Tuesday, September 14, 2021

Unanchored

Hello new readers! Welcome to AM/FX. I have been trading since 1995 and writing about macro almost every day since 2004. There is more background info on page 5; I don't want to bore regulars with a lot of intro stuff.

Regular readers: Hello again. Let's go!

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FX

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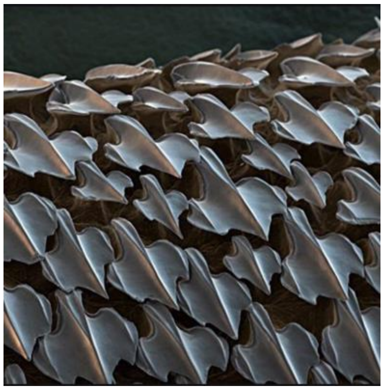


Shark skin under an electron microscope. Dermal denticles. AKA… Skin teeth.

Full non sequitur is always on the last page of AM/FX.

Current Views

Risk of a dollar rally into Fed

(I will write about that tomorrow)

Ben Hunt's canonical essay "Snip!" from 2019 is one of my favorite short reads of all time. It's a prescient look at the seismic shifts that will occur as the cord that once connected taxes and spending is cut. Read the piece later, but for now just know that it outlines the enormous real and psychological impact of renouncing the most important macroeconomic policy relationship of this century.

Once you cut the cord, old meanings disappear, and new ones form. Taxes find new meaning as social justice tools, or as windfall gains for prized constituents.

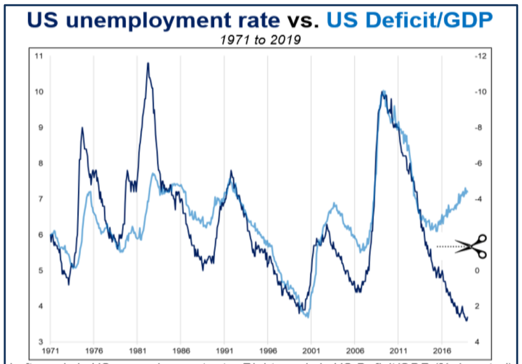
I have been thinking about Ben's piece recently in the context of the many, many *snips* happening all around us. It's not just that spending is no longer anchored to taxation. Important snips are happening all over the place. Concepts that have been paired like Thing 1 and Thing 2 throughout our lives now float adrift. Some snips happened recently, and instantly, while some are a slow process spanning years and decades. Here are a few of the more important ones:

Taxes and spending

How it started: Governments need to "pay for" spending with tax increases or spending cuts, just as households must find tradeoffs to balance income and spending. Keynes drove the bus until 2017. You overspend in bad times, and you make it up in the good times. Then 2017 happened and… **Snip!** See chart.

How it's going: TCJA, MMT and COVID snipped the cord. Now… "How will we pay for it?" is not a question many people ask. Unless they are looking for a laugh.

Meanwhile, the trendiest economists say deficits are a myth.



Left y-axis is US unemployment rate. Right y-axis is US Deficit/GDP (%, inverted)

Valuation and stock prices

How it started: DCF and other methods were once important tools used to calculate the value of individual equities. Equity markets were a place companies went to raise money for expansion and investment.

How it's going: Now, in the most extreme instances, GME and AMC for example, stocks are gambling tokens or crowd attention barometers and have almost no relationship to the underlying company or business. Valuation is totally irrelevant to the bull thesis and overvaluation attracts shorts that fuel further rallies. Discount rate matters but not much else.

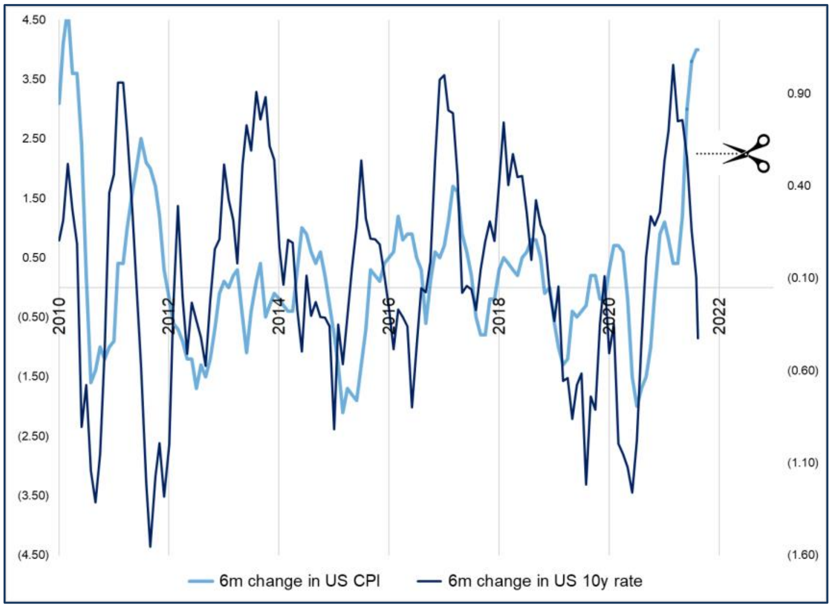
Passive index flows rarely consider price or valuation. And now, the stock market is not where insiders go to raise money, it's where they go to cash out.

