Tian Yang: Left & Right Tails

July 11th, 2024

Erik: Joining me now is Tian Yang CEO and Head of Research for Variant Perception. Tian prepared a slide deck to accompany today's interview, registered users will find the download link in your Research Roundup email. If you don't have a Research Roundup email, it means you haven't registered yet at macrovoices.com. Just go to our homepage macrovoices.com, click the red button above to Tian's picture that says, *looking for the downloads*.

Tian, I have to tell you, I was a little bit taken aback by the title of your presentation, Reduced Left and Right Tail Risks. Hang on a second. I mean, you guys have had some fabulous calls. And I take everything you say seriously. But I've kind of been feeling like this was a time in history that was increased risk, not decreased risk. Are we talking about a different perception, variant perception of risks in the world right now? Are we just talking about a difference between market risks and global political risks?

Tian: Yeah, well, that's a fantastic question. And many thanks for using the Variant Perception. I'll phrase that as well. So, if we look back over the past, kind of18 months, take it back to the beginning of 2023, the question today clearly is, we've had terrible leading indicators, ultimately, has the recession been delayed? Or has already happened? And where do we go from here? So I think the main thing we've been grappling with is headline level, it's been very hard to see much evidence of a genuine recession, right? We all know labor market data has been okay, consumer data has been fine. And certainly, especially in the past kind of six months, a lot of very credible people in the BCA, a lot of strategists I admire, have been talking about recession risks. So, you know, I'm not blind to that. But the one thing that's probably given me a bit more confidence, I think, after digging around in the data, we found a lot of evidence that the areas where there should have been a recession, where we should have seen the stress, there has actually been the stress, and that's a lot of what we cover in the stack.

So for example, micro businesses, if we look at kind of non-financial, non-corporate operating margins, they went to all time lows, right? It looks like what you would expect in a recession, looking at things like consumer credit card debt, very high delinquency rates 10% plus on the Feds data. So again, that's where the recession has been. The issue this time has been that normally manufacturing, recession, so forth. But historically, what you would normally expect to happen is when you get the stress kick in, they create more negative feedback loops, that feed into a more broad based slowdown that gives you like a proper kind of widespread recession. And I think that's been the difference this time around, where, because of the ongoing fiscal deficits, and quite a few kind of quirks of the cycle, we've just not had the negative feedback

loops we would expect. And now you pretty much have lead indicators starting to recover across the board on things we look at. So, we think manufacturing is going to get better within the consumers okay. So it feels to us like the window in which those negative feedback loops should have kicked in, they've been somewhat alleviated by the very large and persistent fiscal deficits we've seen in the government's driven job creation. It's helped to prop up corporate profits. And obviously, there's well known things like, you know, a lot of people locked in mortgages at lower rates. So even today, a new first-time buyer might be paying 7% for mortgages, but the effective mortgage rates still only 3.8% on the stock of existing mortgages. So, household debt service ratios are still fine. So I think before, I would have been pretty concerned that leading indicators, is this the first time ever in history that just wrong? But I think the areas where a recession should have happened, where the impacts should have been like credit cards, like micro businesses, like manufacturing, we have actually already seen the recession. And so that gives me a bit more comfort that the recovery in lead indicators we're seeing is probably real.

Erik: Where does inflation fit into this whole story?

Tian: So, I think our lead indicators do suggest inflation has an upward bias, but a lot of it is being discounted in market prices, I think already. If we look at the price action and in yields, in the stock market this year, we've taken out a lot of cuts already. I think that this is the thing we discussed last time we connected on MacroVoices. So I think from here, our point estimate kind of six months forward is that inflation is probably running at 3.5% annualized rate, which definitely is high and probably a little bit high for the Fed. But the good news is a lot of the leading data for inflation, things like the NFIB price plans, the ITSM price plans, a lot of data we look at, they basically peaked and started kind of rolling over a little bit. So, it kind of gives you comfort that maybe the right tail isn't actually that big on inflation. And even the San Francisco Fed on kind of studies on whether inflation is supply or demand driven, I think they've shown recently a lot of supply factors have been diminishing as well. So overall, it feels like inflation is a little bit uncomfortably high for the Fed, but we don't think enough for them to hike and probably at a level that allows them to do kind of a hawkish cut, like we've been seeing, how this easing cycle globally is going, right? The ECB did that the hawkish cut, and we suspect a lot of the G10 countries are going to go for that as well. So I think it's for sure a risk we need to keep an eye on. But it kind of feels like that inflation scare is probably kind of peaking and petering out.

