Phillip is Dead...

Summary:

- All about the Fed: Senate Testimony and FOMC Minutes
- Seasonals: Slow market action until Q2 earnings season picks up
- Target List:
    - Short Bonds
    - Starter positions in SANW & CPLP
    - Watching Silver and Nat Gas\

Here's my big takeaway from Powell's Senate testimony (which is still ongoing today) and the release of the June FOMC Minutes (link here).

A 25bps cut this month is practically in the books and a follow on 25bps cut at the September meeting is now likely. What happens from there is going to depend on where the data trends (I'll share my thoughts on that in a bit).

An even more important revelation, in my opinion, is the clear and dramatic shift in the Fed's rate-setting framework. Fed Watcher, Tim Duy, explains below:

> *The Fed has gradually shifted a key component of its underlying framework. They are very much less worried about the potential for an outbreak of inflation. I think it is tempting to describe this as the death of the Phillips curve, but that would be too dramatic. More accurately I think is that the Fed has little faith in their estimates of the natural rate of unemployment, the rate that is consistent with stable inflation*.

This is a big deal. In the past, business cycles have ended — or rather, were killed — when inflation began perking up while unemployment was low (below the Fed's idea of NAIRU, a bogus concept about the "natural rate" of unemployment at which inflation doesn't accelerate) and the Fed became nervous and began jacking up rates, even in spite of deteriorating economic data.

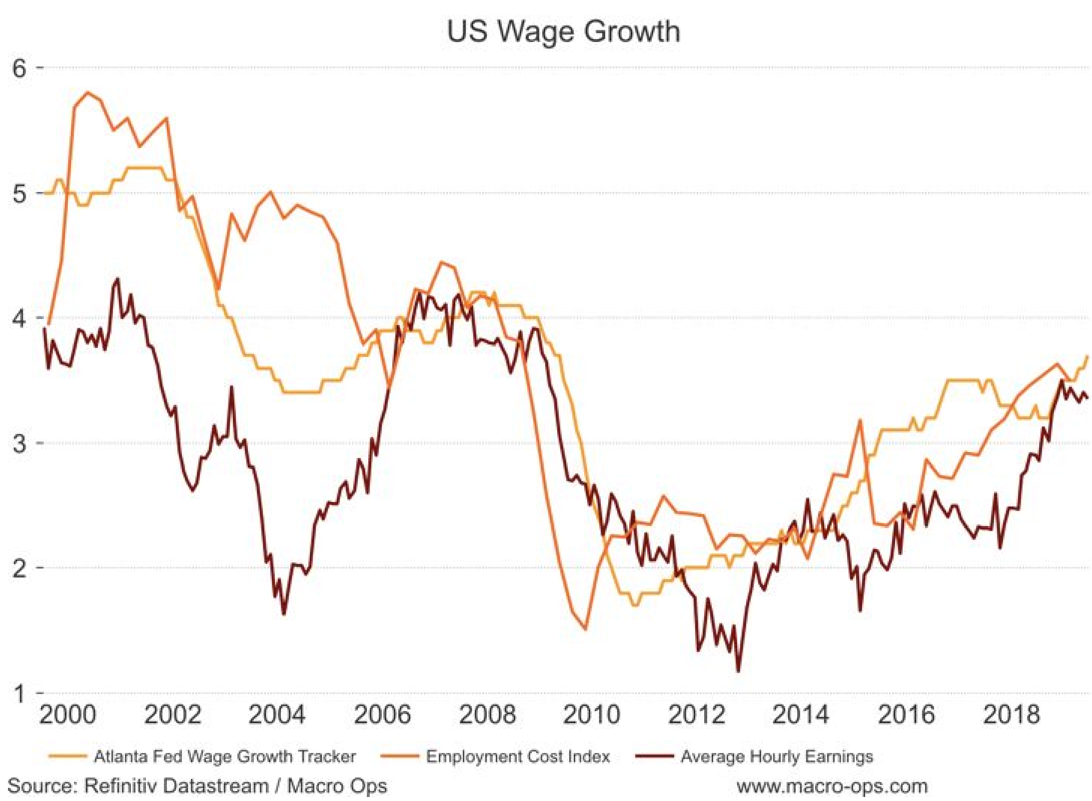
Rising interest rates tighten liquidity, make bonds more attractive relative to stocks, dampen business and investor sentiment, and eventually lead to cascading effects (rising unemployment -> falling demand -> tightening liquidity -> rising unemployment etc…) which kicks off the turning of the business cycle.

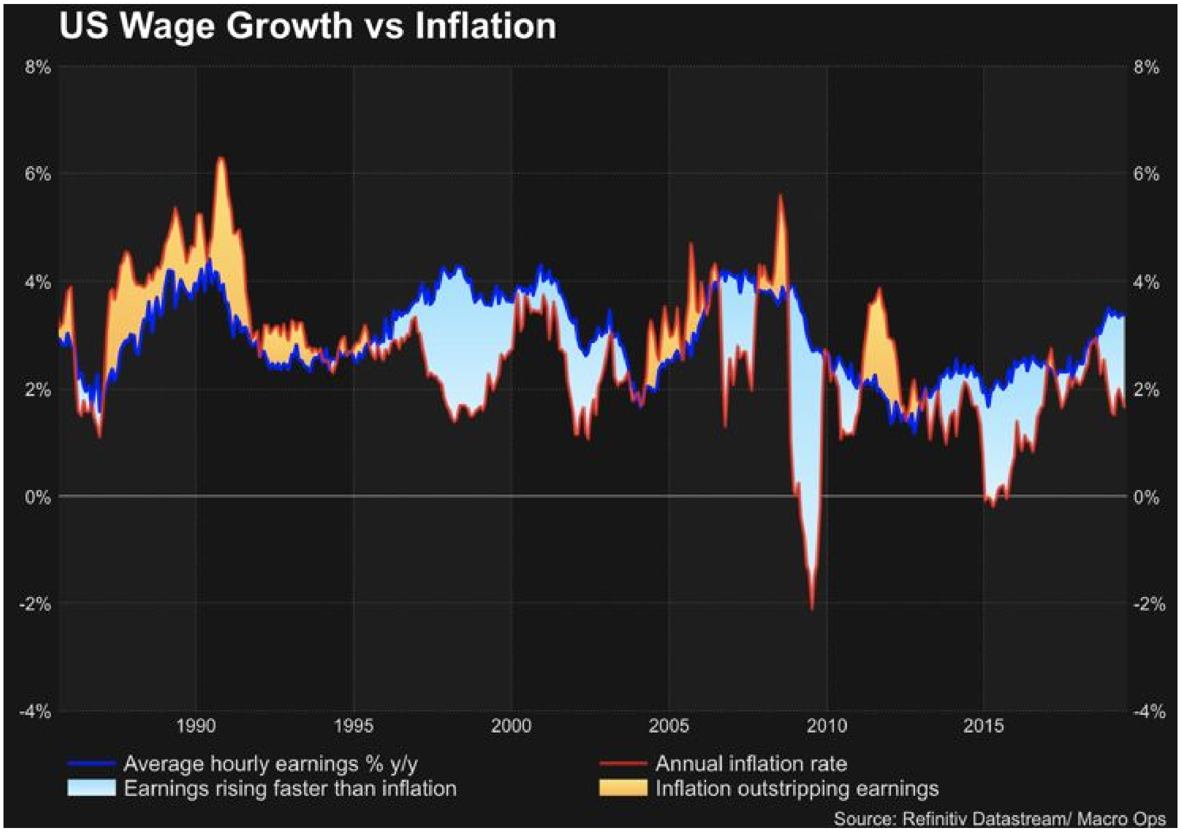
Now, I can write pages on why the Fed has worshipped these bogus econ models, such as the Phillips Curve, which have never shown an ability to correctly reflect reality… But I'll spare you the drudgery. The gist of it is, is that the Fed doesn't understand inflation, they never have, and they've suffered institutional scarring from the days of high persistent inflation in the 70s.

