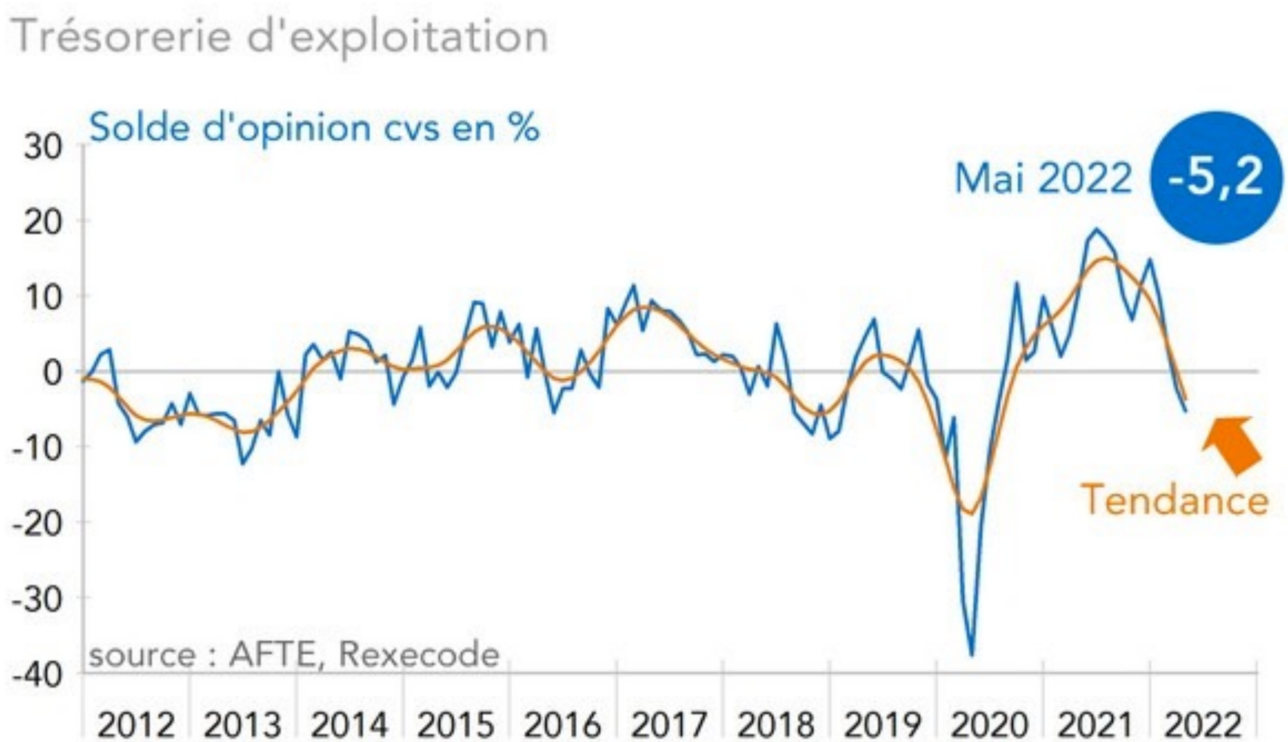
CREDIT ALWAYS MATTERS

- "EXTREME DIVERGENCE BETWEEN CREDIT AND EQUITY! - Leveraged loans (white) are collapsing, trading on average at same level as Sep2020 (only credit spread, no rates effect as they are floaters). Eurostoxx (green) is bouncing back towards 3800. Who is right? Equity or Credit?" - @NicoloMacellari
- Credit matters and give you an indication of where PMIs are heading…South that is.

Graph source –@NicoloMaccelari - Twitter

CREDIT ALWAYS MATTERS

- "When it comes to credit conditions in Europe, not only do we closely monitor the ECB lending surveys, we also monitor on a monthly basis the "Association Française des Trésoriers d'Entreprise" (French Corporate Treasurers Association) surveys."
- In the AFTE latest survey, there is now a clear trend in the deterioration in their operating cash situation showing up:



Graph source –AFTE - Macronomics

CREDIT ALWAYS MATTERS

- We are starting to see weakness in CDS indices which is “global”. Never a good sign.

Graph source – DATAGRAPPLE - Macronomics

CREDIT ALWAYS MATTERS

- We are starting to see weakness in Sovereign CDS spreads as well !

Graph source – DATAGRAPPLE - Macronomics

4

FOOD FOR THOUGHTS

FOOD FOR THOUGHTS

- Sanctions are not helping, they are making things worse.
- Deglobalization means higher prices for everyone. Economic death by a thousand sanctions?

