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am FX

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Platinum Jubilees are extremely rare

Current Views

Short EURUSD @ 1.0702
Stop loss 1.0801
Take profit 1.0520

Clickbait, EURCHF and Todd

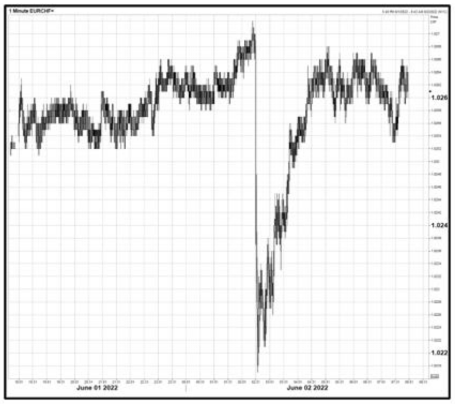
In case you missed it, today and tomorrow are both holidays in London. The UK is celebrating the Queen's Platinum Jubilee. If you don't know what that is (I did not), see today's non sequitur.

Two quick market comments:

1) There is a Reuters story saying the Saudis might raise output to offset Russian shortfalls. Oil is off about $3 on it. To me, the story sounds like the many clickbait articles that came out almost daily during the US/China trade war. It includes a lot of words like "may", "might", "could", "is possible". These types of stories are often thinly-sourced speculation and with other sources talking about a Biden visit to MBS, the story sounds plausible enough. But I would not bet on the veracity of the story and I would not be short CL here.

2) EURCHF rejected the downside rather aggressively after a huge topside miss on Swiss CPI. The MoM figure came in at 0.7% vs. expectations of 0.3%. Bloomberg has 292 months of Swiss CPI data back to 1997 and a miss of 0.4% is tied for the third largest miss in the series. It's a very significant topside miss. In response, EURCHF did that cartoon-style cliff dive and trampoline bounce on the right. The 1.0268/75 level is still capping for now.

EURCHF 1-minute chart for the past two days



EURCHF was 1.0268 going into the data. The level where a currency was trading the instant before the news release is called the NewsPivot. These are important levels to watch after any release; how price behaves around the NewsPivot is critical. A move through 1.0275 would take out both the prior highs and the NewsPivot and create a bad news/good price setup in EURCHF.

Maybe people are getting a bit too excited about the June SNB meeting at this point and the market is trading a decent-sized short EURCHF position now. That's what it feels like. As such, I'm going to cut the NZDCHF because part of the thesis there was to play stronger CHF as the SNB meeting nears. Now, if the market already has the trade on, it might get choppy for a week or so. I'll revisit CHF as the 16JUN SNB meeting date approaches. The NZDCHF P&L was a tiny loss (35 pips or so). I am running cold of late after a long good run.

What do you read?

I am frequently asked the question: "What should I read to learn about or stay on top of global macro?" and I find it harder to answer than you would think. The reason is, it's not static. The stuff I'm finding useful today isn't always the stuff I will find useful tomorrow. Sometimes particular sources or writers go into themes that I find useful or relevant, and then for months they might be focused on something that I don't find particularly interesting. So I rotate a ton.

Also, my tastes change. I never used to read about crypto, for example. Now it's 20% of my reading diet. Sometimes the story on the US economy is pretty clear and/or boring and I'll read less US economics stuff. These days I'm reading more economics because it looks like we're at a turn. Substack, which I first heard of only about 18 months ago, is now a major source of information and long reads. And so on. So my list today isn't my list tomorrow.

There are, of course, stalwarts that are always must reads. Ben Hunt, Matt Levine, Jared Dillian, and Tyler Cowen would be four examples that pop to mind immediately but there are more. One monthly piece that I read religiously is Todd Edgar's "Atreaus Family Office Monthly".

Todd's writing, framework, and ideas are easy-to-understand but not simplistic and his vibe is humble and curious. I have dealt with him as a client and he is a true professional. He writes the note for free to get his ideas out there and to get feedback. I particularly liked his May note, so today I'm going to present the core of it here, with Todd's permission. If you would like to sign up for his monthly (it's free), just email: todd@atreausfamily.com.

Excerpt from the Atreaus Monthly

--all text in Times New Roman is Todd--

I'm really confused right now.

When I think about the state of the US economy and its interplay with policy, I can see three options:

1) The Fed lands the ship – CPI comes off on its own, growth stays ok and 3% is indeed the terminal rate. Unicorns are prancing and dancing in the street.
2) CPI does not come off. Terminal rate is much higher than 3%.
3) CPI does come off, 3% (or lower) is terminal rate, but that's because economy falls over.

If I had to assign a probability to each of those outcomes, I'd put them at 5%, 47.5% and 47.5% respectively[1]. When I think about the market outcomes for each, I'd say:

1) Stocks higher, rates slightly lower, USD unsure.
2) Stocks lower, rates higher, USD higher.
3) Stocks lower, rates lower, USD lower.

Thus, if one builds a probability weighted decision tree from the above, the only clear trade is to be short equities.

With that in mind, I took a look at some previous downdrafts in the SP and came up with the following table:

Start	End	Max Drawdown	Length in quarters
Q4 68	Q2 70	36.1%	8
Q1 73	Q4 74	48.2%	8
Q3 76	Q1 78	19.4%	8
Q4 80	Q3 82	27.3%	8
Q3 87	Q4 87	35.9%	2
Q3 00	Q4 02	50.5%	12
Q4 07	Q1 09	57.7%	6
Q1 20	Q3 20	36.0%	3
Q1 22	?	20.8%	2 and counting

Without being too scientific, the above table suggests that to be "typical", the current move lower in stocks has a fair bit further to go, both in magnitude and length of time it takes to fully recover.

