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am FX

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Psittacosaurus

Did dinosaurs have belly buttons?

Current Views

Short USDJPY @ 136.11
Stop loss 137.15
Take profit 133.15

Gap and Trap

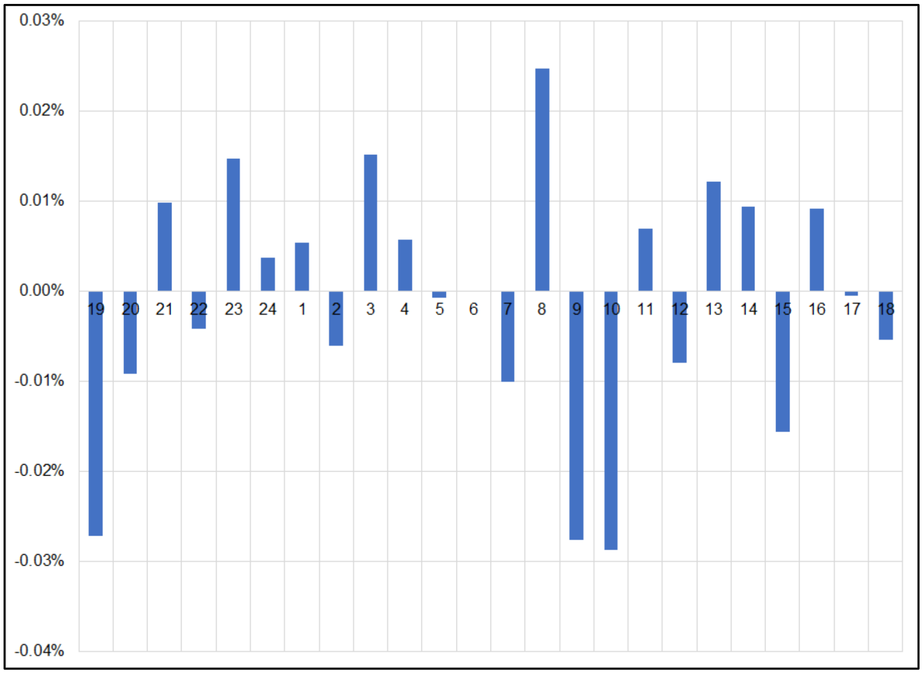
I like to read academic papers about finance but generally find them boring and at times find them hard to understand. This new paper is not boring; it's well written and easy to understand:

Night Moves: Is the Overnight Drift the Grandmother of All Market Anomalies?

The fact that equities outperform overnight and suck wind intraday is well known and has been known for years. Here is the chart from the paper. Variations of this chart has been going around for more than two decades.

And here is NASDAQ performance by hour of day over the past twelve months. The big down bars at 9 and 10 show the 9am to 11am period is no bueno.

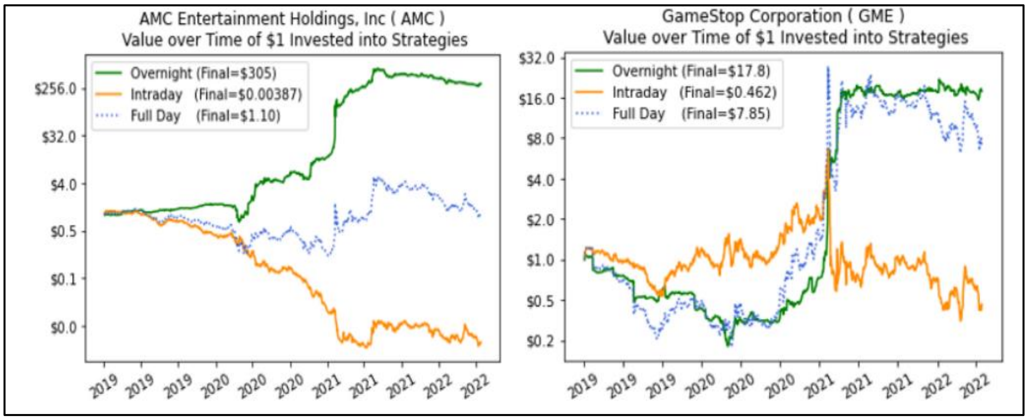
NASDAQ futures performance by hour of day (NY time)



While this effect is well known, a good explanation has been lacking. The authors of the paper do an excellent job of explaining some theories in plain English and the theory that makes the most sense, by far, is that retail traders tend to net buy stocks and retail traders tend to leave “buy on open” orders.

