The JR Liquidity Compass

A Big-Picture Guide to Understanding Market Regimes

Why We Built This

Markets don’t trade on direction alone — they behave differently depending on liquidity.

There are periods when pullbacks are shallow, volatility fades quickly, and mistakes are forgiven. And there are periods when selloffs accelerate, correlations spike, and risk travels further than expected.

That difference is not explained by price alone.

We built **The JR Liquidity Compass** to track the one variable that most directly affects how forgiving or fragile the market environment is: **net liquidity in the financial system**.

This tool is especially timely because, in our view, **controlling money in circulation — not just interest rates — is becoming a policy priority**, particularly under policymakers like Kevin Warsh who have been explicit about the role liquidity plays in inflation and asset prices.

What This Tool Is — and Is Not

The JR Liquidity Compass is a **market-environment tool**.

It is designed to answer one question:

Is liquidity currently helping markets absorb risk — or amplifying it?

It is **not** a buy or sell signal, not a timing tool, not a prediction engine, and not a replacement for price action.

Think of it as **market weather**, not a trade trigger.

What We Mean by “Liquidity”

When people say “money supply,” they usually mean headline measures like M2.

Markets do not trade M2.

Markets respond to **policy-driven cash flows** — where money is being created, where it is being withdrawn, and whether it is actively circulating or sitting idle.
That is what this tool measures.

What the Liquidity Compass Is Built From

The Liquidity Compass combines three observable, policy-controlled inputs:

Federal Reserve Balance Sheet (WALCL)
Expansion reflects QE and liquidity added; contraction reflects QT and liquidity removed. This captures **money creation or destruction**.

Treasury General Account (TGA)
The government's checking account. Rising balances pull money out of markets; falling balances inject money into the economy. This captures **fiscal liquidity flows**.

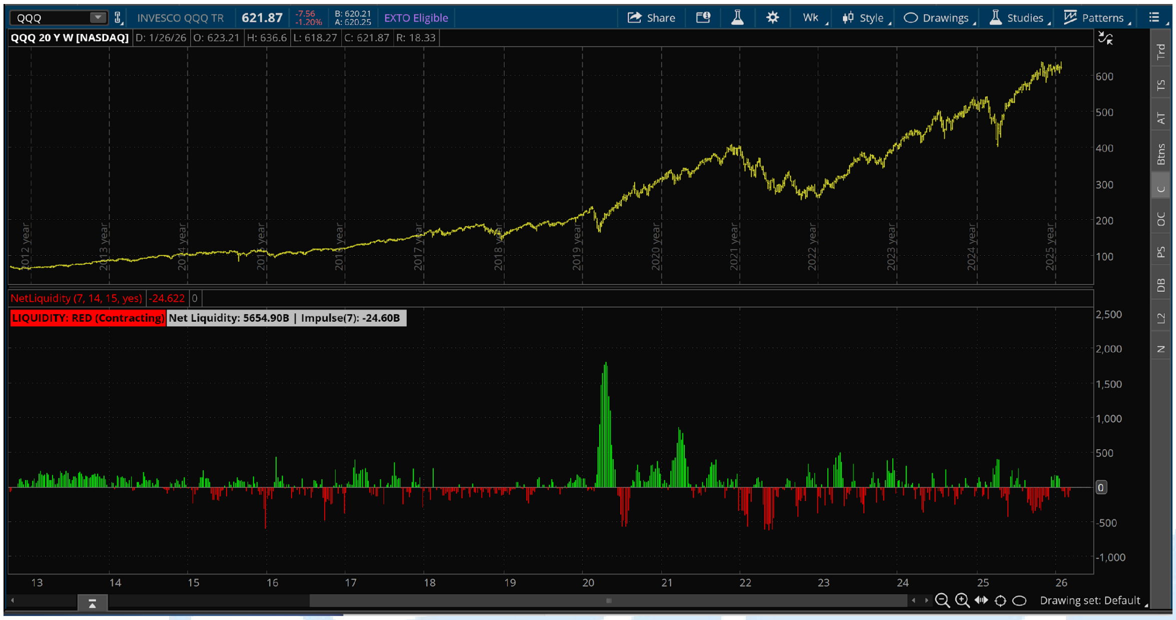
Overnight Reverse Repo Facility (RRP)
Cash parked at the Fed instead of circulating. Rising usage reflects idle liquidity; falling usage reflects money re-entering markets. This captures **inactive vs active liquidity**.

The Core Concept

Net Liquidity = Fed Assets − Treasury Cash − Parked Cash

The JR Liquidity Compass tracks the **change** in net liquidity over time — the *liquidity impulse*.
That change is what matters most for market behavior.

How to Read the Liquidity Compass



The lower histogram represents the **rate of change in net liquidity**.

Green bars indicate liquidity *expanding* money entering the system, markets more forgiving, volatility compressing faster, and pullbacks more likely to stabilize.

Red bars indicate liquidity *contracting* money leaving the system, markets less forgiving, volatility traveling further, and pullbacks deepening more easily.

Small or flat bars indicate liquidity is not a dominant driver and markets are trading primarily on earnings, positioning, and sentiment.

