SPECTRA MARKETS

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FX

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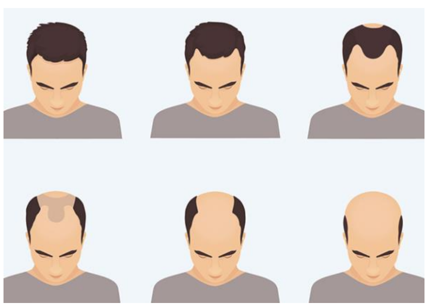


Current Views

Short ETHUSD @ 4210
Stop loss 4902 / Take profit 3010
(From MacroTactical Crypto #4)

Policy complexity and the cheapness of AUD

It's complicated

I am a fervent believer that Fed normalization is generally not bearish stocks. We have many examples of this, notably 2004 and 2013. But Fed normalization isn't necessarily bullish either. It's ridiculously complicated. It boils down to five factors:

Level of accommodation. Are absolute conditions loose or tight? Is policy accommodative or restrictive? There are many ways to measure this, but financial conditions and the yield curve are best.

Direction of policy. Is policy getting tigher or looser? First derivative.

Rate of change of policy. At what speed is policy getting tigher or looser? Second derivative.

Rate of change of rate of change of policy. Are they tightening faster now than they were tightening before? Third derivative.

Predictability of policy. How predictable does policy look over the next 12 months? Policy predictability impacts volatility and volatility impacts the valuation of risky assets. Other things being equal, higher vol means uncertainty and it also makes relative carry less attractive, pushing risky assets lower.

Size of investor commitment to prior policy. How invested is real money and retail in Fed policy at the time is starts to pivot? For example: Are people intellectually pot-committed to a dovish Fed just as the FOMC pivots muy hawkish?

Right now, you have very loose policy, but policy is getting tighter and the tightening effort is speeding up and the speeding up is speeding up. Meanwhile, policy is extremely unpredictable as the mere suggestion of tightening causes (for example) oil prices and breakevens to rapidly reverse course. As the threat of 2022 hikes triggers reversals in risky assets, oil prices and inflation expectations… The need for 2022 hikes should lessen. It's a huge, complex machine.

Ex-post explanations like headlines that read "Stocks fall on rate hike fears" ignore the extreme complexity of the calculus. In 2013, policy was moving very slowly and was highly predictable. As such, equities shook off the taper tantrum and partied on pretty quickly. On the other hand, EMFX never recovered from the taper tantrum because the world was massively overweight EM going into that Fed pivot.

I would say crypto is the EM of this cycle. Massive overweight, huge investment, and much of it predicated on Fed largesse that is no longer a sure thing. Overall, this part of the Fed cycle is probably a chopfest like 2018, not outright bullish or bearish for risky things.

Trade updates

The take profit hit on AUDCHF and ESZ1. Those were good trades. I got a bit lucky on the S&P stop loss as stonks rallied to within 6 handles of my stop. Last time I went short ES, I got just barely stopped out and it cratered after, so perhaps the lesson here is that my ES stops are a bit too tight. Anyway, target reached in spoos and I'm neutral and open-minded on G10 FX and stocks.

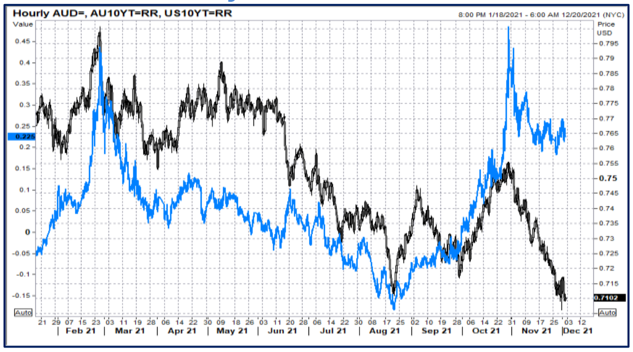
I am clinging to the multi-week bearish crypto thesis. When stuff turns, the leaders are the last to crack. But when the leaders crack, they crack hard (see PTON, ZM, etc. in the WFH space, for example). The epic bear flag breakdown in AMC stock is another harbinger of doom for investors in meme and narrative driven momentum “assets”. The first few days of the month tend to be very bullish crypto so the fact we are lower than where we opened the month gives me some confidence that I might have survived the worst of the crypto strength. Or not!

