Can You Smell The FOMO?

Last week, **FOMO (Fear Of Missing Out)** became the prevalent market narrative.

As data seemed to further validate the soft landing narrative and Central Bankers became ''data dependent'', markets are FOMO-ing **like it's 2019 again.**

In 2019, the **Fed pivoted hard and the economy managed a proverbial soft landing.**
The 2018 hiking cycle which Powell abruptly reversed with his early 2019 pivot slowed the economy down, but not nearly enough to result in a hard landing.

The S&P500 **earnings growth** was only +0.6% (but not negative), **core inflation** was stable around **2%** and the US added 160k new jobs per month: low nominal growth, but not a recession – in other words, a soft landing.

But 2023 isn't 2019 – for many macro reasons we are going to touch upon.

What's the prevailing market regime?
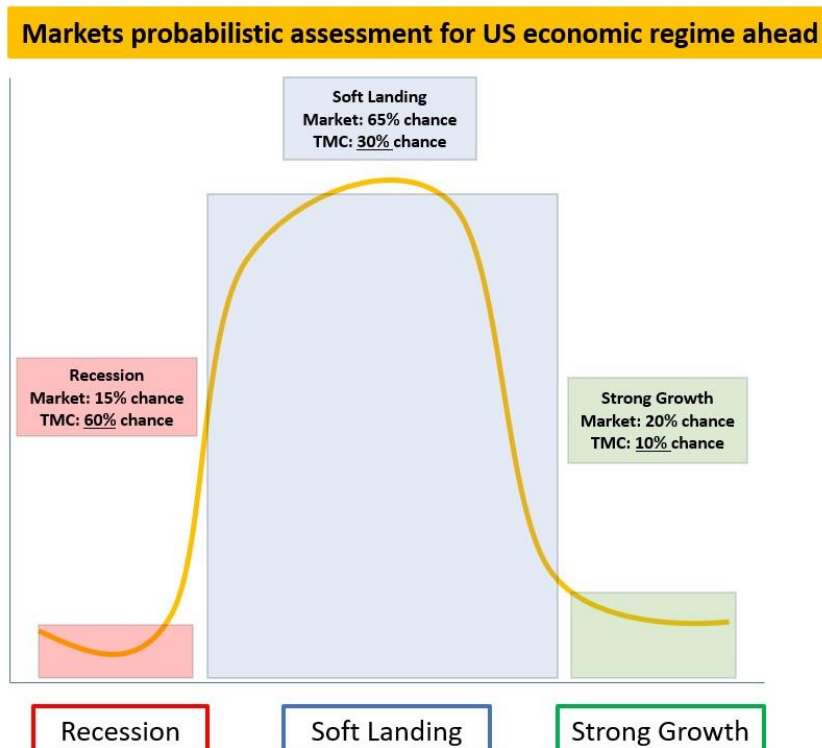
The chart above shows the **TMC's Market Regime Scrutinizer.**
It measures the **market-implied odds assigned to a US recession, soft landing or strong growth regime** ahead.
It is derived by scrutinizing option markets in fixed income, equity, and currencies and blending the resulting market-implied probabilities in this flagship TMC indicator.
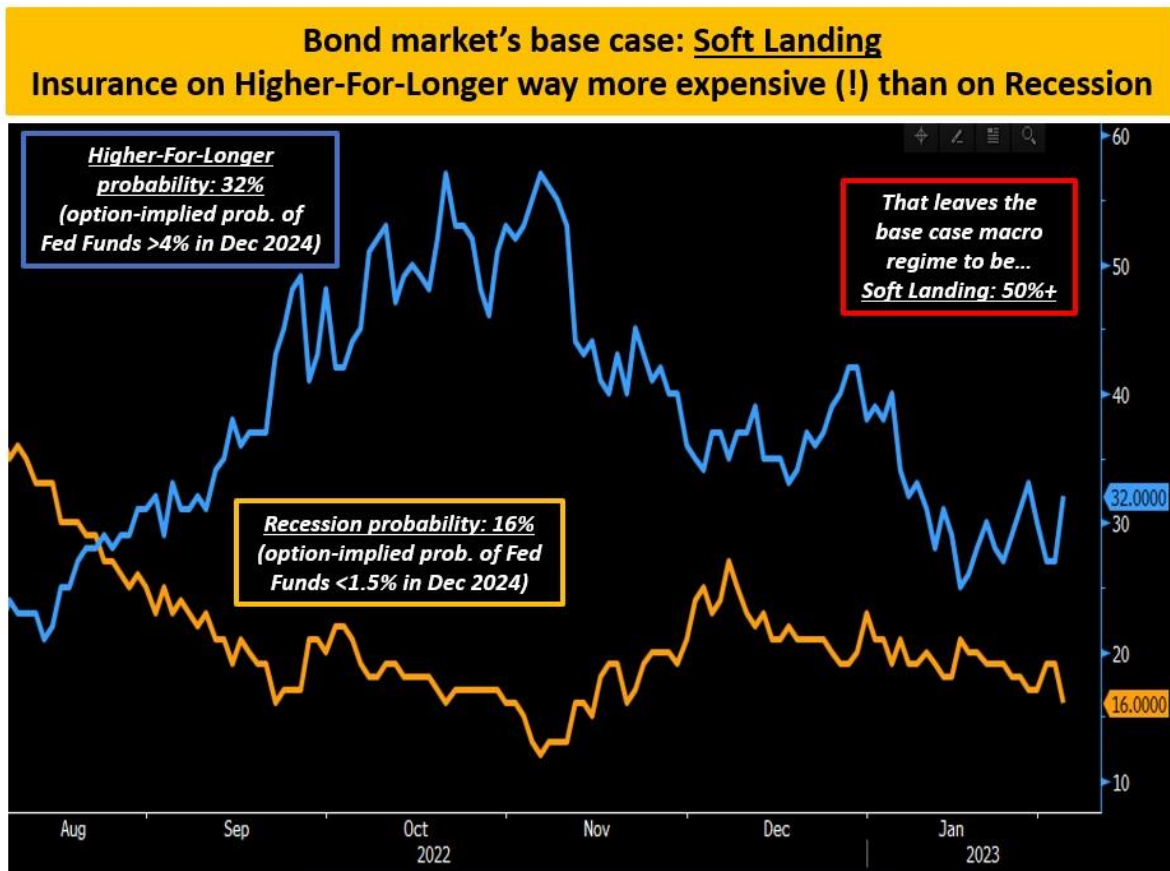
Markets are currently **pricing a US soft landing as the dominant probabilistic regime (~65% probability)**, and in recent weeks the left recessionary tail has been aggressively priced out (now ~15%) while the chance of a strong growth regime ahead has been bumped up to ~20%.

