SPECTRA MARKETS

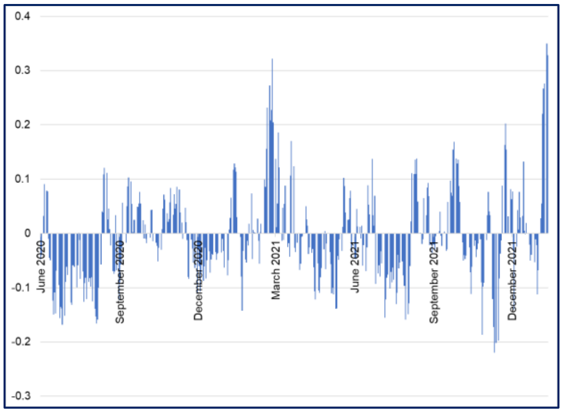
Tuesday, January 11, 2022

Please place seat backs and tray tables in their full upright and locked position

@jon_ftx made a good point today: much of the disagreement around where markets are headed from here comes down to levels vs. changes. For example:

Risky asset bulls: Real rates are still super low!
US 10-year real rates since 2000

Risky asset bears: Real rates are ripping higher!
US 10-year real rates, 7-day change since June 2020



I strongly believe that if your time horizon is one month or less, the only thing you should care about is changes. Levels are 98% irrelevant. Overall levels of Fed accommodation explain where we are right now, but they do not explain where we are going. Levels are already known and priced in. Changes are not always instantly priced in, even if they are known, because markets take time to find equilibrium. Observed changes can be useful but of course, accurately forecasting future change is best.

Longer-term investors can look through the big jump in real rates and say: Real rates are still low, I'm going to stay invested. Traders cannot. Traders need to react to the changes, or predict future changes, but not think much, or at all about levels. In fact, the best traders think about change and its second derivative (how fast is the change happening?). Here is a good JPAM piece on that (they call the second derivative "the impulse", which is a cool way of saying it). Short excerpt:

am
FX

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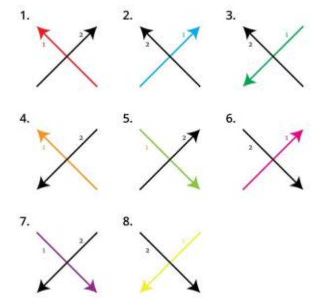


How do you draw an X?

Colored line is first stroke.

Current Views

Long EURUSD @ 1.1317
Stop loss 1.1174

Short CADJPY @ 90.99
Stop loss 91.85

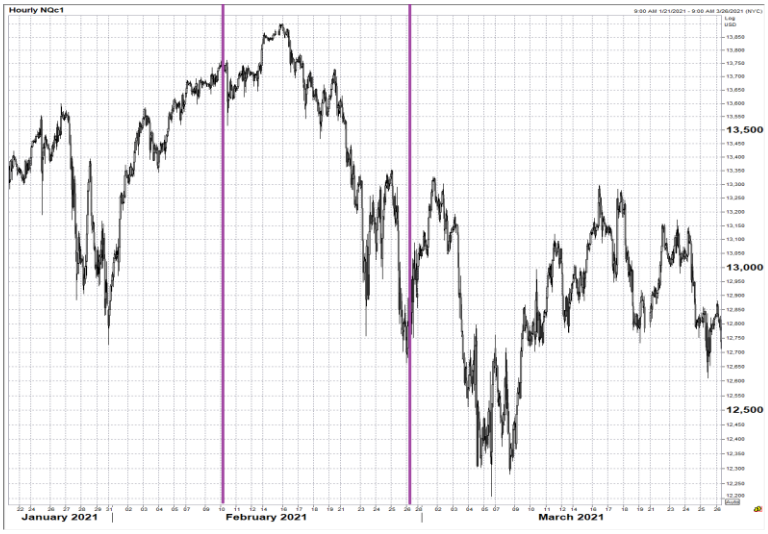
Long 03FEB CADJPY 90.00 put
Spot ref: 90.80 /// Price 75 pips

> Some clever analysis yields a compelling case that the impulse, rather than the flow, of global central bank balance sheets is likely to be the primary driver of asset prices. Whereas the "flow" of QE is the speed of balance sheet increase, the "impulse," is its acceleration. If the speed of balance sheet growth is slowing down, impulse is negative.