AUD suddenly looking cheap

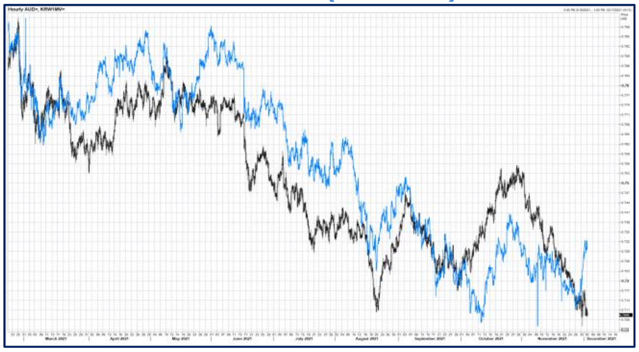
I have been playing AUD from the short side, but I am quickly turning bullish because:

- Stocks hit target of 55-day MA
- VIX has doubled off the lows, often a good finger in the air way to measure freakout levels
- Fed hawkishness reduces inflationary fears as oil and breakevens reverse
- AUDCHF and EURAUD targets reached (1.6000 big resistance in EURAUD)
- AUD below fair value on many measures. Four examples:

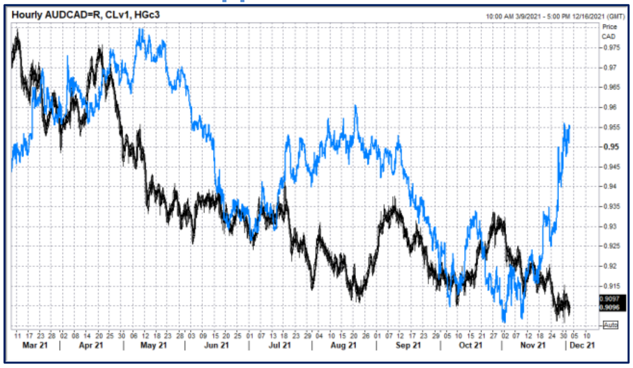
AUDUSD vs. 10-year rate differential



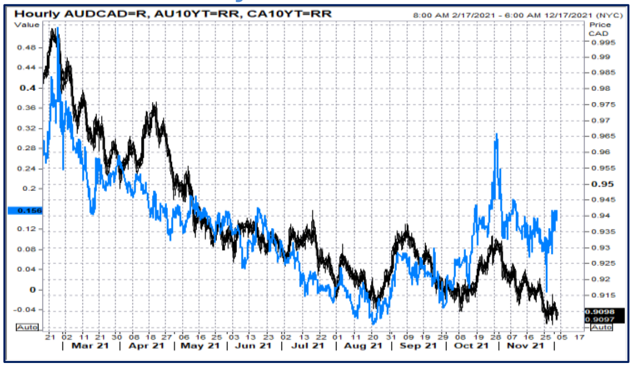
AUDUSD vs. USDKRW (inverted)



