Monday, January 10, 2022

Complacency and complexity

Complacency

The Fed is saying: We screwed up and now we're going to fix it by ending QE, raising rates, and starting QT *much* earlier than we had said. Meanwhile, many market participants are saying stuff like:

- It was only "some" of the Fed members in the FOMC minutes
- Fed is still easing, so don't worry about it
- This is 2017, not 2018
- Fed never hikes unless it's fully priced in

I think people are way, *way* too complacent and are anchored on prior cycles that were all about gradualism. The current moment is not about gradualism. Secular stagnation is over (or at least on a long hiatus). We should be considering the idea that the Fed might simply end QE in 16 days at the January 25/26 meeting. There does not exist, on earth, a single person that thinks Fed QE is the correct policy at this moment. That includes the most dovish members of the Fed. A hawkish surprise could be a strategic show of strength to try to reestablish credibility.

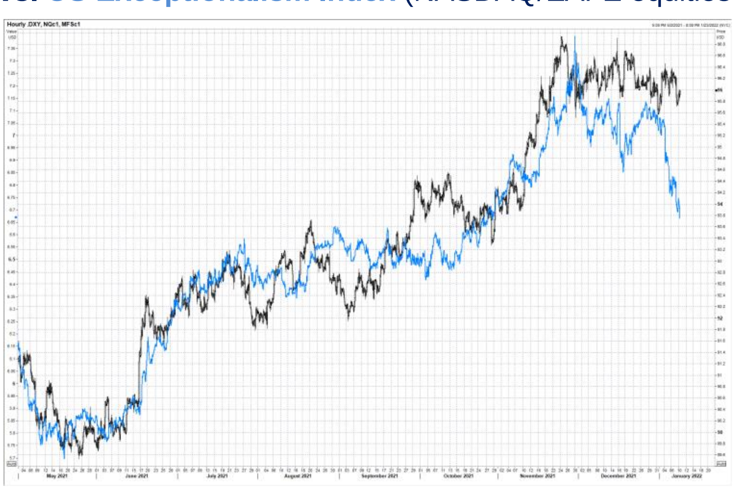
The implication to me is that risky assets should remain under pressure for a few more weeks as the market needs to go from complacency to fear before this is over. I continue to believe this is 2018, not 2017, which implies choppy, sideways action in stocks with large drawdowns and some amazing buy the dip opportunities as the market digests the end of the greatest monetary policy experiment in human history.

USD not trading well

The tiny reversal in US rates after the gap higher in Asia has put USDJPY under pressure. Popular and crowded trades like short EURCHF, long USDJPY and short GBP are getting cleaned out. CAD is the exception: a popular trade that is still working.

I am surprised EURUSD is not higher. I believe this is probably the dip to buy in EURUSD as US equity performance lags more and more. See the chart below. The lighter blue line is the NASDAQ : MSCI EAFE ratio (EAFE is Europe, Oz, NZ, HK, Japan, Singapore) -- Black bars are DXY.

DXY vs. US Exceptionalism Index (NASDAQ/EAFE equities ratio)



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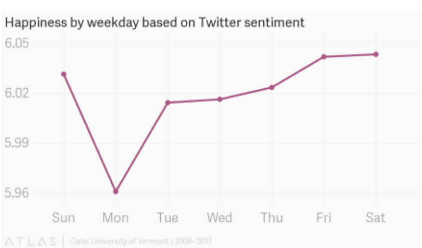


Boomtown Rats agree.

Personally, I don't mind Mondays, but I do like the song… Classic 1980s piano arrangement

https://www.youtube.com/watch?v=o2I84-A9duY

Current Views

Long EURUSD @ 1.1317
Stop loss 1.1174

Short CADJPY @ 90.99
Stop loss 91.85

Long 1-month CADJPY 90.00 put
Price 75 pips

You can see the light blue line, which is a proxy for US exceptionalism, has tracked the dollar well and if FX were a single variable equation, it would suggest USD has peaked. Obviously, it's not that simple with the Fed in play, but I think it's a good place to start. Ideal EURUSD stop is either 1.1269 or 1.1174.

I have added long EURUSD to Current Trades with a stop at 1.1174.

Major risk would be if market starts to discuss end of QE at the January FOMC. CPI Wednesday also a risk, of course, though strong CPI is bad for US high beta stocks and could counterintuitively lead to USD weakness, not strength.

A very important point for the complexity of the current FX framework: there are two factors operating in tandem.

1. The rates story. Who will hike, who will not? How fast. When will QE end, QT start, etc.?
2. The equity flow story. Global investors have been shoveling money into US equities for years. That has been a major source of USD demand and was a big reason the twin deficits were irrelevant in 2021. Now, the equity flow is reversing a bit as the free money / TINA trade is cooling. That is USD negative.

When US rates go up and US equities go up at the same time, it's a no brainer. Buy USD. But when US tightening prospects hit US equities more than global stocks… It's not obvious at all. For now, I think we are a in mildly USD bearish environment as positioning is massive long USD and US equities are decoupling from global equities (in a bad way).

