SPECTRA MARKETS

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am FX

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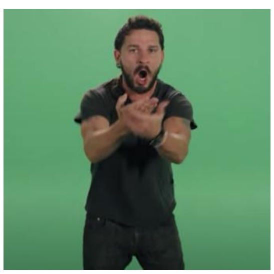


If this all-time classic 1-minute video doesn't get you pumped today, I'm sorry. Nothing will.

Current Views

Long 1-month CADJPY 90.00 put
Price 75 pips

...

Sell the rally spot trades, not open trades yet:

Short CADJPY @ 90.99
Stop loss 91.85

Short AUDJPY @ 83.40
Stop loss 84.40

...

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

QT2: With a vengeance

Hunker like it's 2018

We don't have a large sample of QT events, we have pretty much have one. That episode is still fairly fresh in most people's minds as the reduction of the Fed's balance sheet triggered a highly-tumultuous first year in power for Jerome Powell in 2018.

Since 2010, the average monthly return for the S&P 500 has been 1.1% and the median monthly return has been 1.8%. In months where the Fed's balance sheet contracted by 0.5% or more and the Fed was hiking, the average return is MINUS 1.2% and the median is +0.5%. Here is the entire sample of 10 months:

Months where the Fed's balance sheet contracted by at least 0.5% and the Fed was hiking

	SPX change	Balance sheet change
11/30/2018	-9.2%	-1.0%
9/28/2018	-6.9%	-0.6%
1/31/2018	-3.9%	-0.7%
2/28/2018	-2.7%	-0.6%
8/31/2018	0.4%	-1.4%
5/31/2018	0.5%	-1.0%
11/30/2017	1.0%	-0.5%
10/31/2018	1.8%	-1.3%
7/31/2018	3.0%	-0.6%
6/29/2018	3.6%	-0.5%
Average	**-1.2%**	-0.8%

It may seem strange that I needed to add the (if Fed is hiking) condition, but surprisingly, there are many one-off months in the data series where the Fed Balance sheet contracts kind of randomly in the middle of an easing cycle. In July 2020, for example, the Fed's balance sheet got smaller. These are primarily technical changes and clearly not the QT changes we are trying to pinpoint.

You may recall that 2018 was a horrendous year for assets of all types. In the Appendix, I include a comprehensive list of how various assets did in 2018. In FX, we are seeing the classic risk parity unwind trade. Risk parity unwind (sell stocks, sell bonds) is the textbook outcome of QT. As liquidity disappears and a huge marginal buyer of bonds goes home, financial conditions tighten and stocks and bonds both go down. Some will say that QT leads to lower yields eventually due to disinflationary pressures caused by falling asset prices, but the sequence is that the first move is higher rates and then eventually rates fall as the system seizes up.

The question here and now is whether QT matters now. Are we in 2017, when the Fed started talking about QT and asset prices continued to roar? The balance sheet normalization program was described in June 2017 and initiated in September 2017. Stocks didn't peak until January 2018.

Or are we in 2018, when the Fed actually started doing QT and asset prices struggled?

My bet is that we are in 2018. This cycle is so much faster, and the starting conditions are so much different (high inflation, raging jobs market) that everything is happening at turbo speed. Here are how the last two cycles line up. The rows are quarterly. We got from QE to QT in about 5 years last time and it's looking more like 1.5 years this time. That makes sense given last cycle was a period of secular stagnation and this one is a period of hot, tightly-strung / almost overheating economy.

Last cycle took 5 years, this one looks like 18 months

Rates	Balance sheet	Last cycle	This cycle	Balance sheet	Rates
	QE ongoing	Dec 2012	Mar 2021	QE ongoing	
	Taper talk	Mar 2013	Jun 2021	Taper talk	
	Taper talk	Jun 2013	Sep 2021		
		Sep 2013	Dec 2021	Taper starts NOV, speeds up DEC	
	Taper starts	Dec 2013	Mar 2022	Taper ends / QT outline	**Fed hike**
		Mar 2014	Jun 2022		**Fed hike**
		Jun 2014	Sep 2022	QT starts	
	Taper ends	Sep 2014	Dec 2022		**Fed hike**
		Dec 2014	Mar 2023		**Fed hike**
		Mar 2015	Jun 2023		
		Jun 2015	Sep 2023		
		Sep 2015	Dec 2023		
Fed hike		Dec 2015	Mar 2024		
		Mar 2016	Jun 2024		
		Jun 2016	Sep 2024		
		Sep 2016	Dec 2024		
Fed hike		Dec 2016	Mar 2025		
Fed hike	QT mention	Mar 2017	Jun 2025		
Fed hike	QT outline	Jun 2017	Sep 2025		
	QT starts	Sep 2017	Dec 2025		

