A Market Note: What's Your Game?

Another recession indicator firing, more evidence gold's run is just getting started, and an intermediate top in USDCNH, plus more… Lot's to dive into and cover this week. But before we get started on all that. Let's talk about the importance of knowing what game you're playing.

The other day I was chatting with a fellow Collective member. He asked why so many macro guys were shit…

This is a valid question. Most macro ~~traders~~ personalities have zero clue what this game is about. They talk a lot, though. They sound smart, sure. And they aren't lacking in the confidence (or hubris?) department.

This usually gets them a large audience of followers (twitter, substack, etc…). People quickly forget about all the bad calls. It actually doesn't even matter to them. Not really… What they're looking for… what most people are looking for… is **certainty.**

They want someone to tell them, with confidence, what's going on and what's going to happen.

They want assurance.

Nothing against them. We're all wired this way.

That Collective member shared this line from Jim O'Shaughnessy that goes, "we are deterministic thinkers in a probabilistic world." Which is a smarter way of saying what I often write, which is that we're *linear thinkers in a dynamic complex world.*

It's not just macro traders, though. It's everyone in markets. Value investors are actually worse. **They're just as clueless but five times as smug**.

Industry professionals take this to a whole other level. The vast majority of them don't know what game they're *actually* playing. They think they're playing the "make good risk-adjusted returns" game. But, really, on a subconscious level, they're playing the social acceptance/validation show everyone how smart and great I am game.

Some can do quite well playing this one. Looking and sounding the part can get you a good deal of AUM. Hugging the benchmark can keep you in the racket. And collecting buku management fees can provide the validation you seek.

But usually, when the game you're really playing doesn't match up with the one you believe you're in. You lose. You blow up. Many "rock star" investors from this past cycle are finding this out now.

The skill they thought they had, wasn't skill at all. It was, in fact, just a Pavlovian leveraging of what had been working. This worked. Until it didn't. They quoted Buffett. Tried to sound like Buffett. But weren't Buffett in the slightest. If they were, they would have practiced his two rules of investing:

> *Rule Number One: Never Lose Money.*
>
> *Rule Number Two: Never Forget Rule Number One.*

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

I'm reminded of the line from one of my favorite investing books, *The Money Game* by Adam Smith, who wrote:

> *If you don't know who you are, the stock market is an expensive place to find out.*

Some of the most important work a trader/investor can do is work on himself. Cultivating your inner awareness. Digging into your shadow side to find out what *really* makes you tick. Now that work pays dividends and will help keep you alive in markets.

> *Win or lose, everybody gets what they want out of the market. Some people seem to like to lose, so they win by losing money.* ~ Ed Seykota

Someone shared this excellent post from Graham Duncan in our slack last month. It's titled "The Playing Field" and starts out with:

> Over the last decade, I've interviewed and assessed more than 5,000 investment managers. One of the most important things I've learned in that process is what separates the great investors from the rest. The great ones view investing as a game, and they know exactly what game they're playing. It brings to mind an observation from the philosopher Kwame Anthony Appiah:
>
> *"In life the challenge is not so much to figure out how best to play the game; the challenge is to figure out what game you're playing."*

He goes into the five levels of the game, giving the attributes of the Level 1 Apprentice all the way up to Level 4 Master, and then lastly, Steward. It's a good post and worth reading in full, as it dovetails with our conversation.

The great ones view investing as a game, and they know exactly what game they're playing… is a central truth. One that is worth ruminating on.

Earlier this year, I wrote a note titled *The Naked Sniper... and other lessons on markets and investing*, where I dived into this idea of *knowing exactly what game you're playing.* I suggest giving this one a read if you haven't already. But here's a clip that sums up the main point:

> Trading (and investing) is not about knowing things. That's like maybe 10% of the game if I'm being generous..
>
> You know what's a more apt descriptor of a successful trader?
>
> An **UN**certainty manager. Someone who can successfully manage not knowing things. Someone who can make money over a full cycle, while knowing that he only knows maybe 30% of everything that's critically important to his trade or investment successfully working out.
>
> Being a successful trader isn't, in fact, about knowing the inner workings of central banks, advanced monetary plumbing, finding indicators that tell you where price is headed, or modeling out what a company will earn in 3 years' time. These are all part of the game, sure. Useful

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

knowledge to know, depending on your strategy, absolutely. But it's not the IT, it. It's not the meat. Not the essence.

The meat is full-heartedly accepting your ignorance, embracing your fallibility. And then designing a system, a process, that gives you an edge. An edge that tilts the odds in your favor. And then ruthlessly hitting that edge over and over and over again.