What This Tool Does *Not* Claim

The JR Liquidity Compass does not claim that markets cannot rise when liquidity is contracting, that liquidity controls price direction, or that every selloff requires liquidity tightening.

Markets can — and do — rally without expanding liquidity.

The difference is **how resilient those rallies are when stress appears**.

What This Tool Actually Explains

Liquidity does not determine direction.

Liquidity determines how markets behave **under stress** — how quickly volatility spreads, whether drawdowns are shallow or cascading, and whether risk is absorbed or amplified.

In simple terms:

Liquidity doesn't tell you what to trade.
Liquidity tells you how hard it is to be wrong.

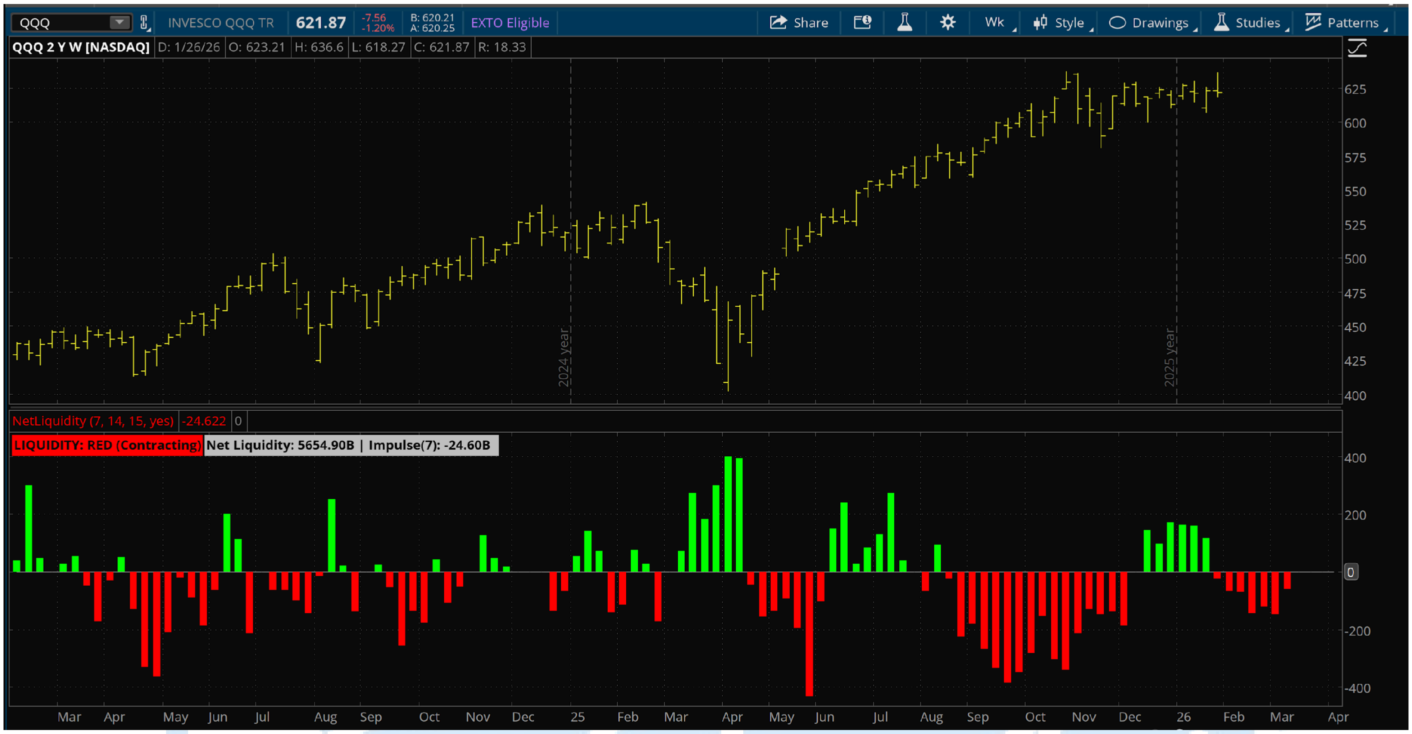
Why This Matters Right Now

Kevin Warsh and others have argued consistently that inflation and asset inflation are driven by the **amount of money in circulation**, that balance-sheet discipline matters as much as interest rates, and that liquidity should not be a reflexive backstop for asset prices.

If that philosophy gains influence, liquidity injections may become **rarer and more conditional**, the "Fed put" may sit further out, and markets may have to absorb more stress before policy support appears.

This does not mean markets can't go higher.

It means **liquidity becomes a regime-defining variable rather than a background assumption** — and that is exactly what this tool is designed to monitor.



How We Use the JR Liquidity Compass

This is **not** a daily trading indicator.

Best practice is to review it on **daily or weekly charts**, use it as *context rather than a trigger*, pay attention only when regimes change, and say nothing when nothing changes.

Silence builds credibility.

Practical Interpretation

When liquidity is expanding, risk-taking is rewarded.
When liquidity is contracting, risk management matters more.
When liquidity is neutral, let price and structure lead.

Final Takeaway

Markets always move — but they do not always move the same way.

The JR Liquidity Compass helps you understand the environment markets are moving through.

That's why we built it.

That's why it's timely.
And that's why it matters.

~Jonathan

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