It's ALL About Asymmetry

There was a lively debate in the Comm Center this week over the merits of forecasting and how to assign confidence levels to such forecast.

Here's my quick take on the subject.

The market moves off stories. These stories are based on both the underlying fundamentals and people's perceptions of the underlying fundamentals.

Our job as traders isn't to try and predict where the market is going (that's a fool's game). Rather, it's to identify areas of potential asymmetry.

We like asymmetric opportunities as traders because they allow us to be wrong a lot, and still make a boatload of money. And that's the key to this game. Finding asymmetric opportunities and also creating them through trade management.

The majority of the time, assets and markets, reflect a wide range of stories (ie, people's perceptions of the underlying fundamentals). This means the market is pricing in a wide range of potential future outcomes. When that's the case, there tends to be little asymmetry in the price — these are trades we don't want to take.

Asymmetry is born when a story becomes popular (ie, consensus) and it prices an asset/market to only reflect a narrow range of future outcomes.

Humans are really bad at predicting the future. Probably why Mark Twain said, "Whenever you find yourself on the side of the majority, it is time to pause and reflect."

This is why it pays to be a contrarian.

The following three things help with identifying asymmetry.

1. **Understand the popular models/beliefs:** Know the popular economic models, theories, and beliefs that people use to assess the market and understand the world. This allows you to get a feel for how the market will react to and interpret certain data and events.
2. **Know the stories:** This is more art than science and it's helped by having a firm grasp on the above. But read constantly, study the headlines, and develop a feel for the stories

that are driving prices. Bruce Kovner calls this "listening to the market." Dominant stories are actually pretty easy to spot, the problem is is that we're likely to believe in them too. Stories only become consensus because they're convincing.

3. **Understand how the economic machine works:** Markets and economies are complex systems. It's impossible to "know" how things will unfold, which is why prediction is futile. But, even complex systems follow broad based principles. Knowing these first principles and understanding how the economic machine works a little bit better than the average of the market allows us to identify dominant stories predicated on faulty models/beliefs. Market prices based off faulty thinking = mispricings and asymmetry.

So It's not about trying to predict certain outcomes. It's about being aware of many potential outcomes. Then comparing these possible futures to what the market is currently pricing in (by understanding the dominant stories) and seeing if there's asymmetry between the outcome that's currently priced in and another outcome that we think is just as likely… or maybe that's less likely but if it came to pass it would force the market to reprice by such a degree that the trade has positive expected value, anyways.

Does that make sense?

It's a different approach to markets than the way most do it. It's an inversion of conventional thinking. Most try to predict where the market is going to go and are focused on being right. We compare where the market is, to a range of where it could be, and focus on how we can be wrong a lot but still get paid.

Market Wizard, Ray Dalio, put it best when he said, "You can't make money agreeing with the consensus view, which is already embedded in the price. Yet whenever you're betting against the consensus, there's a significant probability you're going to be wrong, so you have to be humble."

Markets

The stock market is down a little bit this week. From the financial headlines and talk on twitter you'd think we just went through a huge rout.

The **Stock Market** Is Still Looking Shaky
TheStreet.com - 4 hours ago
Markets were also shook by a sharp rise in European government borrowing costs as investors dumped bonds amid a robust outlook for the ...
Dow finishes 101 points lower as traders fear delay in tax cut
CNBC - 22 hours ago
View all

Gundlach's **Stock Market** Warning Comes True
Bloomberg - 1 hour ago
"A material pullback would be something we need to watch for, as a deteriorating credit **market** has led each of the largest equity pullbacks ...

