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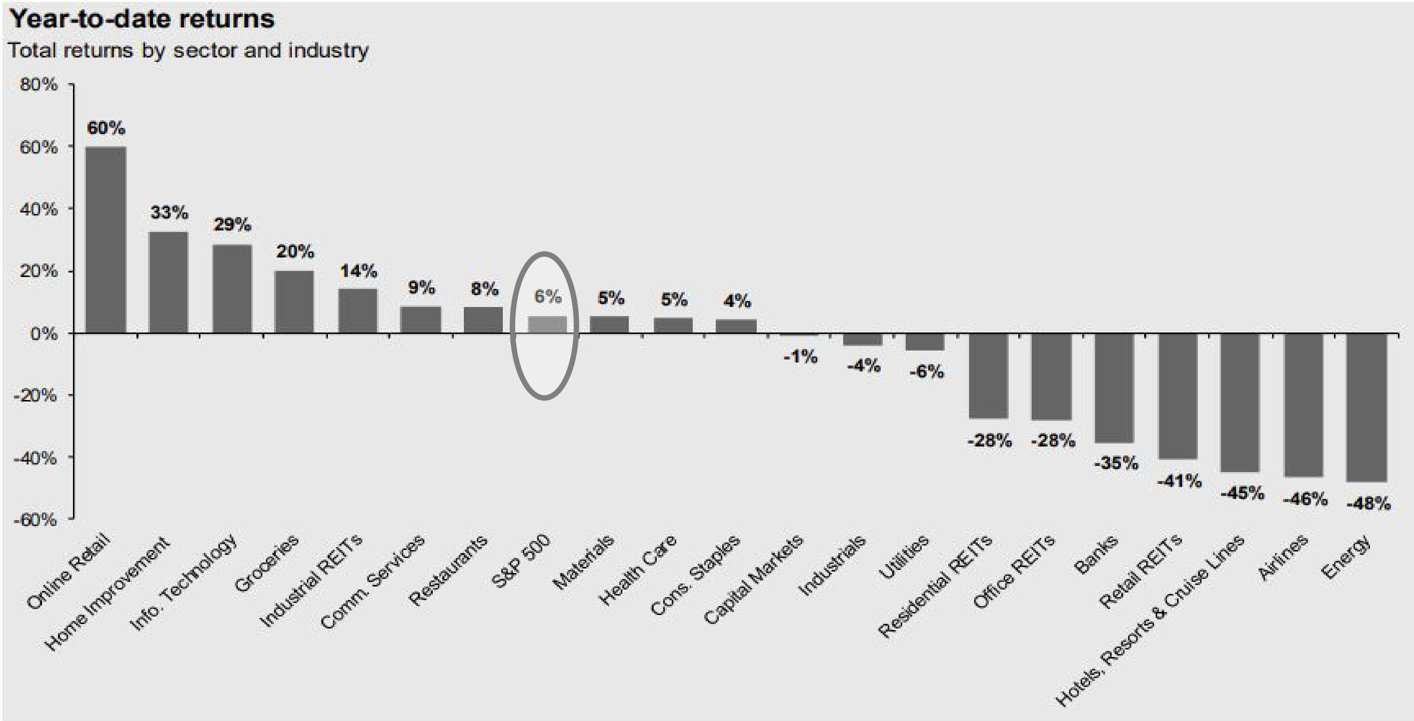
WEEK IN PICTURES

