SPECTRA MARKETS

Wednesday, January 26, 2022

am/FX

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https://xkcd.com/203/

Current Views

Long USDCAD @ 1.2575
Stop loss 1.2439
Take profit 1.2744

Exit at 11 a.m. NY on 31JAN no matter what

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

Take profit 88.65

BOC FOMC Exacta

FOMC and BoC today. My views:

Bank of Canada is 30/70 and priced 70/30. I don't think they hike. See previous am/FXs for reasoning as I have written tonnes about this lately and don't want to bore people.

FOMC: Market is leaning towards a dovish outcome intellectually (people generally arguing that a lot is priced in, etc.) but positioning is more paid rates which has accumulated over the past month or so. Sentiment and positioning don't really match and there is no obvious positioning angle today.

I think Fed ends QE early. Given Fed pivot, statements, and intention to reduce balance sheet soon, further asset buying makes literally no sense to anyone anywhere. The Fed is serious about turning and this is baby step one they will take. Reinvesting MBS into UST would make sense too though not sure they need to worry about that at this meeting.

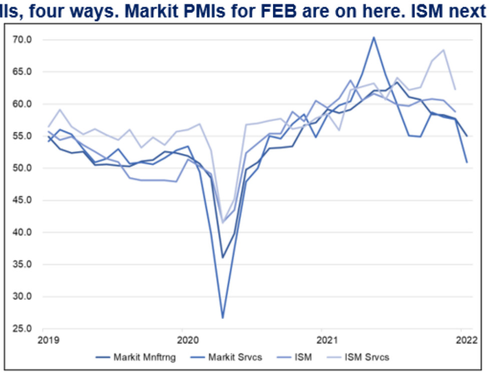
I think the market is overweighting rate hikes and underweighting the intellectual momentum towards focusing the mix a bit more on the balance sheet. While one might argue this is a violation of Goodhart's law, the Fed seem to think that if they keep the yield curve steep, it will keep the economy from rolling over. Some would argue this is like putting a thermometer in the fridge on a hot summer day, so it won't be as hot in the house but I think it's a sound strategy. Higher rates in the back end vs. the front end do more to cool housing and help keep the banking system healthy for a bit longer than aggressive hikes that invert the curve.

With month end likely to see large USD buying across the board, my view that Bank of Canada will hold today, and my view that the FOMC will sound hawkish relative to fairly meh sentiment… **I like long USDCAD as a trade**. Long USDCAD here (1.2575) with a stop at 1.2444 and take profit at 1.2744. If the trade survives to the weekend, the plan is to take it off on Monday once the month end shenanigans are done.

Timing

Unfortunately, the risk that the Fed is tightening into a fiscal cliff continues to rise. Since I published "am/FX: Something Weird is Going On" on January 19 and highlighted some surprisingly weak data in the US, we have got a crazy fat finger initial claims (286k vs. 230k) and a 7 point dump in the Markit Services PMI. This could all be omicron but it's worrisome.

US PMIs, four ways. Markit PMIs for FEB are on here. ISM next week.



My last comment on EMH and TT for a while

The well-known pattern of buying stocks at the close on Monday has become so well-known now that Turnaround Tuesday has become Turnaround Monday Afternoon. This is usually the point at which a market anomaly starts to lose its luster and my guess is that Turnaround Tuesday has peaked as a market meme and six months from now, even if we're in a bear market, the phenomenon will not be useful. Here is a chart:

