Surprise-a-mentals

The famous hedge fund manager, Michael Steinhardt, wrote the following in his book *No Bull* (emphasis mine):

> *I defined variant perception as holding a well-founded view that was meaningfully different from market consensus. I often said that* ***the only analytic tool that mattered was an intellectually advantaged disparate view****. This included knowing more and perceiving the situation better than others did.* ***It was also critical to have a keen understanding of what the market expectations truly were****. Thus, the process by which a disparate perception, when correct, became consensus would almost inevitably lead to meaningful profit.* ***Understanding market expectation was at least as important as, and often different from, fundamental knowledge.***
>
> *As a firm, we soon found that we excelled at this… Having a variant perception can be seen benignly as simply being contrarian. The quintessential difference, that which separates disciplined, intensive analysis from "bottom fishing," is the degree of conviction one can develop in one's views.* ***Reaching a level of understanding that allows one to feel competitively informed well ahead of changes in "street" views, even anticipating minor stock price changes, may justify at times making unpopular investments.*** *They will, however, if proved right, result in a return both from perception change as well as valuation adjustment. Nirvana.*

The more time I spend in this game the more I'm convinced that playing the market (ie, understanding market sentiment, what's embedded in the price, what the dominant beliefs and narratives are etc...) is vastly more important than thinking up and trading off of grand complex fundamental stories.

Most macro traders focus too much on trying to nail down where we are in the cycle when they should be spending more time focused on where the positioning/sentiment is offsides and not being confirmed by the tape.

I'm guilty of this. Grand narratives are appealing. They make us feel smart, like we're in the know. They hit at a deep instinctual human craving for certainty over ambiguity; even if that certainty is based on false ideations.

The human knack for storytelling and believing in misleading narratives serves us well, for the most part. Yuval Harari lays out why in his book *Sapiens,* writing:

> *The real difference between us and chimpanzees is the mysterious glue that enables millions of humans to cooperate effectively.*
>
> *This mysterious glue is made of stories, not genes. We cooperate effectively with strangers because we believe in things like gods, nations, money and human rights. Yet none of these things exists outside the stories that people invent and tell one another.*

Storytelling is a tremendous evolutionary advantage. It just doesn't serve us well as traders.

The best macro traders I know, have stupidly simple processes. They start with the tape (what are the technicals of the market saying), then they track positioning / sentiment / popular-narratives, and then end back with the tape (where is the market not confirming the positioning/sentiment/popular-narratives).

Most of them have a good grasp of the important macro fundamentals (liquidity, capital flow dynamics, the risk/business cycle). But there are plenty who don't and it doesn't matter because they're good at the other stuff.

That's how successful behavioral macro is played. It's heavy on simplicity and light on grand stories. It's robust to uncertainty since it's mostly agnostic to how things *should* play out (a key component of a story) and instead concerned with how things *are* playing out.

Then, of course, there's the important stuff like position sizing and risk and portfolio management which is how the bread really gets buttered.

Einstein once said, "For the simplicity that lies this side of complexity, I would not give a fig, but for the simplicity that lies on the other side of complexity, I would give my life." I like that. That's something I'm working on. Getting to the simplicity on the other side of complexity. Making smaller and smaller circles as Josh Waitzken would say.

Moving onto markets.

