sight beyond sight®

a global macro investment newsletter by **Neil Azous**

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Plenty of Ways to Make Money Into Year-End

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Tracking Portfolio – Performance Update

As of November 27, 2020, COB: WTD +2.28%, MTD +5.65%, +10.19% YTD **net**

Tracking Portfolio – Trade Lab

New Trades:

- Long 2-5-30yr US Treasury Butterfly

Closed Trades:

- None

Watch List Additions:

- None

Admin – Schedule

The next edition of Sight *Beyond* Sight will be delivered **on Thursday, December 3rd, 2020.**

Sunday Edition

November 29, 2020

Tracking Portfolio

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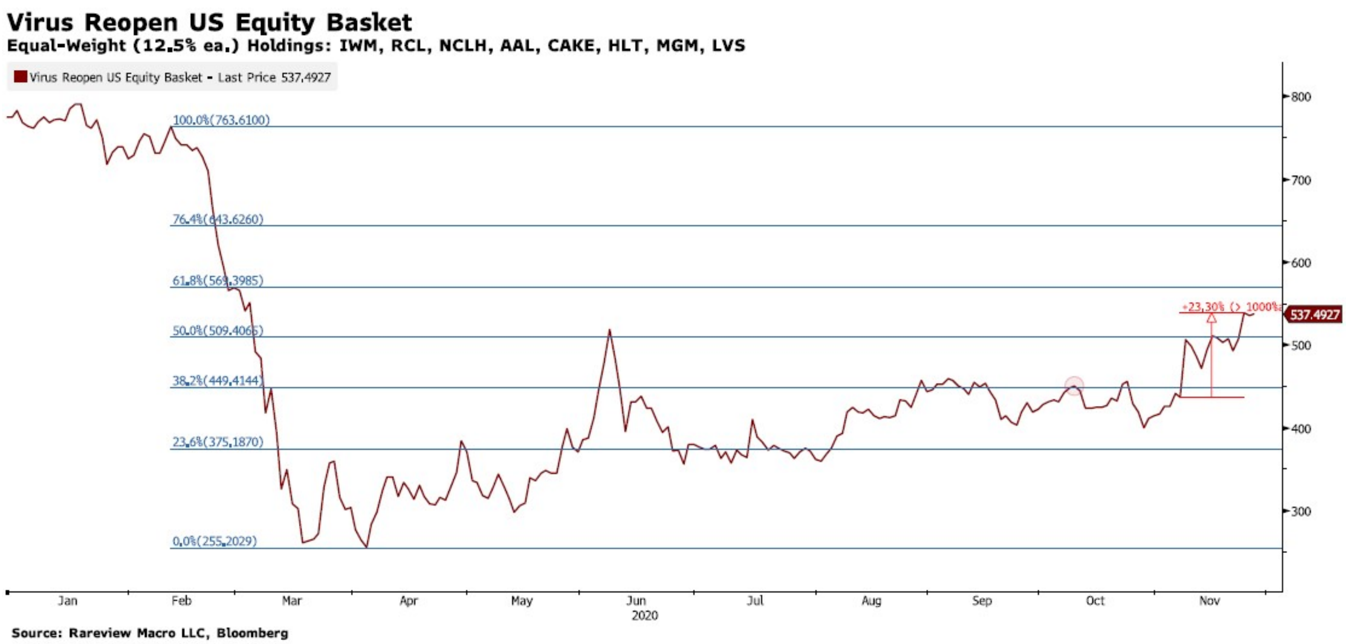
Comments

Update – Long REOPEN Basket – Our Highest Conviction View into Year-End

In the November 8th edition of Sight *Beyond* Sight, we reiterated that our reopening basket was our highest conviction idea into the end of the year.

Three vaccine releases later, and the basket is up ~23.30%.

While there is more room to extend higher, we will look to jam stops, take profits, or replace a name quicker as we seek to lock in realized gains.



Long 2-5-30yr US Treasury Butterfly

In the November 20th Edition of Sight *Beyond* Sight, we provided a compelling argument why a long 2-5-30yr US Treasury butterfly may be the last best fixed income trade of 2020.

Last Wednesday, the spread reached our entry point, and we implemented the Tracking Portfolio position.

The average move in December for the spread is 17 bps. Therefore, we bet 10 bps of the Tracking Portfolio NAV for every 1 bps move in the spread. Said differently, we believe the reward-to-risk ratio is 1 to 3. So, we are risking 4050 bps to make 120-150 bps.

