This Is What Sparked Today’s Euphoric Post-Fed Meltup

Description

A historic Fed decision is in the books and Fed Chair Powell did not disappoint. As Oanda’s Edward Moya writes, the Fed delivered the first-rate hike in 22 years and signaled more rate increases are appropriate and that the balance sheet runoff will begin in June, all of which was as expected. What was somewhat surprising is Powell’s vow (for now) that larger rate hikes are not on the table. ?Risky assets got a boost after Fed Chair Powell said, “So a 75 basis point increase is not something that the committee is actively considering.” Surprisingly, Powell’s confidence that large hikes aren’t coming takes place as inflation is not slowing down anytime soon, but that is not scaring Powell as his confidence grows that he can slow inflation without triggering a recession.

And yet, the truth is that virtually nobody actually expected 75bps of rate hikes which emerged as an extra hawkish bogeyman in the last minute, allowing Wall Street to give itself a dovish release is this unlikely outcome did not take place. Sure enough, in his Fed post-mortem, Standard Chartered’s Steve Englander asks rhetorically “**why the optimistic market reaction**?” and answers:

> We expected investors to approach this FOMC worried about whether the FOMC would explicitly or implicitly endorse shifting to a hiking pace of 75bps down the road, or raise the possibility of tightening well above neutral. Such fears were evident in asset price moves as the FOMC approached. We consequently saw a risk that an “as expected” outcome would be viewed as dovish as this added risk premium dissolved. While today’s price moves were dramatic, 5Y UST yields and BBDXY are still well above the levels that prevailed for almost the entire month of April. **So it is fair to say that positioning and excess pessimism reflect a big part of the market reaction.**

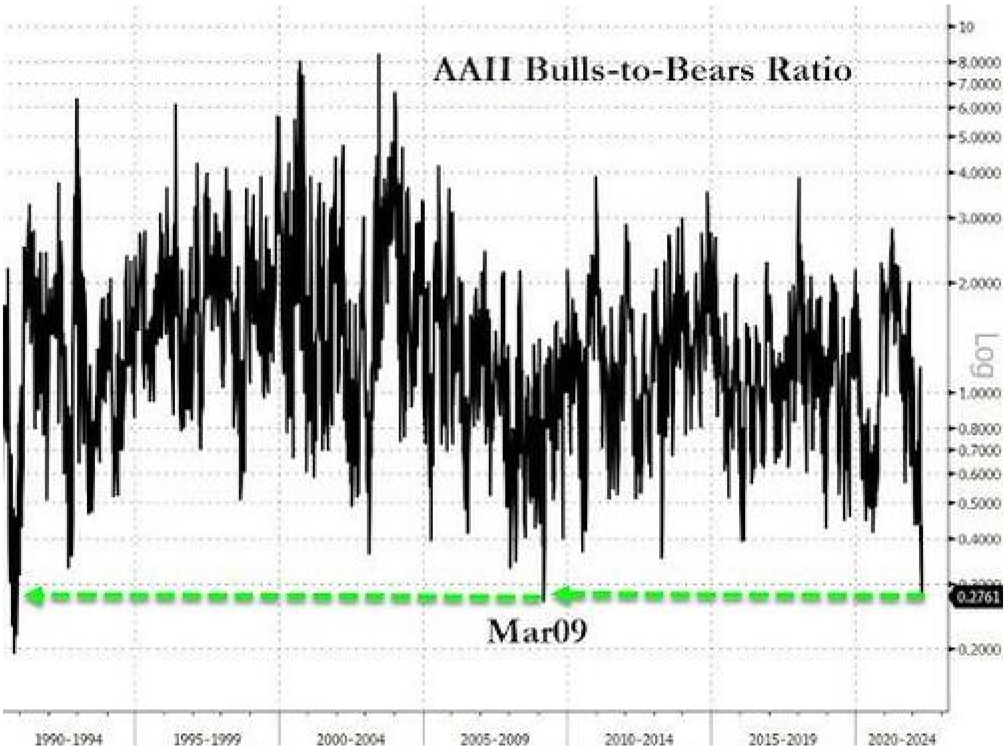
There is more: as we wrote repeatedly over the past week, the Fed is set to hike aggressively **right into a recession,** and it appears that even Powell is becoming concerned about this eventuality. To wit, Englander writes in his post-Fed note that "we also saw a few tentative indications that the Fed sees a little more risk of a slowdown (or at least a moderation in activity), **and that it did not want to endorse the most hawkish views under discussion at this point."**

Some more thoughts from Englander:

> Fed Chair Powell went out of his way to point to 50bps hikes as the norm, provided inflation and activity evolved according to plan, but didn't endorse 75bps. He mentioned a possibility that jobs growth would slow, one of the first Fed characterizations of the jobs market as anything other than 'red hot'. He pointed to some slowing of inflation in monthly data (while indicating that the Fed wanted to see concrete indications that inflation was coming off). **Overall, the tone was much more balanced than at the January and March FOMC meetings.**

