SPECTRA MARKETS

Tuesday, July 26, 2022

amFX

Brent Donnelly

bdonnelly@spectramarkets.com

(212) 398-6230

Can you guess what % of workers have returned to the office relative to 2019?

Answer in today's non-sequitur

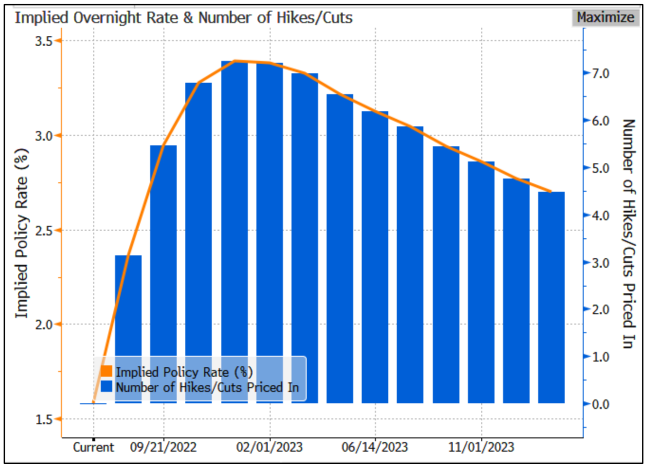
Current Views

1-month 0.99 EURUSD digital put at 18%
Spot ref. 1.0210
Expires August 18

Too early for cuts

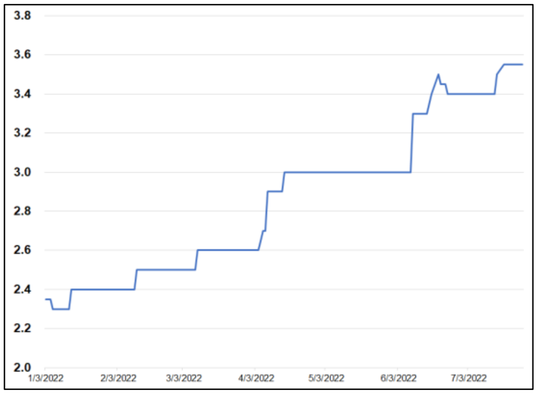
The main pushback I got on my hawkish Fed view is that there is so much priced in for the next two meetings it would be hard for the Fed to exceed it or sound hawkish. With 75bps priced in July and 50bps in September, how much more hawkish can they be? Thing is, I agree. On that part of the curve, it would be hard for the Fed to outhawk.

The way the Fed can sound hawkish is by gradually failing to ratify expectations for rate cuts in March 2023. I find it hard to imagine a durable drop in inflation happening that fast given the laggy nature of the data. And I think the political priority of inflation over jobs will remain long after the inflationary threat has begun to subside. Here's the current implied trajectory of Fed funds. The peak at the end of 2022 seems reasonable, but I really can't see the cuts happening as soon as March 2023. Almost a full cut is priced by May 2023, which again I feel is highly unlikely. So that's the point on the curve that can gradually change as the Fed maintains one compass (inflation) and CPI comes down but bottoms way above 3%.



Powell's "clear and convincing evidence that inflation is coming down" condition will be met and that should lead to a slower pace of hikes or even a pause by the end of the year. But cuts just seem very difficult as inflation will still be well above target. Here is the evolution of economist estimates for 2023 inflation right now.

Median economist forecast for 2023 US CPI



Obviously, those forecasts could be wrong, but I find it intriguing that the same aggregate set of human beings predicting 3.5% average inflation for the entirety of 2023 is predicting Fed rate cuts in Q1 or Q2 2023. It feels dissonant. Especially because if you laid out the probable MoM numbers to get to a 3.5% figure in 2023, the Q1 numbers would almost certainly be higher than the Q2 Q3 or Q4 figures. The Fed does not need to explicitly push back on cuts to move that pricing, all they have to do is stay laser-focused on inflation in their commentary and make minimal verbal concessions to the collapsing growth outlook.