I'm working on a paper right now where I lay out what really drives inflation (hint: in a hard currency, like the USD, it's all about demographics and Labor's power relative to that of Capital's). But I digress…

Going back to Powell's testimony, it's clear that they've now accepted that they don't really understand what drives inflation or at what level "full employment" is. Time and time again, Powell commented on how they're still seeing people who've long been left out of the labor force return. That means there's still slack left in the system.

The Fed is shifting its focus away from inflation, where it's now willing to accept higher persistent inflation prints, and will instead focus on keeping financial conditions supportive of further labor and wage gains. Wage growth is picking up but is still well below past cycle peaks.





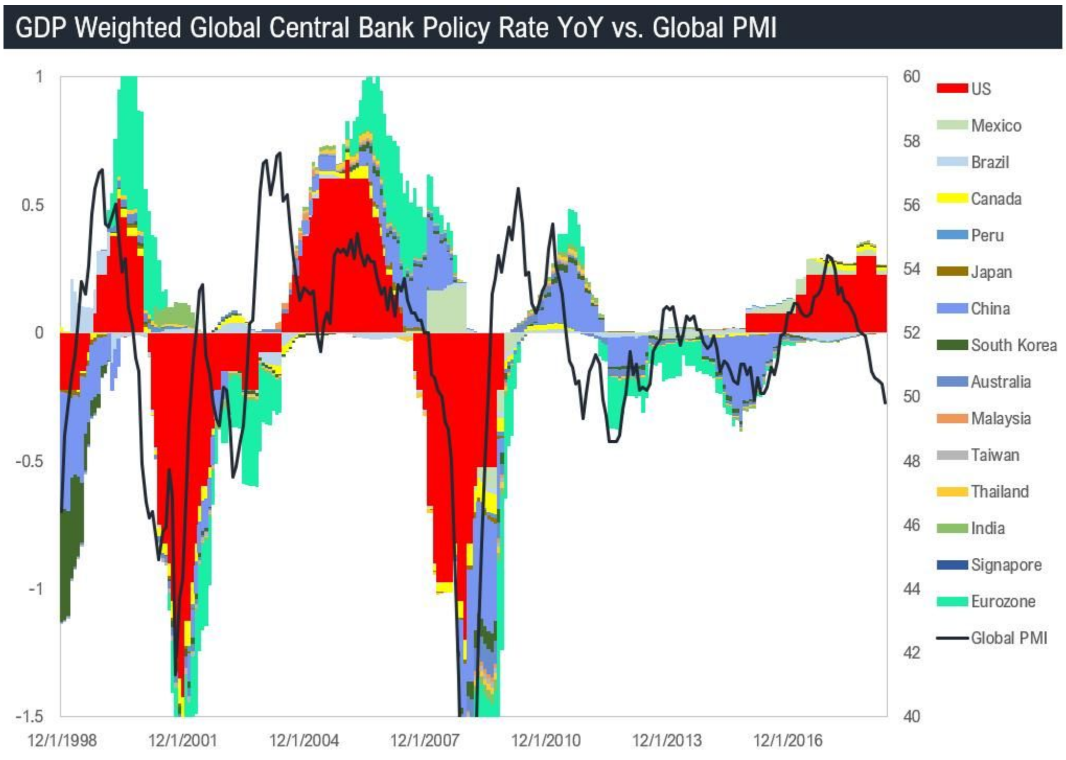
We should continue to see wage growth trend higher but there's an important secular development which will keep this trend-growth muted. Again, it's demographics and it's something that I don't think the Fed or many others are paying attention to.

What I'm referring to is the fact that our labor force is old and getting older. Older more seasoned workers receive higher wages versus those younger less experienced ones just entering the labor force. More and more of these older higher-paid employees are set to retire in the coming years. This trend is going to skew the average and make structural wage growth appear lower than it actually is.

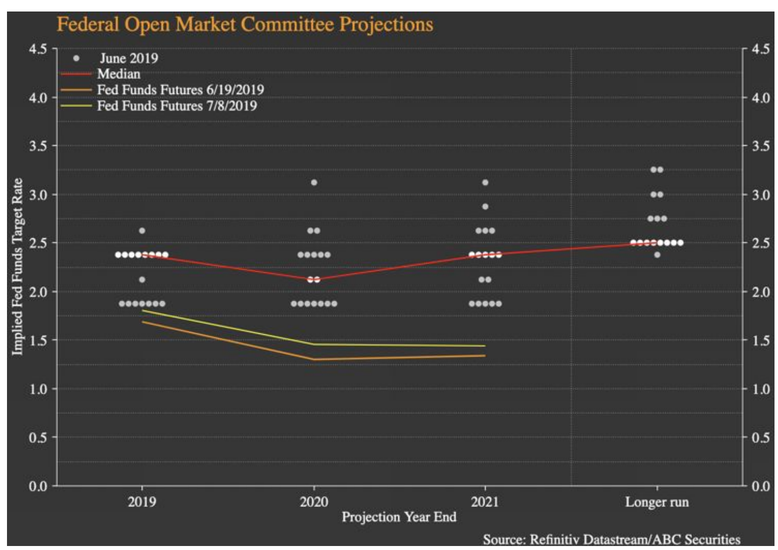
From a practical standpoint, this means that one of the key metrics that the Fed will be utilizing to make its policy decisions should stay sluggish for longer than people expect; due to the structural reasons I just outlined. This means continued dovish monetary policy and an extended business cycle.

