SPECTRA MARKETS

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am FX

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Current Trades

Long EDZ3 @ 98.895
Stop loss 98.79
Take profit 99.03

Buy 2-month 0.7500 AUD digis
spot ref. 0.7285

Unintended Consequences

Would you like to buy a Powell?

BetFair and Predict It now have Powell around 65% with Brainard 25% and a bunch of other candidates on single digits. Each of the non-Powell candidates on Predict It would, by definition, increase diversity at the Fed. Whatever your opinion on this, given the current sociopolitical atmosphere, the current Democrat priorities, and the lack of diversity in leadership at the Fed throughout its history, this variable is important.

I find the rise in Roger Ferguson's odds surprising while Bostic makes more sense because he is in the mix for everything these days. Whether it's the Treasury Secretary role that ultimately went to Yellen, the Comptroller of the Currency role that went to Omarova, or the 2022 Fed Chair role, Bostic is in the zeitgeist. Meanwhile Ferguson hasn't been in the news as much lately so feels a bit out of nowhere.

In case you were not around in the early 2000s, Ferguson was the Vice Chair of the Fed from 1999 to 2006 and was a longshot behind three favorites for the Fed Chair job won by Bernanke in 2006. From 2008 to 2021, Ferguson was CEO of TIAA (the gigantic teachers' investment and insurance association) and he is now retired. When his retirement was announced last March, there was speculation he might be in line for Treasury Secretary.

I was bearish Powell's odds a week ago when they were 84%/87% and I keep marking to market as the odds drop. My view is that Powell's odds are still too high now at 63%. If he was a Democrat, >50% would seem reasonable but given he is a Republican, I like short at 63%. The main reasons:

- Politics. In an us-vs-them world, the government in power wants control of the institutions.
- The progressives have power and Elizabeth Warren just aggressively and publicly downvoted Powell. This article: "Elizabeth Warren isn't in the White House. But she knows how to use the tools she's got." is an excellent summary of all the ways Elizabeth Warren influences the current administration[1].
- No renomination before Labor Day indicates hesitation from Biden. Obama renominated Bernanke on August 24, 2009, after the GFC and similar renomination timing would have made sense if Biden was bullish Jay.
- "Well-timed" trades by senior Fed leaders further tip the political calculus of a shake-up and support arguments for change above those for the status quo.

[1] *If nothing else, the article makes interesting use of a rare stylistic choice: A headline constructed from two complete sentences, using normal sentence capitalization and punctuation. I like it.*

How do you trade it?

If you believe someone other than Powell will be nominated, the best trade (other than selling Powell on Betfair or Predict It) is long EDZ3 or EDZ4. A Powell replacement announcement will trigger an instant repricing of rate hike expectations on the back of:

- Kneejerk uncertainty / fear trade
- Secondary trade: "So-and-so is more dovish than Powell"
- People suddenly remember the hawks are on the way out anyway. Yes, the June and September meetings were hawkish, and taper is on autopilot… But if Powell is gone, I would think EDs reprice around 15 ticks higher on a frozen rope.

