Buy Now, Short Later…

BofA called the last three months the "Longest. Quarter. Ever." A number of investors I've talked with, very much share that sentiment.

Between the *non*-transitory inflation, the Fed kicking off its most aggressive hiking cycle since Volker, major war in Europe, supply chains in tatters, people slapping people at televised award shows… it's been a lot to take in and digest.

One thing that's helped us cut through this noise and be up on the year (18%+) while both stocks and bonds have been hammered, was our dialing down of conviction months ago. We recognized at the end of last year, that we were entering a high noise-to-signal market regime. One coupled with high Trend Fragility, so we *adjusted* our strategy and positioning accordingly. Moving to shorter-term swing trading, staying heavy in our commodity positions, while paring back our open risk on our more strategic bets.

So while this quarter has felt like a year from a news flow perspective. From an investing one, it's been all *chop wood and carry water.*

Something we've been thinking about lately is the topic of regime identification. It's the idea that you have to know where you *are* in order to know where you're *going*.

We use the SQN to quantitatively define market regimes for swing trading strategies, which we've used quite successfully playing in the Ags these past few months. And it's certainly a useful tool for shorter-term strategies.

But I'm interested in expanding this thinking to the market more broadly. I want to quantitatively define broader market regimes in order to know (as much as one can know anything in markets) when we should be backing up the truck and buying the dip, or buying the dip but doing so in smaller size, or not buying the dip but selling the rip, or just moving to a more neutral stance in the portfolio all-together and raising cash, etc…

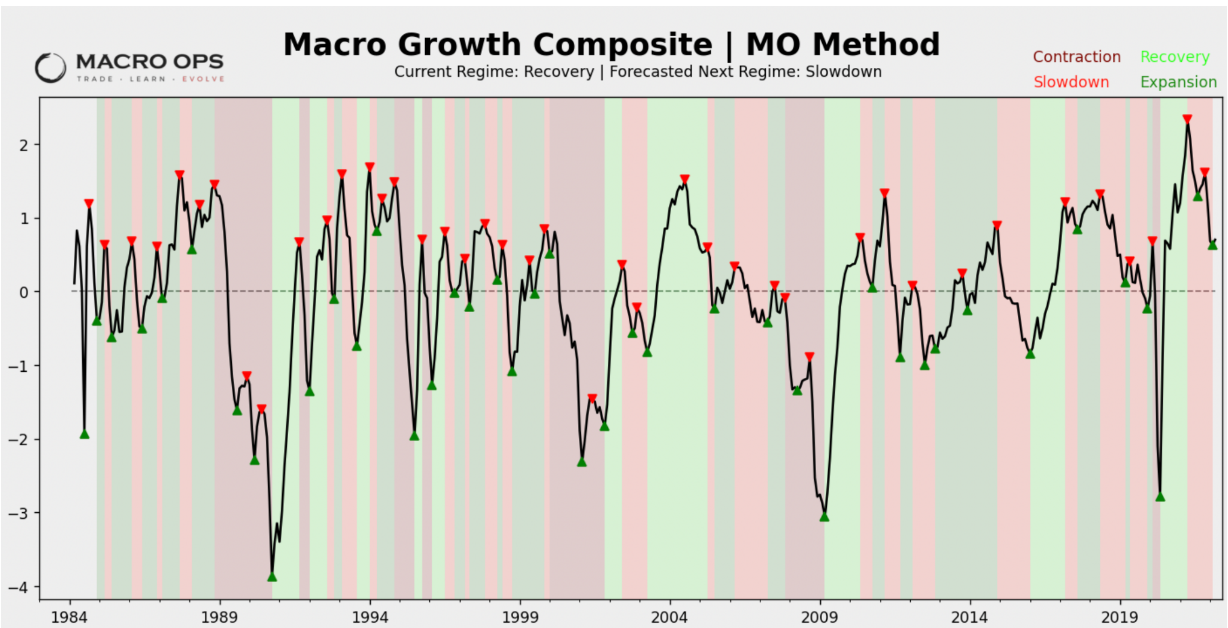
It's these nuances in trade management and knowing when to be more offensive or defensive-minded that form the basis of compounding capital over the long term.

