MACRO HIVE

Macro Hive: Market Indicators That ALWAYS Work

(Thorsten Wegener, 16 May 2022)

It is not too difficult to call market lows, if you focus on the three, time-tested indicators below. They have nothing to do with macro analysis, fundamental number crunching, checking up on put/call ratios or even doing the opposite of what Jim Cramer does on CNBC.

You do not even have to be smart to read the signs. I had the pleasure to witness and experience these three stages repeatedly during my almost thirty-year career sitting in front of the screens, trying to get my mind around how markets work. So I came up with some phrases to describe them.

Stage 1: Meme-ageddon

Markets have started, at first slowly, to crumble from the silly levels the smart guys identified months ago, enabling them to be the first to get screwed while the bubbles kept inflating beyond reason, sense or logic. Volatility finally started to increase and now remains elevated. However, your smart friends are no longer short.

Suddenly Mr. Market seems to notice the news that had been in everybody's face for a while now. Earnings crunch, fraud, inflation, geopolitical crisis; pick any one of them. So, the market finally drops the tinted glasses of eternal bull runs and starts smelling the rat. And this time it will be a big one. But nobody knows yet – as always, forward looking but never sees it coming.

Let us follow the typical playbook for an imminent crisis.

A minor drawback enabling the optimists to buy the f***ing dip becomes a correction. This invites the short crowd for a last hurrah to eventually get their balls handed to them in the inevitable bear market rally. And suddenly, we have left the 10% correction territory and are in firm -20% bear market territory. Peter Schiff gets invited on TV again to tell everyone, 'I told you so'; in fairness, he did. Everybody now seems to have got the memo and starts getting bearish and seriously considers hedging. They never do.

Have we reached a bottom? In a time before the World Wide WebSphere enabled us to swap useless memes without time delay, you had to rely on the weekly nonfinancial broadsheets and magazines to decorate their covers with crashing charts, viciously roaring bears or explosive devices to get a first hint of whether a significant turning point was reached. Once the mainstream media noticed that something was afoot in financial markets, roughly two thirds of the disaster had already happened. When cycles used to last months or even years as opposed to today's shortened timeframes (equivalent to having a long lunch), this was a good first data point to raise attention and look out for subtle changes in market conditions.

Times have changed. Today, my first-stage indicator is the number of gloating messages and videos I receive on my phone by those who did not dare to become rich in the bubble and now feel vindicated for never having had the nerves or the guts to play the silly side. If your WhatsApp account messages have quadrupled in this market phase, we have most likely now entered the final stages of meltdown.

Stage 2: Three-Piece Suits

Everyone who has ever worked on a trading floor knows what I am going to mention next. In our/any bear market scenario, markets keep falling and/or are highly volatile. And while you are being busy keeping the risk in an acceptable one standard deviation risk corridor while sipping coffee, suddenly out of the corner of your eye, you spot a group of immaculately groomed gentlemen in three-piece suits roaming the trading floor: Board Members.

Driven by the size of their inbox memes, they suddenly develop the urge to visit the frontlines. They usually do this between market onslaughts. To become a board member, you must be smart, after all, and you intuitively know to avoid bothering a market-maker during rush hour with pointless questions while they are trying to defend your and their bonuses. Things could get ugly.

Why is this a good indication that we are closing in on a market bottom? There are, as always, two perspectives to the now unfolding circumstances. If you are a trader and your only line of defence is to maintain nerves of steel to navigate the choppy waters, you cannot afford to get distracted by the impending doom or hope of a well-diversified risk book. Most likely, your risk is highly concentrated. And if you do not protect the company's capital, you do not get paid – or worse, you get fired.

However, if you are senior management, you have a well-diversified portfolio of business lines reporting to and coining it for you. If one or two business lines suck, you will still be fine come bonus time. That is the magic of diversification. Only when the dreaded 'correlation one events' start materializing does a haze of nervousness transpire among the well-suited classes, urging them to visit the potential crime scene. This never happens at the beginning of a crisis. Now we have reached the last third of the circles of hell, but it is not over yet.

Stage 3: Scorched-Earth Orders

Your boss, who of course knows the worst is over, gathers the team after a high-level all-nighter with a very nervous board, which has now been briefed by risk management about the pending End of Times, to brief you and relay the orders to drastically reduce risk ('And don't dare to pull any stunts!'). As he is a good boss, he tries to sell it as his own idea to try a novelty approach to risk taking, namely being over-hedged. Where long carry and long volatility used to be bad words, a new, more humble approach to risk taking has arrived.

In the meantime, the memes and gifs in your inbox have changed tune because what just happened on your trading floor happens in all other trading floors all over the free world at the same time. Gloating has turned into self-pity and righteous indignation.

The three-piece suits are congratulating each other on having averted the worst by locking in the lows. They would probably not use my words.

For final confirmation of our working thesis, throw in a couple of late-run SEC investigations and bankruptcies. These events always occur after the crisis.

Now you know the worst onslaught is over. It might stay volatile for a while, but the crisis has run its course.

Bonus Stage: Bloodshed

After heavy losses, spiking volatility and senior management roaming the trading floors around the globe have irrefutably proven to you that the crash is a thing of the past, it would be nice to know what Mr. Market has in store for us for the foreseeable future. I witnessed this twice in my career. And even though this barely justifies the plural in ‘data points’, it can be seen as good anecdotal evidence that markets will play nicely again for some time to come, when the ‘downscaling’ starts.

This can be seen as the super-spreader event of procyclical dumbness, especially when German banks start releasing the teams they pinched at market peaks at ridiculous prices from their Anglo-Saxon competitors into the wild again. You can bet your mortgage money on plain sailing for many moons to come.

Just wait and watch out for these signals, do not jump in too fast, and you will have a very good chance to do some bottom fishing of your own.