

am
FX

Brent Donnelly

bdonnelly@spectramarkets.com

(212) 398-6230



Your tattoo is so...
Interesting.

Current Views

**1-month 0.99 EURUSD
digital put at 18%**

Spot ref. 1.0210
Expires August 18
This feels stale, tbh.

Post-mortem

If you have read [Alpha Trader](#), you might remember the story at the very start, which is all about sitting there short USDJPY for days and days because yields are lower... Trying to wait out the inevitable leads and lags before USDJPY finally collapses. In case you have not read it ... Here is the story:

<https://www.spectramarkets.com/flash-crash-madness-in-usdjpg/>

Does that setup sound kind of familiar?

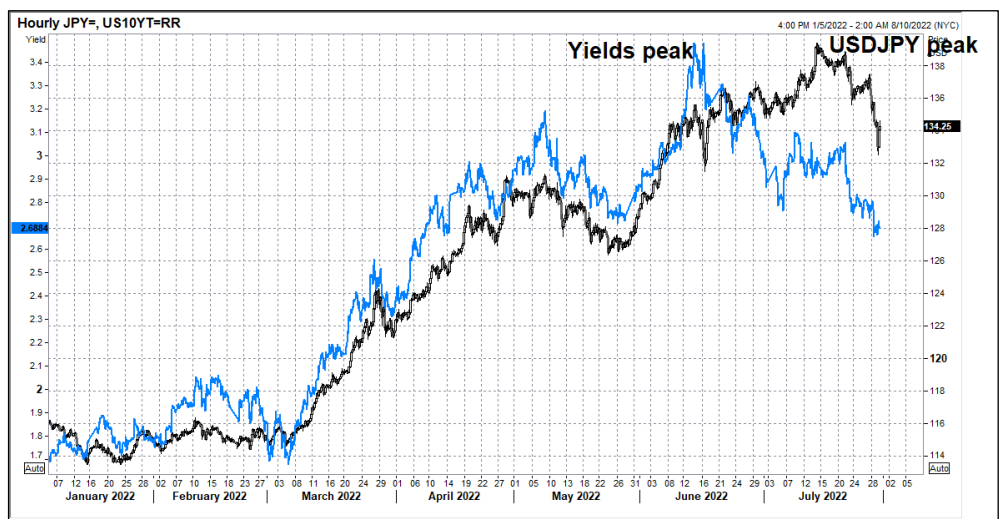
I have been bearish USDJPY and EURJPY since July 6 ([am/FX: JPY Narrative in Flux](#)) but failed to catch the move due to a combination of getting stopped out / bad timing / too early / went on vacation, all of which conspired to ruin the trade for me. The turn in commodities and yields, plus the notable reversal in flow (Japan time zone started selling USDJPY in mid-June, a few weeks before the top) were good lead indicators for USDJPY but it proved difficult to trade because there was one last huge push higher in USDJPY before the turn.

This piece is an ex-post analysis in an attempt to figure out why I wasn't able to make money on what ended up being a textbook lead/lag USDJPY trade. And plenty of Spectra clients *did* make money on it! But not me.

The main reason my normal approach failed was that the setup was more lagged than normal. Yields and oil turned in mid-June, but USDJPY then made a final push from 136 to 139. It turned lower, then made one final short-lived move up on the 20JUL BOJ meeting. That was an excellent example of narrative exhaustion as the BOJ was dovish and kept pushing the "unlimited easing" button, while USDJPY went up for two hours then flopped.

A lot of this piece is hindsight, I acknowledge. That's why I called it "post-mortem."

USDJPY vs. US 10-year yields



The flow story was highly similar. The Tokyo flows have been extremely, extremely positive throughout this terms of trade shock, as you would imagine, and they flipped on the exact same day oil peaked, June 15. Again, USDJPY continued higher, leaving oil behind.

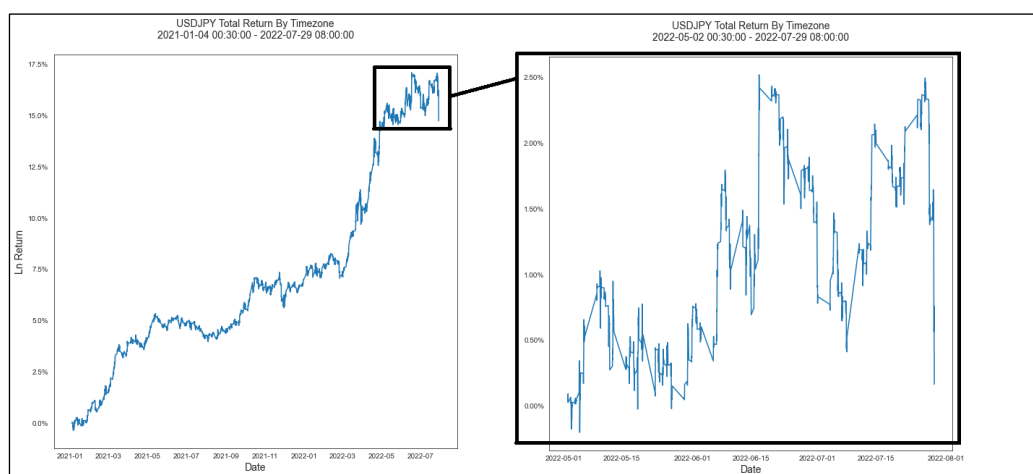
So around mid-June, you had: Peak US rates, peak oil, and peak Japanese USDJPY buying. Then, the death of Abe on July 8 added another layer of intrigue as a scary punctuation mark on the end of Abenomics.