Erik: Now, where do you see, what does Variant Perception see inflation going from here? Because we've had every imaginable view on this program, from people telling us that we're headed back toward deeply negative interest rates, to others say, look, inflation has already bottomed, it's only going up from here. Is it one of those extremes? Or something in between? Where do you see this going long term?

Tian: I think, especially investing, disagreements are often an issue of time horizon. So I think, if we can be explicit on the time horizon, it might add a bit more clarity. So I think for us, we think of the world as kind of tactical, cyclical, structural. Structural is kind of two to three years

forward, cyclicals kind of 6 to 12 months mesocycle and tactical is kind of next one to three months, the next few data prints. I think structurally. So, the two to three year outlook to us is pretty unambiguous that inflation risks are to the upside, this is linked to a lot of our Age of Scarcity type thesis where, we think credit will be scarce or labor will be scarce, commodities will be scarce. So structurally, we do think there's an upward bias to inflation. But obviously, that's a very structural setup. Cyclically, I think we're probably at the point of just peaking. The leading figures have been going up, while other leading inputs are starting to roll over. So more likely than not, we're kind of settling in and this 3 year and a half kind of annualized rate for a bit. But I think tactically, that's when everyone's going to be pretty focused. And here, it kind of feels like the markets somewhat gotten ahead of itself a little bit. You know, at the beginning of the year, everyone was super skeptical on the inflation scare, everyone's focused on like shelter CPI going lower, and so forth. Whereas now, it feels like those underlying factors on things like shelter, and things like wages rolling over, that's still valid. But nobody's talking about that anymore. And we seem to be starting to be more worried about kind of short term, inflation scattered around. So it kind of feels like, on a tactical cyclical basis, we would probably err on the side of inflation is no longer going to be as big of a problem, which again, links back to my earlier point, most likely there's room for kind of a hawkish cut from the Fed. I mean, the market is pricing, one and a half to two cuts from the Fed by year end, and then basically four cuts by mid-year next year. So that feels about fair right now, given the outlook.

Erik: We've had some people suggest that any cuts at all at this point don't make sense. The Fed has basically boxed itself in by setting market expectations, so that everybody thinks a cut is coming. Maybe they have to go through with it in order to fulfill their promise. But it seems like we're not headed back towards 2%. With inflation starting to back up again, is there still a rationale for any cuts at all?

Tian: I think the way we've been trying to approach it is, there's not enough data to justify a kind of an aggressive easing cycle, right? Like a standard, once they start cutting, they go, they keep cutting kind of thing. That's only going to happen if there's like, obvious recession type stress, which we don't think is that likely right now. But in terms of doing like one cut and stopping, I think that's probably enough, enough there to justify them doing that. Like, the one thing I look at quite a lot to figure out, like anchoring in terms of levels, is the 5 year, 5 year forward real OIS, so effectively, that's like a market implied are starting right where real neutral rates should be. And that's trading around 1.5% right now, which is pretty close to our kind of central estimate. If you look at the various Fed Reserve regional Fed estimates, the range is like, 70 basis up to 2%+. So that's kind of the range we're talking about for where our start probably is. So in that sense, it feels like the pricing seems okay, right? Like we don't seem that far away from where that needs to be. So certainly, you shouldn't expect a massive deviation in terms of Fed policy, unless some kind of shocks kick in. So for me, I think the trade right now, the start trades, the front end isn't that interesting anymore compared to the beginning of the year. The way we're trying to position is ultimately, now getting into like 2s10s, steepness, and those kinds of things. Just because if you look at where 2s10s forward, and these things are, they're still pretty inverted, they're still, you know, it seems unlikely 2s10s one year forward is

going to be realized, in terms of still being voted. So I think that's probably where the divergence is, between market pricing and the kind of underlying economy.

