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The Rally Everybody Hates

Markets have been very humbling for the past few weeks: in the face of a stronger US Dollar, debt ceiling uncertainties, and some Fed officials now talking about potential for future hikes the S&P 500 is convincingly trying to break above the ~4,200 area that capped most of its rallies over the past 6 months.

When we are approaching potential regime shifts, I always ask myself: what's the global macro breadth of this move? **Are broader asset classes participating, and what's going on under the hood?**
Let's have a look together.

The SPX 5 has massively overperformed the SPX 495 this year

Source: TheMacroCompass.com, Bloomberg

The equal-weight version of the S&P 500 (orange) has gone nowhere this year while the standard market-cap S&P 500 index (blue) is up around 9% - a stark overperformance.
In other words, we could say that the **S&P 5 has massively overperformed the S&P 495 this year.**
Some interesting statistics on this phenomenon.

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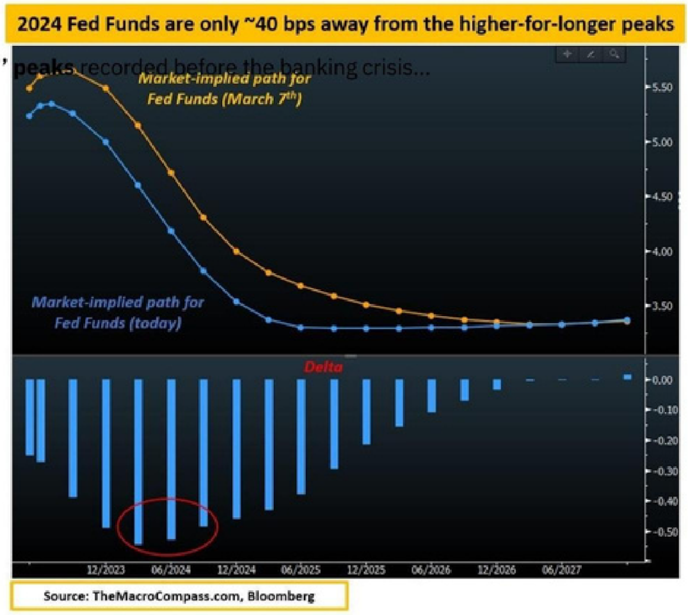
The MacroCompass

Sunday in Global Macro

Hey everybody, and welcome to the first edition of Sunday in Global Macro.
Every Sunday, we are going to make a tour across global macro asset classes reflecting on the most important recent developments and searching for actionable trade ideas – ready, go!

Fixed Income

The latest release of **US core PCE ex-housing shows it's running at 4.4%** on a 3-month annualized basis – down
from the peak, but not down enough?
Sum up that it's been weeks since we've last heard of a regional bank that might blow up, and it makes sense
for markets to **price away the most aggressive Fed insurance cuts** in 2023 and early 2024.
Two key charts: 2024 SOFR contracts (proxy for Fed Funds) only preserve a **~40 bps premium from the ''higher-for-longer'' peaks** recorded before the banking crisis...



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The MacroCompass

Liquidity: What's Next?

Assuming no last minute surprises, it seems like we might be getting a debt ceiling deal in the US which means you should be prepared to get overwhelmed with **financial commentators' takes about ''liquidity''.**

The very unnuanced story goes like: the government needs to rebuild its **Treasury General Account (TGA)** buffer at the Fed so it issues bonds and **it drains ''liquidity'' from the ''system''.**
And here I can picture you guys thinking: what the heck does that mean? And is it true?

In this piece, we will:

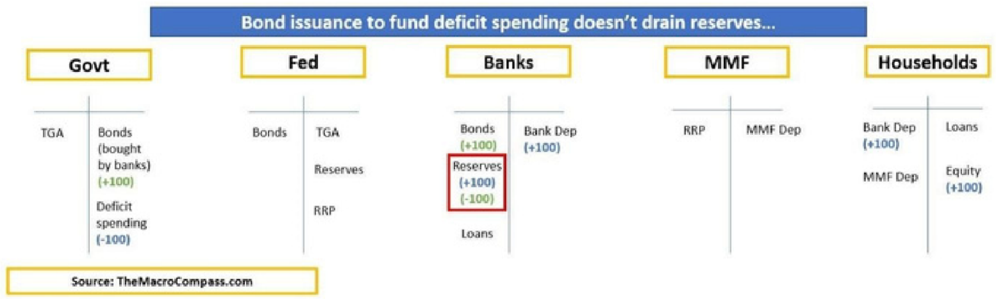
- Show the **monetary mechanics** that underpin a post-debt-ceiling-deal TGA rebuild;
- Analyze **if and how well ''liquidity''** (e.g. bank reserves) **predicts stock market returns**;
- Explain the role liquidity plays in our models to shape our **Macro ETF Portfolio**, and discuss our **investment strategy** accordingly.

------ Monetary mechanics are best understood through the use of **good old T-accounting.**
In our stylized model, we will assume 5 players (government, Fed, commercial banks, money market funds and households) and mimic each monetary transaction – colors will help you ''follow the flow of money''.

