

the daily dirtnap

8FEB18

dillian@dailydirtnap.com

843 448 6141

VOL 10 NO 27

TRADING 101

In a bull market, you buy stuff.

In a bear market, you sell stuff.

Vol was in a bear market, and people sold vol.

Now vol is in a bull market. You want to buy vol in a bull market.

Boy, this is going to be really hard for people to learn. Old habits die hard.

Everyone came in to smush vol the last two days, thinking that XIV was a dumb ETN that blew up and now things can get back to normal. As I said before, you cannot put the genie back in the bottle.

In my P. Coast days, they used to call being short vol "frontspread" and being long vol "backspread." It hasn't been possible for many years, but theoretically it should be possible to BUY OPTIONS and dynamically hedge them and make money. I read the other day that Tuesday was the first day in history that the Dow had a 1,000 point swing. I think that's incorrect—I think it happened in January 2000 on an emergency rate cut. Either way, whenever you hear the words "1,000 point swing in the Dow," you should think of being BACKSPREAD, not frontspread.

But I'm not kidding when I say that nobody knows how to make money long gamma anymore. Go ahead and interview someone for a job on a vol desk. "You cannot be long gamma..." they will tell you. Which was true, because it hadn't worked for a decade. There was a period of time when it did work. It worked from 1997-2001. And guess what—all the old vol traders from the early-mid 1990s that were frontspread traders got blown up, because they could not adapt.

1,000 point swing in the Dow. You want to be LONG GAMMA.

Trading gamma is a bit of an art form. I bet most people don't even know how to do it.

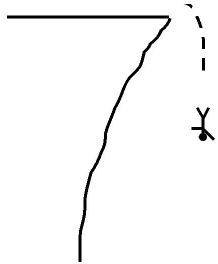
I will make a prediction which could turn out to be false. I don't think this vol environment is a one week phenomenon. I think it is a secular shift. I think long gamma is going to be the trade for years. If you came to DirtCon (and I will have some information on DirtCon 2 soon), then you know that the crux of my presentation was that we were going to get more volatility in 2018. I said it would be because of Trump, which mostly hasn't been the case so far, but Trump will eventually add to the volatility.

It used to be that a 1% move was one standard deviation. Over the last year, a 30-40bp move was a standard deviation. Going forward, I think that a 1.5% move is going to be a standard deviation. Still a huge realized move yesterday. As I write, up about 120bp.

BACKSPREAD.

This is going to be really, really painful. The most difficult transition of all. Every vol desk on the street is going to get cleaned out. Maybe I am being a bit hyperbolic—I have a tendency to do that sometimes. Point is, we've had regime change, and people still think we are in the old regime. The pain will continue until these brokers with the iron condors get wiped out.

I hate Buffett quotes, but the tide is going out. Are you wearing boardshorts, a Speedo, or nothing at all?



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TSX

Everyone knows about the correction in the Dow, but have you seen what is going on in Canada?

SPTSX



Source: Bloomberg

It is even worse.

Yes, Canadian stocks are dramatically underperforming U.S. stocks.

The Canadians are starting to notice, and gripe about it.

Looking at that chart, that's a big bagel for 1 year returns, which is absolutely awful.

If you recall, something similar was happening to the U.S. in 2006. Sure, the market was going up, but not as much as everyone else.

Big payroll number on Friday.

Also, CAD has been under pressure:

USDCAD



Source: Bloomberg

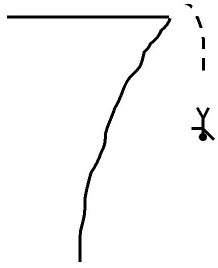
The chart is starting to look a little constructive. Or maybe it is just me.

Lots of central banking yet to be done. The Fed has a rate hike scheduled for March, for which there is an 83% probability assigned. Based on recent Poloz statements, I'm about 70% sure that they're going to pass. Plus, Toronto home sales were down an abysmal 22%, so it really does look like the poison is starting to take effect.

I am feeling better about this trade, for the first time in a while.

We'll see about payrolls, and the StatsCan random number generator, the short murderer. The revisions have been lower.

I'll be glad when this is over.



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I Am Wiped

I am physically tired from this week. I am tired because I was wired. Up late jamming on stuff Monday night and then popped awake at 4am Tuesday because I couldn't wait to get to work. Haven't felt like that in a long time.

I was basically sprinting like that for 9 straight years when I was in the business. Throw in some partying on top of it, and I was a shambles.

I don't miss the partying, but I do miss the market action.

I hear a lot about people being bored at work. Being bored on a trading desk is no fun. It's not like you can read a book. You can kill time on ESPN.com, or maybe do a little shopping, but not too much. You basically sit and stare at the screens in a catatonic state.

Funny—I read the WSJ article about the crash on Monday and it said that "yelling broke out on the trading floor." Hahahahaha. Yelling used to break out over lunch. Imagine writing an article about a trading floor and having to point out that yelling broke out. Amazing times we live in.

Good news, I want to get short boring and long exciting. It might even lead to increased order flow. But there is a pretty good chance that you will have to go to work and actually work.

I can't emphasize enough how awful the low-vol market environment was to people's psychology. There is nothing worse than a lack of intellectual stimulation. That is why I left the Coast Guard.

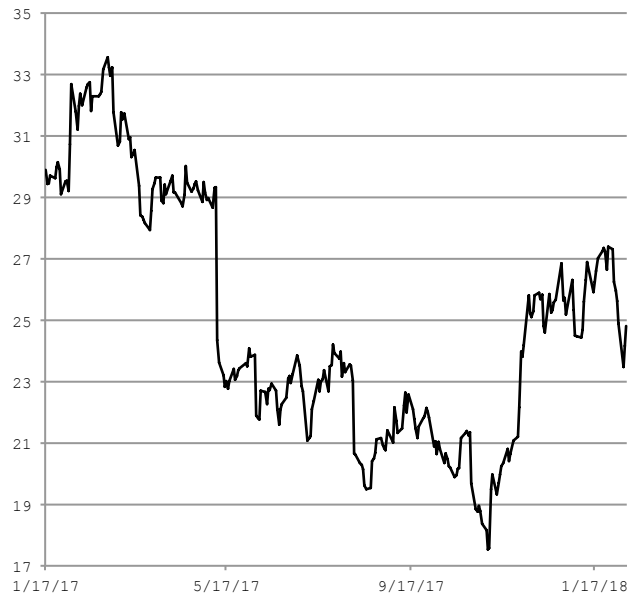
Markets are fun again. Throw in a

couple of seafood towers and we're good.

Macy's

We are still long Macy's.

M



Source: Bloomberg

It's great! What a fun trade this has been, watching the world melt down and watching Macy's hold its gains.

The good part hasn't even happened yet—wait until AMZN bites the dust. Remember, Macy's (and all of retail) is the anti-AMZN.

If we get a bear market, this will be the only place to hide. Macy's is as good as buying S&P puts, in my opinion.

One more day and you're going to get the biggest TGIF, my man the world has ever seen.

Ciao.