SPECTRA MARKETS

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am

FX

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NEO
I've had dreams that weren't just dreams. Am I … Crazy?

THERAPIST
We don't use that word here.

Current Trades

Flat

You have to see it for yourself

Fed

The embarrassing but necessary departures of Rosengren and Kaplan lay the groundwork for an interesting 12 months in Fed world. With 6 possible vacancies out of 19 seats, the FOMC will look quite different this time next year. The questionable behavior from the two regional presidents could mean a more dovish board and (maybe?) a reduced chance of a Powell reappointment.

While Powell's adventures in muniland look completely appropriate to most observers, the well-time trading and poor judgment shown by his direct reports do not help Powell's reappointment odds. Powell is trading 84%/87% on Betfair right now; I would take the under as I think the real odds are more like 72%/75%.

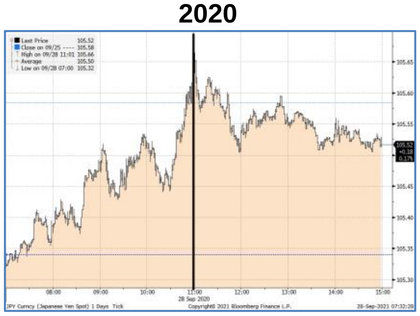
Corporate month end

Today is the last day for spot settlement in September and that is often a USD buying window. US corporations tend to buy an outsized amount of USD from 7 a.m. to 11 a.m. on t-2 and today is also quarter so there is increased attention paid. **If you have any USDJPY to sell, this is a decent opportunity to do so** as we near the LDP leadership race (potential for excitement if Takaichi wins, but mild disappointment if she does not). The LDP result could be out by the time we wake up in NY tomorrow.

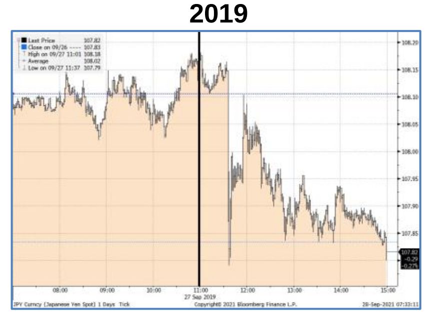
Note that 11 a.m. on corporate month end tends to be a micro peak in USDJPY as the known effect of corporate USD buying fizzles. Here are the intraday charts from the past three years with a black line marking 11 a.m. NY.

USDJPY on t-2

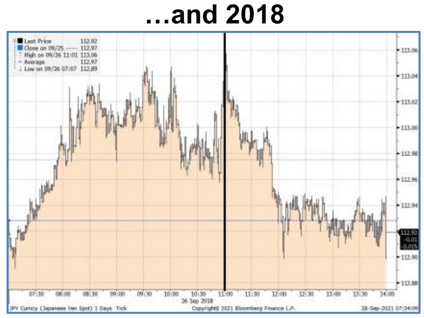
2020



2019



…and 2018



Crypto

In AM/FX: Peaking, I discussed the possible peaks in many markets and policies: Peak NFT, peak accommodation, peak fiscal, etc. On the next page, you can see the total market cap of crypto is putting in a bearish double top with a lower high. The first peak is the night Elon Musk went on SNL, and the second peak is the day El Salvador launched bitcoin as legal tender.

These two peaks reflect important events in recent crypto history and reinforce the importance of old school behavioral setups like "buy the rumor / sell the fact" in what is still a very young and inefficient market. The July low in crypto value was $1.3T and my feeling is that something in the $1.3T to $1.5T area is the *buy the dip* zone.

Inflation expectations: What matters is anchored vs. unanchored

This somewhat famous 2014 Fed memo from Rudd, Detmeister and Laforte (released to the public in 2020) makes the point that nobody (including the Fed) really knows what drives inflation. A key paragraph:

> The observed evolution of the empirical inflation process over time, the difficulty we [the staff] often have in explaining historical inflation developments in terms of fundamentals, and the lack of a consensus theoretical or empirical model of inflation all contribute to making our understanding of inflation dynamics—and our ability to reliably predict inflation—extremely imperfect.

Rudd's barn burning paper last Friday makes the same point specifically about inflation expectations when he states:

> ...invoking an expectations channel has no compelling theoretical or empirical basis and could potentially result in serious policy errors.

I think a big reason for this is that normal models (especially linear models) are not well suited to unpacking the feedback loops of cause and effect that drive inflation. Measuring inertia in expectations, or changes in expectations, yields primarily noise because most changes in inflation expectations are modest and have no impact on behavior. Across a particular threshold (which is not necessarily numerical, but more likely emotional), rising inflation expectations eventually change behavior and trigger the risk of feedback loops like wage / price spirals, stockpiling, hoarding, and so on.

