am FX

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Never schedule a pitch meeting at a seafood restaurant

Current Trades

Long EDZ3 @ 98.895
Stop loss 98.79
Take profit 99.03

Long 2-month 0.7500 AUD digis
spot ref. 0.7285

Fooled by Randomness

Trading an energy crisis

It is fiendishly difficult to trade an energy crisis through FX because:

- **Central bank reaction functions are difficult to gauge**. Are they hawkish in response to energy price inflation, or dovish in response to demand destruction (rising energy is a tax on the consumer)? In the old days, you knew ECB would be hawkish (targeting headline inflation with a bias to defending the German hard money / Weimar memory faction). But the disastrous July 2008 hike will forever haunt them. My favorite FinTwit follow, INArteCarloDoss, probably had it right this morning when he said that it could easily be the Bank of England in the lead this time, hiking into a crisis.
- **High beta currencies are commodity exporters** so do you buy or sell them? Do you trade the bearish SPX correlation, or the bullish terms of trade shock? My AUDUSD trade idea from yesterday is a good example of how focusing on the wrong side of the ledger can put you underwater. I still think the 2m 0.7500s are a good trade, by the way, as Australia will be a net beneficiary of all this and stonks will soon stabilize.
- **Funders are oil importers and yields are going up, not down**. People naturally want to sell USDJPY as a hedge to risk aversion like this but with rates rising and oil at the highs, it's not obvious that USDJPY needs to go down. Oil importers will be on the bid in USDJPY and models that trade rates vs. JPY correlation will be buying USDJPY, not selling. It's a mess.
- **Volatility and chop increase**. Risk aversion usually pushes correlation towards 1.0 and that can be fun and easy to trade. But in this case, you have the crosswinds of higher commodities and lower SPX buffeting the USD and making risky currencies attractive and unattractive at the same time. Not typical risk aversion, in other words. Messy.

First job for traders here is to avoid being fooled by randomness. You cannot chase stuff around or assume there is information in the price action. You need to make a call and stick with it, place stops a bit wider than usual, and stick to your plan.

Ultimately, you also need to make a call: Is this is "the big one" for risky assets? Or not. If it is not, the commodity currencies will probably stabilize and rip. If SPX goes to 4150, my AUDUSD idea is certainly dead in the water, no matter how kookoo bullish the Australian terms of trade looks.

Don't be wowed by recent BTC vs. SPX divergence, it's prolly random

I tend to think of BTC as an extremely volatile risky asset that is in the same family as gold. Sure, they're in the same family the way Brennan are Derek Huff are in the same family, but still. BTC and gold are both risky assets that sometimes perform as safe havens. *More about whether or not gold is a safe haven later.*

Last week, stocks fell 2% while bitcoin rallied 11%. That's bitcoin working as a safe haven, right? Some said that this is evidence that crypto is becoming a good hedge for stocks in times of stress. Is this true? Probably not.

Bitcoin's average weekly change is 9%[1] and the price is unchanged from where it was trading at various times in February, March, April, July, August and September of this year. When bitcoin is whipping around that much and going nowhere, you are going to get some +10% BTC / -2% SPX weeks. As a bitcoin agnostic, last week's performance does not enthrall me, and it does not make me wince.

Bitcoin up 10% with stocks down more than 2% in the same week is uncommon, but not unheard of. When it happens, it's probably more an outcome that results from bitcoin's high volatility, not any safe haven properties. Here are all the times bitcoin was up 10% or more and stocks were down 2% or more in the same week.

The price of bitcoin marked with all the times it was up 10% or more in the same week the S&P500 was down 2% or more ***(n = 14)***

In fact, if we forget about last week and just look at the correlation between BTC and SPX overall, it's increasing, not decreasing. Here is a fairly small table:

Correlation of weekly changes in BTC and SPX

	2010 to now	2018 to now	2020 to now
BTC vs. SPX correlation	9%	13%	20%

Don't be fooled by randomness. BTC is a risky asset that somewhat regularly goes in the opposite direction of the S&P 500. To give you a sense of how the relationship is positively correlated, but features a ton of randomness… See here:

What direction did BTC and SPX go each week?

	2010 to now	2018 to now	2020 to now
UP UP	38%	36%	39%
DOWN DOWN	19%	20%	19%
UP DOWN	21%	20%	23%
DOWN UP	22%	24%	19%

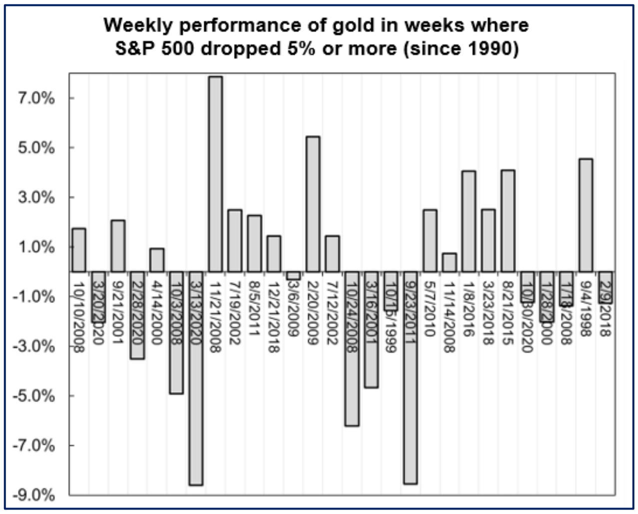
[1] Absolute value of weekly change, 2010 to now.

