WIZARD OF OPS

# TECHNICAL TRADER
VOL. 5 NO. 5 MAY 2022

Wow, what a month! SPX closed roughly 500+ points down, resulting in a volatile -12% month. This month involved a crypto crash thanks to a stablecoin breakdown, a 50 basis points (bps) rate raise by the FOMC, and very downbeat earnings from retail stalwarts (including last month's fundamental pick LOW that was thankfully closed early). It felt like the chickens came home to roost a little bit from inflation.

This past month has been tough, as many corners of the market from crypto to Chinese shutdowns seemed to hurt it from all angles. Inflation reared its ugly head during retail earnings reports, as companies have seemingly assumed the inflationary pressures upon their bottom lines instead of passing those price increases to the consumer. The crypto revolution hit a snag as well, sending liquidity further down from institutions exposed to cryptocurrencies as well as growth companies.

On the volatility front, this month has shown an excessive amount of undervixing. This is not a great sign, as customers have sold a lot of puts in June. While that provides some support for markets, it creates a situation where any sort of implied volatility (IV) crunch becomes muted going forward. This hurts the bull thesis going into autumn. We need to see more hedging and less selling, as what we have seen is selling of individual names and indices overall. The gamma is heavily negative, and the first instance of a decent gamma support is at around 3750, with some more at every 100 multiple SPX level. Meanwhile, inflows to ETFs have been very high; it seems retail is buying the dip, and there is a greater concentration in passive investment. So, I think these levels could mark a bottom in the longer term, but this definitely shows how option dealers can get caught up in a market crash without overvixing. In fact, it seems the market is saying they don't see a path lower. Sometimes that is a bit of a path lower in itself.

The technical trader had a very difficult month. While there were some hedges that were effective in stemming the tide of pain the market gave, there was still some pain. AMZN, WMT, and GLD trades were devastating. AAPL never had a chance. The bullish June trades had to be sold early as liquidity sapped the potential of these trades in the short term, and I have been reluctant to enter October bullish trades at the same time. Now, I heavily question the autumn bull thesis, which is elaborated in the equities section. At this point, I feel most comfortable with my equity calls, since I have better indicators for them. I'm developing my indicators for the other sectors, and without clear trends or macro direction in them, I'm going to hold off on those trades for now.

Particularly for technical trades, sometimes there need to be adjustments. For immediate adjustments, please follow me on Twitter. My handle is @WizofOps. These adjustments HAVE been included in the calculation for the portfolio in this newsletter.

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## KEY TO POSITION TABLES

| Stock Name | Primary Analyst | Other Analysts for Confirmation | | |
|---|---|---|---|---|
| Long Term Position | | | | |
| Short Term Position | | | | |

## EQUITIES

**Position Table:**

| SPX | EcoQuant Insight | Hadik: Insiide Track |
|---|---|---|
| Long Term | Bearish | Consolidation in Fall |
| Short Term | Rangebound | Bullish |

**The Long-Term Trade:** None at this time.

**Thesis:** Last month I was expecting a nice leisurely glide upward, but then the drop started as Jerome Powell stated there would be a 50bps rate hike which shook markets. After the initial drop in markets, we took a stroll down bear lane, dropping .5-1% every day it seemed. Because of the consistency of the drop, VIX didn't react. Part of the calculation of IV and consequently VIX is variance of the daily returns. If the daily returns are the same over a period, the IV declines. That's what we are facing right now. IV declining as the moves become repetitive, even though they are down. This is the sign of an impending carry crash.

Because of that, I'm pretty scared to go ultra-bullish, and might have to make sure there are bearish hedges on anything we do. In fact, I have to cancel the autumn bull. I want to see how this upcoming week goes, but after the past month we need the realized volatility to decline past the implied. If that doesn't happen this week, we are looking at possibly an autumn bear.

From an individual strike standpoint, institutions have sold the 4000, 3800, 3750, 3700, 3600, and 3500 strikes pretty hard. The greatest of those is the 3700 strike. Further, they have bought a lot of 3900 and 3870 puts. So while VIX is declining, it is safe to say we are going to be dragged into a positive gamma zone from a dealer standpoint. That means moves will be hard to come by, especially to the downside. It is the reverse of the sold call phenomenon, but the difference is calls are not being bought. So there is nothing to give pressure to the downside, just "put walls" to keep the market from going down. That means as it stands, we shouldn't move, and perhaps drift to the upside since there is little resistance. 4000 presents some resistance, all those strikes listed above will prove to be supports as the market figures itself out.

