SPECTRA MARKETS

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am
FX

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https://www.strategy-business.com/article/The-Line-between-Confidence-and-Hubris

Current Trades

Long 06DEC 0.7500 AUD digis
spot ref. 0.7285

Must reprogram algo

A quick story before we start

Sunday, March 16, 2008. Late afternoon. I use my right hand to push my son Adam in the orange Bugaboo stroller through barely-navigable crowds at Fairway Market on the Upper West Side[1]. With my left hand, I awkwardly scroll the news on my Blackberry 8700.

I am trying not to be "that guy", but the stupid Blackberry has been buzzing like a fridge in my pocket for the last five minutes. There must be something going on.

I see a headline, clearly a typo. JPM to buy Bear Stearns for **$2.00**? Wut? The stock was $150 less than a year ago. $68 last week. It closed at $30 on Friday. This can't be true. *Impossible.* I nearly crash into a lady with a small dog in her purse.

Bear Stearns common stock price (5 days into March 17)

USDJPY opens around 98.70, unsure if this is good news or bad news. Maybe a relief? Or… A disaster? A headline hits…

*FED CUTS DISCOUNT RATE FROM 3.50% to 3.25% AND OPENS NEW FACILITY

The start of concerted Fed action. Bullish! The market takes USDJPY from 98.70 to 99.10. But I know that's wrong. Typical misread on a rates headline. "USDJPY is a rates trade not an equity trade!" I yell to myself in my head. I push Adam's stroller into a corner by the pitted prunes and almonds and frantically thumb open IB chat.

BD: "50 YOURS USDJPY. Stop at 99.63."

Lehman Tokyo is on it.

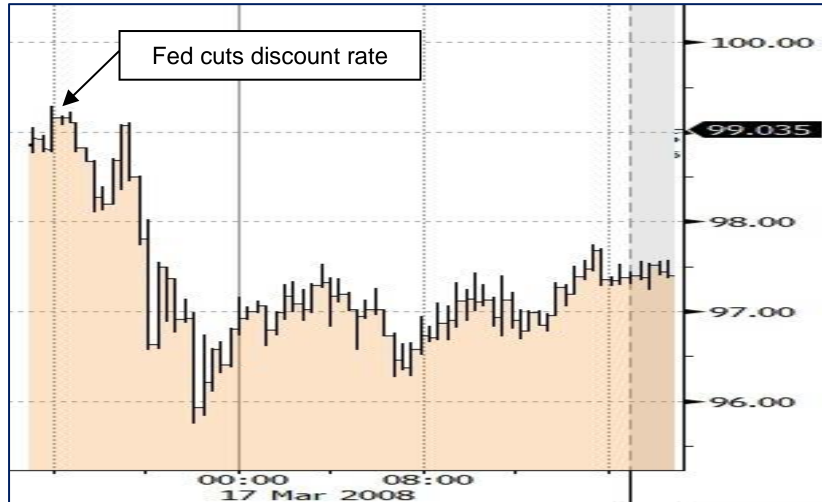
KH: "99.035 you sell 50 USDJPY"

BD: "Cheers."

[1] *Adam is way taller than me now and headed to uni next year. The days are long, but the years are short.*

Here's the chart:

USDJPY from the Sunday open after Bear was bought by JPM (and the Fed cut the discount rate) to 5 p.m. on the Monday



Cool story, bro. So what? The story is informative because people tend to think of the JPY as a safe haven given it often moves in line with stocks. This creates the false impression that USDJPY is an equity hedge. It really is not. It is only an equity hedge when equities go **down** and yields go **down** at the same time. When stocks go **down** and yields go **up**, that's bullish USDJPY. This is not a report from Hindsight Capital… JPY has almost always been a rates trade. In and out of sample.

Data

When you are looking at correlations like this, and all the products are interrelated and cross-correlated and driving each other, it can be hard to unpack whether it's equities or rates that really matter for JPY. The easiest way to disentangle it is to isolate only the times when rates go up and equities go down at the same time. Then, it's pretty easy to tell which one matters, and which one doesn't. Here are the numbers:

USDJPY performance when stocks go down and yields go up in the same week

	SPX down, yields up		
filter	1sd	0.5 sd	no filter
median USDJPY move	1.5%	1.4%	0.4%
average USDJPY move	1.0%	0.6%	0.4%
% of the time USDJPY goes up	80%	65%	63%
count	5	17	122
up	4	11	77
down	1	6	45

