ALPHA SOURCES

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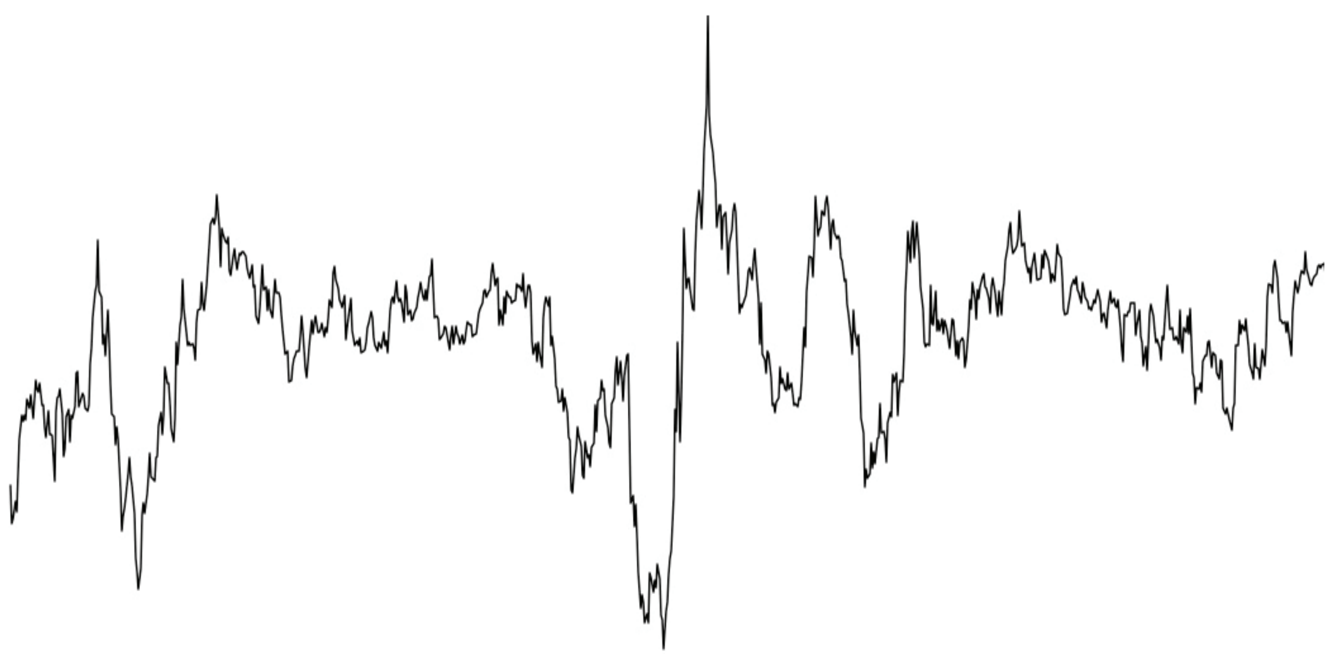

FINDING THE CRACKS

I have a lot of sympathy for pen-wielding strategists at the moment. Every day the empty white sheet of digital paper is staring at them, the little cursor tauntingly flickering in the top-left corner. The most obvious course of action, to copy-paste their previous note, is just about the only thing they *can't* do. We economists at least have a steady flow of new data, however mundane and useless, to write about. In other words, the main questions remain the same, and they remain largely unanswered. Economic activity has collapsed, and is now staging what appears to be a painfully slow rebound. Even in the best of worlds, however, it's difficult to escape the notion that significant damage has been wrought in on both the demand and supply-side. This puts equities on the spot. A reflexive rebound from the nadir in March was always coming, but could it be sustained, and would we re-test the lows? In a normal recession the answer to those questions would be "no" and "yes", but there is nothing normal about this recession. U.S. equities have roared higher, and the ubiquitous growth stocks, which outperformed before, are leading the charge again. The S&P 500 growth index is up a cool 32% from its March lows, and is now flat year-to-date. By contrast, the S&P value index

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is up "just" 21% from the lows, and are still carrying a 20% loss year-to-date.

A lot of ink has been spilt over the divide between these two sectors, ostensibly pitting tech vs everything else. It contains the components for the reality that equity investors are being asked to accept, or deny at their peril, on a daily basis. **As long as growth equities are rising, and leading, U.S. beta will motor higher, outperforming its global peers.**

It's a well-known adage in equities that outperformance begets outperformance, but that the virus should have *solidified* the grip by U.S. growth stocks seems odd at first, until you consider the policy response.

The "kitchen sink" does not do justice to the response mobilised by monetary and fiscal policymakers; they're throwing the whole house at the virus. Financial assets are first in line to benefit—with everyone's fingers crossed that some of it trickles down to Main Street—and more is coming. Expectations are now centred on some of form of interest rate cap in the U.S.—via Yield Curve Control—and I reckon that the ECB, BOE and BOJ have further tricks up their sleeve too. Fiscal policy isn't done either, posing the obvious question; why would U.S. equities, supercharged by "growth", falter?

In relative terms, I struggle to see it, unless the curve is allowed to bear-steepen. **In absolute terms, though, I am now officially worried about the U.S. stand-off with China.** My intuition tells me that the White House is playing election politics—negotiations will be back on if Trump is re-elected—and my intuition also tells that it is a smart move, domestically speaking.

It's a long a time between now and November, however, and the speed with which the rhetoric is heating up is alarming. The situation in Hong Kong, the South China Sea, Taiwan or simply a tit-for-tat economic conflict are all potential, and rather ominous hotspots. We should be watching all of them, though in the context of *markets*, the USDCNY is be the key barometer. It's edging higher, and if it continues, it suggests that cracks are emerging.

fig. 01 / Team Brr is on it — fig. 02 / One chart to rule them all over the summer?