## The Academy T-Report: VUCA Squared

Academy just finished its second annual Geopolitical Summit in Annapolis this weekend. The summit included an array of impressive attendees, multiple retired Generals and Admirals, and a few distinguished guest speakers. The event was a rousing success and one of our Generals summed up the geopolitical environment best by commenting that:

> **We live in a world where VUCA has risen to the n$^{th}$ degree!**

This theme fit in well with our moderator's opening remarks that are summarized below:

> **Normally, I find talking to the GIG comforting as the "inside scoop" seems more manageable than the world presented in the headline news, but lately, that has not been the case.**

The summit was done under Chatham House Rules, so those are the only references that I will use, other than a closing comment that we could have renamed the event the "**Supply Chain Summit**" as issues surrounding supply chains came up repeatedly during the panel discussions.

## VUCA – Volatility, Uncertainty, Complexity, and Ambiguity

Given what we are experiencing geopolitically and in the markets, we are living through VUCA, or VUCA$^2$, or even VUCA to the n$^{th}$ degree!

There is no shortage of any of these factors in our daily lives.

Due to our team being scattered across the country today, this T-Report will be mercifully short and we will follow up with a detailed report at the start of the week (especially on the markets and inflation front). But in the meantime, let's point out a couple of elements that are key for the coming week:

- **China**. To some degree, we expected (and received) some clarity at the end of the Party Congress, but watching former President Hu Jintao being awkwardly removed from his seat is disturbing at best. I fully expect Xi to continue to Recentralize China (August 2021) and for China to continue to Separate from the West (February 2022). These reports have aged well and **China currently remains un-investible** from my perspective.
- **Markets started to Climb the Wall of Worry.** Equities surged, especially into the close on Friday. The 2-year yield finished down on the week, though not before we had what was potentially a crescendo of selling. The 10-year closed the week near Thursday's high yields, but was well off the highest yields it saw earlier that day. The Japanese Yen had a stunning 3.75% reversal from 152 to as strong as 146.2. **FX is an increasingly important subject** in its own right, which we will address in more detail in the coming days. It may be a stretch to say that **FX is entering the realm of geopolitics**, but it may not be. Much of the recent U.S. Treasury and investment grade bond market weakness may be traced to the rapidly rising costs of hedging FX exposure.
- **The Fed.** As the Fed prepared to enter into the **quiet period,** markets rallied as the last messages sent out directly (and via their favorite media outlets) hinted that the December and February hikes are far from being determined. The fact that the Fed meetings have taken on the aura of a papal conclave is disturbing. However, as we now get to digest data without the Fed's constant hawkishness, markets may see how quickly many leading indicators are rolling over and finally

agree with my view that the Fed needs to pause because they have already set in motion a chain reaction that is driving us towards a deeper and longer recession than we want.

- **Will the Treasury announce purchases of off-the-run bonds?** That would help address several issues including a lack of liquidity, the fact that the Fed's balance sheet is now a cost center rather than a profit center, and the absorption of foreign selling of old bonds.
- **Inflation and the economy.** If you don't believe that an economy like ours can experience stagflation for an extended period of time (QT vs Stagflation), then you expect that economic weakness will coincide with lower prices. **The list of leading indicators that are rolling over is extensive and getting longer by the day.** I expect to be able to prove that when inflation is calculated in a way that we experience it, we will see that the Fed has done enough and the prudent choice is to watch and wait (rather than continue on their stated path).
- **Russia and OPEC+.** We talked about the Nuclear Threat, which was a big topic of conversation at the summit (though still viewed as highly unlikely). Draining our strategic oil reserves is a problem and our relationship with OPEC+ (as well as providers of rare earths and critical minerals across the globe) needs to improve.

## Bottom Line

Despite all the risks (or maybe because of them), I expect the **"everything rally" to continue** and even extend into this week. I'm bullish on equities and fixed income products. I'm nervous about commodities, but the strength of the rally could carry them higher as well.

This is definitely trying to thread the needle by capturing the transition of "the Fed is nearly done" to what I think will become a risk-off moment because "the Fed went too far". So, I'm nervous and there is no shortage of global risk that could crush this nascent rally right from the get-go, but I'm still bullish at the moment.

More on FX and inflation this week and hopefully Academy can help you navigate this VUCA focused world!

## Disclaimer