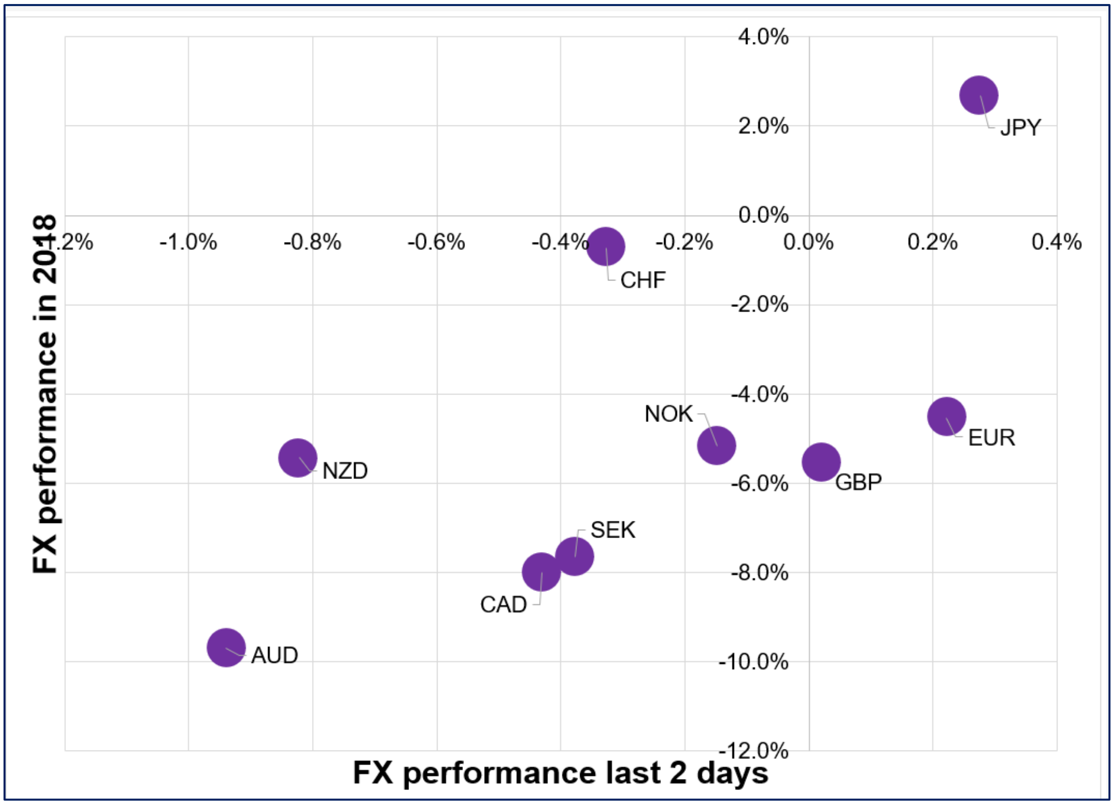
As such, I don't think the market has the luxury of trying to eke out another 3-6 months of risky asset gains like it did in 2017. By the way, here is what bitcoin did in 2018 (85% drawdown from 2017 peak).

Bitcoin dropped from $17,000 to $3,000 in 2018
It was a high-beta risky asset, not a safe haven

There is no bubble in bitcoin this time, but you could argue there is a full-on bubble still in Web3, ETH, SAND, AXS and all that stuff and 85% corrections should be in the playbook, even if they are not the base case.

How did FX do in 2018?

When stocks and bonds sell off in tandem, the USD rallies against the high beta currencies (AUD, CAD, NZD, SEK, NOK) and struggles against the funders (EUR and JPY). This chart shows the performance of FX for all of 2018 compared to the last two days. You can see the similarity. Same regime.



OK, cool, but this is all backwards looking. What do we do?

My view is: this is 2018 not 2017. The market has a clear template to follow, and the market knows QT is bad for risky assets. This makes sense! The whole reason everyone rushed into risky assets in 2020 was because the Fed Put was triggered. Now the Fed Call is lurking up there around 4800/5000 and the Fed Put is nowhere in sight. Plus, in early 2019, the Fed had the luxury of pivoting back to aggressive easing because inflation was on a downward trajectory and already below 2%. Now it's on an upward trajectory and above 6%.