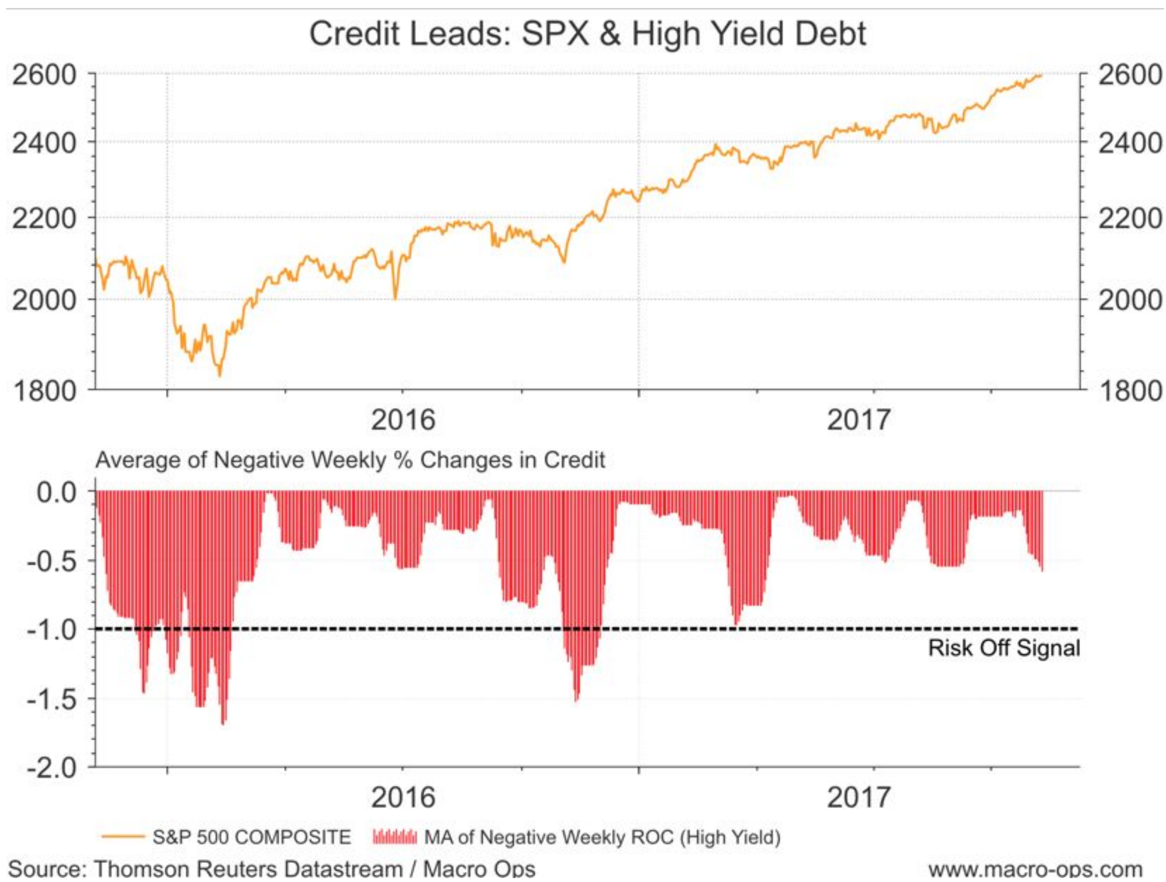
Here's a chart showing the "market turmoil" on a weekly basis. The S&P is currently down 10bps on the week.

Volatility has been so low for so long that people have forgotten how markets usually move and are making much ado about nothing.

The reasoning being given for this "volatility" is that comprehensive tax reform is looking less likely now. That may be the case, but it's just as likely that this week's volatility is random noise.

No way to know. But what I do know is that the larger trend is still clearly up. And despite some growing weakness in the credit markets, all other indicators point higher as the path of least resistance.

Our short-term liquidity model, which measures the cumulative weekly changes in the high-yield credit markets, is still far from giving a risk-off signal.



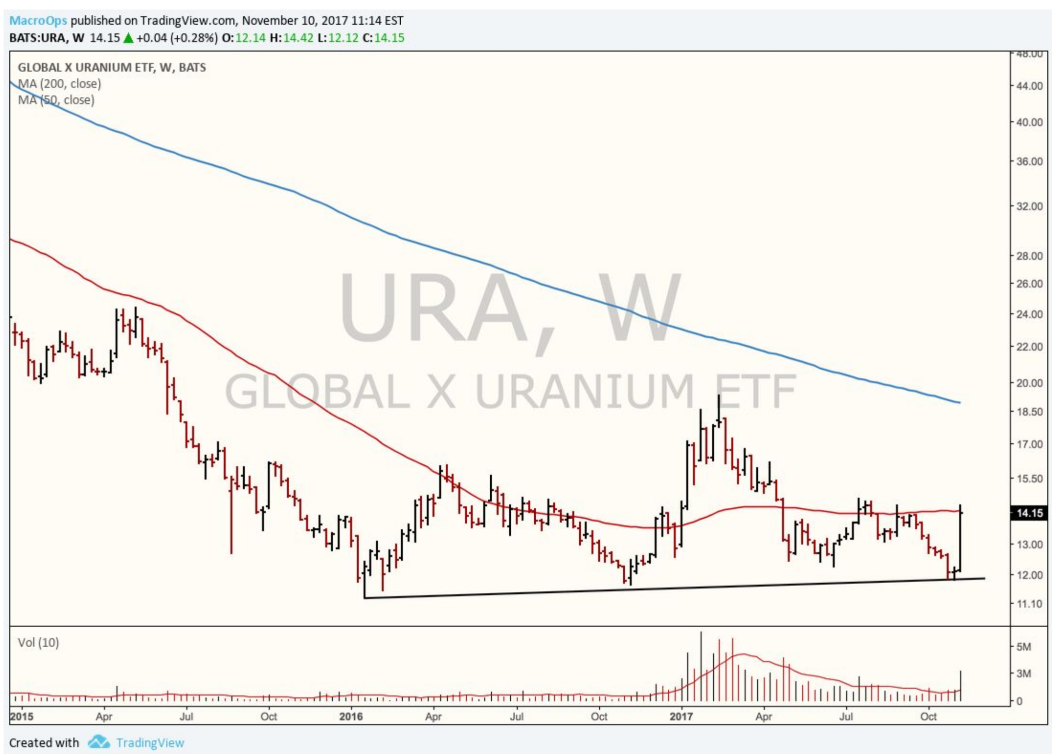
I like how well crude is holding up. WTI is up another 4.5% this week and our energy holdings are looking strong.

