

The Macro Ops Meta Process



Who Am I?

Tyler Kling Co-Founder of Macro Ops

- Former trade desk manager at \$100+ million family office where I oversaw multiple traders and helped to develop highly effective quant strategies for futures and options
- Worked as a consultant to the family office's in-house fund of funds in the areas of portfolio manager evaluation and capital allocation
- Certified in Quantitative Finance from the Fitch Learning Center in London, England where I studied under famous quants such as Paul Wilmott.
- Poker player





*Meta: denoting something of
a higher or second-order
kind*

This meta process I'm about to show you is super valuable because it's a framework that can be used to succeed no matter what trading objectives you have.

- **It will work in any market around the world.**
- **It will work no matter how much markets change.**
- **It has worked since markets have existed.**

It will take you from this...

Not profitable,
luck dependent,
inconsistent,
overwhelmed,
unconfident, and
unhappy trader



To This...

Profitable,
consistent, well
informed, confident
and happy trader

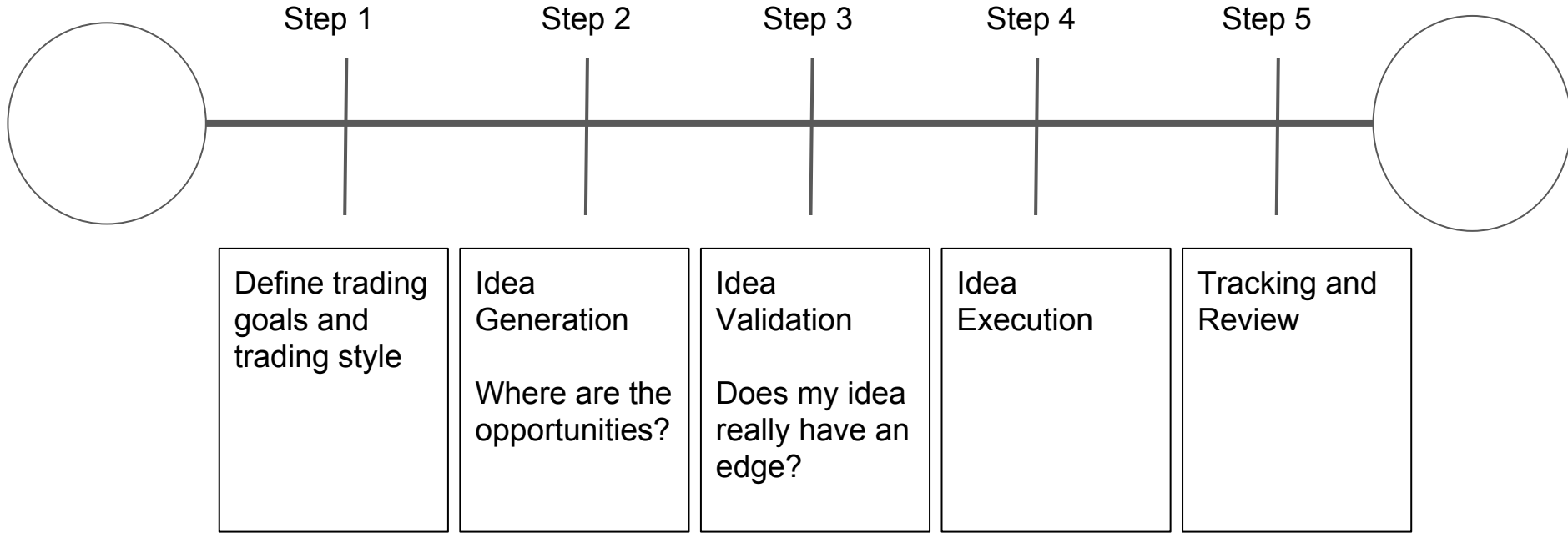


Even if you're already a consistently profitable trader this stuff is still worth reviewing and going over!

The markets are constantly changing and as traders we need to **adapt rapidly** to survive.

The framework laid out in this presentation is the exact step-by-step process you need to adapt rapidly.

The Macro Ops Meta Process



Step 1

Define trading goals and style



Trading Goals

- These are different for everyone and they change over the course of a trading career
- You have to define your goals first so you can design a trading process that's congruent with what you want
- Get as specific as possible! The more specific you are the higher probability of success
- Common goals:
 - I want to make X% a year
 - I want to make X dollars per year
 - I want to manage money for others and create a business
 - I want to try to run a little money into a lot of money in a short time
 - I want to have a trading account with a low drawdown
 - I want to create “passive” income (some money for little time investment)

Trading Style/Trading Niche

- There are a billion and one ways to make money in the market
- You have to decide what will work best for you
- What are your strengths and what are your weaknesses?
- How much time do you have to spend on trading?
 - Discretionary day trading is much more time intensive than once a year portfolio rebalancing
- It's critical that your trading style will work for your trading goals
 - If you want to make 50% a year - investing in unlevered fixed income won't work
- **Style Examples**
 - Discretionary global macro
 - Growth stocks
 - Intraday FX
 - Short volatility
 - Options
 - Explosive small cap

Style Guide

Quant/Science Based Styles

- Systematic trading
- Option trading
- Trend following
- Technically backed

Narrative/Art Based Styles

- Discretionary global macro
- Small cap “story” stocks
- Fundamentally backed
- Special situation investing
 - Spin-offs
 - Mergers
 - Distressed debt

