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ROHR ALERT!! Not a Powell Put

1 message

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Dear Subscribers,
While the Australian Open is over, the US Equities Open is in progress and looking much more like it is game, set, match for the bears in the near term. Consistent with the old axiom "*Don't fight the Fed*", there would have normally been a natural extended 'risk on' psychology driving US equities higher on the assumption Chair Powell was going to maintain the extremely accommodative "*Not worried about inflation while reviving a pandemic-crushed economy*."

Yet as noted in Monday's "US Equities Critical 'Risk On' Decision" ALERT!!, the problem for US equities is that the longer-term yields have already begun to anticipate a recovery later this year. Two aspects of this are very typical. The first is the classical axiom, "*The market is a creature of expectations*." While that is most often applied to US equities (and others), it also applies to other asset classes as well. And recent extended weakness of the global govvies (i.e. higher yields especially in Europe) is on the expectation the previous extremely low, rampant pandemic interest rates cannot maintain during a strong recovery.

As there have already been some signs of increased inflation on top of the recent economic data improvement, it is a reasonable assumption that the trend toward higher prices will continue. However, the degree of those increases will be the issue after stronger than expected jumps into the first part of this year. There is also reinforcement from this morning's Organization for Economic Cooperation and Development's latest G20 International Trade for Q4 (https://bit.ly/3upRy0s for our mildly marked up version.) While it notes the slight cooling from an explosive Q3, that was on renewed pandemic restrictions which may be easing from here.

It is also worth noting OECD says the trade strength in the UK and Continental Europe may well have been more elevated due to anticipatory purchases and shipments in anticipation of the final Brexit breakup into the end of last year. It is possible that is waning to some degree on the Brexit hurdles which have now taken effect. There is also the continued weakness of the UK economy as seen in today's weaker than expected Employment Change. That was -114,000 on a -30,000 estimate, continuing the weakness of the loss of 88,000 jobs last month.

That is important due to the UK inflation anticipation being a primary driver for the front month Gilt future being the downside leader of global govvies. It has come down from near 137.00 into early December to trading below some key lower 130.50-.00 support early this week. If that fails, the next interim support is 128.00, yet with more major support not until the 126.50-125.50 range. While it may not be a market many of our readers trade, it is important for the potential to reflect the already aggressive long yield rise extending significantly from here.

It also reflects the degree to which the current yield bulge weighing on the US equities is anticipatory in nature on further interest rate increase expectations. This will be interesting

to watch in the context of especially sustained weak UK employment indications. The question is whether the inflation to date reflects real strength, or anticipation of stronger sustained price rises in the near-term future.

That's where Powell comes in on the prospect for the Fed and other central banks to stick with their commitment to let inflation rise until an economic recovery is in place, and inflation has demonstrated durability beyond what have previously been temporary blips due to pandemic-driven supply disruption. As we have noted on many occasions, the inflation the central banks need to see is the more telling 'demand-pull' inflation from too much currency chasing too few goods.

That is a better sign there is a more impressive economic recovery in progress, and the signal to the central banks that they need to start boosting base rates once again. Yet the second historically typical aspect we initially alluded to above may be a bit of a shocker for those who have not seen a rate hike cycle before (which is likely for many of our younger readers): the Fed and other central banks do not actually determine when rates rise… it's the longer dated instruments.

The Fed and the others are for the most part lagging actors who are forced to reinforce what in most cycles is the rate pressure already established in the longer end of the yield curve (i.e. the 5-30 year yields.) That is because, as opposed to the shorter-term yields that are so heavily impacted by the central bank base rates, longer-dated debt instruments are freely traded, and can more actively anticipate future inflation and yields… this is obvious on recent form.

The degree to which central banks remain more accommodative than longer-term rates suggest is consistent with controlling near-term inflation is apparent in Monday's speech by the ECB's Lagarde, and even more so in Fed Chair Powell's first round of testimony today in the US Senate. In his already released prepared statement (https://bit.ly/2NTg0ql our mildly marked-up version) he was very clear on several points. Inflation is not as yet anywhere near the Fed's 2.0% target.

It is also the case on the recent policy changes (revisited in his statement) that labor market repair is going to take precedence over inflation control. That means allowing inflation to run somewhat above the 2.0% target if necessary to allow for the millions of unemployed Americans to find employment in an economy which will in general only gradually emerge from the extreme pandemic pressures.

While this would historically amount to central banker blasphemy, it is wholly consistent with the recent Fed shift to a focus on average longer term inflation from the previous concern over near-term control. The recent policy revision was highlighted by Powell today in citing the long period of below target inflation likely calls for a period allowing modestly above target inflation to 'average out'.

That is likely of particular concern in the context of the global govvies yield rise not appearing particularly extreme in the longer-term view. Yet the '*creature of expectations*' view leaves a troubling psychology. That is due to the degree to which global govvies prices are set on the 'real yield'. That is the difference between the nominal interest rate on the debt instrument and the inflation which erodes it. Current yields are actually below the Fed's allowance of 2.0%+ inflation.