Erik: Now, if I'm not mistaken, this inversion that we're in right now has persisted longer than almost any other inversion on record. So, it seems to me, if you're going to make continuing predictions about, you know, it can't last much longer, you have got to have some explanation or understanding of why this one was different from others in the past. What's your perspective on that?

Tian: I'm, a lot of times, looking at the forwards rather than just a spot. So for sure, if you look at treasuries 2s10s spots being inverted, like you say, for donkey's years, but obviously, the market is a forward looking mechanism. And there's obviously a lot of shifts in the curve. So when, a lot of times, the way we try and approach fixed income is look at where the forwards are trading. So, 2s10s, kind of one year forward in the swaps market was actually uninverted at the beginning of the year. And if you look at 2s10s 2 year forward, these tend to be pretty, you know, that they're already uninverted, right? So a lot of times, our approach in fixed income is to look where these forwards are, look at the macro, and think about, is it reasonable for those forwards to be realized or not? And then that's kind of guiding the trade. So it's not so much the spot alone, because obviously, what one of the major issues has been, the carrier has been horrific to put on a steepener, it's like the Widowmaker trade, if the Fed doesn't cut instantly. So I think the timing works out a little bit better if you try and use the forwards to help time the entry of the trade.

Erik: And of course, the opposite risk is that if we were to go the other direction in terms of policy, that the trade wouldn't work at all. What is the time frame that you expect this 2s10s steepen or to be profitable? How far can it go in the other direction before you decide it's a bad idea? What are the risk parameters on the straight?

Tian: I mean, like I say, it's been one of those things, right? Because the carry, the concern, I think it's not that clear to just put it on pocket, I think, for us, it's a case of in the coming kind of weeks, months, the inflation scare probably peters out, the market has a bit more reinsurance that the Fed could cut if need be, but they won't be in a rush to cut. But then the economic data holds up a little bit better. So that probably gives the chance for the trade to perform a little bit. But then obviously, if we start getting more like election news, we might get the bad kind of steepening, the bad steepening, we saw a little bit of that after the Trump Biden debate. So the idea is that if we start getting any kind of risks of a sweep, by one party or another, they pretty much demonstrated everybody wants to keep going with fiscal, everyone's happy to keep spending money. And so that might also encourage a bit of a steepening as well. So I think it's kind of probably the main way we want to position for the second half. But certainly, to your point, I think, if the inflation data doesn't start rolling over, if inflation lead indicators start going up, that'd be the concern. A nice way to pair the trade in a way is also, you know, we've had on these Aussie flatteners for a while, because our model is, Australia's kind of should be the most hawkish Central Bank as they should have been since the beginning of the year. So in a way, if

you're lagging in and out, that might add a bit of a natural offset. So then you set Aussie flattener on and then dollar steepener.

Erik: On page five, you bring in manufacturing recovery, what's the story there?

Tian: Yeah, so this is actually pretty interesting, there's so many distortions linked to COVID. So one of the big distortions has been the kind of bullwhip effect being exaggerated and delayed. We remember in COVID, that was big supply chain issues. So inventories were fully run down across the supply chain, and it's taken a while to refill. So as a result of that, you've had this very elongated inventory cycle bullwhip effect, where customers ran down their inventories fully and slowly rebuild back up. And so that's kind of normalized now. And the way you track that is by looking at ISM manufacturing inventories versus customer symmetries. And that's kind of the top right chart on slide five. So as that normalizes, it kind of suggests the distortions are over. So now there's a chance for like a more standard inventory rebuild cycle, which kind of suggests to us that the manufacturing cycle is probably bottoming out now. Now, this is a key indicator for the cycle because it would have kept you from being too early in predicting or manufacturing recession, the kind of Q3, Q4 last year when there was a little bit excitement on some of the kind of ISM new orders to inventory ratios and stuff. So, yeah, I think this is a pretty key indicator. So it feels like that there's scope to have a kind of more bog standard normal inventory cycle. And so we're likely past the worst in manufacturing.