Global Macro Charts & Commentary

RATES, EQUITIES, COMMODITIES, FX & CREDIT

October 5, 2020

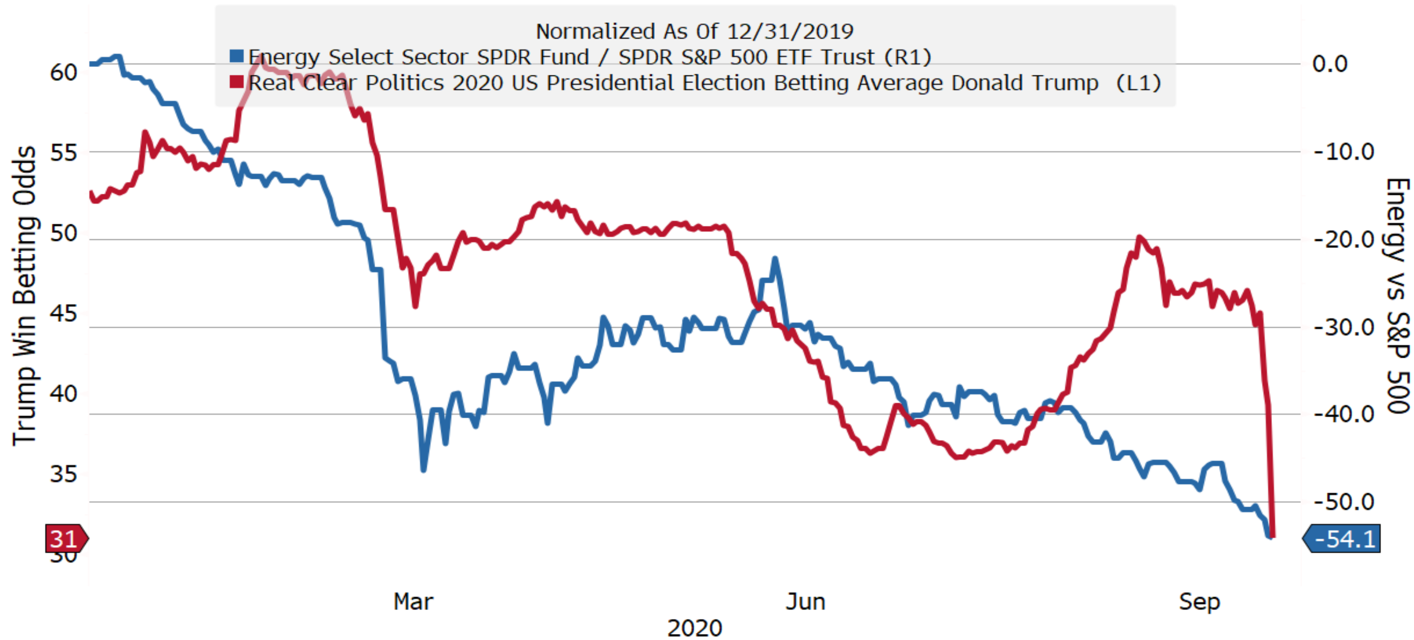
S&P Return Dispersion Grows



Source(s): JP Morgan Asset Management

The S&P 500 ended Q3 with a total return of 6%, a result most investors would be thrilled with given the outlook for the market six months ago. Yet, investors in certain industries such as energy, travel and leisure, and banking are still nursing heavy losses. Energy stocks are 48% lower on the year, making it the worst performing sector in the S&P 500. In contrast, online retailers have generated a positive 60% total return. The dispersion between the top and bottom performers is massive.

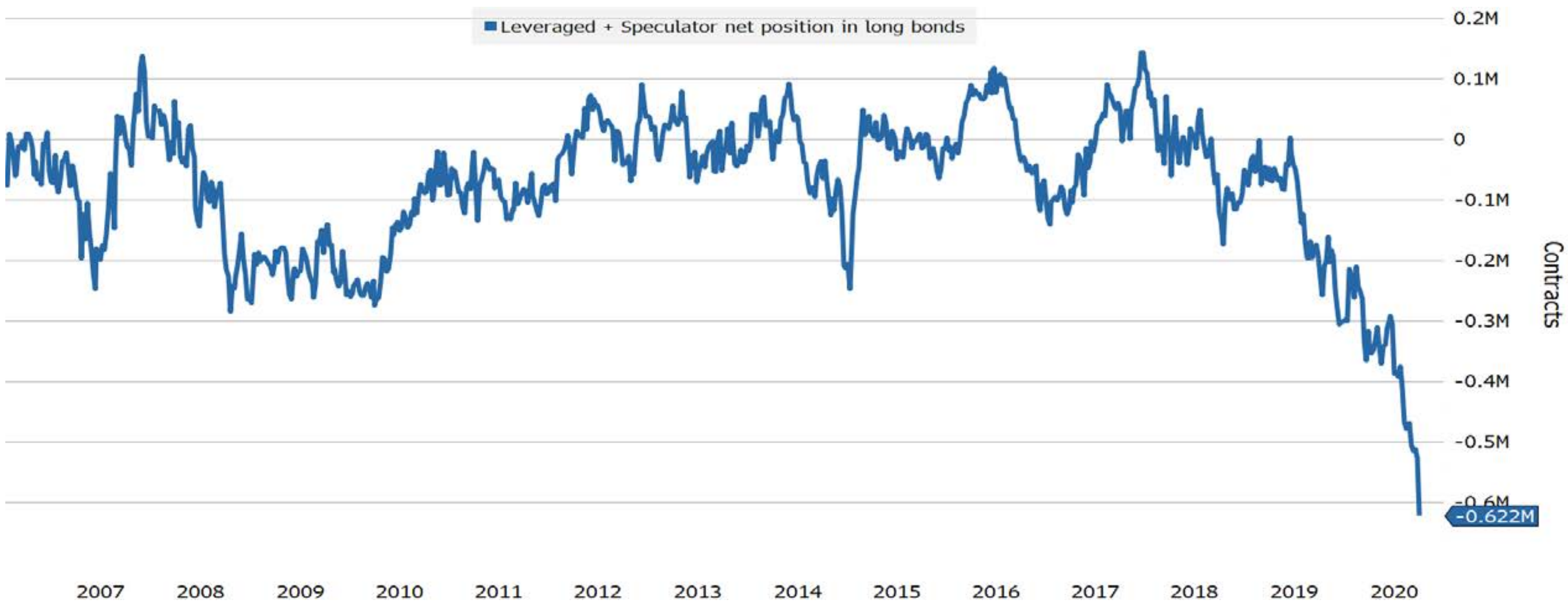
Energy Sector Follows Trump's Election Odds Lower



