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Nasdaq

Is Trend Trading Your Friend?

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Is Trend Trading Your Friend?

Macro trends driving asset prices
in 2022

Interactive Brokers Webinar

August 9, 2022

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Index

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A Brief History of Trend Trading

- What is “trend trading”?
 - Trading/investing style designed to capitalize on an asset’s momentum in a direction (higher or lower).
 - Often utilizes technical analysis in the form of trend lines, moving averages, etc. to target entry/exit points.
 - Trend trading can be applied by short, intermediate and long-term capital allocation.
- Investing based on macro trends has existed for centuries.
- Renowned Trend Traders
 - Bill Dunn
 - Salem Abraham
 - Richard Donchian
 - **John Henry**
 - Paul Tudor Jones
 - Jesse Livermore
 - Cliff Asness
 - Nicolas Darvas



Example: John Henry + Applications

- Who is John Henry?

- Billionaire owner of Boston Red Sox, Liverpool FC, the Boston Globe and RFK Racing.
- Made his fortune running a CTA focused on trend trading.
- Emphasis on non-discretionary/systematic trading driven by price behavior.

- Early “quant investors” set out to eliminate emotion/subjectivity inherent in most approaches.

- Applications

- Commodity Markets (CTAs)
- Equity Indices
- Individual Equities
- Within Target Funds
- More.....

- Considerations

- Qualified Investor?
- Ability to manage emotion?

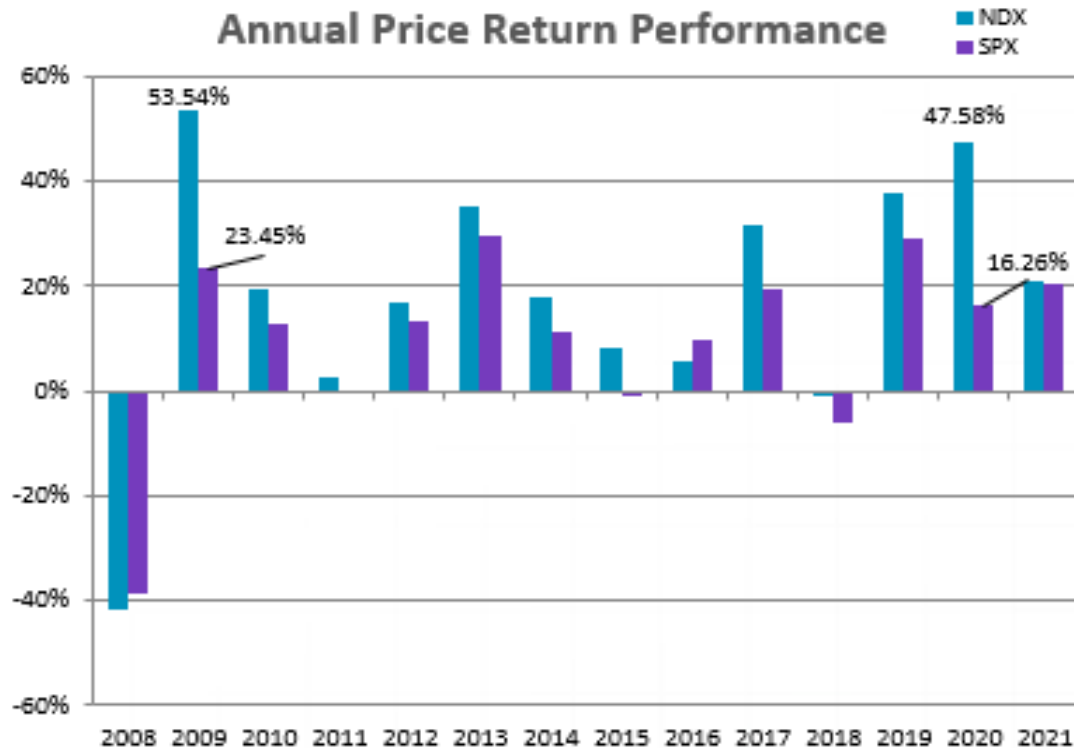
- Option-based Alternatives

- Defined risk + convexity depending on strategy



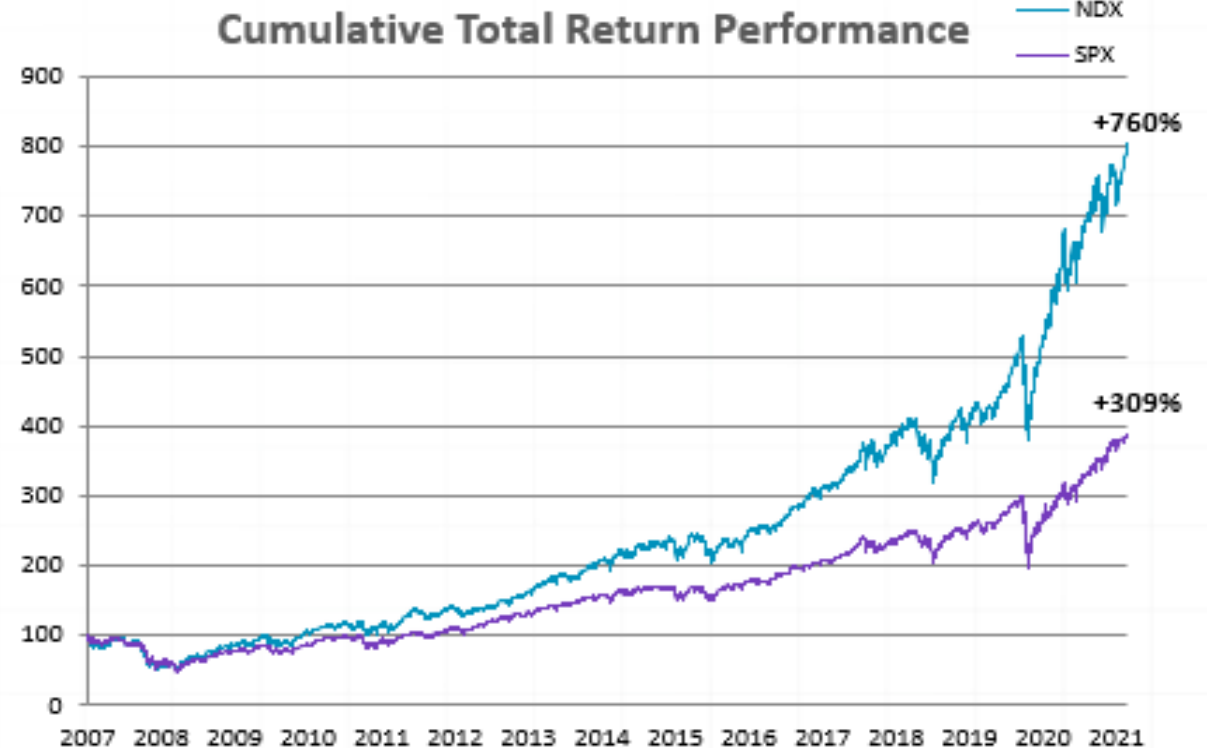
Nasdaq-100® Index: Performance

INDEX ANNUAL PRICE RETURNS – 2021 DATA AS OF AUGUST 31



- NDX has outperformed SPX in 11 of the past 12 years, including by more than 30% in 2020

