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Brent Donnelly

bdonnelly@spectramarkets.com
(212) 398-6230


Jared Dillian

Current Views

Flat

Dirtcon: Day 2

As explained in Thursday's piece, I spent the back half of last week at Dirtcon, Jared Dillian's conference in South Carolina. Now, highlights and takeaways from Day 2.

Speaker 1
Mark Lapolla
Sixth Man Research, providing market and portfolio strategy to institutional investors.

Mark's a wily veteran, having started in the pits in the 1980s and worked at Goldman Sachs in the 1990s. His presentation was a compendium of his views for markets and society over the next 5-10 years. Of note:

- **The US is operating under something close to an MMT** policy framework and this will continue. That means rates cannot rise above nominal GDP for long. Mark strongly believes the Fed anchors the entire curve and there is a reason 10s never go much more than 300bps over Fed Funds. As such, he thinks Fed Funds are capped wherever you think nominal GDP is (1% population growth + 2% inflation = 2.50%/3.00% max approx..) Productivity factor is hard to quantify.
- US society is not willing to accept pain. This drives all forms of policy.
- **Oil spike will be deflationary just like every other oil spike** in the past as it weighs on discretionary spending.
- Commodity prices will stay high but inflation will dissipate as there is not the characteristic bringing forward of purchases that one would expect in a truly persistent inflation dynamic. Wages are rising and the price level is rising but there is no classic inflationary psychology (panic buying/hoarding).
- Unfortunate that while cheap energy is indisputably the single largest factor that has lifted people out of global poverty, **there is no intellectual freedom to debate the merits of ESG policies** in developed countries. The debate is settled and contrary opinions are not welcome.
- US demographics are bad but still way better than China, Germany or Japan.
- Active to passive is a fundamental regime change in equity markets. If you're not long AMZN (for example) you are synthetically short AMZN vs. your benchmark and your peers.
- **AI and trend following models are solving for slope in equities, not the endpoint**. Therefore, valuation is irrelevant to a huge cohort of participants. Problem is, vol-adjusted momentum is reflexive. Models tune to each other and become alike. Syncopation and herding have occurred to an unprecedented degree and this has created one or more interrelated tech bubbles (megacaps and disruptors).
- Zero chance the dollar loses its reserve status in our lifetime. His Dad was in the CIA and always said: The first three things people in war-torn areas want is food, water, and petrol. Fourth thing: US dollars.
- We are still in the haze of the COVID policy response but when the smoke clears: no fiscal juice, high gas prices, and weaker housing markets will push the US economy off its current robust course.
- If we can get back to 2% Fed Funds and 5% 10-year rates and stay there for a bit, Mark would feel hopeful that some return to normalcy is possible. Positive yields are a fundamental feature of properly-functioning capitalism. Currently we are in a never-ending cycle where we bounce off, then return to the zero bound.

Speaker 2
Carolyn Dillian
Archeologist and Chair of the Anthropology and Geography Department at Coastal Carolina University

A scheduled speaker cancelled at the last minute so Jared's wife filled in. Her presentation was not finance-related but I found it super interesting and the break from market-related topics was welcome. Her presentation was on the relationship between Neanderthals and homo sapiens during the period when both coexisted on Earth.

It was once thought that homo sapiens evolved from Neanderthals but it is now believed that both Neanderthals and homo sapiens evolved from homo heidelbergensis. It is unclear whether Neanderthals and homo sapiens could mate to create viable offspring, but the presence of Neanderthal DNA in current human populations suggests they probably did. Most cross-species offspring, however, such as ligers, zedonks and mules, are infertile.

A zedonk. A cross between a zebra and a donkey.

The name "Neanderthal" comes from the fact that the first remains of Neanderthal man were discovered in the Neander Valley (a gorge near Dusseldorf) in Germany. That's why you don't pronounce the "h". It's the German pronunciation of th, which is "t". And that's why it's capitalized and homo sapiens isn't—Neander is the proper name of the valley in Germany so Neanderthal keeps the capital N. Now you know!

The global population of Neanderthals was concentrated in Europe and Asia while homo sapiens dominated Africa. Neanderthals were shorter and fatter for better heat conservation while homo sapiens were longer and leaner. Over time, the much larger homo sapiens population headed north and east and encountered the Neanderthals. The evidence strongly suggests that there was interbreeding between the two species—many current humans have some percentage of Neanderthal DNA. If you do a 23 and Me or ancestry.com DNA test, you will find that you might have Neanderthal DNA. Jared's DNA is 2% Neanderthal.

