SPECTRA MARKETS

Friday, January 21, 2022

USA 9, Canada 5

Another one

First, it was Elon Musk: Time Man of the Year. Now, this latest cover of The Economist (at right) presents another reason to wince if you're long tech. The stuff major tops are made of. For a full explanation of this anecdotal indicator, see here: A Somewhat Empirical Look at The Magazine Cover Indicator.

The Canada debt boogeyman lurks

This Bloomberg article on Canada does a nice job of outlining the tremendous challenges facing Canada as the BoC attempts to normalize from absurdly low interest rate levels under a weighted wet blanket of consumer and federal debt, plus perennial fears of a housing bubble. It's worth remembering that the Canadian debt and housing bubble boogeyman has been stalking markets like Michael Myers since 2012. Is he ready to pounce now?

Here is an assortment of alarming headlines from the Housing Crisis that Called Wolf:

Brace for debt shock, Bank of Canada warns	February 2012
Great Canadian real estate crash of 2013	January 2013
Canada's governments brace for looming debt crunch	May 2015
Drowning in debt, freaked out Canadians brace for a reckoning	March 2019
Canada's Looming Fiscal Reckoning	October 2020

The 2013 headline and story are particularly comical given the hysterical prose and the fact that house prices went up in 2013, not down.

Canada housing was predicted not just to crash, but to catch on fire lol


BUSINESS

Great Canadian real estate crash of 2013

The housing bubble has burst, and few will emerge unscathed

By Chris Sorensen
January 9, 2013

Maclean's

The reason I present these old headlines is that the media and Twitter are aggressively biased toward calling crashes. Crash headlines are clickbait. They sell magazines. They spur engagement. Negativity bias is real. There is also a long and illustrious history of US debt panic in the media as well. Here's a beauty from 1950:

amFX

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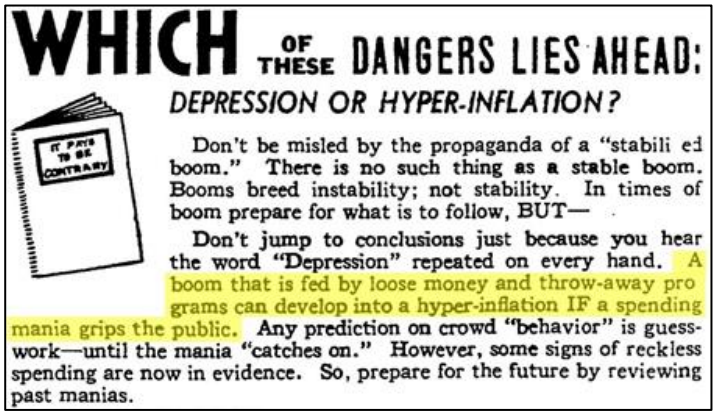
Current Views

Long TYH2 @ 127^24
Stop loss 126^24
Take profit 129^24

Long 03FEB CADJPY 90.00 put
Spot ref: 90.80 /// Price 75 pips
(stale for now, but you never know!)

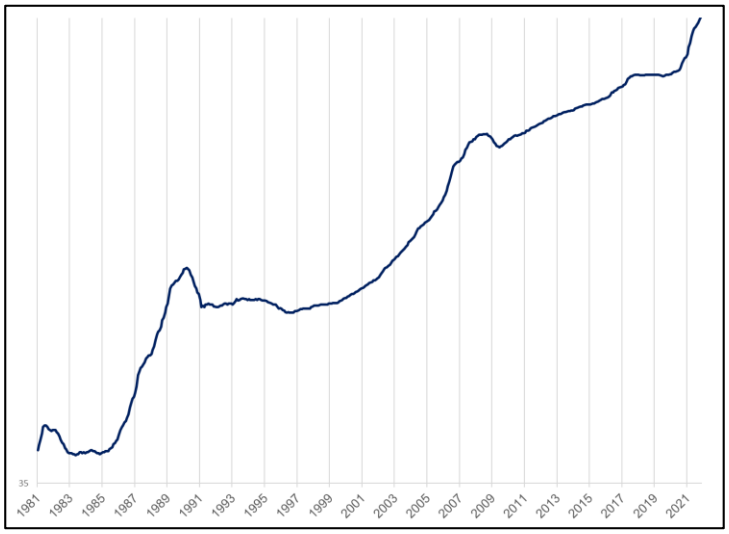


Barron's ad from 1950 (via @NewLowObserver)

I too am worried about what's going to happen in Canada when rates go up. I simply present all this because I think it's easy to get sucked into a hyperbolic hyperbearish narrative when in fact, Canada housing bubble clickbait has been a continuous and meaningless part of the financial and MSM landscape for the past 10 years.