While global govvies slide to date looks more dramatic in the UK and Europe, the US 10-year T-note is considered an important benchmark. While it has been under pressure down

to new 11-month lows, by comparison the UK Gilt has dropped back to levels not seen since April 2019. And with its more limited slide, the US 10-year T-note yield is only up to a new recent high of 1.37% today. Think about it.

If Fed Chair Powell is signaling that as part of the curing the US employment situation (in itself a laudable goal) the FOMC is not concerned about the inflation rate spending some time up into the (let's pick a number) 2.30%, what does that likely mean for the global govvies yields and prices? Without getting into any of the complex permutations of what drives inflation expectations and how much of a 'real yield' might be attractive, that likely means a 2.50% 10-year T-note yield.

And that is the sort of thing which is obviously not priced into the US equities remaining up near their recent highs. While there is consideration of the positive impact of Biden's ARP $1.9 trillion additional support to the US economic sectors which are suffering, it is also considered inflationary to the degree it will drive demand beyond already improved levels. Even allowing that the pandemic path might not evolve in as positive a manner as the improved vaccination program expectations have encouraged, there will just be more money chasing goods.

That is why this phase coming out of unusually low longer-term yields (the 10-year German Bund is UP to -0.32% and the UK Gilt is 0.70%) with (rightful or not) improved economic expectations leaves the sustained accommodative central bank policies stranded instead of a 'driver' for risk appetite. US equities needing to price in another full point of higher longer-term rates into expectations for future business conditions will not allow for the classic '*Don't fight the Fed*' to be a key psychological driver, as the market is now signaling this week. While the US equities had been supported by the Greenspan Put, Bernanke Put, and the Yellen Put since the 1990s, any Powell Put isn't going to work right now.

Just what that means for how much lower the global govvies are going in the near term can be assessed from a longer-term Evolutionary Trend View. And what it means for the US equities seems to be at least fulfillment of the minimum near term Head & Shoulders Top 3,881 DOWN Breakout (see Monday's ALERT!! for a full discussion and annotated short-term chart link) Objective in the 3,800 area.

However, that is indeed a minimum (also weekly MA-13 into next week.) The more prominent supports if global govvies continue to exert pressure are in the 3,700 area (held during the GameStop volatility), the 3,600 area, and even down into the 3,500 area… the Negated September CPR top and weekly MA-41 into next week.

This is the critical consideration
Aside from the sheer magnitude of the selloff in the first week of September, it was also a technical pattern top. That is clear on the front month S&P 500 future weekly chart https://bit.ly/3aloWb6 (updated through Friday.) Such a significant rally above the previous week's 3,504.50 Close and drop well below it established a major DOWN Closing Price Reversal (CPR) with a 3,510 Tolerance.

The next significant support after it traded below the February 3,397.50 previous all-time high looked like the 3,230-00 range we had previous highlighted as rally resistance into early June. After that held once again, the recent surge back above the 3,400-30 area left a burden of proof on the bears to get the market to fail back below that area. Yet instead the December S&P 500 future posting weekly Closes above first 3,505-10 and ultimately the 3,550 area looks like it is indeed again 'Risk On' Forever. This is confirmation of our

estimation the US election would be a win-win for US equities, with the key accelerated bullish influence from the serial positive vaccine announcements since early November.

The near-term question was whether it could hold support at the early-September 3,587 trading high and 3,582 early November Close, with a Tolerance to the 3,575 congestion? Even though it slid below them in early-mid November on US election concerns, those issues clearing up reinstated the 'risk on' psychology.

Above that range since late November left minor congestion resistance in the 3,625-35 range. Also above that pointed to the recent 3,668 all-time high that was exceeded into the beginning of December with a 3,700 new all-time high. While it traded slightly above that into early December, the lack of a Trump signature on the COVID-19 relief package sent it back down to a very temporary late-December test of the 3,600 area. Finally more fully out above the low 3,700 area on a belated 'Santa Claus Rally' saw it up near and ultimately above the 3,750-3,800 resistance.

Based on previous weekly Closes, there are elevated weekly Oscillator historic indications. Those December thresholds are weekly MA-41 plus 520 and plus 550. Based on weekly MA-41 now rising an impressive 25 points per week, those are up to 3,975 and 4,005 this week (Friday Close-based.)

Yet those are now less realistic near-term targets with the March S&P 500 future dropping below the key near-term 3,880 area congestion support on a near-term Head & Shoulders Top DOWN Break. While that has a nominal Objective in the 3,800 area, that is a minimum which will need to be closely watched. The more prominent supports if global govvies continue to exert pressure are in the 3,700 area (held during the GameStop volatility), the 3,600 area, and even down into the 3,500 area… the Negated September CPR top and weekly MA-41 into next week.

Thanks for your interest.

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