My hope is that as this happens, the market finds itself not moving much, and realized volatility drops faster than IV, prepping for a rally. But that is a pipe dream right now until we see it happening. In the meanwhile, since equities seem to be the area I'm most in tune with, I will put on a rangebound trade, but with a downside hedge that will help in case we have more wild days.

We will also have a crash hedge on. See the volatility section for more details on that.

**The Short-Term (1-Month) Trades**:
Buy 5 SPY 17Jun22/31May22 350/360 diagonals at $1.71 debit. This uses $5000 in capital.

Buy 10 SPY 17Jun 280 puts @$.24 debit. This trade uses $240 in capital.

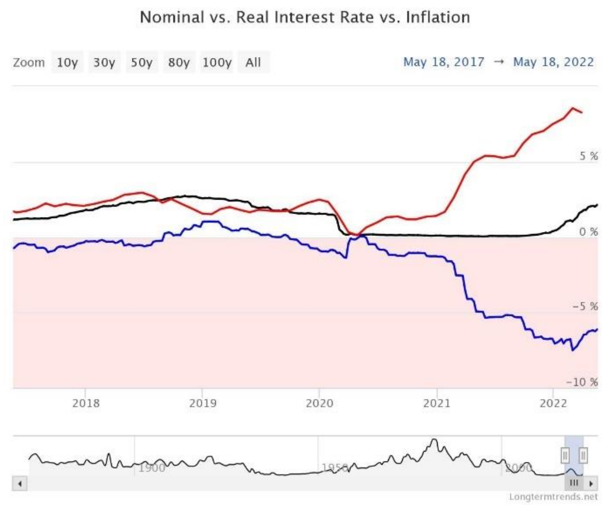
## METALS

**Position Table:**

| GLD, SLV, GDX | Hadik: Insiide Track | EcoQuant Insight |
|---|---|---|
| Long Term | Bullish | Rangebound |
| Short Term | Bullish | Rangebound |

**The Long-Term Trade:** None at this time.

**Thesis:** Last month was a disaster. Metals are not so much an inflation hedge as they are a real rates hedge. When real rates drop, (which means inflation goes up faster than nominal rates), gold goes up. The inverse happens, gold drops. Interest rates have been skyrocketing a lot faster than I thought they would, implying I felt the Fed was acting too slowly (which I have said in previous newsletters I believed to be the case). The market took matters into its own hands and interest rates skyrocketed faster than the Fed wanted to raise them. As a result, gold dropped. I think inflation will level off but interest rates can continue to rise as FOMC members talk with hawkish tones. The true inflation hedge is bullish metals, bearish bonds in a 1-1 ratio. As I absorb this information, I will form a strategy better capable of capturing an inflation thesis. It might be convex gold and bonds in opposite directions.




In this chart, Inflation (red), nominal interest rates (black), and real interest rates (blue) are plotted together. Real Interest rates are inversely correlated with gold.

**The Short-Term (1-Month) Trades:** None at this time.

## ENERGY

**Position Table:**

| UNG, USO | EcoQuant Insight | Hadik: Insiide Track |
|---|---|---|
| Long Term | Bullish | Bearish |
| Short Term | Rangebound | Bearish USO, Topping UNG |

**The Long-Term Trade:** None at this time.

**Thesis:** Energy has been rangebound for a while. USO has been rejected at the 82-84 level for quite some time and been supported by the 72-74 area. So why not try to take advantage using a double calendar? If we hit an upside target (which would indicate breakout) there are several adjustments we can make. We can take off the winning calendar while selling puts on the “losing” calendar. It will help collect profits. Please only do this trade if you are paying attention to Twitter for adjustments.

As for UNG, it has looked like it is about to turn a corner to the downside. As the weather gets warmer, I’d imagine natural gas is going to take a hit. Starting up wells again will also contribute as the labor market cools. Really, natural gas prices are a result of inflation in the labor market, so when interest rates rise and jobs become scarcer, I can imagine natural gas prices will come down. But I’m not going to act on that yet since that is a much more long-term thesis.