Source(s): III Capital Management, Bloomberg LP

The COVID-related disruption of the President's re-election campaign last Friday introduced more volatility into the market. Betting sites were quick to reduce the odds of a Trump victory down to 39% from as high as 50% following the Republican convention. Should Biden win the election, the implications may be greater at the sectoral level compared to the macro level. For example, a democratic controlled House, Senate and White House, and a focus on clean energy that would likely follow, is expected to be detrimental to the energy sector. XLE has underperformed the S&P 500 by 54% YTD, with most of the cheapening taking place when Trump's re-election odds dipped below 50%.

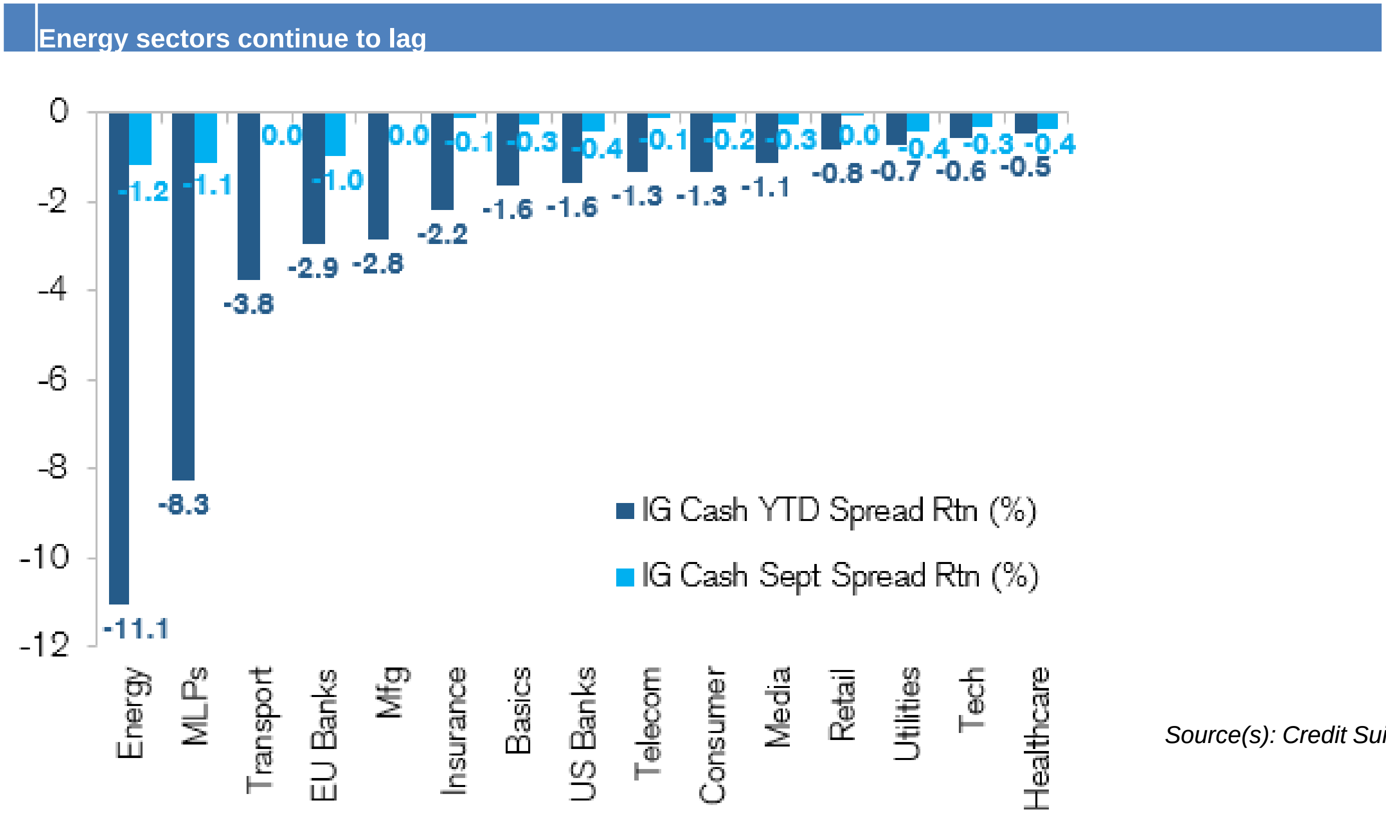
Record Short Bond Futures Positions



Source(s): III Capital Management, Bloomberg LP

Traders appear to be setting up for higher bond yields and a steeper curve. The latest CFTC data shows speculator and leveraged net short positions in long bonds both at record levels with a combined net short of over 620,000 contracts. Some short positioning may be related to the 30-year bond auction this week, but there is a growing consensus that a Biden victory next month will lead to higher rates, led by a sell-off in long-dated bonds. One thing is clear no matter who emerges victorious in November: more Treasury supply is coming.