We already do this in some ways, with the [TL Score], Trend Fragility Indicator, [Macro Growth Composite], etc… But there's still plenty of room to improve upon these indicators each individually and more interestingly, using them in aggregate in order to create a broader quantitative lens for defining market regimes and telling us where to focus our attention and positioning.

This is our big project at MO currently. We have some exciting ideas on how to execute on this and I'm looking forward to sharing them in the coming weeks.

A disaggregated look at where we are now…

The economy is in a late-cycle slowdown economic regime. Equity returns in these regimes tend to be low, averaging around 1% annually.

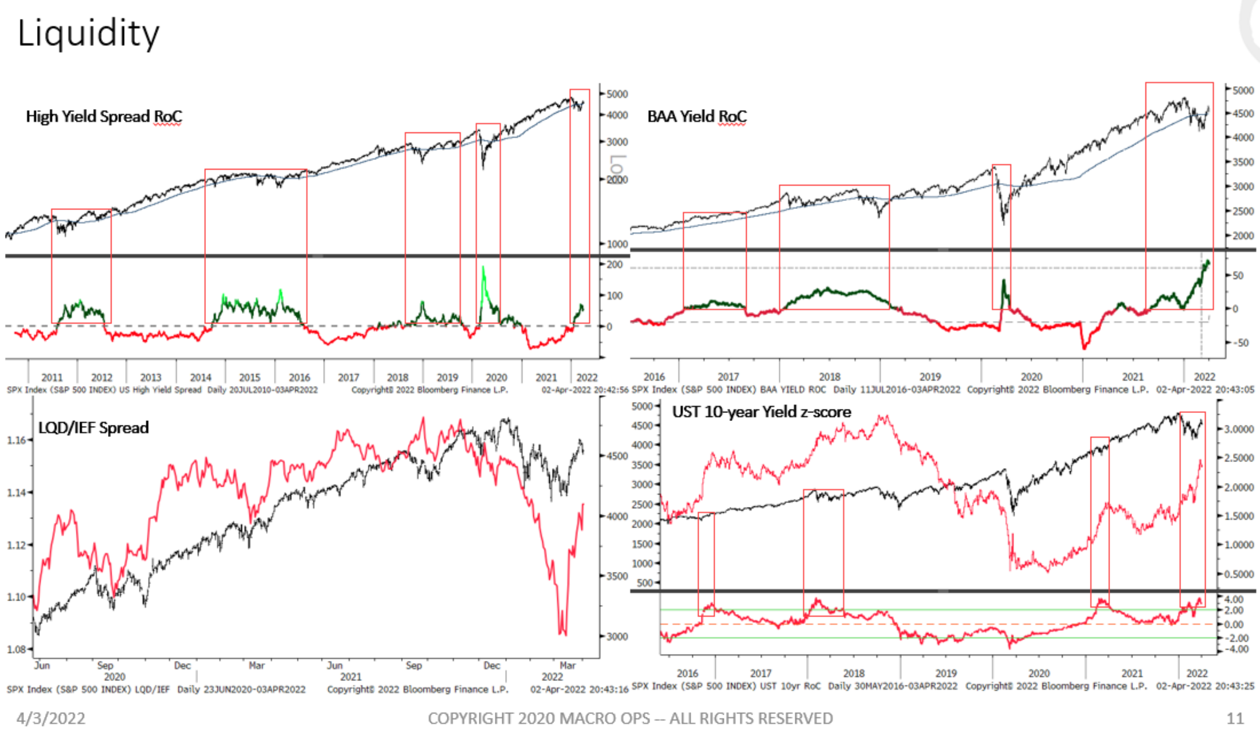


We are also firmly in a liquidity regime that tends to offer poor to negative equity returns on average.

The 10-year yield has seen a 3stdev move over the last couple of months. Stocks and bonds compete for capital flows and higher yields make equities *less* attractive on a relative basis, while also feeding through to the rest of the economic system in the form of tighter liquidity.