**The Short-Term Trade:** Buy 10 USO 3Jun22/17Jun22 77/87 double calendars @$2.07 debit. This trade uses $2070 in capital.

## BONDS

**Position Table:**

| TLT | Hadik: Insiide Track | EcoQuant Insight |
|---|---|---|
| Long Term | Rangebound | Bearish |
| Short Term | Bottoming | Bottoming |

**The Long-Term Trade**: No long-term trade at this time.

**Thesis:** In credit markets, we are seeing high yield credit spreads expand. This is a sign of poor credit liquidity and would result in a bond selloff. Equities last month dropped hard in an unexpected fashion (to me) and held bonds up in the short term. Bonds have led equities over the past several months, and bonds have been modestly bullish during May. Again, I don't have an edge here yet, so I'm going to hold off on anything here since all it will take is an FOMC speaker to say something hawkish and bonds will resume their descent. Because I have no edge, I'm staying away for now.

**The Short-Term Trade:** None at this time.

## THE STOCK PICKERS

### *EcoQuant Insight*

Image source: EcoQuant Insight.

**New Trade Idea:**

Trade ideas to come Monday on WizofOpsVIP Twitter.

**Old News:**

**China Large Cap ETF (FXI)**

**Wizard of Ops Commentary:** China is still in trouble, but they are using monetary policy to keep their stock market afloat. This trade is yielding some profits, but keep an eye on it as China re-opens.

> **The Trade:** Hold 10 17Jun22 FXI 30/26 long put verticals @$.73. That's $730 in capital.
>
> **The Plan:** Risk full capital. Sell when 200% gain.

**Amazon Inc. (AMZN)**

**Wizard of Ops Commentary:** AMZN earnings destroyed the stock, even though they weren't the worst earnings in the world. Regardless, we had a trade that allowed for 5% downside and what we got was immediate 33% downside. Some hedges saved a lot of the losses, but make no mistake, this is a disastrous trade at this point. I think cash-flow positive tech will have a slight bounceback, but at this point I will sell when we get to the vertical strikes, and use this trade as a bullish market hedge going forward.

> **The Trade:** Hold 1 21Oct22 AMZN 2700/2800 short put verticals @$33.00 That's $6760 in capital.
>
> **The Plan:** Sell when AMZN reaches 2700-2750 area.

## VOLATILITY TRADING

### *Introduction to Volatility Products*

**VIX** – a 30-day measure of implied volatility based on SPX options. While you cannot trade this as a stock, it represents the fair price of a product only institutional investors can trade called variance swaps. When you have a VIX of 30, and you buy/sell a variance swap, you are betting that the realized volatility will be over/under 30% annualized in 30 days.

2 out of 3 months, you win by selling that var swap, so typically pension funds and insurance companies will execute this strategy. Funds sell var swaps like crazy... but the payment on the swap is the difference between the realized volatility and the purchase price, so those months when realized var is 80 are bad months for pension funds, particularly Canadian ones.

There is a clear correlation between the VIX and percent change in SPX. Sometimes VIX runs higher than the SPX change implies. I call that "overvixing". The opposite is "undervixing". When the market overvixes, typically it mean-reverts strongly with an SPX rally and a VIX drop. When the market undervixes, it typically doesn't strongly mean-revert; it gradually gets more and more undervixed until an event that causes an overvixed drop in SPX. So, overvixing is corrected swiftly due to market maker vanna exposure while undervixing needs a catalyst to be corrected.

**VXX** – This is a ratio of monthly VX Futures between 23 and 37 days away to try to reflect the VIX index. This is an Exchange Traded Note, so you can buy this like you would a stock. When VX futures are in contango (near term VIX is lower than long term VIX) this product degrades. In backwardation, it accumulates. As institutions buy VXX, it can accelerate the degradation or accumulation as well. Unfortunately, institutions know how this is managed and front-run its buying and selling. So, unless the market is extremely volatile, even with event risk, there is pretty much always term risk premium in the rollover.