Sidebar: Despite the view that this is an "A trade", we are not risking more because we are already long a frontend steepener in Eurodollars in much larger size (i.e., EDZ1/EDM3 is a version of 2-5yr steepener, the foreleg of this spread).

Long ETFMG Alternative Harvest ETF (MJ)

Five states legalized marijuana on November 3rd, including New Jersey. On November 4th, both the New York and Connecticut governors said their states are next. On Friday, an updated U.S. House schedule showed a vote would be held this week on marijuana decriminalization. If all else fails, the next Attorney General, after consulting with HHS, can remove marijuana from the controlled substances list.

The short-term trend, as measured by a parallel, up-sloping 21- and 40-day moving average, has been established.

On an intermediate-term basis, the 150-day moving average recently shifted to upward sloping. Collectively, it is easier to understand why cannabis stocks are attempting to come out of their 2020 base.

Note: Regarding trend, we only pay attention to the 150-DMAVG for intermediate-term changes in its slope.

Long Mexico Equities – EM Value with a Kickstarter

The story for Mexico entering 2021 includes these chapters:

1. Vaccine upside risk highest in MSCI EM

2. 38% earnings beat in 3Q20; positive earnings momentum; upside risk to consensus 2021 EPS growth

3. Valuations cheap (market down 12% this year, underperforming MSCI EM by 19%)

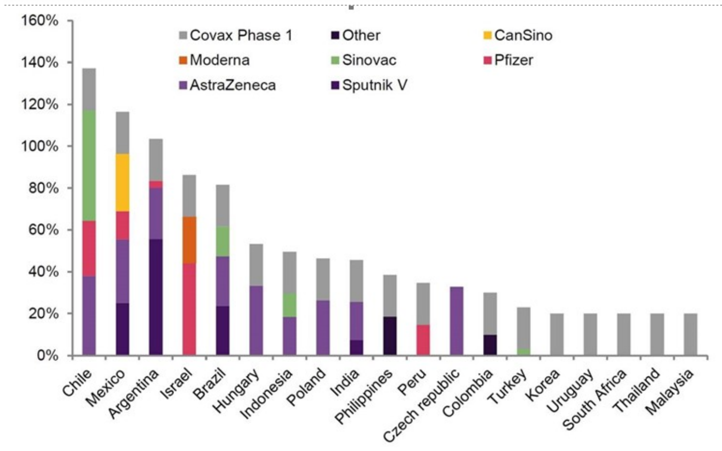
4. US politics are likely more supportive.

We are most interested in vaccine-related outcomes because the re-rating is the swiftest of the supporting arguments.

Said differently, the early EM trade in 2021 will be about how much of its population can each country vaccinate and how fast?

The chart to the right highlights that Chile and Mexico have secured a higher quantity of vaccines than others, specifically Pfizer, Moderna, and AstraZeneca.

Finally, what makes Mexico a value play is a fact that it did little fiscal stimulus relative to the rest of the emerging markets. So, with an external balance in a stronger position, Mexico should benefit disproportionately.



Source: Ministries of Health, NWM Strategy

Long Chinese Equities

After forming a cup and handle pattern on the weekly chart, China A50 made an all-time high in November. If you follow classical charting, the follow through higher is playing out as expected.

Foreign Exchange

Prior to the US Election, this was the consensus view:

1. Foreign exchange is the cleanest asset class to express a view on a Biden win.
2. The US dollar will weaken 4-6% into the end of the year following a Biden wins.

The only question was, how much leverage do you use regarding a short US dollar basket?

Following the US elections, the weaker US dollar view received an added boost from the vaccine announcements. Emerging markets will outperform the US on the reopening, and foreign central banks one day in the future will remove extraordinary policy faster than the Federal Reserve. Therefore, the US dollar should weaken.

With this sentiment still firmly entrenched, here is where opportunities exist.

Long Euro Exchange Rate (EUR)

In the November 8th edition of Sight *Beyond* Sight, we said to wake us up at the EUR/USD September 10th high price. Here is what we wrote:

> *At the September 10, 2020, European Central Bank (ECB) meeting, the ECB's chief economist, Philip Lane, warned that the euro's appreciation this year has dampened the inflation outlook. He specifically used more hawkish language than President Christine Lagarde and signaled that more monetary stimulus might be needed. The EUR/USD high that day was 1.1917. Until it takes out that level, the EUR/USD is morphing on a chart. Said differently, there is no trade now.*

After several attempts to break higher mid-last week, on Friday, EUR/USD decisively closed above that level at 1.1963. The September 1st intraday high was 1.2011. Above that level is air on a chart up to 1.25.