[1] *Completely made-up probabilities always look less completely made up when they have a number to the right of the decimal point.*

The other things that jumped out at me was what the two shortest drawdowns had in common – a reversal/aggressive rate cuts by the Fed. If we get that, for whatever reason, buy with both hands.

Three last thoughts on this, quoting from three3 investment legends and someone else I can't remember:

1) Ray Dalio put out a piece on valuation and bubbles the other day. The part of it that really caught my eye was the idea that, post bubble, stocks typically don't go from overvalued to fair and then bounce. They go from overvalued, back to fair, then all the way through to undervalued before basing.
2) Old Soros quote that I want to keep in mind– "there's the low, then there's the test of the low."
3) From the person I can't remember – you don't make market lows when the news is good. You make them when the news is awful and it's all priced.

OK, enough of the negativity. Was talking to a friend who is a private wealth advisor the other day. He has been underweight equities all year, which has saved his clients a ton of money. That's great, but we were chatting about how that's really only half the job. If you are running a real money type strategy, as both of us are, avoiding the drawdown in nice, but you also have to pivot at some point and get long again to catch the up move. As I wrote last month: "I need to have a plan though, as it's not like someone is going to tap me on the shoulder and say "ok, now".

So, what is that plan?

I can think about it along two lines:

1) Macro
2) Valuation

For the first one, the macro factors that would get me long again would be:

1) A pivot from the Fed
2) Some sort of guaranteed confirmation that 3% (or thereabouts) is indeed the terminal rate for this cycle.
3) Inflation much lower
4) Growth lower, which might lead to all of the above. Wouldn't want to be early here though, as think Fed will be slow, so them tightening into the slowdown could be quite ugly first.

For the valuation angle, I'd be looking for the following:

1) Earnings revised down and SP PE multiple of 13-15 ish. There are probably 150,000 equity specialists out there who will be quicker to spot this than me, so I'm not super-confident about this one being much use to me.
2) Potentially more useful, a combination of index level and vol level that make buying longer dated upsides seem attractive. Been watching this pretty closely as feel this might be something that could be attractive at some point. Think some sort of dollar cost averaging here could be the way to implement.

One last little thought on this – the above framework has been referencing the US. It probably applies equally to most of the developed countries in Europe as well as places like Australia and NZ. However, you can think of a few other countries, China and Japan being the most obvious, where something completely different is going on. Thinking about these divergences/differences will hopefully be a good source of opportunities going forward, especially in the FX space.

IMPORTANT POSTSCRIPT – I wrote all of the above on the morning of 24 May. I then spent the next few hours thinking about it and realized there might be an interim step–one where the rate of change of inflation comes off yet growth/ISM/employment etc. doesn't yet suggest a recession is imminent. If we got into this zone, this would mean stocks higher, bonds sideways, and USD sideways as would go up cause of flows and down cause of rates, so net sideways.

Thinking about it more, I think there is a good chance that this is where we might be for the next month or so., hence, in almost complete contradiction of the first two and a half pages of this missive, I got long equities in the real money book. Being long equities here is one of those positions that I really don't believe in, hence I will be running it with a pretty heavy dose of optionality around it. Furthermore, I shall be aggressive in terms of rolling up strikes as and when the market moves higher.

One last final thought–thinking about the three scenarios I outlined 3 pages ago–the market will move to price whichever one is the eventual winner well before it becomes obvious from the data. As much as I think the first option of us all living happily ever after with inflation and rates at 2-3% and the economy still doing fine is very unlikely, if it did end up being true, by the time I realized it was true, equities would be way higher and probably at a level that would be rather hard to buy. Thus, given I am now long, I really want to use options to ratchet up stops rather than picking some level to take things off as, in the off-chance that the unicorns are prancing and dancing, I will still have the position.

OK, Brent here again. I hope you enjoyed Todd's thoughts.

I agree with most of his framework. I will point out that this contradictory approach (bearish bigger picture but tactically long just in case) is not unique to Todd. Most people I know are bearish and very few are short or underweight. Many of the conversations we had in Miami also reflected this duality. Something like: "I think stocks go lower but they've had a big move so I'm flat".

When the market is bearish and flat, I think the risks remain to the downside so my guess is Todd's micro long will end up being a bummer given his higher assigned expected value for eventual macro bear market continuation.

Final thoughts

I try to read as much as possible on both sides of the crypto debate because I honestly believe both sides are valid.

On the crypto skeptic side, two of the best reads are Stephen Diehl and https://web3isgoinggreat.com/. Diehl has escalated his efforts to push back on regulatory capture by Big Crypto lobbyists. Here is his tweet about the effort of a global community of programmers, software experts, and other technologists to address the massive fraud and negative externalities of crypto.

Have a royal day.

good luck ⇅ be nimble

Princess Elizabeth, before she was queen

The Platinum Jubilee is a celebration to mark the 70th anniversary of a monarchy. Today is Queen Elizabeth II's Platinum Jubilee.

These are rare. The only other ones are:

Louis XIV of France (1643-1713), Johann II of Lichtenstein (1858-1928), Bhumibol Adulyadej of Thailand (1946-2016).

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