the daily dirtnap

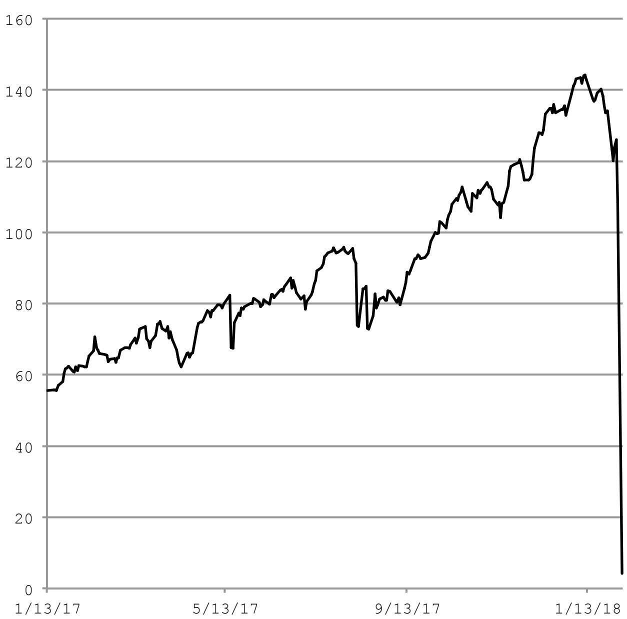
6FEB18 dillian@dailydirtnap.com 843 448 6141 VOL 10 NO 25

ASYMMETRIES

Some follow-up thoughts in the wake of the dirtnap.

The market is very asymmetric, and what I mean by that is, short vol is by nature asymmetric, and we have loaded so many asymmetric strategies (like risk parity) into the market over the last few years that nobody should really be surprised that the market goes up 20bp a day, and then goes down 400bp. Of course, markets are *always* asymmetric—up on an escalator and down on an elevator. But more so than usual.

XIV

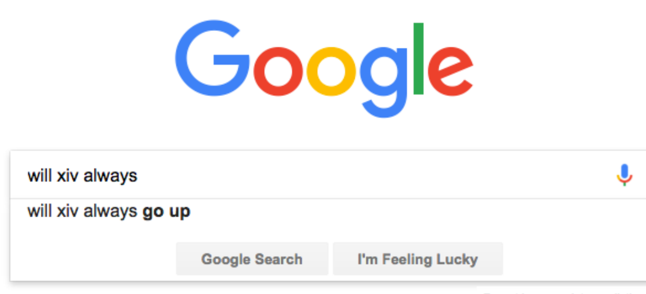


Really what I wanted to talk about was the idea that you could pursue short vol as a strategy, which was dumb. Anyone who read *Fooled By Randomness* would know that it is dumb, and that book came out in 2001. Of course, I'm not the biggest proponent of long vol strategies either—you can't bleed to death and keep your job, but all you have to do is look at the XIV short to know what the payoff profile of systematically selling vol looks like. Make money for nine years, get blown up in year ten. This might be rational behavior if they can't claw back pay for years 1-9, and if you can get a job after you blow up, but for Mr. Target Logistics Manager, it is probably the end of the line.

The weird thing is that if you traded vol in the early to mid 2000s, the idea that you would buy some financial product whose sole purpose is to short volatility and roll it, would be totally insane. But people forget! Remember, in 2001, 1987 was only 14 years ago. We are currently 17 years from 2001. Attitudes change.

Let me settle the debate once and for all. Short vol is a stupid trade. Long vol is a stupid trade. Whether you should be short or long vol depends on the price of vol, otherwise known as the risk/reward. At 90 vol I am okay selling puts. At 10 vol I am okay buying calls. It is all situational.

More broadly, there isn't a strategy in the world that works *all the time*, not one single strategy, and I am betting that buy and hold doesn't work either. It didn't if you lived in Iceland. Remember that next time someone is trying to sell you some magic beans.