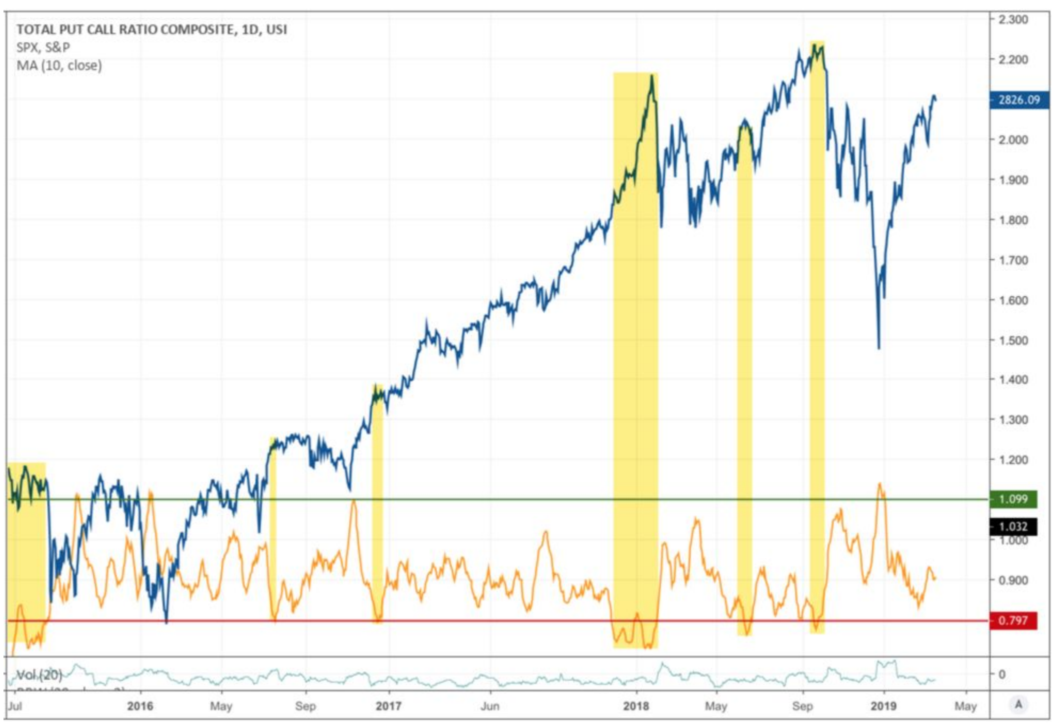
The SPX is now within a few percentage points of the upper weekly Bollinger Band target that we pointed out a few weeks ago. My overall read of the US market remains the same, which is that we're (1) in a broader technical uptrend and (2) long-term positioning/sentiment is still offsides which supports higher stock prices.

With that said, the market needs to work off some of its short-term overbought conditions.

The chart below of the % of stocks trading above their 50dma shows that this process is beginning to take place. And while I don't assign much weight to analogs, I do think the early

2016 market action (highlighted in yellow) serves as a good indicator of what we may see over the coming weeks.

A couple weeks of choppy volatility will help keep sentiment in check and indicators like our 10dma of the Total Put/Call ratio elevated and above the red line; meaning fear is present.

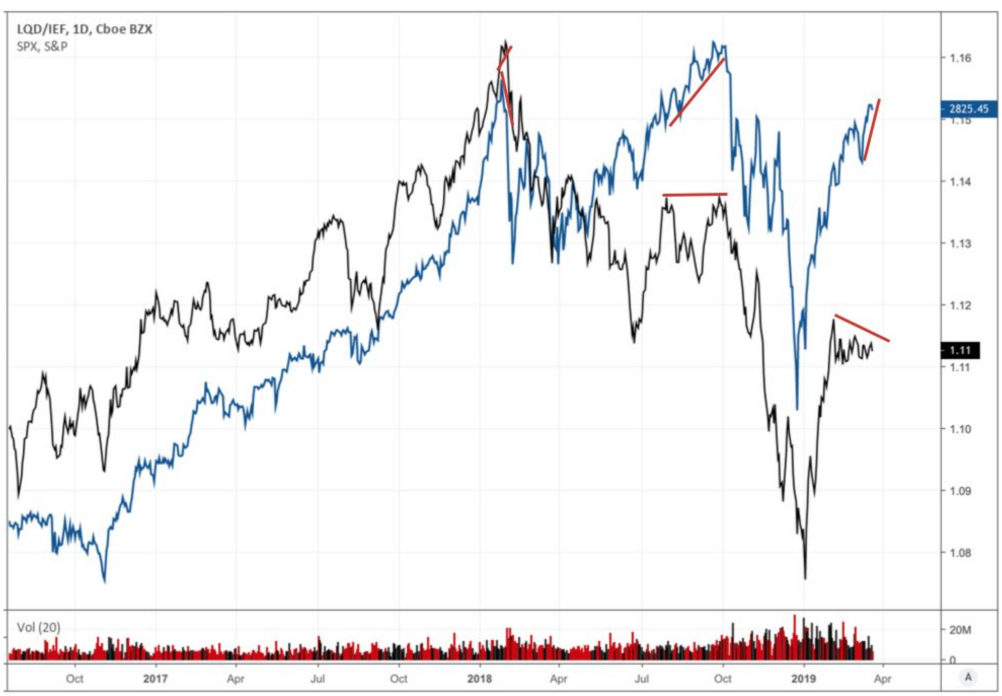


It'll also help reset shorter-term indicators of sentiment which have become elevated recently.

