SPECTRA MARKETS

Thursday, March 10, 2022

am
FX

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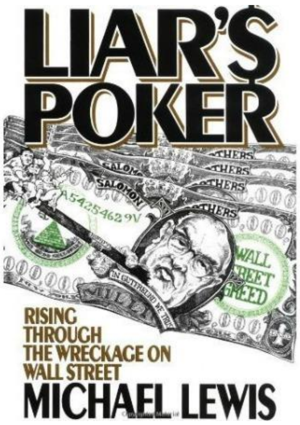


[5-minute video: Michael Lewis reflects on Liar's Poker, 30 years later]

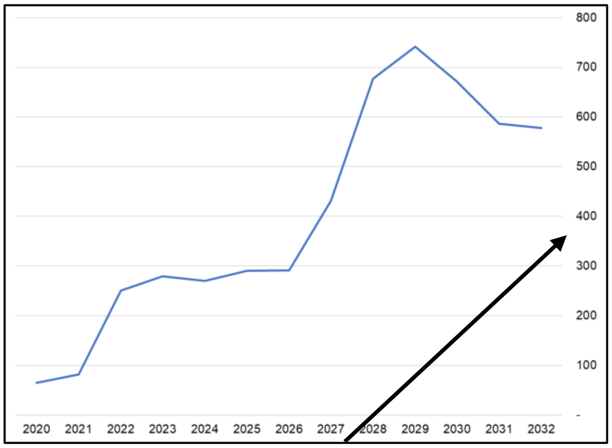
Current Views

Flat

Seasonality of JPY++

First, a quick bit of perspective in case someone is telling you this oil move is just like the 1970s all over again.

If oil 2020 to 2032 followed the same path as 1972 to 1982



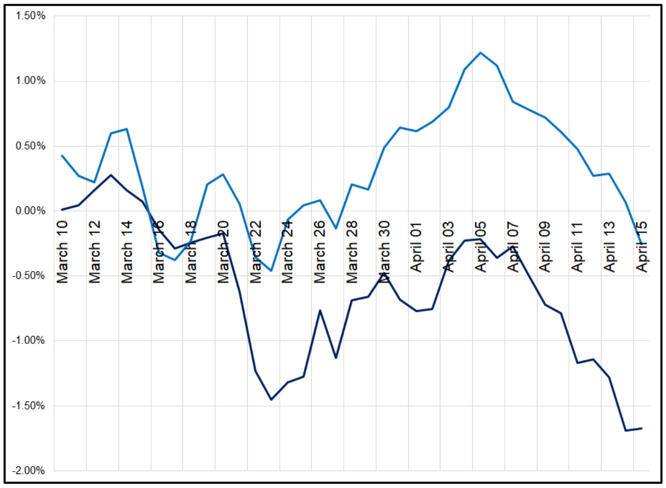
Note the scale of the y-axis

Seasonality

There is some notable seasonality coming up with March moves always a hot topic in JPY, and April (tax time) always a hot topic in stocks and crypto. Let's start with yen.

In the next chart, I have committed a bit of mild statistical blasphemy but I think it's useful, so I did it anyway. The lighter blue line (the one on top) shows the average cumulative return for USDJPY from March 10 to April 15 going back to 2010. Nothing weird about that. But I was worried about outliers because of Abenomics and the tendency for some of the huge BOJ announcements to come near the start of April in 2012/2014, so I wanted to look at the median as well. Adding medians together is kind of weird math but still, I think gives you a sense of how the data is distributed.

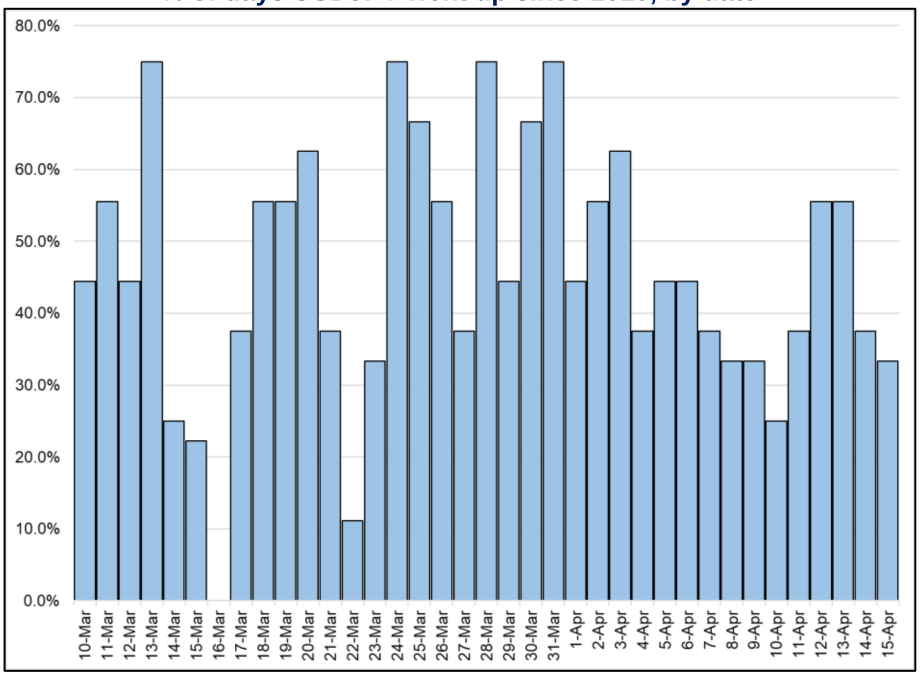
Cumulative average and median performance of USDJPY from 10MAR to 15APR
2010 to now



