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ROHR ALERT!! Liquidity Bifurcation

1 message

ROHR Alert <rohralert@gmail.com> Fri, Jul 31, 2020 at 10:06 AM
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Dear Subscribers,
The market responses in the context of recent data and Fed indications leave only one conclusion: We are seeing 'liquidity bifurcation'. US equities pushing above a key level once again (more below) while the global govvies renew their recently stalled rise along with extended pressure on the US dollar against other developed currencies can be attributed to two key factors. The first is the Fed's massive accommodation, yet with little chance that will rescue the US economy.

In the first instance, on Wednesday the Fed confirmed both its downbeat view of a US economy burdened with the continued spread of the COVID-19 pandemic, and the degree to which it is committed to almost endless accommodation in the form of liquidity provision and major extension of its low base rate regime. It is as Chair Powell said in his press conference response to a reporter's question about any consideration of when the Fed might be raising rates, when he noted it...

"...*had not even thought about thinking about <u>thinking about</u>*…" any potential rate increase. At first it was easy to consider he may have misspoke; on reflection it seemed more so his form of extreme emphasis that no such thing is possible. The full FOMC Statement (https://bit.ly/30a5vT0) and video of Chair Powell's press conference (https://bit.ly/2BNKCE0) are available for your direct review.

The important implication is that there will NOT be any traditional 'risk free' yield available anytime soon through the classical vehicle of the debt markets. THAT is driving at least some measure of the US equities (and others) strength. Folks who cannot earn any return in the bond markets are biting the bullet, and shifting into chasing profits as capital gains in the seemingly 'Teflon' stock markets.

Yet as we also noted again on Thursday, "*The bond market is the equities smarter older brother*." That is because the global govvies tend to trade off of the baseline economic expectations, while US equities (among others) can trade off all sorts of extended forward expectations. Global govvies were pushing above recent resistances on Thursday in the context of even weaker than expected global economic indications that have spilled over into today… especially Europe.

This means that on a forward economic view the global govvies are not expecting any recovery strong enough to trigger any inflation. What we learned in the 1980s is that the bond market trades on a spread between their 'real yield' and inflation. In an environment where inflation continues to wane due to economic weakness, global govvies can rally based on that dynamic; regardless of the size of the debt offerings from governments or the major liquidity infusion by central banks.

As a brief aside, note the most recent release in conjunction with the expected nasty implosion of US Q2 GDP of the long-term graph of the 'Velocity' of the US Monetary Base

(https://bit.ly/2XeMQ6W our lightly marked-up version courtesy StLouisFed.org data with graph by DavidPaulLaipple.) As an aside, note the lack of 'velocity' back into 2015-2016, even as the Yellen Fed was warning of an uptick in inflation based on economic growth. Along with Congress' lack of lowering corporate taxes and regulation, this is when we noted the Fed 'normalcy bias' as it sought to justify the extended QE programs under Chair Bernanke.

The lack of business confidence and investment/hiring meant that no matter how much liquidity the Fed provided the money was not being recirculated (i.e. the actual 'velocity' driver) in a manner that would deliver greater growth. It is little wonder that under the Obama administration the received wisdom was that it was not possible to ever achieve annual US GDP growth above 2.0 % again.

Further note that even under major Trump administration moves on taxes and regulatory reform, the 'velocity' only recovered to slightly above the all-time low from back in the early 1940s. This was likely in some major measure due to the improved tax and regulatory environment being offset by Trump administration heavy tariff orientation in its trade policies, depressing corporate confidence.

And now? It has slumped into another new all-time low. This is not necessarily a big surprise in the context of most businesses not having any incentive to invest and hire in the current and near-term future environment. The exception is of course those who are bringing on more staff for shifting businesses to adjust for the continuation of the COVID-19 pandemic; like restaurants shifting to more carry-out volume while restricting their inside seating capacity. Yet that does not bode well for many businesses which are burdened by the extended problems.

That leaves quite a bit of near-term future (i.e. pre-vaccine) activity dependent on whether US consumers remain confident, and have the wherewithal to continue their recent strong spending. Yet the Consumer Confidence number this week was softer than an already weaker estimate, the Weekly Jobless Claims were not encouraging, even if this morning we saw US Personal Spending come in at the expected 5.6% rise. Yet Personal Income was almost twice as weak as expected at -1.1%, and there is one more point to keep in mind: These are June data, with the expectation they will weaken as the July COVID-19 problems take hold.