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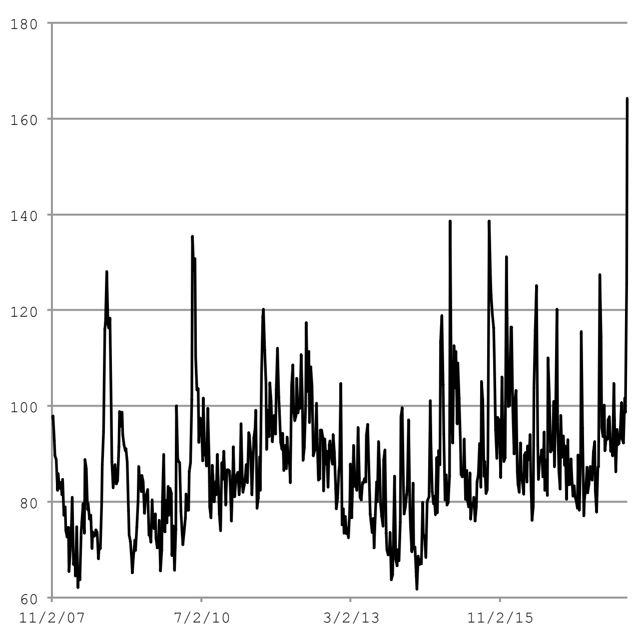
Buy Signals

There are reasons to think that the bottom is in.

VIX 50 has always been a buy signal. But even more than VIX, high levels of vvol are often a better indicator of a bottom.

Looky here.

VVIX



Source: Bloomberg

Let me put it this way—if I were 33 years old in the ETF seat, I would be buying deltas out the wazoo. Of course, my time horizon would be half a heartbeat, and I'd bail at the first sign of trouble.

At 43, I'm going to sit this one out.

Re: yesterday's issue, I just think there is more deleveraging to be done. Just as there are "no soft landings," also, "nobody gets out alive." If you have a stupid strategy, you're going to get a margin call. And there are still lots of people with stupid short vol strategies who are still around.

I certainly am not going to stake my reputation on a "the market won't bounce" call, but I am mostly willing to stake my reputation on a "the highs are in" call. Of course, someone who studies sentiment (like me) would know that bearish sentiment was maxed when we walked in yesterday morning, but my days of hero trades are over.

The trend is now lower. Trade the trend.

Anyway, one thing worth mentioning is that yesterday was like 27Feb07, *really* the day that the financial crisis began. More of a warning shot, really. Also, the biggest vvol spike ever at the time. Anyone who was trading back then remembers that day. And you know what happened after 2/27/07...new all-time highs, up to the tippy top in July.

So all of that is possible.

But I think people are missing the symbolism here. I had a TV interview the night before last, and the anchor asked me if this was the end of the Trump trade. I said yes. I said that tax reform was sell the news, and the Trump trade was over. That is the symbolism of it, which I think is accurate.

In any case, we're not done deleveraging. If we have to make new highs before we are done, so be it.

It's all Steve Wynn's fault. I'm only half kidding. The top in WYNN was the top in stocks.

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The Bond Market Is A Mess

That seems like an obvious statement, but...we just had the biggest vvol event in history and treasurys are *down*. I hope you understand the significance of that.

To be more specific, as I write, stocks are below Monday's close and fives are off 8 clicks. That's bad.

I suspect it is all supply. What a time for supply to matter.

10yr Yields

Source: Bloomberg

By the way, if it is because of supply, in a roundabout way, you have Trump to blame for the selloff. If the selloff is because of higher rates, he is at least partially responsible for higher rates. Sorry guys.

My guess is that this is going to continue to be a factor. Any other point in history, you have a selloff and VIX blowup like this, bonds are up seven HANDLES. This is really incredible.

Remember, there is nothing worse than an exciting bond market.

People are going to find value in tens at 3% for sure, and you'll get a bounce there, but if you thought before that nobody could tolerate higher volatility and higher rates, here we are with higher volatility and higher rates. And you wonder why I am so bearish.

No Help

Saw lots of screenshots of people getting locked out of roboadvisors. Apparently Vanguard had some outages, too.

Imagine you are the Dunkin Donuts guy and you log into Vanguard and you see that your S&P 500 index fund is down four percent. Who do you call? Nobody. You are on your own.

That is because you paid 4 basis points in fees. If you wanted someone to talk to, you should have paid more.

Honestly, I think this is all a boon to the financial advisory industry. We always wondered what the test would be like for Vanguard and the roboadvisors. Until now, it's been the magic money machine. These things weren't supposed to produce losses. They were supposed to mint gold coins.

I've said before, I bet there's any number of people who thought Vanguard was a bank and they were putting money in a CD.

Enjoy.