Erik: The charts on page six, take us to the credit aspects of this. What's the story there?

Tian: Yeah, I mean, the key chart is the bottom right, where you can see the mortgage rates, that first time homebuyers need to pay more than 7%. But if you look at the effective mortgage rate on the existing stock of mortgages is still 3.8%. And that's basically the story of why I think it's been hard to get, or why the headline data hasn't looked that recessionary. Ultimately, a lot of households are locked in low level mortgages. And so, these only reset very slowly, obviously, they are resetting as time goes on. And as rates go up, stay up here. But it's not been that big a reset. And so as a result, debt service ratios have been manageable, and not really spiked higher, even with all the Fed hikes. And that's been like a big feature, kind of preventing the worst excesses in terms of like a typical deleveraging cycle. And by the way, obviously, this is pretty unique to the US, because of these study in mortgages. You know, when we look at countries like Canada, where it's a lot more floating mortgages, 2-year, 5-year, that, obviously, that like household debt service ratios have exploded, ran and they've clearly had a much more of an economic slowdown. So I think the point here is that the mechanism in which a credit deleveraging is supposed to feed into recession hasn't worked fully, as you would expect. Historically, the areas that were exposed, so consumer credit card delinquencies, those things have deteriorated, but mortgages have been fine. And now lending surveys and stuff, as we see here, the SLOOS lending surveys, and everything is showing easing lending standards. So again, it feels like that window for these negative feedback loops to kick in, it has probably shrunk.

Erik: Tian, the chart on the bottom right kind of speaks to me from the standpoint that a doubling of the interest rate that consumers pay, you know, this is not an obscure financial ratio that only finance guys pay attention to, we're talking about how much it costs to have a house to live in, pretty much doubled for most average people recently. What does history teach us about the effects of that? there's a lot of psychological effects, obviously, people feel like, well, surely the rates are going to come back down, aren't they? Back down to 0%? They're going to wait for that for a while. What is this going to do to the market that everybody's shocked by this doubling of rates?

Tian: I think that's two aspects. So one, I think you're 100% right, in the sense that, clearly, if rates stay up here, then over time that will feed through as people refinance. And ultimately as those expectations or hope that rates go lower, slowly die away. That's clearly like a lack of margin of safety for a lot of balance sheets. And certainly, that's been the theme in terms of smaller businesses, micro business. If you couldn't issue IG debt, you've been forced to pay up for lungs. So certainly, that's a risk. But the problem is, you can't look at that in isolation. There's also like an income side of the equation, right? Because ultimately, you're servicing your debt from cash flow, and then from your income. And so one of the main features of the cycle has been that the government, the US government, the fiscal deficits, the fiscal generosity, that's on net pumped in, you know, the 6%, 7% of GDP into the private sector based on annualized rate, that's helping to prop up incomes and preventing this feedback loop where incomes drop, which then means that people can't service their debt, which means that they have to cut their expenditure, cut their activity, which then in turn feeds into even lower incomes. That's the mechanism that hasn't been allowed to work, just because the government has been so proactive in using fiscal policy, and also in driving job creation linked to fiscal sectors. If you look at a lot of the jobs created since 2023, bulk of it is actually being in things that are either directly government or linked to government. So I think that's the thing like, yes, if this carries on, this credit thing is definitely a weak point, a point of vulnerability. And if you get income shock into this, then it will be bad. But I think the challenge has been that we haven't really had that income shock this time around, that we normally would have seen.

Erik: Page seven says micro business risks have likely already peaked. What kind of risks are we talking about?