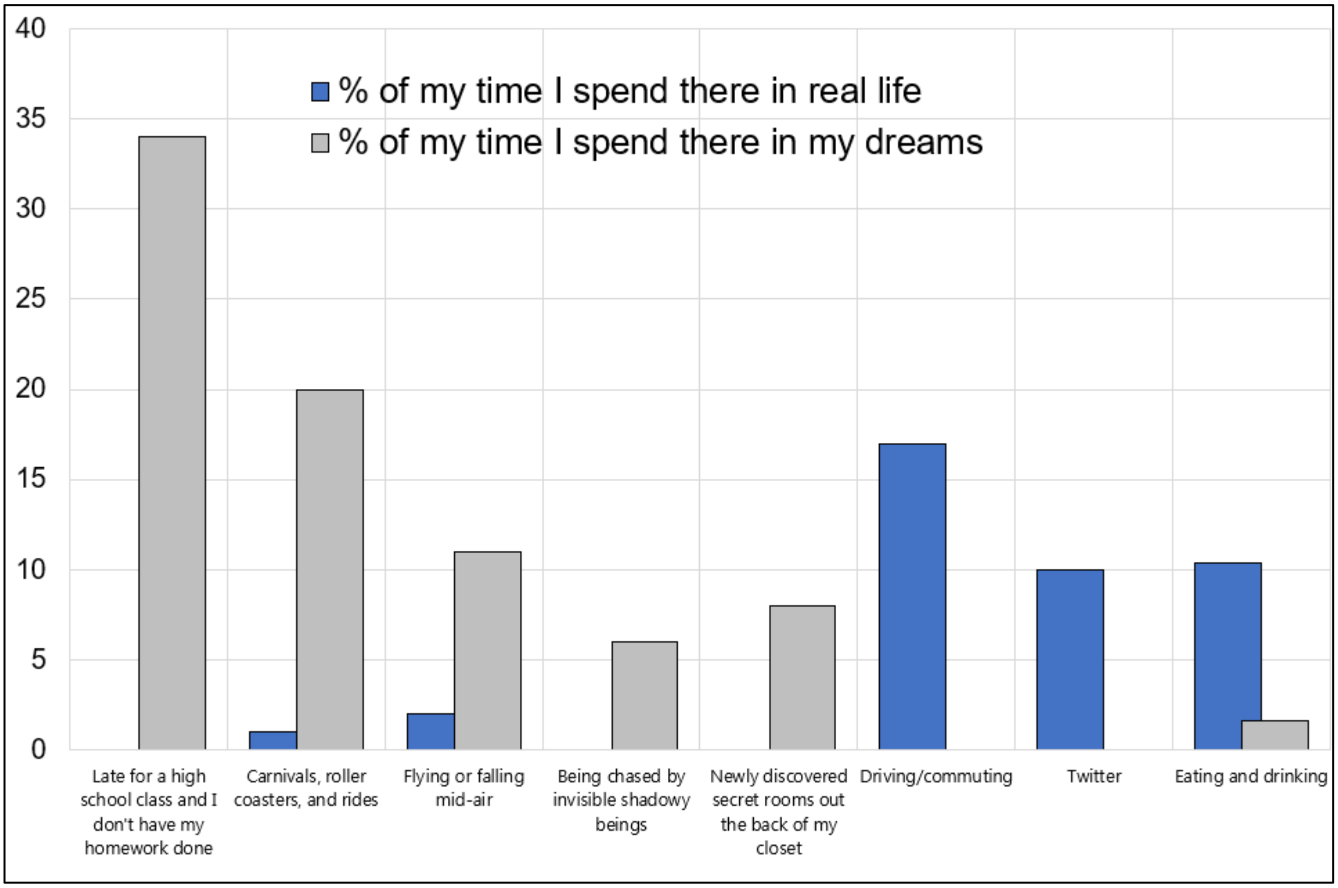
The old pattern was Thursday and Friday down, Monday down, Tuesday up. The new pattern is Thursday and Friday down, Monday morning down, then UPPPPP. The general reasoning is the same. Thursday and Friday are scary, weekend news is grim, people get too bearish and market gets short at the lows. The only thing that has changed is the timing of the reversal which has moved from Monday close to Monday around noon. Like I said… It's getting too obvious but still working for now.

S&P futures: Thursday and Friday down, Monday AM down, then UPPP

This is classic efficient markets hypothesis in action. Since markets are forward looking, a known effect moves earlier and earlier and slowly dilutes until it's no longer an effect.

Have a dreamlike day.

good luck ⥮ be nimble



Source: My life and dreams

NB: Dream flying = levitation, arm flapping, spinny hat *IRL flying = Commercial airlines*

APPENDIX: Trading fast markets

From Alpha Trader

Markets alternate between order and chaos. Chaotic markets (often called "fast markets") generate temporary inefficiencies and outsized opportunities but also tend to be short-lived, dangerous, and volatile. Order and equilibrium are the market's default state, but when chaos arrives, so does disequilibrium. Dislocations present the opportunity for traders to capture abnormal returns. Fast markets are high risk and high reward. Here is a primer on trading fast markets.

Trading fast markets

In World War 1, there was a famous quote:

> "Modern warfare is months of boredom punctuated by moments of extreme terror"[1].

