03/23/2021: Watch Your Six

A quick note and trade alert for you guys

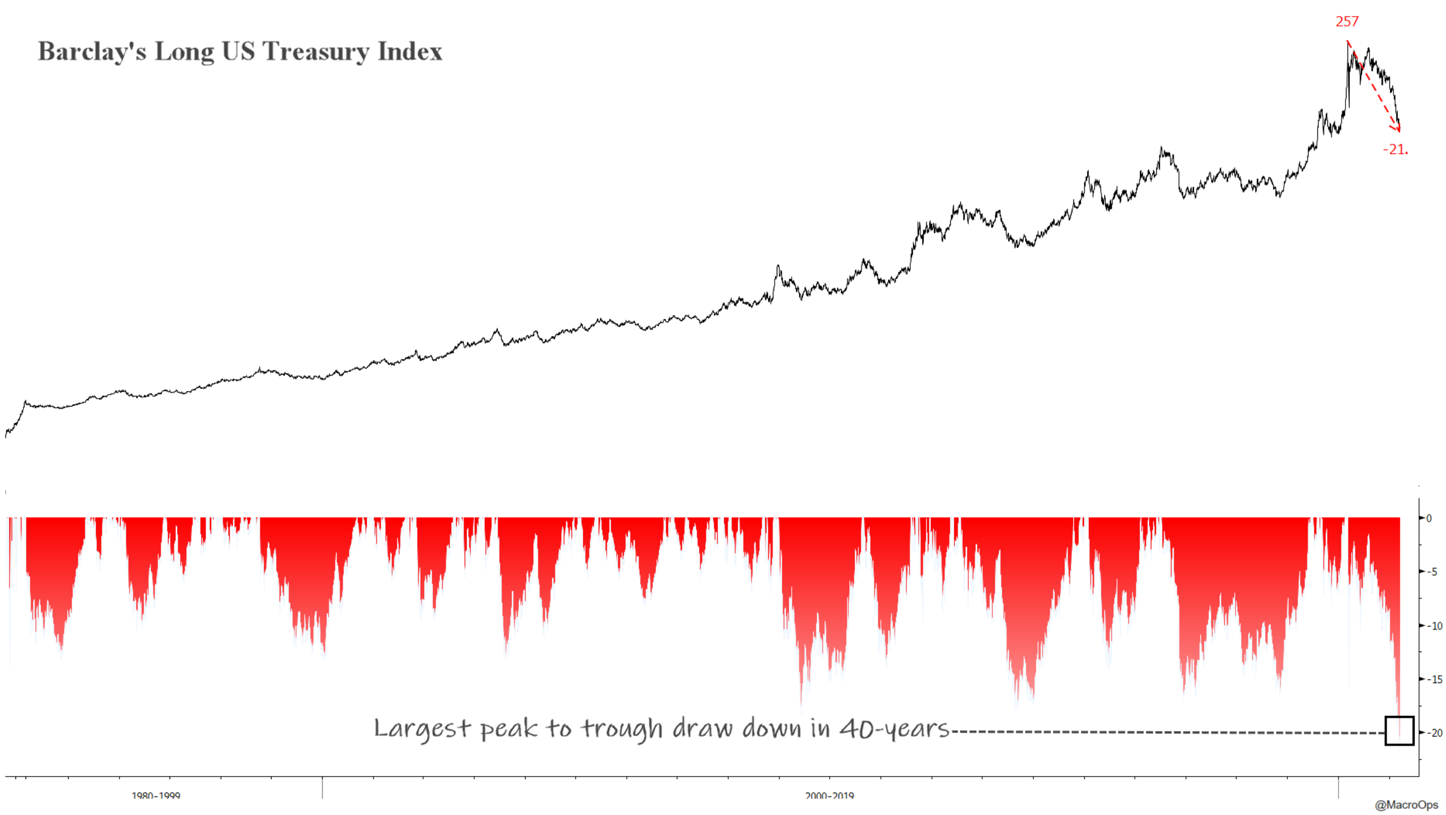
First, our TL Score dropped below -3 today, as it lost one point from breadth. The individual scores now stand at: liquidity (-3), sentiment (-2), and breadth (+2).