Goals and Style Must Be Aligned

- Goals and trading style must be aligned!
- Without alignment you are setting yourself up for disappointment
 - If you are trading a style that tries to catch 1-2 big moves a year, it's not going to resemble income, there will be years where nothing is happening and you'll make nothing, the gains will be concentrated into a short window
 - If you are looking to raise money and trading a super volatile trading style you're going to have a really hard time raising funds
 - If you are trying to only spend a few hours a week on trading, discretionary day trading won't work - that takes 7-8 hours a day in front of a screen
- As you think this through adjust either your trading goals or trading style so they are congruent

Tips

- It's easier to start with defining your goal and then from there work backwards to figure out a possible trading style that can achieve that goal
- Look at other traders or people who have a similar goal to you and see what they did
- Make sure that trading style is something that you can do over the long haul
- If you don't enjoy the process you'll never last!

Step 2

Idea Generation



How Do I Find Ideas?

- Once you have defined a trading style you need to constantly monitor and watch that area of the marketplace
- Go grab all the material and literature in your niche and start reading
 - Books with an emphasis on your market niche
 - Other people's research on that market niche
 - White papers relevant to your trading niche
 - Trading groups/forums/chat rooms with traders in your niche
- Do not waste time reading stuff outside of your niche - easy to get lost in the deep blue ocean of financial literature
- Idea theft is not a crime in finance!
 - Steal the best stuff you find out there
- Once you become really experienced and advanced in one area ideas will naturally come to you, you won't need these other sources as much
 - This ability comes from 1000s of hours of niche observation

Ideas = Hypotheses

- The FED will raise rates faster than what the market expects therefore the 10-yr note will fall 10% in a sustained downtrend
- GAIA's growth will continue to surpass estimates and the stock will rally as investors finally come around to the fact that an all star CEO is back leading the company
- This SPX put option is overpriced because the implied vol is at 15% when SPX has only been moving with a 10% realized vol
- Oats will sell off hard because there's an overcrowd long position, the technical picture is deteriorating, and this year's crop yield will be higher than expectations
- Stocks with low P/Es outperform those with higher P/Es

Quality Over Quantity

- You don't need a ton of ideas to successfully trade
- You can make a lot of money identifying one opportunity and beating the hell out of it until it goes away
 - Perfect example of this has been BTFD since the 2013 US market breakout
 - This simple “obvious” trading idea has won again and again for years
 - People have made a ton of money on this one trade idea
- This is one of the hardest things to stick to in the beginning stages
- Idea formation is fun to do and it's why we all tend to go overboard on ideas
- Going overboard on ideas is what leads to overtrading and overtrading leads to poor performance

Have Fun With It

- Don't be afraid to get really outside the box during this step
- You want to think of a bunch of wacky innovative ideas because those often become the best trades
- If you can't think of any ideas then steal someone else's idea and move on to the next step

Step 3

Idea Validation



Idea Validation Is The Most Important Step!

- In order to make money we have to take trades that have a positive expected value meaning that over the long haul the trading idea is a profitable one
- Ideas are a dime a dozen!
 - Easy to come up with but hard to validate and execute (just like in any other business)
- Ideas have to be scrutinized, researched, and dissected thoroughly so we can prove to ourselves that they will lead to profitable trades!
- If we don't do this we are wasting our time! Might as well go to the casino to gamble

What Do You Need To Verify?

- Every trading idea will have assumptions embedded within it
- **You need to find those assumptions and see if they are true**

Hypothesis

The S&P 500 will go up this year because we are in a low inflation, low growth environment so the Fed will be accommodative and keep financial conditions loose.

Assumptions

- We are in a low inflation, low growth environment
- The Fed reacts to a low inflation, low growth environment by adding liquidity to the system
- The S&P 500 tends to rally when there's a lot of liquidity in the system



Hypothesis

Gold will rally hard because the Fed has eased too much. We are going to get run away inflation causing investors to pile into precious metals.



Assumptions

- Gold rallies when inflation goes up
- The Fed has eased too much in the recent past
- Too much easing from central banks leads to higher inflation

Verification Methods

- **Backtesting**
 - Turn the idea into code and see if it's worked in the past
 - Manually backtest the idea and see if it would of worked in the past
- **Regressions** - Look and see if the there's a relationship between the variables - Do bond yields affect stock returns? etc.
- **Plain old logic** - Does the idea make sense intuitively?
- **Peer review** - What do other people think of it? Have other people used it?
- **Forward testing** - Sometimes you don't have the data or means to figure out how it did in the past so you just have to start trying it out for yourself by paper trading or using small size

Key Question

Who is the person on the other side of your trade willing to lose money?

You must have a good answer to this question if you want a deep understanding of your edge.

If you can't answer this question your edge probably isn't robust.



How Much Verification Is Enough?

