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The Macro Investing Tool

Raoul's Take

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with Raoul Pal

It's not a green light to buy the dip yet. Liquidity and financial conditions, while not a strong headwind, are still gusting — so I hold and wait.

The most important thing on the dashboard over the last two weeks is that the liquidity picture has split in two. US liquidity is holding up, with the broad measure growing 4.9% year on year, close to its high for this cycle, and the narrow measure, which has been the laggard all year, turning up from -0.7% to +1.8% over the last month.



Global liquidity, on the other hand, is still rising at 5.9% year on year and sits at \$143.7 trillion, but the rate of change is what matters, and that has slowed hard. The three-month annualized rate is down to 2.9% from about 17% at the February peak, the six-month rate is also 2.9% having been above 11% in May, and the level is still below the \$145 trillion high it set in early September, with China drifting as the PBoC balance sheet shrinks again. So the tide is still coming in; it's just coming in much more slowly.



That matters because the global number is the one that leads risk assets by about three months, and a slowdown in it, even without a turn, is usually enough to give equities a wobble, as I've said before.

You can already see it. The Nasdaq has been trading sideways since June, in a range of roughly 29,000 to 31,000, and it has just given back its early October breakout to sit at 29,600. The S&P is at 7,659, down from 7,812 a week earlier; the advance-decline line has been rolling over since the middle of September, and high-yield spreads have widened from 2.70% to 3.23% in a month, which is still well short of the 4% line where credit stress starts to matter, but it's moving the wrong way.

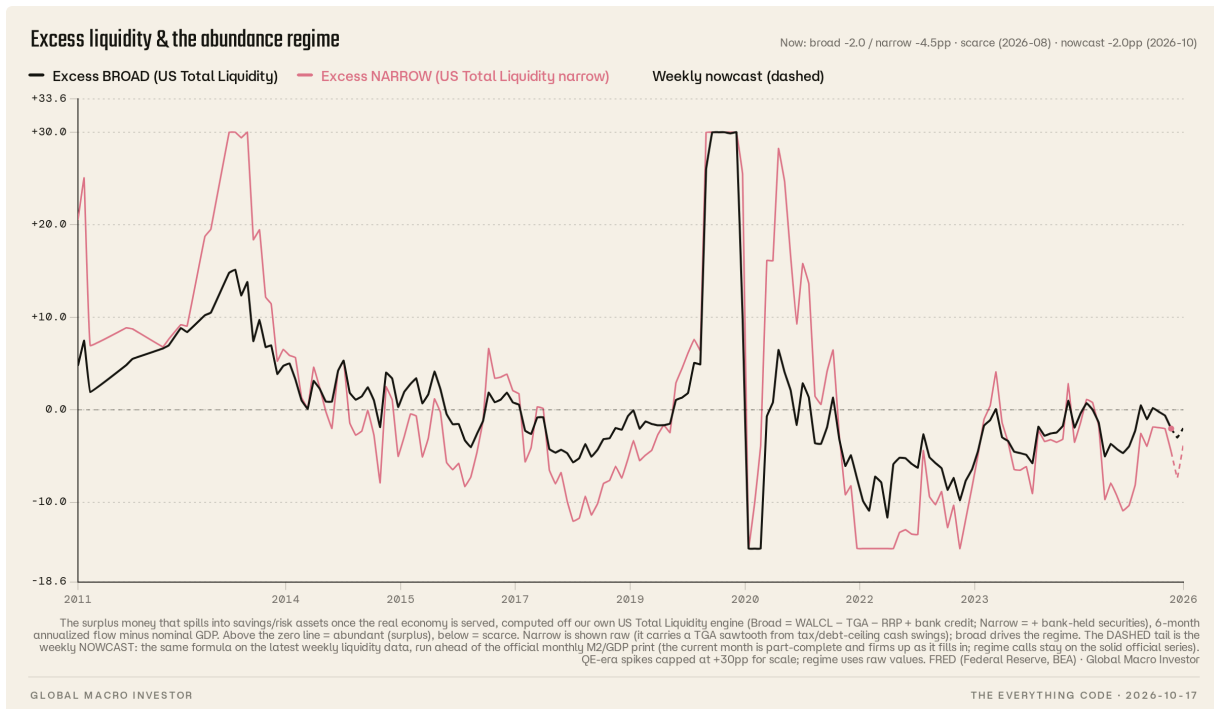


The narrow breadth in US stocks is the same issue. When the index is being carried by a handful of the biggest names while the advance-decline line rolls over, it's because there isn't enough liquidity to drive all assets, so what there is goes to the largest and most liquid growth names, and everything else gets left behind. That is exactly what a liquidity slowdown looks like inside a bull market, and breadth won't broaden out again until liquidity does.

On the usual lead, the softer patch from the global liquidity slowdown lands from mid-December into January...so this is the market starting to sniff it out early.