Inflation and bond prices

How it started: If inflation rises, the bond vigilantes take yields higher to add a premium for the erosion of purchasing power.

How it's going: Asset shortages. Risk parity. Central bank bond buying in the middle of a massive housing boom. QE∞. CPI = 5%, US 10-year = 1.2%. **Snip!**

6-month change in US CPI vs. 6-month change in US 10-year yields (since 2010)



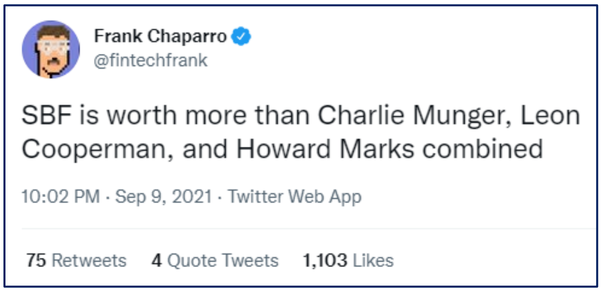
Data from Bloomberg, Chart by AM/FX

Effort vs. output

How it started: Once upon a time, large companies employed huge teams of people to manufacture goods. Then, we transitioned to the service economy.

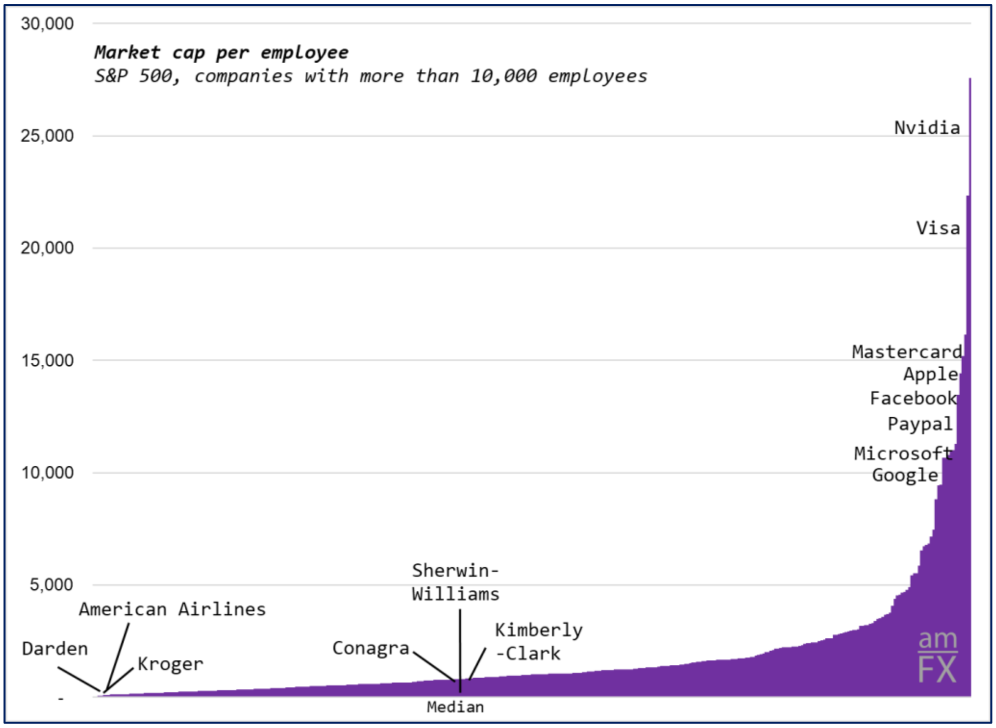
How it's going: Long and HODL; diamond hands. Take as much financial risk as possible. Start a money-losing app and IPO it or sell to one of the behemoth oligopolies. Financial engineering. Doge to the moon.