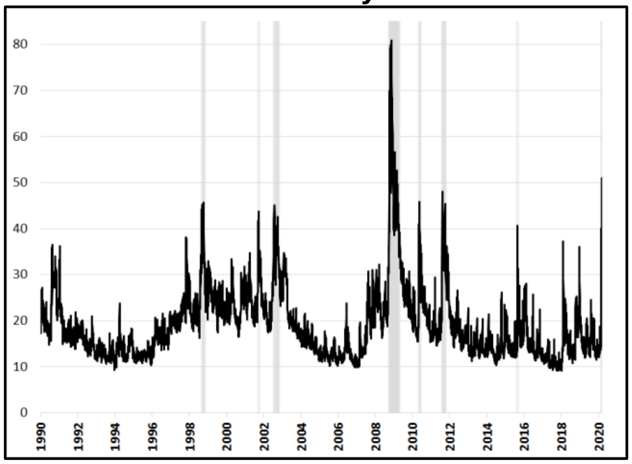
I would paraphrase here and say modern trading is hours of boredom punctuated by minutes of extreme terror. Things are quiet most of the time but what matters is how you act and react when the guano hits the rotating blades.

Crisis markets can provide the best opportunities for profit and the greatest chance of ruin. Markets can lay dormant for months, then go completely insane. A whole day can go by without excitement, then a headline hits at 4:00PM and everything boots off.

In this section, I discuss fast markets and, more specifically, trading during a crisis or extreme high volatility event. Trading crisis markets and trading idiosyncratic bursts of extreme high volatility involve most of the same skills and concepts.

It is usually easy to identify when a crisis is happening but for simplicity, I would say any time the VIX is above 40, that's a crisis market. Looking at all days since 1990, the VIX closed above 40 just 2.2% of the time. Here is a chart:

VIX marked with vertical bar any time it closed above 40



[1] https://english.stackexchange.com/questions/103851/where-does-the-phrase-of-boredom-punctuated-by-moments-of-terror-come-from

The vertical bars are all famous events in financial market history:

1998	Asian Financial Crisis, Russia Crisis, LTCM meltdown
2001/2002	September 11 / Dot com bubble burst
2008	Global Financial Crisis
2010/2011	Eurozone Crisis
2015	Energy crisis and China deval
2020	COVID-19 and Saudi / Russia oil price war

There is nothing special about the number 40, it's just a level we rarely see in the VIX.

When markets are in crisis, you need to trade differently. You need to be faster and smarter. The challenge is to be both more careful and more courageous at the same time. That is hard to balance! Fast markets are scary, but they are the best times to make money, and to truly excel at trading you need to crush fast markets.

Here are some tips to help you trade fast markets:

1. **Correct position size is the difference between winning and losing in a crisis**. Too big is not OK; you might blow up or get fired. Too small is not OK either; you need to seize the moment. Trading in fast markets is when the most money gets made and the alpha traders emerge.

   I remember as volatility went to the moon in 2008, I changed my normal trade size in USDMXN from 20 million to 3 million and I was still amazed (scared) by the volatility of my P&L. If you can size dynamically using forward-looking estimates of volatility, that is ideal. Look at what options markets are pricing for 1-week volatility. If you can't do that, look at the average daily range over the past 5, 10 or 20 days.

   As a rough logic check: for day traders, your stop loss should rarely or never be closer than within 1/3 of a day's range. For swing traders, use one full day's range. In other words, if you are trading Apple common stock and the average daily range over the past 5, 10 and 20 days is $25: day traders' stops should be $8 or more away from the entry point and swing traders stops should be at least $25 away from entry. This should be a good starting point in most markets.

   If you are getting stopped out and chopped up every day, your stops are too tight. A smaller position with a wider stop is necessary in crisis markets but you need to be mindful that you don't get so small that you are trading meaningless positions that won't move the needle on your P&L. Yes, a lot of traders get blown up in a crisis, but a lot just hide under the desk and reveal they are fundamentally risk-averse actors who are not really fit to trade moving markets.

Striking the balance between too big and too small is vital in trading and that balance can be the difference between crushing a crisis period or getting crushed by it.

2. **Keep an open mind and use your imagination**. When COVID-19 hit in 2020, the market took oil from $65 to $50 as concerns about consumer demand knocked a market that was already bulled up on "cheap" energy stocks. Then the OPEC meeting in early March crumbled and crude plummeted from $50 to $27 in a week. The pressure from COVID-19 started the ball rolling then the Saudi pledge to pump like crazy broke the back of the oil market. Anyone watching oil go from $65 to $50 might have thought that was enough of a move. "It's a big move! I'm going the other way!" *Not a good plan*. Eventually oil went to MINUS $40. This leads to the next point about crisis markets.