As expected, the averages are skewed by a few big up days in early April but overall, the pattern is the same whether you look at median or average performance. USDJPY sells off into mid-March, then rallies up and through fiscal year end and then gives it all back by mid-April. The explanation for this tends to be “repatriation before fiscal year end and then rebalancing at fiscal year end and then bonuses in April (some of which go into foreign assets)… And then mean reversion.” Whatever the explanation, March is always a busy and exciting month in JPY and having worked at a Japanese bank for three years, I can vouch for these flows. The pattern makes sense and I don’t think it’s an artifact of randomness. It’s an artifact of flows.

Another way to look at this same data is to ask: What percentage of the time does USDJPY go up on day X? In other words, starting with March 10th: What percentage of March 10ths did USDJPY go up vs. down? This can give you a sense of the persistence of the effect vs. its magnitude. Since I’m only looking back to 2010, the sample size is small but it’s still another layer of info.

% of days USDJPY went up since 2010, by date



I am bullish USDJPY as the ECB puts a floor under global interest rates, and oil remains a problem for the Japanese current account. Meanwhile, USDJPY can’t go down on bad news, falling yields, global war, exploding gold prices… Seasonality is never the be-all end-all, but in this case, my bullish enthusiasm is tempered a bit and I am cautiously bullish and not ready to pull the trigger. Buy dips not rips, kinda thing.

If you work at a hedge fund, the trade is probably to sell 1-month downside in USDJPY in some sort of limited loss kinda way. USDJPY vol has come off the highs, but still seems like a decent sale vs. owning topside.

Tax day

The other big seasonal this time of year is the selling of risky assets to fund tax payments into mid-April. This is primarily a feature of extremely speculative bubblicious markets like the one we saw in 1999, 2000, and 2021. I have written about this in years past and don’t want to make today’s am/FX too girthy, but if you would like to know the story, you can read it here. I recommend you read that note, it’s funny. The gist of it is that spec bubbles create huge unpaid tax bills for noobs and those people need to liquidate assets to pay the tax bill. That was me in 2000.

I will write more about the tax day stuff as the time nears. In that note that I linked, I discussed tax day as April 15, but note the IRS later moved the tax date to May 17. Crypto absolutely collapsed into May 17, as predicted (by me and others).

Wonk you very much

Burt sent me this research paper which concludes that FX option volume predicts future FX returns, especially when demand for USD is high. It is worth a read! I would have expected that higher options activity would be *coincident* with USD appreciation due to the safe haven nature of the USD and the left side of the USD smile (higher vol = risk aversion = buy USD). But I am surprised that it's predictive!

If you read the paper, you will see that the primary sample they use is 2014 to 2016 and that was a huge red flag to me at first because that was a period when the USD was skyrocketing. I reached out to one of the authors of the paper about it and he was kind enough to respond. Here is the email exchange, abridged.

From: Brent Donnelly <bdonnelly@spectramarkets.com>
Sent: Tuesday, March 8, 2022 10:57 PM
To: Czech, Robert <Robert.Czech@bankofengland.co.uk>
Subject: quick question

Hello sir I am an FX trader and have been writing and trading global macro and FX since 1995. I had a question about your study on option volumes.

Generally, whenever I have done a study of the sort you did (mine are much simpler, but conceptually similar) .. the trend in the data often dominates the information of the effect I am studying. Given the USD was in a massive up trend in the period you selected 2014/2016 .. could the result not just be a product of the trend? Higher activity in a massive up trend will always show the activity as predictive of a higher USD when the USD is moving up and moving up large a majority of the time. Events such as BOJ easing, ECB easing and Fed tapering were all pushing the same way so every event (and thus every hedge fund speculative play) revolved around a higher USD.