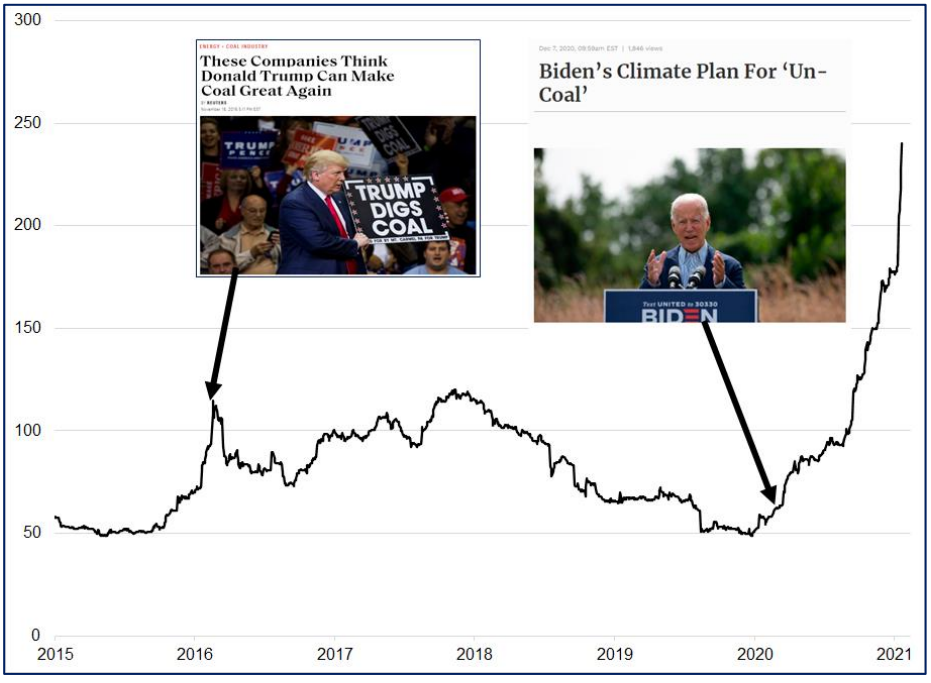
I added the trade to the sidebar. The superior risk/reward is probably in options, but I'm not expert in Eurodollar options, so I'll let you decide how to trade it.

I know many people don't like trades with ~1:1 risk/reward, but to me this trade is probably 65%/35% (and it's 6:5 payout) and that's solid EV. I would put Powell's renomination probability at 41%/44% now, and there are plenty of scenarios where even if Powell is renominated, EDZ3 still goes up anyway. If you want more leverage, just do it through options.

Another way to trade it: Long AUDUSD (2-month 0.7500)

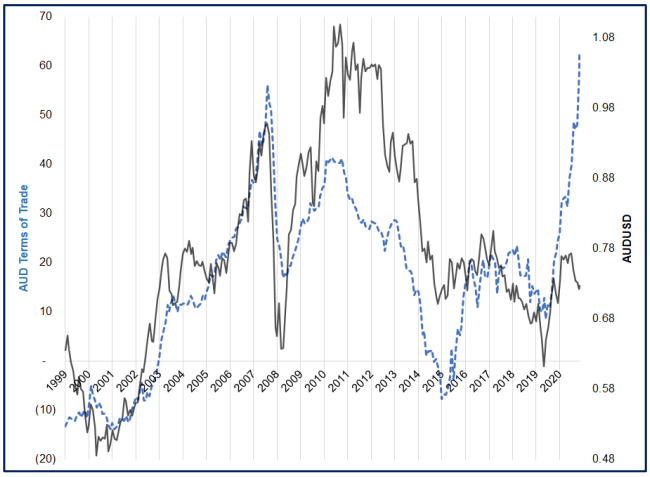
One of the many ironies in financial markets over the last few years is the way coal has gone the exact opposite direction of the sitting President's agenda. This is classic unintended consequences, especially on the way up right now as long-term ESG goals crash head on into short-term supply/demand reality.

What does "unintended consequences" mean, Daddy?



This moonshot in coal and some other key Australian exports yields this ludicrous overlay:

