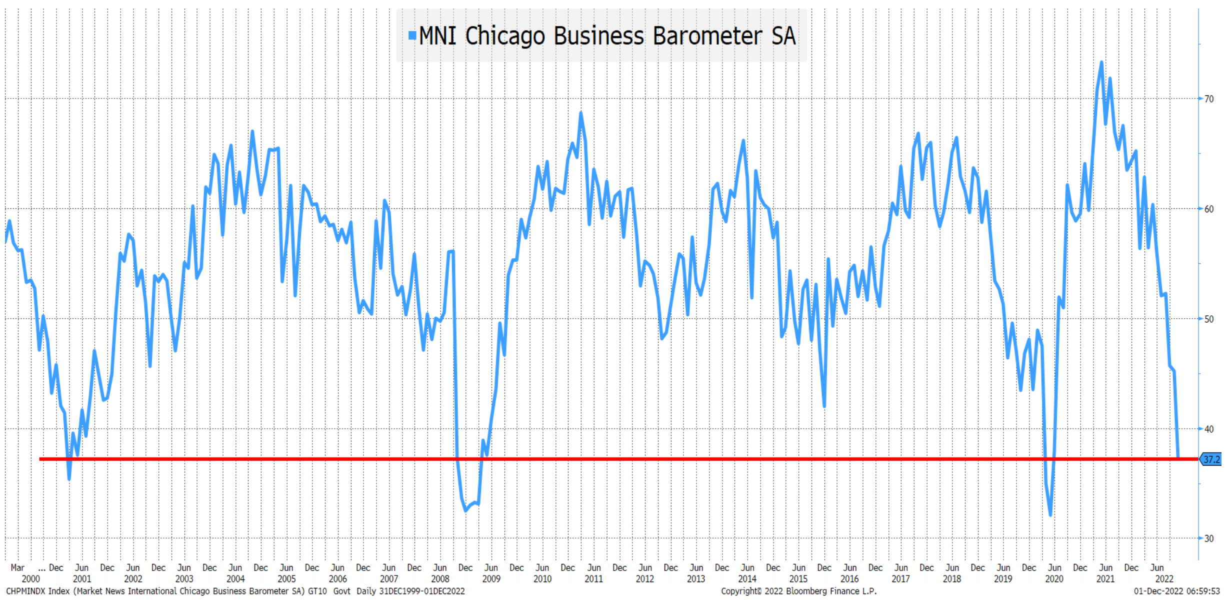
Doesn't Goldilocks Get Eaten in the End?

Yesterday was a great "everything" rally day! The market "finally" or "once again" got to price in a "soft landing." It is possible that Goldilocks survives in the end, but growing up with Slavic folk tales, the endings rarely seemed to be "Hallmark" endings.

It started with a deluge of data.

- **ADP** jobs were weak, but no one understands how their new methodology works.
- The price and **inflation components of GDP** came in higher than expected, but not by much.
- **JOLTS** report showed that job openings were down ,but were better than expected (and still much higher than I find believable).
- **Chicago PMI was "Showgirls" bad!** Maybe it is "specific" to the Chicago area, but this number stuck out like a sore thumb.



The data was only worse than this during the Covid lockdown, in the aftermath of Lehman, and at the height of the dotcom bubble bursting (which saw some fraud at massive IG companies). We will come back to this!

All that really mattered was Powell.

- Powell confirmed what we and many other have been saying for some time: the pace of hikes has to slow! In addition, the risk of overtightening is real (we think that they already have overtightened, but that's another story).
- His words helped:
  - **Lowered the terminal rate to 4.9%** according to Bloomberg WIRP. Still a touch too high as discussed in last weekend's Positioning & Key Drivers.
  - **Sent the 2-year Treasury from 4.55% to a low of 4.31%.** The entire yield curve moved, and we had some serious bull steepening (or less inversion). There should be more steepening to come!

- **The S&P 500 was up 3%**, the Nasdaq was up 4.5%, and the beleaguered ARKK ETF was up 7.7%.
- **DXY** (a dollar index) had a weak day, which continued overnight and is now the lowest it has been since August and could break through to levels not seen since June!
- **Even crypto participated** (though the rally started overnight). More on this another time as it is a sideshow for the moment.

We are also getting signs that China, while not "technically" submitting to the protestors, is starting to submit to the protestors. There are hints that China's "official" policy is reflecting the changes in how COVID is affecting people, which would support a decision to ease restrictions.

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Back to the main theme of today's quick report.

We have been looking for lower yields and an admission by the Fed that they have potentially gone too far, too fast. We got that. But what is next?

- If for no other reason than we got an almost 5% rally in the Nasdaq, look for some **Fed speakers to try to talk markets down**. It won't be horribly effective, but it won't stop them from trying.
- **What if the PMI is a sign of things to come?** What if, far from being an outlier, this is indicative of the direction that the economy is headed? I remain staunchly in the camp that the recession is coming sooner and will be deeper than consensus. It will be driven by losses in **higher paying jobs, the wealth effect, and the inventory overhang!**
- **NFP** should now be set up for a "**bad news is bad**" trade.
- Don't underestimate the power of **daily and weekly expiration options** driving markets far more than they should be on days like yesterday. Considering options expiration on Friday, it is anyone's guess on which way traders will decide to try to drive the market, but after yesterday's big move (where we started with relatively "neutral" positioning) trading to the downside on any catalyst seems easier than driving it much higher. But in any case, this trading pattern has introduced a new randomness to the size of the moves.
- **The quiet grind of QT continues.** Liquidity (slowly but steadily) is leaving the system. Far less dramatically than how QE inserted the liquidity, but a headwind nonetheless.

Bottom Line

Small fade on the rates move. Generally, front end yields are still too high, and we should see steepening (less inversion).

Larger fade on the equity side. A **China reopening** would be a wildcard, but realistically the timing for this would be in the spring and we have plenty of issues to deal with before then.

It is encouraging that the Fed is finally on the "nearly done hiking" page, but once that gets fully priced in (and it may already be), we can then move to the "done too much hiking already" phase, which won't be pretty for risk assets. There was a time (in a galaxy far, far away) where "risk-off" was a thing and stocks did poorly as yields went lower.

The market is in the "just right" stage of the 3 bears story, but I don't think that is how the story ends!

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