Even after the apparently very hot labor market data and ISM services, the **bond market keeps screaming immaculate disinflation/soft landing** as the main regime ahead.

- Inflation is priced to drop to 2.5% by year-end, and stay close to 2% in the long run;

- Fed ''soft landing'' cuts are priced in: as inflation slows down but without a recession, the Fed can gently cut rates to neutral levels (2.50-2.75%) without resorting to recessionary cuts or being forced to keep rates higher for longer

Bond markets assign a **~15% probability to recessionary cuts, and a ~30% chance to Higher-For-Long**er Fed Funds amidst strong growth and sticky inflation.
As a result, the **option-implied market points to a ~55% probability of a disinflationary soft landing.**

Bond market's base case: Soft Landing
Insurance on Higher-For-Longer way more expensive (!) than on Recession

Higher-For-Longer probability: 32% (option-implied prob. of Fed Funds >4% in Dec 2024)

That leaves the base case macro regime to be... Soft Landing: 50%+

Recession probability: 16% (option-implied prob. of Fed Funds <1.5% in Dec 2024)

Source: TheMacroCompass.com, Bloomberg

When a disinflationary, immaculate soft landing becomes the dominant market regime **it's all about selling insuranc**e and getting paid while...well, **not much happens** and the **Fed is on a very predictable path.**