- This is where you move from the science of trading to the art of trading
- Some people like to see 100s of trades...
 - Pure system guys
- Some people only need a few
 - Ray Dalio of Bridgewater
 - Only so many depressions and hyperinflations have occurred in the history of recorded economics, he didn't have the luxury of thousands of samples
- Or sometimes 0 - example subprime mortgage bet “the big short”
 - The biggest opportunities and fattest edges actually come from stuff that can't get properly verified by traditional quant techniques because it **has never happened before**
 - These types of trades are the “big picture” trends macro guys try to capture

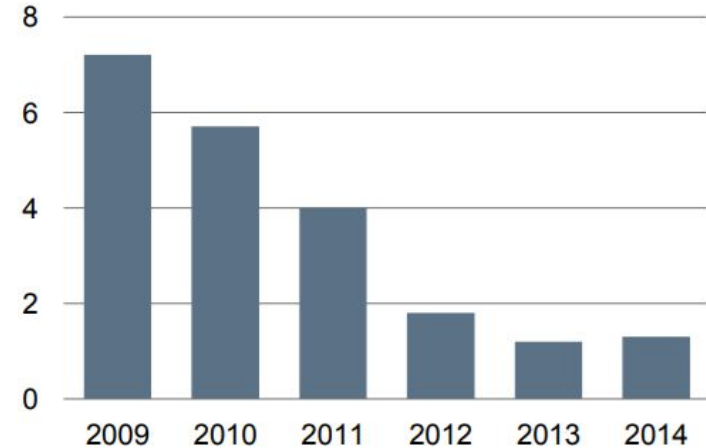
Rare Edges

- The rarer the opportunity or setup the less amount of verification you will be able to do.
 - This is a blessing and a curse
- **Blessing** because the frequent edges are the ones that get mined out of the market the fastest
 - Example HFT
- **Curse** because you have less supporting evidence to bolster your assumption

Revenues of HFT firms in the US

3

USD bn



Sources: TABB Group, Deutsche Bank Research

Confidence Comes From Research

- After thorough investigation you should have enough information to either scrap the idea or implement the idea
- By the time you're ready to implement the idea you will have immersed yourself in the idea for so long that you will feel very confident when executing in the next step
- If you find yourself feeling anxious or worried while in the middle of a trade you probably haven't dug into the idea hard enough
- Conviction comes from the process of putting data and verification behind your original hypothesis

Step 4

Idea Execution



Time To Pull The Trigger

- After you've got a well vetted trading idea that's also congruent with your style and goals it's time to pull the trigger on the trade
- **Advanced tactic** - investigate the best way to express the idea
 - Outright
 - Option spread
 - Futures
- When you're at this point it's not time to second guess yourself or change things
- The goal is to execute a pre made plan backed by research
- Make sure you know how you're going to get out before you get in
 - Stops, targets etc.

Sizing

- At this stage you also have to figure out position sizing which is a critical component - size too large and you risk going broke or killing mental capital
- Size too small and your research & development efforts won't be properly monetized
- Position sizing is one of the most complex topics in trading
- There are many nuances and it gets increasingly complicated at the portfolio level when you're trying to figure out how multiple positions correlate with each other
- Portfolio level sizing and correlation is outside the scope of this webinar

Sizing Tips

- A quick little hack to help cut through the complexity is to risk a static 1% on every trade
- This isn't perfect but it will prevent you from ever blowing out an account and it will buy you enough time to learn the craft
- The more advanced you get the larger you can trade, but you must have considerable experience before you start sizing up
- Do not underestimate the pain of drawdown - if you lose too much money you'll want to quit

Trade Is In the Market

- Mentally prepare for every possible outcome of the trade
- Picture how you will feel as the trade goes for you and is close to becoming a booked winner
- Picture how you feel once the trade goes against you and is close to becoming a loser
- Anticipate these feelings in advance so you can properly fight any type of emotional craziness as the trade plays out
- We do not want to get overly emotional during a trade

A Note On Psychology

- Always be thinking in probabilities and not certainties!
- Must accept that any trade - even one with a positive expectation over time has a chance of losing
- It can be a brilliant idea - properly vetted - but still lose due to impossible to see events that transpire after the trade is on
- This might feel like the most exciting part of the process but in reality it should be the most boring part of the process
- Your bed has been made and the results of the trade are out of your hands



Trade Finale

- After enough time goes by you'll exit the trade for a profit or a loss
- It's now time to move on to Step 5 and do a post-mortem