JPM recently estimated that investor allocation to bonds globally now stands at only 18%, which is the lowest level since 2008. They went on to write that "the mirror image of this is a very high equity-bond position gap, which currently exceeds the previous post-Lehman period high of 2018 and is approaching the previous cycle highs of 2006-2007… Historical experience suggests that severe bond fund outflows do not last more than one quarter outside crisis periods."

The rate of change in yields is currently at levels that historically lead to equity volatility and seeing how bonds closed near their lows on the month, we should expect higher yields (lower bonds) over the short-term.

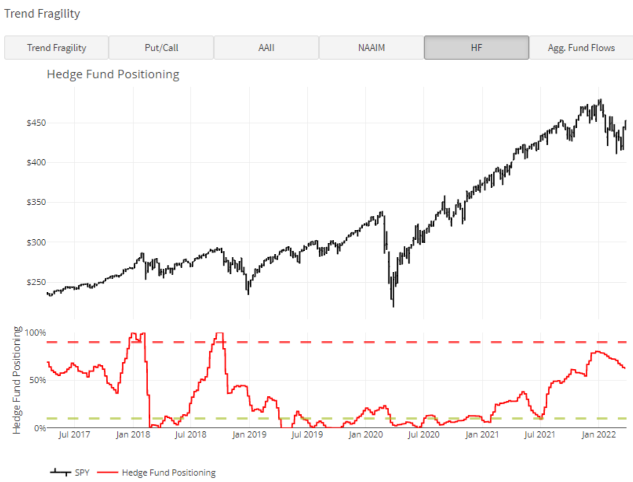


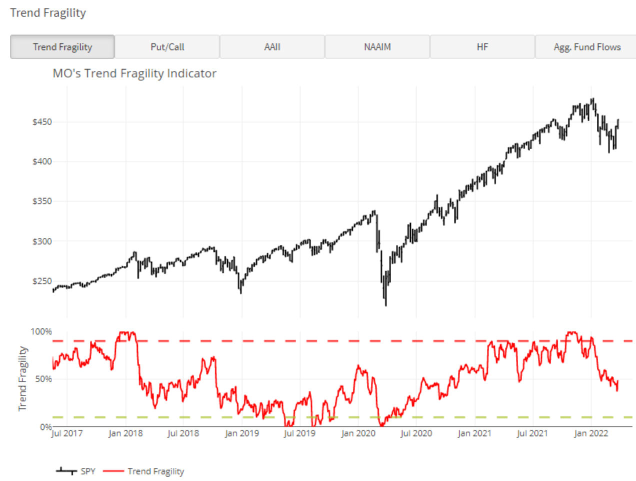
Positioning and sentiment can be looked at in a number of ways. But for our purposes, it's important we separate the shorter-term narrative-driven swings from euphoria to fear, versus the longer-term structural behavioral and allocation changes.

The former is still fairly supportive of higher prices over the next month or so. But, longer-term, there's a lot of short-termism and aggressive pavlovian dip-buying that makes for quite a fragile trend.

Take the two indicators below. The TF score (chart on right) is only at a neutral reading after hitting the 100th percentile at the start of the year. While HF positioning remains in the 60th percentile.

This is a far cry from the capitulatory washout conditions that are necessary to form an enduring bottom and provide the fuel for a major bull leg. This supports our base case for an extended sideways volatile regime.