And indeed, as the Fed is assumed to be on a more predictable path ahead **bond volatility is getting crushed**. Lower bond volatility is leading to a much better risk sentiment in equity markets.
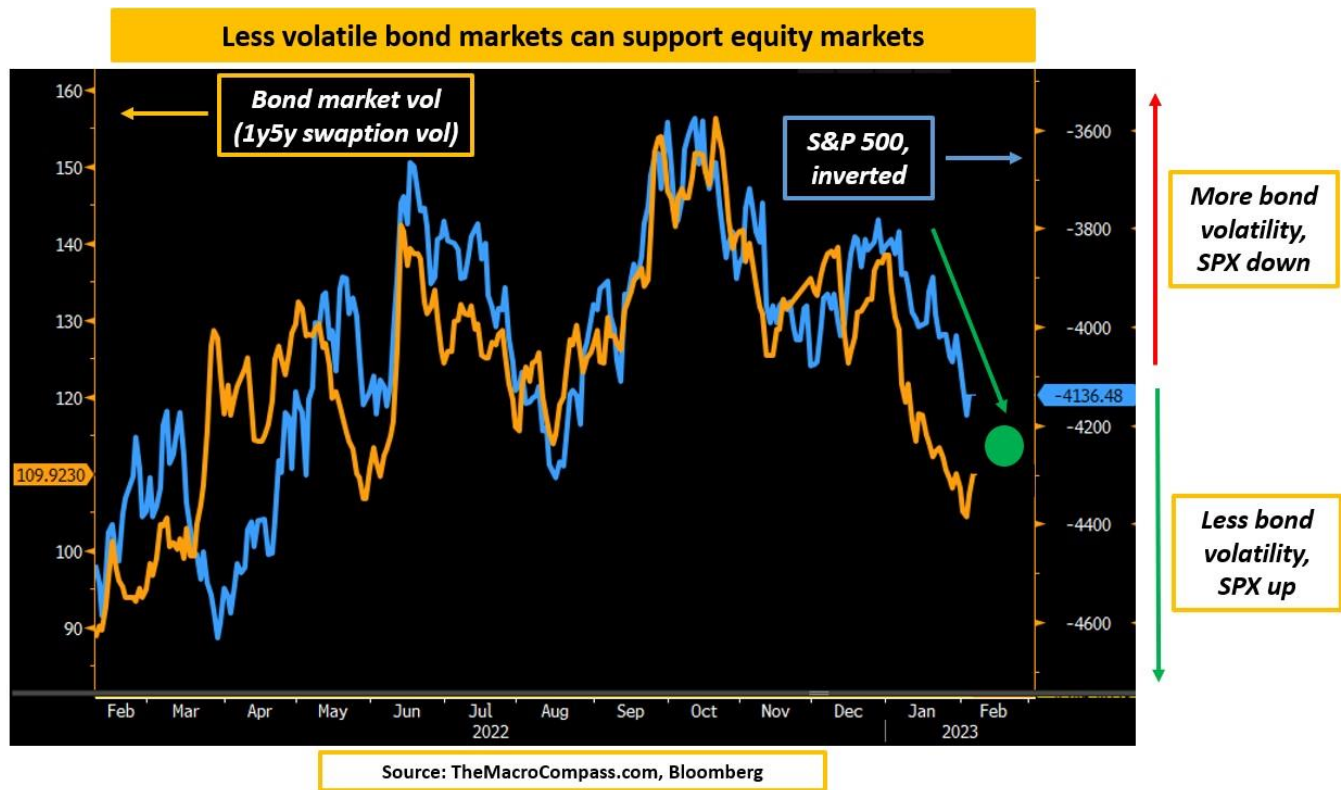
Now, to the **key questions.**

Are **macro data really validating** the soft landing base case priced in by markets?
Are **Central Banks really on a predictable path** ahead?
And finally: is **2023 going to look like 2019**, a year when the S&P rallied 30%+ with minimal volatility?

Let's find out, starting from last week's relevant macro data.

Non-Farm Payrolls and ISM PMIs

The bottom line: there is **a lot of noise** in the data, but the **downward trend remains pretty much intact**.

The headline NFP figure grew by over 500k in January, leading to many calls for a ''red hot'' US labor market.