To sum up, the Fed now realizes that it needs to throw out its old playbook. They know our world is now structurally different, even though they don't fully understand why. And they need to reverse the overly constrictive rate moves they executed last year because it doesn't align with the deteriorating data.

See this great chart from our friend @TeddyVallee showing the Fed's misalignment of monetary policy.



Source: Pervalle Global, Bloomberg



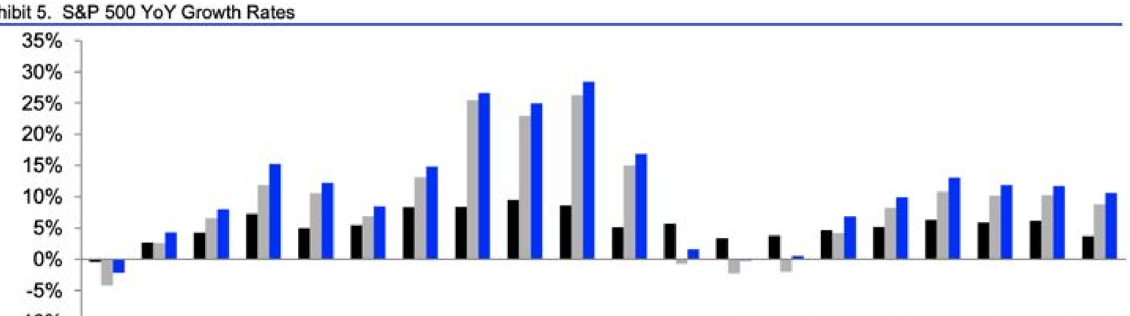
Another key point to understand is that this easing is already priced into markets, which means we'll see little stimulative effects from it in the real economy. It' going to take even more dovish forward guidance from the Fed to move market expectations and juice things a bit more.

I think we'll get there eventually but we'll need to see growth materially weaken before that can happen. Our leading indicator of US GDP, which is the Philly Fed Business Outlook Survey, advanced 3-months, points to GDP growth decelerating to sub 2% over the coming quarters.

We've been in a seasonally slow period for markets over the last couple of weeks — money managers in the Hamptons combined with being in between earnings seasons — but this will change with Q2 earnings kicking off in earnest next week.

Consensus analysts expectations are for just 3.4% revenue growth and a -0.2% drop in earnings. Even with slowing economic growth, this makes for a fairly low bar to clear though looking out to Q4 and beyond, expectations remain way too high.

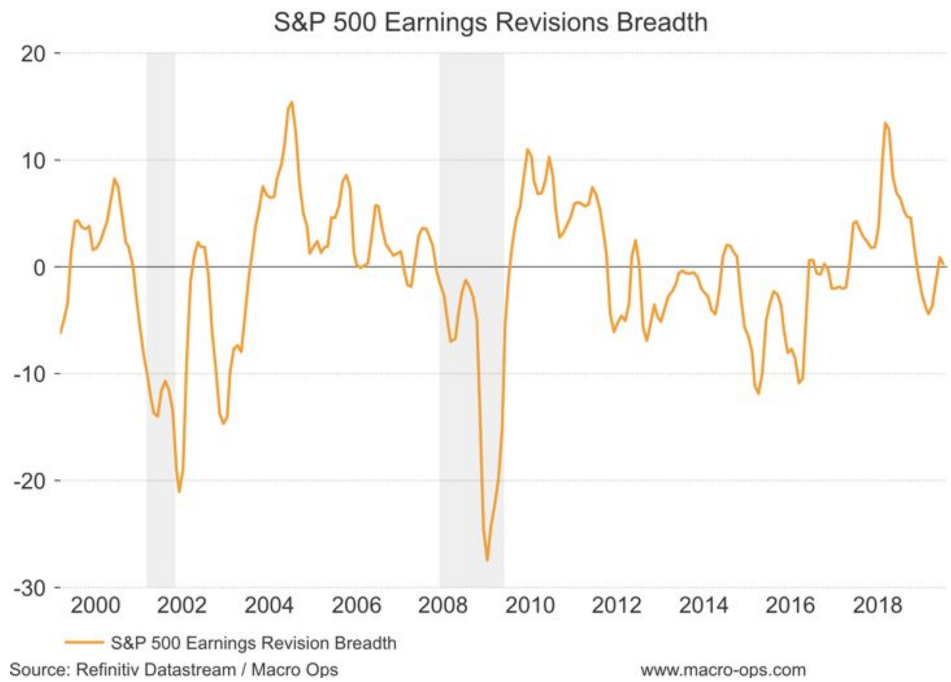
Exhibit 5. S&P 500 YoY Growth Rates



	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1
Revenue	-0.4%	2.6%	4.2%	7.3%	5.0%	5.5%	8.3%	8.4%	9.5%	8.6%	5.1%	5.7%	3.4%	3.8%	4.7%	5.2%	6.3%	5.9%	6.1%	3.7%
Net Income	-4.2%	2.6%	6.6%	11.9%	10.6%	6.9%	13.1%	25.4%	23.0%	26.3%	15.0%	-0.8%	-2.3%	-2.0%	4.2%	8.2%	10.8%	10.2%	10.3%	8.8%
Earnings	-2.1%	4.3%	8.0%	15.3%	12.3%	8.5%	14.8%	26.6%	24.9%	28.4%	16.9%	1.6%	-0.2%	0.5%	6.9%	9.9%	13.0%	11.9%	11.7%	10.6%

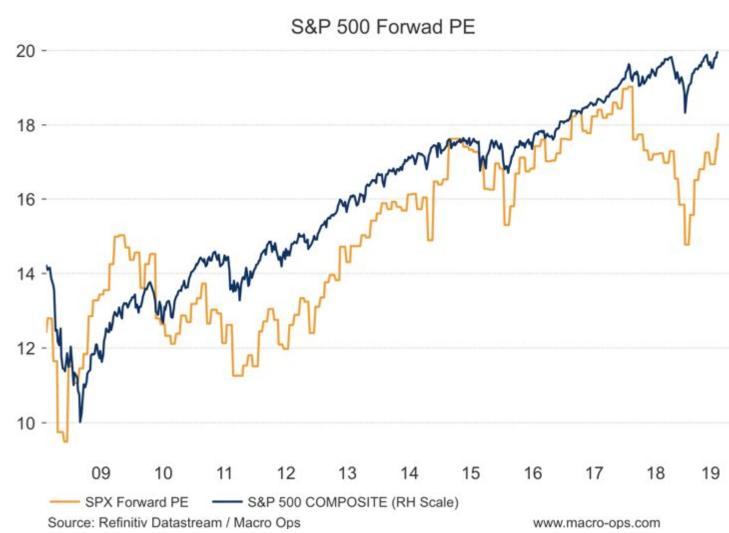
Source: I/B/E/S data from Refinitiv

Earnings Revisions Breadth has rebounded from negative territory back to neutral. This is generally a positive development heading into earnings season.



