The Discretionary Global Macro program returned -4.2% in November 2020, leaving performance at 45.4% YTD.[1]

When to trend follow and when to be a contrarian

Deciding when to follow a trend and when to pick a top or a bottom in a market is one of the most vexing questions in the land of trading. In many ways it is the ultimate arbiter of whether you are a trader or an investor, as the ultimate version of trend following – holding a long position in equities for decades – devolves into plain vanilla investing. Here is how we are thinking about the markets today based upon that dichotomy.

We are trend following in currencies. Our strongest fundamental convictions play out over years to decades. One of these is that the US dollar is entering a bear market that will last years, after recently (Q1 2020) completing a secondary top in a dollar bull market that began all the way back in 2011. The reasons are myriad but include the fact that, at the margin, the Fed will be more accommodative over the years to come than foreign central banks, and the fact that real rates no longer are a tailwind for the dollar.

There is no spectacular insight in the preceding paragraph – every investment bank and most buy-side boutique research firms have the same house view. It has become a consensus opinion. But just because it's consensus doesn't mean that we should fade it. There are times when you should go with the consensus, even for years, and we believe that this is one of those set ups. Our job in currencies, therefore, is to continue to find good risk/reward trades where we hold positions for months at a time, rotating among the various FX pairs (British pound, euro, Australian dollar, etc.). But broadly speaking, we want to trade with what we believe to be the fundamental, multi-year trend (dollar depreciation).

We are picking tops in commodities (countertrend). On the other hand, despite their strong trends higher in recent months, we are looking to short most commodity markets. The fundamental narrative on the bull side seems weak: neither Chinese re-stocking of industrial commodities nor their imports of grains seem sustainable beyond the near-term, particularly with Chinese monetary policy makers strongly hinting at tightening. Weather disruptions to agricultural commodities have also been priced in. Although we were stopped out on a few of these trades recently, our reading of sentiment, fundamentals, and technicals indicates that the best risk/reward remains fading the consensus of an ongoing bull market across the commodity complex.

We are trend following in equities and bonds. Our view, which we have expressed in previous letters, is that inflation is potentially years away, but with economic growth looking promising past a tough winter (markets quickly discount the known, like a weak Q1/Q2 due to ongoing Covid-19 cases), we believe that the path of least resistance is for higher equity prices and higher bond yields. The latter will be driven higher not by the term premium or by the inflation

[1] Returns are net of management fees and incentive fees. Returns may vary for each individual client's separate account, due to the rounding of positions traded, as well as differences in subscriptions and redemptions.

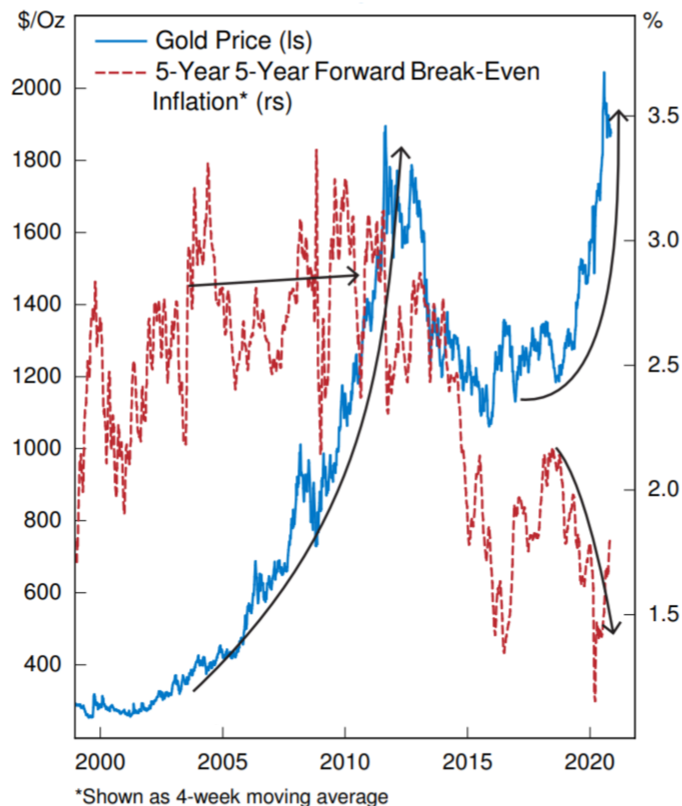
component, but rather by the real yield. Note that this is not inconsistent with our dollar view, as we believe that real yields will remain pinned at sub-zero levels at the front-end of the yield curve while rising at the long-end.