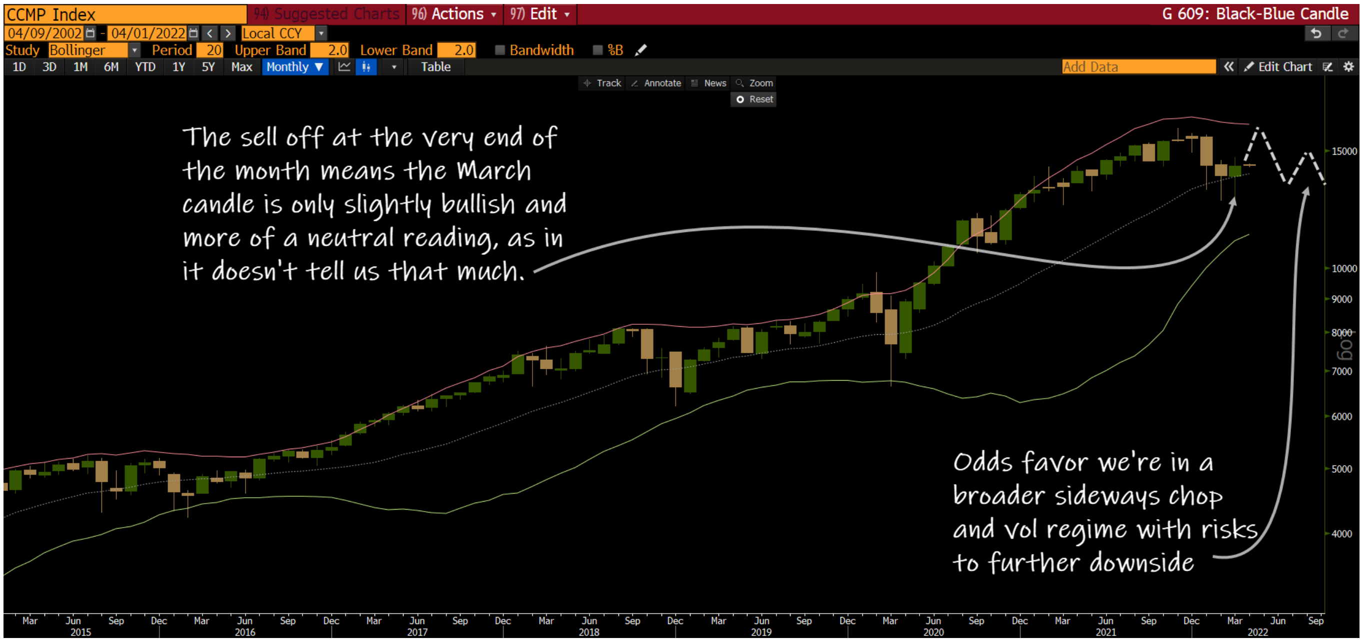




The technical picture gives a similar read to that of sentiment and positioning. It's one where the short-term favors the upside while the longer-term setup continues to look precarious.

The bulls couldn't drive a strong close into month's end, giving the monthly candle only a slightly bullish to neutral reading. But the bottom tail is still much larger than the top wick and this follows February's bar which also put in a large lower tail.