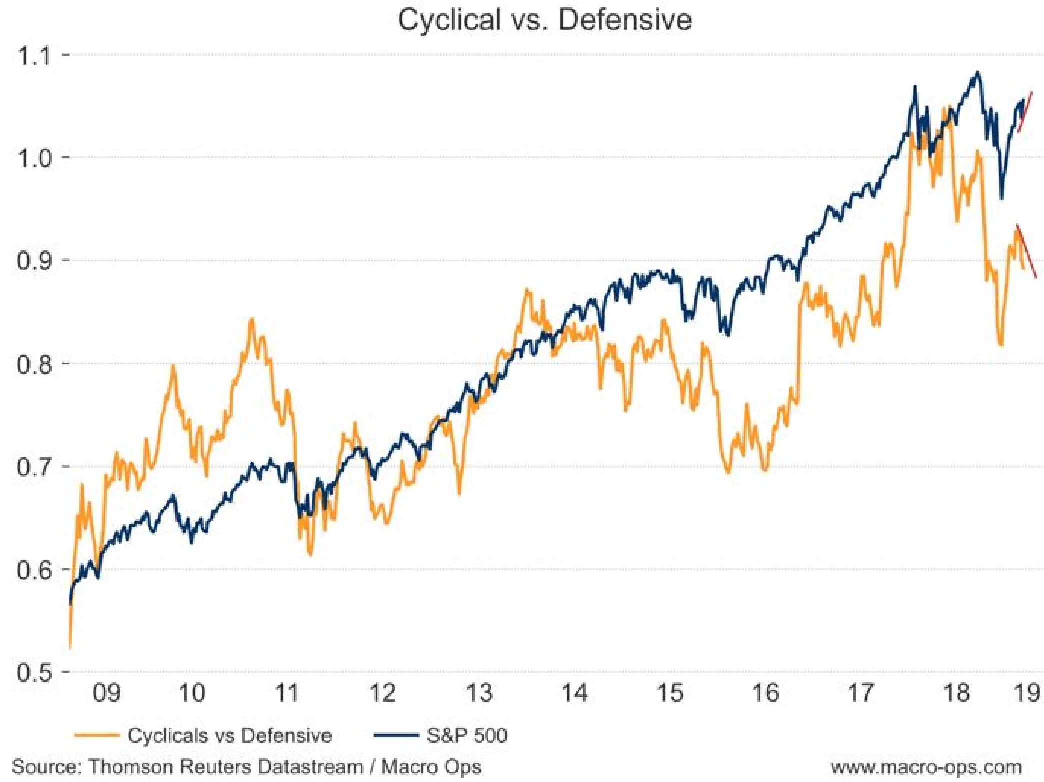
Sentiment Trader noted that as of Monday, "not one of our indicators were showing a pessimistic extreme, but there was a jump in indicators showing an optimistic one, to a total of 40% of all indicators. This is the third time since the beginning of 2018 that we've seen this condition." See chart below.

According to *Sentiment Trader*, the S&P's returns going forward were decent though the market tended to experience some weakness in the near-term after this indicator was triggered. Which is pretty much in line with what we're expecting.

The credit market is also diverging from stocks which suggests we should expect some equity weakness ahead.



And the same with Cyclical vs Defensive stocks.



But because of the quick bearish reaction function and offsides positioning in the market, currently, I don't expect the pullback to be deep.