Some would argue "there is nothing new under the sun" and speculation has always been a thing. Yes, it has, but the amount of wealth being created out of nowhere right now feels pretty special.



PS, I'm a card-carrying SBF fan.

Tech and finance create enormous market value with less human effort

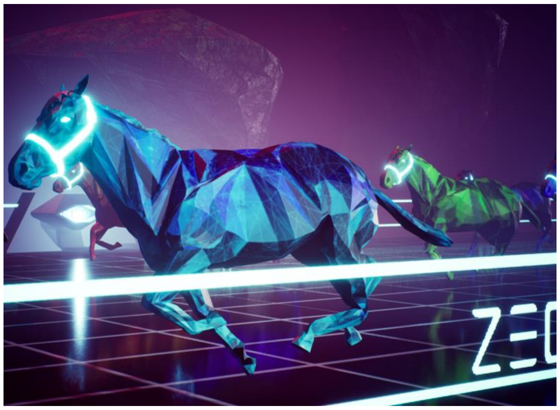


Real life vs. virtual life

How it started: Your body is outside any device you use to play video games or watch movies. Most economic activity is real while video games have a score that cannot be exchanged for goods and services.

How it's going: VR takes you inside the game. My kids meet up with friends online, not outside. Play-to-earn games allow you to make currency in a game that has value IRL. The metaverse existed as fiction for ages (Snowcrash, Neuromancer, Ready Player One…) but now there is enough bandwidth for it to become (virtual) reality.

One of my best childhood memories is going to the horse races all the time with my dad. I can assure you those afternoons and evenings did not look like this:



[Breeding and selling the million-dollar racehorse that does not exist]

BTW: My dad proofreads most issues of AM/FX for me. Hi, Dad.

OK, but what does this all mean?

I am not pining for ye good old days here. My point with all this is that there is a cascading series of societal shifts happening and these have implications for trading and investing. Yes, some traditional frameworks may be useful again at some point in the future. Valuation and quality matter more on the way down than on the way up. I am open to that idea. But as we move further along the path of what I would describe as "capitalism with centrally-planned characteristics", and as we wander further towards the outskirts of reality and into the metaverse… We may have passed the point of no return.

The wrong framework made me skeptical about bitcoin in 2018 and 2019. The wrong framework crushed bond shorts in 2021. The wrong framework blew up the GME shorts. Meanwhile, people like David Tepper and Dave Zervos have had mostly the right framework as they focused more on liquidity than valuation.

What frameworks do you use to evaluate the world? Are any of them dated—and you kind of know they're dated—but you don't want to let go of them because you have a lot of time, money, or self-worth invested in them? For example, does your framework for evaluating assets include questions like "Can I hold it in my hand?" or "Is it shiny?" or "It's not a real thing!"?

Those who are stuck in old frameworks may find themselves yelling at clouds as this potentially fantastic or dystopian new future unfolds.

One last thing

If you are new to AM/FX: This piece is not supposed to be a crypto or NFT bull case. I am bullish crypto as an asset class, but I am agnostic and opportunistic on price (long or short, I don't care). In the world of NFTs, I think there are tons of cool things happening and Web 3.0 will probably be nearly as exciting as 1.0 and 2.0. I think NFTs are much more than just an in-group flex but… Wherever there is infinite supply, there will be a hellacious thinning of the herd that will send a huge majority of NFTs to the zero bound[1].

Finally: Today's piece is a longer thought piece, but I don't engage in intellectual navel-gazing like this every day in AM/FX. I try to mix things up. It could be super macro big picture one day, and a deep-in-the-weeds trade idea the next. Usually, it's just one or two pages.

You'll see.

Thanks for reading. See you tomorrow!

good luck ⇅ be nimble

[1] *OG NFTs like CryptoPunks will always be buy-the-dip. Anyone who has collected comics (#1 issues hold value the best), or baseball cards (rookie cards hold value the best), or wine… understands the importance of vintage.*

What is AM/FX?

AM/FX is Brent Donnelly's must-read daily macro letter, published since 2004.

It is a clear and concise daily look at one or two important topics related to global markets. Brent talks macro, narrative economics, trading strategy, tactics, positioning, technicals, and market psychology as he covers whatever markets are in play. Topics covered include FX, crypto, stocks, fixed income, commodities, and macroeconomics.