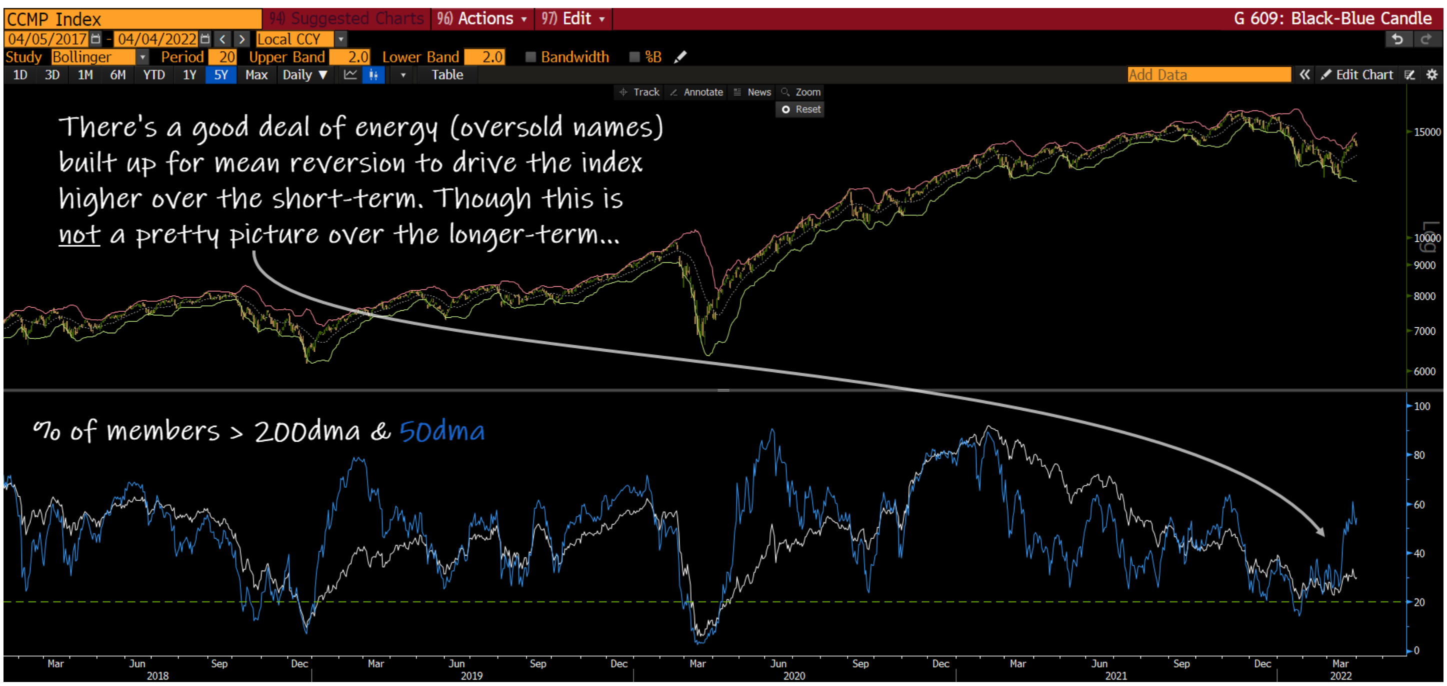
This [bar-by-bar analysis] shows that there's a decent bid for equities right around March's lows. And because strong 2-year bull trends tend to not *die on a dime*, there are decent odds the market makes its way back toward its Dec/Jan highs. It may even poke just above forming a larger double-top bull trap, which is typical after such long trends.



The only other real reason to be bullish here other than supportive sentiment/positioning, is mean reversion. There was a large bear market in richly valued growth names over the last year. Many of these names fell over 60% from their highs.

The chart below shows the percent of Nasdaq members below their 50 and 200 day moving averages. Both readings dropped to the 20% level (green horizontal line) by the middle of last month. These conditions give us breadth that is so bad it's good.

Again, like sentiment and technicals, this only applies to the very short-term (next 1-2 months tops). So it's likely we're seeing broad-based mean reversion putting a bid under the market right now.