INDEX PERFORMANCE FROM 2007 TO AUGUST 31, 2021

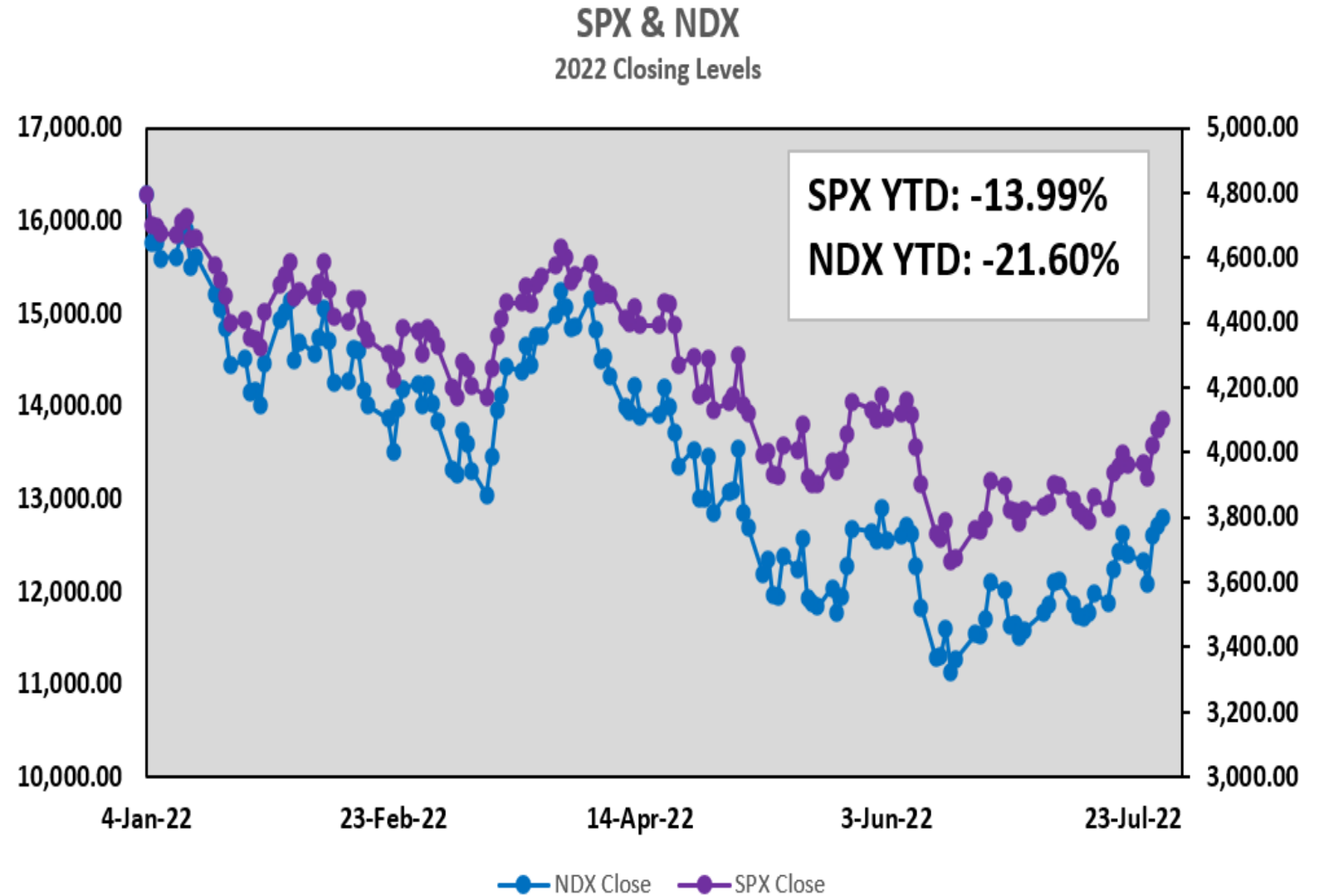


- Cumulative total returns through August 31, 2021, were 760% for NDX – more than doubling the returns of 309% for SPX.



To Be Fair.....

- In 2022:
 - NDX – 21.60%
 - SPX – 13.99%
- Growth companies have suffered relative to value in higher rate environment.
- **Key Question:**
 - Looking ahead, where would you prefer your investment capital?



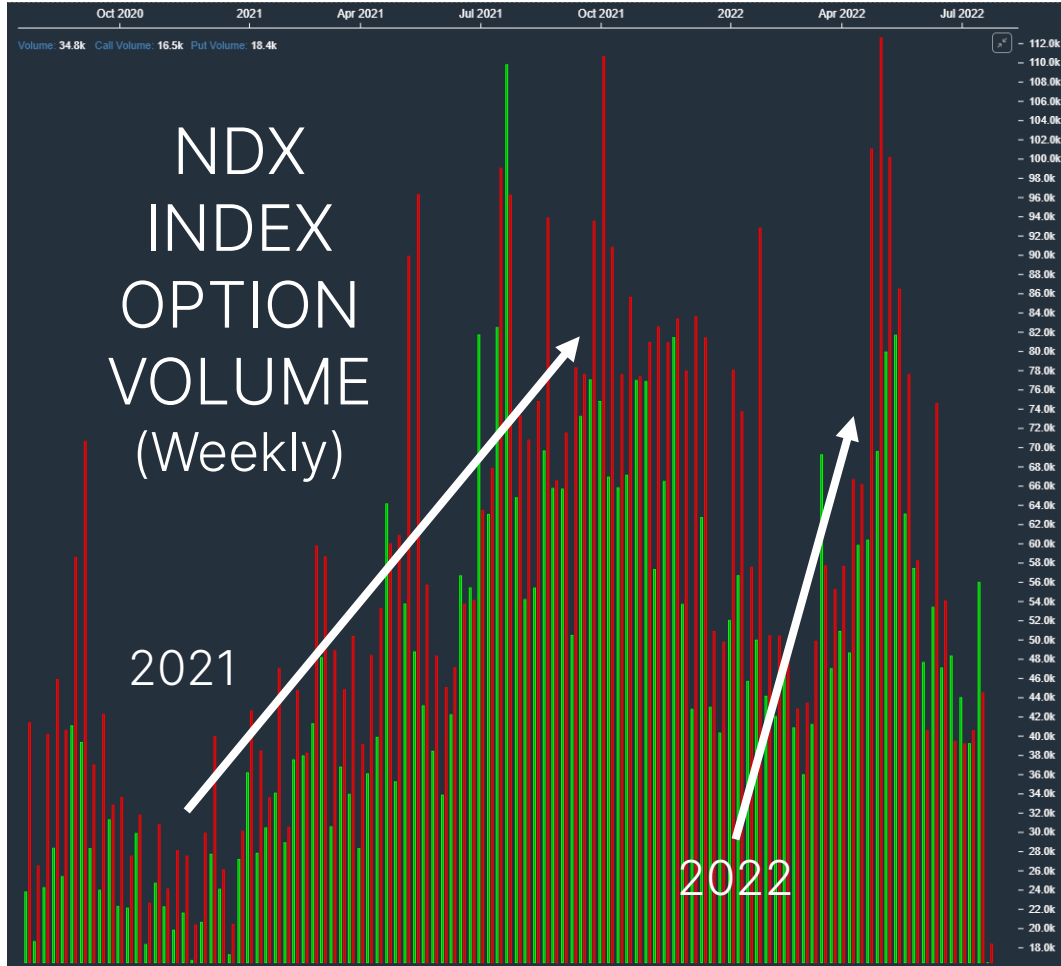
Source: Nasdaq; Data as of 7/29/2022



Nasdaq-100 Index (NDX) 30-Day Realized Vol



Vol Up – Index Option Volume Up



Equity Index - Top Contracts

Rank	Contract	Jan-Mar 2022 Vol	Vol % Change	2022 March OI	OI % Change
1	Bank Nifty Index Options, National Stock Exchange of India	3,513,356,732	124.4%	2,859,074	163.6%
2	CNX Nifty Index Options, National Stock Exchange of India	2,683,498,930	200.2%	5,195,608	154.7%
3	Mini Ibovespa Index (WIN) Futures, B3	1,107,671,420	2.5%	874,472	-15.5%
4	SPDR S&P 500 ETF Options *	427,350,316	57.3%	17,648,223	-5.7%
5	Powershares QQQ ETF Options *	158,761,351	105.0%	10,535,116	13.8%
6	S&P Sensex Index (BSX) Options, BSE	158,206,453	54.8%	104	-94.4%
7	Kospi 200 Options, Korea Exchange	126,250,769	-19.8%	2,143,435	9.0%
8	E-mini S&P 500 Futures, Chicago Mercantile Exchange	121,696,857	9.5%	2,113,865	-18.2%
9	S&P 500 Index (SPX) Options, Cboe Options Exchange	107,202,522	44.2%	15,979,990	23.7%
10	Micro E-mini Nasdaq 100 Index Futures, Chicago Mercantile Exchange	99,429,440	49.2%	85,431	23.6%



EQUITIES/OPTIONS RECAP

Overview

- Many global equity indexes made new all-time highs in late 2021 as monetary and fiscal stimulus was supportive of economic activity.
- Global equity markets have suffered through one of the most difficult half-years ever.
- Idiosyncratic (pandemic) risk gave way to more systemic risk in 2022.

Volatility

- NDX realized volatility levels have trended consistently higher in 2022.
- Forward volatility measures (VOLQ) indicate a probability that higher volatility may persist.
- Volatility historically tends to cluster.

Volumes

- Index option volume has increased globally.
- The Nasdaq-100 ecosystem experienced massive growth.
- Technology (growth companies) sensitivity to higher rates.



The Cost of Money

- Interest rates fell globally in the wake of COVID-19.
- Since summer 2020, the U.S. 10Y yield moved from 56 bpt to 350 bp.
- The Federal Reserve sets the fed funds rate (very short-term borrowing).
- Historically, yield curve inversions have preceded technical recessions.