Carolyn went through some of the features that Neanderthals and homo sapiens had in common and showed some differences, including skull shapes. Homo sapiens has a more spherical skull and more front matter in the brain while Neanderthals have a longer skull that goes further back and contains more back matter. This could explain why homo sapiens were more innovative and creative (the front part of the brain is responsible for abstract thought and creativity). While both Neanderthals and homo sapiens developed stone tools, for example, homo sapiens continued to improve and adapt their tools while Neanderthals did not.

Adapt or die. Eventually, the Neanderthals were both outbred and killed off by homo sapiens and they disappeared. Recent discoveries have led scientists to believe that Neanderthals could speak. Fun fact: People with red hair have more Neanderthal DNA than those without red hair. The gene for red hair is thought to be passed down from Neanderthals. Those are my Neanderthal info highlights. Now, back to finance!

Speaker 3
Turney Duff
Author of "The Buy Side", consultant on Billions, writer, ex-hedge fund manager, cocaine addict

Turney is a great speaker and generally funny guy who talks with disarming honesty about his years of insider trading, cocaine addiction, party-hard lifestyle and his eventual, seemingly inevitable drop into the abyss. The presentation was called "if/then" and focused on his never-ending past belief that "if X happens, then I'll finally be happy". Turney grew up lower-income in Maine and had a 970 SAT, so it wasn't obvious what he was going to do with his life. He thought:

If I move to New York, my life can start. Then, I'll be happy.

Then, he moved to New York, and with significant help from his uncle, he scored a $22,000 / year job at Morgan Stanley. He thought:

If I can just make $50,000, then I'll be happy.

With his high EQ and fun-guy-at-the-bar persona, he was soon finding success in sales. He was quickly earning north of $50,000 / year, but the role didn't appeal to him. He thought:

If I can just be a trader, then I'll be happy.

So, he worked his network and got a job as a PM, trading at Galleon. Not long after he started, he's sitting there on the trading floor. It's 1:00pm. Everyone is off desk, gone for lunch. The phone rings, so Turney answers it. There's a guy on the other end, whispering.

"Is Gary there?"

"No, he's out of the office."

Long pause. Nervous breathing.

"How about Raj?"

"Off the desk."

A few moments of silence, then the guy whispers.

"Jefferies is gonna upgrade Amazon in six minutes."

Duff had two choices, and of course he made the wrong one. He bought 100,000 shares of AMZN. A few minutes later, at 1:06pm, the phone from Jefferies rang.

"We are upgrading Amazon."

Turney felt like saying, but did not say "I know!"

A few minutes later, he sold the shares and banked a $500,000 profit. That was the start of a multi-year run as Turney drank more and more, did more and more cocaine and made more and more money. People around him would either say:

"That dude scares me," or, "I wanna party with that guy!"

His life became a bunch of epic ups and downs where no amount of partying or adoration delivered lasting happiness. He recalled one night he was feeling so down and out he called the JPM automated bank system so he could listen to the electronic voice repeat his bank balance over and over.

"Your balance is 1.8 million, three hundred and forty two thousand—" **he presses 1**
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The most degenerate anecdote of Duff's speech was the story of the night he took a client to a Marlins/Yankees World Series Game in 2003. Duff bought 8 tickets at $2,000/each for just the two of them. Yankee Stadium has a no smoking and also a no re-entry policy, so with eight tickets, they could repeatedly go outside for a cigarette and then come back in using a fresh two-thousand dollar ticket.

Of course, underneath all the funny, there is sadness and self-destruction as Turney eventually had a daughter with his girlfriend right in the heat of the worst days of his addiction. He went to rehab, then came out and thought.

If I can just get a job on Wall Street again, then I'll be happy.

He did get another Wall Street job, and was soon back nose-deep in another bag of cocaine. He found himself in midtown at 5am after a sleepless 72-hour binge. He knew if he didn't go to work, he would be fired. So, he threw himself into a puddle. Over. And over. And over. Until his $3,000 Prada suit was soaking wet and his face and arms were covered in blood. Then, he walked onto the trading floor, past his shocked coworkers, and into his boss' office.