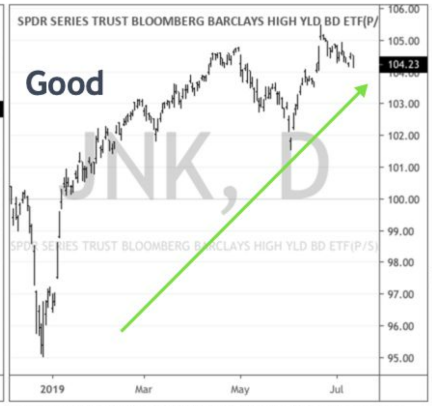
The main concern of mine though is that valuations are now a little heady. The SPX's Forward PE is 17.8x; a level which has led to some instability in the past.

We could see multiple expansion. There are a lot of fund managers who've been offsides this entire rally. The rising market could create some FOMO and a stampede out of bonds and back into stocks. But unless we see significant stimulus out of China or a resolution to the trade war, I have a tough time banking on this.



This puts me in a bit of a pickle. My indicators tell me that sentiment and positioning is overly bearish (except for Put/Call 10dma which is still around sell-signal territory), credit is trending higher and spreads are tightening, breadth and participation are good.


VANECK VECTORS ETF TRUST SEMICONDUCTOR ETF, D, Cboe BZX
BB (20, close, 2)
Good
SMH, D
120.90


SPDR SERIES TRUST BLOOMBERG BARCLAYS HIGH YLD BD ETF(P/
Good
JNK, D
104.23


ISHARES INC EMERGING MARKETS HIGH YIELD BOND ETF, D, Cboe
Good
EMHY, D
105.54


USI:PC, 1D 0.844 ▼ −0.004 (−0.47%) O:0.792 H:0.844 L:0.651 C:0.844
TOTAL PUT CALL RATIO COMPOSITE, 1D, USI
MA (10, close)
SPX, TVC
Bad
PC, 1D
109.12
106.09
85.25
80.60


BATS:LQD/BATS:IEF, D 1.13 0.00 (−0.1%) O:1.13 H:1.13 L:1.13 C:1.13
LQD/IEF, D, Cboe BZX
Good
LQD/IEF, D
101.09

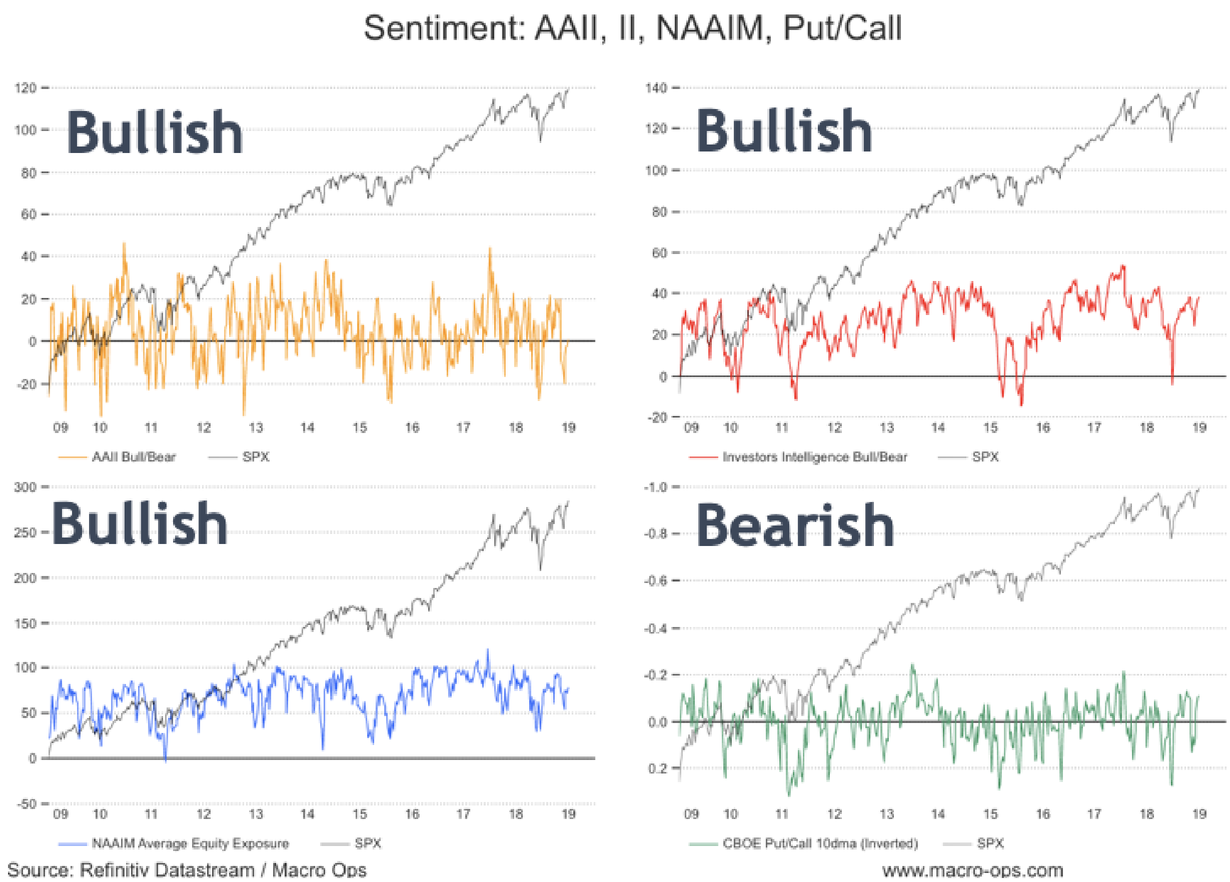

TVC:VIX/CBOE:VIX3M, D 0.9 0.0 (1.31%) O:0.9 H:0.9 L:0.8 C:0.9
VIX/VIX3M, D, TVC
MA (5, close)
Good
VIX/VIX3M, D
0.9


S&P 500 Index, D, FXCM
SPX, TVC
ADL
Good
SPX500, D
7.08%
6.98%
ADR_B (15)