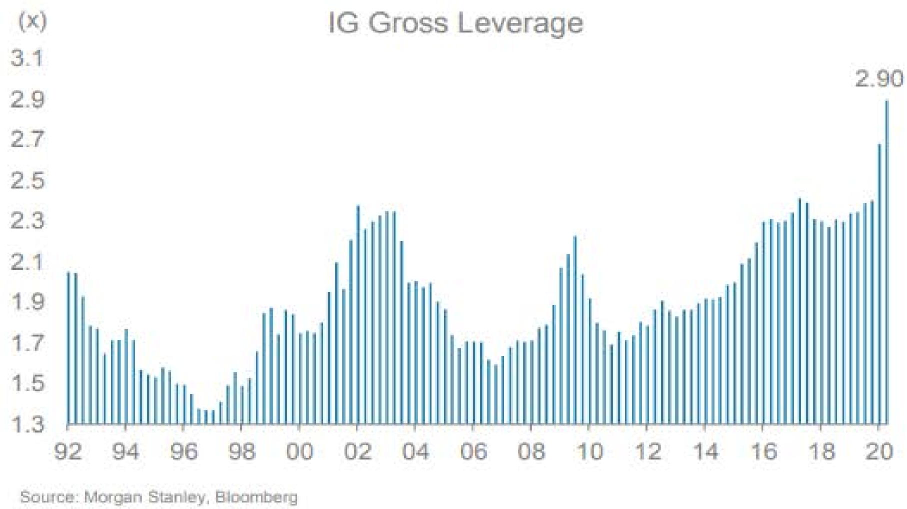
Credit Dispersion Remains High

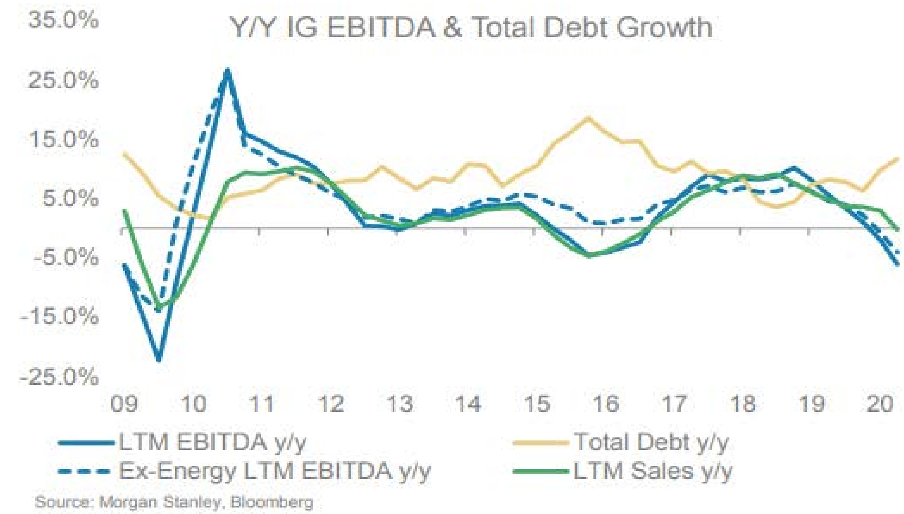


Source(s): Credit Suisse

September was the first month that investment grade spreads widened since March as record issuance of $1.6 TN YTD, up ~60% over prior years, is now weighing on the market. The Federal Reserve remains on the sidelines having only bought ~$13 BN YTD. While the transport sector has continued to recover, the market remains concerned about the energy sector.