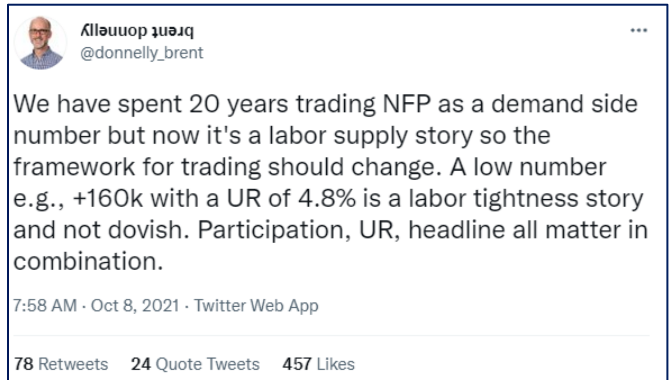
Data back to 2003

I would also add that energy price moonshots trigger even more JPY selling as they directly impact the Japanese current account. When rates are rising on an energy squeeze, that's turbo JPY negative. You can see this in the time zone performance recently, as USDJPY has been rallying in Japan time, which is unusual. The main message here is: Stop watching stocks while trading JPY. It's a bad habit.

Must… Reprogram… Algo

The market went the "wrong way", then the "right way" on Friday's NFP data and while it's normally boring to rehash economic data that is days old, I think there is some value in making sure your trading framework matches the current regime. We spent 20 years trading NFP as a demand story and now that it's a supply story, I can see many traders (and economists!) are still looking at it backwards. I saw a bunch of headlines on Friday saying stuff like: "Weak jobs number, etc., blah, etc." The number wasn't weak.

During a shortage of workers, a low headline number combined with a low unemployment rate is a sign of labor market tightness, not weakness. That should mean higher rates, strong USD, strong cross/JPY etc. Please note that I hate when people look at the market reaction and then spin a macroeconomics story after they see which way the market moves. That's not what I'm doing here. I posted the Tweet at right at 7:58 a.m., 32 minutes before the number came out.



And I posted this to all my chats on Bloomberg, seconds after the number came out:

08:30:10 BRENT DONNELLY: Tight labor market
08:30:19 BRENT DONNELLY: Not dovish

The market reaction to NFP comes from the interplay of the three main release figures and how they describe the current tightness of the labor market. This is important! The framework used to be "low headline number = sell USD". That's not how it works anymore.

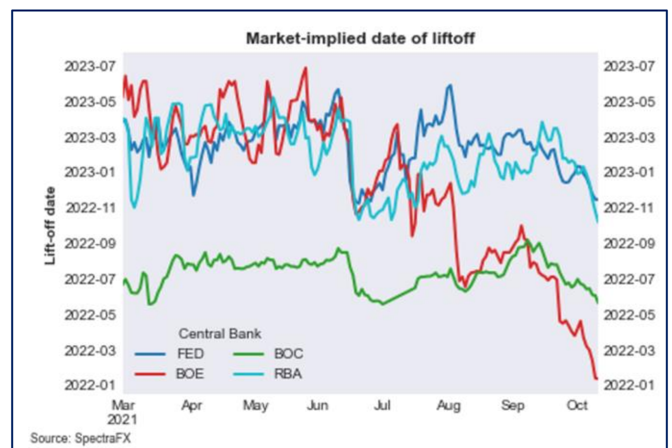
My point here isn't to do a victory lap (I acknowledge it sounds like I'm bragging here, which makes me uncomfortable, so I made today's non sequitur about hubris) but I think it's useful to realize that you can go into economic data with an ex-ante understanding that the *old normal* reaction functions no longer apply. If I just say all this stuff and you think it's hindsight, it's not useful. That's why I'm showing evidence that I was talking about this before the market moves, even though I generally avoid victory laps and tend to write more about the times I'm wrong, not right.

There was a similar lesson in the spring and summer of 2021 when CPI would come out strong and USD would try to rally and fail every time. At that time, the Fed was looking through the data given its transitory view, base effects and spiking lumber and other prices. Now, the market reaction to CPI should be more orthodox because the transitory argument is wearing thin, and many committee members are getting nervous. We get to test this theory on Wednesday.

The broad point I'm trying to make today is that *everything has changed*. Don't just use the old way that you used to look at or trade the numbers. And if you're running data trading algorithms, you can use this PDF to explain to your boss why the thing isn't making money anymore. Time to reprogram it.

Hike timing

Finally, Spectra legend Tanguy Bretagne produces a cool chart that shows when the first hike is coming for each central bank. I have included that chart at right for your enjoyment. The y-axis is "date of first hike."



Have a hungry and humble day.

good luck ⇅ be nimble

In case you missed it…

I am keeping this one for my "The Cycles of Capitalism" scrapbook.

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