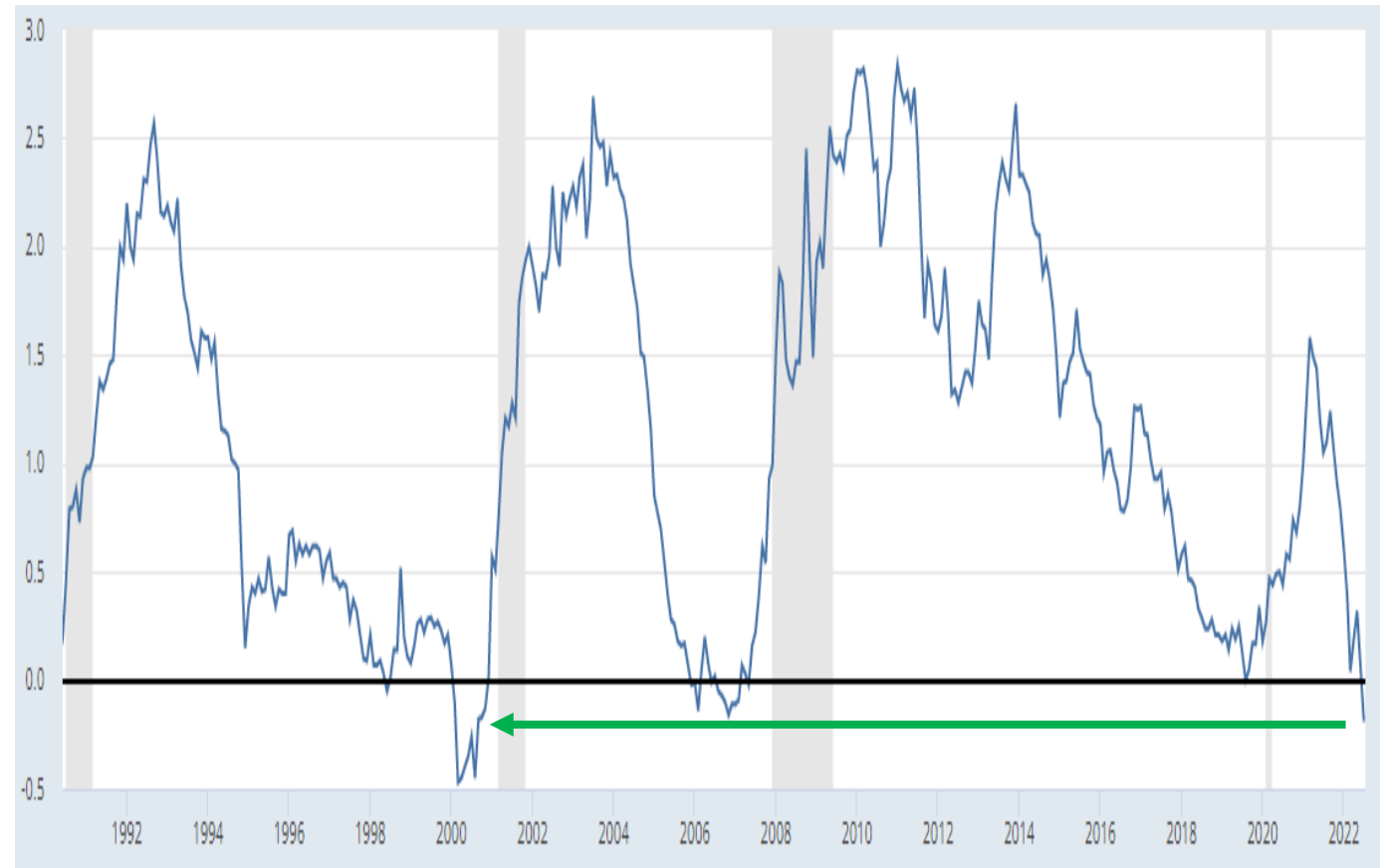


Source: St. Louis Federal Reserve Bank Data as of 7/15/2022

U.S. Yield Curve Inversion

- The recent inversion in the yield curve is the most significant since 2000/2006.
- Impactful for any financial firm, growth companies and those looking to roll over debt.
- Significant USD strength puts pressure on Emerging Market economies.
- Recession inevitable (shallow or prolonged)?

U.S. 10Y Yield – 2Y Yield



Source: St. Louis Federal Reserve Bank Data as of 7/15/2022



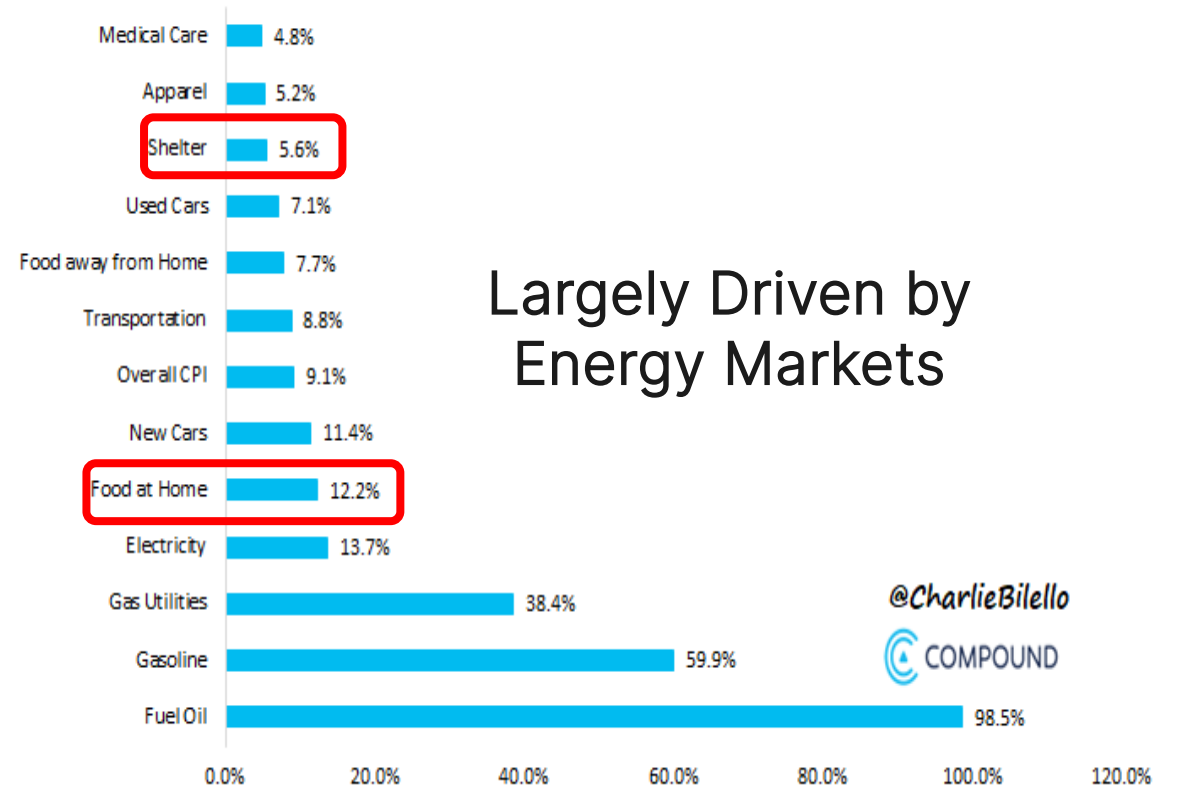
Inflation Trend

WHY? – Inflation Concerns

Highest CPI (Y/Y) Measure in 1981



YoY % Change (June 2022 CPI Report)



Source: Bureau of Labor Statistics, Compound Advisors @CharlieBilello

Terminal Rates – Declining!

- In mid-July, Fed fund futures were pricing short-term rates at ~3.7% at year-end.
- The Fed fund futures market also priced potential further hikes in 2023.
- The trend for FF futures shifted demonstrably lower.
- Current forecast prices rate CUTS in 2023.
 - End 2023 Forecast: 2.8%



EQUITIES/OPTIONS RECAP

Overview

- Interest rates declined globally following COVID-19 outbreak as monetary policy eased.
- Interest rates began increasing (long term trend?) last year and moved significantly higher since Russian incursion.
- Higher interest rates are the transmission mechanism to slow demand & economic activity.

