SPECTRA MARKETS

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am

FX

Brent Donnelly

bdonnelly@spectramarkets.com
(212) 398-6230

"Cool mask! You big into hockey?"

Current Views

Flat

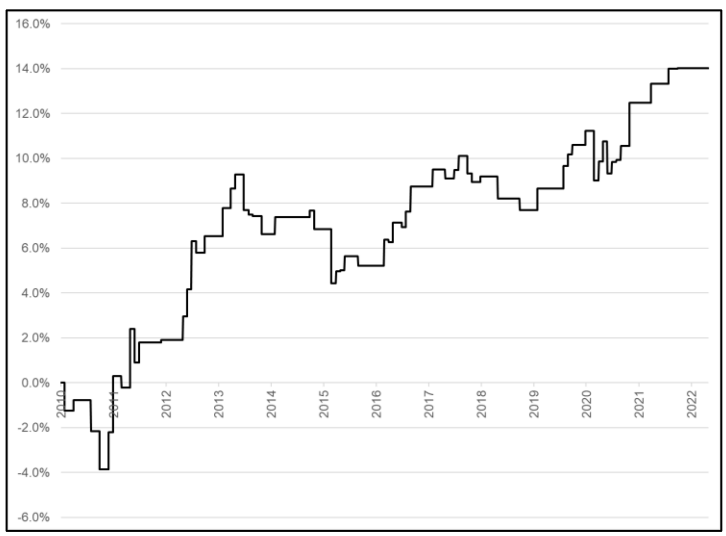
Dollar at a crossroads

The dollar is at an interesting crossroads here. Historically, when the dollar makes a move into the end of the month, that move tends to mean revert in the first week of the following month. This is because there is always a large concentration of price-insensitive flows going through in FX at the end of each month. Speculators know this, and step aside until the mutant buying or selling subsides.

Flow has both temporary and permanent impact on price, and the impact of flow is highly contingent on a ton of variables including any signal the flow triggers and how much inventory is in the market to offset the flow. But overall, markets move when flows come in, and they mean revert somewhat when the flows end. Since many FX flows are programmatically timed around the end of the month due to particular benchmark-matching and cashflow timing needs, there tends to be directional FX movement toward the end of the month, and mean reversion after.

This chart shows the P&L of going the other way every time the DXY moves 75bps or more in the final week of the month. Cover one week later (at the end of the first week of the new month). The DXY was up 172bps (1.72%) in the last week of April. *To be clear, this strategy fades the final week of the month move, if it's 75bps or more, and covers at the end of the first week of the new month.*

Cumulative P&L of going the other way every time DXY moves 75bps or more in the last week of the month. Enter at close on last day of month. Cover at close one week later.



Why did you pick 75bps? I chose the parameter in order to get a sample size of 30, which is a heuristic often used for acceptable sample size.

This effect is not huge, but it's fairly consistent. Not a reason to get short USD, but perhaps a reason to lighten up on longs. If that was it, then there's really nothing to see here. But there is more. The Fed meets Wednesday and while I've been consistently preaching "DO NOT PLAY THE 'TOO MUCH IS PRICED IN!' GAME"… There are now 110 bps of Fed hikes priced in for the next two meetings just as US 10s approach the 3.04%/3.25% mega target. If I had to pick a side into this FOMC meeting, my guess is we get the first quasi-dovish outcome in a long time.

Meanwhile, the DXY chart looks like this:

DXY flirting with a 20-year high

High last week was 103.92

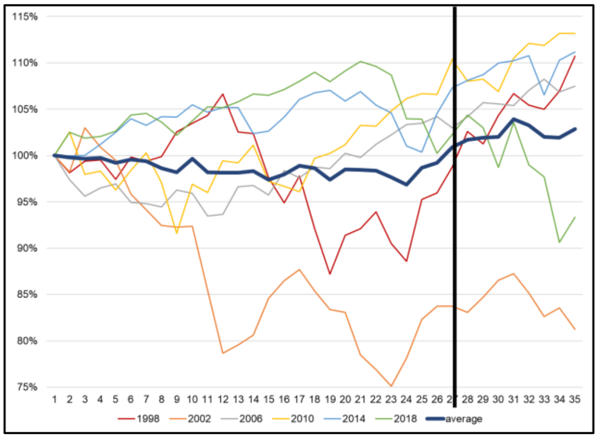
It's hard to get short dollars here. The Fed have just started their slow-motion turn after finally dropping the ridiculous asset buying policy a few months ago. Sure, a lot is priced in, but an animal backed into a corner is scary to mess with. This is one of those annoying setups where long USD looks like abysmal risk/reward, but short USD doesn't quite make sense. If I was forced to take a position, I would be short USD (short USDCHF, long AUDUSD, long NZDUSD, for example) given the easy risk management (stop loss if DXY breaks 104.30, say) … But I am not forced to take a position. I do acknowledge I haven't had a strong FX view in about 10 days but hey, sometimes that happens. Better for me to be honest than to force a view just for entertainment purposes.

Another problem with the USD is the correlation to equities. When there is a high-velocity move lower in equities, the market reflexively buys dollars. I don't have a strong view on equities here but with QT just about to begin, a war raging, inflation out of control, margins collapsing, summer seasonality generally bad (sell in May), China slowing down, US ISM missing today, peak US employment[1] and so on… I am not sure what the bullish equity story is for now. You need some kind of view on short-term equity stabilization to confidently sell USD. I don't have that right now.

For your info, here is May to December equity performance in the last six midterm years. You can see the results are heavily skewed by 1998 and 2002. I don't attach much significance to this chart given it's really a 1998 and 2002 effect, but I am sharing it with you in case you hear something about how equities perform poorly into midterms, then very well after. That's where that story comes from.

2018, a year that feels much like 2022, saw the exact opposite pattern. Stocks rallied all summer than dumped into and after midterms.

Equities through midterms (May to December with 01MAY = 100%)

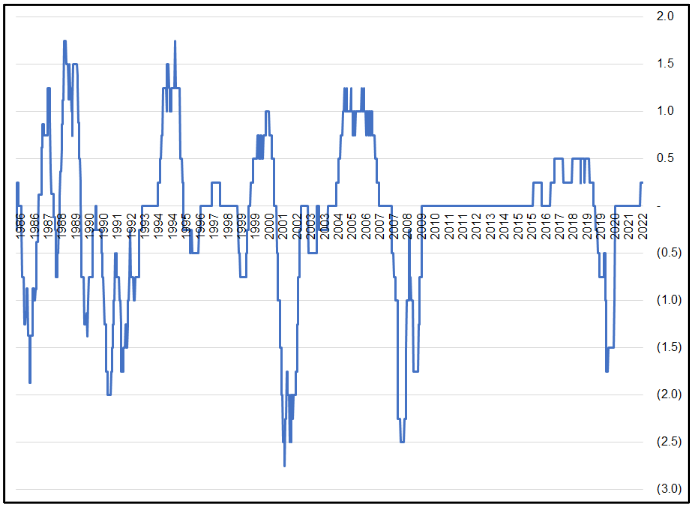


[1] *See, for example, ISM employment today and [AMZN "overstaffed"](#) comments.*

The problem with asymmetric policy

In the WSJ this weekend: Trio of Fed Officials Lament Central Bank's Actions, See Good Odds of a Recession. Fast to cut, too slow to normalize. Every single time.

6-month change in Fed Funds



Down a lot, up a bit, down a lot, up a bit…

Big week

There is a ton of holidays around the world this week, but also plenty of action. RBA (tonight) and then Fed, BOE, Norges and double payrolls (Canada and USA). The RBA outcome is split three ways with 5 economists calling for "on hold", five economists calling for a 40bps hike, and 19 economists in the middle calling for 15bps. One of the more interesting meetings in a while. My guess is that the end result will sound hawkish but it's copper and risk appetite driving AUD for now, not RBA policy.

Final thoughts

In case you missed it, here are my notes from Jared Dillian's conference last week. Day 1 and Day 2. The original Day Two piece I sent last week had broken hyperlinks, so my slides were not accessible. These copies have working hyperlinks. Sorry for the aggro.

Have a hair-raising day.

good luck ⇅ be nimble

Hi, my name is Jason Voorhees, nice to meet you

Months that begin on Sunday contain a Friday the 13th

e.g., May 2022

HT CnD

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