But Kuroda and the JGB trade remained steadfast and the market, still anchored on the old “BOJ powerful easing” story, ignored the new, more important narrative of reduced terms of trade shock pressure, lower US yields, and a flip in the dominant flows.

For your enjoyment, Deepak was kind enough to prepare these charts, which show the cumulative return of USDJPY in Tokyo since January 2021. The flip in flows is notable and I find it intellectually satisfying that they peaked on the same day as oil because this confirms the real-life importance of the price of oil as it influences Japanese importer behavior in real time and that behavior change is clearly visible in the data. We always saw it in the flows at banks too.

USDJPY cumulative performance in Tokyo (6AM to 3PM Tokyo)

Box on left: Since January 2021. Box on right is since May 2022



There are four takeaways:

- The JPY terms of trade story is real. Importers are hedging in real time. That’s why oil and Tokyo flow data peaked the same day.
- That last failed rally in USDJPY after BOJ was a huge tell. I missed it for some reason. Good news / bad price gave a great signal for the end of the old BOJ narrative and the start of the repricing towards fair value implied by oil, yields and flow.
- Lead/lag is hard. I was sniffing out a new narrative, but the market didn’t care what I thought. The market traded the old narrative for another week and a half. If I’m honest, I’m not sure how I could have known this, but the one takeaway is that scaling into 1-month, or 2-month downside would have worked (and that’s what we saw clients doing) while trying to thread the needle in spot did not.
- Using correlation data for relationships like this is pointless. The r-squared of daily USDJPY and 10-year yield changes is 20% or so since the start of 2021. Yet the reliable relationship between USDJPY and yields (with variable leads and lags) remains strongly in force. Yields have been the primary driver of USDJPY since 2006 (with a few notable, temporary regimes where that was not the case). That has not changed. But this is why they call it the art of currency trading. Long and variable lags. With the occasional regime shift.

Any bearish USDJPY trade you put on since July 6 is now in the money, unless you bought short-dated downside or did spot. I did spot. This write-up is more to stir up thoughts. The conclusion is not necessarily that doing USDJPY options is always better than doing spot. The conclusion is just to make sure you are not too early on a narrative flip call because if the market doesn’t agree with your timing, early = wrong.

Looking forward: **The fun part of the short USDJPY trade is nearly over.** Now you need to consider the possibility we hang out 132.00 / 136.00 for a week or two. NFP and CPI coming up soon enough.

Fed

Remember that this loosening in financial conditions will continue only as long as the data cooperates. The data might cooperate, and it might not. My only point is that the Fed vibes are meaningless if the data don't oblige.

It's easy to confuse a dovish market reaction to a Fed meeting with a dovish Fed. I'm going to try to keep as open a mind as possible as the Fed thinks they are at, or close to neutral and it kind of feels like anything can happen. I would still bet against cuts in H1 2023, but maybe the CPI fixings market is smarter than me.