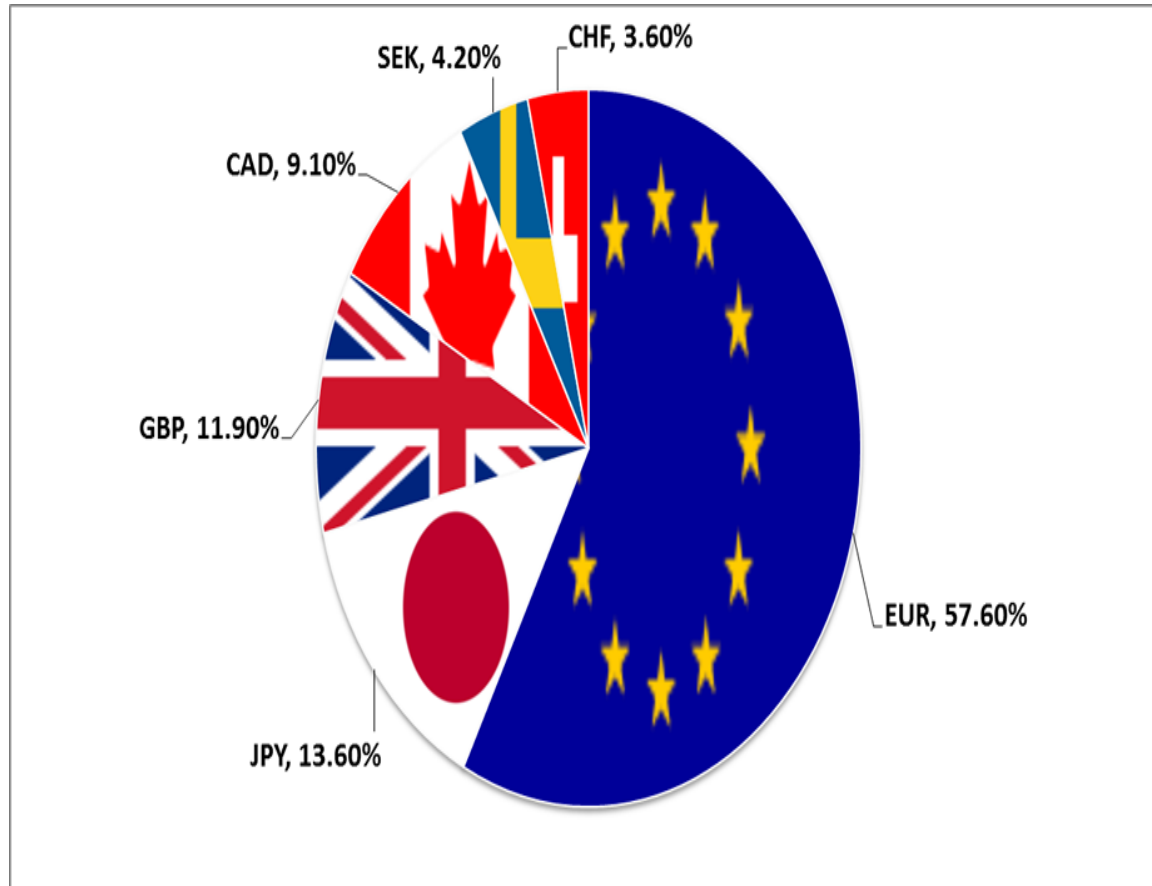
Volatility

- Interest rate vols have been elevated relative to equity vols in recent months.
- MOVE Index is frequently cited as benchmark (higher than March 2020 weeks ago).
- Short-term rate expectations have eased considerably.

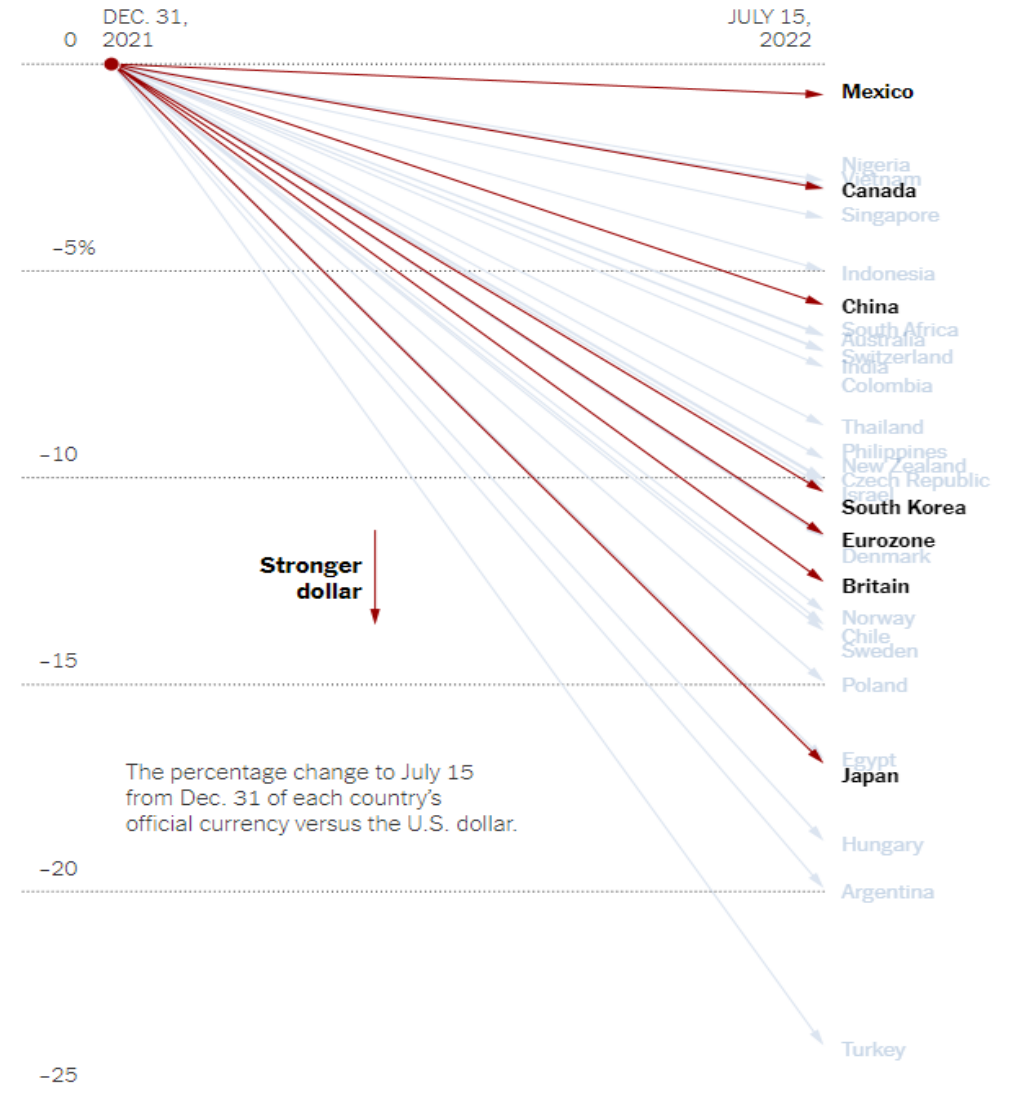


Currency Market Trend

The U.S. Dollar Index Implications of Dollar Strength



Source: Baby Pips



Source: NY Times & FactSet



Currency Markets @ Extreme Highs/Lows

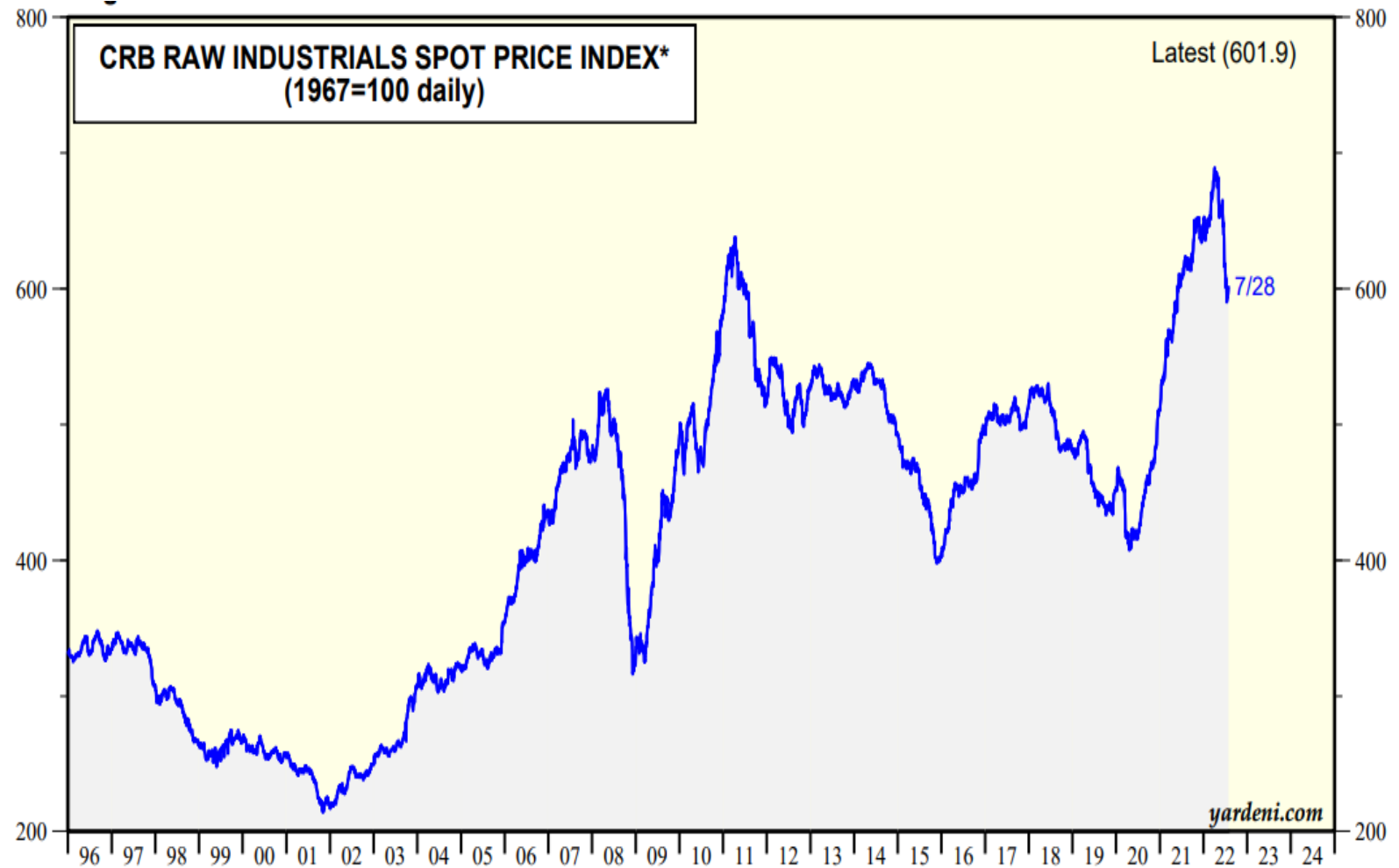
- USD is the Global Reserve Currency.
- Most international trade is USD denominated.
- Significant USD strength puts pressure on Emerging Market economies.
- Will there be more situations like Sri Lanka?
 - Russia? Italy? (2011)