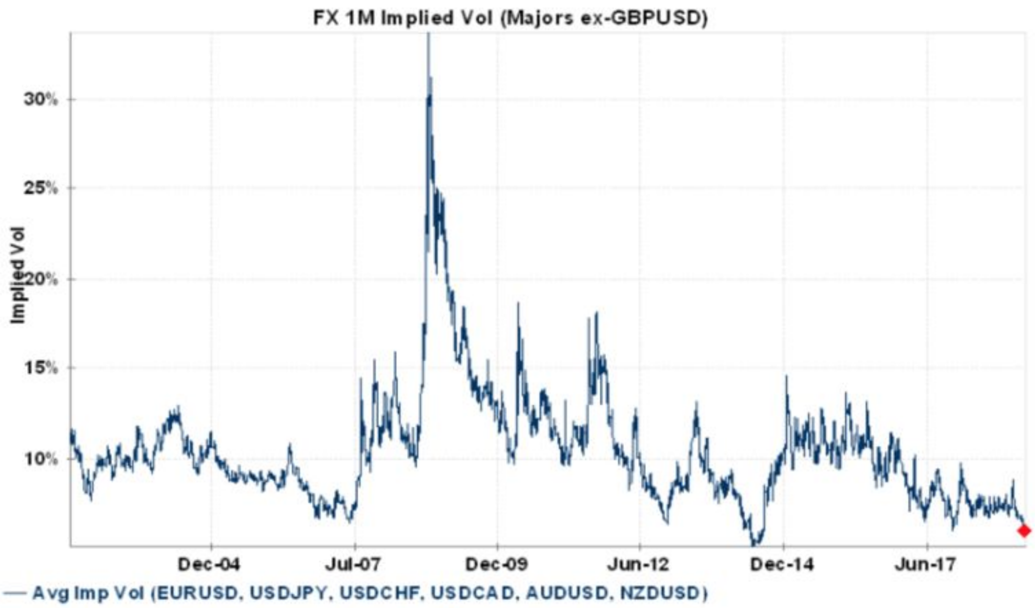
It's likely to be more like the 16' analog with choppy and volatile sideways action. Of course, things can change. The Fed could come out today and surprise the market with some renewed hawkishness, though that's unlikely. We'll have to keep an eye on the proper indicators as things play out.

We'll be using the coming volatility to put on a starter position in shipping stocks (we've got a research piece on some specific names we like, coming out soon) as well as add to our energy basket, barring no major bullish USD surprises out of the Fed.

The most interesting market to me at the moment is still the FX space, where it looks like things are gearing up for a big move.

FX implied vols are near all-time lows.

Exhibit 2: FX Implied Vols Near All-Time Low



Source: Credit Suisse Derivatives Strategy

Sentiment Trader states that the last three times FX 3m implied vol was this low, going back to 1990, volatility in the dollar soon spiked, more than doubling over the following year. On average, over the following couple of months, the dollar ended up trading lower, the S&P higher, and both oil and commodities up.

There's a number of catalysts to drive a major FX spike in vol, particularly one driven by a lower relative US dollar. But the catalysts almost don't matter because the sentiment/positioning/technical conditions are already ripe for a very tradeable reversal, even if it doesn't become a sustainable long-term trade.

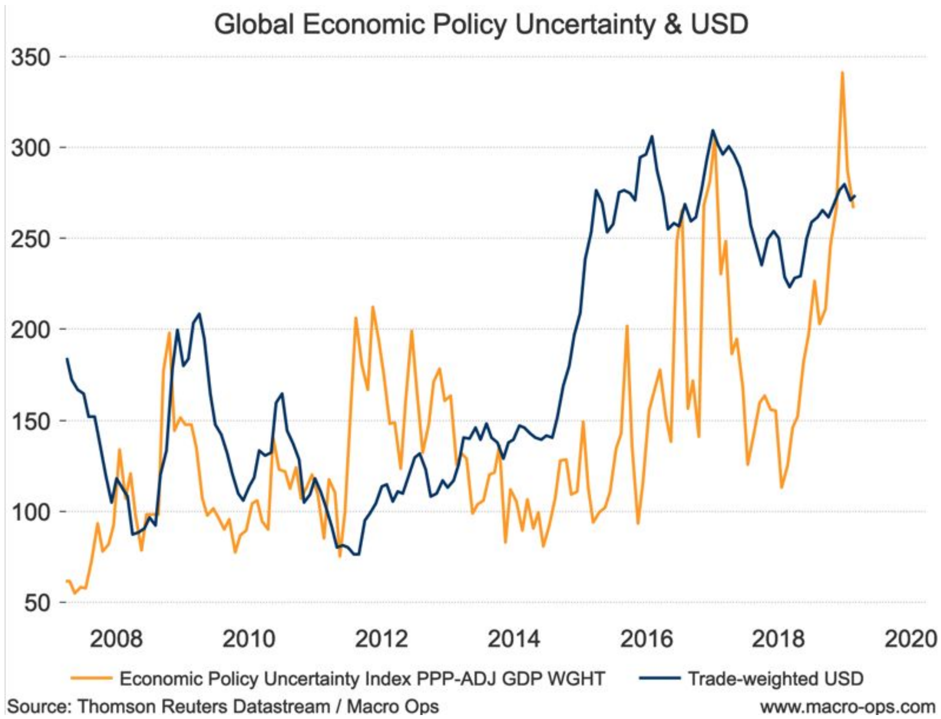
I've been writing a lot about these conditions over the last few weeks but let me share some new data points with you by playing a game of "What if".