Before we go to the post-debt-ceiling TGA rebuild, let's start from bond issuance to fund deficit spending.

BLUE: the government spends $100 (deficit spending) and it injects net worth into the private sector (household's equity) and so households now have $100 more bank deposits. These bank deposits end up as a liability for banks, and the corresponding increase in asset is a boost of $100 in bank reserves.

GREEN: the government ''has'' to issue $100 in bonds to ''fund'' its deficit spending, and banks use some of their increased reserves to buy $100 in bonds.



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The MacroCompass

Credit Crunch

Hey everybody! Before we start, **two quick announcements.**

The first TMC Macro Course is in the making and it **will cover the bond market** like it's never been done before: the objective is to share the knowledge, the tools and the data sources necessary to master this incredibly important market like a pro.

We aim to launch in 7-8 weeks, and we will uncover more details as we approach the x-date!

Also, we are about to **release another Interactive Macro Tool** which will greatly help you identify breaking correlations and trade ideas across asset classes.
The team and I are working hard every day to improve the TMC service – stay tuned!

Investors have been asking themselves **when and if are we going to see a real credit crunch.**
I think that's the wrong way to phrase the question.
Data shows we are ***already*** in a credit crunch.

The real questions to ask are ***how badly*** **and** ***when*** **is it going to affect the economy and markets.**
Let's try to answer both questions together.
Why **so much attention on credit creation** in the first place?

A fiat system with weakening demographics and stagnant productivity trends can only achieve acceptable growth levels through the use of leverage: ample and cheaply available credit to the private sector.
When you want to engineer cyclical growth, providing the private sector with **cheap credit works like magic.**

Even as wages and earnings are unchanged, through cheap and readily available mortgages people can bid up the housing market and through lower borrowing rates companies can more easily finance their businesses and engage in more sales.

With a lag, this **drives up economic activity and a virtuous cycle begins**: cheap credit, strong activity and earnings, buoyant markets, more robust hiring trends and higher wages.

1 Mark Dow

ASSET SHORTAGES AND INCOME INEQUALITY

The bare bones thesis is that asset shortages exist and are largely driven by income inequality. And by ‘assets’ I mean both safe and risky assets. I’ve been thinking and tweeting about these issues for at least 7 years. And as I have, the linkages have become increasingly clear to me. But they’re complex and hard to boil down into the simple blog posts that I prefer. It’s probably why I have held off on trying to lay this out for so long. Nonetheless, here’s the simple version:

We had a phenomenal 30-year period of global growth, much of it turbocharged by demography, deregulation (finance and trade), and a massive global credit boom. Two industries drove the boom more than the rest: finance and technology.

These industries have an unusual feature in common: massively increasing returns to scale. To oversimplify, it used to be that to expand production you had to build a factory and hire a number of people roughly proportional to the desired increase in output, and this is manifestly not the case in much of technology and finance. Companies like Facebook, Google etc. have a marginal product of 1s and 0s that costs basically zero. In finance, the due diligence you need to do on a $10 million loan and on a $100 million loan is the same, but the fees you collect are ten-fold larger. Asset management has similar scaling.

The result is huge margins and profits that accrued to a very small number of people, producing vast fortunes. This, more than tax policy or Fed policy rates, drove the income and wealth inequalities that characterized the past 30 years—starting long before we could even spell QE or before embarking on the past 20 years of tax cuts.

The other reason we know it’s not primarily policy driven is that it’s been a global phenomenon. Yes, in the US, it’s 100% true that we have had policies that favor capital over labor—including a less progressive income tax code. And these polices have no doubt exacerbated the income and wealth disparities here. But it’s hard to argue these policies have driven the global phenomenon of increased inequalities within countries and decreased inequality across countries when we haven’t had common policies. What we have had in common, though, mutatis mutandis, has been an economic transformation driven by inequality producing technology and finance.

MARK'S WEBSITE

How do global income inequalities matter to the Asset Shortage theory?

If you think about ‘asset production’ as being correlated to GDP, it is easy to recognize that if income (GDP) is evenly distributed, the aggregate marginal propensity to consume (MPC) is higher and the marginal propensity to save (MPS) is lower. If unevenly distributed, wealthier people will consume less of their income and save more. Lower MPC and higher MPS translate into higher demand for financial assets for a given level of aggregate income. And, remember, we’re talking global, not just the US.

While this may be the most important driver of the Asset Shortage, to be more complete, it isn’t the only one. Central banks have contributed to the demand for assets—especially safe assets. Corporate buybacks have contributed at the margin too. More significantly, global financialization has produced insurance companies, pension funds and asset managers in countries where they didn’t exist 30 years ago, and they have grown massively in countries where they already did, increasing the demand for assets to match future liabilities and mobilizing the excess savings of the wealthy. If you take all these factors together, it makes—at least to me–a pretty compelling case for the Asset Shortage thesis.

MARK'S WEBSITE

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