Don't Take My Word for It (Digital Gamma Blog)

Shots Fired

Week ending Aug 30

	8/23/2022	8/23/2022
BTC	19729	21390
ETH	1517	1625
BTC Implied Yield (Qtly)	-3.50%	0.00%
ETH Implied Yield (Qtly)	-15.5%	-9%
BTC 1M Implied Vol	65	69
ETH 1M Implied Vol	105	105
BTC 7 Day Realized	50	72
BTC 1M 0.5 std dev skew	-6.85	-7.2
Implied 1 Std Dev Move	669	772
Avg Daily Move	520	639
Avg Daily Range	789	914

Chartbook Here — grab it first

Hi All,

Taiwan is under pressure: post-Pelosi provocations from China have produced a warning shot near a Chinese drone over their airspace. Powell delivered a similar warning from Jackson Hole to financial markets. It does appear that markets took it to heart. Perhaps surprisingly, these are two related events, or possibly more accurate, these represent two driving forces to which our trading ought to pay attention.

Zoltan Pozsar normally pays attention to things both arcane and near & dear to our Digital Gamma hearts: repo, financing, liquidity. This week, he turned toward geopolitics (hat tip to Ronnie Stoeferle whom I do not know but he published a good thread). He brings together themes discussed here before and puts it into a nice framework and easy to remember framework: re-arm, re-shore, re-stock, re-wire. The TLDR is that we are seeing regionalization, repatriation, and the primacy of security. A few weeks ago I posted the “Taiwan is Arrakis” (the source of chips via TSMC). The point is that the prior globalist order is breaking down — Pozsar channels Dale Copeland and suggests it is due to loss of trust. I disagree. I think it is that internal politics (offhandedly called populism although I suggest it is the vast majority of the population realizing that they have been sacrificed for years) is forcing the hand of foreign policy.

I write the above only because it is the new regime. The re-arm, re-shore, re-stock, re-wire is a demand driven economy and these are national priorities. Onshoring chip fabs, handling energy needs, and ensuring access to secure satellites are going to be done *no matter the cost*. Economies of scale will be sacrificed for stability. Robustness is trumping optimization. That’s inflation. And the Fed has announced that it will do *what it takes* to keep stable money. That means “satellites and chips for me, austerity for thee”. It is a world where real rates are, at least targeted to be, non-zero. That is an uphill battle for hard money, dollar inverses without yields like gold and bitcoin.

I could argue that it may also be the way that passive investing via index funds starts to decline in popularity as overall stock correlations move away from near 1 (risk on - risk off) and toward earnings & projections. But that, really, is a job for another substack.

Let’s Go! ETH Merge by the numbers:

Poloniex ETHW	$51
9/30 calendar implied ETHW price	$22
Sep-Dec Implied Forward Rate	-2.3%
Dec-Mar Implied Forward Rate	+1.5%
Next critical “date” (really hash level)	Approximately 9/6 Bellatrix upgrade

I wrote this yesterday and while some of it is not totally in line with market pricing, the ETH trading ranges of the past 24 hours enforce its point.

When I was growing up, one of my friend’s families had one of those folksy signs in their bathroom:

If your feet smell and your nose runs, you are built upside down.

I feel that way right now with my options pricing. I feel like my long delta from calls is a loser on the way up and that my delta against my puts is not enough. That's telling me that my model is wrong. I mean, I know it is wrong, because ya know, it's a model. I can deal with it by changing my model or changing my trading. As Euan Sinclair likes to say, I'd rather trade with a model where I know where it is wrong.

This "shortcoming" is also an opportunity. For a speculator, these out of the money calls are being hunted by market makers. But no matter what implied volatiltiy does, if ETH (or whatever the underlying) moves enough, the calls will perform. This is clearly far more easily accomplished for the shorter dates. Right now we have 9/2 coming up with the lowest implieds on the board yet the Labor Day holiday coming up. On the one hand, there are going to be a lot of BBQ in the US and that will likely keep much of late Friday and Saturday quiet-ish. On the other hand, the lack of liquidity with senior traders most likely not in the office for late sunday (Monday is also a "holiday") the potential for instability is definitely there. I feel 9/9 expiration at 8 vols above 9/2 is a sale that I'll be able to get back prior to Sunday. Plus in the meantime, you get positive gamma. And you will see me at the keyboard Sunday evening 😊

Note that current 9/2 is 89.5% and 9/9 is 94.1%. YMMV.

Things I'm reading:

- You have to knows flows. Foreign investors swapping debt for interest rate differentials held in place by active central banks. David Kotok teaching.
- How bad is it? It's so bad that … China sends ministers to "supervise" economic progress.

Tell me (how) I'm wrong (please)

Ari

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