Source: Barchart Data as of 7/15/2022

Inflation Abating?

- CRB Raw Industrials includes Copper, Lead, Steel, Zinc, Cotton, Cloth, Resin, Tallow.
- Many commodity markets, including Energy, have been declining.
- Improving supply chain issues and lower commodity prices contribute to expectations of lower “terminal rates.”

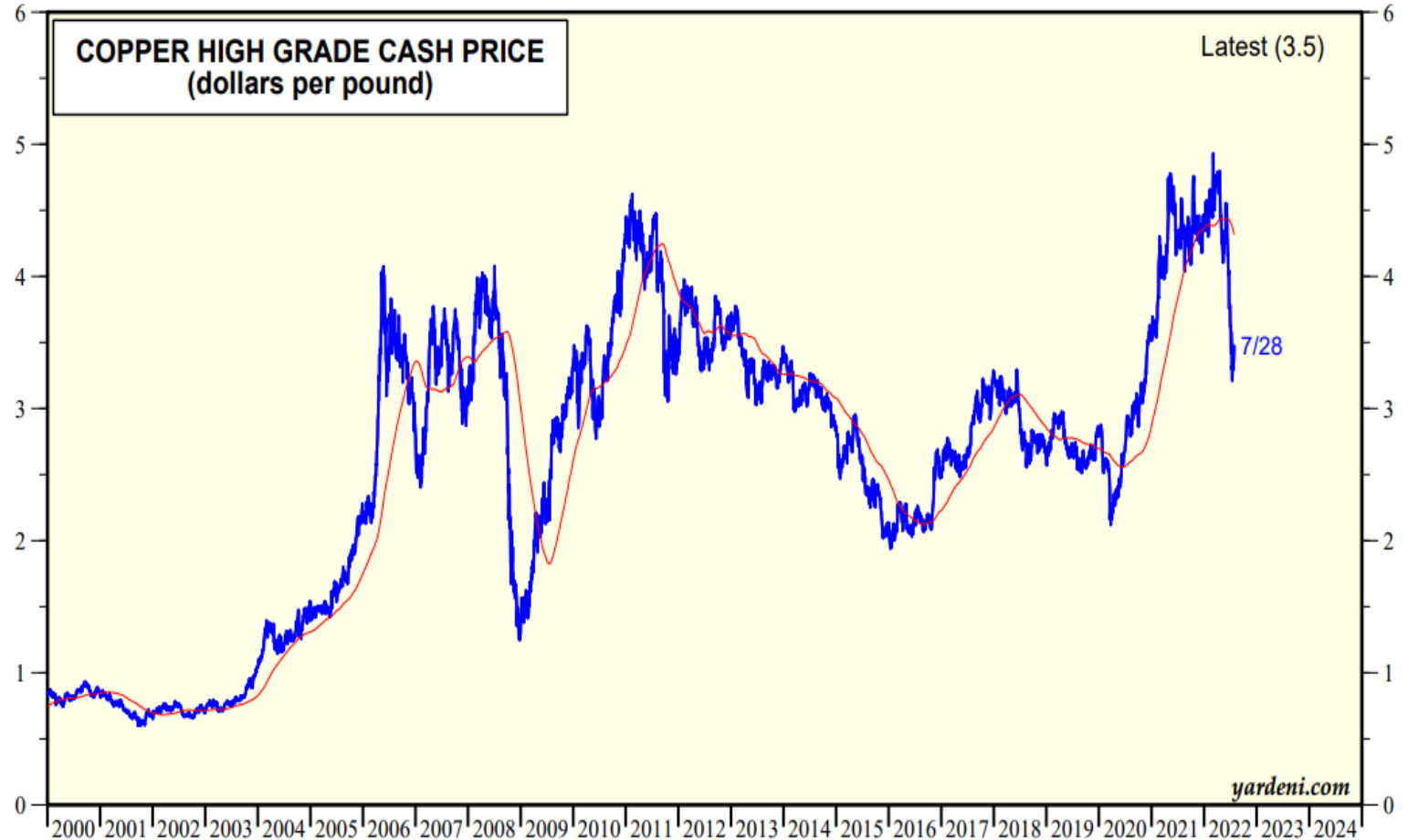


Source: Yardeni Research



Do You Believe “Dr. Copper?”

- Copper is said to have a “PhD. in Economics.”
- Now copper is more correlated to the Chinese economy (which is struggling).
- Does the combination presage a serious global contraction?

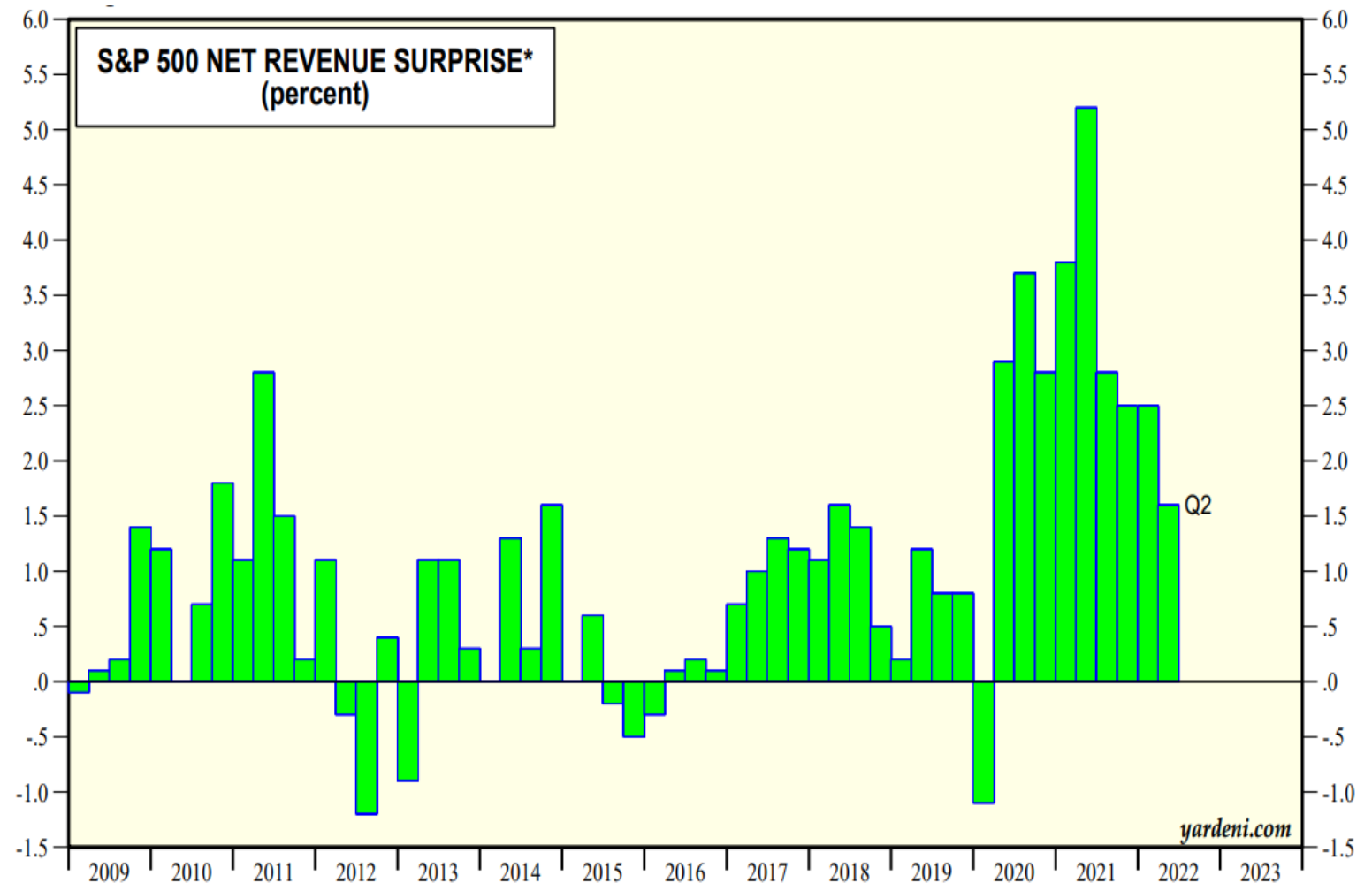


Source: Yardeni Research



Earnings Season – Return to the Mean?