A score of -3 isn't horrible, but it isn't *great* either. It typically means lower to sideways vol and chop. It's when the score drops below -4/-5 that we want to more aggressively reduce our risk exposure. Nonetheless, it's still a good idea to add some hedges once the score crosses below -3. Which is what we're going to do.

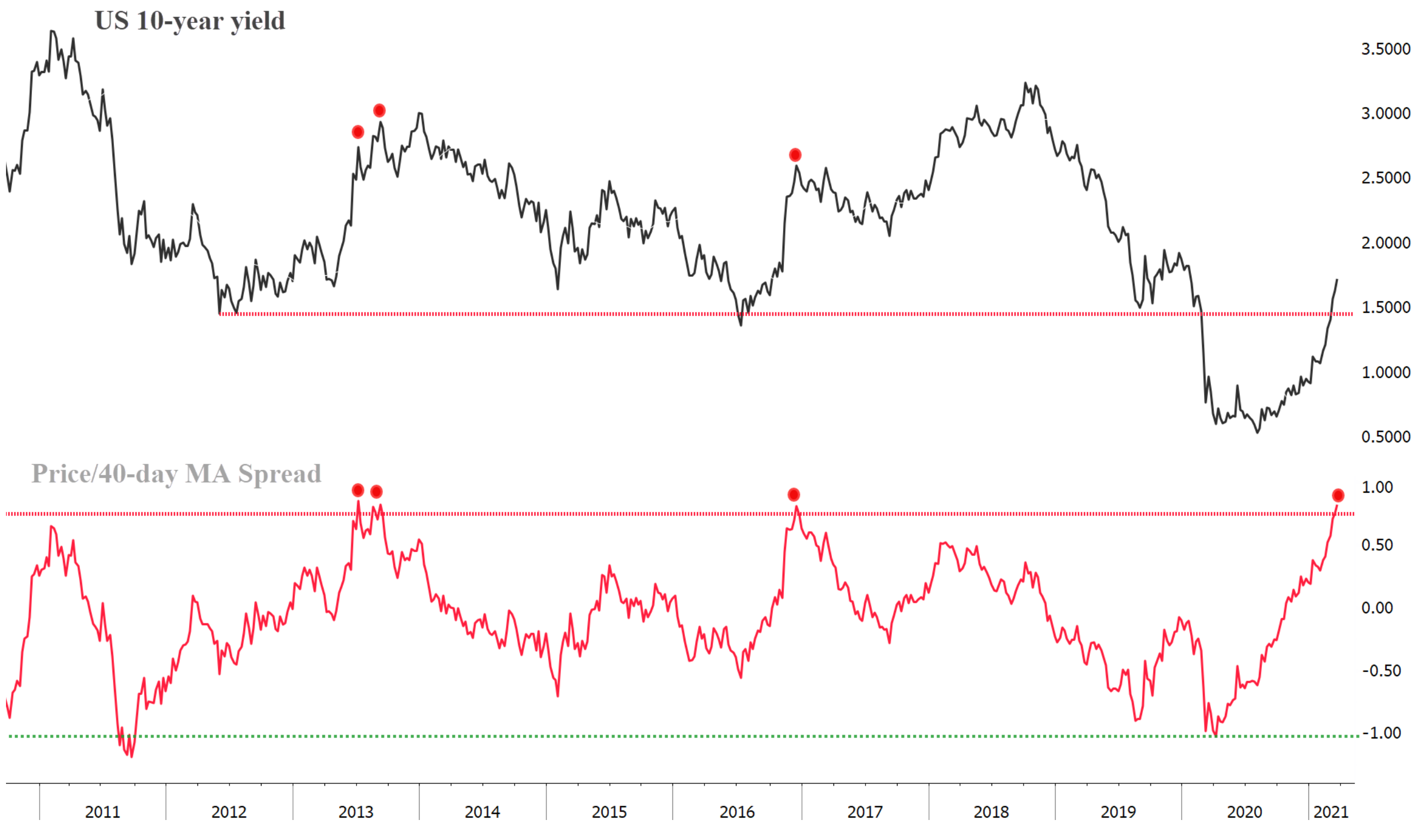
We still have our short copper trade on and today we're going to add some long bonds to our port.

Let's run through some quick charts and stats.

Treasuries have been getting dropped like the crap end of a stick. The Barclay's US Long Treasury Index has now seen its worst drawdown in 40+ years.