Graph source –Bloomberg - Twitter

FOOD FOR THOUGHTS

- "Meanwhile, it's playing out in corporate earnings. Cisco warns that Chinese lockdowns & other supply disruptions will wipe out sales growth in the current quarter." – Lisa Abramowicz

Graph source –Bloomberg - Twitter

FOOD FOR THOUGHTS

- Liquidity struggles? JP Morgan notes that market depth is not much better than it was during March 2020 when looking at average number of S&P 500 contracts with tightest bid/ask prices
- Beware: “Liquidity is a coward”

Graph source – Bloomberg - Twitter

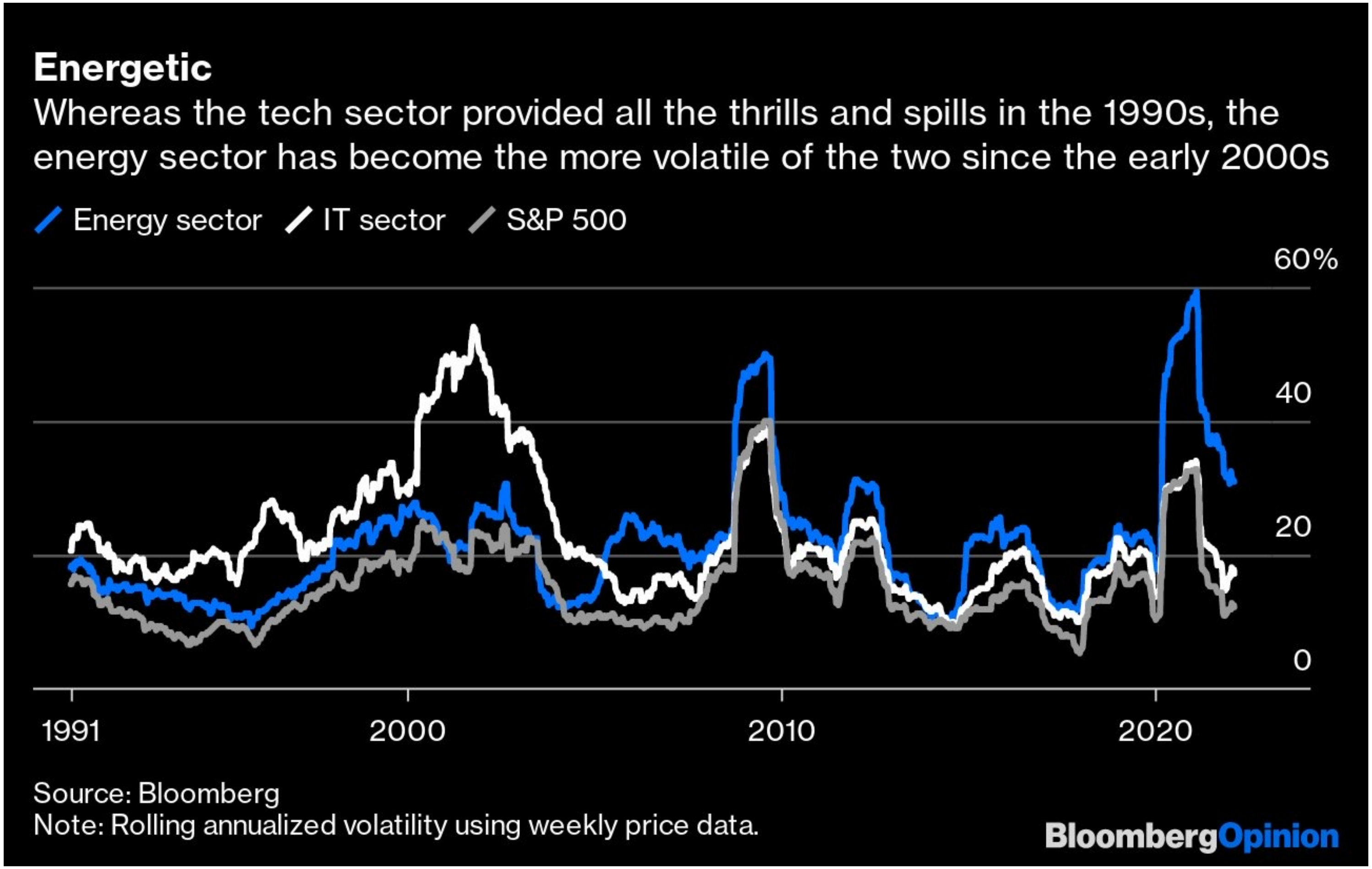
FOOD FOR THOUGHTS

- Some market segments like materials, industrials, energy, and banks perform better during rising inflation expectations and higher interest rates.