This creates a premarket buy imbalance which means market makers must move the price as high as possible into the open (at which point they are now short the stock) and then step away once the opening bell rings and the imbalance is filled. This is similar to any fixing in the FX or oil markets. There is a large imbalance centered on a particular moment in time and the market peaks right at that time. So… It’s not that stocks do well overnight and poorly during the day, it’s that individual stocks attract buy imbalances on the open that drive the stock up into 9:30am. In aggregate, this effect can be seen in the futures, but it operates at the single stock level.

The more retail-y the stock, the bigger the impact:



When I used to trade single name equities at a place called SwiftTrade during the dotcom bubble, one of the main strategies I used was called the “gap and trap.” Put simply, you look around for the biggest pre-market topside gappers, wait until about 10 seconds before the open, go short, and cover about ten minutes later. Again, if there’s big news overnight, it attracts retail “buy on open” orders and it also triggers resting stop losses that will all be filled at the opening price. Market makers are going to be short the net balance at 9:30am and so their incentive is for that open to be as high as possible.

To grab some examples, I simply looked at the biggest premarket gappers yesterday. KZR and SNOW were two. Here is how they traded yesterday. KZR was a buyout story and SNOW was an i-bank upgrade.

KZR and SNOW: Gap and traps from yesterday

I can hear you thinking: "Wow, I love free money, I'm going to do this every day in every stock that gaps!" It's a hard strategy to risk manage! And it doesn't work every time! The two I showed are beautiful textbook examples, but it's not always easy like this. Here are a few basic rules to follow:

- Retail stocks only, no ETFs etc. The more retail-y and the dumber the story driving the gap, the better.
- Investment bank upgrades can be great as those moves often mean revert.
- Size it small enough to avoid risk of ruin in worst case scenarios.
- Careful with biotechs and takeovers.
- No penny stocks. No illiquid stocks.
- Automate your stop loss to avoid face ripper.

Notes from London

Client trips can be an excellent source of ideas and information and are useful for gauging positioning and sentiment. Matt Gittins (Head of Sales here at Spectra FX Solutions) was in London last week visiting a plethora of clients. Here are his main takeaways:

1. Risk has been massively reduced... Many people caught the USD and FI trade. High water mark was June CPI/Timaraos WSJ article/FOMC.
2. The "pay any point of any curve" FI trade is over... We have repriced to a reasonable estimate of terminal in the US, and with the global economy rolling over, we need to see continued inflation beats to price more
3. Bias though, is that we will continue to see those prints.
4. Nearly universal negativity on the global economy and stock markets.
5. US economy deteriorating faster but consumer in a better position....EU and UK discretionary spending has to come under a lot of pressure.
6. EPS and ERP haven't really adjusted yet, stocks have just rediscounted to higher terminal rate – 3000/3100 was an oft cited target. Does it matter that everyone is bearish? Maybe, but it hasn't mattered for the last 15%.
7. Divide on the broad USD - SMALL consensus that USD rallies due to risk off flows, but in terms of rate differentials, etc. there was not a consensus view...
8. Which leads to less trend, BUT no real expectation of a drop in vol - ergo lower expected Sharpe.
9. Short AUD/NZD/CAD/EM v JPY or CHF stuck out as strong views - short growth with yields now able to go lower.

Final thoughts

Rates and oil are becoming a concern again, suddenly. Not good for my short USDJPY.

