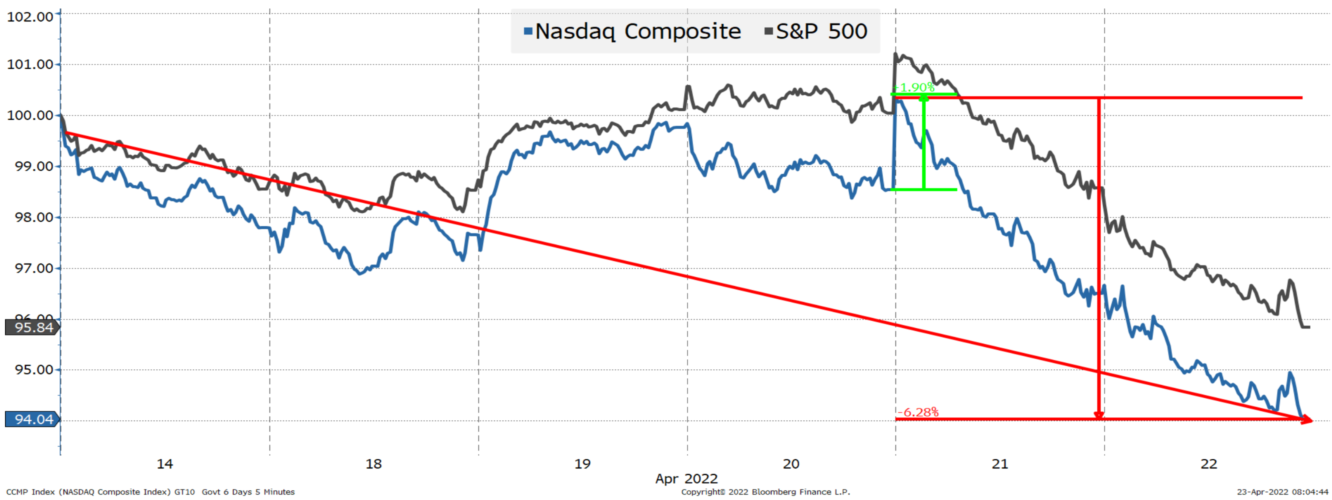
The Not So Good, the Bad, and the Ugly

This has been such a busy time for Academy Securities and our Geopolitical Intelligence Group. I've lost count of the number of calls, video meetings, and in-person meetings I've attended, let alone the purely geopolitical ones that I've not been a part of. Rachel Washburn continues to do an amazing job in pulling it all together and we just got back from our first European business trip. We had the great pleasure of meeting with clients in Dublin as we find increasing interest in our capabilities from European based corporations and asset managers. But enough on that, let's get to the work at hand.

The Ugly

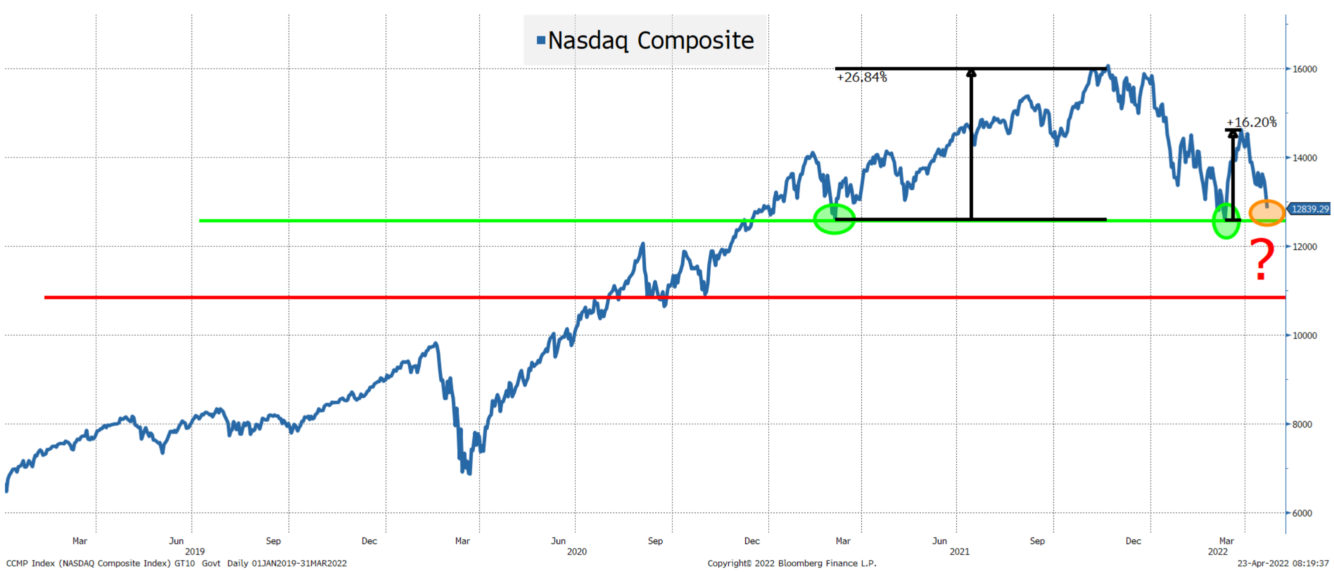
It seems easiest to start with **the ugly**.