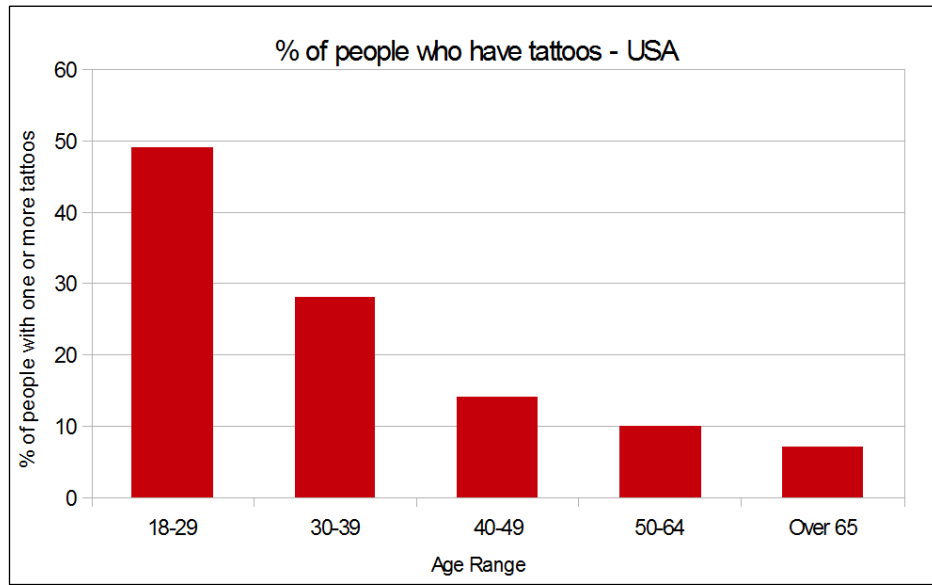
Final Thought

A good friend of mine sent me a video of himself and his wife accompanying their 20-year-old daughter to get her first tattoo. Parenting has changed!

If you are 40+ reading this: Imagine your parents taking you to get your first tattoo. LOL. Hard to visualize!

Have an inked day.

good luck ↑↓ be nimble



Source: 2016 Harris Poll

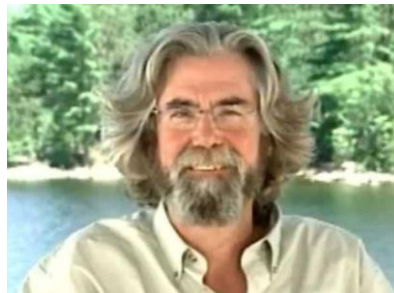
And speaking of altering your appearance... **Anyone seen Fred Goodwin lately???**

No haircut since February 2020:



Source: Fred's phone

Almost reminds me of McCulley at Camp Kotok...



[Click here to subscribe to am/FX](#)

Markets and Trading Commentary Disclaimer

This material has been provided by Spectra Markets, LLC (“Spectra Markets”). This material is confidential and therefore intended for your sole use. You may not reproduce, distribute, or transmit this material or any portion thereof to anyone without prior written permission from Spectra Markets.

This material is solely for informational and discussion purposes only. Spectra Markets is not a registered investment advisor or commodity trading advisor. This material should not be viewed as a current or past recommendation or an offer to sell or the solicitation to enter into a particular position or adopt a particular investment strategy. Spectra Markets does not provide, and has not provided, any investment advice or personal recommendation to you in relation to any transaction described in this material. Accordingly, Spectra Markets is under no obligation to, and shall not, determine the suitability for you of any transaction described in this material.

To be clear: Your individual circumstances have not been assessed. You must determine, on your own behalf or through independent professional advice, the merits, terms, conditions, risks, and consequences of any transactions described in this material. Securities described in this material may not be eligible for sale in all jurisdictions or to certain categories of investors. This material may also contain information regarding derivatives and other complex financial products. Do not invest in such products unless you fully understand and are willing to assume the risks associated with such products. Neither Spectra Markets nor any of its directors, officers, employees, representatives, or agents, accept any liability whatsoever for any direct, indirect, or consequential losses (in contract, tort or otherwise) arising from the use of this material or reliance on information contained herein, to the fullest extent allowed by law.

The opinions expressed in this material represent the current, good faith views of the author at the time of publication. Any information contained in this material is not and should not be regarded as investment research or derivatives research as determined by the U.S. Securities and Exchange Commission (“SEC”), the U.S. Commodity Futures Trading Commission (“CFTC”), the Financial Industry Regulatory Authority (“FINRA”), the National Futures Association (“NFA”) or any other relevant regulatory body. The author is currently employed at a trading desk. The opinions may not be objective or independent of the interests of the author. Additionally, the author may have consulted with various trading desks while preparing this material and a trading desk may have accumulated positions in the financial instruments or related derivatives products that are the subject of this material.

Spectra Markets does not guarantee the accuracy, adequacy or completeness of the information presented in this material. Past performance and simulation data do not necessarily indicate future performance. Predictions, opinions, and other information contained in this material are subject to change continually and without notice of any kind and may no longer be true after the date indicated. Any forward-looking statements speak only as of the date they are made, and Spectra Markets assumes no duty to and does not undertake to update forward-looking statements. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual results could differ materially from those anticipated in forward-looking statements. The value of any investment may also fluctuate as a result of market changes.

Spectra Markets is affiliated with Spectra FX Solutions LLC, an introducing broker that is registered with the NFA; Spectra FX Solutions LLP, which is a registered entity with the U.K.’s Financial Conduct Authority; and SpectrAxe, LLC, a swap execution facility that is currently in the process of registering with the CFTC. The disclosures for Spectra FX Solutions LLC and Spectra FX Solutions LLP related to the separate businesses of Spectra FX can be found at <http://www.spectrafx.com/>.