This is why Thursday's ALERT!! was titled 'It's Up to Congress Now'. We suggest a read of that for anyone desiring more details. Yet the key is that there is still a wide chasm between the Republican and Democratic positions on many features. Those include the level of supplemental unemployment benefits with the current $600/week expiring today. There is also relief for states and municipalities that is an anathema for Republicans, yet is a nonnegotiable item for the Democrats.

Which is why we were a bit surprised by the US equities rally after the Fed was obviously sympathetic, yet had nothing new to offer. The liquidity-based 'yield chasing' is the only explanation we can offer. And that 'risk on' psychology typically only lasts until such time as the worst case scenario becomes more glaringly apparent. As another sign that the 'risk on ' psychology is suspect at present, while the US dollar has suffered against other developed currencies, the emerging currencies are suffering a bit once again at the same time. The latter is typically a sign they are worried about the future path of the global economy.

As such, the 'It's Up to Congress Now' psychology still abides, with real concerns about how far they will distend the current negotiations that will impact the lower and lower-middle income consumer psychology. Without being at all political about it, the Republicans coming to the table so late with their proposal was already a problem for timely agreement. For more on all of that please see the Monday and Tuesday 'Rocky Relief Show' and 'When a Good Idea is Bad'.

Suffice to say for now that the Republicans are still pushing their view of the supplemental unemployment benefits going to "70% of previous wages" (as calibrated with October 2019 levels.) In addition to much more in Thursday's assessment and more to the point we have raised previous, can the individual state unemployment agencies even implement at all timely such a complex program? After initial problems for some states in just sending out the original additional $600 supplement, we remain very skeptical this can be done timely.

As such, it is not a surprise that as the House COVID-19 pandemic inquiry with the administration disease experts is proceeding this morning the September S&P 500 future has sunk back from challenging higher 3,272 resistance (from last week's top), and is now nominally back below the key 3,230 area. It is going to be interesting to see how it finishes the week. Along with that the global govvies are mostly holding their bids up into or slightly above key resistances. And while the US dollar has recovered a bit, its overall downward momentum remains intact.

Is this the beginning of US equities versus global govvies 'liquidity bifurcation' reverting back to a more realistic response by US equities to the still weak likely path of the US and global economy? Or will they continue to reflect the excess liquidity chasing yield which ignores the most likely economic progression? Whatever that decision may be, it is likely the US dollar will continue to suffer from both that extensive US liquidity growth and seeming US COVID-19 disarray.

Courtesy Repeat of Thursday's critical consideration
COVID-19 virus spread caused US equities intermediate-term bull psychology to 'crack'. Early March already saw front month S&P 500 future 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.

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/3jD6WB8 updated through Friday.) That was then the key higher resistance subsequently violated on its mid-April push above its 2,675 trading high Tolerance from prior to the DOWN Break (also monthly MA-48.)

The front month S&P 500 future pushing out of the broad higher range top in the 3,030-2,970 area in early June was the key to it surging to the 3,200 area. That was the next meaningful higher resistance with a 3,230 Tolerance at which it failed previously on the current rally. That is also where It stalled all three days after the early June US Employment surge with no sign it was going to push further after the June 10th negative OECD indications and disappointment with the FOMC.

And it remains a very prominent technical area, which it has just pushed above. After churning recently around the 3,100-30 interim congestion in the middle of the 3,030-2,970 and 3,200-30 ranges rallying above 3,230 despite the expanding US COVID-19 concerns was a strong indication. However, sinking back below 3,230 late last week is a cautionary sign,

as the weekly Close above that level was necessary to fully signal that UP Break. Back below 3,200 (and especially its Tolerance at the 3,187 previous DOWN CPR signal) would indicate a 'false' UP Break, which could signal an important near-term top… it's still on the cusp.

If it does manage to press higher, next resistance is the February 24th major gap down from the February 21st 3,339.25 weekly Close. That is also key congestion as higher resistance, even if the gap begins at the 3,312 high of the following week (established Monday of that collapse week.) The only nominal resistance above that is February's 3,397.50 front month future all-time high.

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