- Monetary policy & fiscal stimulus drove corporate revenue numbers to record levels in 2021.
- The unwind is having the opposite effect.
- Many firms have managed higher costs well to this point.
- Will it continue?



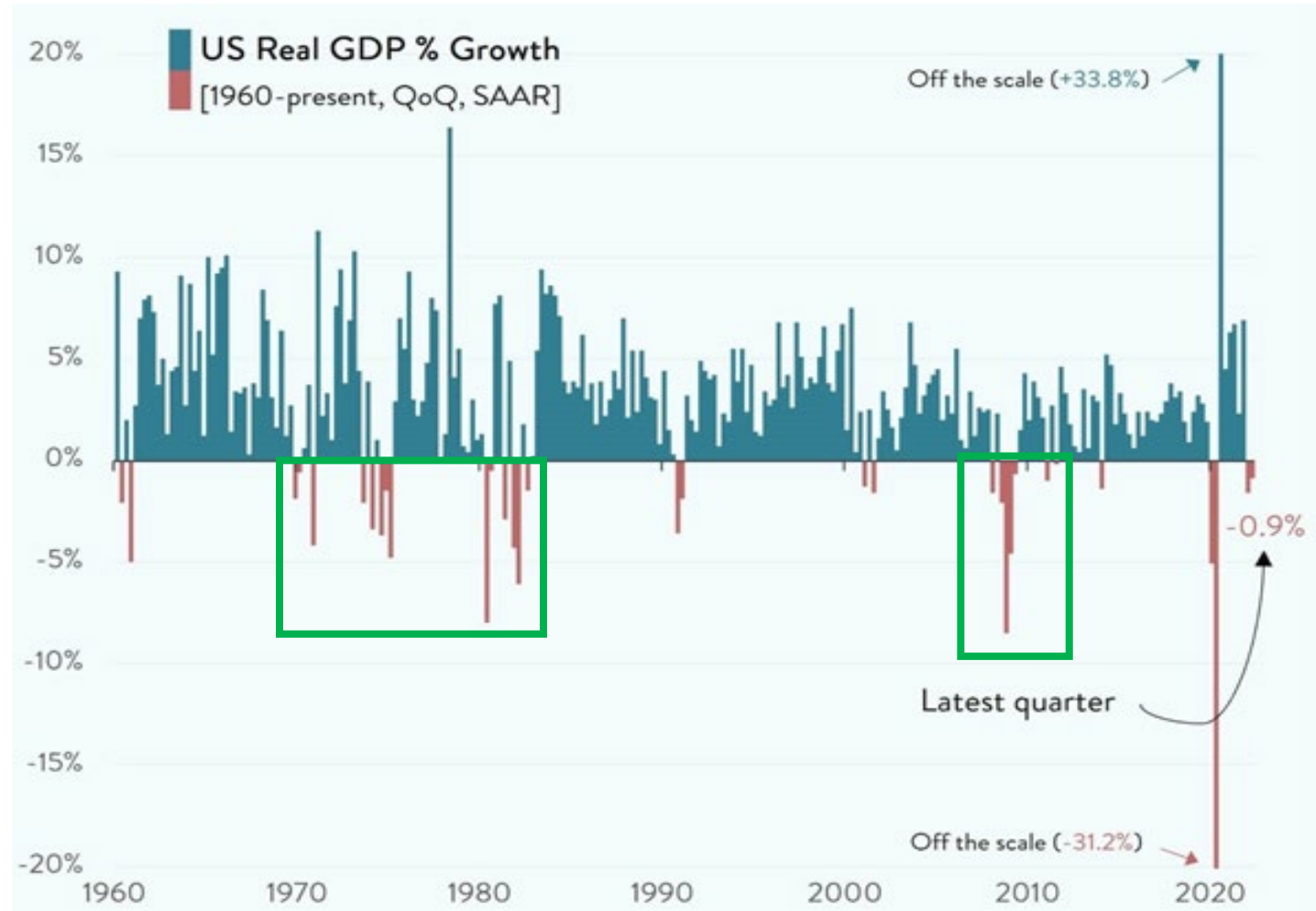
Source: Yardeni Research



“Recession” – Depends....But What Type?

- Technically: Two consecutive quarters of negative GDP growth.
- Formally: NBER – not declared a recession.
- Key Question:

Will this be a severe slowdown a la 1970s and early 80s? Or more pedestrian contraction?

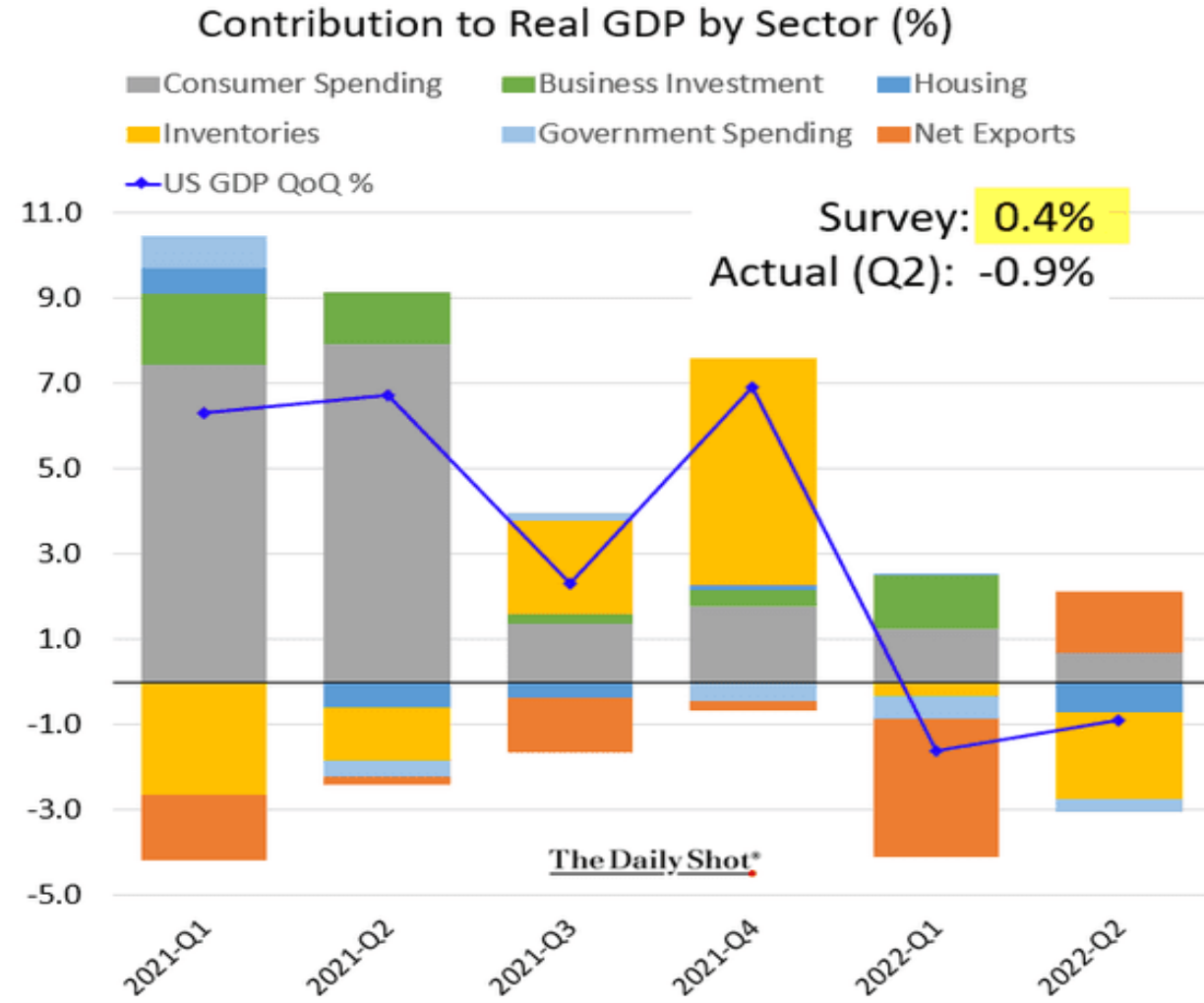


Source: Bureau of Economic Analysis & ChartR



Where Is the Slowdown Coming From?

