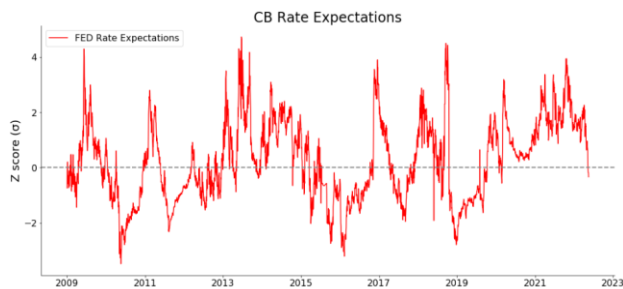




18.05.2022

This is important

- Lower inflation expectations, bond yields, commodities plus sell-side surveys suggesting cyclicals like Industrials & Materials are where an increasing number of short positions reside. None of these are moving in a straight line but turning points are often a process rather than a single, clean event.
- All the above speak to markets' **increasing focus on downside risks to economic growth** rather than fears of inflation. In that context, this chart is important.



- The next bit is geeky bond market speak but important. Qi captures Central Bank rate expectations via forward interest rate swaps. Specifically, 2y1y – 1y1y OIS spreads. For those who trade in listed space & watch Euro\$ futures, this is the same as Reds vs. Greens.
- Put even more simply it looks at the difference between market expectations for **where the Fed Funds rate will be in 3 years time versus 2 years time**.
- When the spread between the two is increasing, the market is pricing in more rate hikes – a higher ‘terminal rate’ in bond speak. When it is falling, the market perceives less hikes from the Fed.
- The spot spread turned negative some weeks back &, on Qi which measures these things in standard deviation terms, the z-score has just fallen into negative territory. It is has now edged **below trend**.
- For some this is the old, post GFC playbook – the Fed hike until they break something, but then undergo a dovish policy pivot – that no longer holds in an inflationary world. For others, this is money markets telling you recession risks have materially increased.

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