And there are a number of things that are foundational to building out and executing on an edge. These are the "empty" platitudes and "tired" adages… *risk management above all else… respecting the tape and being humble… not wedding yourself to an opinion, etc…*

It's one thing to hear these things. It's an entirely different thing to know them. To embody them.

One of my go-to contras is a popular fintwitter with well over 100k followers. He posts lots of fancy-looking charts with "proprietary" indicators. He's always confident and nearly always wrong. He's great. I get a lot of value from following (fading) his work.

He's playing the certainty game, which isn't how this game works.

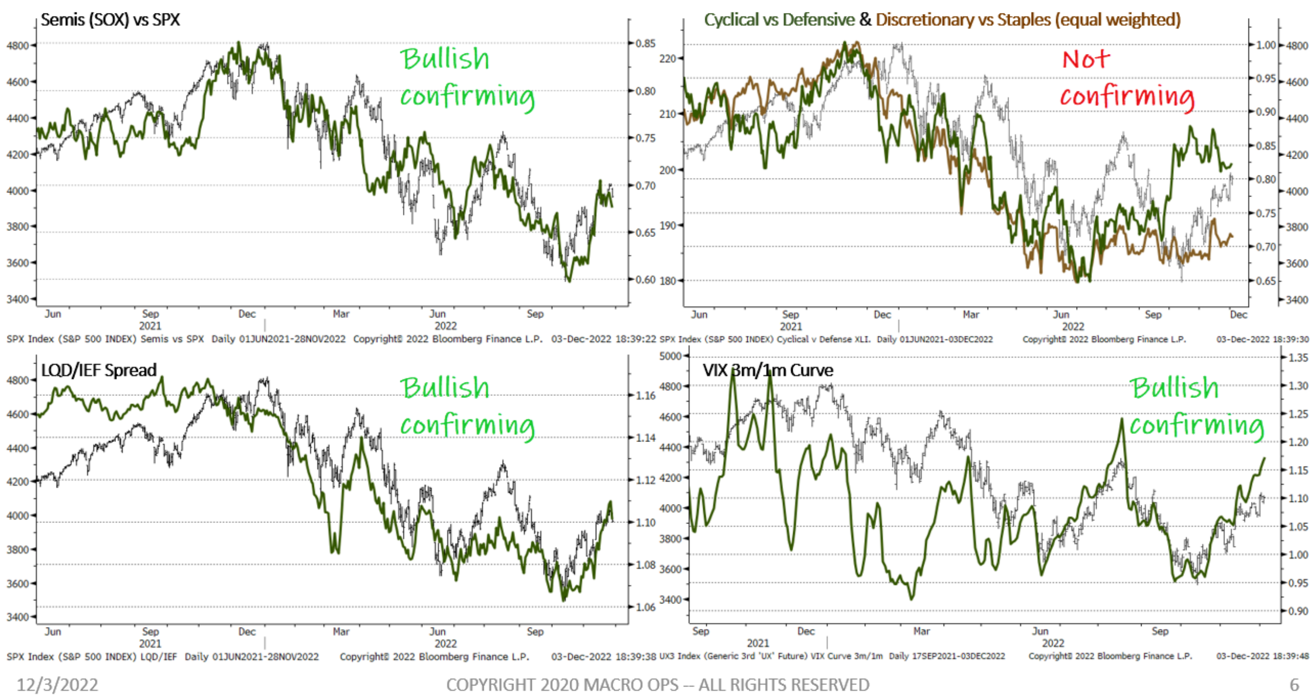
End of rant. Let's get to markets.

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

Rates and positioning are driving this bear market rally…

The conditions for the continuation of this bear market rally remain valid (1) yields keep coming in (2) financial conditions are easing (3) positioning is coming off historic lows, and (4) strong seasonals are providing the additional tailwind.

Though, importantly, as I pointed out last week. Several leads are starting to soften. Combine this with the lack of any material confirming breadth thrusts, and we get a rally we want to participate in but not get too aggressively long, or comfortable. As my mentor would always say "only the paranoid survive!".



It's good to stay paranoid here. Follow the tape, read the internals, and look for signs of weakening breadth and credit. Cause this rally will end, and the bear market will resume. My guess is it turns sometime after the new year once financial conditions ease to the point that the Fed is forced to talk tough again. By then, the positioning will have reset, and the birds will all be chirping "soft landing."

Switching up gears a bit. Here's a setup on the equity indices going into the week.