Transmission of expectations to inflation is non-linear. Expectations don't matter at all, and then at some point, suddenly, expectations de-anchor and drive a dangerously-accelerating feedback loop. Snip.

Trying to find causation or a relationship between the Michigan survey and subsequent inflation over the last 30 years is like slowly bringing a microphone closer and closer to a speaker, then stopping a few feet away and concluding: "there is no loud screeching coming out of the speaker, therefore microphone proximity to speakers does not determine feedback volume". And we don't have inflation expectations data going far enough back to build robust regime-switching models.

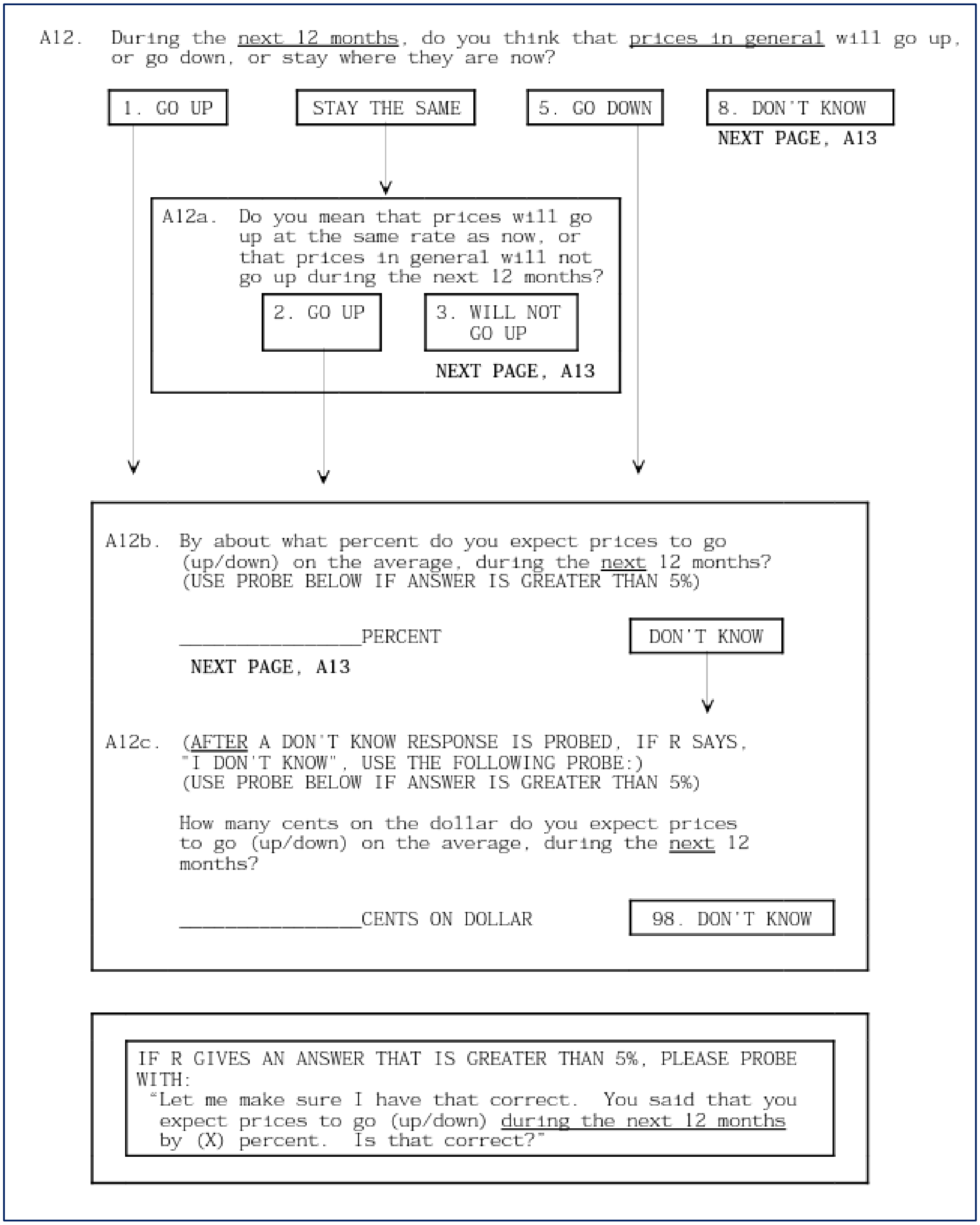
I am a finance professional and I have no skill in forecasting inflation over the coming years. I doubt a musician in Illinois, or an entertainment lawyer in San Diego do either. On the other hand, individuals do have certainty about whether inflation matters to them personally, right now. They know if they are scared or not. For the past 30 years, the answer for most consumers has mostly been "NO, I'm not concerned". Today, the microphone is getting perilously close to the speaker and many more survey respondents are probably about to answer "YES".