Step 5

Tracking and Review



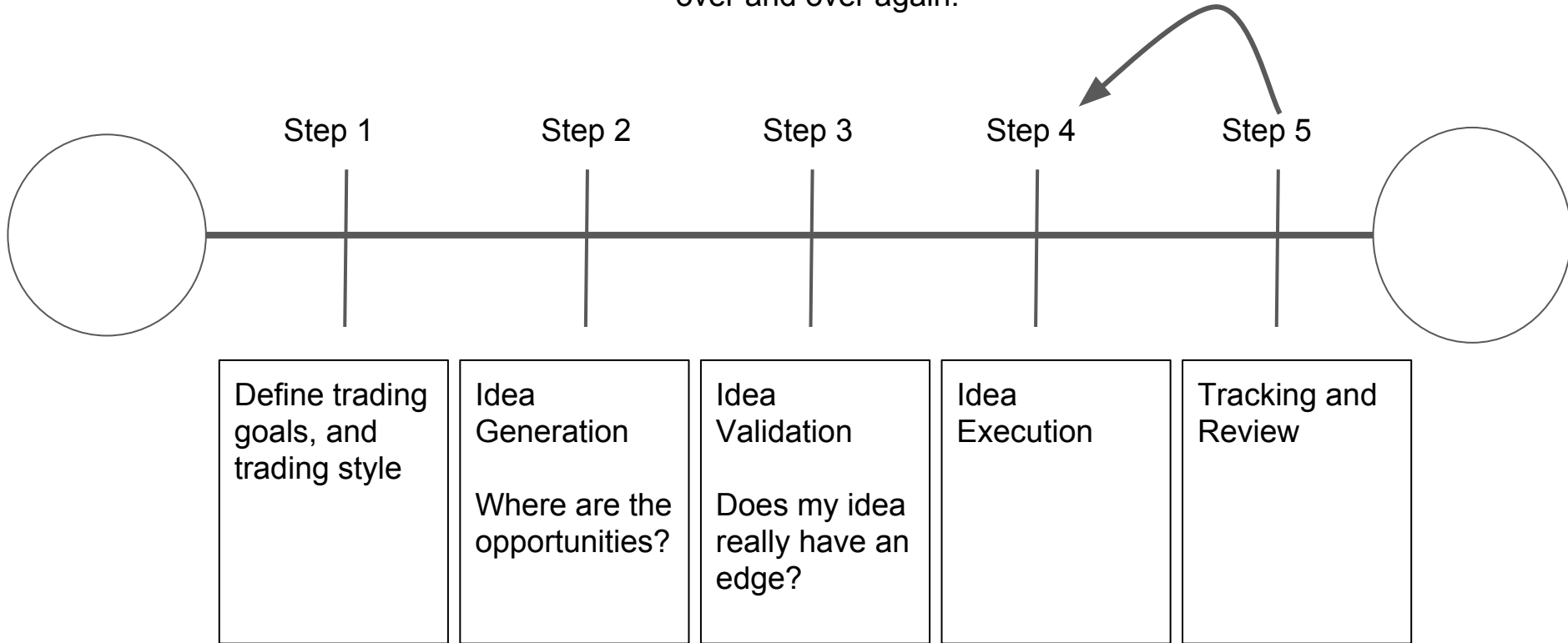
You Cannot Skip This Step!

- Kaizen 改善 - “continual improvement”
- Part of the trader’s job is to “continually improve” otherwise you fall behind the rest of the market and your edge erodes
- The best way to do this is to meticulously track and record every trade
- Record as much as you can
 - Mental State
 - Trade Thesis
 - Trade Parameters (Risk point, target, position size)
 - Trade Outcome
 - Execution Quality
- The more detailed your records the better
- If you don’t have records you’ll never know what part of your trading business to double down on and what part to throw in the trash