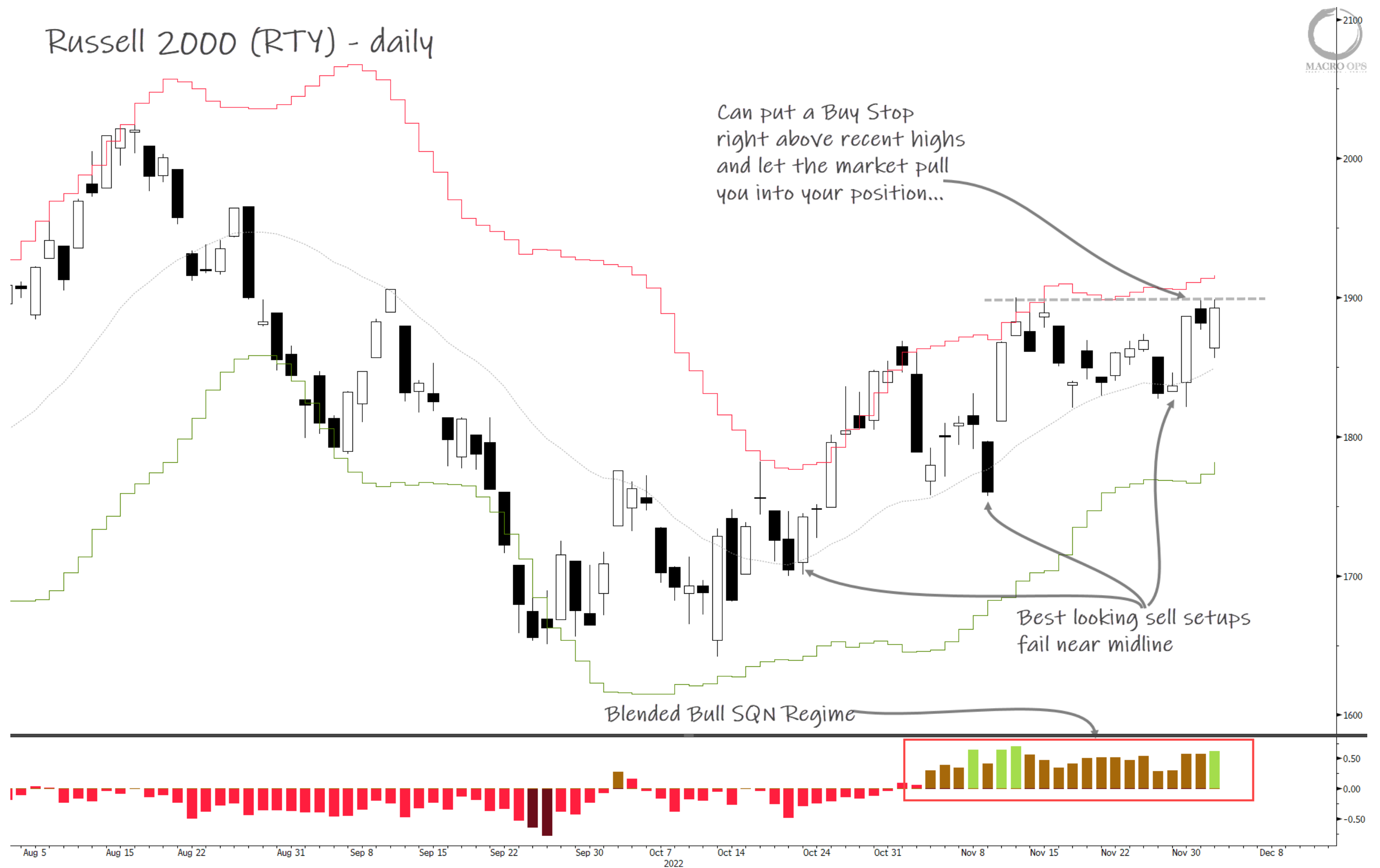
We've been writing about the relative value case for small-caps these past few months (here and here).

RTY is showing strong leadership. It's in a textbook Bull Quiet regime with good looking sell setups

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

failing around the midline.

A good spot to enter/add to our long positioning is right above this week's high. We'll be putting in a Buy Stop order and letting the market pull us in if it breaks higher this week. If not, our order doesn't trigger.