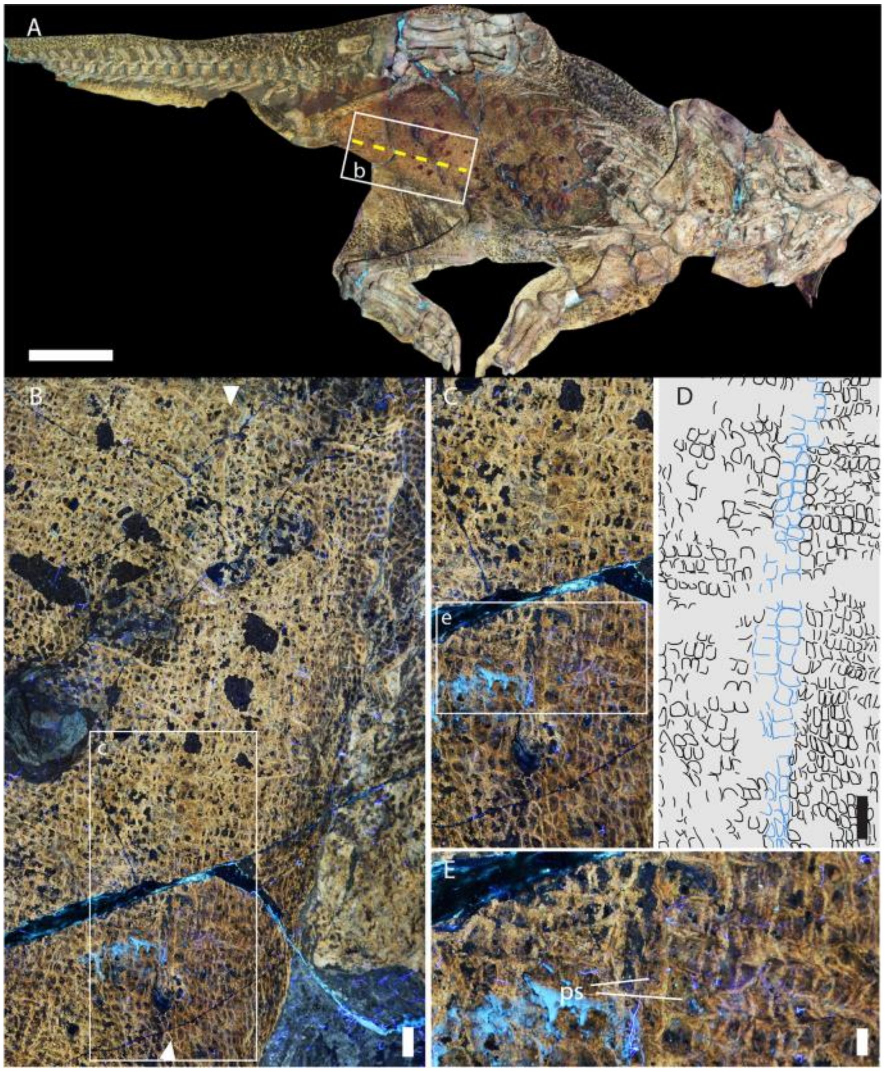
My latest crypto note is "Bitcoin is a loose policy hedge, not an inflation hedge". It's on the free side of the paywall and you can read it here.

I will be on Twitter Spaces with Christophe Ollari and Jon Cheesman of FTX today at noon NY time. We will talk global macro, crypto, and the outlook for H2. To hang out with us, just click here.

good luck ⇅ be nimble

Oldest preserved umbilical scar reveals dinosaurs had 'belly buttons'

https://bmcbiol.biomedcentral.com/articles/10.1186/s12915-022-01329-9



Umbilical scar in *Psittacosaurus* SMF R 4970 under LSF. **A** Cropped image of *Psittacosaurus* sp. (SMF R 4970) showing just the skeleton and soft tissue outlines, with the umbilical scar highlighted by the dashed yellow line. **B** Close up of boxed region in (**A**) with the maximal anteroposterior extent of the umbilical scar indicated by arrowheads. Wrinkling forming irregular wavy creases in the integument can be seen on the far right on this image where the abdomen meets the inner thigh; **C**, **D** Close up of boxed region in (**B**) showing paired quadrangular scales (blue outline in **D**) delimiting the umbilicus. Transverse banding is visible in the remaining abdominal scales (black outlines in **D**). **E** Close up of paired quadrangular scales (ps). A clear line of interstitial tissue, delimiting the former scar, can be seen between the paired scales. Anterior is towards the top in (**B**–**E**). Scale bars equal 5 mm (**B**–**D**) and 2 mm (**E**)

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