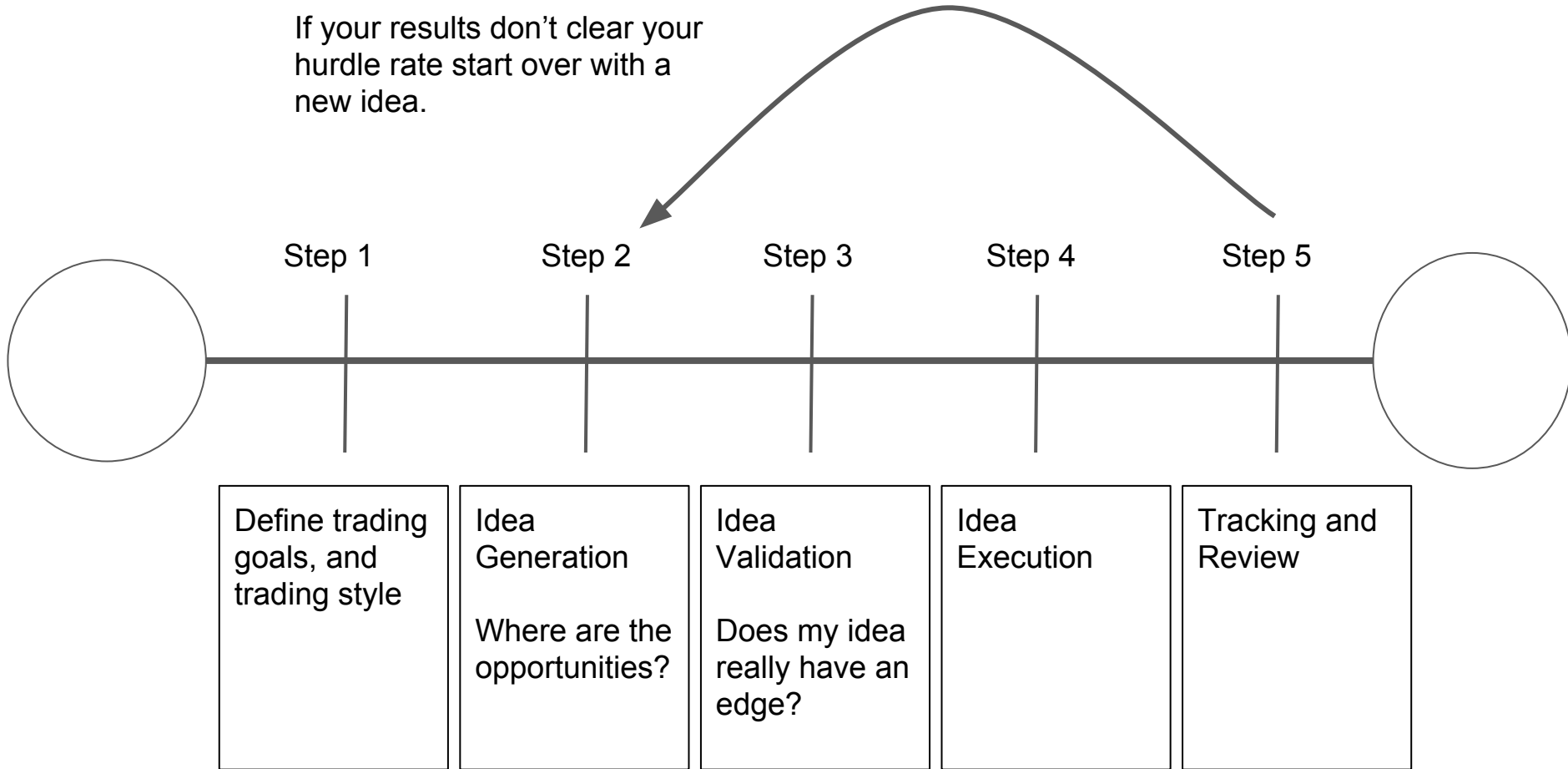
Hurdle Rate

- After you have enough records on a particular trading idea you can see if it clears your hurdle rate
- Hurdle rates are different for everyone and they depend on your trading style and goals
- Example Hurdle Rates
 - 60% Win Rate
 - 10% Return on invested capital
 - 5% Max Drawdown
- If your idea clears your hurdle rate - great! Keep using it over and over again when the setup occurs in the future
- If your idea doesn't clear the hurdle rate that's okay - wind down the idea, scrap it and move on to the next one
- Sometimes the idea might "sort of work" in that case tinker run through execution and tracking again

If trade idea is showing positive results return to Step 4 and repeat over and over again.



If your results don't clear your hurdle rate start over with a new idea.



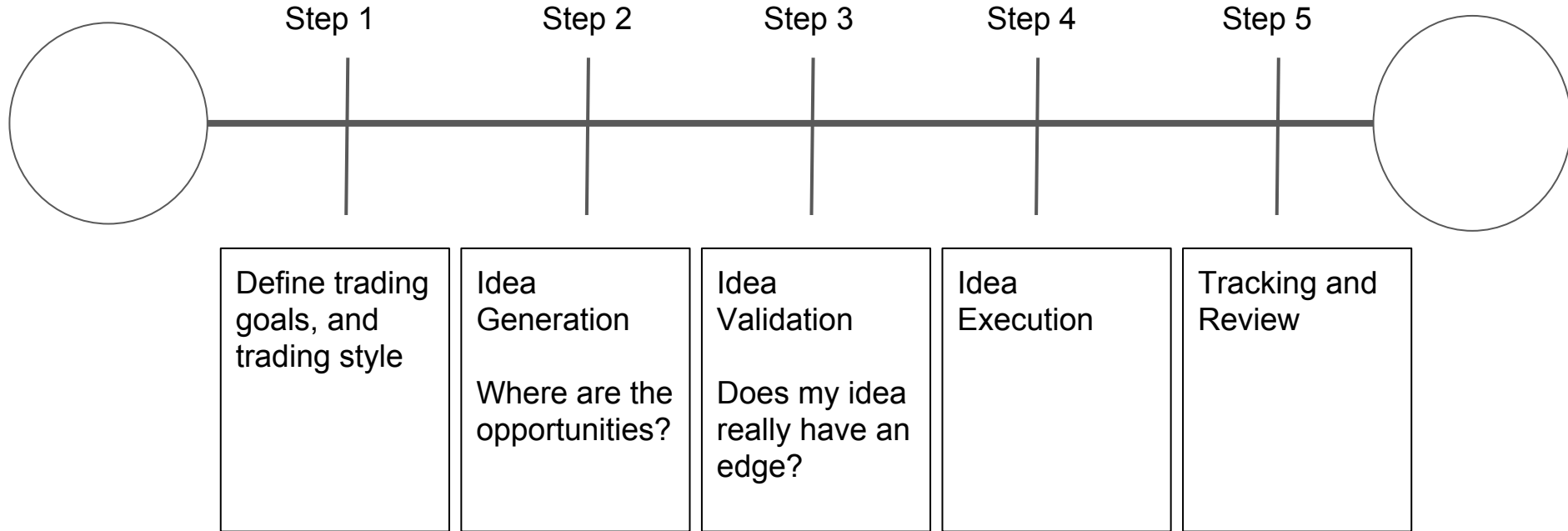
Multiple Ideas

- In the beginning, when you're unfamiliar with this process start with one idea and take it all the way through from start to finish
- After you get more comfortable you'll want to be generating, testing, executing, and tracking lots of ideas simultaneously
- It can take a long time to get one successful idea through the entire process and prove through real trades that it works
- While you're waiting for results to play out on one idea you can start working through the next one

A Note On Style Drift

- After you have many trades recorded you can do a more in-depth analysis to see if your current trading goals and trading style still make sense for you
- Changing styles is okay, it's a natural part of the process as you age and goals change
- But don't overdo it!
- It's easy to quit things too early and hop around to a bunch of different trading styles effectively "resetting" your knowledge base

Review of The Macro Ops Meta Process



Example Time

Step 1 Example

- **Define Trade Goals and Trade Style**
- **Trade Goal** - I want to find 1-2 macro trends a year that I can hit to achieve 20% return on capital
- **Trade Style** - Macro - I'm trading Commodities, FX, Stock Indices, and Sovereign Credit on daily and weekly timeframes. I want to target trends that last from 3-12 months.

Step 2 Example

- **Idea Generation**
- **Trade Idea** - Central banks will continue to respond to any dips in the economy by aggressively printing money. They think a major deleveraging is too painful for society to take and the only way out is to inflate ourselves out of the debt load.

If inflation starts to heat up during economic strength central banks will be slow to stop the overheating by rate hike. They would rather run things hot then cool them off. Inflation is more likely to run hot during a late-cycle economy.