3. **In crisis markets, there is no such thing as overbought and oversold**. Don't be the person that fades the whole bear market all the way down. In a crisis, stocks can stay oversold for ages and then get wildly overbought days later. You need to differentiate between run-of-the-mill risk aversion and crisis-level risk aversion.

   Most risky asset sell-offs are routine affairs that should be traded using sentiment and overbought and oversold signals. When you see put/call ratios or the Greed & Fear Index or DSI or whatever positioning indicators flashing a reversal signal, it is normally time to pounce. But in a real economic or financial crisis, these signals are useless.

   For example, there is a simple metric I use to calculate overbought and oversold which I call The Deviation, as discussed in Chapter 10. It measures the difference between the current price of an asset and the 100-HOUR moving average. As The Deviation gets to prior extremes, it can give a nice mean reversion signal. Here is an example using EURUSD:

EURUSD (top, black) vs. deviation from the 100-hour MA (gray, bottom)
September 2019 to January 2020

Chart courtesy of Refinitiv

You can see that The Deviation (the gray line in the bottom panel) oscillated consistently between -80 pips and +80 pips[2] over the course of five months and the overbought and oversold readings offered up some decent reversal trades. Then, the COVID-19 crisis hit and all hell broke loose. Now look at the same chart, adding February 2020:

EURUSD (top, black) vs. deviation from the 100-hour MA (gray, bottom)
September 2019 to January 2020

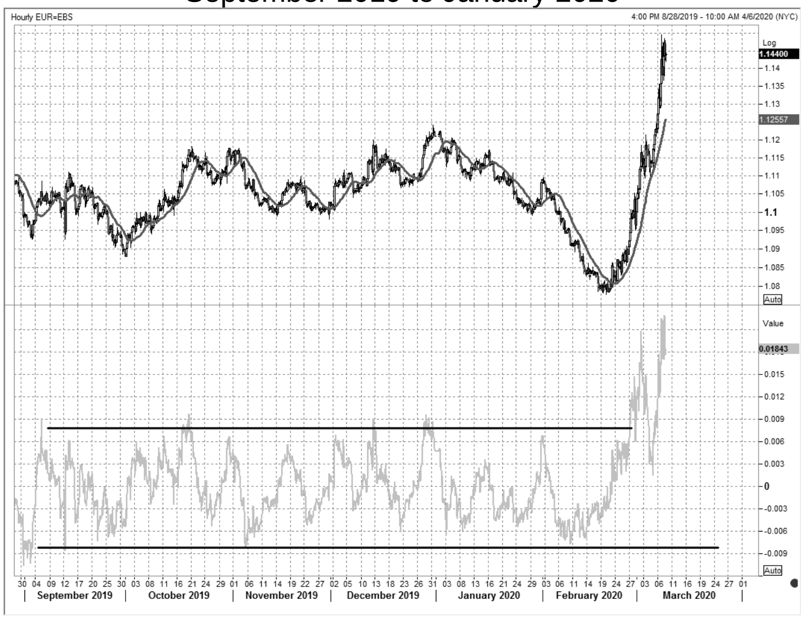


Chart courtesy of Refinitiv

As the crisis hit, the old measures of oversold were blown away as EURUSD ripped higher.

4. **Have courage.** Insane markets are the reason you got into this business. Don't hide under your desk and hope for the tornado to pass. Get involved and trade like you know you can. Don't put yourself in a position where you look back years later with regret. It is better to try and fail than to forever wonder what kind of trader you could have been.

   By the time the 2008/2009 Global Financial Crisis was over, careers were made and lost. Some of those lost were not people that blew up but just traders that sat there doing nothing while their peers extracted insane P&L out of thin air. Most of my best trading memories are from crisis periods because these periods deliver fast, volatile, and exciting markets.

   Like any high stress profession (pro sports, jet fighter pilot, professional poker…), it all comes down to how you respond in the periods of extreme stress. Don't be shy, get involved.

   Recognize when your product transitions from normal trading to a fast market and adjust your position size and trading strategies accordingly.

   END

[2] See dark, horizontal lines. Note: 80 pips = 0.0080

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