On Thursday, the Nasdaq and S&P 500 both opened almost 2% higher, but quickly gave up ground and never saw a significant bounce for the rest of the day (including on Friday).

I chose the Nasdaq and S&P 500, but **you could pick almost any risk asset** (from other stock indices, to junk bonds, to IG credit spreads, to cryptocurrencies, etc.) **and the charts look eerily similar**.

In last weekend's Thunderdome!!! we called for **stocks to test the March FOMC lows**, which also roughly coincided with their spring 2021 lows.



The Nasdaq lows in and around the press conference matched almost exactly the lows of March 2021. What little I know about charting tends to support the idea that if we test a level for a 3rd time, it often fails. From the March 2021 lows the Nasdaq bounced 27%, but "only" bounced 16% on this recent rally (albeit in just a few weeks). Again, with my limited chart skills I do know that lower highs tend not to be bullish (I was going to try and claim that these somehow look like Fibonacci retracements, but that would only have been an attempt to sound cool, though 26 divided by 16 is pretty close to Fibonacci's "golden" ratio).

The charts don't look as bad for the S&P 500 (or some other indices), but look far worse for crypto and ARKK type of stocks (nothing against that ETF, it just represents a "theme" that isn't easily expressed by an index, so I resort to pointing out that ETF).

Corporate bond charts (on a price/yield basis) look awful. The next points of reference are the March 2020 lows, but this is far more of a rate story than a spread story. The Bloomberg Corporate Bond Spread is 132 versus its recent highs, though the CDX index is getting close to recent wides. Remember, the CDX index rolled in late March, so to be fair you should look at Series 37 which got to 78 in early March and is back to 74, whereas Series 38, which only began life on March 20th, is at 79.

There is reason to believe that credit spreads will be supported by "yield buyers" who find current yields attractive. However, spreads are correlated to equities and I am nervous that equities will test and fail the prior lows and that leaves a big gap A(in my estimation) to fill.

Ugly may have only begun, and I harp on so many of those reasons in last weekend's Thunderdome!!! that I won't rehash them all here.

The Not So Good

There are a few things that I will lump into the "Not So Good" camp:

- **The War in Ukraine.** Part of me is desperate to claim the war in Ukraine is actually "good" as Ukrainian forces seem to have contained Russia's ambitions (for now) as weapons pour into Ukraine and Putin even seems to be setting the stage for "victory" in the Russian media that would possibly give peace a chance. It would be nice, but I can't quite get there because:
  - While the number of issues has diminished, both sides are dug in, so it might be more difficult to find a resolution that works for both sides.
  - No matter what happens **we are NOT returning to business as normal**. **Bad Actors Behaving Badly** is now something every corporation and every asset manager in the world must consider, and that isn't going away even with a peace deal. Yes, we will follow up today's report with that theme, along with the theme of moving from **"Just in Time" to "Just in Case" manufacturing**, which I cannot take credit for, but think is brilliant and deadly accurate.
  - Second order effects are only starting to creep into the system, which we will address in next week's Around the World report.
- **Treasury yields barely moved as risk assets sold-off.** The Nasdaq is down 6% since Tuesday's close and the S&P 500 is down 5% since then. But, since Tuesday's close, the 10-year yield has

FALLEN from 2.94% to 2.9% and the 30-year yield has dropped from 3% to 2.95%. Even the 2-year yield, which finished the week at 2.67%, only moved up from 2.6% on Tuesday and actually dropped to 2.67% on Friday. The "higher yields" narrative, while plausible, doesn't fit as neatly as the equity market apologists are going to try and convince you this weekend. I'm filing this breakdown between yields and risk assets as "not so good" because it calls into question that narrative, which means **something worse might be going on behind the scenes** in terms of de-risking (cough *QT* cough). **It escapes the "bad" category because hawkish Fed talk did play a role in triggering the move.**

If it was perfectly clear that peace would be achievable in the next week or so (and that peace would quickly correct any issues related to the war) and if I thought we could easily wish away Friday's ugly close as being only a short-term/algo driven reaction to yields, I might have written a totally different report. I really want to write about "Bad Actors Behaving Badly," but that is a "theme" not a "trade".