I wonder if the results would look different if you studied 2017 or 2002-2007 .. i..e, USD lower regimes.

Curious what you think. Thanks for the paper tons of interesting stuff in there!

Brent

From: Czech, Robert <Robert.Czech@bankofengland.co.uk>
Sent: Wednesday, March 9, 2022 5:06 AM
To: Brent Donnelly <bdonnelly@spectramarkets.com>
Subject: RE: quick question

Hi Brent,

Thanks a lot for getting in touch!

I agree with your concern about the sample period 2014-2016, given that the dollar was often appreciating during this period.

However, we have included several tests that should hopefully alleviate this concern.

First and foremost, in Table 11, we use non-proprietary data on aggregated option volumes from Bloomberg for an extended sample period (March 2013 – December 2020). Consistent with our headline results, we show that the low-minus-high portfolio still generates a statistically significant annualised return of 9.37% (t-stat: 3.03). Furthermore, in Table 3, we use day fixed effects in our panel regressions to control for common moves in exchange rates. In other words, when the dollar appreciates on a given day against all currencies, then this would be captured in our fixed effects.

Third, we also control whether our results remain robust when controlling for well-known common FX risk factors, incl. *dollar*, carry, value, momentum, volatility, liquidity, reversal, and VRP (variance risk premium) factors. As shown in Table 4, the long-short portfolio persistently generates significant alphas after controlling for these factors.

I hope this answers your question! Let me know if you have any further questions or comments.

Thanks,

Robert

Robert Czech
Senior Research Economist | Bank of England

It's nice both Robert and I like to use exclamation marks. This chart from the paper is nice.

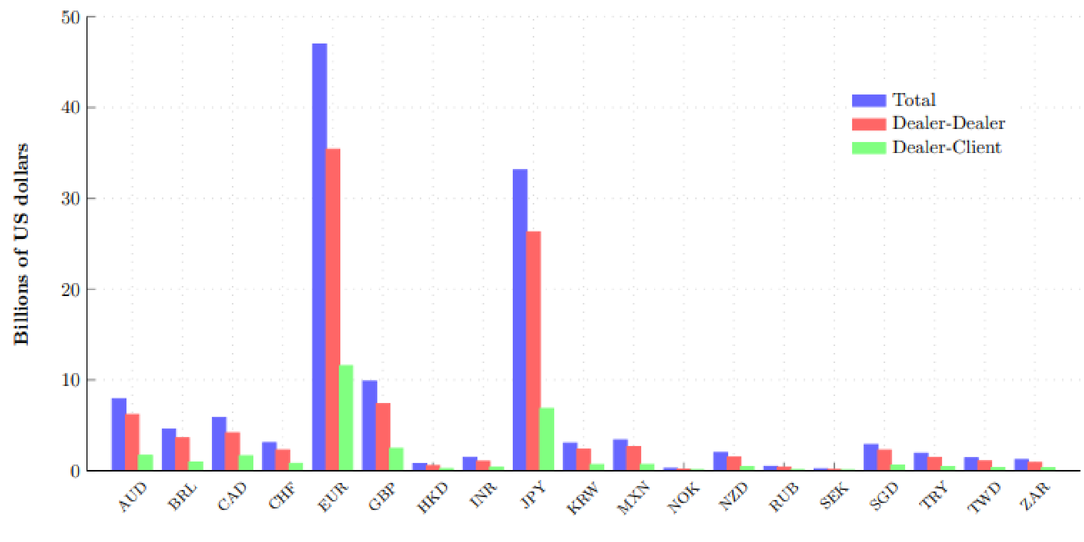


Figure 2. FX Option Volume: Currency Pairs

Sample is 2014 to 2016 (GBP probably overrepresented due to Brexit)

Final words

Finally: I have lost patience with crypto. The regulatory stuff looks bullish, the sanctions are bullish, risky assets have stabilized, gold went to Mars, and BTC is unchanged. Maybe I'm showing a lack of patience here, but the thesis has played out and the price is unchanged. For me, that means it's time to move on. Flat strong etc.

I hope your day is straight up beast.

good luck ⇅ be nimble

Click here for a 15-minute video interview segment on how Jimmy Donaldson (MrBeast) became one of the biggest entertainers in the world.

A very wise man at the age of 23.

Trigger warning: it's an interview with Joe Rogan.

Here is MrBeast counting from 1 to 100,000, with no food or water for 40 hours

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