Everybody knows that everybody knows that the political and economic uncertainty is high around the world right now. And between the trade wars, Brexit, and Venezuela on the fast track to total destitution, it's really hard to see how things could get better.

But, what if… Brexit gets resolved in an acceptable manner or what if… China and the US strike up a trade deal soon or what if… All of this stuff just gets kicked down the road enough that it stops being an immediate concern of the market?

Unlikely? Sure. But, possible? Of course.

And seeing as how much uncertainty is ALREADY priced into markets thus affecting investor's willingness to take risks. It may not take much to calm things down for a bit (if only a bit) and less global fear is typically a dollar bearish driver.



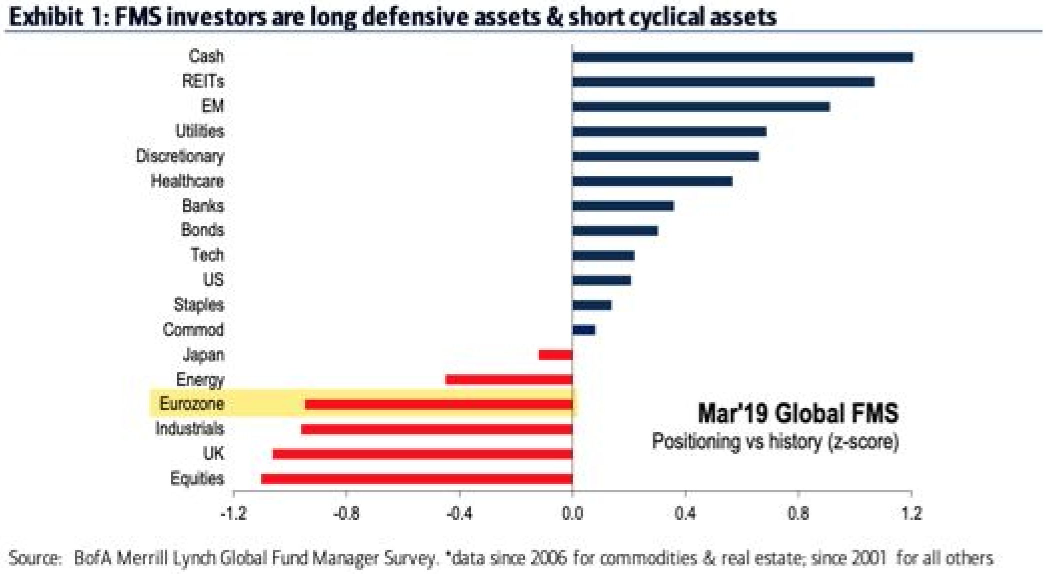
And everybody knows that everybody knows that Europe is going to *Scheisse* and that its markets are totally uninvestable with its weak economic growth and large exposure to a slowing China.

But, what if… all of that and some is already baked into the price? What if… these horribly low expectations are actually too low? What if… Europe is able to clear this exceedingly low expectations bar which would drive capital flows back into its markets thus sending EURUSD higher?

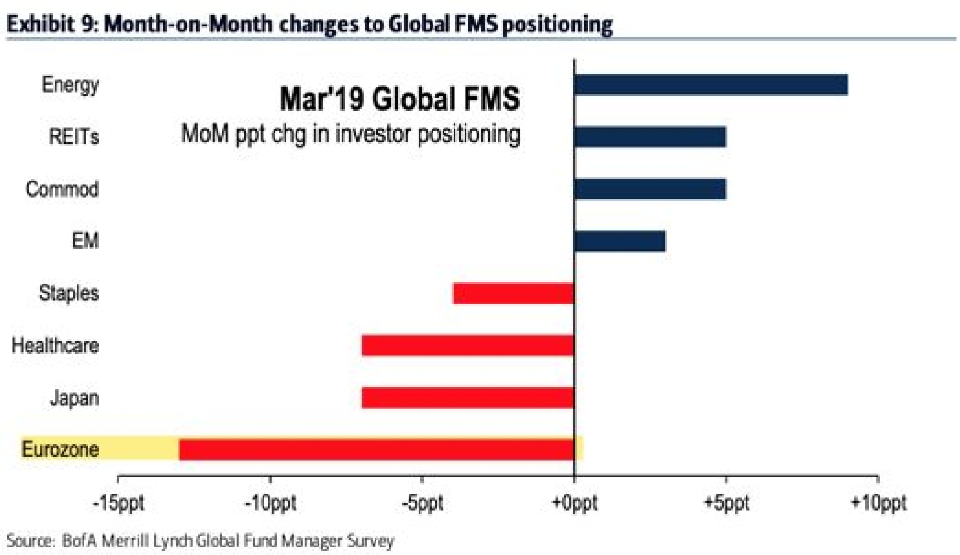
The latest BofAML FMS (which is hung up in the CC) notes that Europe is currently the most crowded short.