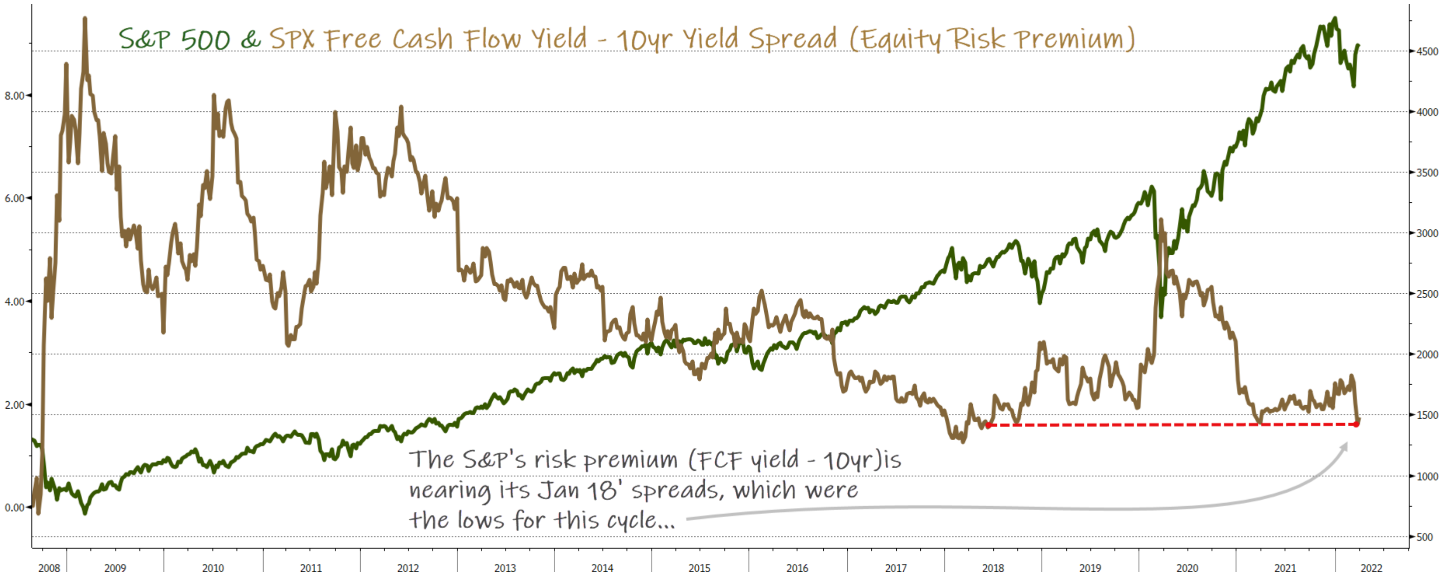


Concluding macro thoughts…

We have not seen any major follow-on Buy Thrusts which is another point against the bulls (see latest Trifecta report). The macro, liquidity, sentiment/positioning, and technical regimes all point to a large volatile sideways regime with significant risks of a much larger downside move in the coming months.

Short-term bearish sentiment and broad-based mean reversion should keep the market relatively bid over the next 1-2 months though. This may be enough to drive the SPX and Qs back near their Dec/Jan highs. But it's likely any push above will be a bull trap and opportunity to fade the optimists.

The market's risk premium is nearing its cycle lows reached in early 18'. War in Ukraine will keep commodity prices and thus inflation elevated and the Fed hiking rates at a fast clip. Slowing growth and higher costs will lead to lower earnings growth. Higher bond yields will at some point attract an exodus from pricey US equities, which will drive a larger selloff in the market.



Keep your eyes on the commodity ball…

We'll continue to take stabs at getting long/adding to a few beaten-down growth tech names we like (SQ, TWTR, DM, etc…). But we're not in a market regime that is favorable to this space. So the play there is to size small and stop tight. Our main focus will continue to be on commodities, which are still very much in the early stages of a secular bull.