Percent of Stocks Above 50-Day Average, D, INDEX
Good
MMFI, D
57.02


INDEX:MAHE, D 111.00 ▼ −86.00 (−43.65%) O:111.00 H:111.00 L:111.00 C:111.00
52-Week Highs ETFS, D, INDEX
MA (10, close)
Good
MAHE, D
111.00


INDEX:ADVN/(INDEX:ADVN+INDEX:DECN), D 0.37 ▼ −0.20 (−35.25%) O:0.57 H:0.57 L:0.37 C:0.37
ADVN/(ADVN+DECN), D, INDEX
MA (10, close)
Good
0.60
0.40
0.37



This all means that we want to stay positioned mostly long. But, I have an increasing feeling that US markets are running towards a wall. I'm not sure what it is exactly, something is off and I haven't been able to put my finger on it quite yet. I hope to write something up as soon as my thoughts congeal a bit more.

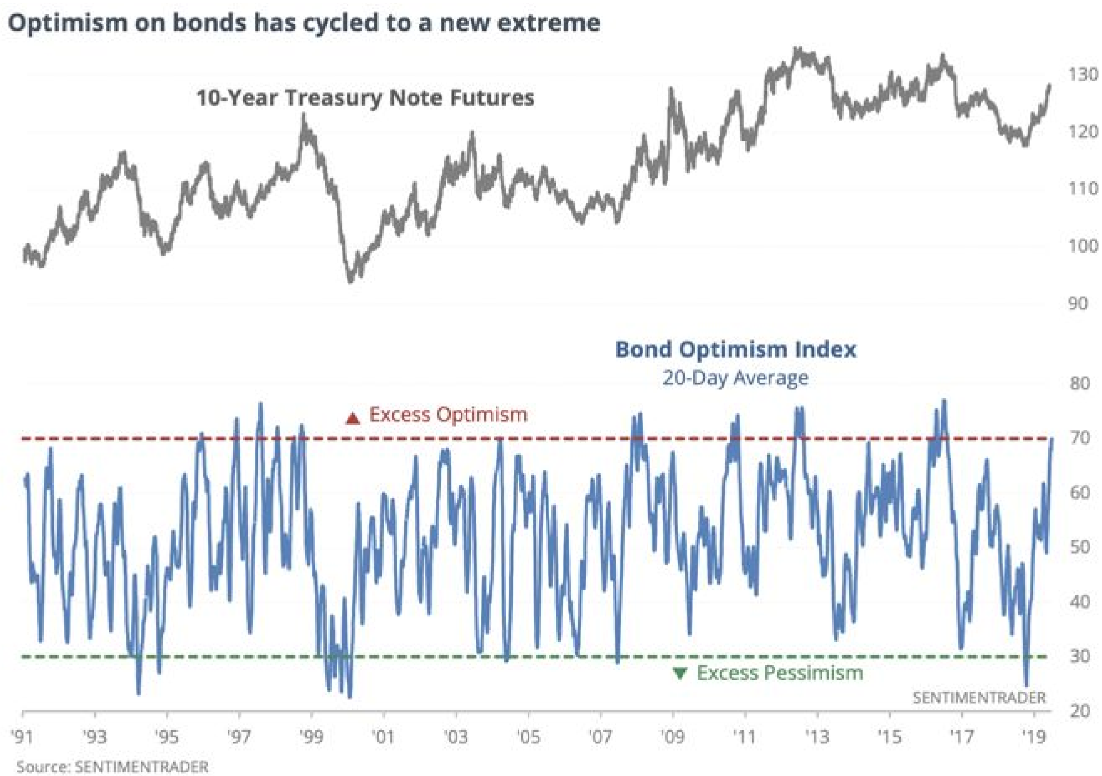
I should clarify that I don't think a major market crash or bear market is imminent. I'm just saying I think the market might be vulnerable to another late 18' style selloff in the near future. We probably need to see some FOMO induced chasing first, new market highs, and a full flip in sentiment first, but I think the environment going forward is going to be a tactical one (ie, lots of ups and downs over next couple of months) and we're going to have to be nimble and tight with our risk.

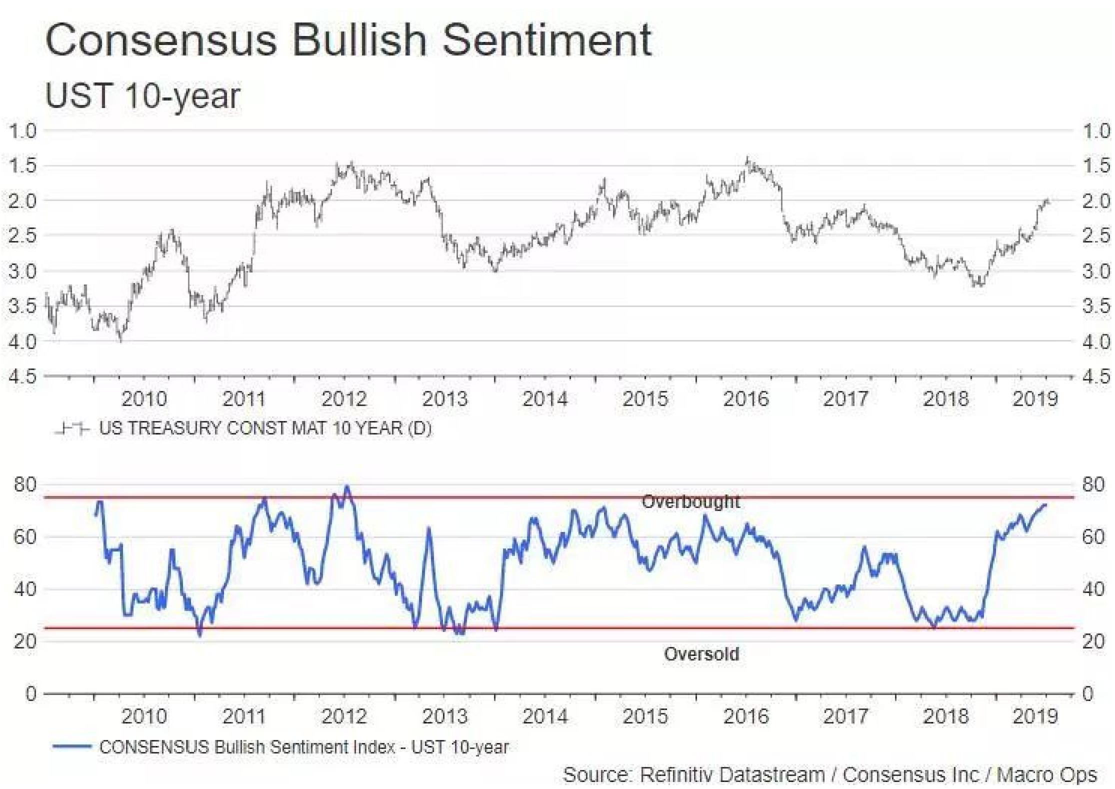
Valuations in the US are too high, earnings expectations from Q4 onwards are too optimistic, and economic growth expectations in the US are too bullish. All of these are going to need to be corrected. Expect chop and volatility in the coming months, after maybe one more leg up.