Tian: The big conundrum for me has been, why have profits been so good? Why have non-financial corporate profit margins held up very right? All these things you would expect to see a slowdown, it hasn't happened. And so we've been kind of scouring for evidence of, where has the pain been. And so this top left hand chart here, it shows you non-financial, non-corporate businesses. And it's a pretty chunky amount. It's all the sole proprietorships partnerships. You know, I think it's a reasonable proxy for smaller businesses. And so the red line is the operating margin basically, for these guys. And it's updated to Q1'24. So that's where the pain has been. You see the collapsing operating margins for these guys. That's where the recession has been. That's who suffered from high interest rates, the economic slowdown or the leading indicators stress. But what's very interesting is, if you look in the black line, net income margins have actually held up. And if anything has gone up, which just doesn't, it shouldn't really make sense.

And the only reason we can find has potentially again, or rose, maybe come back to fiscal. So if you look at the top right hand chart, that the government has basically not really been collecting taxes at the rate they should. And I think that's provided the buffer for a lot of the private sector to avoid a kind of income shock that they would have had to write if we look at the top right hand chart that shows nominal GDP, against taxes on production. So you know, there's a capital gains tax in here, there's no income taxes, purely taxes on production. So historically, it should be super correlated, right? Because clearly, taxes on production should reflect in GDP. And after COVID, is when we've seen this big, big gap where nominal GDP has been high, but the taxes have not been and the government hasn't really collected. And there's various series around it in terms of the expiry of, or like the ongoing kind of support from COVID policies. It could be green tax credits, in the various things linked to that. But regardless, this gap is there. And we also see this divergence between net income margins and operating margin. So it kind of suggests that there has definitely been operational pain, but it's been somewhat buffered from ultimately really damaging the bottom line. And maybe that's why, if you look at the bottom left here, micro businesses, small businesses, they've had very elevated job openings since COVID, which kind of suggests, for some reason, there still weren't workers, right? If they were really in a recession stress, you would expect they don't want to be hiring anymore. But Job Openings remain super elevated for the smaller businesses. By the way, it's a very different picture of aggregate for bigger businesses. So putting all this together kind of suggests that small businesses had the operational recession. But they've kind of come through it for now. And as wages start to slow, as kind of interest rates peak, potentially, yeah, the worst is kind of over here as well.

Erik: Page eight moves on to housing headwinds. What's the story there?

Tian: Right now, we talked a lot about certain aspects of the left tail being cut off in terms of consumer labor market micro businesses, but equally, it's not like obvious signs that we're going to get Bonanza economy, like a really nice post-recession kind of post COVID style massive recovery. And ultimately, if we look at certain key sectors, like housing is still not doing that great, which is why I think we've framed as both the left and right tail have actually been cut off somewhat. And so it feels like an environment where you, it's just kind of muddle through it steady. And then if market pricing gets too far away either side from that, then you want to take the other side, that's kind of where it feels like. Of particular concern is building permits have drawn down and or ticking a little bit lower again, that's not great. Housing starts shrinking again, that's not great. So there's still definitely areas of risk to keep an eye on. And it's fairly clear, right? If mortgages have surged by new build, demand isn't going to be as high. So clearly, this area isn't going to come back as fast. So even though the kind of households being insulated from the credit stress of rates going higher, it's obviously helping to defer homebuilder activity a little bit. So this is a genuine risk, and therefore, we would frame as, it's actually cutting off the right tail a bit on growth as well.

Erik: Now, your firm Variant Perception has an excellent reputation for the work you do with leading economic indicators. Many of them have your own design. What's going on with the LEIs you got on page nine? It says sideways growth LEI.