The ECB are absolutely itching to pivot

I get the impression the ECB wants to pivot and we should be ready for it at any time now. Schnabel is a well-respected voice at the ECB and in a speech today, she makes a compelling argument for why central banks should not always look through energy price inflation. Key excerpt:

> So far, however, there are no signs of broader second-round effects. Wage growth and demands by unions remain comparatively moderate. But in an environment of large excess savings and protracted supply disruptions, the energy transition may lead to inflation remaining higher for longer, thereby potentially raising the risks of inflation expectations destabilising.
>
> In this case, monetary policy would need to respond to, rather than look through, higher inflation to preserve price stability over the medium term.

It's a good read: https://www.ecb.europa.eu//press/key/date/2022/html/ecb.sp220108~0425a24eb7.en.html

ETH target hit

My short ETH hit the take profit on the weekend. I always admit when I am wrong or when I do something stupid, but in this case, I will say I'm really happy about this trade. It was hard to sell into the teeth of the hypefest in November and the timing ended up being pretty good. I'll write MacroTactical #9 later today or tomorrow to outline where I think we go from here. The TLDR is: **long BTC vs. short Web3 should be good** with emphasis on SAND for the short Web3 leg. You can't short SAND in the USA, unfortunately, but in many countries there is a way to do it.

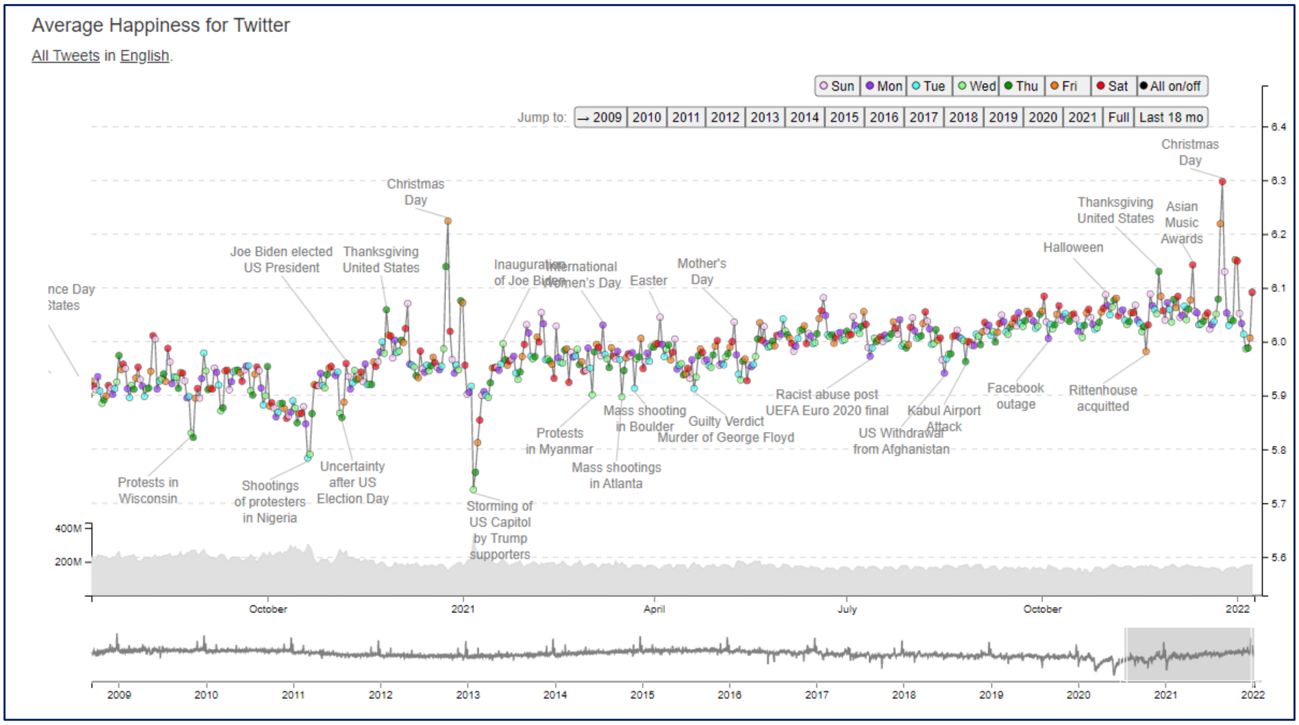
Almost perfect = no good

Finally, I had a trade in the sidebar since last Thursday, which was: sell AUDJPY on the bounce to 83.40. The high overnight was 83.36. That is a bummer as we are now 60 points lower, but whatever, it happens. I have deleted the idea now because I have the short CADJPY already, plus a rally all the way back up to 83.40 in AUDJPY would now probably be something I would not like to sell. Have a moody day.

good luck ⇅ be nimble

Twitter average happiness 2009 to now.

If you go to the site and click on the dots, you can see more detail.



http://www.hedonometer.org/timeseries/en_all/?from=2020-07-10&to=2022-01-09

I am around 7.34 / 10 right now.

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