SPECTRA MARKETS

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am FX

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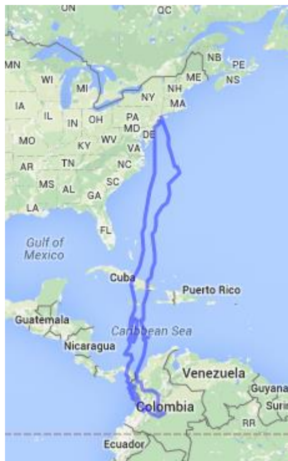


NYC to Bogota = 1 Chile

What do South Africa, Mexico and New Zealand have in common? They are all less than two Chiles away from Chile.

Current Views

Short EURUSD @ 1.0702
Stop loss 1.0801
Take profit 1.0520

A dragon named Lazarus

Three quick points on FX to start:

1. USDJPY to 135 seems like the path of least resistance still, and I continue to believe that EURUSD is going lower, regardless of the ECB story.
2. To me, the ECB will end up like the BOE... A reluctant hiker with low terminal rate story. Not an ambitious motivated hiker like Fed or BoC ... Furthermore, as the ECB turns hawkish, look at BTPs widen ... EURUSD has followed BTP spreads pretty well since last October ... See chart. This highlights the challenge of hiking rates while still protecting the periphery. There has been some talk of an ECB package to backstop the periphery but so far, the market obviously doesn't buy it.

EURUSD vs. Germany/Italy 10-year spread

3. AUD! Classic good news, bad price reaction to the hike means I would be cutting long AUD here anywhere near 0.72. I can't really think of why you'd be short AUD though, other than a bearish equity view. I am bearish equities, but would rather be short NZDUSD not AUDUSD. Coincidentally, I wrote about "good news/bad price" yesterday in my educational Substack.

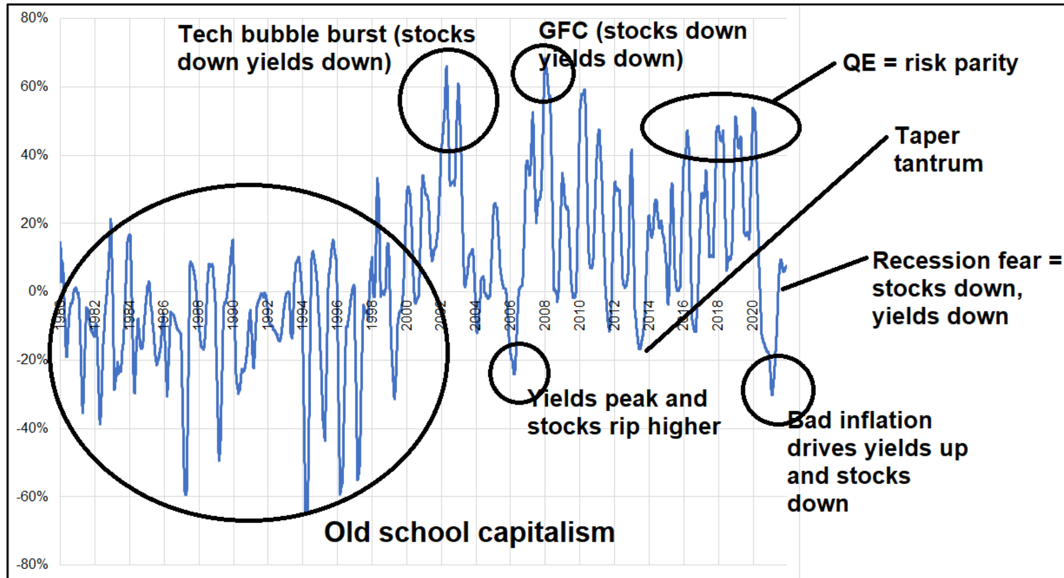
2-year yields

I had a lot of interesting feedback on my piece yesterday (more than usual) and one person was able to replicate it to confirm I am not on crazy pills. Main feedback was that increased sensitivity of equities to rates right now is driven by two main factors:

a. Yields are very low, so a 30bp move now is much more painful than a 30bp move in 1999. In other words, 2-year yields moving from 0.20% to 0.50% is a lot different than a move from 4.20% to 4.50%. An issue I always have with comparing yield moves over long time frames is that I don't think it's appropriate to use % moves when yields are already a percent. For example, if US yields go from 0.05 to 0.15 that is a 200% increase. The 200% number is totally meaningless and clearly that move isn't the same as yields going from 3.0% to 9.0%. z-scores work but the output is much less intuitive. I guess I should just be using z-scores.
b. High inflation in 2022 means rates are going up for bad reasons. In the past, higher rates were usually a good thing, signaling growth in a world of manageable inflation. Now, the Fed has lost its grip on the inflation mandate so higher yields and higher yields are mostly bad news, not good.

Looking at the rolling 100-day correlation of changes in 2-year yields vs. changes in SPX, the output is super interesting despite a fair amount of noise. Here is the chart:

100-day rolling correlation of US 2-year yields and the S&P 500 Index



You can clearly see the massive regime shift that kicked in after the tech bubble burst and China entered the WTO. As the inflationary dragon was slain (so we thought!) we entered a period where equities collapsed with yields as the Fed turned from arsonist to firefighter and then yields rebounded with stocks once the fire was out.