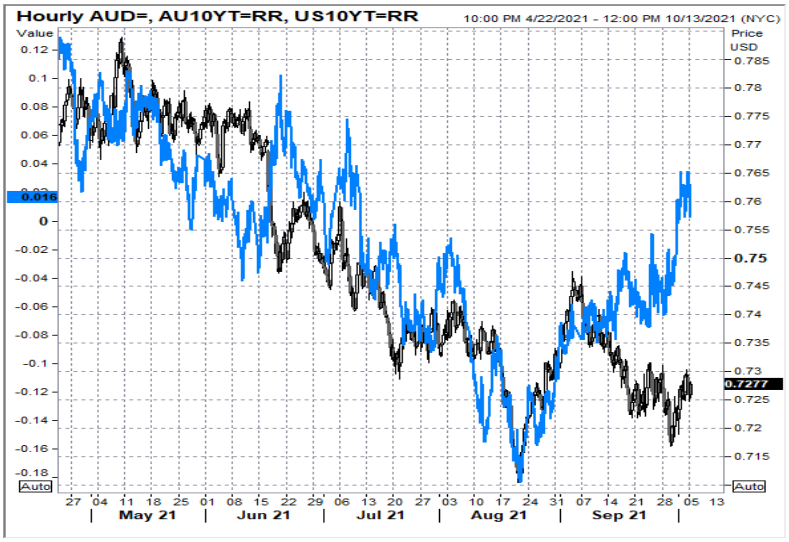
AUDUSD vs. Australian Terms of Trade



Ticker CTOTAUD from Bloomberg

The story of AUDUSD and its failure to follow the Aussie terms of trade has been a narrative off and on (throughout 2017 and 2018 especially) so this is not EXACTLY anything new. When stronger terms of trade has no transmission to capex, jobs or monetary policy, FX markets should not care about it. In other words, if rates aren't moving, ignore the terms of trade. So let's take a look. Hmmm…

AUDUSD vs. AU/US 10-year interest rate differential



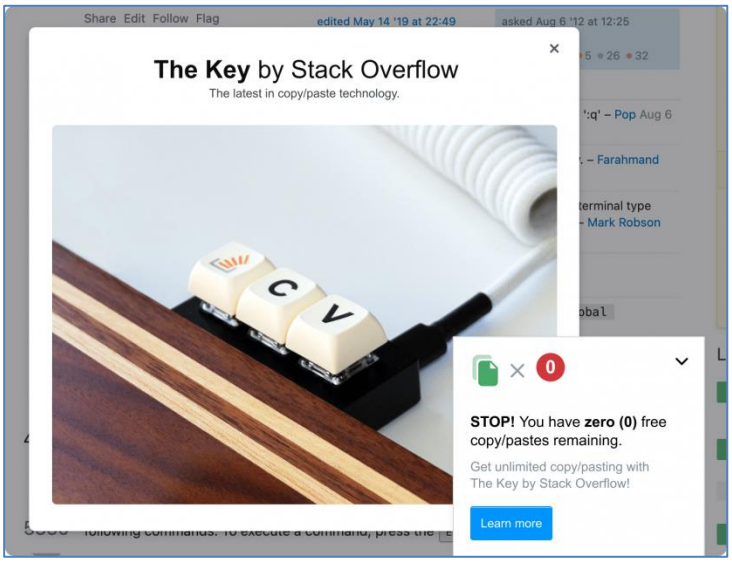
Full disclosure, this chart looks way less exciting if you zoom out to a 10-year x-axis.
For trading, changes are always more important than levels.

Meanwhile, China is quietly releasing Australian coal despite prior aggro. And the negative seasonality in risky assets is almost done (October 9 is historical seasonality bottom day for SPX).

All is not rosy for AUDUSD with Evergrande, the China property bust, continued lockdown issues, etc. etc. But the RBA is getting worried about credit growth and optimistic on labor markets for Q4 and the CFTC and other data show the market remains mega short AUDUSD. **This feels to me like a trade that goes nowhere, or works EXTREMELY well, so leveraged plays like 2-month 0.7500 digis make the most sense.** You want an expiry date past November 15, so you get the Brainard kicker. Have an efficient day.

good luck ⇅ be nimble

In 2021, Stack Overflow (a hugely-popular website where designers and programmers answer questions about technical challenges) created the pop-up warning below as a joke that riffs on the fact that people tend to cut and paste a lot from Stack Overflow.



The response was overwhelming: **People wanted the mini keyboard**. So they made it. The mini-board has sold 7,700 units and is on back order. Funny. I showed this to my son and he said: “Wow, that’s stupid.”

One out of every four users who visits a Stack Overflow question copies something within five minutes of hitting the page.

https://stackoverflow.blog/2021/04/19/how-often-do-people-actually-copy-and-paste-from-stack-overflow-now-we-know/

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