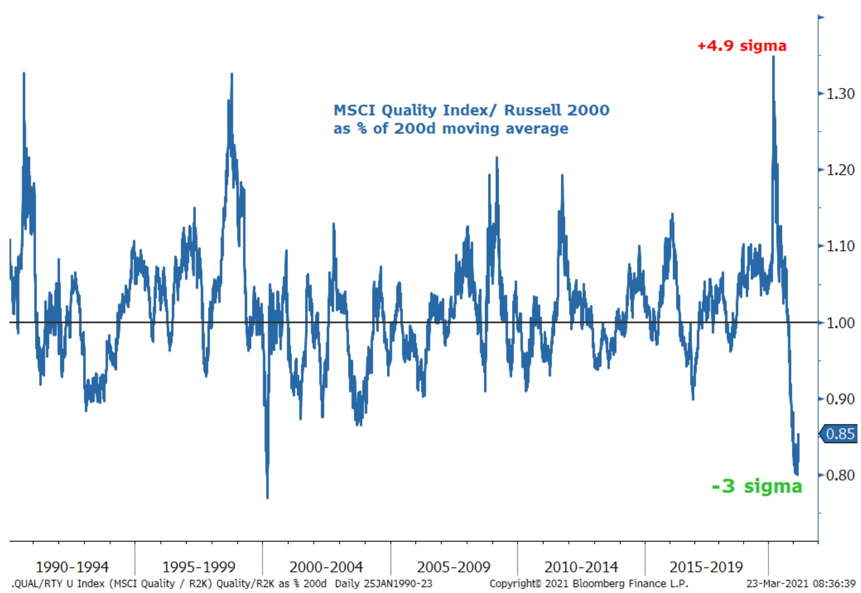


In the past decade, this wide of a spread between yields and their 40-day moving average have coincided with an intermediate top.



There's also increasing evidence suggesting that the reflation trade *might* be in for a bit of a breather. The wild herd has absolutely piled into crowded reflationary assets, as I pointed out in this week's Dozen.

They are also technically *very* stretched on both a straight and relative basis. The relative performance of Quality vs Small-caps versus its 200-day moving average is turning up after a -3std move below it (h/t Jake for the chart).

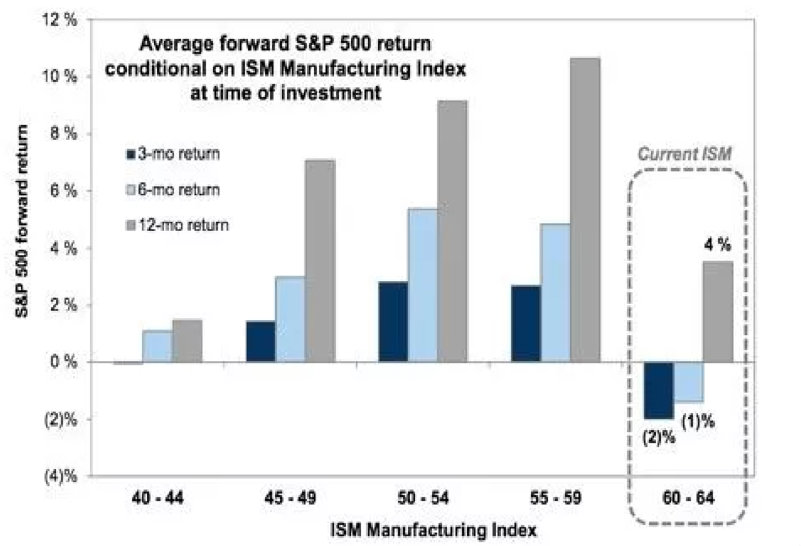


It's possible we see a little reversion here. Probably with small-caps taking a bit of a bath and washing out weak hands — which is great as it'll hopefully give us a good spot to scoop up some names on sale!