The “anti-corruption” campaign being carried out by the crown prince in Saudi Arabia isn’t hurting this move either. The Kingdom, along with Kuwait, also recently ordered its citizens to evacuate Lebanon, where a regional war between the Saudi led Sunnis and Iranian led Shias is becoming likely.

This could have a large impact on markets, especially energy. I’ll be writing more on this next week.

China A-shares, which is our largest position, continues to pay us well. We’ve been sitting on this one for over five months now and that continues to be the play until markets clearly signal otherwise.

Uranium stocks are breaking out. See the uranium etf (URA) shown below on a weekly basis.



We took a crack at uranium stocks near the end of last year, only to see them round trip on us. Picking bottoms is hard and it often takes multiple swings before connecting. But the potential payouts are large enough to where it's often worth the effort.

With uranium, the fundamental case is pretty clear. It's a capital cycle play where the commodity has been in a drawn out bear market which has led to a large cut in CAPEX and lower future supplies. At the same time, we're about to see a jump in demand.

There are currently some 440 nuclear reactors in the world, which produce roughly 11% of the world's electricity.

There are 50 new reactors under construction (most in China and India). The IEA expects the world's nuclear capacity to grow well over 50% over the next 25 years.

We also now have a catalyst. Two of the largest uranium producers (Kazakhstan and Cameco) have announced extensive production cuts, in order to stabilize the market. *Marco Tourist* wrote a great article on this which you can read here.

Since bottoms are often really choppy and volatile it's difficult to trade them naked. The play might be to buy DOTM calls on Cameco (CCJ) which is the largest publicly traded uranium pure play.

I'll be digging more into this trade over the weekend and we'll send out an alert if we decide to take it.

That's all I've got for this week. I'm in NYC for 24hrs meeting up with my old teammates to celebrate the Marine Corps 242nd birthday. I'm waiting to see if I can swing an extra day (waiting to hear back from my pet sitter) and if so, I might be doing a last minute meetup with our NYC members sometime tomorrow. If you're in the area and are interested in meeting up for drinks, let me know.

Your Macro Operator,

Alex

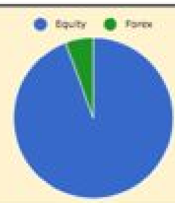
Strategic Ops

NAV $1,286,605

Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Notional	Beta
Equity	Limbach LMB	7,750	$13.66	$12.50	$8,990.00	$18.00	$104,703	-0.1902
Equity	Interactive Brokers IBKR	1,800	$41.71	$38.50	$5,778.00	$55.50	$74,628	0.9292
Equity	GAIA	7,600	$9.88	$8.50	$10,488.00	$13.75	$79,040	0.4497
Equity	Portugal ETF PGAL	8,000	$10.57	$9.98	$4,720.00	$11.75	$85,040	1.0467
Equity	China A-Shares ASHR	6,764	$26.69	$25.83	$5,817.04	$31.30	$199,876	1.475
Equity	Intrepid Potash IPI	13,769	$3.70	$3.20	$6,884.50	$6.00	$117,403	1.053
Equity	Daseke DSKE	6,400	$13.49	$13.10	$2,496.00	$19.00	$89,920	0.7348
Equity	W&T Offshore WTI	16,000	$2.18	$2.00	$2,880.00	$4.50	$40,800	2.415
Equity	Ensco ESV	3,700	$5.15	$4.30	$3,145.00	$6.50	$18,574	1.667
Equity	Transocean RIG	2,900	$9.32	$8.26	$3,074.00	$15.00	$26,796	1.683
Equity	Cabot COG	1,350	$26.28	$24.00	$3,078.00	$34.00	$36,288	0.4829
Equity	Tuesday Morning TUES	7,500	$2.60	$2.00	$4,500.00	$5.00	$18,000	2.041
Option	FCAU Jan '19 25 Call	108	$0.90	$0.00	$9,720.00	$5.00	~	2.373
Option	JD Jan '19 70 Call	108	$0.92	$0.00	$9,936.00	$7.00	~	1.3
Option	TRIP Jan '19 75 Call	108	$0.89	$0.00	$9,612.00	$7.00	~	2.378
Option	CHK Jan'19 10 Call	750	$0.14	$0.00	$10,500.00	$1.00	~	2.105
Option	Tesla Mar '18 240 Put	28	$8.80	$0.00	$24,640.00	$24.00	~	1.048
Forex	Yen Futures (6JZ7)	-3	$0.0087853	$0.008988	$7,601.25	$0.008445	$329,644	-0.2696

Metrics

Exposure Breakdown	
Equity	$126,258.54
Commodity	$0.00
Fixed Income	$0.00
Forex	$7,601.25



Total Open Risk

$133,859.79

10.40%

**Updated 11/9