

Land Wars in Asia, Opening Two Fronts, & Fighting Consensus in August

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There are a few things that I knew about the military before I joined Academy Securities:

- **Never fight a land war in Asia.** Whether it was Montgomery, Eisenhower, or MacArthur who said it first, it was made famous by *The Princess Bride*.
- **Don't fight a war on two fronts.** While this seems relatively obvious (unless you have overwhelming equipment, troops, morale, and logistics), the blunder has been made repeatedly.

While having nothing to do with war, I've found that over time (as a contrarian):

- **Don't fight consensus in December and August.** Of the two, December is the most obvious to me. Whatever you think about the consensus always being wrong, consensus seems to be able to handle December remarkably well. August comes in a close second. There are plenty of reasons why this could be true (senior decision makers on vacation being high on the list) and I am reluctant to fight consensus in August.

We will explore this topic (briefly), but if it isn't your cup of tea or if you want to really focus on the current geopolitical landscape, please read this month's [Around the World](#) where the Geopolitical Intelligence Group provides their latest insights on:

- **Russia and Ukraine.**
- **Taiwan** presidential candidate's trip to the U.S.
- Heightening tensions with **North Korea.**
- Sending forces to the Gulf to deter **Iran.**

Fighting Consensus

Academy had a busy media week where we got to discuss our market outlook for the coming weeks.

On [Bloomberg TV](#) they distilled our view to the simple headline – **Commercial Real Estate to Squeeze Higher**. The [full interview](#) starts at the 7:40 mark and talks about credit and central banks in addition to our broader market outlook.

Our view that high yield will continue to surprise to the upside was articulated in this [piece](#). On this topic we have been fighting consensus because too many people are bearish. Also, we try to point out how **expensive it is to short credit**. We almost dragged out some examples showing how easy it is to conflate charts that show credit spreads widening and making money by being short. The historical spread charts tend to make it look easier to make money being short credit than it really is. Of note, the cost of carry, rolling down the curve, etc. are all "kind of" boring, but real when trying to time "credit crashes". The BBB tranches of ABX CDS Indices were an incredibly unique opportunity (small spreads and 0 recoveries when they went).

This [article](#) captured some of the "don't fight consensus" view that we currently have. It highlights both the enthusiasm and many of the risks/dangers facing the market. I wholeheartedly agree with the risks (especially with jobs at the forefront), but I'm not willing to fight it for now. Basically, the views put forth in [Ch-ch-ch-ch-Changes](#) seem even more relevant today than they did last weekend (when I also thought that they were quite relevant).

This brings me to another central theme.

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Central Banks are Truly Data Dependent

We wrote [Central Banks Taking a Backseat](#) on Thursday morning and [thestreet.com](#) picked up on it. It is something that we repeated in other reports, but the main theme is:

- **Central Banks are TRULY DATA DEPENDENT at the moment.**
 - Not “data dependent” in a way that really means that “any sniff of strong data and we will hike”, but truly data dependent.
 - **They will be weighing all sorts of data.** From jobs, to inflation, to retail sales, to housing, to bank lending, to financial conditions, and measuring them all against each other. It will take real strength or extreme weakness across a variety of data for the Fed (or ECB) to act. No single data point means that much right now.
 - **They will be looking for trends.** One exceptionally high print (or low print) will be largely ignored. They want to think about where the data is heading. They might even, at least in private, use the word “anomaly” in regard to individual data releases. That is very different than their view over the past year where anything hinting at inflation was taken as “gospel truth” (while deflationary indicators could be ignored).
 - They have a **high hurdle to hike and an incredibly high hurdle to cut** in the coming months. That should reduce volatility in the rates market, which is supportive for risk assets.

The BOJ almost upset the apple cart as we got to discuss on [Asia Daybreak](#) (12:35 mark) on Thursday evening. Thursday’s sell-off seemed overdone as chatter circulated that the Bank of Japan would ease back on bond purchases and target higher yields across the curve. Yes, higher Japanese bond yields should put pressure on global bond yields (some Japanese buyers who bought foreign denominated bonds and hedged out the FX risk will just buy yen denominated bonds, but that seems like a relatively minor change in the grand scheme of things). If anything, Thursday’s sell-off gave bears a chance to reset shorts, which if I’m correct, will help fuel the next legs of this rally.

Bottom Line

I cannot say that I like valuations, that consensus hasn’t turned bullish, or that recession risks are being too readily dismissed. However, I can say that right now doesn’t seem to be the time to fight it.

Market resiliency will force the last bits of money on the sidelines into the markets (and I think that many will chase the laggards more than the [Magnificent Seven](#)).

Look for **rates** volatility to decline and 2s vs 10s to become less inverted (mostly through 2-years rallying).

Credit should grind tighter. I want out of that trade. It has been a good one, but I think that August could see another leg tighter given a lack of supply, too many bears, and lower volatility across asset classes.

Sticking with long the laggards and a marginally overall bullish bias on **equities**.

Stay cool, hydrate, and wear sunscreen ([a fun graduation speech/song](#)).

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