Note that while I'm pooh-poohing the media's obsession with trying to call housing bubbles in Canada, house prices can go down! Here is a chart:

Canada house prices, 1981 to now



Bloomberg CAHUPI (log)

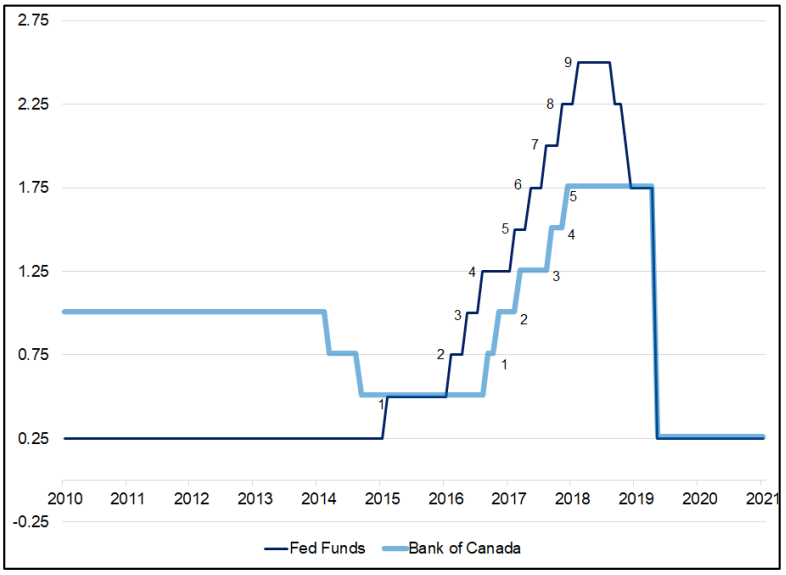
The real story here is more nuanced than CRASH IMMINENT! It goes like this:

A) Canada has a very interest rate sensitive economy, and also…
B) Media loves a crash story and will never present a balanced view, so ignore all the bubble stuff and do your own due diligence.

Point A is important and leads me to believe that relative central bank hike pricing Canada vs. the USA is wrong. I have been saying this for a bit, and I know playing the "too much is priced!" game during tightening cycles is generally a good way to lose money but I will say… **I find it hard to believe that the more interest rate sensitive country (Canada) will hike twice as many times as the less sensitive one (USA). Remember the Fed hiked 9 times last cycle and Canada hiked 5**.

It was harder for the BoC to hike because of the interest rate sensitivity of the Canadian economy.

Hikes in the last cycle: USA 9, Canada 5



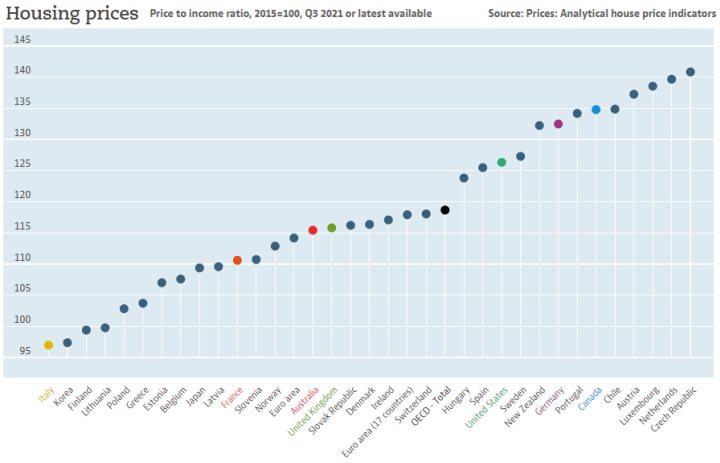
Last time the Fed and BoC faced off, the Fed won 9-5. It's not clear to me why we should now expect Canada to win this matchup 6-4. Oil was in the $60s then, now it's in the $80s… I don't think that's enough to change the dynamic this aggressively.

I still don't think the BoC hikes next week, but I'm in a shrinking minority as markets are now pricing in a ~73% chance of a hike. There is some challenging reflexivity for people in the "no hike" camp that makes it hard to hold your ground on the wrong side of 50%: The more the hike gets priced in by the market, the easier it is for the Bank of Canada to hike… Because it's priced in. It's circular, but it's true.

I'm not going to put a trade rec in the sidebar because it's a longer-term idea and more complicated to execute than a sound bite. But betting on the US vs. Canada rate hikes in the next twelve months to be roughly equal (not 6-3 Canada) looks super high EV to me.

For your enjoyment, here are price-to-income housing metrics from the OECD. If you're bored later, check out the OECD website it's got a nice interface.

Canada … Most expensive housing in G10



Must love Excel

Finally, I ran the following table in am/FX a few times last year to remind everyone that the current monetary policy cycle is completely macadamias. The last QE to QT transition took six years. This one looks like it's going to take six months.

Here is the up-to-date version for your perusal.

	Where we were at the start of the tightening cycle									
Tightening cycle start	Fed Funds	US 10-year yield	10-year real rate	Claims	UR	NFIB small biz hiring	JOLTS	Core CPI YoY	Core PCE YoY	USD debt to GDP %
March 1972	5.50	6.1	2.8	258	5.8			3.3	3.5	36
December 1976	5.88	6.9	0.7	380	7.8	3.0		6.1	5.9	35
December 1986	6.00	7.2	3.5	345	6.6	11.0		3.8	3.2	47
February 1994	3.25	6.0	3.3	327	6.6	11.0		2.8	2.3	65
June 2004	1.25	4.5	2.7	348	5.6	14.0	3,814	1.9	2.1	61
December 2013	0.25	2.9	0.8	332	6.7	8.0	4,121	1.7	1.7	101
January 2022	0.25	1.8	(0.6)	231	3.9	28.0	10,562	5.5	4.7	141

Have an elegantly multiplicative weekend.

good luck ⇅ be nimble

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