Target List: Short bonds and SANW / CPLP starter positions

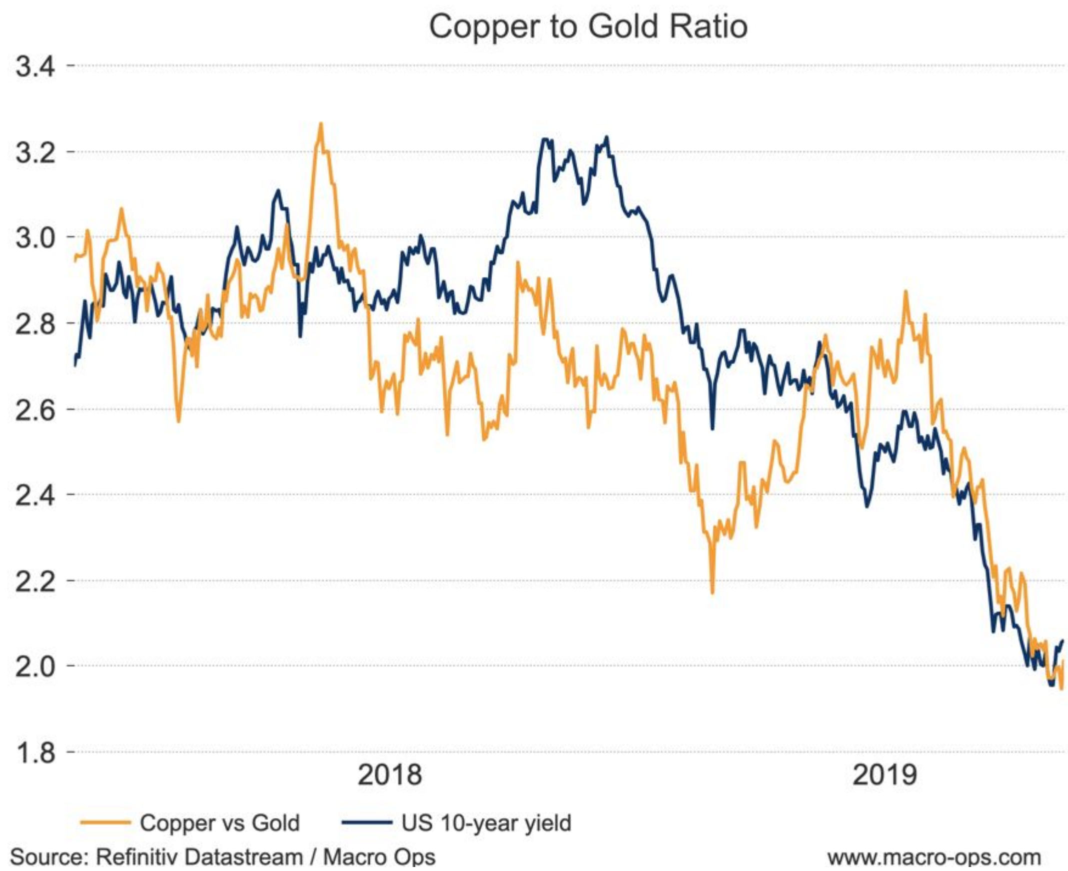
Bonds just completed a weekly DeMark 9-count and have reversed after piercing their upper weekly Bollinger Bands. We've been waiting for an entry to short bonds for a swing trade and now I think we've got one.

I've written plenty over the last month about how flows, positioning, and sentiment had become stretched in bonds. But not wanting to step in front of a freight train, I've been waiting for a technical crack which is what we now have.


Optimism on bonds has cycled to a new extreme
10-Year Treasury Note Futures
130
120
110
100
90
Bond Optimism Index
20-Day Average
80
70
60
50
40
30
20
▲ Excess Optimism
▼ Excess Pessimism
SENTIMENTRADER
'91
'93
'95
'97
'99
'01
'03
'05
'07
'09
'11
'13
'15
'17
'19
Source: SENTIMENTRADER


Consensus Bullish Sentiment
UST 10-year
1.0
1.5
2.0
2.5
3.0
3.5
4.0
4.5
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
US TREASURY CONST MAT 10 YEAR (D)
80
60
40
20
0
Overbought
Oversold
CONSENSUS Bullish Sentiment Index - UST 10-year
Source: Refinitiv Datastream / Consensus Inc / Macro Ops

We'll have to keep an eye on the copper/gold ratio but it looks like it's turning higher. Also, short positioning in copper is crowded at the moment so it won't take much to cause a squeeze higher.



I only expect this trade to play out for a few weeks at most. I ultimately think US yields are heading much lower and this retrace will give us a good buying opportunity to flip and get long bonds.

We'll be putting on a short position either today or tomorrow. Expect a trade alert soon.

We're also going to be putting on starter positions in S&W Seed Company (SANW) and Capital Partners (CPLP) shipping company.

We've been following SANW for a few years now, ever since the talented turnaround specialist, Mark Wong, took over as CEO. Mr. Bean did an excellent writeup on the company's prospects and the stock's deep value proposition in his new *Value Ventures* newsletter (link here).

The stock looks like it may be breaking out of its base. Not a bad time to start building some exposure to the Ag space which is in the process of bottoming from a long and painful secular bear market.