Therefore, the strategy is to sell anything that went down in 2018. Stocks, bonds, AUD, CAD, and crypto are the standouts. Sell rallies in everything. Or sell here with a wide stop. My bearish crypto dreams are finally coming true, and I would like to add some shorts in risky FX pairs. The entry points here are not great and with Daly and Bullard today and NFP tomorrow, there might be a chance to capitalize on a random squeeze. I'm going to put two *sell the rally* ideas in the sidebar:

Sell CADJPY at 90.99 with a stop at 91.85. Oil has held up very well so far, but the BoC looks overpriced to me, especially the January meeting. I talked about this in AM/FX: Unwinding and since I wrote that piece, Ontario has gone back into partial lockdown. No shot the BoC hikes in January IMO, and yet 8 to 10 bps are still priced in. Odd.

Sell AUDJPY at 83.40 with a stop at 84.40. AUDJPY is the ultimate risky pair in FX and it tends to follow bitcoin, which is slowly cratering in a series of waterfall bear flag formations.

Both these trades (short CADJPY and AUDJPY) also factor in the massive crowding in long USDJPY and the potential nerves into the January 17/18 BOJ as the Bloomberg sources story has put that meeting on the radar. See yesterday's AM/FX for that. The other option here is to just **buy 1-month or 2-month downside in AUDJPY and CADJPY**. That makes the entry point less critical and gives you breathing room if you think the QT theme is back with a vengeance (which I do).

So I also add: **Buy 1-month 90.00 CADJPY put for 75 pips.**

Tanguy points out that at current levels of JPY positioning, forward returns are bleak for USDJPY.

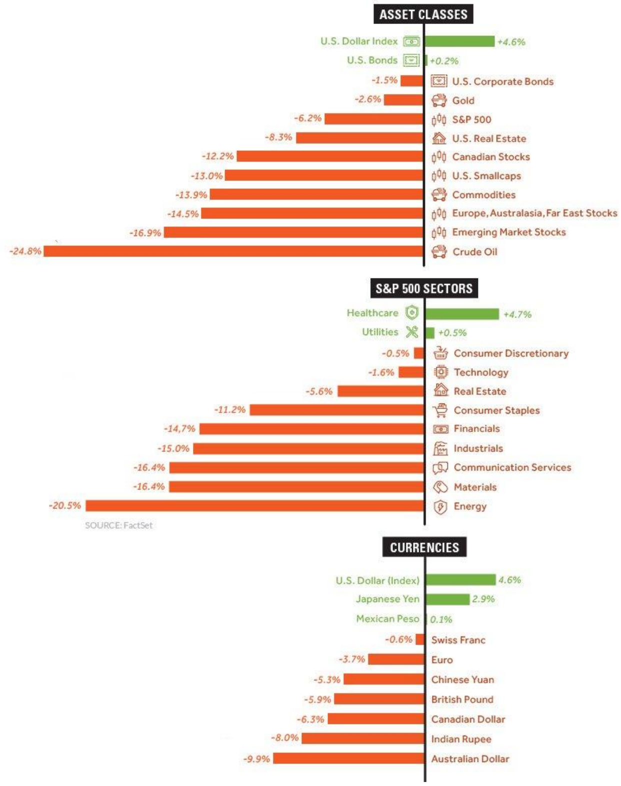
Finally, this October 2021 paper from the KC Fed is interesting in the current context. It shows there is some intellectual backing at the Fed for rapid QT to keep the curve from flattening. This paper takes it to the extreme and argues for QT *before* hikes. *HT Chuck.*

https://www.kansascityfed.org/research/economic-bulletin/when-normalizing-monetary-policy-the-order-of-operations-matters/