A modest proposal

Instead of asking consumers to predict future inflation, the University of Michigan (or other surveys) should ask something more like: "Are you worried about inflation right now?" The simple binary response would be more useful than a data series showing numerical ups and downs of household point estimates of future inflation. If surveyors insist on more granularity, maybe "How worried are you about inflation over the next year? Three years? Five years?" could work. What matters is the level of concern, not the expected level of inflation.

Writing this piece, I was curious about the exact questions they ask on the University of Michigan Consumer Expectations Survey. Here is the inflation section of the UMich survey (view full questionnaire here).

University of Michigan Survey of Consumers, page 5


A12. During the next 12 months, do you think that prices in general will go up, or go down, or stay where they are now?

1. GO UP | STAY THE SAME | 5. GO DOWN | 8. DON'T KNOW

NEXT PAGE, A13

A12a. Do you mean that prices will go up at the same rate as now, or that prices in general will not go up during the next 12 months?

2. GO UP | 3. WILL NOT GO UP

NEXT PAGE, A13

A12b. By about what percent do you expect prices to go (up/down) on the average, during the next 12 months? (USE PROBE BELOW IF ANSWER IS GREATER THAN 5%)

_______________PERCENT | DON'T KNOW

NEXT PAGE, A13

A12c. (AFTER A DON'T KNOW RESPONSE IS PROBED, IF R SAYS, "I DON'T KNOW", USE THE FOLLOWING PROBE:) (USE PROBE BELOW IF ANSWER IS GREATER THAN 5%)

How many cents on the dollar do you expect prices to go (up/down) on the average, during the next 12 months?

_______________CENTS ON DOLLAR | 98. DON'T KNOW

IF R GIVES AN ANSWER THAT IS GREATER THAN 5%, PLEASE PROBE WITH:
"Let me make sure I have that correct. You said that you expect prices to go (up/down) during the next 12 months by (X) percent. Is that correct?"

I am suggesting UMich replace A12b with a *level of concern* question instead of a *future point estimate* question. Or at least add a *level of concern* question in there somewhere. This goes directly to the heart of the question that matters: Are inflation expectations anchored, or unanchored?

There is a funny little quirk in the survey methodology. High estimates get probed and double-checked, and low estimates do not. I understand why this workflow might reduce errors and outliers, and I'm sure it was once logical in a world of sub-2% inflation. Now, it's a biased survey flow process as we live in a world where inflation is rising into the 3% and 4% zone. High estimates get challenged with: "ARE YOU SURE??" while low estimates are dutifully accepted and recorded.

One last thing on inflation, and I'll stop talking about it for a while, I promise

This September 23 Odd Lots podcast on inflation is excellent. It features Julia Coronado and Laura Rosner-Warburton of Macropolicy Perspectives. The guests discuss the causes and likely future trajectory of the current global inflation episode. It's easy to digest and not boring.

One of the most interesting takeaways is the lucid explanation of how the gigantic fiscal stimulus in the US destroyed the normal recession playbook and created all sorts of impossible-to-predict outcomes that are totally logical in hindsight. The 2020 recession was unlike any other in so many interesting ways. Coronado and Rosner-Warburton offer up a bunch of detailed insights that I had not previously heard and I feel like having listened to them, I now understand the current inflation story a bit better than I did before.

Views vs. trades

A common question I get from new readers is: Why don't all your views show up in the sidebar? The reason is that I reserve the sidebar only for tactical, directional trades with a clear stop loss and take profit. I don't want to pack it full of multi-week macro views.

Short-term trades are easy to track and measure, and they have a manageable lifespan. Therefore, I put those in the sidebar. In real life, I do many trades via options (usually 2-day to 1-month options). It gets too noisy if I start putting multi-week option trades, and bigger picture macro views in there. All that goes in there are tactical, directional trades.

The multi-week macro views and anything worth trading through options are often my bread and butter but those go in the body of AM/FX, but not in the Current Trades portion. It's just a logistics and tracking thing. I hope that I am always clear about what my views are, even if the specific tactics are not always in the sidebar. Honestly, I think the views are more my responsibility and the tactics are more the readers responsibility. The only reason I do the Current Trades is because it gives me a different angle through which to explain what I'm doing, and it allows me to discuss topics like risk management, volatility, and other real world trading considerations more easily.

Then again, if this is all just a simulation, the Current Trades don't really matter much, do they Mr. Anderson?

good luck ⇅ be nimble

It's always been trendy to disparage the second and third Matrix movies—but that's mostly because they are held up for comparison next to one of the greatest films of all time.

Don't let your bias ruin The Matrix: Resurrections for you. It's going to be amazing.

Here's the trailer

Ontolofloxin, the pills from The Matrix: Resurrection
Name presumably derived from: Ontology, the branch of metaphysics dealing with the nature of being.

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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.

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