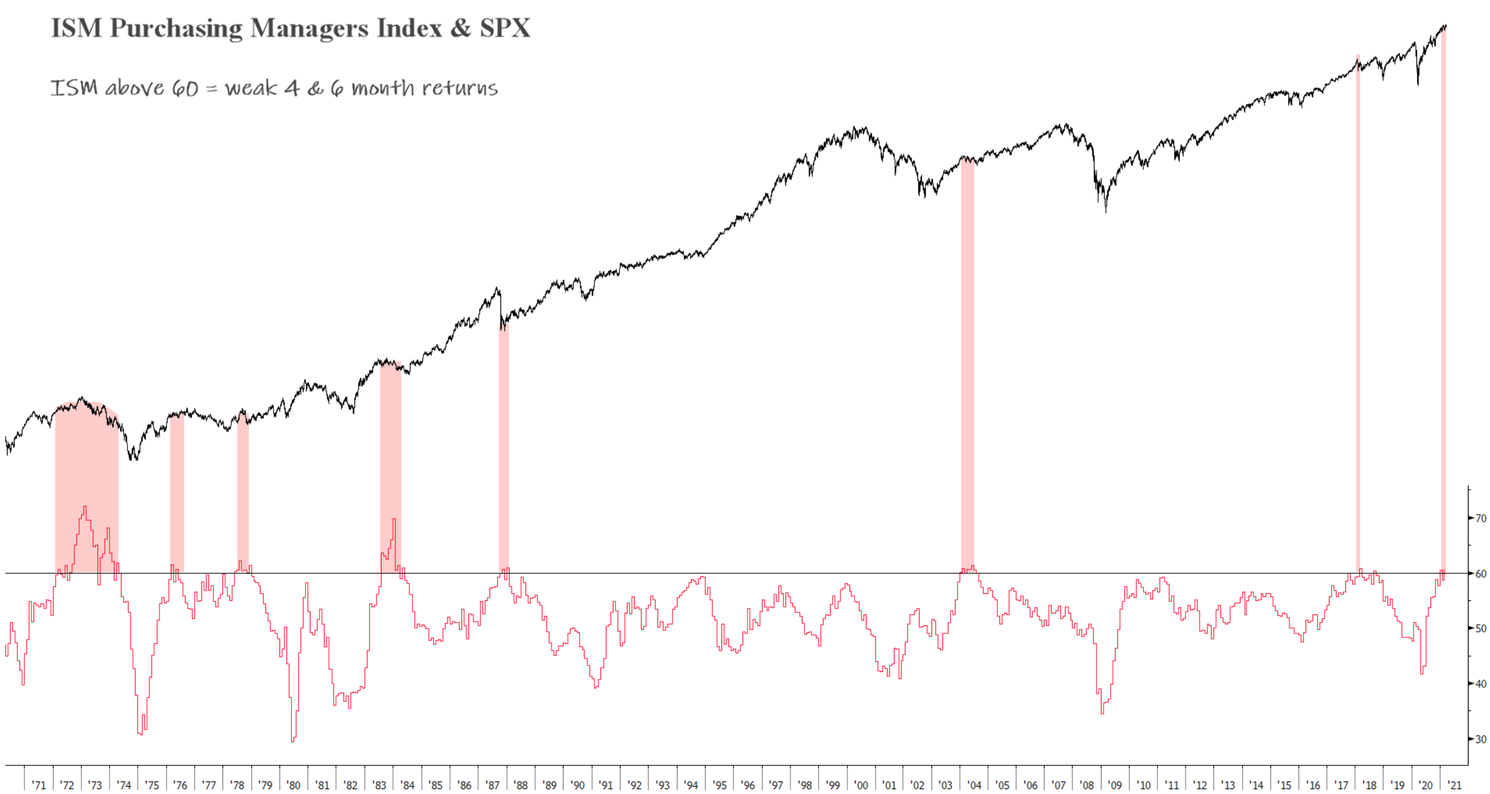
The ISM is over 60, which I've pointed out in the past typically leads to weak returns over the subsequent 3-6 months. The reason being is that a high ISM means a hot economy, which means a repricing of growth and rates. And fast-rising yields don't often bode well for stocks over the short-to-intermediate term.

A weak equity market then reverses flows back into safety (bonds) and the process begins again... wash, rinse, repeat.

Exhibit 4: S&P 500 has averaged weak returns following ISM Index above 60 since 1980



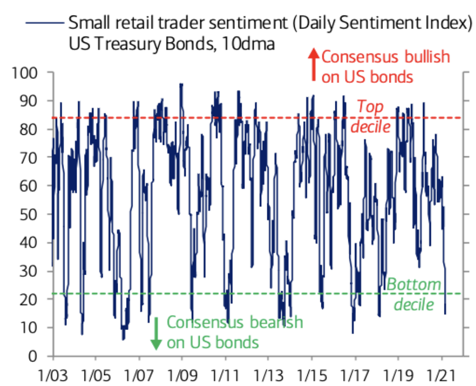
Source: ISM and Goldman Sachs Global Investment Research.