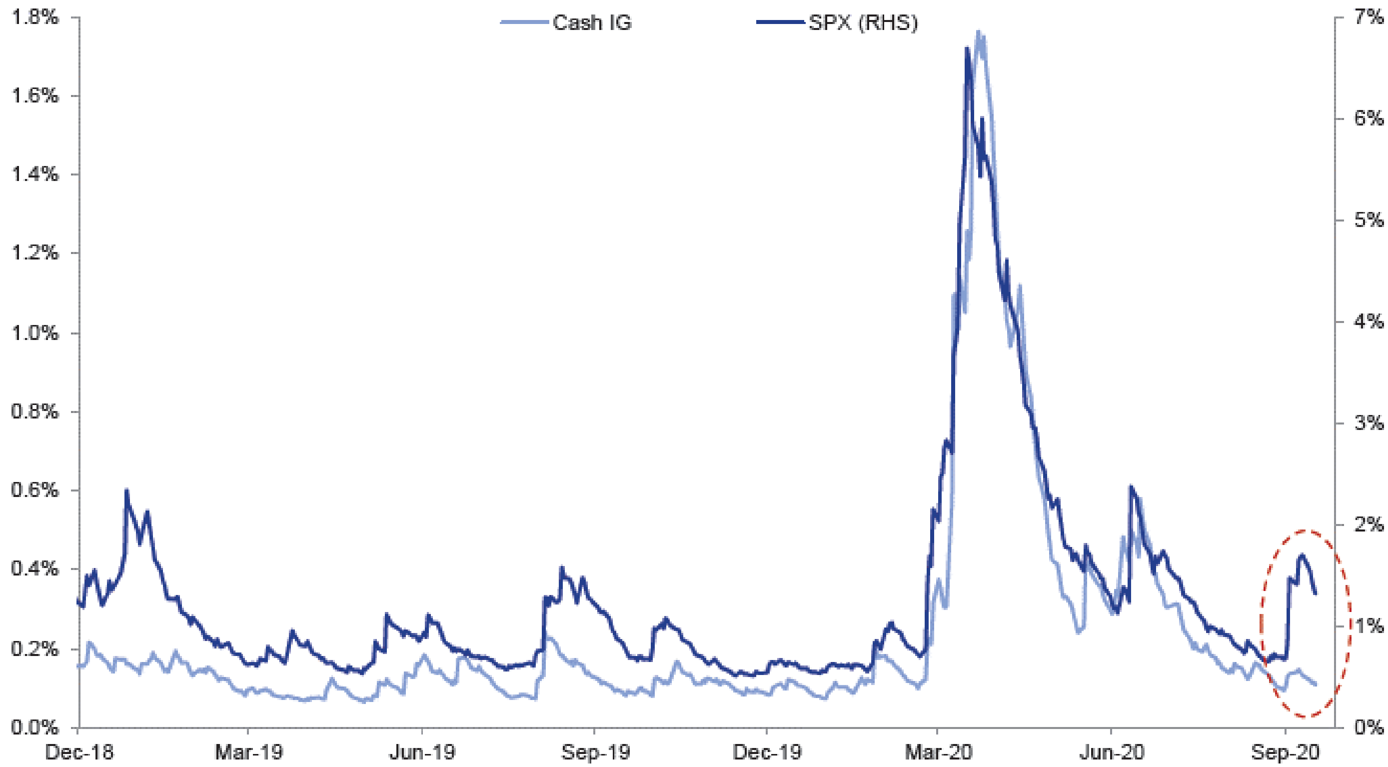
IG Spreads Tight, IG Leverage High





While IG spreads have normalized to ~150 bp, after reaching ~377 bp in March, leverage continues to increase to record highs as issuance has risen and EBITDA has fallen. While investors are looking for an alternative to low treasury yields, and place some faith in the Fed coming to the rescue in a widening, IG spreads still may still widen in the face of CB support. European IG spreads reached 200+bps in March despite the ECB actively buying IG bonds in Europe.