I have the same view on how QE works: The impact from QE on risky assets is something like 50% announcement effect, 40% impulse, 10% flow and 0% stock. Anyway, the point here is that just because real rates are low, that doesn't mean TINA is going to come and rip stocks higher. She only cares about direction and impulse of real rates, not levels. Remember TINA was just as powerful in 1999 when real rates were 4.25%. But when real rates went parabolic in late 1999, stocks (and civilization?) peaked.

The most recent micro run up in real rates took place in February. Here is what the NASDAQ did:

NASDAQ in Q1 2021 with real rates runup marked by purple vertical lines



Real rates peaked at 30bps on February 25th and were negative again by March. Therefore, the NASDAQ stabilized and ripped to new highs as the threat from real rates subsided. **I do not think real rates go back down this time and that is why I think we are in a turbulent phase for equities**.

The Captain has turned on the fasten seat belt sign. Please return to your seats. Please place seat backs and tray tables in their full upright and locked position. Keep your seat belts fastened.

It's not sell dips, or a bear market… It's sell rallies and keep an open mind. And keep that 2018 chart handy.

Turnaround, bright eyes

As someone who wrote about Turnaround Tuesday (TT) as far back as 2006 at Lehman Brothers, and a guy who dedicated a small part of a book to TT, I get a lot of engagement when TT happens. Usually, when the setup triggers (down Thursday, down Friday, down biggish Monday), I get 3 to 5 emails and a few pings on Bloomberg. Yesterday, no joke, I got >35 total pings and emails about TT. As such, I decided to recuse myself from the festivities as EMH starts to kick in when too many people are talking about the same market anomaly. My guess is the rally from 1pm to 4pm was on the widespread belief that TT was on the horizon.

This is similar to the month end FX model (WMR). When it works very well, it attracts more and more interest until it blows up in everyone's face. Then, people give up on it for a while. December 21 was an epic TT and there is recency bias with this stuff—people are all over it this time. Markets are not THAT inefficient. Hence my caution / bearish view on equities today.

I tweeted about this at the close yesterday and blasted all my chats. See image at right.

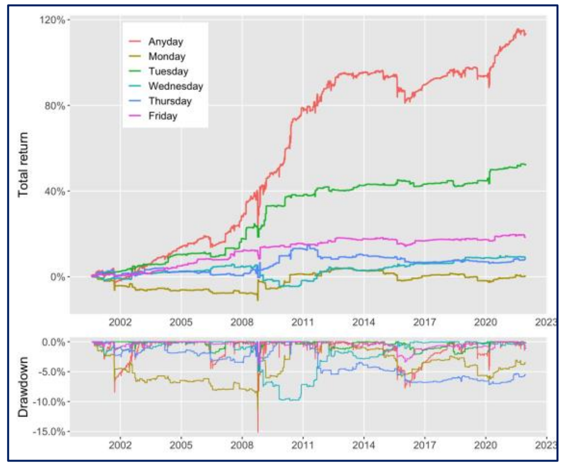
More data

When I posted some TT results on Twitter in late December, I got a few responses like "talk about overfitting, lmao". But for every troll on FinTwit, there are three or four smart people that are nice. A random quant dude from Brazil came to my defense with this nice bit of empirical validation for TT:

Bianco (from Brazil) on Twitter:

Here I expand the Tuesday Turnaround study a bit, with >110,000 trading sessions from 22 country ETFs since 2000. This may help against overfitting temptation Table summarizes aggregated data from all symbols, and chart shows equal-weighted returns.

	Anyday	Monday	Tuesday	Wednesday	Thursday	Friday
# trades	7289	1368	1597	1441	1411	1472
hit_ratio	55.33%	50.58%	61.49%	56.21%	52.80%	54.62%
avg_trade	0.24%	0.06%	0.60%	0.28%	0.09%	-0.06%



This is cut and paste from Twitter, with OP's permission. I cannot guarantee the accuracy of the output. The Tuesday numbers are very close to my numbers, so it passes the sniff test.

The takeaway is that TT has been a feature across global markets but also: If you buy stocks after they are down three days in a row, you tend to make money. The trend in stocks has been up, so this is pretty much a mathematical certainty. **Tuesday is by far the best with a 61.5% hit rate, but Wednesday offers decent returns too.** The spiciest trade is buy Monday close, sell Wednesday close. The effect is persistent over time and geography. But as I said, I'm not doing it today because I'm half expecting my mom to call me and ask about Turnaround Tuesday. Hi mom! Believe it or not, both my mom and dad read AM/FX most days. Winning!