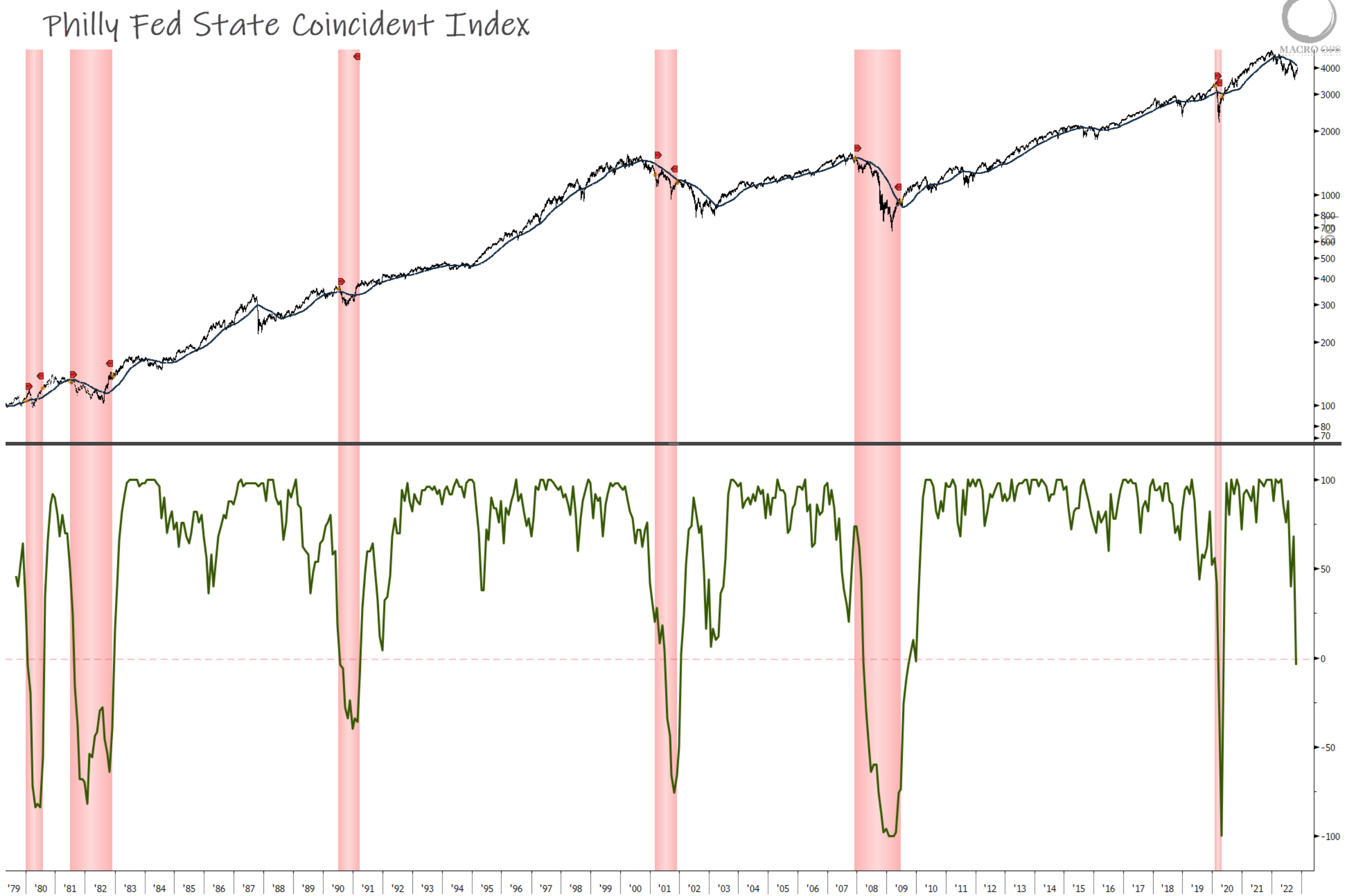


Philly Fed State Coincident Indicator Says 2023 Recession Is On…

The Philly Fed State Coincident Indicator, which measures the percentage of US states seeing slowing economic growth, dropped to **-4%** on its last print. This confirms our other recession signals (see slide 11 in the Trifecta).

This indicator goes back to the late 70s. It's never fallen below 0 without a recession soon following.