The QE era was mostly a period of risk parity nirvana where bonds and stocks rallied in tandem, year after year. There was a brief pause during the taper tantrum in 2013 and that was a sneak preview for the real QT risk parity wipeout clearly visible on the chart, starting in the back half of 2021. You can even see the recent corr flip where US recession fears drove both equities and yields lower last month.

Now, as I've been talking about for a week or so, my feeling is we are heading back to negative corr as stocks and bonds will sell off in tandem again because:

1. The Fed knows it can't let financial conditions loosen very much or oil will gap higher. Oil is more of a problem than it seems because while it's only trading at $118, gas and diesel prices trade like oil is at $150 as spreads blow out due to refinery shortages and other issues. If oil goes to $150, gas and diesel are a huge problem.
2. Recession fears are overblown. The data so far show a rotation out of tech and into leisure and hospitality. This is not necessarily a stable equilibrium, but it is better than the extremely bearish US economic expectations clouding the horizon just a few weeks ago.
3. Many are bearish and long equities. The more people I talk to this week, the more surprised I am at how many tactical equity bulls there are despite the gloomy macro outlook. QT is just starting and most people I talk to are trying to play a squeeze instead of a continuation lower in stonks.

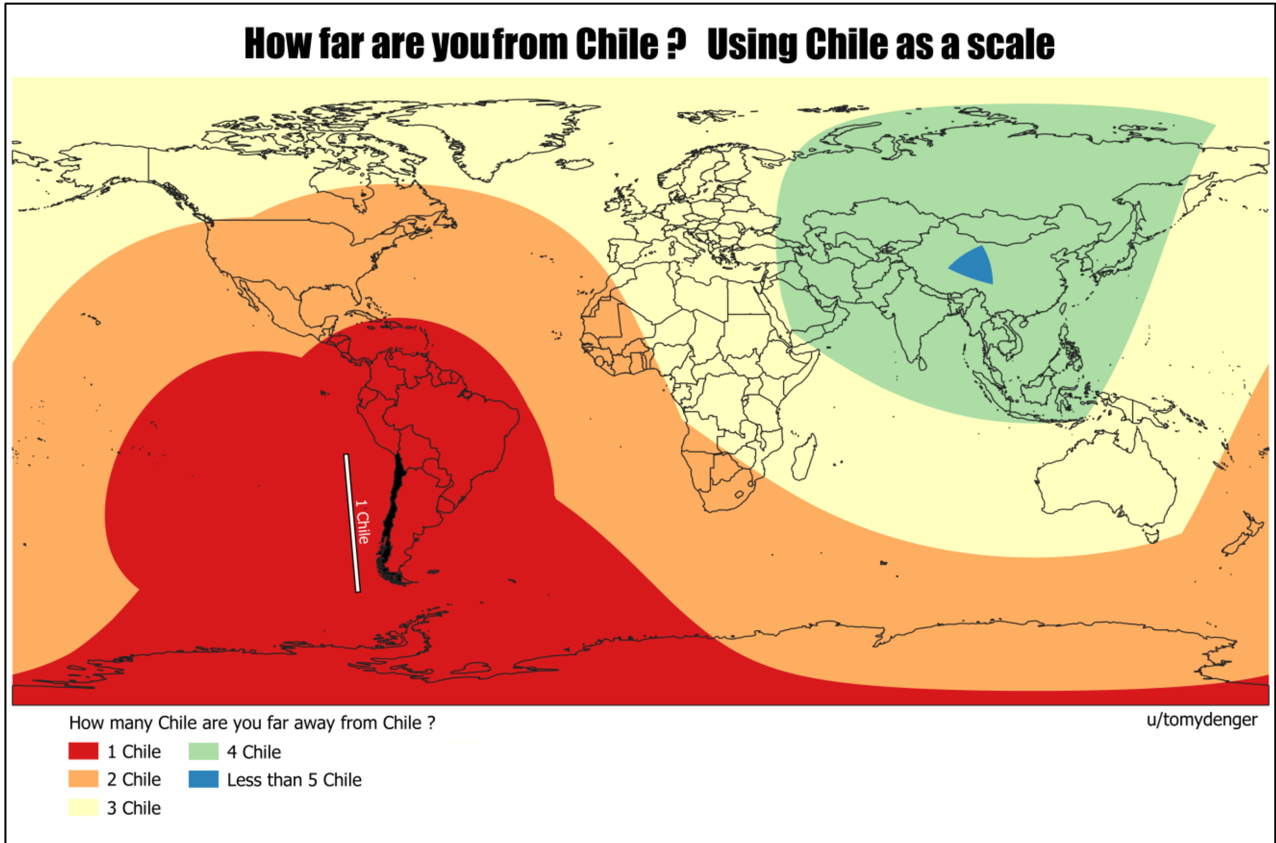
Stocks and crypto will get worse before they get better, I think. Especially ETH.

Final thoughts

The question of whether utility tokens like BNB and even ETH are securities remains unanswered. The SEC announced yesterday that it's looking into BNB. It is the third largest non-"stable"coin cryptocurrency, after BTC and ETH. Regulatory clouds have always loomed over crypto but the regulators are so slow-moving it's really hard to tell if any of it matters. It feels like there has recently been a slight increase in momentum towards more regulation.

Have a chilly day.

good luck ⇅ be nimble



Source: tomydenger, via Reddit

HT recent high school graduate, Adam D.

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