The domino impact on euro crosses was meaningful, especially on the -EUR/+CNH consensus carry trade. As you can see, the downtrend channel was decisively broken.

The critical point here is that the euro is strengthening relative to both the US dollar and the Chinese yuan simultaneously. That is a statement in-of-itself.

Two Cleanest FX Charts: Short USD/JPY and USD/CHF

The VIX Index traded below 20 last week for the first time since February. Volatility should continue to fall in other safe-haven proxies, like Japanese yen and Swiss franc. The technical setup in USD/JPY and USD/CHF for lower prices also remains strong.

Short USD/JPY

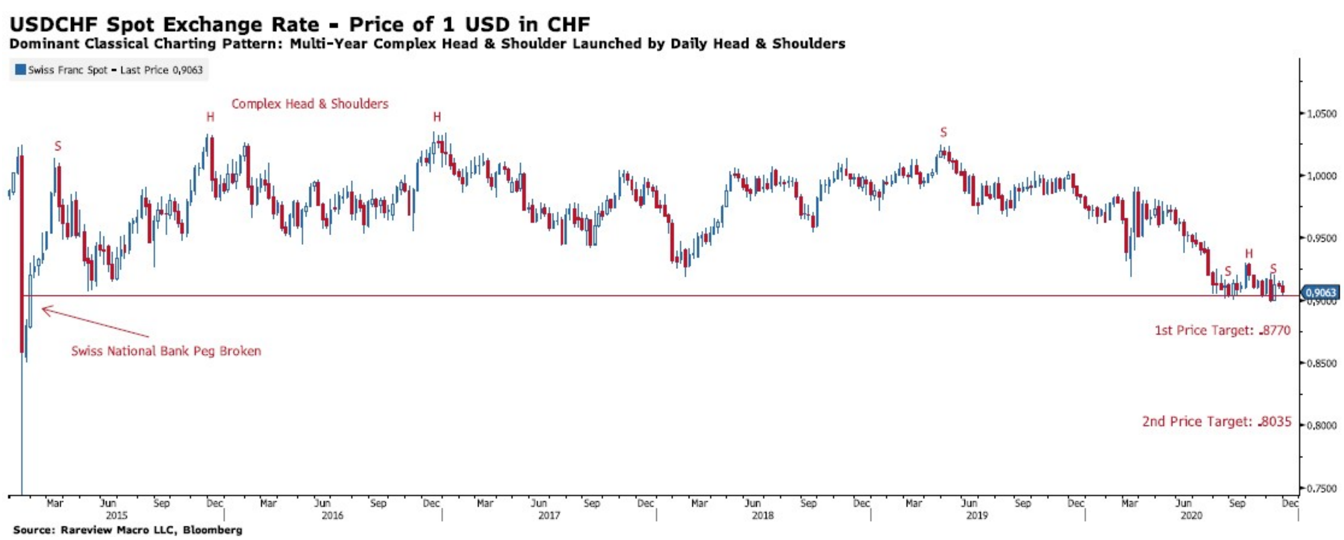
The dominant classical charting pattern is a three-year descending triangle on a weekly basis. On the daily chart, USD/JPY has completed a descending triangle. Said differently, the same daily pattern is launching the weekly pattern.

The Dollar-Yen (USD/JPY) continues to morph at a four-year low. A break below 104.00 targets 101.90.

Short USD/CHF

The dominant classical charting pattern is a multi-year complex head & shoulder pattern on the weekly chart and an 11-week head & shoulder pattern on the daily chart. Said differently, the same daily pattern is launching the weekly pattern.

The Dollar-Swiss (USD/CHF) continues to morph at a five-year low. The significance of this is that it dates to when the Swiss National Bank EUR/CHF peg was broken. Anecdotally, the SNB has been defending 0.9000 for weeks. There is an argument that once the SNB stands aside, the pair's weakness could be swift. A break of this shelf targets .8770, with a secondary target of .8035.



Rarely Looked at FX Pairs Communicate A Lot of Macro Information

Like the pandemic, the primary portfolio construction following the Global Financial Crisis was long safety versus short cyclicals. In foreign exchange, short Swedish krona versus long Swiss franc (-SEK/+CHF) was a prime example. After all, Sweden is one of the world's cyclical engines of growth, and the Swiss franc is perceived as a safe haven. Some version of this interpretation lasted 10 years until now.