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE



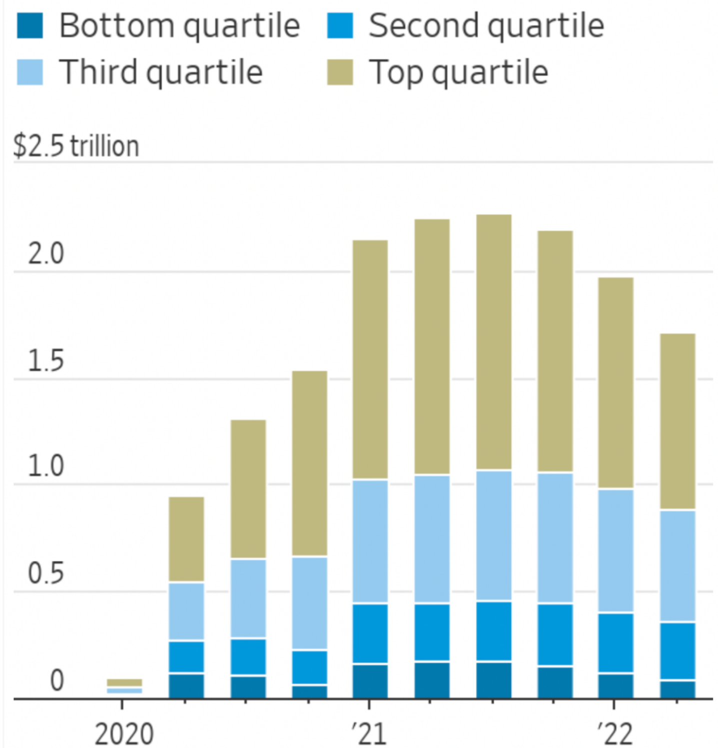
This time won't be any different.

But, as we've been writing all year, the recession is unlikely to hit until the second half of 23'. Real retail sales growth (YoY%) remains positive, the labor market (which is typically the last domino to fall) is running on momentum, and consumers are burning down what's still a sizable cash cushion, according to the [WSJ](WSJ):

> *Household, nonfinancial corporate and small-business sectors ran a surplus of total income over total spending equal to 1.1% of gross domestic product in the quarter of April to June, according to economists at Goldman Sachs Group Inc. Using a three-year average, the measure is healthier than on the eve of any U.S. recession since the 1950s.*
>
> *Using a three-year average, the measure is healthier than on the eve of any U.S. recession since the 1950s.*
>
> *U.S. households still have around $1.7 trillion in savings they accumulated through mid-2021*

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

above and beyond what they would have saved if income and spending had grown in line with the prepandemic economy, according to estimates by Fed economists. Around $350 billion in excess savings as of June were held by the lower half of the income distribution, or around $5,500 per household on average.



And so we remain in a bit of limbo. We're in the 4th to 5th inning of this bear market. To date, the market selloff and the subsequent compression in multiples have been driven purely by higher rates.

Concerns over slowing growth and lower earnings have yet to feed into expectations. Though I suspect that changes after the start of the New Year.