Graph source - Bloomberg - Twitter

FOOD FOR THOUGHTS

- When it comes to volatility, energy and tech stocks have done a with each other in the past 20 years. It's not a healthy development for the energy sector.



Graph source - Bloomberg - Twitter

5 CONCLUSION

CONCLUSION

- Harpex index is now receding, but the level will continue to put pressure on prices and corporate margins. We continue to watch the Harpex index very closely for cues on global trade. Harpex has closed around record level of 4395. Last was 4495 level as well.
- Oil We continue to like Energy and Uranium as a long term play. Gold miners could bounce more once Mack The Knife cool down. Lithiums is an interesting play in terms of theme.

Theme		Day	Week	Month	Year	# Assets
Solar	•	▲ 1.51%	▲ 12.67%	▼ -9.73%	▼ -8.27%	11
Lithium & Battery tech	•	▲ 1.91%	▲ 9.66%	▼ -1.75%	▲ 15.70%	10
Clean Energy	•	▲ 1.54%	▲ 9.63%	▼ -11.28%	▼ -13.86%	18
Uranium	•	▲ 0.83%	▲ 8.33%	▼ -24.65%	▼ -4.48%	2
Gaming & esports	•	▲ 0.80%	▲ 7.88%	▼ -6.16%	▼ -23.65%	3
China tech	•	▲ 2.43%	▲ 7.43%	▲ 0.75%	▼ -43.50%	15
AI & Deep learning	•	▲ 0.62%	▲ 5.70%	▼ -12.88%	▼ -29.75%	12
Disruptive Innovation	•	▼ -0.35%	▲ 5.42%	▼ -28.37%	▼ -58.94%	22
Genome	•	▼ -0.49%	▲ 5.26%	▼ -23.61%	▼ -58.70%	12

Table source – CMC Markets - Optp Thematic ETF Screener

CONCLUSION

- We continue to view negatively Investment Grade. Convexity is biting with rising government bond yields. **Avoid**.
- While we continued to like China Tech over US Tech from a valuation perspective, the latest lockdowns are weighting on the market in general and TECH in particular. We stay clear for the time being.
- Inflation has not been "transitory". We do not buy the receding narrative for 2022 as pressure in energy prices has yet to meaningfully recede at least in Europe. ECB is in a bind with inflation and rising real yields. **Short EUR**
- **Short JPY via ETF YCS?. Right now we switch to neutral on JPY**
- Rising food prices and prices of ammonia, continue to be on our radar and a cause for concern. This could lead to more social unrests in 2022. This issue is still building up.
- We continue to like VALE. We continue to like ARLP and BTU in coal miners but BTU is more volatile (only for the brave). If you were brave enough to add BTU, then you made good money and will continue to do so. We like GALP and SHELL. Oil producers are the only bright spot YTD with Utilities. We also like some shipping companies.
- Gold receded but we still like it. It might be worth adding more gold miners exposure but slowly.
- US High Yield is weakening. Something to take into account in the current set up. Energy is not supportive anymore of the CCCs bucket so watch what credit is doing.
- Crypto is getting whacked. High beta is getting slaughtered by Mack The Knife and we see cracks building in the narrative. Sure equities investors are eternal optimist and credit investors are eternal pessimists, right now we see additional signs in the deterioration of credit markets. Not year a panic but something to monitor very closely in the coming months.

- That's all for now. Don't be shy and don't hesitate to reach out / comment. Happy trading to all !

ON A FINAL NOTE

- **On top of the on-going crisis we are seeing very important shift in geopolitics with alliances shifting all over the world and being redrawn. To name a few:**
- More dissension in Europe with Russian oil and gas imports with Hungary being the sanctions party spoiler for the delusional Van der Leyen.
- Sweden and Finland about to join NATO. Turkey opposing their entry and bargaining hard.
- Sri Lanka going through total melt down
- Russia and China increasing their presence in Africa. US stepping back into Somalia with Special Forces.
- US about to alleviate sanctions on Venezuela.
- More trouble looming in Emerging Markets and in Europe with high inflation and rising US dollar.
- More sanctions from Europe and more diplomats being expelled on both side with Russia.
- We do not see any kind of willingness in de-escalating, on the contrary.
- Russian military operations are continuing in Eastern Ukraine for the second phase.
- In the fog of war, it is very difficult to distinguish the facts.

- ***"Politics is war without bloodshed while war is politics with bloodshed." - Mao Zedong***

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 received around 20,000 views per month. Mr Tixier also published many articles on Seeking Alpha, the leading financial site.

- Mr. Tixier previously 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, following a career in the sell-side in London

- 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.