We like to analyze this FX pair because both countries have similar characteristics. Sweden and Switzerland are high capacity, not in the Eurozone, have significant economic exposure to the Eurozone, have comparable current accounts, have similar interest rate structures (i.e., negative yields), have a high standard of living, etc.

So, when something changes regarding this ultimate risk barometer, we pay attention.

Below is a chart of SEK/CHF. There are three observations:

1. A 23.6% Fibonacci retracement going back to the GFC.

2. The 2017-2020 downtrend channel broken.

3. The 2019-2020 head & shoulders pattern completed.

For our non-FX readers, this is a version of a "high-powered" re-opening trade. Said differently, it is like gaining deficit emerging market exposure with a G10 volatility profile or buying small caps, but with a 7 implied volatility product instead of 30.

If you believe in the "Roaring 20's", SEK/CHF has communicated that it is one way to capture it.

Gold Talking Points & Road Map

Gold (XAU) closed at 1787.79 last Friday. It has fallen 14.51% from the August high, including closing below the 200day moving average and the key resistance level of $1780-1800 from 2011-2012.

What is confusing for most gold longs is the decoupling from real interest rates, which is the primary factor that drives the price of gold. For example, the 10yr US real interest rate has fallen from -0.73% to -0.93% since November 9th – gold should be up, not down.

The extrapolation is that a more important theme in the short-term is driving the price of gold. That is, following the Presidential Election and vaccine news, the market has transitioned from pricing a fiscal led recovery to a private sector one. The implications for gold are important to recognize because a "vaccine reflation" has an identifiable outcome, whereas a "fiscal reflation" has an unknown outcome. Add in the recent bitcoin outperformance and it is easier to understand why the yellow metal has now given up half of this year's gains.

So, what is the outlook for gold now?

The arguments for buying weakness at current prices are:

- Gold has retraced 50% of this year's gains
- Gold has fallen below the 200-day moving average
- Gold is oversold (i.e., 14-day RSI is 30, 9-day RSI is 24)
- Seasonally, the December to February period is the most bullish
- Every research house has already downgraded its 2021 price targets
- The Street no longer believes in a trillion+ fiscal support before a vaccine
- Positioning is cleaner. PnL pain was the lead driver as investors were caught flat-footed because real rates fell. This suggests that the crowded trade is being unwound, in line with the investment outflows in ETFs.
- The Fed and ECB could ease policy at the December meetings, including increasing the scope of QE

- ③ A Yellen-Powell duo supports gold as Yellen has been vocal about the need for stimulus and has often stated that government spending is needed to boost the natural rate of interest.