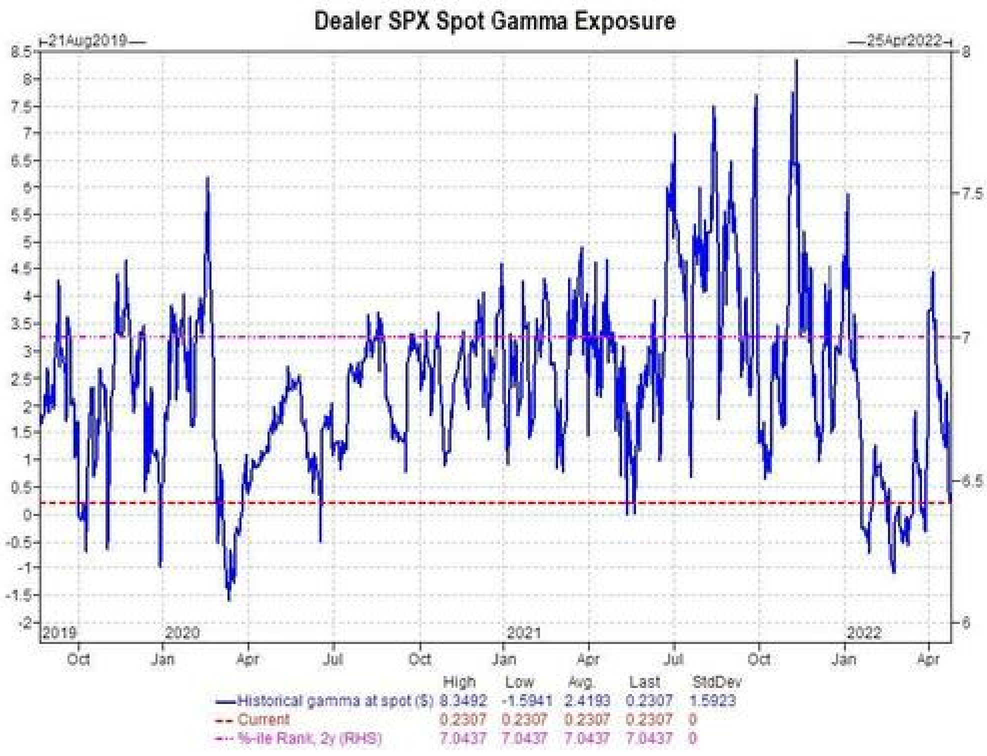
Today's tone shift is in line with our expectation that activity and, eventually, inflation will slow as 2022 progresses, and ultimately be reflected in a significantly lower fed funds path and USD level once we slide into a recession some time in the second half of 2022 at which point the Fed will not only cut rates but resume QE. However, until the slower growth trend is well established, the ups and downs of data could produce big swings in expectations and in the tone of Fed commentary.

Finally, how did this "strategic" easing of Fed tensions translate into the actual tactical buying euphoria? Simple: as we first explained *in "Buyback Blackout Period Is Over, And 10 More Reasons Why Goldman Calls The End Of The Market Carnage",* positioning was almost universally bearish, not only with AAII net bullish sentiment tied for the lowest ever…

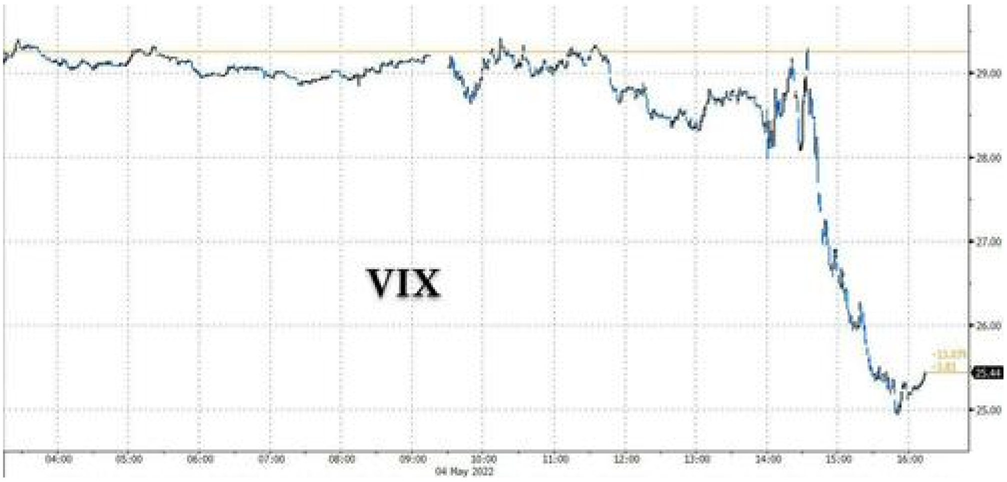


… but hedge funds were almost uniformly positioned for much more losses, with a huge imbalance in put/call ratios as well as an extremely negative dealer gamma. Recall what Goldman said over the weekend:

> S&P Index Gamma (no longer long) given institutional "forced hedging" of May puts – do we see monetization of puts after the big FOMC event next week? **Dealer long gamma has been unwound, and works in both directions. This will exacerbate, not buffer moves in the same direction as the market.**



Indeed, today's "*unclenching*" which was catalyzed by Powell "taking 75bps off the table", sparked precisely the epic short squeeze , both in cash and gamma, that Goldman expected **as puts were aggressively monetized, sending the VIX tumbling.**



Another take on this phenomenon comes from our friends at Spot Gamma, who have shared the following video explaining how vol sellers drove today's 3% market rally (if only practically speaking, it was of course Powell who started it).

That said, there is some disagreement about what happens next is: according to SpotGamma, 4,300 still remains a line of resistance on the S&P, while Oanda is more bullish and concludes that "risky assets can rally now that Wall Street has fully priced in the rest of the year's rate hikes by the Fed." While it is easy to turn optimistic here, a warning: the last thing the Fed wants is for its 50bps rate hike

– the biggest in 22 years – to be viewed as a green light to more risk on. In fact, if we indeed see stocks surging in the next few days, we fully expect the next crew of Fed talking heads which will hit the mic as soon as Friday…

> At this rate, stocks will be at ATH by Friday and Fed speakers will be throwing around emergency 100bps rate hikes
>
> — zerohedge (@zerohedge) May 4, 2022

… to warn that not only is a 75bps – and even as 100bps – rate hike on the table, but that an emergency, inter-meeting announcement is distinctly positive if algos ignore the Fed call at their own peril.

by Tyler Durden

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