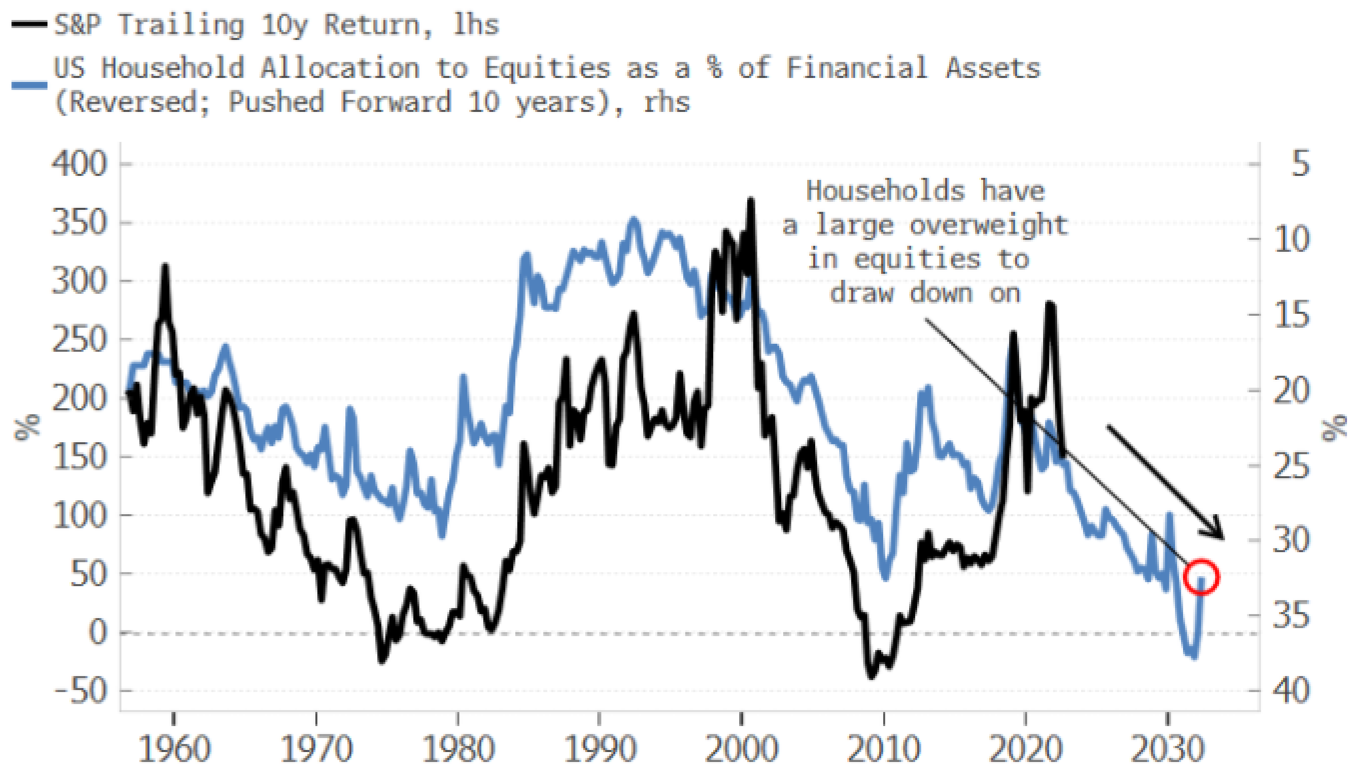
Gold is in a Goldilocks environment…

We continue to be very bullish on precious metals looking out over the next 2-3 years.

You can read our framework for analyzing precious metals here. But the gist of it is this:

1. Over the long run (and this is one of Ray Dalio's "principles" regarding gold, as well) the price of gold will approximate the total amount of money in circulation divided by the size of the gold stock.
2. And it's not inflation or deflation that is the principal driver of gold, but the expected real return from other long-term financial assets, particularly equities.

The expected real long-term return on equities is largely driven by valuations and asset preferences. Obviously, high equity ownership equates to elevated valuations. This is why there's a clear historical inverse relationship between Household allocation to equities and the market's 10-year return.



The data suggests the rest of the decade will be a poor one for US real equity returns. This means it'll be a great one for gold and silver.