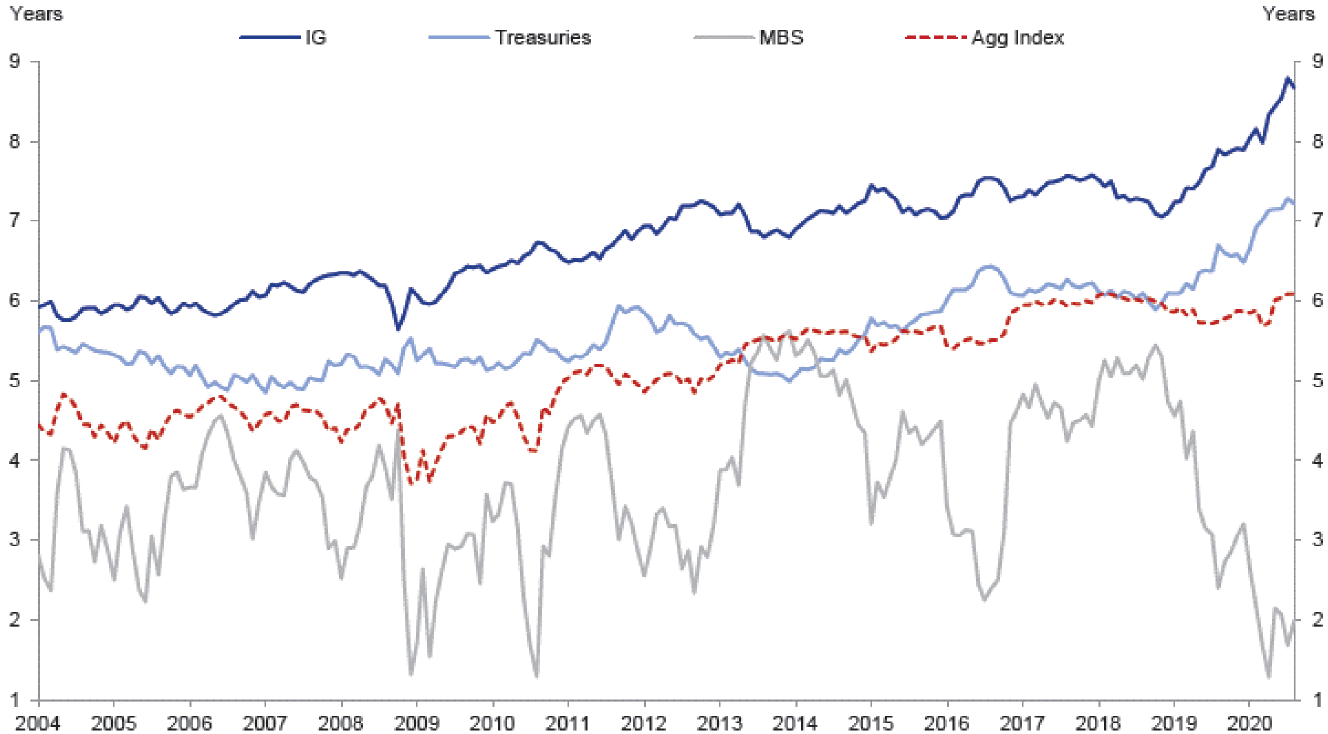
Divergence in Realized Volatility between S&P500 and IG returns



Source(s): Goldman Sachs

September saw a general risk-off tone in markets with a -4% selloff in the S&P500. The selloff in equity markets was accompanied with an uptick in daily realized volatility in the S&P500. However, in contrast to equity markets, the realized volatility of corporate bond excess returns has barely moved. The divergence in volatility between the two markets may be a direct effect of the support by the Federal Reserve for investment grade bond markets.