AUDCAD vs. copper/crude oil ratio



AUDCAD vs. 10-year rate differential

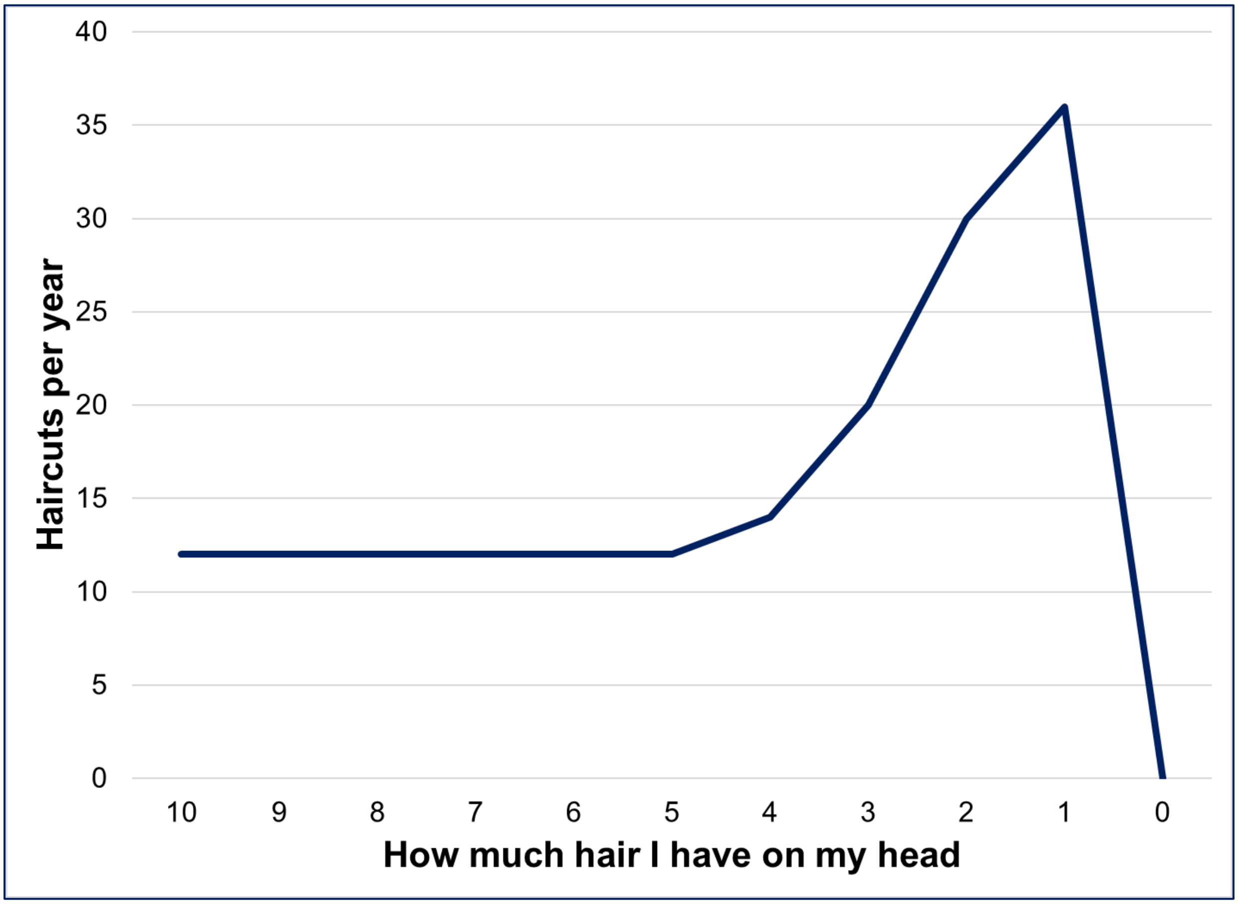


The big support in AUDUSD is 0.7000 (Q4 2020 double bottom), so I’m not sure this is exactly the dream entry point, but long AUDUSD and AUDCAD are both on my radar. I’ll probably be scaling in from here to 0.7050, but I’ll let you know if I’m officially doing it as a high conviction sidebar trade rec.

AUD is particularly interesting because **there is a sneaky transition happening in Asian markets**. They are outperforming over the last few days. That AUDUSD vs. USDKRW chart (top right corner) doesn’t look all THAT dramatic, but for two pairs that tend to move in lockstep (due to USD as primary driver), that is a strong signal from KRW that assets in Asia are trying to turn the corner after suffering through a short but frigid Evergrande winter. Maybe looser policy in Asia and tighter policy in the USA means investor preferences are shifting? Note too, that copper never dirtnapped with oil, despite having every reason to do so if it so desired.

Have a hairy day.

good luck ⇅ be nimble



x-axis could have been "my age" and chart would look the same

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