In case you missed it

A senior Fed leader traded his PA immediately before the most important Fed announcement in US history, misrepresented the trades, was subsequently caught in what appears to be a lie (investigation pending, maybe), and then was allowed to walk out the door without reprimand. Then, that leader was praised by the bossman as he left… Lucrative speaker circuit career intact with full pension.

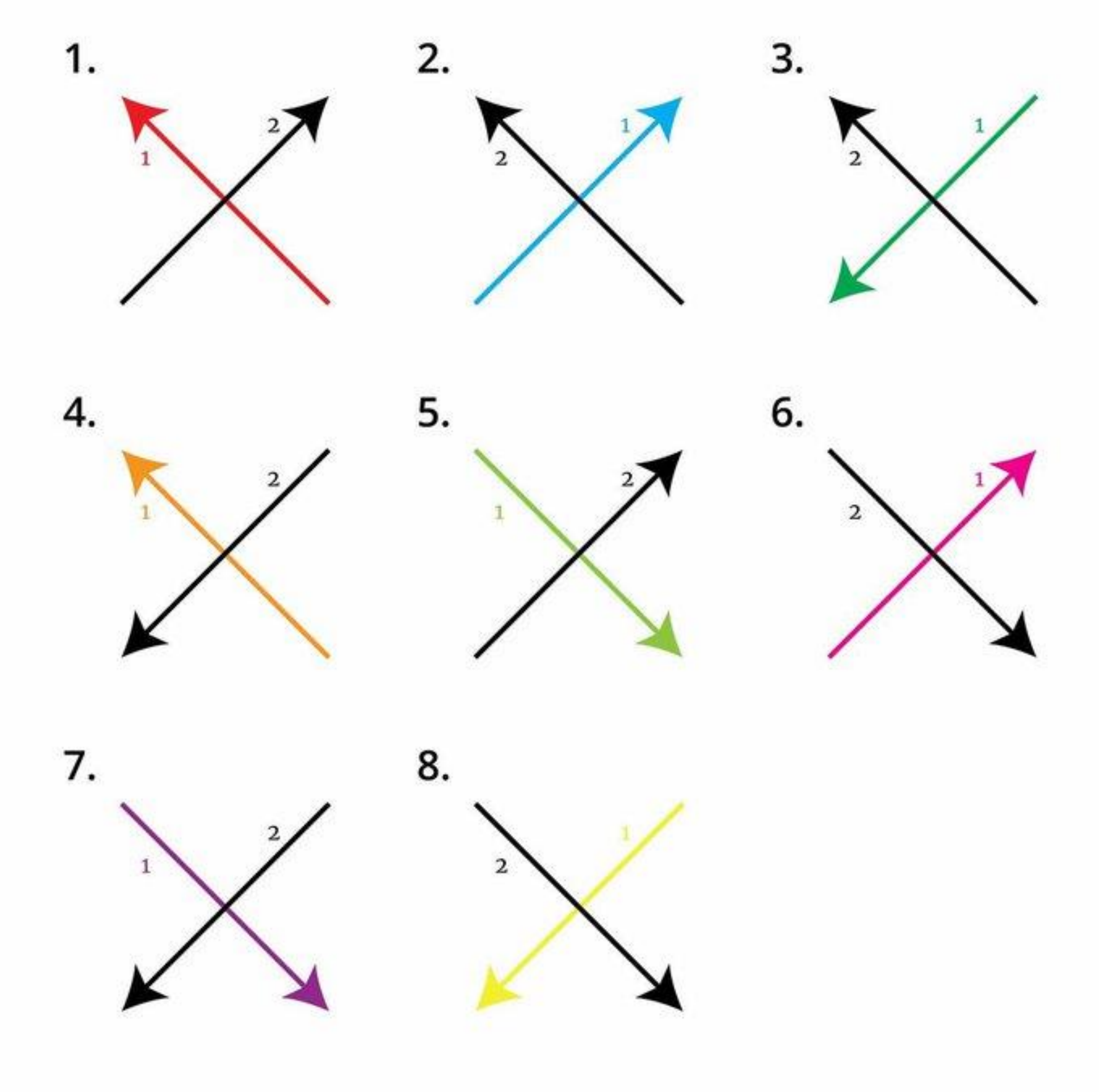
Meanwhile, anyone that did similar at a bank would have their career and possibly life destroyed by, guess who: The Fed. I hope the Inspector General is all over this. It's all incredibly disheartening. I used to be a Fed apologist, but they make it impossible not to be cynical.

Have yourself an Xcellent day.

good luck ⇅ be nimble

Which way do you draw an X?

Colored line is first stroke. I am 6.



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