Crowds & contrarians: the most crowded FMS trade is short European stocks; overvaluation of US$ is the highest since Jun '02; relative to 20-year FMS history investors long cash; "long stocks-short cash", "long EU-short EM", "long industrials-short REITs" are all contrarian.

Nobody wants to touch it.

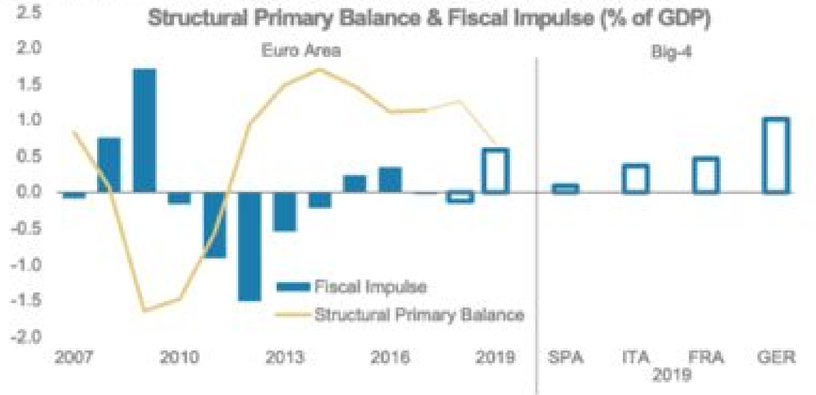


And the few who hold it are quickly dumping it…



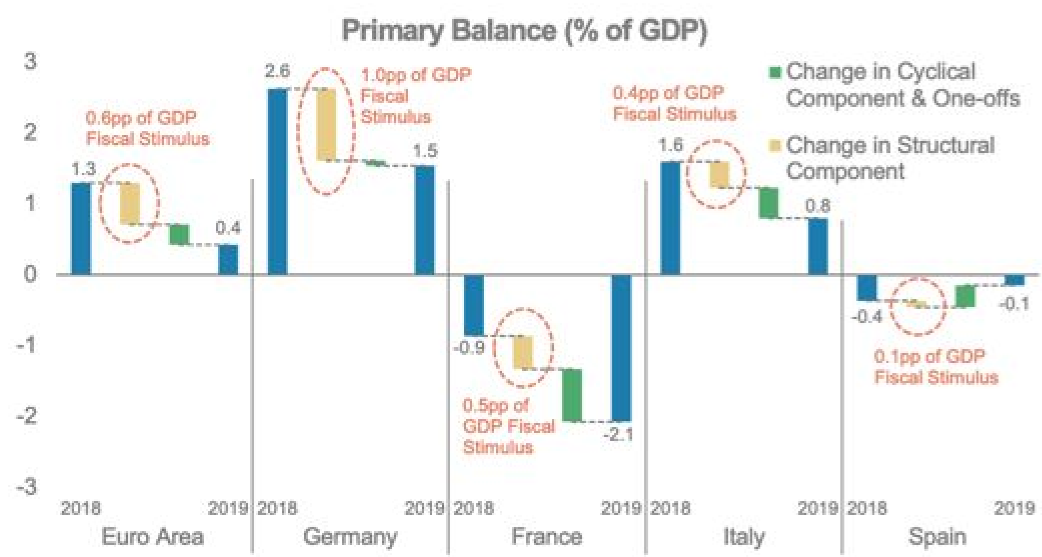
Which is interesting because Europe is about to see its largest fiscal boost in over 10-years. Charts below are from Morgan Stanley.

Exhibit 1: The biggest fiscal boost in ten years



Source: European Commission, Morgan Stanley Research; Note: Empty bars, thin line = Morgan Stanley forecast; Structural primary balance = cyclically adjusted primary balance ex one-offs; Fiscal boost = change in structural primary budget balance; +/- = fiscal boost/drag.