- Significant decline in business investment in Q2.
- Housing slowdown!
 - NAHB Index + new/existing home sales at 2Y lows
- Consumer spending down (from record levels) but remains positive.
- Exports improving despite strong U.S. dollar.

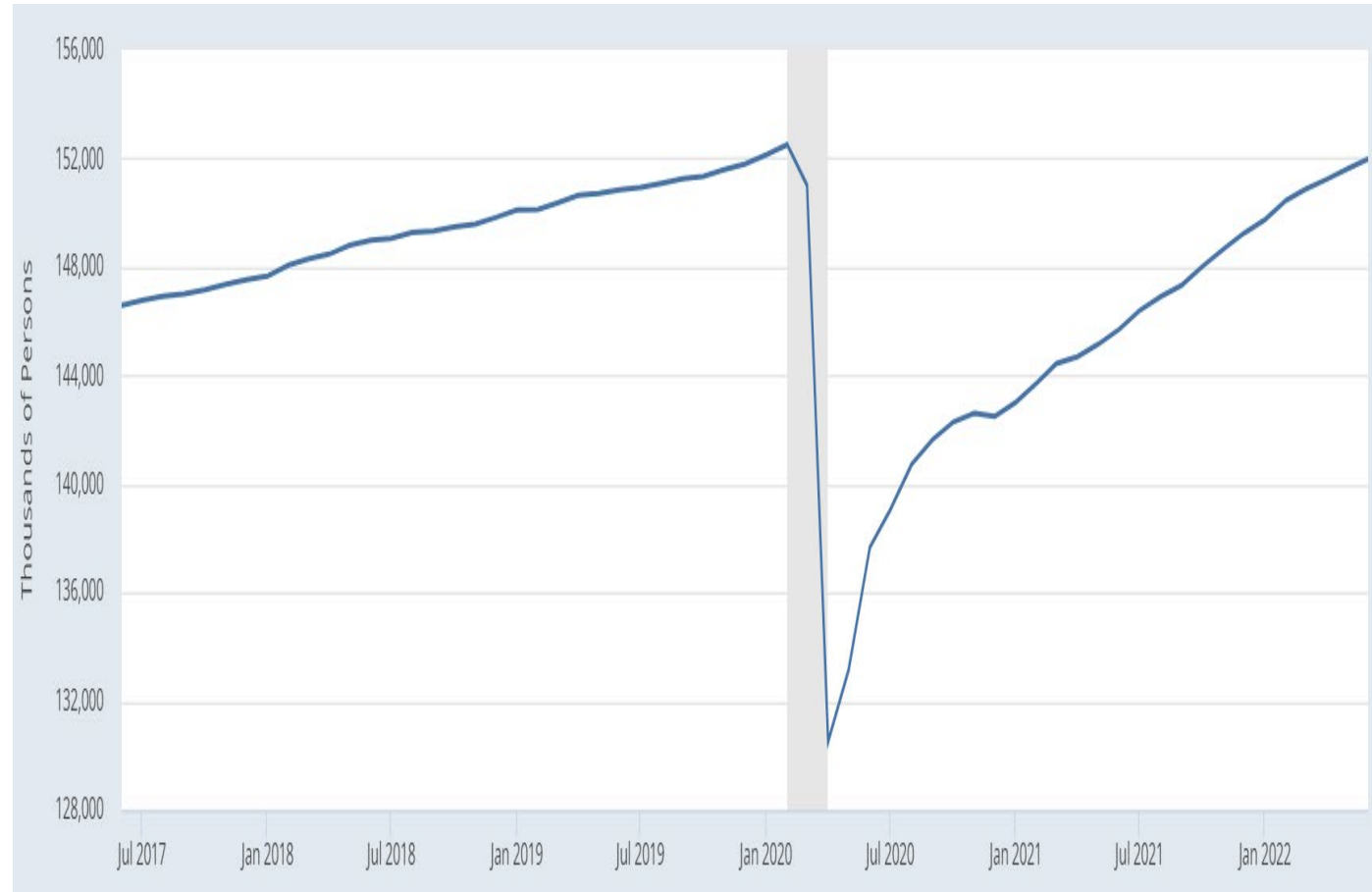


Source: Bureau of Economic Analysis & ChartR



The Labor Market Remains Strong!

- Typically, the jobs market slows if the economy is in recession...
- ...but not ALWAYS.
 - Example: Mid-70's
 - 8 months of jobs growth
- Initial Jobless Claims (monthly moving avg) at highest point in well over a year.
 - Up 79k (46%) since April

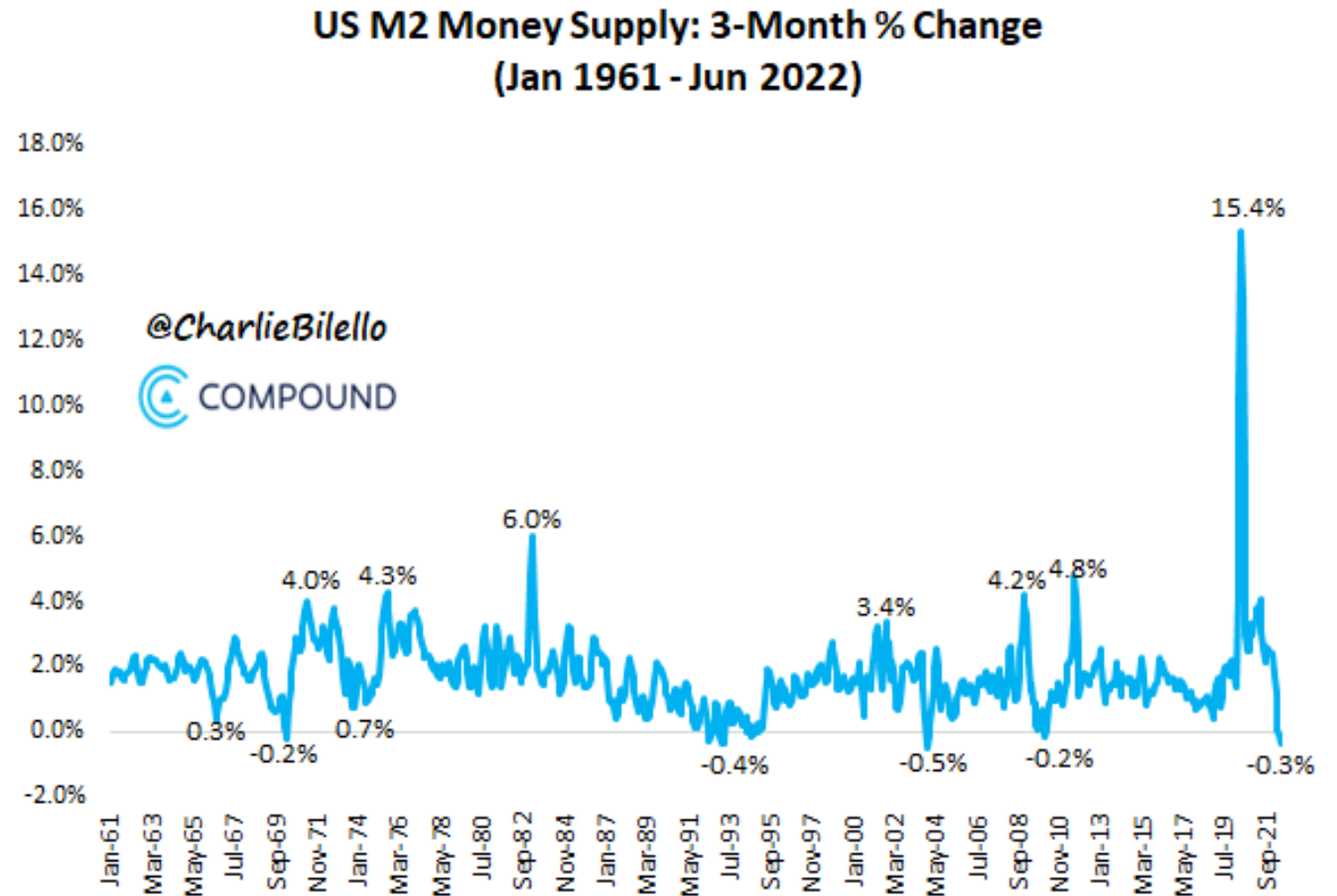


Source: St Louis Federal Reserve Bank. Data as of 7/31/2021



Years of Monetary Stimulus - Unwinding

- Federal Reserve's Balance Sheet is contracts (from all-time highs).
- The combination of monetary & fiscal stimulus distorted total money supply in 2020.
- The impact on “financial conditions” (much tighter) is already occurring.