Gold has huge upside potential due to this pro-inflation bias.

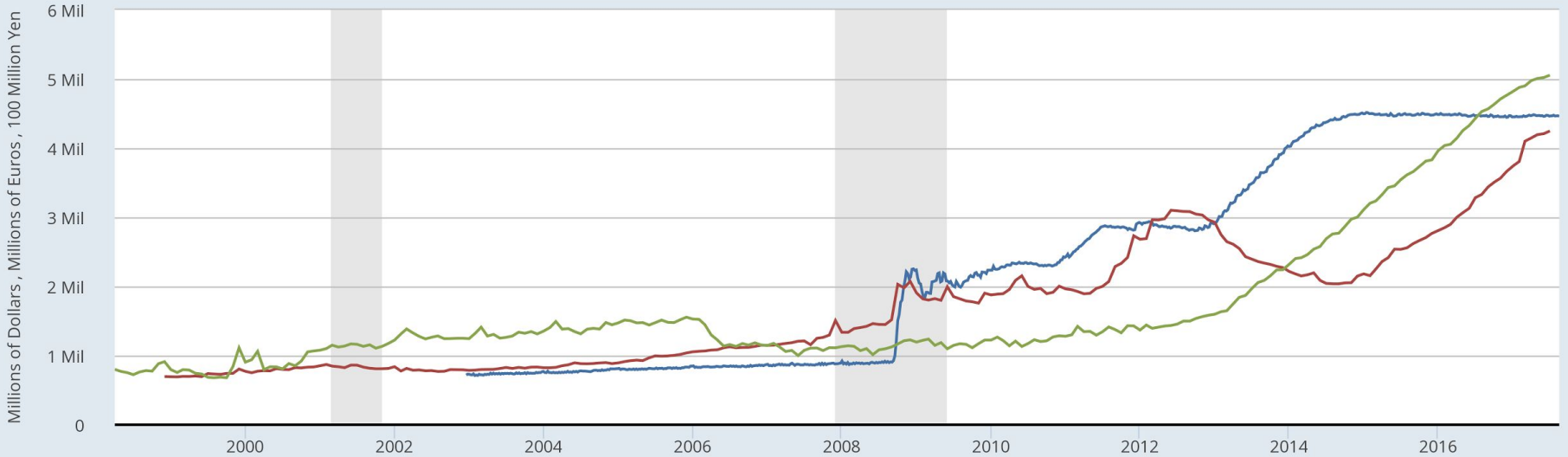
Step 3 Example

- **Idea Validation**
- **First find assumptions**
 - Central banks will respond aggressively to dips
 - Central banks are biased towards inflation rather than deflation
 - Excessive central bank stimulus causes inflation
 - Late-cycle markets produce high inflation
 - Gold rallies in high inflation environments
- **Test assumptions**
 - Read central bank meeting minutes to gauge policy
 - Look at past central bank behavior during economic weakness - what did they do?
 - See if central bank stimulus in past has caused inflation
 - Look and see if late-cycle markets usually come with higher inflation
 - Look and see if gold rallies in high inflation environments

Central banks have printed a ton of money since 2008...



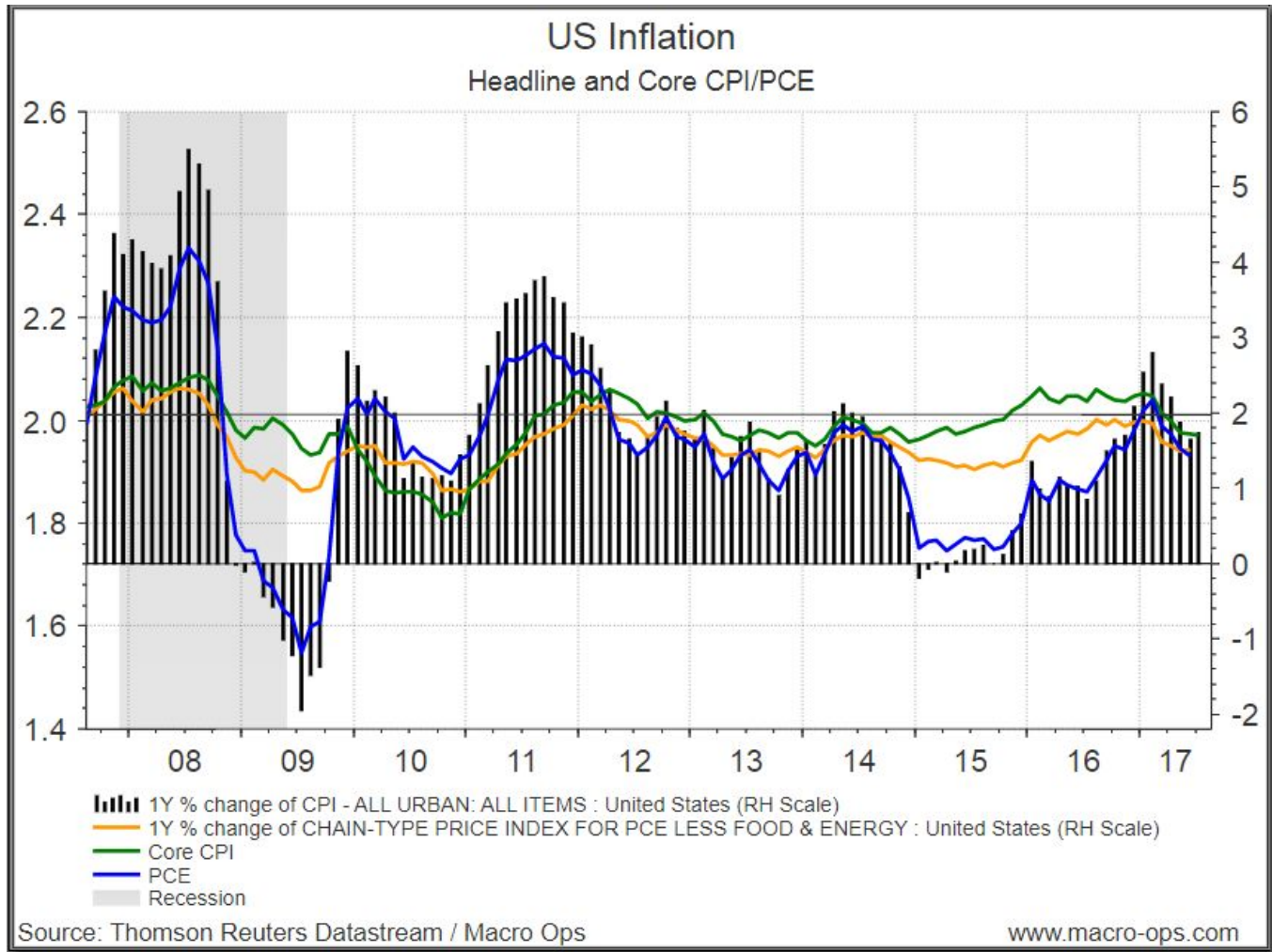
- All Federal Reserve Banks: Total Assets
- Central Bank Assets for Euro Area (11-19 Countries)©
- Bank of Japan: Total Assets for Japan©