Exhibit 5: Loosening the belt across the board

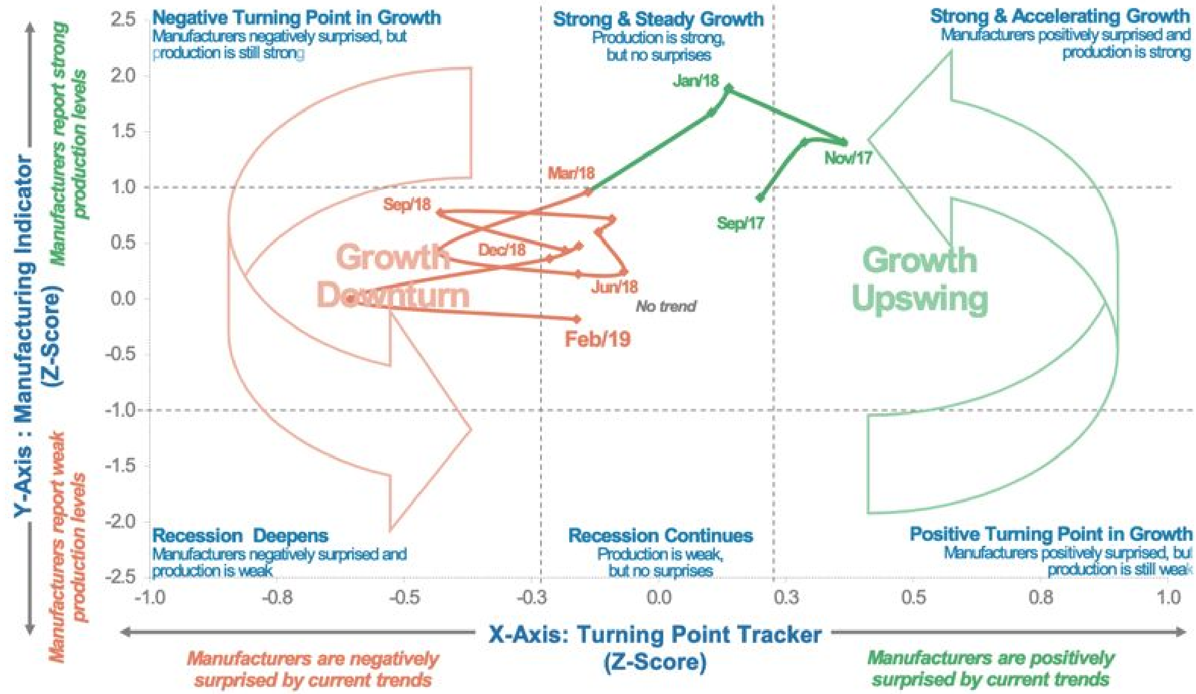


Source: Morgan Stanley Research estimates

This fiscal loosening is already beginning to show in the data.

There are now less negative surprises.

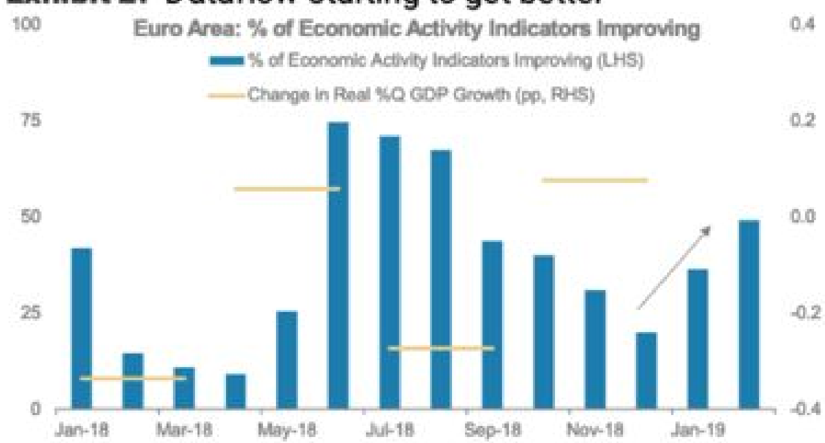
Exhibit 10: From growth downturn to less negative surprises



Source: Morgan Stanley Research estimates

And the % of economic activity indicators is actually improving.

Exhibit 2: Dataflow starting to get better



Source: Eurostat, Morgan Stanley Research estimates; Note: Activity indicators include headline numbers and components from the IHS Markit PMIs, European Commission surveys, retail sales and industrial production.