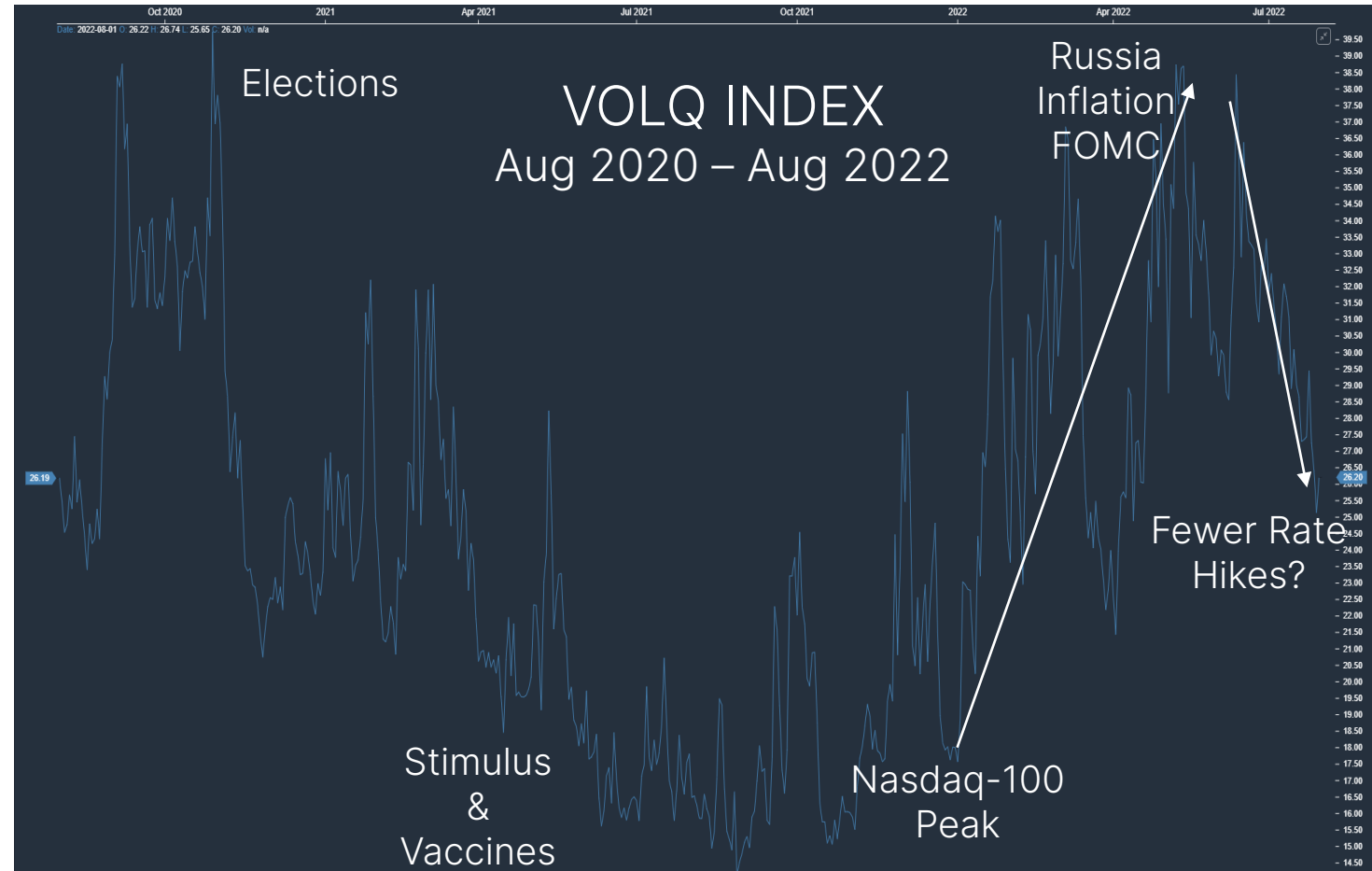


Source: Compound Advisors



Forward –Vol Measures Are High...but Declining

- Monetary policy likely muted forward vol measures in 2020/2021.
 - 2020 Avg VOLQ: 29.54
 - 2021 Avg VOLQ: 20.47
 - 2022 Avg YTD VOLQ: 29.61
- Vol measures have declined for most of summer.
- The “volatility regime” likely shifted higher as a result of the pandemic/lingering economic uncertainties.

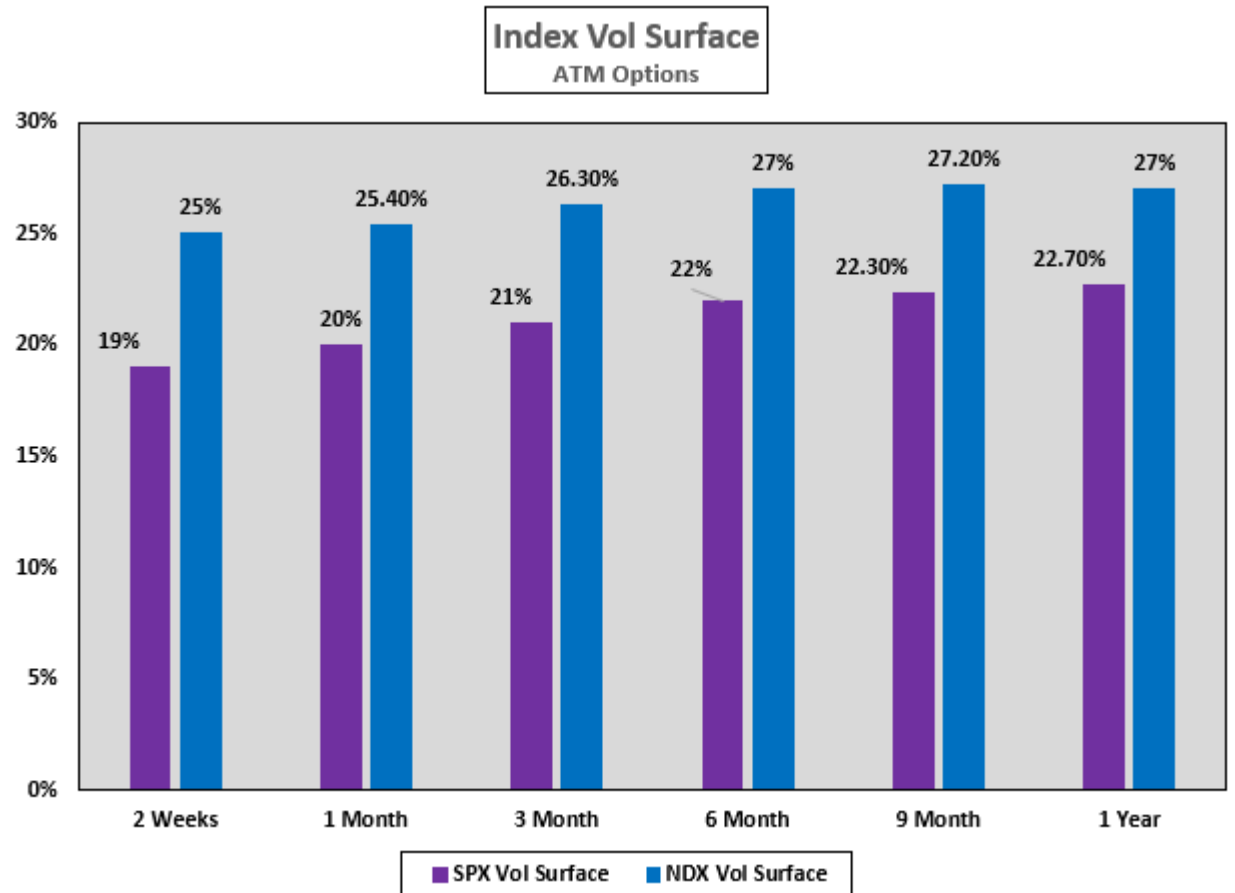


Source: LiveVol Pro



“Normal” Vol Surface with Higher “Base”

- The relationship between short-term ATM vols and longer-term vols typically slopes upward (contango).
- NDX ATM money vol is almost always > SPX ATM vols.
- Longer-term ATM vols are elevated relative to pre-pandemic “norms”



Source: LiveVol Pro

Questions?

Email:

indexoptions@nasdaq.com

VOLQ Overview:

<https://www.nasdaq.com/VOLQ>

VOLQ Futures Spec Sheet:

<https://www.cmegroup.com/education/files/volq-fact-card.pdf>