Adjusting for the effects from the annual benchmarking that took place in January and the milder weather (~140k), plus the return from strikes (~40k)...
...the underlying pace of NFP creation was **still very strong, roughly in the 340k area.**

But what are **other labor market indicators** telling us?

The seasonally-adjusted **Household Survey** recorded only 84k new jobs added.

Category	Dec.-Jan. change, as published	2023 population control effect	Dec.-Jan. change, after removing the population control effect [1]
Civilian noninstitutional population.......	1,118	954	164
Civilian labor force..........................	866	871	-5
Participation rate......................	0.1	0.1	0.0
Employed....................................	894	810	84
Employment-population ratio.......	0.1	0.1	0.0
Unemployed................................	-28	60	-88
Unemployment rate..................	-0.1	0.0	-0.1
Not in labor force.......................	252	82	170

Source: TheMacroCompass.com, Bureau of Labor Statistics

Also, the **ADP** Private Non-Farm Payrolls grew by only 106k, and **wage growth** didn't nearly respond in line with a "red hot" labor market.
Most importantly, **the pace of full-time hiring in the US is...0%?!**

Source: TheMacroCompass.com, Bloomberg

Nowcasting the labor market is a tough cookie, and often data are subject to large ex-post adjustments.
In reality, **the truth is always somewhere in the middle.**

Accounting for seasonal adjustments, and benchmarking NFPs with other labor market indicators we estimate the underlying **3-month moving average pace of US job creation to be in the 150-175k area.**

That's **neither a recessionary pace (yet) nor a red-hot labor market pace.**
There is evidence that companies are hoarding labor and being reluctant to dispose of employees, as hiring qualified staff throughout the pandemic proved difficult.

Ultimately, as the nominal growth slowdown continues hoarding should only temporarily delay a more material weakness in the labor market.

Talking about growth: what about the ISM PMIs?
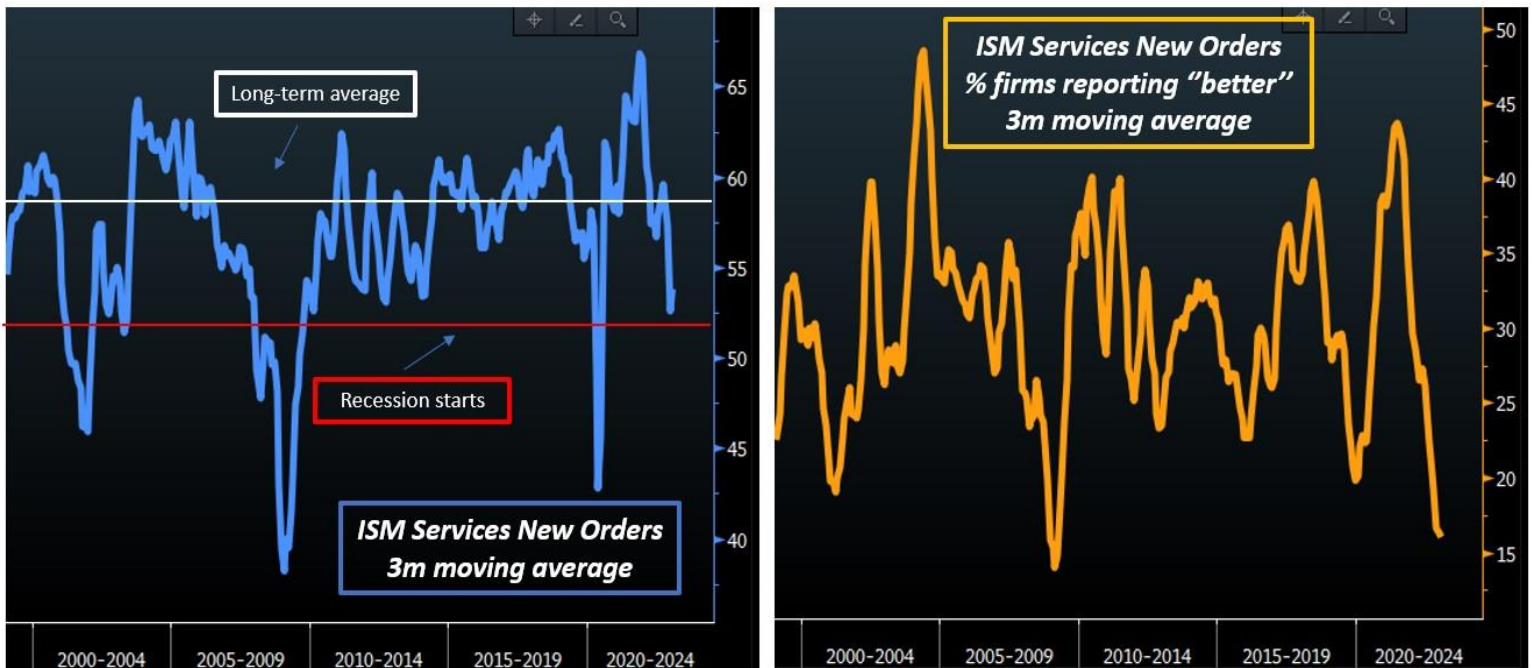
Source: TheMacroCompass.com, Bloomberg