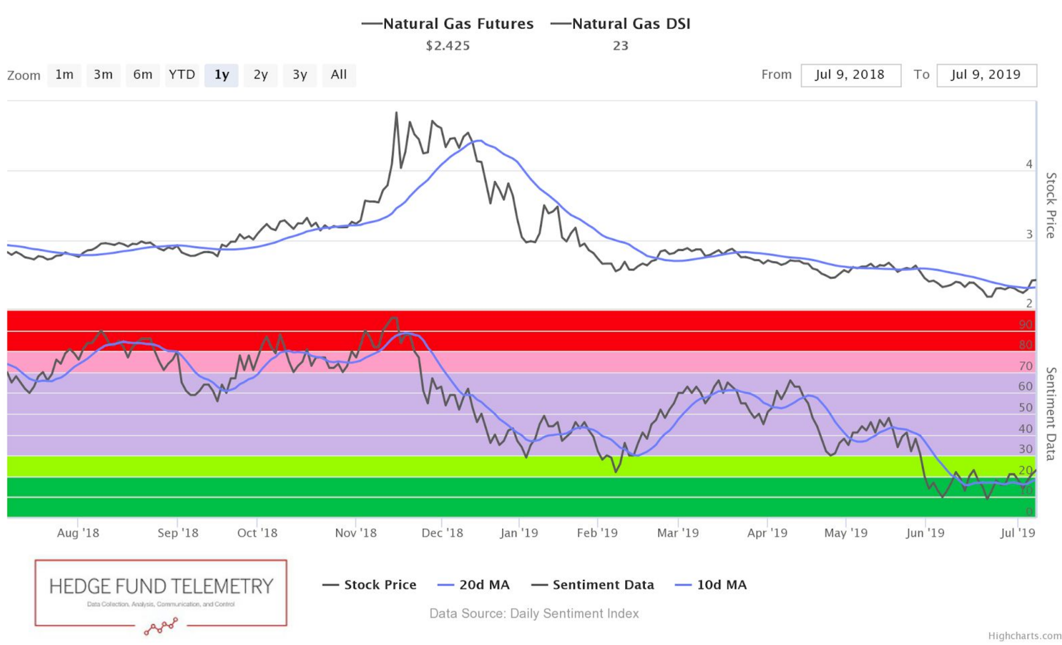
Mr. Bean also wrote up the bull case for CPLP ([link here]()).

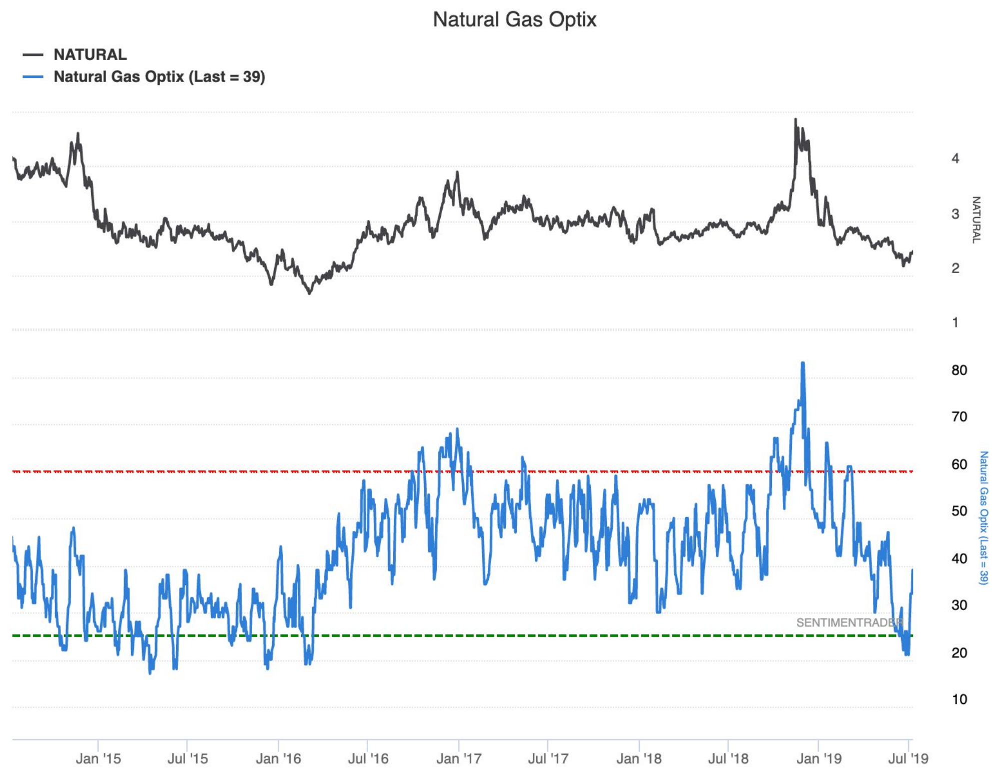
This stock is also making a move out of its base. This will make a nice addition to our other shipping position in STNG. You can read my bull thesis for the shipping industry [here](#).

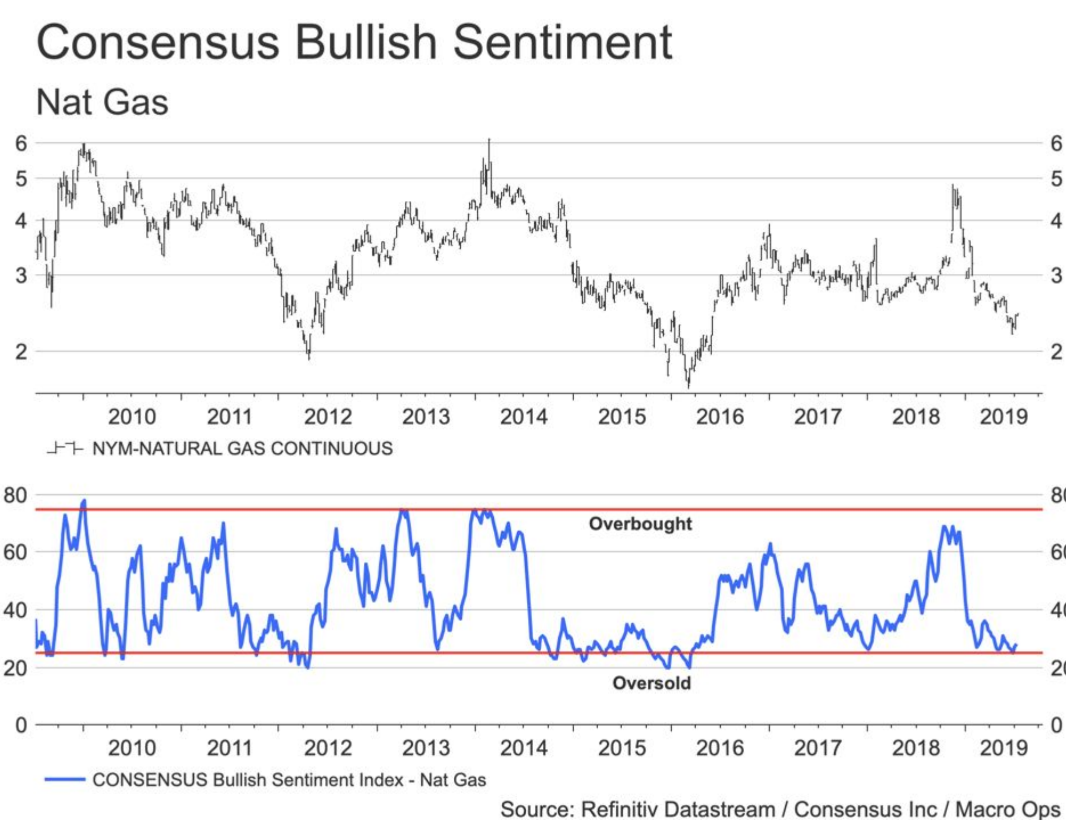
I'm also keeping a close eye on nat gas and silver/miners.