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

Looking at our HUD's multi-chart view for gold. We can see that the current bullish impulse in PMs is going up against crowded short positioning. This is a LOT of fuel to drive this trend higher as trends are formed by the forced conversion of disbelievers.

3-year average net speculative positioning is just 11% (dotted orange line). PMs enter a period of strong seasonality at the end of this month. While the technicals are stretched over the short-term (50dma price spread is > 2std), meaning there's high potential for a pullback/consolidation soon.

Any pullback/consolidation should be viewed as an opportunity to add. This is a higher conviction call for us so we are playing this aggressively.

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

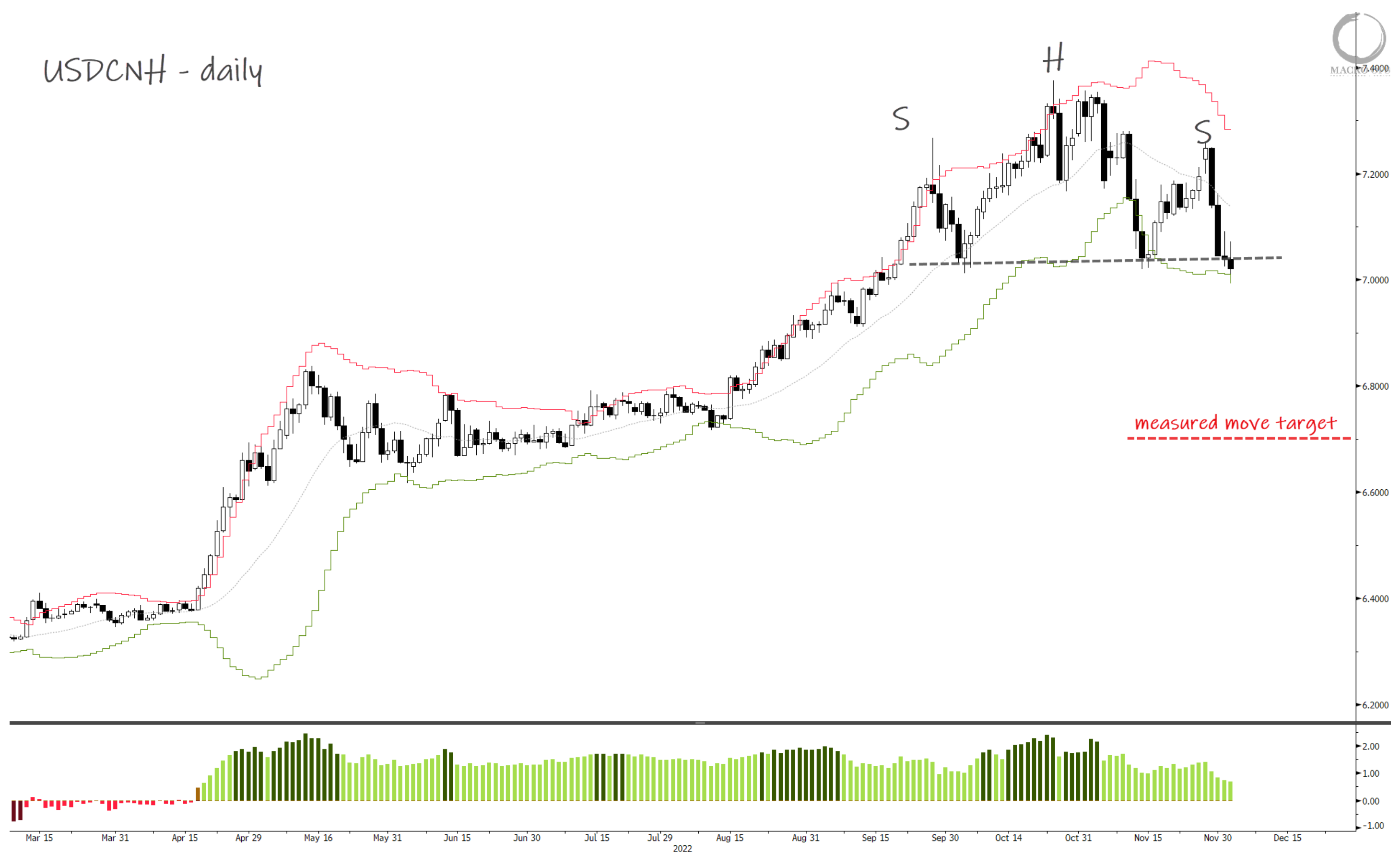
Implied vol is still low in many of the miners, which are so far lagging the spot price. Though I expect that to soon change as sentiment begins to flip.