You can see that UP/UP and DOWN/DOWN cover around 58% of all weeks (bitcoin and SPX go in the same direction) while a bit more than 40% of the time BTC and SPX diverge. I'm always on the look out for changes in microstructure and correlation because sometimes they can be super important, but I would chalk up last week's movements to noise, not signal.

Gold is not really a safe haven

While many view gold as a safe haven, historically in times of stress gold performs much like bitcoin: it's a weird and random mix of safe haven and risky, liquid asset. There is a section in my book Alpha Trader: The Mindset, Methodology and Mathematics of Professional Trading that fact checks nuggets of questionable conventional wisdom in markets. Here is the bit about gold:

> **Is gold a safe haven?**
> *Kind of. But not really.*
>
> A safe haven is an asset that goes up, or at least holds its value during periods of risk aversion. Bonds typically perform this role, though with interest rates approaching zero in most countries by the year 2020, that role is now in question.
>
> The Japanese yen and Swiss franc are traditionally viewed as safe havens though their role as safe havens has diminished in recent years due to central bank and semi-official currency intervention (perceived or actual).
>
> Many prognosticators and journalists talk about gold as if it is a safe haven. When you see a headline like: "Gold rallies as US stock market sell-off accelerates", ignore it. Gold is just as likely to go up or down when stocks fall.
>
> Gold's behavior during periods of risk aversion depends mostly on positioning and overall financial market and USD liquidity. If stocks sell off because of economic worries, you might see gold rally. On the other hand, if stocks sell off because of liquidity fears (like in March 2020), expect gold to plummet right along with stocks.



> The correlation between changes in the price of gold and changes in stock prices is usually mildly positive, meaning gold and stocks go up and down together, a tad. Above, I present a simple table to demonstrate simply and quickly.
>
> I identified the 25 worst weeks for the stock market (largest fall, in percentage terms) between 1990 and 2020 and then checked what gold did during those same weeks. If gold is a safe haven, it should reliably remain unchanged or go higher at these moments. The table shows the results, sorted by worst SPX performance, starting on the left with the worst week in S&P 500 history.
>
> The average move for gold in big down weeks for stocks is -0.4%. There are 13 down weeks vs. 15 up. The takeaway is that gold is not a reliable safe haven. If stocks collapse, gold might go up, or it might not.

Have an animalistic day.

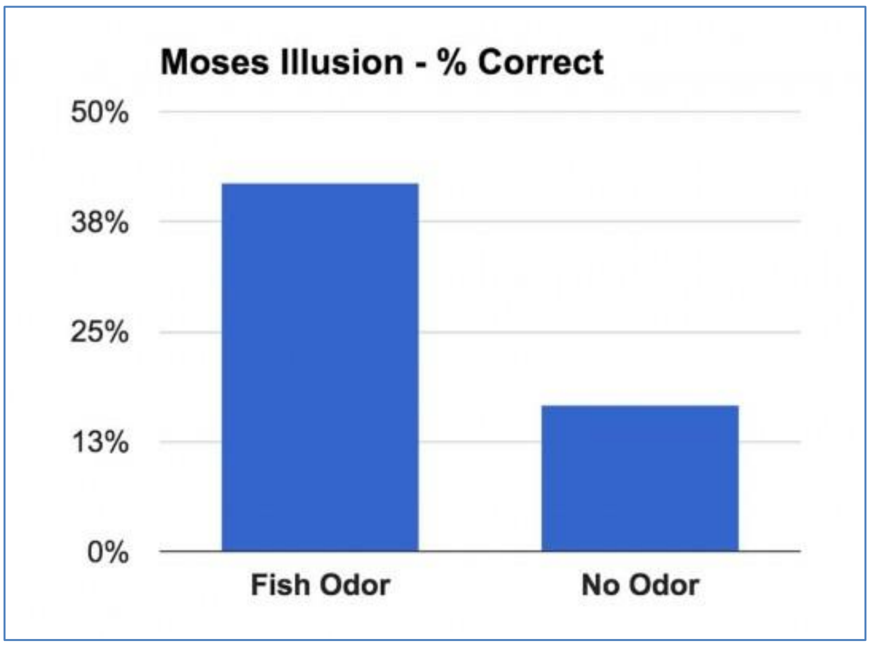
good luck ⇅ be nimble

Question: How many animals of each type did Moses take on the Ark?

Answer: He took zero. Noah took the animals on the Ark.

Around 80% of people get this question wrong. There are various theories on why that is but the main one is called the partial-matching hypothesis. When we are presented something that closely matches something else, we just ignore the difference and register it as the first thing. Efficiency!

There are a ton of experiments replicating and varying the Moses Illusion. In one, researchers introduced a fishy smell to the room for some participants and not for others. The fishy smell seems to trigger subconscious skepticism:



Incidental olfactory suspicion cue!

Full paper here: Something smells fishy: Olfactory suspicion clues improve performance on the Moses illusion and Wason rule discovery task

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