- ③ The US Government will continue to spend, and spend big

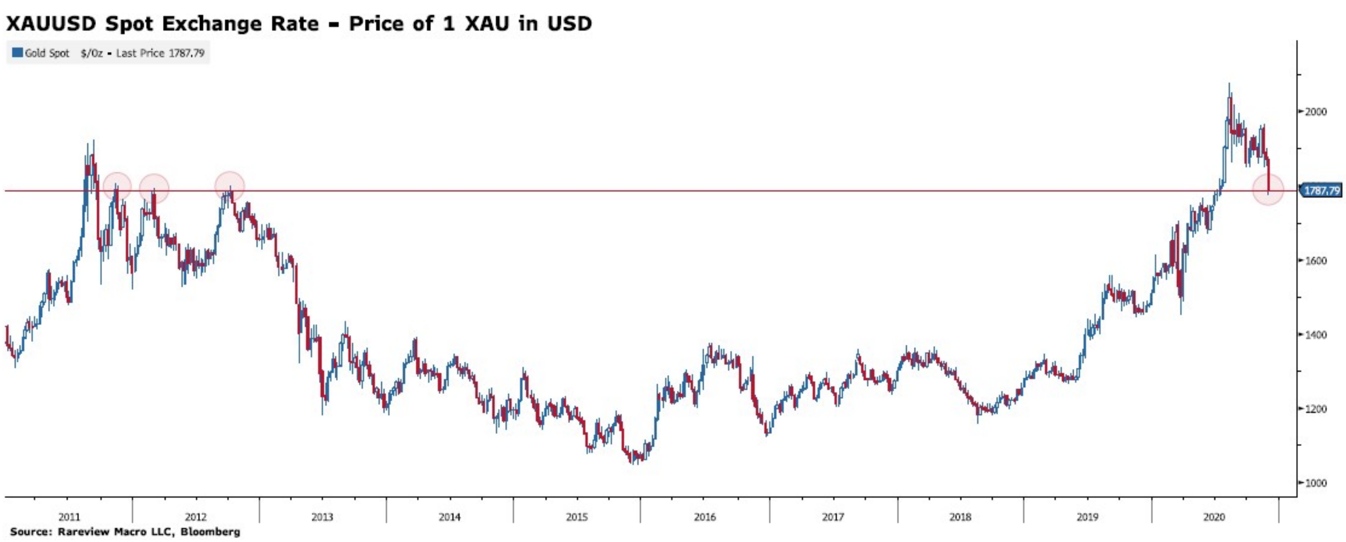
Conclusion

The problem with the current entry point is that the $1780-1800 zone tested in 2011-2012 three times led to larger selloffs.

Therefore, gold should not be bought on weakness until the correlation with real interest rates reinserts itself, there is a new low in real interest rates, or fiscal stimulus above $1 trillion becomes a clear talking point again.

This is especially true given how many are still trapped long at higher prices because they missed the changeover in the factor driving gold in the short-term.

Feb Gold futures (GCG1) closed Friday at 1788.10. At best, you can buy a short-term washout near 1745.50.



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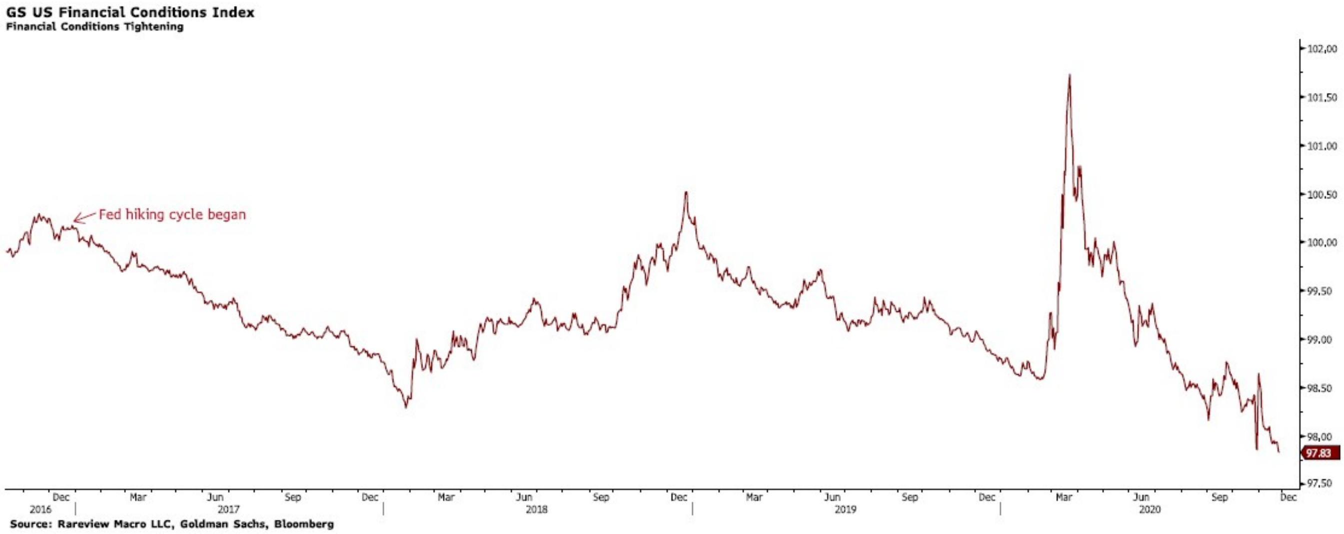
Portfolio Manager Talking Points

- ③ **It Does Not Get Any Better Than This**: Janet Yellen is back! Fed's balance sheet turning up again. Negative yielding bonds at new highs.

- ③ **If You Are Not Long Energy Now, You Never Will Be**: 3 vaccines = ability to believe in a post-COVID world + global mobility trends showing positive inflection + Brent term structure improving + stocks breaching resistance levels + FOMO kicking in + many energy stocks still -50+% YTD.