The technicals in natty are shapping up. I need to see some more follow-through before I become convinced a bottom is in, though.

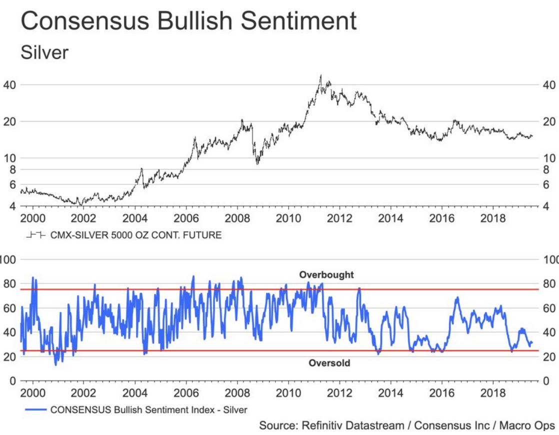
No matter how you slice it, sentiment on gas is very low.




Natural Gas Optix
NATURAL
Natural Gas Optix (Last = 39)
SENTIMENTRADER
Jan '15
Jul '15
Jan '16
Jul '16
Jan '17
Jul '17
Jan '18
Jul '18
Jan '19
Jul '19


Consensus Bullish Sentiment
Nat Gas
NYM-NATURAL GAS CONTINUOUS
Overbought
Oversold
CONSENSUS Bullish Sentiment Index - Nat Gas
Source: Refinitiv Datastream / Consensus Inc / Macro Ops

I think we'll see precious metals pullback here with bonds (rising yields are bad for precious metals). But, like bonds, this pullback will set up for a great entry/add point. CDE has the best looking chart of the bunch.



Our position in gold miner AU is now up close to 60% since we entered a little over a month ago. We'll look to add to this position on a pullback.

That's all I've got!

Oh, and if you get a chance, give this recent blogpost by *Wired* cofounder Kevin Kelly a read. Kelly comments on the profound global demographic shift we're going through (basically what I wrote about in the last MIR). Here's the link and a section from the piece.

> *We have no experience throughout human history with declining population and rising progress (including during the Black Plague years). Some modern countries with recent population decline have experienced an initial rise in GDP because there are fewer "capitas" in the calculation made per capita, but this masks long-term diminishment. But there can always be a first time! We might be able to figure it out. Here is the challenge: this is a world where every year there is a smaller audience than the year before, a smaller market for your goods or services, fewer workers to choose from, and a ballooning elder population that must be cared for. We've never seen this in modern times; our progress has always paralleled rising populations, bigger audiences, larger markets and bigger pools of workers. It is hard to see how a declining yet aging population functions as an engine for increasing the standard of living every year. To do so would require a completely different economic system, one that we are not prepared for at all right now.*

We're living in interesting times!

If you've got any questions for us in the meantime, let us know in the Comm Center. Have a great week!

Your Macro Operator,

Alex

Macro Ops Portfolio		YTD						
		13.75%						
Big Bet Macro								
Asset Class	Position	Position Size	Cost Basis	Notional %	Risk Point	Target	Last Price	P&L
Equity	Construction Partners (ROAD)	8,438	$12.25	10.84%	$10.80	$17.00	$14.49	18.29%
Equity	Disney DIS	2,146	$102.34	27.32%	$108.50	$150.00	$143.56	40.28%
Equity	Yatra Online YTRA	13,877	$7.24	4.59%	Investment	$15.00	$3.73	-48.48%
Equity	Graftech (EAF)	2,205	$13.59	2.17%	$10.00	$25.00	$11.11	-18.25%
Equity	Frontdoor (FTDR)	1,240	$34.10	4.84%	$28.00	$55.00	$44.00	29.03%
Equity	Anglogold (AU)	2,750	$11.79	4.40%	$10.75	$18.00	$18.04	53.01%
Equity	W&T Offshore (WTI)	4,710	$4.81	1.90%	$3.60	$8.00	$4.56	-5.20%
Equity	Ecopetrol (EC)	1,686	$18.78	2.87%	$15.40	$25.00	$19.17	2.08%
Equity	Sandridge Energy (SD)	9,661	$6.41	5.87%	$5.80	$12.00	$6.85	6.86%
Equity	Target Hospitality (TH)	10,000	$9.90	8.40%	$9.30	$15.00	$9.47	-4.34%
Equity	Scorpio Tankers (STNG)	1,700	$27.10	4.51%	$21.00	$40.00	$29.94	10.48%
Equity	TSLA Sep '19 175 Put	11	$13.81	0.57%	$0.00	$85.00	$5.80	-58.00%
Equity	TSLA Jun '20 100 Put	14	$10.70	0.99%	$0.00	$85.00	$8.00	-25.23%
Equity	TSLA Jan '20 150 Put	5	$15.01	0.43%	$0.00	$60.00	$9.80	-34.71%
Equity	DIS Jan '20 165 Call	205	$1.11	5.19%	$0.00	$10.50	$2.86	157.30%
FX	Sep CAD Futures	5	$0.7587	33.94%	$0.7467	$0.8096	$0.7653	0.87%
FX	Sep CHF Futures	7	$1.0301	78.73%	$1.0067	$1.0887	$1.0145	-1.51%
							**Updated 7/7	