"I got mugged," was the best he could muster.

And… Back to rehab. But even after he emerged from rehab a second time, re-established his relationship with his daughter, and signed a lucrative book deal, he heard himself thinking:

If my book is a NYT best seller, then I'll be happy.

But at that point, Duff was finally self-aware enough to know that he should ignore the dumb thought. His view now is "Forget happiness. I want a life of honor, integrity, and peace." He talked about "affective forecasting" which is the notion that human beings are terrible at forecasting what will make them happy (or sad). We dream about that thing that will finally make us happy or we obsess over worst case scenarios. But when the event we were anticipating actually arrives: it doesn't impact our happiness much, or at all.

Duff's life story reminded me of the middle chapters of one of my favorite books, "Siddhartha". In that book, Siddhartha immerses himself in a sinful and debaucherous life, eventually becomes disgusted with that life (and with his own ego), nearly drowns himself in a river, falls into a deep sleep, then wakes up refreshed and reborn, seeking peace, not worldly stimulation.

Now, Turney's book is a bestseller, he consults for the HBO series "Billions" and he's engaged in creative, not financial pursuits. He sees his daughter every day and finally, after losing everything, he appreciates that there is no if/then, there is only right now.

He closed with:

"Now I live in a small, split-level two bedroom. I'm barely paying my rent… And I've never been happier."

Speaker 4
Brent Donnelly
Guy that trades and writes about finance.

My presentation slides are here. Most of the content is similar, but not identical to my books. Here's a summary of the presentation:

Behavioral Finance and the common trader and investor biases are well known. The next step of the evolution is to take the lessons of Behavioral Finance and apply them directly to your trading or investment process. It's not enough to know about bias, because knowing about a bias very often still does not stop you from falling victim to it. Smart people do stupid things. All the time. The key is to see and acknowledge the types of bias that hurt your trading and develop and implement systems to plug the leaks.

For example, if you overtrade, introduce friction to reduce your trading activity. Make it harder to trade by creating speedbumps or resistance. When I worked at a bank that had a phone app so I could trade FX on my phone at night (as opposed to having to call Hong Kong or Tokyo to trade), surprise, surprise, I traded much more! So, I removed the trading app from my phone.

I also went to a performance coach in 2019 as I was getting frustrated with my inability to stop overtrading. He asked me to picture a video of myself overtrading. What was the specific chain of events? By doing this visualization, I realized that it was the jiggling prices of other asset classes on the screen that was triggering my cross-market correlation instincts and leading me to compulsively enter low-EV correlation trades.

Every time gold went up five bucks or e-minis dropped seven handles, I instinctively reached for the BUY and SELL buttons to trade the short-term correlations in FX. Problem is, unlike 10 years ago, that type of intraday correlation trading now only works when there are huge dislocations. My solution was to introduce friction. I minimized the window of my trading cockpit as often as possible, and all afternoon. This reduced the firehose of noise coming out of my monitors and cut down on my overtrading.

Think about your suboptimal behaviors and think of how to create roadblocks and friction around them. If you constantly check your phone in the middle of the night, turn it off when you go to bed and put it downstairs in a hard-to-access location. Just like: If you don't want to eat chocolate chip cookies, don't have chocolate chip cookies in the pantry! Identify suboptimal behaviors and don't assume you can overcome your weaknesses. Instead, implement systems that acknowledge the weakness and reduce or eliminate the behavior. And automate good behavior, like stop losses.

The slides will guide you through the gist of the presentation. The main ideas that I hope people took away:

- Behavioral finance is interesting, but my objective in recent years is to take it out of the psych lab and into the real world. Apply your knowledge of behavioral bias to identify and stop your personal suboptimal behaviors.
- **Collect as much data as you can on your trading or investing**. Quantify exactly how much you are paying per month or per year in transaction costs. You might be surprised. I sure was!
- Look for overtrading, overconfidence, and negativity bias in your trading and find direct solutions that offset the bias. Don't say "I'm not going to suffer from that bias because I know about it." Say "My instincts are biased, so I need to lean hard the other way and implement direct, actionable solutions."
- Don't be a reflexive contrarian but also: don't be a sheep. This is hard!
- Since all media (financial and otherwise) is biased toward negativity, **be deliberate about finding positive voices and sources**. To offset negativity bias, cut out permabear information sources and add positive ones.
- **Can you explain your edge in 50 words or less?** If not, you should probably not be trading. Not everyone was born to be a star trader or successful investor. **See slides 31 and 32**.
- **Don't leave limit orders on the round numbers**. That's a noob move. Round Number Bias isn't a hugely important topic, I just put it in there for fun. That said, the response was more positive and there was more engagement on this topic than I expected.
- Be humble. If you are not humble, the market will kick your ass. Humility is a superpower.
- Be probabilistic, not deterministic.
- Be Bayesian. Update your views as new information comes in.
- Step outside yourself and observe your behavior as objectively as possible. Speak to yourself in the third person if necessary. It's unrealistic to try to avoid all mistakes and bad thinking. Instead, accept that you will have dumb thoughts, and that you will make mistakes. But observe your own mistakes dispassionately in real-time, and quickly course correct.
- s e l f - a w a r e n e s s.

Speaker 5
Mike Lingle
CFO of Security Token Group

Mike is a cool dude. He is a musician, house DJ and producer, three time Burning Man attendee, and active NFT trader. He has been involved with tech since pretty much forever. He's a serial entrepreneur, former software developer, and entrepreneur in residence at Babson College.

DJ Supatheef, AKA Mike Lingle

Mike's presentation was about a brand-new market: Security tokens. Here's the basic blockchain landscape, and where security tokens fit in:

Crypto	No underlying asset	Unregulated
NFTs	Underlying asset	Unregulated
Security Tokens	Underlying asset	Regulated

Security tokens are a brand new market that trades on various exchanges such as tZERO, Securitize, and INX. The underlying asset is often real estate, but can also be common stock, a venture capital operation, or pretty much anything. The setup allows cheaper, more efficient access to capital for some companies and can offer private deals without the involvement of lawyers and red tape.

The process is: Create an entity, put assets in the entity, tokenize, issue a token, trade the token. A list of security tokens currently trading can be found at stomarket.com. This is not like altcoins which are unregulated and often face legal uncertainty because they are often security-like. Mike's firm is operating in a 100% legal and regulated way as every issuance is Reg. A or some other Reg.-compliant.

ETH is programmable money and security tokens are programmable securities. You can code them to pay out fiat dividends or other payouts, schedule airdrops, or deliver other shareholder perks. Mike is excited about this very, very new industry and thinks most of the cool ideas of how to program securities have not even been thought of yet. While he trades NFTs, he points out the NFT and altcoin market are rife with fraud and their unregulated status means traditional finance will probably mostly stay away. In contrast, security tokens could be a HUGE market as they streamline and speed up the fundraising process and avoid expensive and cumbersome IPO regulation.

Mike says he'll take the over on blockchain, and security tokens offer a new approach that offers a crypto product backed by an underlying asset in a properly-regulated structure that protects against fraud and theft. Exodus (the crypto wallet) and the OSTK common stock token are the two best-known security tokens trading on tZERO right now.

Speaker 6
Jared Dillian
Host of the conference and author and editor of the Daily Dirtnap

Jared presented his macro views in the last presentation of Dirtcon Day 2. Here are the main bullets:

- Conversations about inflation are dominating the zeitgeist outside finance and this could be a sign that we're near peak inflationary psychology.
- The Fed is highly political. They could have been hiking in early 2021, but they needed to wait for political cover. Once the politics changed, the Fed changed.
- Jared thinks inflation has peaked, but we are still in for structurally higher inflation. He is bullish ags, gold and oil.
- Need mortgage rates around 6% for housing to hit the wall.
- Household debt is very low in the US.
- Expect the UR on a 2-handle before the US cycle peaks.
- There are more job openings than available workers in the US. The economy is still very hot.
- XLE/SPY correlation is negative. That is rare, and telling.
- Global earnings revisions have turned negative.
- Supply of homes will increase markedly in a year or so.
- Most people agree inflation is close to peak here, but the real question is: "Where is the floor?" If it comes back off to 2% that is a totally different regime than if it backs off to 5%. Jared thinks we will transition from inflation to stagflation as 2023 nears because demand will come off and housing will cool, but inflation will only pull back to 5% or so.

That's it! Thanks for reading.

Enjoy your Sunday.

Regular am/FX returns Monday.

good luck ⇅ be nimble

Liger

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