So, I had so little in the "good" category that the best I could do was "not so good."

The Bad

Food. **Inflation**.

Virtually everywhere I look I see long-term trends that are inflationary:

- Supply chain disruptions – inflationary.
- Moving supply chains "closer" – inflationary.
- "Just in Case" rather than "Just in Time" manufacturing – inflationary.
- Building out sustainable energy AND ensuring a stable base of traditional energy sources – inflationary.

Yes, a slowdown in Europe, hiking too quickly, and skyrocketing mortgage rates will cause us problems. However, while I don't think we will get anywhere near the number of hikes that the market is pricing in and we will see prices come down in some commodities and products, I cannot help but see inflation as a persistent part of our existence for the next several years as we see this shift away from globalization in its purest form. The world has lost that innocence.

But food scares me the most!

There is not a single story in my feed that seems good for food!

The number of conversations that veer towards fertilizer is astounding. We are seeing and hearing of disruptions in agriculture at every step of the way.

This is one area which could normalize more quickly if we get peace in Ukraine soon, but it remains top of mind in terms of concerns. Month to date, oil prices are roughly unchanged, but most ag futures are up 2% to 6% (not comforting).

With food a real issue and central banks being forced to confront inflation, I think that the "Fed put" is a long way off.

I continue to believe that balance sheet reduction is extremely powerful and that it behaves differently than rate hikes because it puts immediate pressure on asset prices with more influence on riskier asset prices than "safe" asset prices (QE in reverse).

Having said that, we've priced in more negatives now than we had last weekend.

Wonderwall

It is impossible to spend a week in Ireland and not come away with the song "Wonderwall" stuck in your head (I guess you could lock yourself in your hotel room and avoid every pub, but what would be the point of that?)

So given how bearish last week's piece was, which this one largely piles on to, I've got to go with the market singing, "*Because maybe, you're gonna be the one that saves me!*"

What could "save" the market?

- **A change in tone from central bankers as they get nervous about falling asset prices?** A year ago, yes, but today, doesn't seem bloody likely.
- **Everyone being too short?** The massive rally after everyone got caught being too short ahead of the "dovish interpretation of the last FOMC meeting" squeezed out a lot of shorts. My stream, even after Friday, remains mixed between doomers and buy the dippers (yes, the ratio was too bullish, but I don't see it as full-on bear yet). Also, I pulled up TQQQ and ARKK shares outstanding and both ETFs had significant inflows on the week and on Friday. I picked the triple leveraged QQQ ETF as it is representative of the "gambling" nature of this market and the gamblers haven't given up. SARK and SQQQ (inverse ETFs) both had outflows on the week, though SQQQ had some inflows Thursday and Friday – so it is balancing out a bit. There is a short base, but I'm not convinced it is as lopsided as it was the last time we bounced, and the consensus doesn't always have to be wrong, especially as we approach the summer which could be hit by even less liquidity than usual this year as vacation and lifestyle is a priority for so many as we finally seem to be truly emerging from Covid. It was nice to able to wander around the airport on Friday without a mask if you didn't want to wear one.
- **China?** China did attempt to prop up their markets. China could wield their influence with Russia, though I'm willing to bet that we see China selling weapons to Russia so they can see them in action before we see China stop buying Russian commodities. China also has their own Covid issues (which are some of the biggest lockdowns since Covid hit).
- **Earnings.** Always a potential catalyst, but it is difficult to determine how relevant last quarter's earnings are in this evolving world and markets seem to like to wait until companies are done with their quiet periods and are fully able to ramp up share repurchases before markets get too excited.

So maybe this market will find its Wonderwall, but I'm highly skeptical.

I kind of hate signing off with saying that "I hope I'm wrong" because I prefer to be right, but I just don't like the conclusions I'm left with – more downside risk for risky assets (including spread widening), but I am increasingly comfortable trading Treasuries at the long-end as we could be shifting to more of a "risk off" trade than a yield led headwind.

And today is Ukrainian Easter, hoping that the beets with horseradish are the spiciest ever!

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