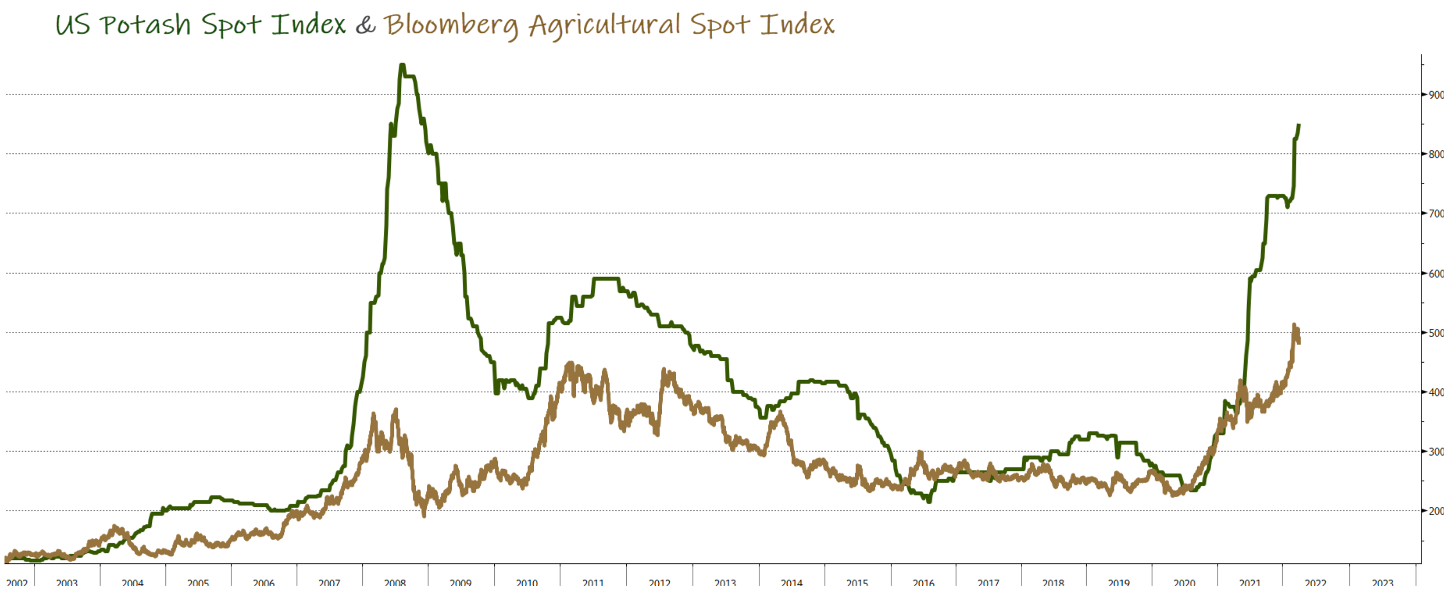
I have a note going out on the energy space in a few days but I wanted to go over Ags briefly here.

We talked about this last month when we bought corn and wheat shortly after the invasion. But, Russia and Ukraine account for roughly 30% of wheat exports globally. The longer the war progresses the more it means the majority of this wheat won't get to market. And not just this year but in the years to follow

The geopol strategist Peter Zeihan tends to err on the side of hyperbole but I think he's spot-on in his take on the direness of the budding food shortage situation (link here). The TL;DR is this:

- ➢ Russia and Ukraine account for roughly 30% of global wheat exports.
- ➢ Russia's scorched earth policy in Ukraine means Ukrainian farmers won't be able to plant this year. And even if they can next year, they probably won't have the infrastructure to sell it into global markets.
- ➢ A global fertilizer shortage will further dampen crop yields in the years to come.
- ➢ Due to rampant African Swine Fever, China was forced to cull its hog herd. Concerned about its food security, China banned the export of the fertilizer phosphate, in order to secure their rice production.
- ➢ Record-breaking natural gas prices mean nitrogen-based fertilizers are too expensive to be used economically at current market prices.
- ➢ Potash is the other remaining major fertilizer. Russia and Belarus (which is effectively Russia now) account for approximately 40% of global potash exports.

It's not rocket science. Higher input costs combined with a growing supply deficit mean prices need to rise in order for the market to clear.



We're still sitting in our long wheat position after taking half profits last month, once the chart hit major overextension as shown below in the [HUD breakdown.](#)

The longer-dated charts look better than the front-month contract, so we'll probably roll into the Dec 22s soon (chart below). Wheat is consolidating and working off some mean reversion after a large thrust. It's in a Bull Quiet regime, seasonals are neutral and probably don't matter much in the current environment. Spec positioning is long and I suspect some of that will be worked off as the chart consolidates.

Our largest equity holding currently is Corteva Inc (CTVA), a global producer of seed and crop protection products, with a high beta to the price of corn, wheat, and soybeans. The monthly chart is below and shows a nice rounding bottom continuation pattern leading to a new major bull trend.

US-based potash producer and water rights play on the US shale industry, Intrepid Potash (IPI) is another one that's kicked off a major bull trend. Charts like these look overextended in the short-term but IPI could very well take out its all-time highs before this cycle is over…

We have a number of potential swing long setups this week in a number of other softs (Oats, Soybean Oil, and Rice). We'll be sending out a swing setup (VBO/FVBO) chart pack on Tuesday.

We'll be out with more soon,

Stay frosty and keep your head on a swivel.

Your Macro Operator,

Alex