**VX Futures** – These are bets on what volatility will be on the expiration date. This is different than a var swap, as this predicts what the implied volatility will be, not the realized volatility. Without a futures license, the way to play this is through VIX options, which are based in VX futures (with changing expirations, so please be careful when considering this).

**SPX Options** – The driving force between all of these volatility products is the implied volatility on SPX options. The VIX is derived from it, which is the basis for var swaps and VX futures, and VX Futures are what derives VXX. But all of these products can get bought and sold, so it creates situations where the tail can truly wag the dog. And last but not least...

**/ES Futures** – These are futures on the dividend adjusted value of SPX. The term structure on these cannot be read into very much, but the near term /ES futures are used to hedge the institutional positions of SPX options traders, and the no arbitrage rule states that SPX must move in concert with /ES futures. So, this product does have implications on volatility and the equity market. Not to mention /ES also has options associated with them, further complicating the landscape.

There are also a bunch of other products out there that shows the tail wagging the dog. UVXY, SVXY are examples of other ETNs that are based on VX Futures. There is VVIX, which is just an index (which cannot be traded) showing the volatility of volatility (whoa). There are many other indicators showing the volatility of other markets, like OVX monitoring the volatility of oil markets, but this section will focus on the equity volatility landscape.

### *The Equity Volatility Landscape*

Right now, we are in a scenario that can result in a massive carry crash, like 1987 or the flash crash. My checklist for that included negative variance risk premium (VRP) and that's what we are beginning to see. This is not a typical scenario, and I cannot find a time in the past couple of decades where this has become the norm. Sure, there have been times where IV spiked, but then it **(continued on page 6)**

**(Volatility Trading continued)** retreated to where VRP was once again positive pretty quickly. This is different. There is no IV spike; it is an RV spike with an IV decline.

This is a pain trade for us option traders. In all honesty, the correct move (as seen in the equity section) is IV down, SPX down. That butterfly should be very effective in capturing downside, as long as it doesn't happen too fast. With the strikes above presenting support, I think those equity trades are the perfect way to play this for now.

Overall, there is a danger of a carry crash right now. IV and RV inverting, deep negative real rates, inflationary pressures with a rising dollar at the same time, and widening credit spreads are all presenting a scary scenario that makes the market primed for a carry crash. I would quite honestly always be carrying some sort of put hedge. It is necessary at this point to buy deep out of the money puts probably every month to hedge everything you have. If there is a carry crash, everything will decline despite the economy being okay. We are beginning to see signs of this now. So *please be careful*, and hedge deep out of the money monthly. Consider it the price of doing business.

## PAST PERFORMANCE

This chart details past performance over a 1-year timeframe. For a comprehensive trade list, please send us an email at info@addeumfunds.com. Open trades are not included in this chart.

| Technical History (Past Year) | | | | |
|---|---|---|---|---|
| **Trade Type** | **Open Capital ($)** | **Realized Risk ($)** | **Realized Profit/Loss ($)** | **Realized Percentage (%)** |
| **Equity Trades** | 5,240 | 23,419 | 3,749 | **16** |
| **Bond Trades** | - | 7,233 | (10) | **0** |
| **Energy Trades** | 2,070 | 8,348 | 7,987 | **96** |
| **Metals Trades** | - | 10,135 | (3,147) | **-31** |
| **EcoQuant Insight** | 7,190 | 7,679 | 9,574 | **125** |
| **Total** | **14,500** | **56,814** | **18,153** | **32** |

## ANALYST CREDITS

Image Source: Eric Hadik

**Analyst:** Eric Hadik provides technical & cyclical-based analysis and publications - dedicated to educating & informing traders and investors while preparing them for developing opportunities. This analysis is structured to take a practical approach to trading, rooted in sound principles of proper money management and risk control. This analysis is limited to markets, currencies, commodities, and metals.

Image source: EcoQuant Insight.

**Analyst:** EcoQuant uses his PhD training in Integrative Biology and Quantitative Ecology to identify human behavioral patterns in economic markets that mimic cycles observed in the natural world. Using concepts of natural selection, scale, and spatial patterning, he positions in trades that will respond similar time and time again given the same set of initial conditions. EcoQuant is a self-taught investment analyst and advisor and believes in demonstrating process for instruction and providing consistent results to increase the likelihood of your trading and investment success.