Here's some additional color from a recent BofA note (emphasis by me):

> "Strong economic growth – the kind we have been expecting since last summer, closes the output gap and leads to inflationary pressure. No surprises there. **This is standard operating procedure for early bull markets**. Since 1982, from peaks of the prices paid component in the ISM index, and the National Federation of Independent Business (NFIB) series for the net percentage of small companies planning to raise prices in the next 3-months, as they are now in all likelihood, bond yields have fallen at **twice the pace of their normal average decline in that period**.
>
> "Being bearish on bonds when these two series are in the bottom, NOT TOP DECILE, is much more profitable. On measures of bond sentiment, we see inordinate pessimism – the **Daily Sentiment Index (small retail trader sentiment) is at the lowest 7th percentile since 2003, the sentiment from Consensus Inc is at the lowest 1st percentile since 2003. The non-commercial short positions are 188000, also in the lowest 1st percentile since 1995. In the Fund Manager Survey, net 66% are underweight bonds, at 1.2 standard deviations below the long-term average**."

Exhibit 2: US Treasury bonds sentiment is at washed out levels (I)
Small retail traders are bearish on US Treasury bonds



Source: Trade Futures

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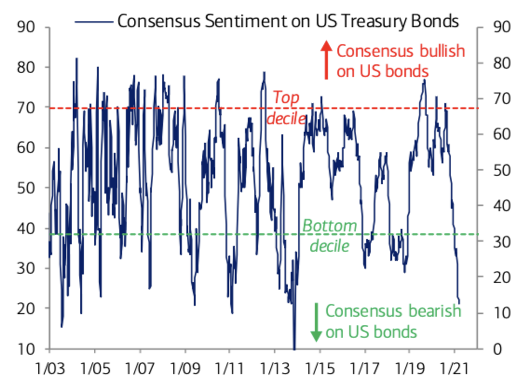
Exhibit 3: US Treasury bonds sentiment is at washed out levels (II)
Consensus Sentiment is bearish on US Treasury bonds



Source: Consensus Bullish Sentiment. Note: Consensus Bullish Sentiment is the gauge of positions and attitudes of major professional brokerage firms and independent advisors as interpreted and recorded by Consensus Inc.

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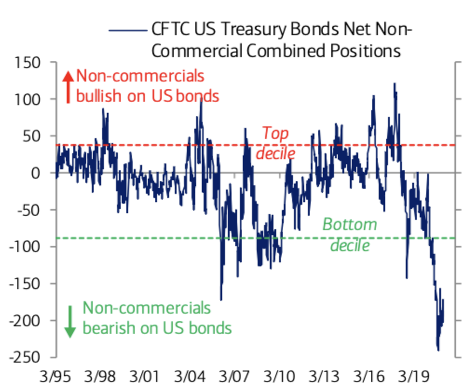
Exhibit 4: Bearish positioning on US Treasury bonds (I)
Non-commercials are bearish on US Treasury bonds



Source: BofA Global Research, Bloomberg

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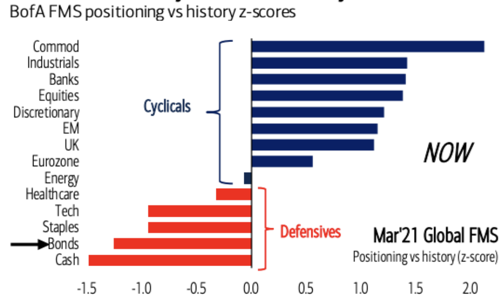
Exhibit 5: FMS shows cyclical consensus is "cyclical"
BofA FMS positioning vs history z-scores