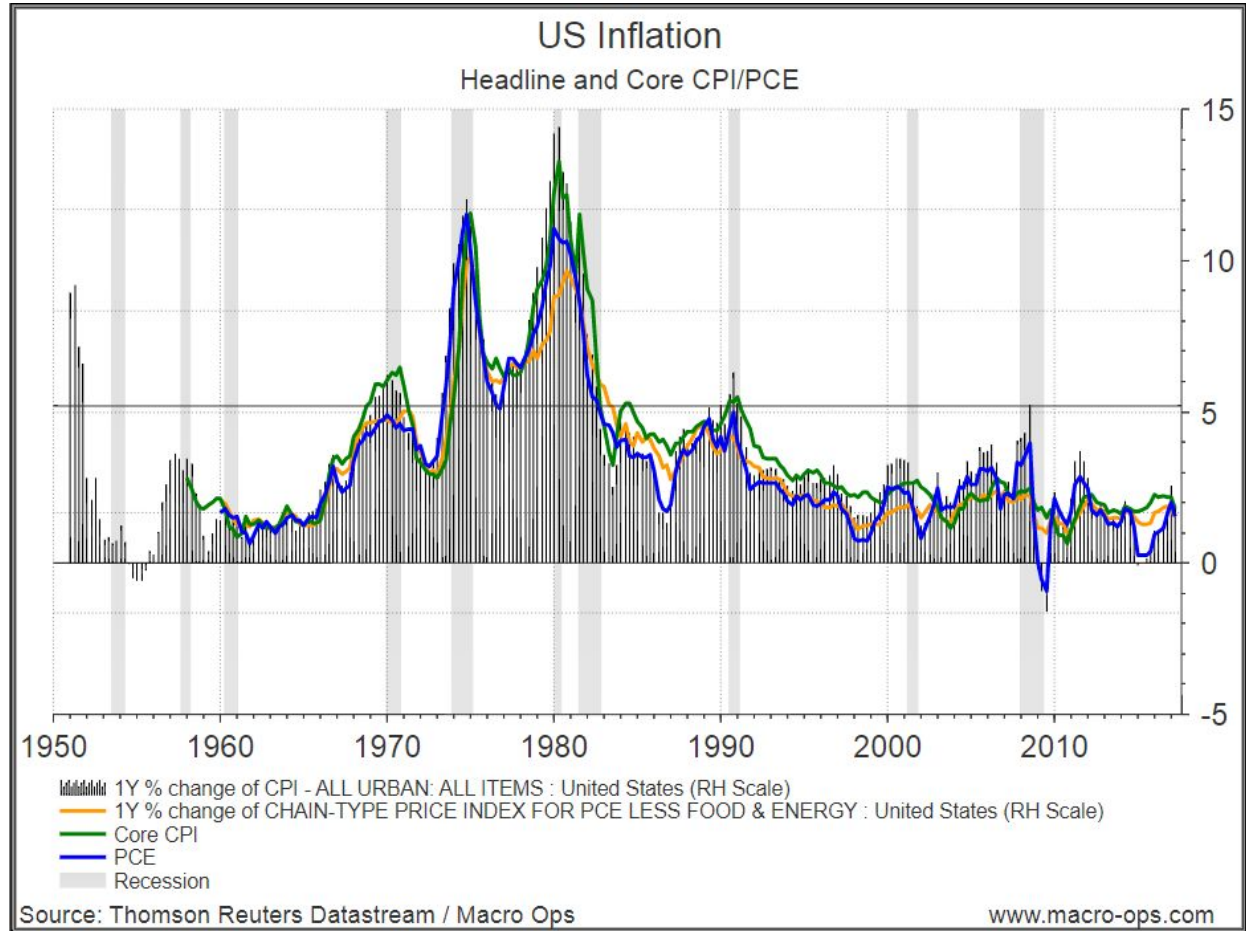
Sources: BoJ, Board of Governors, ECB
fred.stlouisfed.org

