

## 999 Luftballons

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I could have gone with 99 Luftballons, but since inflation is the hottest topic coming into CPI, 999 Luftballons felt more appropriate.

I could have gone with Red Balloons rather than Luftballons, but the original German lyrics tell a different and much clearer story than the lyrics that were created for the English version.

Heck, I could have even gone with 1 Chinese Balloon, but that probably isn't enough (as the U.S. has since shot down two unidentified objects, in addition to the balloon). Academy's Geopolitical Intelligence Group had a busy week:

- Saturday evening, we published [U.S. Shoots Down 2 Unidentified Objects](#).
- We addressed [Chinese Surveillance in the U.S.](#)
- [Shooting Down the Balloon](#).
- Provided some analysis and refutation of a [Nord Stream Explosion](#) report that has garnered some attention.

### This is it Boys, This is War

I found this to be one of the "catchier" lines in 99 Red Balloons. It is easy to imagine back in 1983 a bunch of men (and it would have been mostly men back then) huddled around a table in a smoke filled room deciding to attack something. Toss in a Captain Kirk reference (who is Canadian) and you are all set to hit the proverbial "button".

**Fortunately, that is not how it works!** I've spent almost 6 years working with our Geopolitical Intelligence Group and many other veterans and most (if not all) view war as a last resort. They know the risks and devastation that war causes and are not looking for "kinetic" action. Yes, they want to be as prepared as possible (with the best training and equipment) so that if war occurs we can achieve our objectives with minimal loss of life. This is far different from wanting or encouraging war, **so the song got that part wrong.**

### Unintended Consequences

However, the German version did get one part right.

The GIG (and veterans I work with) always talk about the risk of unintended consequences. An example of this would be a mistake (anywhere along the chain of command) that results in loss of life and/or escalation.

The German version of the song addresses 99 balloons floating to the horizon. Then one country's military sent planes to intercept these balloons (thinking, ironically given what is going on in the world this weekend, that they were UFOs). This attack effectively spooked their neighbors, who then also shot at the 99 balloons, which then led to war.

Definitely far-fetched, but there are many tense situations across the globe that do have the risk of sparking into something more significant. Academy's GIG discusses these situations in many of our meetings as corporations and asset managers assess potential "unlikely, but possible" risks:

- **Russia and the nuclear threat.** It doesn't come up as frequently, but it remains a risk.
  - Does **Ukraine** do something that triggers an even more aggressive response from

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Russia? As Ukraine's capabilities improve, do they change Russian behavior?

- As **the West** provides more and more equipment, training, and expertise, do we trigger a new response from Russia?
- **Does Russia accidentally (or on purpose) trigger an Article 5 response from NATO?** Remember when missile fragments killed civilians on Polish soil? That turned out not to be what was first reported, but this remains a risk.
- **China and Taiwan.** The moments around China's increased military exercises after Speaker Pelosi's trip to Taiwan was fraught with risk. That risk has diminished (along with Chinese and Taiwanese activity), but it could increase at any moment.
- **Iran.** Iran building a **nuclear** weapon is an existential threat to **Israel** and even **Saudi Arabia**. Since little seems to be getting done to prevent Iran from developing nuclear weapons, does some country (or group of countries) take preemptive action? While Russian nukes come up frequently and early in discussions, this topic is often more of an "afterthought" and I am increasingly concerned that is a mistake.
- **North Korea.** It is difficult to shake the image of some "crazy uncle" sitting in some technology deprived/backwoods country with nuclear weapons (and missiles). To make matters worse, he tests them when he feels that the world isn't paying enough attention to him. What could go wrong?

Not sure there is anything to act on immediately, but ever since Putin invaded Ukraine we have had to deal with "Bad People Behaving Truly Badly" and that seems to be a risk that is increasing, rather than decreasing.

## Inflation

Today is the actual Super Bowl. However, Tuesday will be yet another "super bowl" for the markets as CPI will be released. Yes, NFP was also a "super bowl" as was Powell's speech, the FOMC decision, and so on and so forth.

**CPI, in the end, will just be a number and moments after it is released, the market will need to start focusing on the next number** (knowing that [Zero Days to Expiration Options \(ODTE\)](#) will make the gyrations ahead of and after the number even greater than they would have been a year or so ago). I really do recommend reading last weekend's report. We've had a lot of feedback on the report and ODTE is not only attracting attention from traders and asset managers, but also from regulators and policy makers.

Regarding CPI, Powell has finally decided that disinflation is as risky as a resurgence in inflation ([Why Am I Fighting the Fed, When I Agree with Powell](#)).

But since the FOMC meeting on February 1<sup>st</sup>:

- WIRP has shot up from sub 4.9% in June to almost 5.2% in July.
- The 10-year yield has shot up from 3.42% to 3.74% (and 2s vs 10s has inverted more).
- The S&P 500 is right between where it was pre-FOMC on the 31<sup>st</sup> and where it closed on the 1<sup>st</sup>. The Nasdaq 100 is closer to the post FOMC closing level but is 500 points lower than where it wound up on Thursday the 2<sup>nd</sup> (a day that opened many peoples' eyes to ODTE).

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The reasons for inflation fears increasing are real:

- Jobs data (even trying to account for a bunch of year-end revisions) was strong.
- The BLS changed how CPI is calculated. They changed some weightings which had the effect of showing that less progress was made on inflation than previously thought.
- The consumer seems to keep spending (even if more of that is going on plastic and draining savings).
- The “soft landing” or even “no landing” narrative is getting incredible amounts of airtime!
- Oil and gas had big weeks, but last week “Dr. Copper” actually fell. Seeing oil prices go higher always gets the inflation juices flowing (even if it has little to do with Core CPI and is largely ignored, at least over short periods of time, by the Fed).

Could we see a higher than expected CPI print on Tuesday? Yes. We are on the path to get negative prints in Q1 and Q2, but need to respect the data as it comes in and some of the positive data may be more than just a “snapshot” effect. However, I continue to believe that collectively we are being far too complacent about the direction of markets and the economy.

**Sometime soon, the weakness the real world saw in housing late last summer and into the fall will start showing up in the CPI data.** Remember, three of the highest monthly prints on rent were in the last 5 months, which just doesn’t seem sensical or believable.

**Bottom Line**

**Risk markets remain positioned bullish** (though not as bullish as at the start of last week) and remain **susceptible to disappointment**. Treasury yields, on the other hand, have moved to the high end of my ranges.

**I’m slightly bearish risk assets** (stocks and credit spreads). Price action has been abysmal (no idea why we had some of the reversals we’ve had) and there is little the Fed can say or do to help markets that hasn’t already been said or done.

I continue to watch the **MOSO page on Bloomberg** (most active options) and will get bullish when VIX calls/SPY puts stop dominating the daily flows. When SPY calls (along with TSLA and ARKK calls) were dominating flows, we had the short squeezes. That just isn’t working and if anything, it looks like baskets of “most shorted” stocks led the way lower, which only helps those “laddering” into put spreads.

I like rates and would start nibbling here. **As an issuer I’d probably hold off and see if all-in rates can come back down a little.**

**I want to be prepared to buy stocks and bonds on any lower than “whisper” (or expected) CPI print.** I see the reasons why we are starting to price in a higher print, and agree with many of those reasons. But I do think that **OER is going to be disinflation’s friend.**

**In any case, the volatility (not just day to day, but also intraday) means keeping positions relatively small and nimble.**

Good luck if your team is in the Super Bowl! For me, at least this year, the Bills can’t lose in the Super Bowl!

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