December: ISM Services New Orders at 45...recession!
January: ISM Services New Orders at 60...booming economy!

Again, the truth lies somewhere in the middle.

The 3-month moving average of ISM Services New Orders is sitting in the 53 area: not yet at levels historically signaling the start of a recession, but very close by – and certainly not in line with a red hot economy.
Also, **the breadth** of companies signaling a healthier pace of new orders ahead is not picking up: less than 20% of services sector firms expect stronger activity ahead.

There is a lot of noise in labor market and soft growth data, but **smoothing these macro indicators out** and taking nuances into account helps us focus on the **big picture.**
We are not in a recession yet, but the job market and economic growth momentum **remain very weak and dangerously close to recessionary levels.**

So, have Central Banks pivoted yet?!

''Data Dependence''

The Fed and ECB meetings last week were very interesting, and also somehow similar.
There was a clear turning point in both.

Powell and Lagarde both pronounced **some magic words: ''we are going to be data dependent''.**
And markets FOMO-ed the hell out of gold, Bitcoin, the stock market, the bond market, everything.

You see, as soon as the mechanically tight stance is over and the future monetary policy path will be dictated by (inflation) data...**markets are free to reprice** the Fed and the ECB actions based **on their very own expectations for inflation ahead.**

And they **expect inflation to collapse towards 2% in a few quarters (!) already.**
Conditional to that expectation, the era of tight monetary policy can be declared as over and **La-La Land pricing** can be extended to the stock market too.

I am not so sure.

Powell cares about core services ex-housing inflation, and even if this chart looks very friendly **he didn't seem to be very constructive about it.**
He stressed out that most of the recent downward momentum is due to weakness in medical care and transportation (read: a derivative of lower gasoline prices) while the subcomponents linked to the slack in the labor market are not really decelerating.

