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ROHR ALERT!! 'Normalcy Bias' Fosters Return of Bifurcation

1 message

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Dear Subscribers,
For a brief while two weeks ago there was a true 'risk on' psychology across all asset classes. US equities surged into the first real weakness in a while hitting global govvies, and emerging currencies along with even developed currencies continued to strengthen against the US dollar. A temporarily unified psychology.

Alas, that is no more. And it is typical that the return to a more realistic view in other markets has still allowed US equities to push higher... the great bifurcation. While global govvies stalled a bit in their recently renewed bid (and the UK Gilt is burdened by Thursday's BoE QE expansion), they remain above key support overall after recovering from the selloff two weeks ago. That was in the wake of generally weak international economic data and, more importantly, the signs of rising COVID-19 infections… especially in the US on the key reopening effort.

So how can US equities continue higher after recent sessions of sideways churn? Well, there are multiple reasons, one of them being our favorite which we recently cited again, "*The govvies are the equities smarter older brother*." That is to say the US equities can trade on a longer term forward view of everything being fine, while global govvies are more inclined to take serious the economic challenges.

As we have revisited many times in recent assessments, the key is not likely the hopes for a COVID-19 vaccine or that the pandemic will just "*fade away*" (as the Prez has recently predicted.) It will ultimately be the 'stabilized' level of economic activity into later this year. That will revolve around whether the 'at risk' folks will be willing to return to full retail economic engagement (in store dining, travel, hotel stays, shows, etc.), or will remain reticent in their spending habits.

The US is additionally burdened by the lack of following the best advice of the health authorities (CDC, WHO, Trump COVID-19 task force members and others) during the reopenings. In fact, Mr. Trump refusing to publicly wear a mask has politicized the issue. Just today on CNBC was a report of a theater chain owner who will only 'recommend' and not 'require' patrons of his reopening theaters to wear a mask… because he views it as a politicized issue. Wait... What?!

Right into the planned indoor Trump Tulsa rally, new US COVID-19 infections hit a 2-week high of 27,000 on Thursday. The good news is that hospitalizations and deaths have lagged. Yet it must be allowed that those tend to trail infection rates by about two weeks. Along the way are ostensibly positive announcements from governors and others there will be no new quarantines or stay-at-home orders.

That is fair, given the damage the prior shutdown caused. Yet their lack of official restriction does not mean things will get back to normal, or even a 'new normal' with the continued COVID-19 infection threat. As noted previous, what is coming is more so a 'new abnormal'

with significantly depressed levels of activity. Even considering recent very strong economic data, that only signals activity which is back to half of what it was into the best levels prior to the March-April debacle.

As we noted regarding the Fed's communication on its need to raise rates out of early 2015 into early 2016, current positive statements smack of 'normalcy bias'. That is the tendency to wish, and even imagine, things are still normal (or getting there) despite clear signs that they are not. Our December 8th 2015 Rohr-Blog post 'Commentary: Will 2016 be 2007 Redux?' (https://bit.ly/2YdRBhG) explains the nature of 'normalcy bias' and that the Fed's problem was not the lack of sufficient QE. It was more so high tax and regulatory hurdles suppressing the key 'Velocity of Money' in the US economy (see the opening graphic.)

This gets back to the point of the importance of the actual economic turnover versus hopeful aspirations of what it might become. As noted in Thursday's 'Bothers and Banks' ALERT!!, there is historically high central bank largesse along with Brobdingnagian government fiscal stimulus at present. All of which fosters a sense that it must surely end well… just like the 2008-2009 crisis.

However, this one is based on nature and a broader human psychology which cannot necessarily be 'cured' by massive amounts of liquidity and government spending in a once again cautious environment. And yet, the US equities remain bid from the middle of their recent major higher and lower technical trend levels.

There was a very good Reuters article this morning (https://reut.rs/37IKKzX) that discussed the various psychologies driving the US equities versus the bifurcated activity in other asset classes. There is "Don't Fight the Fed" and "FOMO" (Fear of Missing Out) among others. Yet our favorite is the classic "Hopium" sanguine expectation that things will return to 'normal' despite the factors we have noted.

In the end the US equities will need to respect the real levels of economic activity and the attendant corporate earnings (the real driver of their performance.) It is the case however that the US equities can trade on 'hopium' for a long time prior to reality biting. Just look at how much further they rallied into the first half of 2007 after the OECD's December 2006 warning in "A Smooth Unwinding or the Crash or 2007?" Indeed the US equities comeuppance did not occur until 2008.

It is now a matter of not fighting the trend. Even though we were bearish on the economy and US equities into early 2007, the Evolutionary Trend View remained strong enough to leave us happy to follow the up trend. As we noted in a post on the Financial Times LEX column blog (since discontinued), "*Learn to Love the Bubble*" without getting married to it (http://bit.ly/2c03eOH.) In any event, any extended success of the US equities bull will depend on what happens up at those higher or lower major front month S&P 500 future levels (more below.)

As far as the global govvies are concerned, they are 'country' markets right now. The UK Gilt is suffering under the influence of Thursday's BoE QE expansion while the German Bund and US T-note maintain their firm activity. That is even with the slight discount in the September T-note as it becomes the new front month on today's June contract expiration. And the developed currencies and emerging currencies weakening against the US dollar are indicative of the return of quite a bit more of a 'risk off' psychology… bifurcation indeed.

Courtesy Repeat of Thursday's critical consideration

[Although otherwise stated on Thursday morning, these were indeed revised after Thursday's Swiss National Bank and Bank of England decisions and statements.]

COVID-19 virus spread caused US equities intermediate-term bull psychology to 'crack'. Front month S&P 500 future was already back below key congestion around the mid-2019 3,030-00 previous all-time high congestion. That was below support from the push above the multi-year topping line at 3,070 as well, and left a late-February intermediate-term up channel 2,970 DOWN Break. Isn't it interesting that the next significant decision is back in that area now.

The subsequent DOWN Break below the front month S&P 500 future 2,600 area major up channel seemed to indicate more of a near-term failure. That was from the early 2016 low (https://bit.ly/3hrXDTC updated through Friday.) That was the key higher resistance it had violated on its mid-April push above its 2,675 trading high Tolerance from prior to the DOWN Break (including monthly MA-48.)

As such, it is reasonable the front month S&P 500 future will now treat the low 2,600 area (with a Tolerance to the mid-2,500 area) as support, with interim levels at 2,850 and 2,750 that were important in the recent up trend. And the front month S&P 500 future pushed out of the broad higher range top in the 3,030-2,970 area three weeks ago and sustained it, with the 3,200 area the next higher meaningful resistance that has a 3,230 Tolerance. That is obviously what the market knew once it exceeded the 3,030 area, as it rallied directly to 3,200 by late last week.

It then stalled all three days early last week right up against that 3,230 Tolerance with no sign it was going to push further. Especially after last Wednesday's friendly Fed communication yet with no additional stimulus announcement into a still weak economic situation (see last Thursday's ALERT!!), the US equities were extremely disappointed. In the context of recent hypervolatility, this opened the potential to retest that more prominent confluence of technical factors in the 2,970-3,030 range, which it vigorously tested into early this week.

That congestion is reinforced by the manner in which the market churned up against the low end of it into May. It is now churning in the middle of those two major ranges pending clarification of the future 'macro' factor psychology.

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