Tian: Yeah, so obviously, it's been a pretty interesting environment, the past 18 months that's driven some pretty volatile moves in the LEI. But as of right now, you can see the point estimate for where we think kind of growth is going to be at 1.8%. That's kind of six months forward. But what's been interesting is that our recession regime has not really fallen away on the US because, with the fiscal, it's been a pretty distorted regime model for a while. So when you put it all together, it's not that easy to draw a definitive conclusion, but basically a bunch of mixed signals that it probably nets out, and it probably go sideways. And one way we try to explain this a little bit, like using the kind of the GDPNow, because obviously, that gets a lot of headline attention. But it's pretty volatile day to day and week to week. So one thing we like to do is we try to extract the kind of core components of GDP from that GDPNow estimate. So basically, private consumption and private investment, both residential and non-residential private investment, and we take those components, put in a three month moving average. And that gives you a sense of the underlying picture of where the economy is. And that's basically the red line in the bottom left chart. So yes, like the GDPNow has a tendency to spike higher and lower as data updates. But the core underlying message for the kind of main private sector of the economy is the red line, is basically making higher lows and marginally higher highs. So that's why it kind of feels like somewhat sideways. It's not Bonanza, but it's kind of okay, that's kind of what it feels like.

Erik: US presidential election is coming up in November. And you're bringing that into view on page 10. What's the story there?

Tian: Yeah, so we're not going to pretend to be political experts. And obviously, these things get harder and harder to forecast as time goes on. But I think we might have even a hit on last time as well. So a framework we like a lot is The Keys to the White House framework by historian Adam Lichtman, you know, obviously, we can all see the betting odds and the polling and stuff, but he has a somewhat differentiated approach, where he essentially says we should think of elections as purely a referendum on the past. So elections that either change elections or continuation, so if people are happy with the past four years, they'll just vote for continuity. If people are not happy with the past four years, they vote for change, and you shouldn't bring too much the personalities into it. And the policies into which obviously, you know, with Trump and Biden, it's obviously a very extreme version of trying to prove if this works, but the basic idea is we want some quantifiable measure of the past four years, and be like, okay, on net, did people's lives improve or not in aggregate. And if they have, it's more likely than not people go for continuity rather than change. And so is very, very close at a nationwide level where it's marginally in favor of a continuation win right now. So the Democrats are supposed to win. And when we dig into like the kind of swing states, again, in terms of economic improvement, which we define, it's kind of real GDP per capita growth. Again, for most of the swing states, it has actually improved in the past four years. So that would again suggest, again, purely from an outsider checklist point of view, this kind of continuity change election point of view, the Democrats should have a slight advantage. That said, obviously, the Biden/Trump debate has been a pretty, pretty shocking event. I mean, to be fair, we'll see what happens, but at least this gives you kind of an anchor, independent of kind of the specifics of the situation. So yeah,

maybe Biden gets replaced. If he does, it kind of suggests that underlying conditions are good for the Dems, and that the surge by Trump right now might not come through, but obviously, there's still a few months to go, we'll see. But I think it's interesting, because the betting odds, and the polling is obviously now diverging from this framework. Whereas before the debate, it was pretty much aligned.

Erik: It seems to me that this particular election might actually be unique in the sense that there's so much uncertainty late in the race, as to the potential of maybe one of the primary candidates being replaced. I can't remember any presidential race in my lifetime, where this late in the race that there was a very distinct possibility that one of the main candidates, you know, the top two guys might be taken out of the race completely. I don't know if we have another example like that, is there? Is there anything we can draw from or how do you adjust your models for this completely unprecedented uncertainty of who's actually running from the Democratic side?

Tian: Yeah, well, I think, like you said, I don't know how you model it. I mean, people said Reagan was too old, and he was only like 69, I think. So we're in somewhat uncharted territory. But I think regardless, the way I'm trying to think about is, what are the impacts if things play out fine? Or if things play out with the worst outcomes, what would happen? And I think most signs still suggest that a steepener would probably makes sense, right? Like, if anything when you have increased uncertainty, I mean, it feels like Trump's kind of like has somewhat no entity, right? The only question is whether Biden's mental, some of those things, is enough to sway the election into a sweep election. So, if we get a sweep election, is kind of suggesting more fiscal policy, so risks of bear steepening. If not, we'd probably just carry on. So that's probably the framing. Again, I wouldn't necessarily be taking, I think it doesn't make sense to take huge risks into it. You know, like we saw with the French election, right? Obviously, we're recording this July 9, a lot of these things is probably the more uncertainty you have, the more it's kind of a buy the rumor, sell the fact type situation where the market tries to trade a theme into it, and then you basically unwind into and around the event. So that's probably more likely what happens. And so it's a case of just keep sticking with the underlying trade themes that make sense. Rather than putting all your eggs on the election outcome, I would say.