This means that real growth might actualy stabilize and even increase in the quarters ahead.

Exhibit 18: A tactical bounceback

Source: Eurostat, Morgan Stanley Research; Note: Empty bars, thin line = Morgan Stanley forecast.

Now, do we know this is going to happen? Do we have high conviction on a global growth rebound with Europe leading the way? Do we have a complex and compelling narrative about how the ECB's renewed LTRO is going to accelerate M1 growth which will spark a new liquidity gush, driving European stocks higher?

No. No. And…. NO.

We don't need any of that. We just need to know that the market is still very long the dollar and very short Europe, where pessimism and expectations could hardly be lower.

This makes both markets susceptible to a reversal. And the data is beginning to suggest that maybe the current positioning and expectations is a bit excessive and liable to a surprise.

I'm reminded of the Ed Seykota quote of "Fundamentals that you read about typically are useless as the market has already discounted the price, and I call them 'funny-mentals.' However, if you catch on early, before others believe, then you might have valuable 'surprise-a-mentals.'"

Maybe we have some valuable "surpise-a-mentals" here. Or maybe not. But the risk-reward + odds seem good.

We'll look to add to our dollar short following further price confirmation and no surprises out of the FOMC.

That's all I've got for this week!

If you've got any questions for us in the meantime, let us know in the Comm Center. Have a great week!

Your Macro Operator,

Alex

Macro Ops Portfolio

		YTD
		6.01%

Big Bet Macro

Asset Class	Position	Position Size	Cost Basis	Notional %	Risk Point	Target	Last Price	P&L
Equity	Construction Partners (ROAD)	4,500	$12.07	5.12%	$10.80	$17.00	$12.02	-0.41%
Equity	Facebook (FB)	216	$138.00	2.81%	$119.50	$144.19	$163.76	18.67%
Equity	Fiat (FCAU)	2,666	$15.20	3.82%	$13.70	$28.00	$14.74	-3.03%
Equity	Sharpspring (SHSP)	859	$13.71	1.11%	$10.80	$20.00	$15.35	11.96%
Equity	Garrett Motion (GTX)	5,630	$15.11	8.02%	$13.80	$25.00	$14.68	-2.85%
Equity	Criteo (CRTO)	3,333	$25.47	8.01%	$23.00	$45	$25.89	1.65%
Equity	Grupo Financiero (GGAL)	1,536	$26.13	3.79%	$21.00	$44.00	$28.40	8.69%
Equity	Stratasys (SSYS)	2,335	$24.76	5.45%	$20.50	$50.00	$23.74	-4.12%
Equity	Discovery DISCA	1,300	$28.09	3.44%	$26.70	$60.00	$26.23	-6.62%
Equity	Google GOOGL	195	$1,129.78	20.78%	$1,100.00	$1,400.00	$1,210.79	7.17%
Equity	Disney DIS	2,146	$102.34	20.72%	$108.50	$150.00	$108.41	5.93%
Equity	Yatra Online YTRA	13,877	$7.24	9.48%	Investment	$15.00	$4.96	-31.49%
Equity	Diamond Offshore (DO)	1,820	$10.75	1.85%	$9.00	$20.00	$10.54	-1.95%
Equity	Transocean Ltd. (RIG)	2,581	$9.04	2.20%	$7.85	$15.00	$9.38	3.76%
Equity	Matador Resources (MTDR)	1,162	$18.75	2.06%	$16.00	$16.00	$19.36	3.25%
Equity	TSLA Jan '20 150 Put	5	$15.01	0.71%	$0.00	$60.00	$11.25	-25.05%
Equity	TSLA Jun '19 220 Put	4	$18.01	0.68%	$0.00	$60.00	$9.75	-45.86%
Equity	FCAU Mar '19 24 Call	135	$0.25	0.32%	$0.25	$2.50	$0.00	-100.00%
Equity	SPX Mar '19 3150 Call	7	$8.10	0.53%	$0.00	$80.00	$0.00	-100.00%
Equity	DIS Jan '20 165 Call	205	$1.11	2.15%	$0.00	$10.50	$0.25	-77.48%
FX	June Dollar Futures	-7	$96.21	-63.53%	$97.00	$90.00	$96.05	0.17%
Commodity	May Crude Futures	1	$58.92	5.56%	$54.50	$75.00	$58.90	-0.03%

**Updated 3/18