The choice of whether to trend follow or place a countertrend bet in any given market hits at the essence of our business. Every money manager must follow their own conviction, particularly when they go against the herd and fight the trend.

Charts that have our attention

It's been quite a while since we shared a few charts that caught our eye during our daily research reading process, so let's take a look.

Gold not correlated with inflation expectations anymore



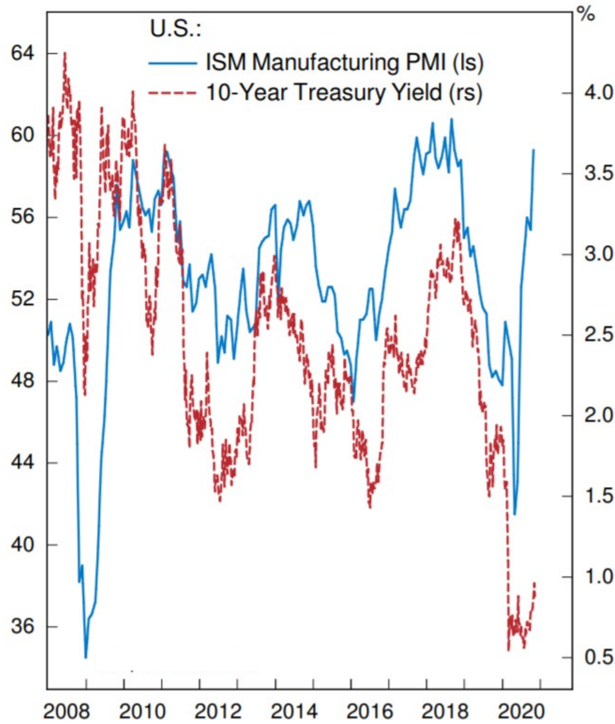
Source: Alpine Macro

This is an interesting chart and does a very good job of encapsulating the counter-intuitive nature of our thesis on gold versus mainstream thinking.

There certainly are times when gold is a hedge against inflation (the 1970s). But its central – and more important – role is as the anchor of the monetary system.

As we move from the petrodollar regime of the past fifty years into something "new" over the course of this decade, gold should perform much better than what you would expect from inflation expectations alone.

The case for higher yields

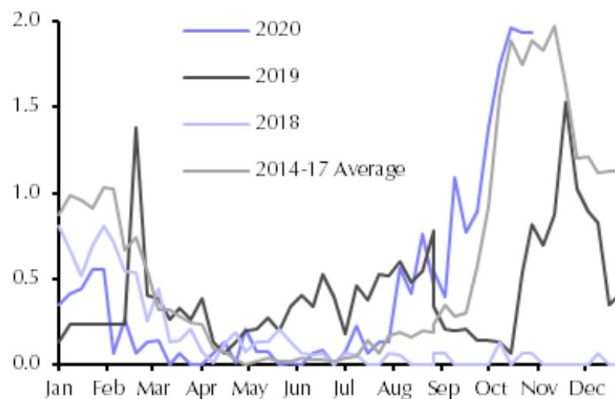


Source: Alpine Macro

We are not always a fan of double Y-axis charts that have overlapping series – it can be easy to find spurious correlations and even easier to amplitude adjust the series for a tight fit. But this one makes sense from a fundamental perspective to us in addition to what the sharp ISM pick-up indicates.

In short, expect a continued recovery and higher yields. The Fed may eventually cap long bond yields with yield curve control but probably not until the 10-year gets closer to 2%, which is a long way off.

Soybean exports: US to China



Source: Refinitiv, USDA, Capital Economics

Usually by the time these charts look most bullish (i.e. exploding exports at the top of their historical averages), it's time to look the other way.

Barring a continued weather issue in Latin America, there is a reasonable chance we've seen the highs in grain prices.

We've gotten this far and completely neglected to mention November's performance. Not much changed after our explanation for the first week of the month in our previous letter – we were whipsawed by volatility in gold and Treasuries several days after the election and carried smaller position sizes in the remainder of the month.

Sincerely,
AG Capital

Trading futures involves substantial risk of loss and is not suitable for all investors. Past performance is not necessarily indicative of future results.

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