SPECTRA MARKETS

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am FX

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March 4

https://www.polygon.com/2020/2/21/21147436/batman-set-photos-robert-pattinson-costume-motorcycle

Current Views

Initiated November 17
Short ETHUSD @ 4210
Stop loss 4902 / Take profit 3010
(From MacroTactical Crypto #4)

On the other hand

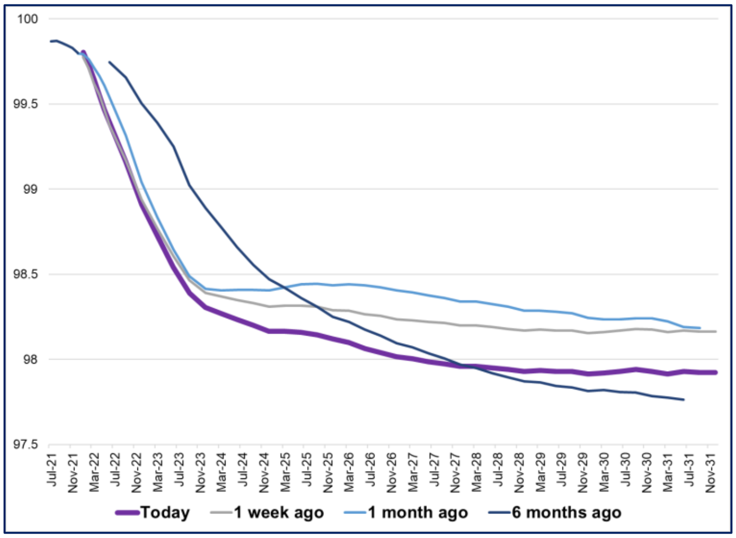
Consensus 1 Donnelly 0

The USDJPY trade was wrong. Japan ripped USDJPY higher from the word "go" last night and London followed through. The good thing about tactical trades like this is the psychological pain and opportunity cost are limited and you can quickly move on. USD bulls must be encouraged by the clean rip through 115.50 and that level in USDJPY now becomes support.

Despite the explosive rally in USDJPY, I still can't get excited about the idea of a stronger USD right now. I am open minded, but skeptical. The rates move certainly has grabbed everyone's attention but it's hard to know how much to read into a move on the first trading day of the year. The big question remains: **Can the Fed hike more than a few times without breaking everything?**

The verdict is evolving. The cliché is that the Fed will hike until something breaks. The market has viewed that breaking point as relatively nearby, and that is why the curve flattens dramatically once you get out to 2023. It is worth noting, though, that market pricing for the Fed is getting a bit more normal again as the very mild inversion from a month ago has been ironed out. You can see the evolution of the curve here:

ED curve now, 1 week ago, 1 month ago and 6 months ago

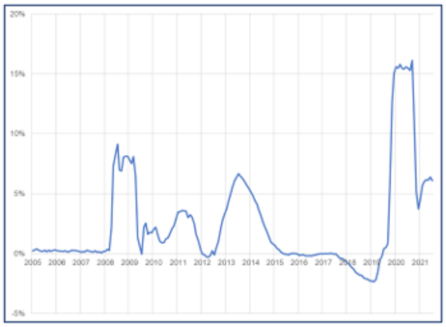


A more normal-looking curve helps the USD at the margin, as the "policy error" and "mega low terminal rate" narratives lose a bit of steam.

Can risky assets rally as the Fed hikes? In a normal cycle, the first few interest rate hikes trigger turbulence, but they do not trigger a full reversal in risky assets. The market gets nervous about tightening policy but then realizes policy remains extremely loose despite the direction of travel. 2017 is a good example of this as stocks went pretty much straight higher as the Fed hiked three times. Then, in 2018, stuff broke.

On the other hand, this has been a totally different monetary policy cycle with much larger stimulus coming faster (see chart on next page, for example) and so the taper might be more important or potentially damaging to sentiment. In the last cycle, the taper started in 2013 and the first rate hike came two years later at the end of 2015. This time, we're going to get a taper and then rate hikes BAM / BAM. That's much quicker sequencing and potentially more difficult for risky assets to digest. I think that's an important consideration, especially as the distribution of equity outcomes looks different with the Fed put much lower than usual in many scenarios if inflation remains sticky. To me, the 2022 equity distribution looks like it has a fatter left tail than usual and skews left more than usual as rapid tightening into blistering inflation will be harder to digest (and harder for the Fed to quickly reverse) than the Fed tightening we've seen in recent decades.

Fed balance sheet YoY change vs. GDP



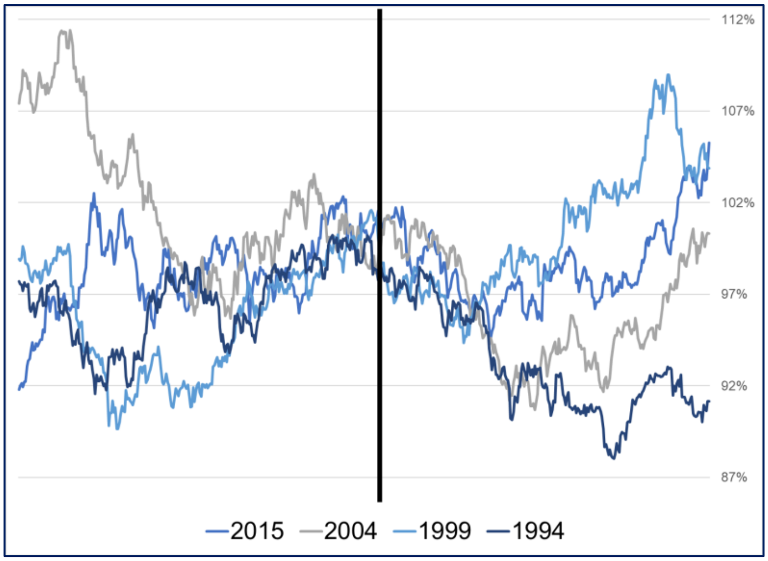
The two main scenarios for the USD are likely to be 1) The Fed hikes and risky assets do well (USD bullish). Or, 2) The Fed starts to hike and risky assets wobble and USD struggles. Of course, we also have the fiscal drag and many other economic variables to juggle. The market seems much more comfortable selling EUR and JPY on a US rates move, while currencies like AUD, CAD and NOK are more confusing in a reflationary world as you get the positive reflation impulse (good for commods) and also a generally strong USD (bad for commods).

Adding to the crosswinds here: historically, **the first Fed rate hike has been a great time to sell USD**, and my guess is this cycle will be similar. Still, we are months away from the first rate hike so getting short USD here could be many percent early if we get the last USD kaboom.

For reference, here is the performance of the dollar starting one year before the rate hike and out to one year after.

DXY into and out of the first Fed rate hike

One year before to one year after. Huge vertical black line is the date of the rate hike



So for now, I'm watching rates and remain skeptical of USD upside. At the same time, I understand the bullish USD narrative and I'm not going to slam my head against the keyboard for three months trying to get short the dollar over and over if that doesn't look like it's going to work. I realize I'm not presenting a strong view here, just the two sides. While it's nice to have a strong view all day every day, right now I'm waiting for new inspiration before putting anything on. Have a heroic day.

good luck ⇅ be nimble

The new Batman is inspired by Kurt Cobain

https://www.empireonline.com/movies/news/the-batman-robert-pattinson-inspired-by-kurt-cobain-matt-reeves-exclusive/

The music for the first trailer was "Something in the Way" by Nirvana

HT SkD

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