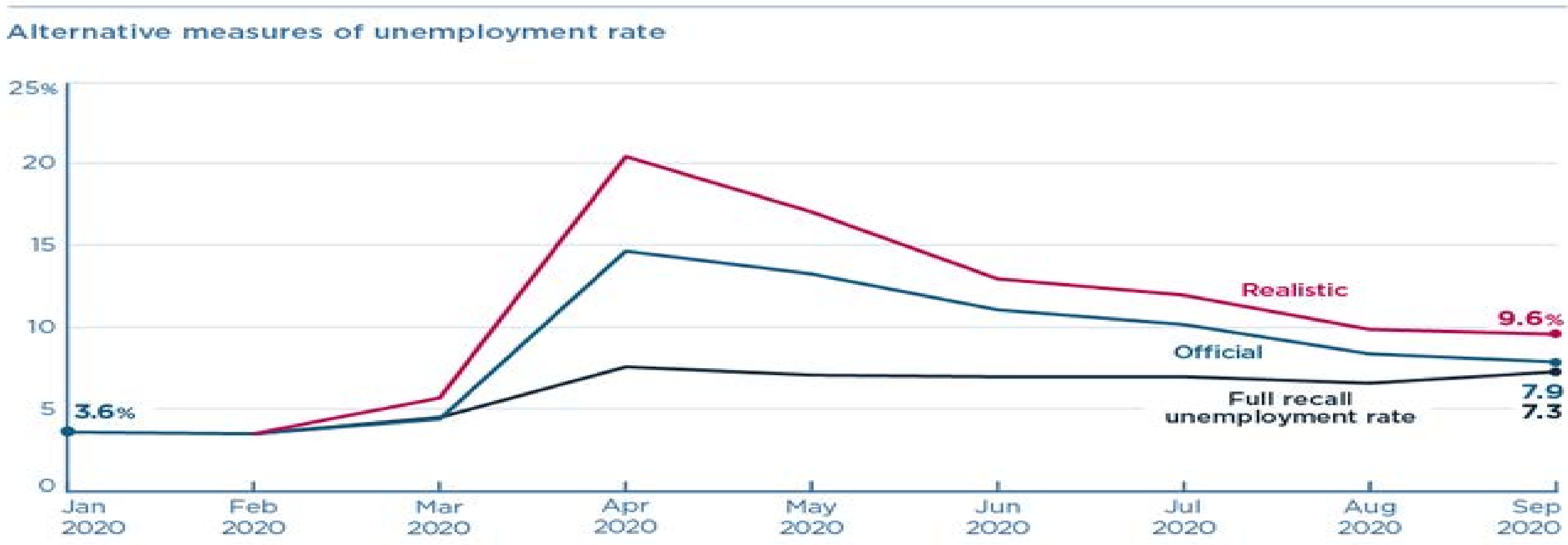
Fixed Income Market Duration



Source(s): Goldman Sachs

While the rally in interest rates that started in Q4 2018 has led to a significant increase in duration for US Treasuries and investment grade corporate bond markets, the duration of the Bloomberg Barclays US Aggregate Bond Index remains near unchanged. This is because of a collapse in duration of the agency MBS market which stands at record lows.

‘Realistic’ Unemployment Rate Still Near 10%

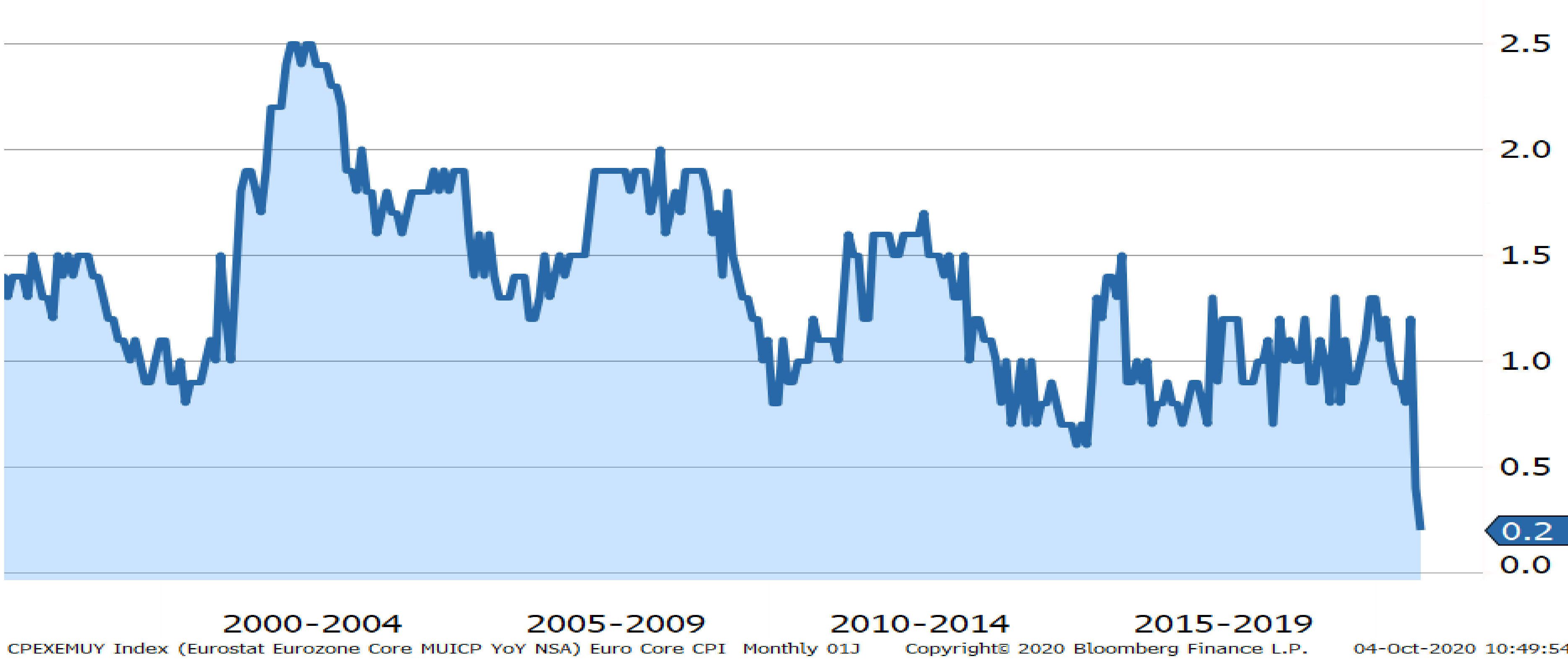


Note: Realistic unemployment rate refers to the adjusted unemployment rate for the unusual circumstances of a pandemic labor market. Full recall unemployment rate is the unemployment rate if all workers on temporary layoff (above February 2020 level) were immediately recalled to work and labor force participation increased in an amount consistent with the reduction in unemployment.

Sources: Bureau of Labor Statistics; Macrobond; calculations by Jason Furman and Wilson Powell III.