- ③ **Fed Could Be in a Tricky Spot When They Meet in December:** Pressure to ease more given increased COVID cases/mitigation measures, especially as fiscal impasse continues. However, Financial Condition Indices have never been easier. It is a problem central banks at the Effective Lower Bound face post market stabilization – that is, how to be counter cyclical?



③ Higher vs. Lower Inflation Debate Summaries

Higher: The basis for our 2021 inflation call is our thesis is that the Keynesian model and the Austrian model are not mutually exclusive but, rather, complimentary, and mutually reinforcing. We believe the massive increase in money supply combined with the unleashing of pent up demand post pandemic will ignite inflation. The pent-up demand created by lockdowns, once unleashed, will overwhelm supply thus causing inflation. Post-pandemic, the massive increase in the money supply that has built up on the sidelines will be released into the economy, causing inflation too. Thus, for Keynesian and Austrian school reasons, simultaneously,
inflation will occur. (Source: Larry McDonald)

Lower: We share the view of DM central banks that the COVID-19 shock has been disinflationary and likely to result in a 'sticky' inflation backdrop going forward on the back of the large slack in the economy. At the end of next year, we expect global and DM growth to be around 3.2%-pt and 2.9%-pt, respectively, below their pre-COVID-19 path at the beginning of 2020 Increased price pressure on supply constraints is expected to be only temporary, with more pressure on central banks to deliver additional easing. The sharp growth rebound that took place in 3Q20. (Source: JPMorgan)

Top Observations

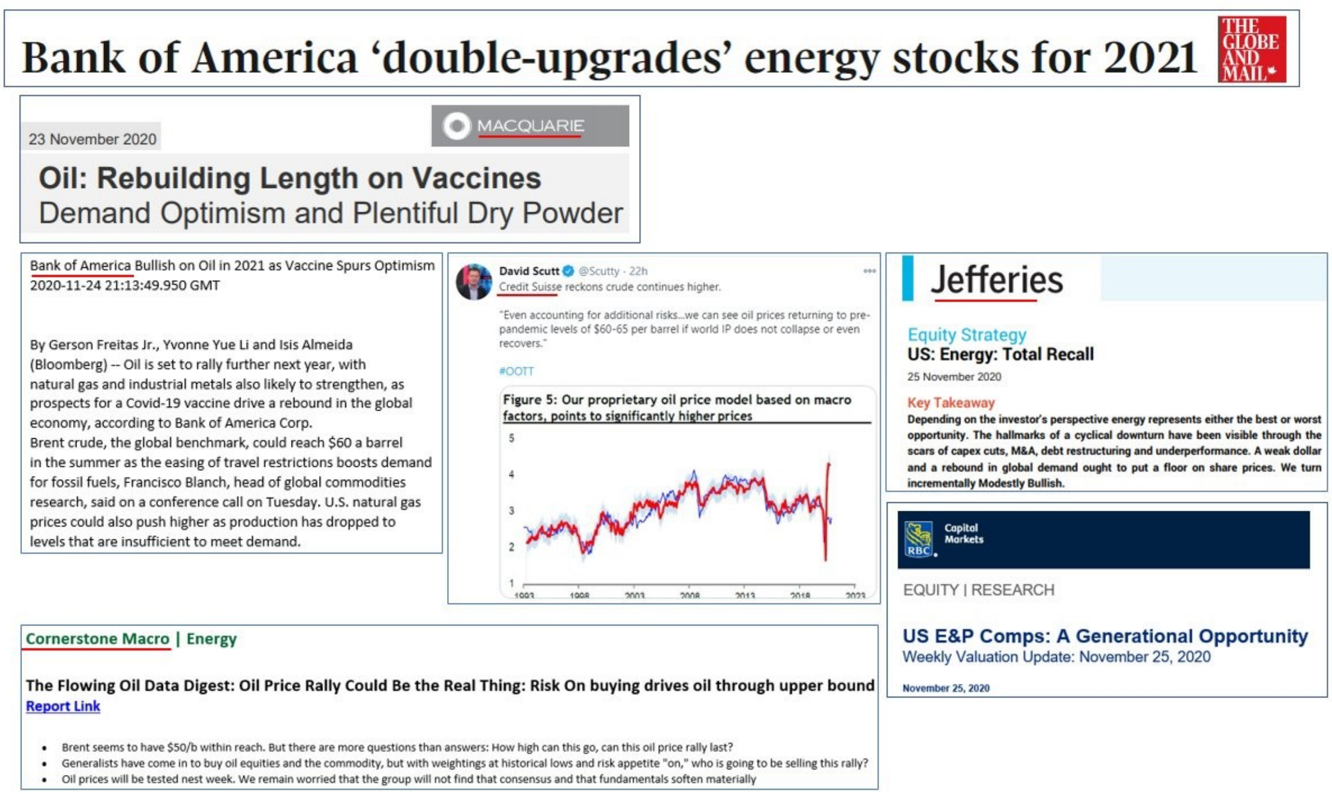
③ **Mutual Funds Begin to Buy Bitcoin**: It has been widely observed that corporations have started to buy Bitcoin as a Treasury reserve. The same will be said soon about mutual funds. For example, Guggenheim Partners updated their prospectus Friday for the Guggenheim Macro Opportunities Fund (symbol: GIOAX), see page 81:

> *Exposure to Cryptocurrency: Cryptocurrencies (also referred to as "virtual currencies" and "digital currencies") are digital assets designed to act as a medium of exchange. The Guggenheim Macro Opportunities Fund may seek investment exposure to bitcoin indirectly through investing up to 10% of its net asset value in Grayscale Bitcoin Trust ("GBTC"), a privately offered investment vehicle that invests in bitcoin. To the extent the Fund invests in GBTC, it will do so through the Subsidiary. The risks associated with exposure to bitcoin are described below.*

③ **Base Metals Strength to Continue**: The LME metals complex remains red hot, as China's manufacturing engine drives a second wave of stockpiling, sapping metal from the global market, likely in anticipation of a recovering rest-of-world. Thus far, the Middle Kingdom's stockpiling wave continues to drive our real-time commodity demand indicator to new highs, while also fueling a supply risk premium as metal is withdrawn from the global surplus — this is providing another dimension to the rally across LME metals, suggesting it still has room to run. (Source: TD Bank)

③ **Crude Oil Signaling**: The 1-year Brent crude oil time spread closed in backwardation on Friday for the first time since February. To be fair, it was 0.01.

③ **Energy Sector – Change in Sell-Side Tone**



Bank of America 'double-upgrades' energy stocks for 2021

THE GLOBE AND MAIL

23 November 2020

MACQUARIE

Oil: Rebuilding Length on Vaccines

Demand Optimism and Plentiful Dry Powder

Bank of America Bullish on Oil in 2021 as Vaccine Spurs Optimism

2020-11-24 21:13:49.950 GMT

By Gerson Freitas Jr., Yvonne Yue Li and Isis Almeida (Bloomberg) -- Oil is set to rally further next year, with natural gas and industrial metals also likely to strengthen, as prospects for a Covid-19 vaccine drive a rebound in the global economy, according to Bank of America Corp.

Brent crude, the global benchmark, could reach $60 a barrel in the summer as the easing of travel restrictions boosts demand for fossil fuels, Francisco Blanch, head of global commodities research, said on a conference call on Tuesday. U.S. natural gas prices could also push higher as production has dropped to levels that are insufficient to meet demand.

David Scutt @Scutty · 22h

Credit Suisse reckons crude continues higher.

"Even accounting for additional risks...we can see oil prices returning to pre-pandemic levels of $60-65 per barrel if world IP does not collapse or even recovers."

#OOTT

Figure 5: Our proprietary oil price model based on macro factors, points to significantly higher prices

Jefferies

Equity Strategy

US: Energy: Total Recall

25 November 2020

Key Takeaway

Depending on the investor's perspective energy represents either the best or worst opportunity. The hallmarks of a cyclical downturn have been visible through the scars of capex cuts, M&A, debt restructuring and underperformance. A weak dollar and a rebound in global demand ought to put a floor on share prices. We turn incrementally Modestly Bullish.

RBC Capital Markets

EQUITY | RESEARCH

US E&P Comps: A Generational Opportunity

Weekly Valuation Update: November 25, 2020

November 25, 2020

Cornerstone Macro | Energy

The Flowing Oil Data Digest: Oil Price Rally Could Be the Real Thing: Risk On buying drives oil through upper bound

Report Link

- Brent seems to have $50/b within reach. But there are more questions than answers: How high can this go, can this oil price rally last?
- Generalists have come in to buy oil equities and the commodity, but with weightings at historical lows and risk appetite "on," who is going to be selling this rally?
- Oil prices will be tested nest week. We remain worried that the group will not find that consensus and that fundamentals soften materially

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