The Good, The Bad, and The GoodBad

We just saw another session of overnight volatility where the 30-year Gilt moved 50 bps (in the "right" direction this time).

The markets moved at least twice overnight in response to "**intervention**" news.

- **Gilts bounced on news from the BOE that they will buy as many long-dated bonds as needed to calm the market**. There are varying degrees of central bank autonomy and my understanding is that the BOE has more political hoops to jump through than the Fed. **Maybe that is why we got QE rather than an emergency 100 bp hike?** Just Monday, the market was hoping for an emergency hike, only to be disappointed. Now we are back to easier money rather than tighter money, yet it is helping. **Hence the term GoodBad.**
- Markets did not like it when the White House National Economic Council Director Brian Deese said that he **didn't expect another Plaza Accord to globally control the dollar's strength**. There has been a lot more chatter about this as DXY (a dollar index) is 27% above its levels from the summer of 2021 (in an almost straight line) and it is 11% higher than at any point in the last 20 years! With the UK resorting to QE (to fix a mess where they certainly added fuel to their own fire), Japan fighting Yen speculators (more or less successfully, so far), and other countries eyeing their currencies nervously, I expect more chatter about some sort of globally coordinated effort. For now, it looks like that won't be discussed domestically until after the election. **The strong dollar helps with inflation (cheaper imports) and it would help exports if global trade was robust (it isn't), BUT it will hurt corporate earnings over time**. Once again, the term GoodBad comes to mind.

What To Expect in Terms of News Flow

In a world where Russia could easily decide to escalate (the alleged Nord Stream sabotage is a possible example – please see our geopolitical webinar replay from yesterday) and where the UK launches a surprise budget, it is difficult to anticipate specific news, but we can prepare for how to define and react to various types of news.

- **Good News**. There can be actual, honest to goodness, good news. We could see central banks begin to work together to address some of the FX volatility (from Brexit to Covid, coordination has been rewarded by markets). There are any number of things that we could see as good news, which is truly good.
- **Bad News**. This too is reasonably obvious. Apple announcing that they won't proceed with an iPhone 14 production boost is not good. **I expect bad news headlines to heavily outweigh good news in the coming days and weeks**.
- **The Good News that is actually Bad News**. This to me is more difficult to define, so I will call it GoodBad for now. **Home prices are just one example.** The FHFA House Price Index and the S&P CoreLogic 20-City Index both showed a home price decline in July (I can only imagine what August will look like when it is released). **If you want a short-term signal that inflation is coming down, this is one, but what are the longer-term ramifications?** Commodity prices coming down are still viewed as positive (less inflation), but Oil vs the S&P Since 1999 shows that lower oil prices, in particular, don't bode well for stocks over time. News that may be perceived as "good"

originally (but is ultimately deemed "bad") is difficult to trade. Trying to time when and where shifts in interpreting data as "good or bad" for markets is difficult.

- **The Same News - Traded Again, and Again.** It seems odd that hawkish Fed comments can move markets this week. The ones that I've heard mostly just reinforce the well-coordinated message from last week (not surprising given how well-coordinated it was and that barely any time has passed). Yet, markets still seem "surprised" (though it is difficult to tell whether the weak auctions and the garbage fire in the Gilt market had more to do with Treasury yields than Fed speak). Everyone is expecting earnings guidance to drop (quite literally everyone). Yet, will we take prices even lower based on things that we already know? Seems like the answer is yes, even if that doesn't make a lot of sense.

Bottom Line

Contrarian signals abound. Contrarian signals like the CNN Fear & Greed Index, put option activity, and RSIs on major indices like the Nasdaq 100 are plentiful. The largely "failed" attempt at "Turnaround Tuesday" launched another wave of bearishness. **Betting on the contrarian signals fits the GoodBad narrative and I like it, but it is very precarious** (though it always is, otherwise this business would be easy). TQQQ, ARKK, and even QQQ had inflows yesterday, while SQQQ had large outflows, which indicates that buying the dip isn't dead (hardly contrarian).

Friday's PCE data seems like the big "expected" news flow this week barring any surprises in the GDP revisions or a Fed speaker slipping up and getting off message. Since CPI disappointed (higher than expected), could PCE surprise the other way? However, it seems like it would take a much higher than expected PCE print to move markets significantly (higher yields and lower stock prices), given how much is already priced in. **I do like that more and more people are pointing to the backward-looking nature of much of the data that the Fed seems to be relying on.**

Credit is orderly but heavy. We are seeing credit spreads widen, with Europe and CDS leading the way. So far, the ETFs are trading close to NAV, which was not the case in the aftermath of the Covid shutdown. Having said that, I am starting to get the feeling that the worst thing that can happen to a bond you own is to see it trade because that TRACE print is unlikely to be anywhere close to where it is marked. Lots of contrarian signals are being sent in credit and I particularly like the resilience of the ETF discount/premium, but I need to see sovereign debt volatility drop across the globe. **For now, at least in IG, this is a rates and market liquidity issue, not a credit issue, but if the bad data mounts, credit could become a concern.**

Real Bottom Line

My view remains that:

- **Central banks have tightened too rapidly and have already set in motion a series of problems for markets that will result in a recession even if policy is changed today!**
- A soft landing would be shocking at this stage. The question now is how hard and how soon that landing will be (it also concerns me that many companies are too blasé about this). Many economists seem to be bringing their recession expectations more in line with ours, but there is still a significant gap.

- The current levels of FX and sovereign debt volatility, which were not part of our bearish economic thesis, only serve to enhance the hard landing case. This level of volatility forces investors and companies to change behavior, reactively, which is rarely positive.
- The problem is that there seems likely to be a window where we get GoodBad news (news that is bad but sparks a strong risk rally). That rally will be aided and abetted by positioning.
- **Bitcoin** will face ongoing pressure and that will have a far bigger impact on the broader economy than most people give the crypto industry credit for.
- **The absolute lows of this bear market will be in a full-on risk off trade** (stocks sliding rapidly while investors scramble for safety). That is not what this current sell-off is. This sell-off could mutate into that, where one day the market wakes up and realizes that we are getting bad news and that is actually bad, but most of my scenarios now would take us through a GoodBad phase first.
- **Jobs.** If there is one thing that virtually everyone seems comfortable with, it is that the jobs data will remain strong for now. Wage inflation remains a topic of conversation, though many of the deals being negotiated now have been in the works for months and may not send a very good signal for the future.

Remain small and use options judiciously. Hopefully, you are not in the awkward position of believing that we haven't yet seen the lows for the year, but want to position for a bounce in both stocks and bonds (it is gut wrenching and looks wrong this morning). "Turnaround Tuesday" would have been too easy, especially as it started with such a bang. Maybe we can reverse that pattern of strong openings followed by weak closes.

Just to highlight my own wishy-washyness, I had a Bottom Line and a "Real" Bottom Line, and I believe in the GoodBad scenario while hating the concept of it.

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