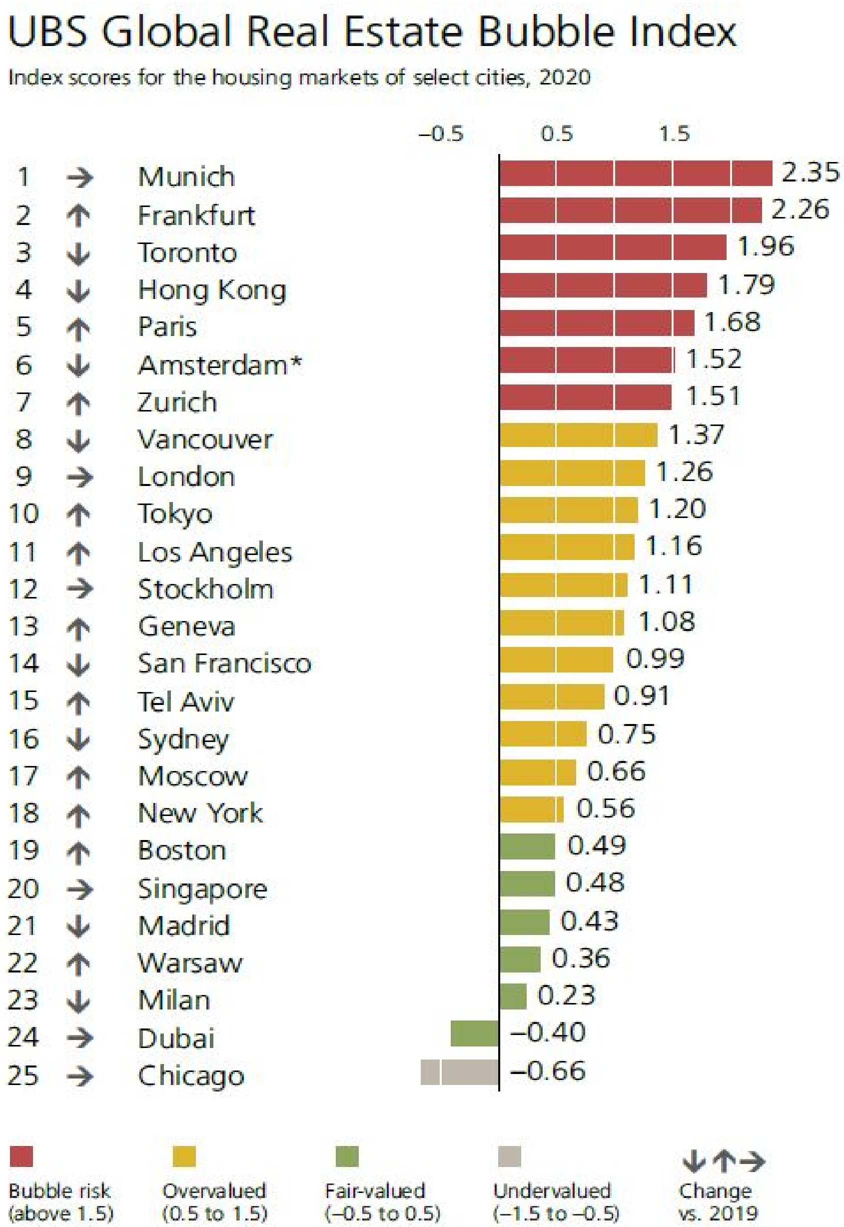
The headline unemployment rate fell to a post-April low of 7.9% in September but masks several concerning factors. Accounting for misclassified workers by the BLS and those prevented from looking for work due to Covid-19 would bring the realistic unemployment rate to 9.6%, little changed from prior months. Further, permanent job losses rose by 345k and the median duration of unemployment is now at its highest level since 2012.

European Core Inflation at Historic Low



In September, Euro core CPI inflation fell to its lowest level since the inception of the euro, somewhat driven by technical factors. In a speech last week, ECB President Lagarde hinted at changes to the ECB's current inflation target of "close to, but below, 2%" as part of its current strategic review. These could be a symmetric target around 2% or an average of 2% as the Fed recently announced. The rare occurrence of Euro core inflation above 2% and the current distance to 2% suggests the ECB could stay on hold for even longer than current market pricing.

Housing Bubble Monitor



Source: UBS * Index altered due to data source revision.

UBS released its annual [Global Real Estate Bubble Index](#) last week. Two German cities, Munich and Frankfurt, are at the top of the list. Bubble risk is also elevated in Toronto, Hong Kong, Paris, Amsterdam, and Zurich. Chicago screens as one of the most undervalued cities. According to the report, inflation-adjusted price growth rates in most of the cities analyzed have accelerated in the last four quarters. In Europe, prices in major cities soared by more than 5%. Price growth in Asian and U.S. cities remained in a low-to-mid single-digit range.

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