This gives us a good opportunity to add to our DOTM calls on First Majestic Silver Corp (AG), which we'll be doing this week (look for an alert in the next few days).

We're short the US dollar through EURUSD, which is so far working in our favor. I expect this bearish USD trend to continue into the end of the year or as long as financial conditions keep easing.

One setup we're eyeing is the major H&S top in the USDCNH pair.

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE



We made a good deal of money long USDCNH earlier this year. And we got lucky with the timing of our final exit. But now the tape is looking heavy. And there's a lot of bearish China sentiment in the market.

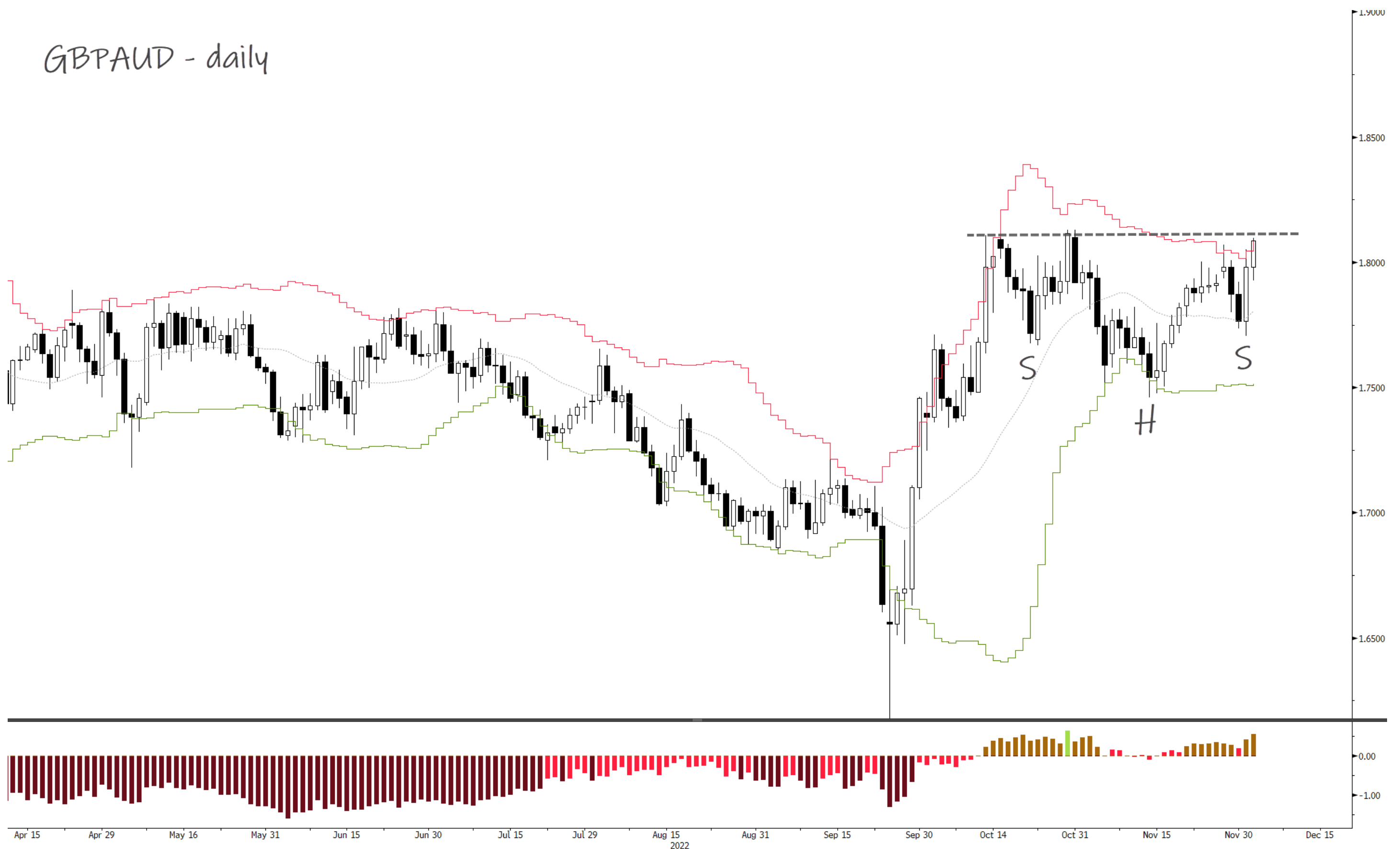
China is a black box, so we always take our expectations with a good deal of salt. But, from where we sit, it looks like Xi is making moves to ease up COVID restrictions on his people. We're long-term China bears for a host of reasons (link here and here). But the market is likely due for some more mean reversion over the near term.

We may take a swing at this one. But if so, we'll size on the light side with a wider stop.

I'm also tracking the GBPAUD setup, which has completed an inverted H&S continuation pattern and is in a neutral SQN regime.

10-year yield differentials are trending in the pound's favor. Though I'd expect a China reopening (if it does happen soon) will act as a bit of a headwind to this trade. We'll watch to see how this one develops over the coming days.

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE



Lastly, let's talk about Natty.

We got knocked out of the Dec 23' contract this last week.

This was a bad entry on my part. I got sloppy, and I chased when I should have practiced patience and waited for a pullback/consolidation. Inexcusable…

Entries near the 20-day (Bollinger Band midline) have a higher tendency to work. They also typically allow you to get more size on.

This is because traders like to buy value and sell extended/rich markets. A common measure for both is the price's relation to the 20-day moving average. This is why markets tend to oscillate in sine waves along broader trends.

I still like this trade longer-term as there are early indications this winter will be colder on average in the North East. While supply remains incredibly tight globally. Also, 3-year net speculative positioning is in the 1st percentile, while a strong negative seasonality bias ends in 10 more days (see the HUD for more).

The Dec 23' contract is in a Bull Quiet regime and trying to break out of a larger sideways range. It will

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

be telling how the price reacts Monday/Tuesday. Do we get a sell setup failure, trapping shorts, driving a rip higher? Or does the tape revert back into its larger sideways range?

We'll wait for the market to give us the answer and then act accordingly.

I'm not going to lie. This year has been a grind for us. After being up **+30%** in May following the Russian invasion of Ukraine and our timely trades in wheat and long USD, we've been stuck in Chop City since.

Our port is still up **+16%** ytd. Which is okay, considering. But it still never feels good to work your ass off running fast while standing still.

That's how this game is though. As my old platoon commander used to say, *we have to piss with the dicks we've got, not the ones we wish we had.* And so it is with markets… we have to play the cards on the table. And sometimes, that means grinding it out and just trying to stem the bleeding.

But while we've been grinding away in these markets, we've also been working on building out new tools, researching new systems and strategies, along with a host of other things that we'll be rolling out to our Collective soon.

I'm not going to lie. I'm getting pretty excited about it.

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE

That's it for now. We'll be out with more this week, including the inflation primer I've been working on.

Stay frosty and keep your head on a swivel!

Your Macro Operator,

Alex

COPYRIGHT 2021 MACRO OPS — ALL RIGHTS RESERVED // DO NOT DISTRIBUTE