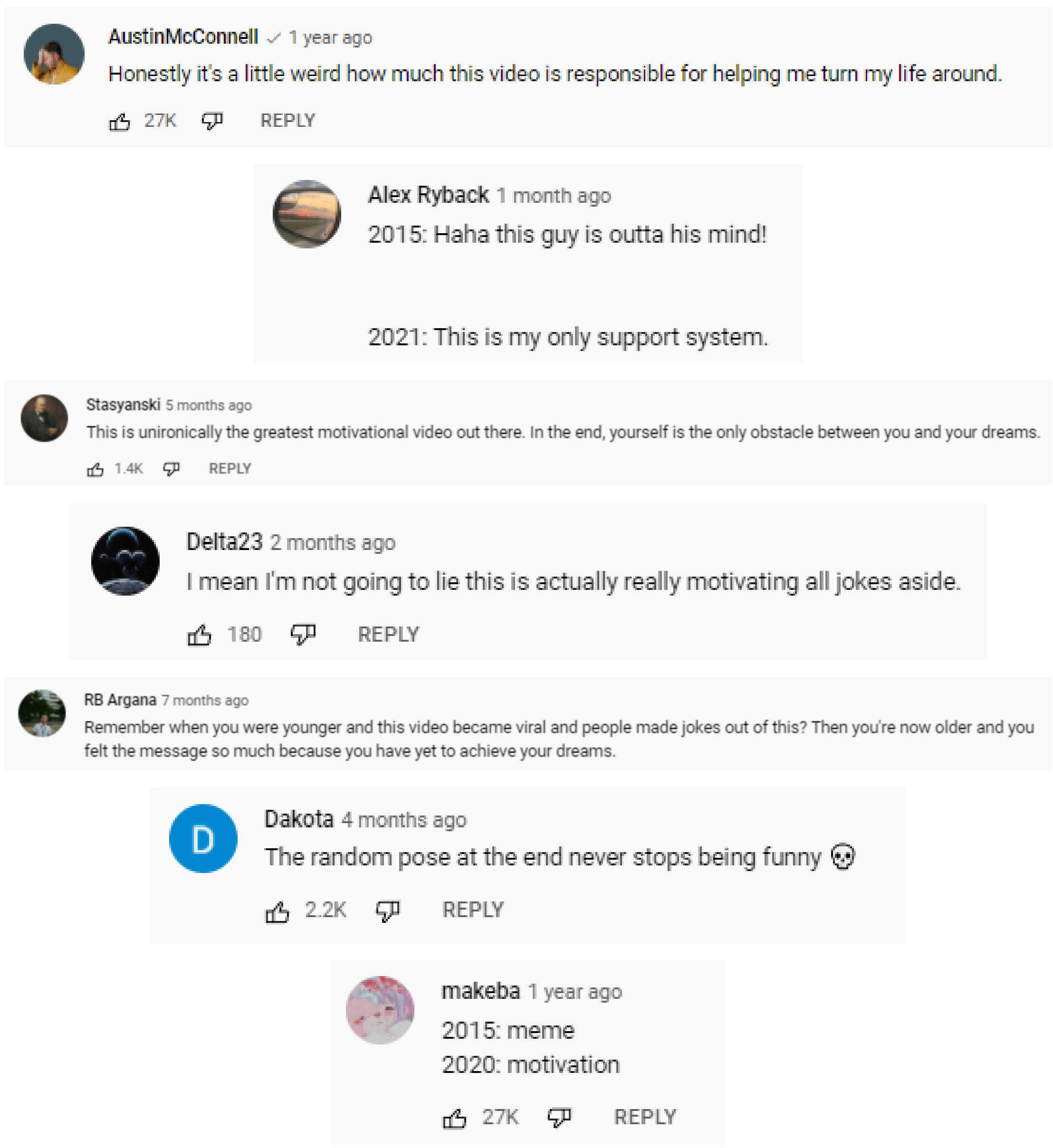
Have a pumped up day.

good luck ⇅ be nimble

Appendix: 2018 returns



You can tell from the comments, everyone loves this video but feels awkward about loving it. Like… “I wanna be ironic here but like … Dude I’m so pumped right now!”



AustinMcConnell ✓ 1 year ago
Honestly it's a little weird how much this video is responsible for helping me turn my life around.
27K REPLY

Alex Ryback 1 month ago
2015: Haha this guy is outta his mind!

2021: This is my only support system.

Stasyanski 5 months ago
This is unironically the greatest motivational video out there. In the end, yourself is the only obstacle between you and your dreams.
1.4K REPLY

Delta23 2 months ago
I mean I'm not going to lie this is actually really motivating all jokes aside.
180 REPLY

RB Argana 7 months ago
Remember when you were younger and this video became viral and people made jokes out of this? Then you're now older and you felt the message so much because you have yet to achieve your dreams.

Dakota 4 months ago
The random pose at the end never stops being funny 💀
2.2K REPLY

makeba 1 year ago
2015: meme
2020: motivation
27K REPLY

https://www.youtube.com/watch?v=ZXsQAXx_ao0

HT The original Ark

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