This is the inflation Powell cares about

Core services ex-housing CPI, 6m change annualized
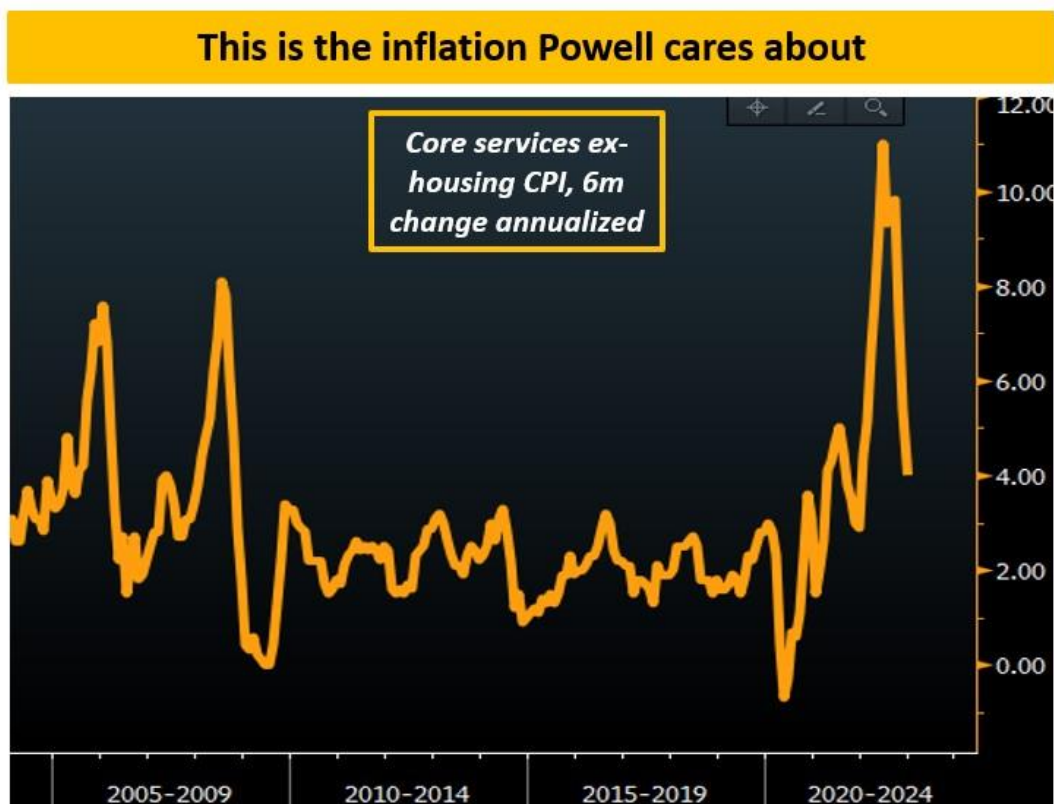
Source: TheMacroCompass.com, Bloomberg

Which brings me to the second point - please **pay careful attention to this table.**

This is the December **2022 Summary of Economic Projections (SEP) by the FOMC** itself, and it shows how the Fed expects core inflation to slow to 3.5% by the end of this year...

...contingent on **unemployment rate moving to 4.6% and staying there.**
With 11 months to go, we are still far from these higher unemployment rate levels the Fed "wants" to see.

Percent		Median[1]		
Variable	2022	2023	2024	2025
Change in real GDP	0.5	0.5	1.6	1.8
September projection	0.2	1.2	1.7	1.8
Unemployment rate	3.7	4.6	4.6	4.5
September projection	3.8	4.4	4.4	4.3
PCE inflation	5.6	3.1	2.5	2.1
September projection	5.4	2.8	2.3	2.0
Core PCE inflation[4]	4.8	3.5	2.5	2.1
September projection	4.5	3.1	2.3	2.1
Memo: Projected appropriate policy path				
Federal funds rate	4.4	5.1	4.1	3.1
September projection	4.4	4.6	3.9	2.9

Source: TheMacroCompass.com, Federal Reserve

Yes, the disinflationary trend is showing progress – but Powell didn't sound the green light, at all.
And if the labor market doesn't weaken, the Fed might be afraid of the good old Phillips curve (tight labor market = higher inflation) and refuse to cut rates in H2 2023 as markets are expecting.

No, the Fed and the ECB didn't pivot – which brings us to the final point.
Even if the FOMO fever is running loose again, **2023 is not anything like 2019.**

Fade The 2019-Like FOMO Fever

In 2019, the Fed pivoted swiftly and the economy managed a proper soft landing.
The S&P500 delivered a 30%+ return with a 2x (!) Sharpe ratio – an incredible risk-adjusted performance.

In January 2023, the narrative and macro data might resemble early 2019: the economy is slowing but not recessionary, inflation is cooling off rapidly, and a "data-dependent" Powell will have our back.

So long carry & risk premium versus short US Dollar and any volatility/insurance trade: right?

