newnormal Insight

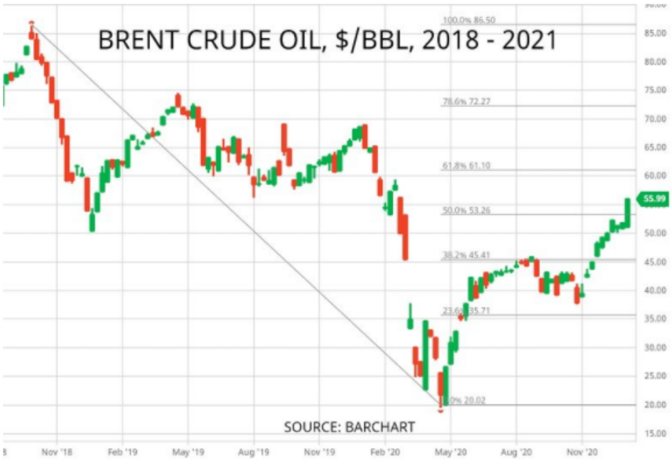
Now we have seen everything

11 January 2021

An insurrection in the US capital, the formal election of the next President interrupted, and 5 people (including a law enforcement officer) dying in armed clashes. But the markets sailed on, untroubled, in their financial bubble.

Oil

Brent rose to $55.99/bbl as technical traders partied on news of Saudi's 1mbd production cut. Their next target is the Fibonacci 61.8% retracement level at $61/bbl. But importantly, Saudi had to make this cut alone, with no support from the rest of OPEC+.



✦ HIGHLIGHTS

- ✦ Saudi's unilateral cut repeated its failed 1980-1985 policy, when it cut output from 10.2 mbd to 3.6 mbd to support prices
- ✦ The idea was that the oil should be "left in the ground for future generations", when prices would be higher
- ✦ But prices still crashed to $10/bbl in 1985. And today, the end of the Oil Age means its oil will be "left in the ground" if it isn't sold now
- ✦ President Roosevelt's 1944 "Oil for Security" deal with King Saud is already now over, with US oil imports from Saudi at zero last week
- ✦ Biden's Middle East priorities instead focus on the Iran nuclear deal: Saudi's reopening of its Qatar border shows the new realities

WATCH FOR

Technical traders to continue to try and push prices higher, in line with the wider financial bubble

S&P 500

The S&P ended at a new record of 3825, with the VIX volatility index down 5% at 22 on the principle "all news is good news". Its initial post-election jump was based on the potential benefits from gridlock in Congress. Today, Democrat control is also "good news". The worst jobless numbers since 1939 failed to raise an eyebrow.

✦ HIGHLIGHTS

- ✦ The market's response to the insurrection was extraordinary – "nothing to see here" seemed to be the reaction
- ✦ But the closing of Trump's social media accounts suggests radical change may be on the way for the FAANMGs
- ✦ President-elect Biden's press conference also featured a very downbeat view of the pandemic's impact
- ✦ And he now expects it will be easier to build cross-party coalitions for key policies with the Tea Party weakened
- ✦ We continue to expect significant policy changes in Biden's State of the Union speech, including tax rises on the rich

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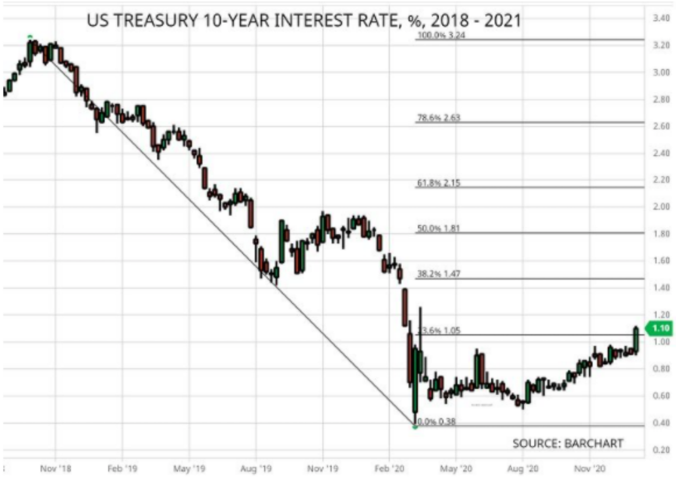
Discussion of likely tax rises in Biden's first State of the Union speech to begin

Interest rates

"Everyone knows" that the US$ will keep falling, that commodity prices will continue to rise and that the Fed will ensure inflation is soon above its 2% target. But what would happen to this self-reinforcing narrative, if the dollar instead started to rise on the prospect of a return to cross-party government and US leadership on the world stage?



✦ HIGHLIGHTS

- ✦ The 10-year rate jumped to 1.1% as the "inflation trade" continued, with the MOVE volatility index down 9% to 45
- ✦ "Technical traders" were in heaven, with the market breaking through the Fibonacci 23.6% retracement level
- ✦ But unnoticed in the excitement, the US$ receovered to the 90 level, rather than continuing its expected decline
- ✦ If it were to rally further, then hedge funds would quickly take profits on their current "Buy commodities, Sell the US$" trade
- ✦ Futures market data shows it is only the speculators who are trying to push the dollar lower, the commercial players are buyers
- ✦ Although, of course, the Fed is actively hoping to push inflation well above 2%, as Vice Chair Clarida made clear on Friday

WATCH FOR

Traders to start to reconsider whether further dollar weakness is inevitable.

China

China's rising currency is causing major problems for its exporters, in addition to the rising cost of raw materials – threatening its export boom.

✦ HIGHLIGHTS

- ✦ The Chinese economy continues to be the stand-out global performer: the IMF expects 7.9% GDP growth for 2021
- ✦ The RMB is back at mid-2018 peaks v the US$ and exporters are now struggling.
- ✦ The governemnt is easing capital controls to try and stabilise the RMB's value
- ✦ The alternative of reducing interest rates could dangerously increase debt levels, espcially in the housing market
- ✦ The long-term solution is to boost domestic consumption – currently aorund half of Western levels as a percentage of GDP
- ✦ But this would mean reducing support for state spending, which has been the key to economic policy for decades

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The risk that cash will start to flood out of China in response to the liberalisation of capital controls.

Summary

Trump has been the first US President in history to obsess about the value of the stock market. We expect it to lose this support with Biden, who will be much more concerned with social policy.

	Oil	S&P 500	Interest rates
Market view today	Positive	Wildly positive	Expecting inflation
Our current view	Negative medium/long-term	Reversion to mean inevitable	Expect long-term deflation
Positioning began	December 2020	December 2020	December 2020
Confidence level			
Initial	◐	◐	◐
Today	◕	◐	◕
Relevant positioning	Neutral Oil – Brent/WTI	Neutral major Western market indices	Neutral 10-year and longer-dated Treasuries

Confidence level: ● = 100%, ◕ = 75%, ◐ = 50%, ◔ = 25%

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