Erik: On page 11, you're bringing into focus benign earnings outlook, what's the story there?

Tian: Yeah, I mean, to ask that, there isn't a huge amount of story, right? We know, like S&P large caps have rallied a lot. But the underlying data suggests that earnings outlook is good. So there isn't a huge amount of divergence right now, I think between the equity market, and what lead indicators or earnings outlook says. So there's obviously a lot of temptation to say that equities look extremely overvalued the AI bubble. But it doesn't seem like an obvious short, like, you know, the divergence isn't that big. So yeah, that's probably the thing to say on it. I think there's pockets of interesting things in equities. So we like things like Brazil, Brazilian equities, which being obviously hammered and it's just coming off like an LPPL crash climax. So there's areas that are more interesting to go into. But in aggregate, it's also not obvious that you want to

be either pressing overweight or going to a big underweight, it just feels like you know, keep a neutral outlook probably makes more sense.

Erik: Let's move on to the US dollar on page 12.

Tian: Yeah, so I think at the beginning of the year, a long dollar trade was more obvious, a lot more contrarian. Whereas right now, it feels like it's starting to flip around, whether from a positioning point of view, our various tactical models, and even kind of our longer term, 12 months forward, our fundamental edge models and these things race is starting to show things are starting to roll over for the dollar. So as I mentioned, I think a bit earlier, we still like long Euro expressions, we think European growth, lead indicators are kind of recovering pretty unambiguously, procyclical European Trade kind of makes sense. So in that sense, we're still kind of positioned for long Euro short Dollar, which was a trade theme we initiated after Powell spoke at the beginning of May, it's been pretty choppy, obviously, because of the French elections. But again, buy the rumor, sell the fact and the Euro is coming back a bit now. So I think this broadly fits into that. The top left hand chart is pretty interesting, like the city pay index, the various measures of positioning effects, and it shows people still position pretty long the dollar rather surprisingly. So that does suggest some room to kind of unwind the dollar, the dollar long further.

Erik: Let's move on to commodities on page 13.

Tian: Yeah, so I think the structural story still hasn't changed on commodities still, we're still very bullish structurally on commodities, or supply constraints, energy constraints, all those things. The main difference has been that China's growth outlook and leading outlook has been pretty weak, year to date. And so the rally at the beginning of the year was very much, I think, an unwinding of the recession trade from last year. And it was more positioning driven, and rather than fundamental driven in a way, and so we've had that kind of short covering rally, we had the big jump, and then the underlying Chinese data hasn't come through, so commodities have rolled over a bit. And from now we're starting to get more tactical models starting to align again, since the start of July to go long commodities. So it kind of feels like just putting on a huge amount of edge now, given the year to date recovery, but the bias would be to err on the side of buying dips in commodities and positioning that way. But I don't think it's hugely, hugely compelling for now, like the China data continues to look pretty bad. So I think you've got a lot of negative headline risks around China. But the good news is China looks like somewhat of a lonely outlier among most economies, which most economies are seeing growth between the cases recovering. So there should be a fairly broad base kind of stabilization to recovery in most global economies. So ultimately, that should be okay for commodity markets. But the negative headline risks around China is going to still be around for a bit. So it kind of feels like trade with a long bias, buy dips on some bad China News. But yeah, it's probably more, again, maintain your core commodity allocations. But we ideally want to see a bit more stabilization in China before being a bit more full blooded on commodity long again.