Bitcoin is feeling it first, as it usually does, because it is the highest-beta expression of liquidity there is. It's at about \$83,000 after the spot ETFs lost roughly \$680m the week before last and another \$230m last week, and it remains cheap to trend, i.e., it is still sitting well below where the liquidity cycle says it should be, which is why I keep saying it has the most catching up to do once the fuel arrives.

The excess liquidity measure, which is the money left over for savings and risk assets once the real economy has been paid, is still below zero, at -2.0 points on the broad measure and -4.5 on the narrow one; i.e., the regime is still scarce, as it has been since August, and the weekly nowcast has it staying there into October.



So there isn't enough excess liquidity in the system yet to drive speculation, whatever the headline US numbers say, and add the PBoC slowdown we flagged on the 1st, which has led bitcoin by roughly a quarter and lands around November, and bitcoin has the global leg easing just as the US leg is only starting to turn. The ETF flows are simply telling you that.

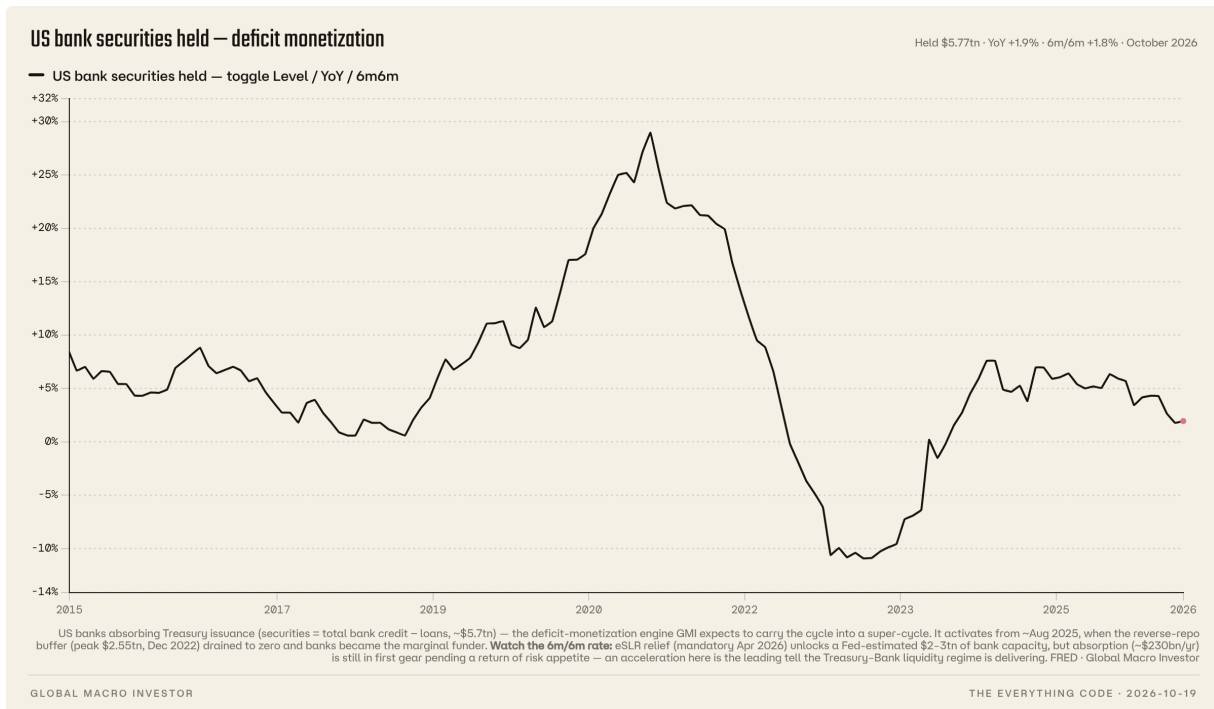
So why isn't the US liquidity pickup enough on its own...

Because it's early and the conditions side is working against it. Start with the yield curve. Last week I was watching for 2s10s to hold above 45 basis points and it didn't; it got to 47 on the 8th and has since fallen back to 35, with the 2-year barely moving at 4.77% while the 10-year came back to around 5.1%.

That's the wrong kind of flattening, and with bank lending still at 7.9% year on year, the credit valve is open, but as I've said many times, without a steeper curve driven by the front end, the banks don't accelerate, and the US liquidity boost stays a trickle rather than a flood.



You can see the problem in the banks' securities book. US banks now hold \$5.77 trillion of securities, which is the deficit monetisation engine, i.e., the banks absorbing the Treasury issuance since the reverse repo buffer ran dry last year and they became the marginal funder, but that holding is growing only 1.9% year on year and 1.8% on a six-month annualised basis, down from 7% a year ago. With the Treasury issuing as much debt as it is, we need the banks operating at full capacity, and the eSLR relief gave them the room to do it, but they won't use it while the curve is this flat, because the carry isn't there. That's what the yield curve is costing us right now.



Which brings me on to rate expectations...