Source: BofA Global Fund Manager Survey

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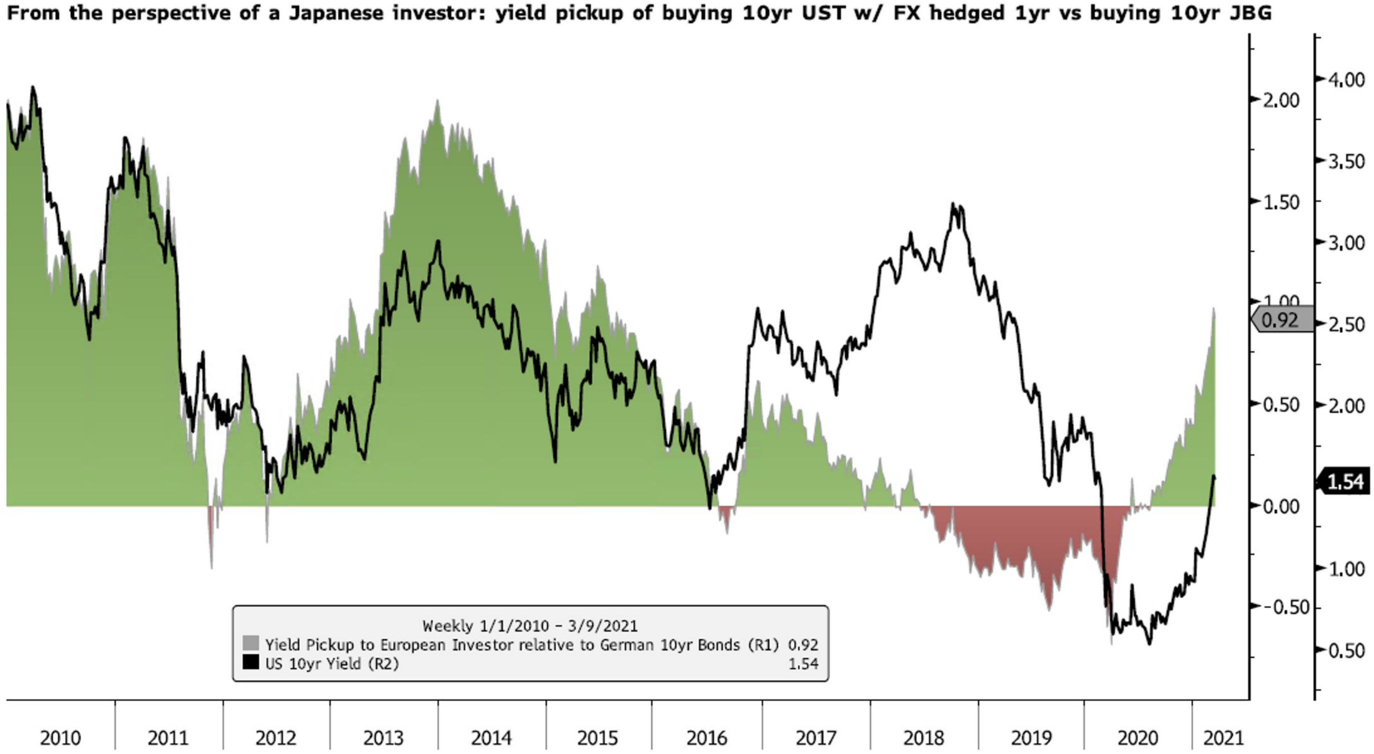
Also, Treasuries are now offering pretty decent currency-adjusted carry to the foreign holders out there carrying $14trn in return-*free* NIRP debt.

From the perspective of a European investor: yield pickup of buying 10yr USTs FX hedged 1yr vs buying German 10yr Bunds

From the perspective of a Japanese investor: yield pickup of buying 10yr UST w/ FX hedged 1yr vs buying 10yr JBG



There'd be some symmetry to things if we see the market slow its roll for a bit… The SPX is up 77% off its late March lows. This is also the exact percentage gain that the market saw off its 09' lows before it experienced its first significant congestion zone/pullback.

Maybe we see bonds bounce here, maybe we don't… The important thing is they're starting to move inversely to stocks, regaining some utility as a hedge for risk-off.

We remain bond bears (and equity bulls) and view any bounce (dip) as a counter-trend retrace. The curve still has plenty of steepening to do. But... buying a position here with a stop below the recent low will give us some added protection if things get squirrely.

Here are the details for the trade.

Buy Long Bond Futures (ZB_M2021 or TLT as ETF alternative)

- **Entry: 156'18**
- **Exit: 153'02**
- **At-Risk: 150bps**

Hit us up in the CC if you've got any comments/questions,

Your Macro Operator,

Alex