No: we instead fade the 2019-like FOMO fever.
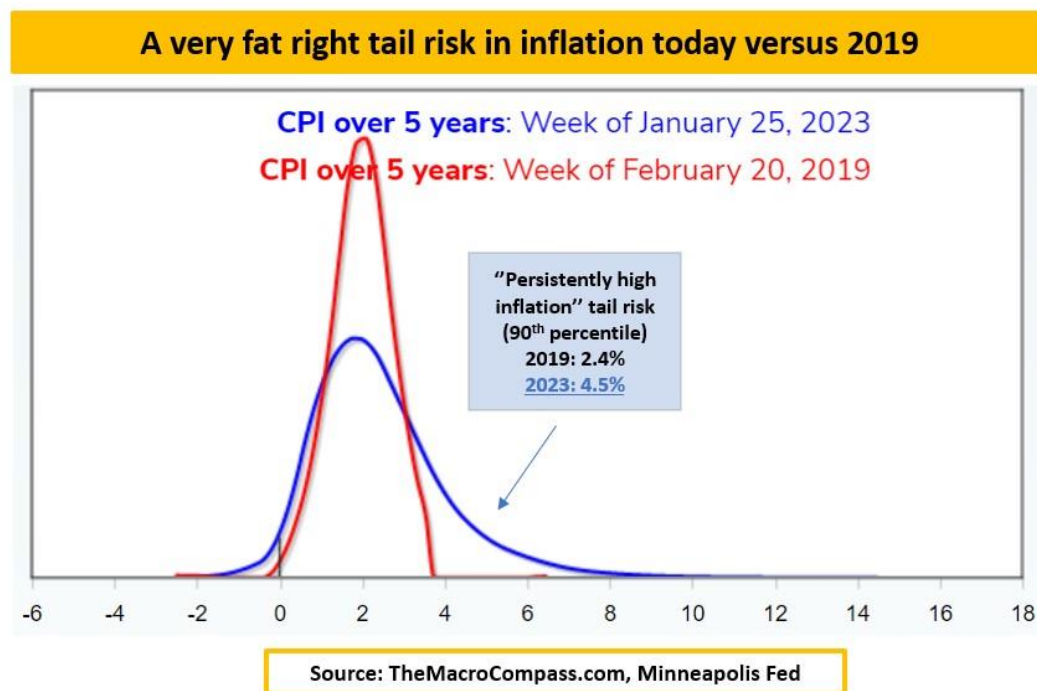And here is why.

1. (Real) short-dated **risk-free rates** were around 0% in 2019.
   Today, they are positive as the Fed is forced to keep policy tight for long and pivot much later.

The incentive to chase risk assets higher and squeeze away risk premia to the maximum extent is much lower when **sitting on cash rewards investors a hefty 4%+ nominal return and positive real yields.**

2. The probability distribution of 5-yr ahead inflation has a **much fatter tail risk for higher inflation** today than in 2019.

Contrary to 2019, today markets still price a **10% chance that on average CPI will print at 4.5%** in 2023-2028!
Such a fat tail for upside inflationary risks limits the Fed ability to pivot.
Loosen financial conditions too much, and the risk of a second bout of inflation dramatically increases.

A very fat right tail risk in inflation today versus 2019

CPI over 5 years: Week of January 25, 2023
CPI over 5 years: Week of February 20, 2019

"Persistently high inflation" tail risk (90th percentile)
2019: 2.4%
2023: 4.5%

Source: TheMacroCompass.com, Minneapolis Fed

3. It's **mostly priced in** already

Bond markets are already pricing in a disinflationary soft landing via a swift return to 2% inflation, non-recessionary cuts, tight credit spreads, and lower implied volatility: **La-La Land.**
Equity markets have FOMO-rallied accordingly, with **Equity Risk Premia** trading expensive on a long-term basis and cyclicals strongly overperforming defensives: no recession, squeeze shorts and risk premia away.

Conclusions

The **weaker nominal growth trend remains intact**, and we keep expecting a US recession to start around May.
Markets are instead pricing **Soft Landing** as the strong base case, and a 2019 FOMO-like fever is running loose.
For medium-term investors, **macro conditions are NOT in place to take aggressive risks in the stock market.**
No changes to our ETF portfolio positioning (see the TMC ETF Portfolio section at my.themacrocompass.com), which captures macro trends and risk/reward with a 6+ months horizon.

If the market conditions warrant it, **we might soon buy more bonds and perhaps precious metals.**