September CPI came in at 3.7% headline against 3.6% expected, and the odds of an October hike jumped after the print before falling back during the week, which tells you how jumpy the market is around the Fed.

Core is 2.6% on the year and still falling, but I have to be honest about the momentum, because the three-month annualised rate of core has picked up to 3.4% and supercore to 3.6%, so the Fed has more of an excuse than I'd like.

The 2-year is still sitting about 80 basis points above Fed Funds, so hikes are still priced, and I still think they come out over time for the productivity reasons I laid out two weeks ago, but this month's numbers made that argument harder rather than easier, and the market knows it.



Most of the headline problem is oil. WTI is around \$97, up from \$93 a week ago and up about 50% on the year; energy CPI is up 20% year on year and CPI ex-shelter is at 4.0%, which is exactly where an oil shock shows up first.

It's also leaking into the long end, which is why the 10-year can't come down much even with growth expectations wobbling. The tell that it's a supply shock rather than an inflation problem is that 10-year breakevens haven't moved, at 2.35%, i.e., the bond market is not pricing a new inflation regime; it's pricing an oil price, and that's the kind of thing that passes. Oil is also close to multiple DeMark exhaustion signals, which could help, but the thing that actually resolves it is Trump and the Iranians making a deal, and we still don't have one.



Now the dollar, which remains the most important signal of all...

It was the biggest mover on the dashboard this week, down from 102.6 to 101.8, so it's back below the 102 I was watching, but it's still up from 100.2 a month ago, and it needs to get back under 100, where the 200-day average sits and where the rising channel from the February low would break, before it stops being a problem.

The dollar is the leg that matters for financial conditions, because only two of the four pressure legs, the long end and oil, are squeezing right now, and a squeeze that narrow has historically been absorbed rather than transmitted. If the dollar joins them, it starts to bite, and if it keeps falling, the tightening fades, and the US liquidity pickup gains room to become something bigger. Gold has at least stabilized, with it at around \$4,190.



Underneath all of this, the cycle itself is fine, and to be clear, this is a liquidity slowdown, not a growth slowdown — because growth isn't slowing yet. The ISM is at 54.5, with new orders above it at 55.3. Lending standards aren't tightening, and the liquidity crest is still ahead of us, with the base case around March 2027.

So this reads to me as a global liquidity slowdown and a narrow conditions squeeze arriving before the US liquidity engine has properly started, which historically gives you a wobble and a sideways stretch in equities rather than the end of the move.

But a wobble inside a bull market is still not a green light to buy the dip — and that's the whole point this week.

Liquidity and financial conditions are both a headwind right now, not a strong one, but a headwind nonetheless, and until the excess liquidity measure gets back above zero, the curve steepens from the front end and the dollar heads back under 100, I don't have the signal I want. So I hold what I have; I don't add, and I let the data come to me.

Crypto is the exception in the sense that it's cheap to trend and can still catch up, but it needs the same fuel as everything else.

Where Am I Wrong?

The bad version is that the global liquidity slowdown keeps going, the pickup in core momentum gives the Fed cover to hike on the 28th, the curve flattens further, and the dollar goes back above 102, at which point the dollar becomes the third leg, and the tightening transmits.

The tells for that are high-yield spreads pushing on towards 4%, the 2-year moving up rather than down, and global liquidity's year-on-year rate heading for zero rather than stabilising around 5%.

Into next week, I'm watching global liquidity's year-on-year rate and whether it holds above 5%, the narrow US measure and whether its turn continues, 2s10s and whether it gets back above 45 basis points, the October hike pricing ahead of the 28th, the dollar and whether it holds under 102 and heads towards 100, oil against \$100, and the ETF flows into bitcoin.

The tide is still coming in... it's just slower, and until it speeds up again, the position is patience.

Raoul

Contributors



Raoul Pal

Raoul also publishes Global Macro Investor (since January 2005) providing original, high quality, quantifiable and easily readable research for the global macro investment community: hedge funds, family offices, pension funds and sovereign wealth funds. GMI draws on his considerable 33 years of experience in advising hedge funds and managing a global macro hedge fund. Global Macro Investor has one of the very best, proven track records of any newsletter in the industry, producing extremely positive returns since inception: www.globalmacroinvestor.com.

Raoul retired from managing client money at the age of 36 in 2004 and now lives in the tiny Caribbean island of Little Cayman in the Cayman Islands. He is also the founder and CEO of Real Vision, which is a digital media group: www.realvision.com.

Previously he co-managed the GLG Global Macro Fund in London for GLG Partners, one of the largest hedge fund groups in the world. Raoul moved to GLG from Goldman Sachs where he co-managed the hedge fund sales business in Equities and Equity Derivatives in Europe. In this role, Raoul established strong relationships with many of the world's pre-eminent hedge funds, learning from their styles and experiences. Other stop-off points on the way were NatWest Markets and HSBC, although he began his career by training traders in technical analysis.

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