EURUSD

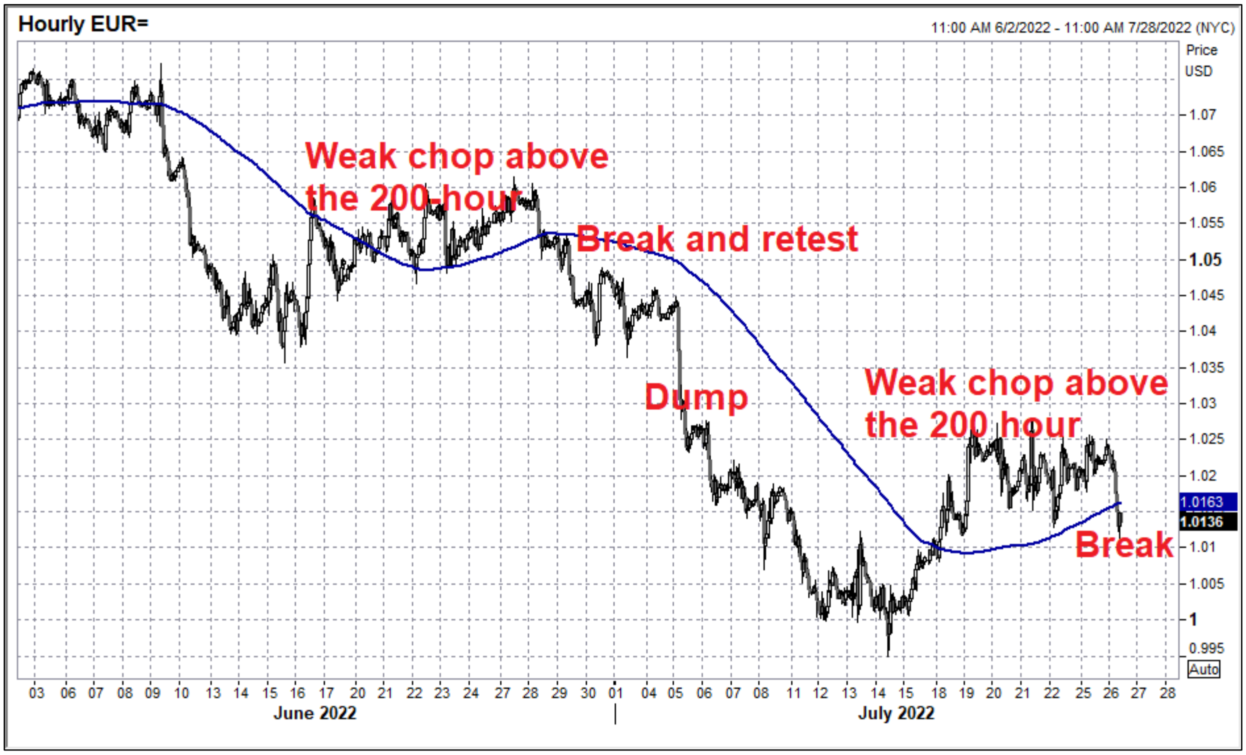
French benchmark power at all-time highs, EURUSD back below the 200hour, EURCHF new lows... The ECB has put in the top with its 50bp hike as positioning has cleaned up somewhat off the 0.9950 lows and terms-of-trade / energy pressure is the story that never goes away for more than a day or two. ECB hiking into weakness and EURUSD lower is reminiscent of the June ECB and of the failed ECB hikes in 2011.

Not much in the way of EURUSD options expiries down here (the first relevant downside strike is 1B of a 1.00 expiring tomorrow) … and tomorrow is corporate month end (bullish USD). There is extra attention on corporate FX earnings impacts with MSFT earnings coming out today (more than 50% of their revenue coming from outside the US.)

Short-term 1.0120 is a decent support EURUSD so let's see how it trades there but I would rather be short EUR with a stop above 1.0210 going into Fed and corporate month end. Crypto trades pretty weak too, despite some ETH Merge hype, so that's another small lead indicator for USD strength.

In June, EURUSD bounced and did some weak chop above the 200-hour before breaking it cleanly, retesting it and then dumping hard. We just saw a similar pattern with weak chop above the 200-hour and now a break. Let's see if it can stay below that level today (the 200-hour is currently 1.0163).

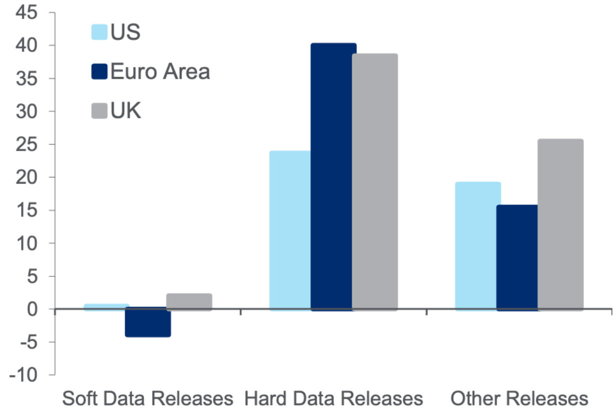
EURUSD hourly since the start of June (with 200-hour in blue)



Soft vs. hard

I wrote about the soft vs. hard data divergence late last week. The main reason soft data leads hard is that it is collected and collated more quickly and released faster. This chart is from 2017 but is 100% still applicable today. It shows that hard data comes out about 20 to 40 days after the soft data, depending on the country.

Figure 14: Weighted Average Release Delay Relative to End of Reference Period (Days)



Source: Citi and Bloomberg; Jan00 – Jul17

This is a wonkier piece on the same topic (ECB, 2007).

Final Thoughts

One of my favorite reads at the intersection of capitalism and politics is the quarterly slide deck published by Bruce Mehlman. The Q3 deck came out last night and you can view it here:

http://mehlmancastagnetti.com/wp-content/uploads/BACKLASH-Mehlman-2022-Q3.pdf

Have a counter-revolutionary day.

good luck ⇅ be nimble

https://www.kastle.com/safety-wellness/getting-america-back-to-work-recreation-vs-office-occupancy/

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/.