Erik: And finally, on pages 14 and 15, you've got your Variant Perception heat maps, showing us both for growth, as well as for inflation indicators, where the action is. Talk us through what's going on.

Tian: Oh, yeah, this is effectively like just a quicker way for clients to visualize and also to help us find where the outlier trades might be. So just to clarify these levels, it shows you the level of growth and the level of inflation, obviously, what also matters is kind of the rate of change. But the main thing to highlight is just how much of outlier China is on both growth and inflation. It's terrible. It's like a really bad reading, when most others are seeing inflation takeoff or growth back to more neutral, or certainly improving. So that's still the big theme. So again, you would expect on the depreciation pressure, so you know, they're going to have to manage the depreciation, the PBOC is going to have to manage that. So I still think that that's like a really big thing that jumps out when you scan across. Other than that, again, I think something that I've hit on before just a little bit earlier, Australia still looks a bit of an outlier where Australia, inflation LEIs are still super, super strong, Australian growth is bottoming. So again, the RBA looks to be kind of the most hawkish within the G10. So obviously, we have various trades linked to that. So it's things like long Aussie CAD, and things like that, it's still a way to express that policy divergence.

Erik: Tian, let's tie all of this together. Now, you mentioned a steep runner, is that the primary trade that you're recommending here? Are there other trades that people should consider? And I know particularly you had a really amazing call on gold with your LPPL indicator, any further indications when gold or any further indications on other assets from LPPL for that matter?

Tian: I guess, overall, portfolio wise, yes. So I think steepener is something we're looking to start adding, and lagging into core portfolio, still long Euro long Euro Swiss, in terms of what we're long, long dollars against is still on China. So you know, long dollar short CNH. And like, I think in equity land, long Brazil is pretty interesting to us. In fixed income land I mentioned, you know, Aussie flatteners. And actually, we also think like UK is pretty interesting, but you know, it feels like the relative pricing of Bank of England versus the Fed has gone a bit stretched. So we're like betting on a kind of less hawkish Bank of England relative to the Fed now, so you can do that via SONIA spreads against SOFR spreads in those countries. So that's kind of overall where we are. But I guess the marginal main thing is, we want to take a shot at the steepener, the negative carry Widowmaker trade for this year. But we think the timing is better now because the 2s10s for it is already inverted in terms of the LPPL model. So again, as a quick reminder, it stands for log periodic power law. It's really a trend exhaustion model that aims to basically screen for patterns of stoploss behavior, when there's mad widespread stop loss price action. And so yeah, we've had on gold before I think, we had on palladium last time I was on. The main live signal is actually like a for hourly on Bitcoin that could be quite interesting. It's been working pretty well on some of the shorter time horizon on Bitcoin. So to extent, you have clients who would like to take a punt on these. That's the main one that probably is somewhat interesting to keep an eye on right now. But yeah, that would be about it. There's no major daily kind of LPPL is right now.

Erik: Well Tian, I can't thank you enough for another terrific interview. I always enjoy our talks. Before I let you go, though, please tell us a little bit more about what you do at Variant Perception. It's a boutique institutional research firm that has a terrific track record, although I would say probably not as well known or well recognized as you deserve. Tell us a little bit more about what services you offer, what's on offer and how our institutional listeners can get a hold of you.

Tian: So variantperception.com, we think of ourselves as agile, is really in building models, being creative in how we build models and aggregate data and trying to be empirical in our approach. And so, ultimately, that translates into various models of lead indicators for the business cycle. or policy regime models, various tactical timing models, single stock scoring models and so forth. So the way the clients interact with that is either via the research via our portal or via data kind of API feeds. So hopefully that gives a kind of overall sense of our focus on how to model building and trying to model kind of the parts of the investment process that we think is repeatable and can be modeled.

Erik: We'll look forward to getting you back in a few months for another update. Patrick Ceresna, Nick Galarnyk and I will be back as MacroVoices continues right here at macrovoices.com.