myf.red/g/ePy9

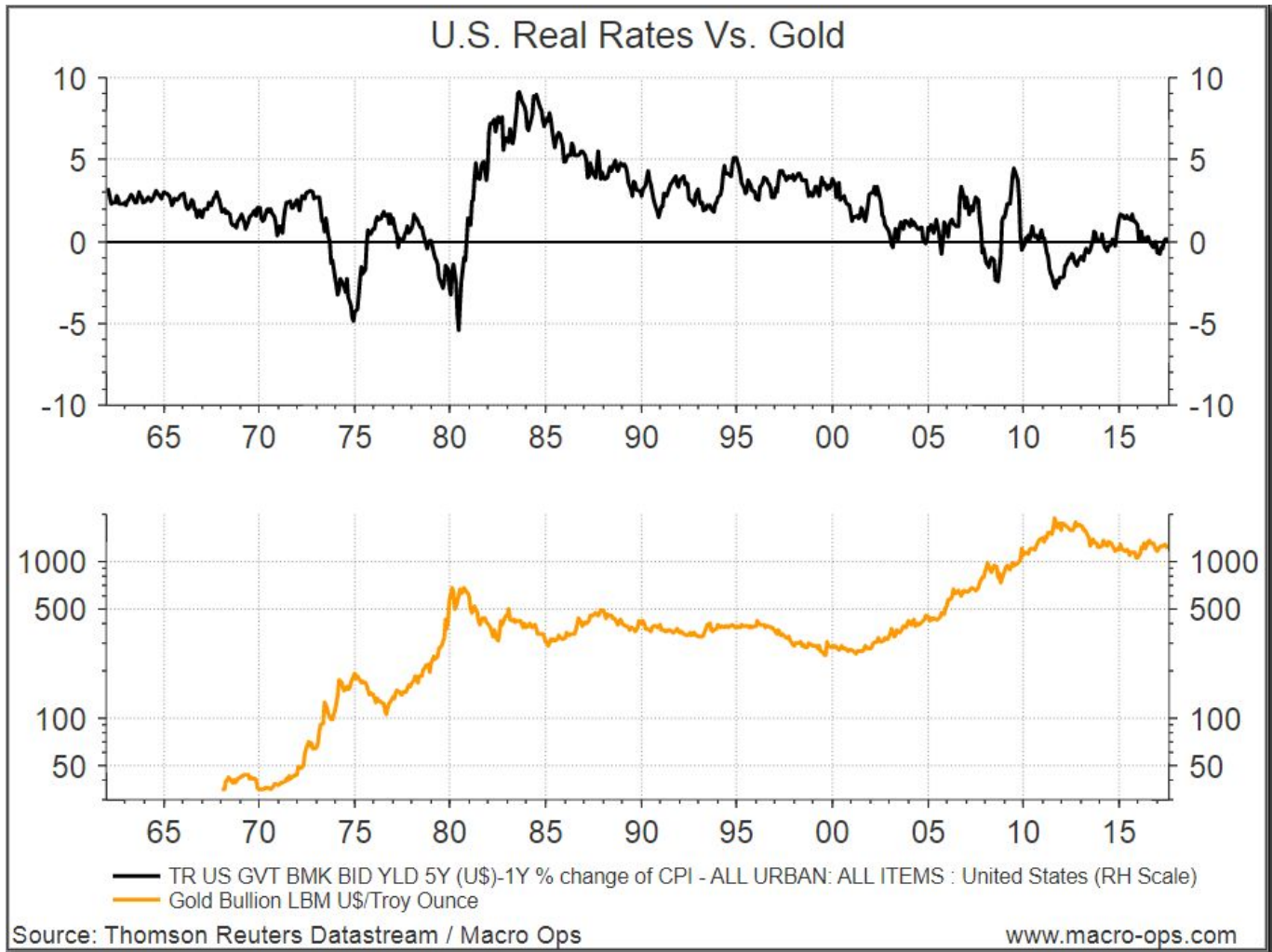
But inflation
has remained
tepid...



Inflation looks like it runs hot during a late cycle market



Gold rallies
when real
rates are low
or negative



Step 4 Example

- **Idea Execution**
- **Decide Expression**
 - Gold Calls
 - Gold Futures
 - Basket of Gold Miners
- **Determine Position Size**
 - Use standard 1% sizing
 - Make sure the bet is not overly correlated with the rest of the portfolio
- **Example execution:** Buy out-of-the-money gold calls 6 months out with 1% of portfolio risk

Step 5 Example

- **Tracking and Review**

- Record results and then do a post-mortem
- If successful we now have a trade we can store into a “playbook”
- Every successful trade that goes through the process correctly can be stored in the “playbook” and used again when a similar setup occurs
- This is what Ray Dalio did to build up his abilities over the course of decades as he was up and coming in the trading world

Thanks For Watching!

There you have it! **The Macro Ops Meta Process**. This is a super high level framework that you can apply to all types of trading - everything from penny stocks to options to macro. It's a comprehensive process that works no matter what type of trader you want to become.

Thanks for taking time out of your day to watch the presentation.

Good luck out there in the markets!