Brent's huge network of hedge fund, real money, central bank, and trading contacts give him unique insight into what's driving markets today, and what will move markets tomorrow.

Brent offers actionable analysis, clear directional views, and real trade ideas as he helps you surf the current narrative. He puts new themes on your radar before they hit the mainstream.

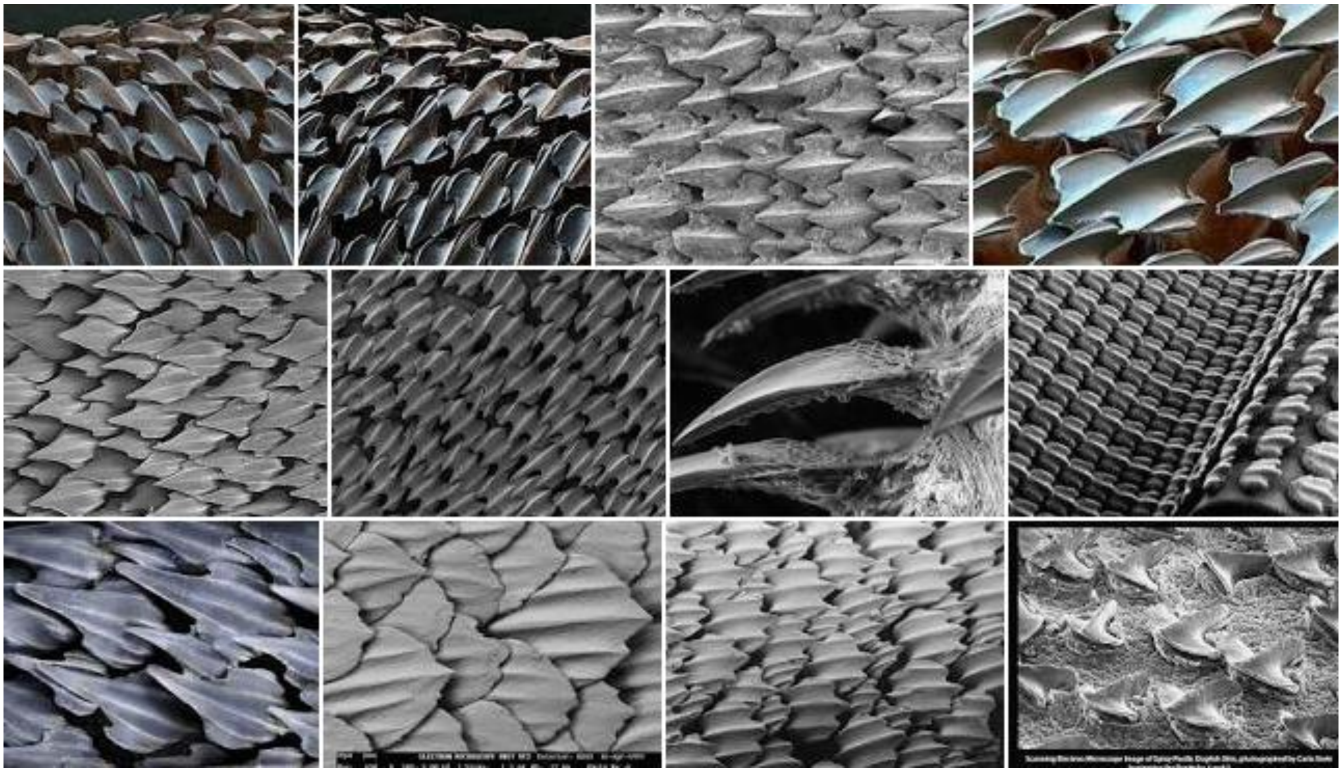
AM/FX is relevant, concise, and original. And not boring.

What is Spectra Markets?

Spectra Markets is the shiny new digital media division of Spectra Holdings.

As President of Spectra Markets, my goal is to build a place where every trader and investor goes for smart, independent, and original financial markets content. The vision is to build a company that produces forward-thinking and mind-expanding financial markets coverage. Real-world market intelligence for every trader and investor.

Spectra Markets: Look Forward.



Shark skin under a microscope. These things are called dermal denticles (literally meaning skin teeth).

If you drag your hand against it,
you will get something like rug burn.

Also: Used as part of wasabi graters in Japan!

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