PTJ is averaging Down….Kind Of

‘Losers Average Down’ a famous quote that is allegedly sitting on the desk of Paul Tudor Jones. Does this mean that PTJ has NEVER bought a stock at a lower price than his initial purchase?

No.

The key term is ‘Average Down’, buying a stock or an option to lower the average cost of the trade is a terrible reason to buy. It basically says “The stock is cheaper might as well buy.” My question would be:

If you buy manure for your garden and then manure goes on sale, do you buy some so that you average your overall cost?

No, because you are not going to be using it any time soon.

But what if you are a farmer? Then the answer is yes…because you know you will need it.

Averaging down is buying more manure you don’t need. Adding to a trade is like being a farmer.

If you like a stock and it drops and you still have a strong case to own, then you can add to a trade. Adding to a trade means I like the stock MORE, not might as well buy because it’s lower.

Adding to a trade means the base case and assumptions for WHY you bought the stock have not changed, only the price.

Averaging down means buying the stock because it’s cheaper…that is all.

The difference is subtle but important. Losers average down, Winners add to trades.

I have gotten many questions about my BA call. The base case has not changed, thus as it is dropping I intend to buy more. If I thought the MAX was a year away that might be a difference.

Typically, I do not like to add to a trade the day it drops, I like to wait a day or two to see if there are more shoes. I will be doing the same with BA, but can absolutely see myself adding to this trade.

If my base or assumptions change, not only will I NOT be averaging down, I will be taking a loss.

I used a LEAPS option trade on purpose, because I wanted time on my side, that is why I did NOT use a near dated option. I still like the call and it needs a few days.

Let’s talk markets:

The MARKET

THE SPX is sitting just off its all-time highs. We are down slightly as I write this on some mildly gloomy economic outlooks for the World Bank. That said, most of the time, the 'news of the day' really is not the news of the day. In the coming days we are going to hear all kinds of high falluting talk out of DAVOS. NONE of it really matters. Here is what I think is going to matter:

1. Earnings: THERE IS A TON of upbeat news priced into this market right now. AAPL has been incredibly strong over the last few weeks. There are now four companies worth a trillion dollars. This is all INFRONT of earnings.

If there is a near term risk to the All-time high in the S&P 500 its earnings, notably AAPL.

The market run up has been almost one directional; this is because of the other important factor:

2. FED Repo:

I find it concerning that the NY Fed is engaging in so much REPO. Recall repo is for banks to borrow short term cash while putting up long term collateral, like treasuries. I find it confusing that this is going on, while the banks just reported record profits in trading. Where is all this cash going?

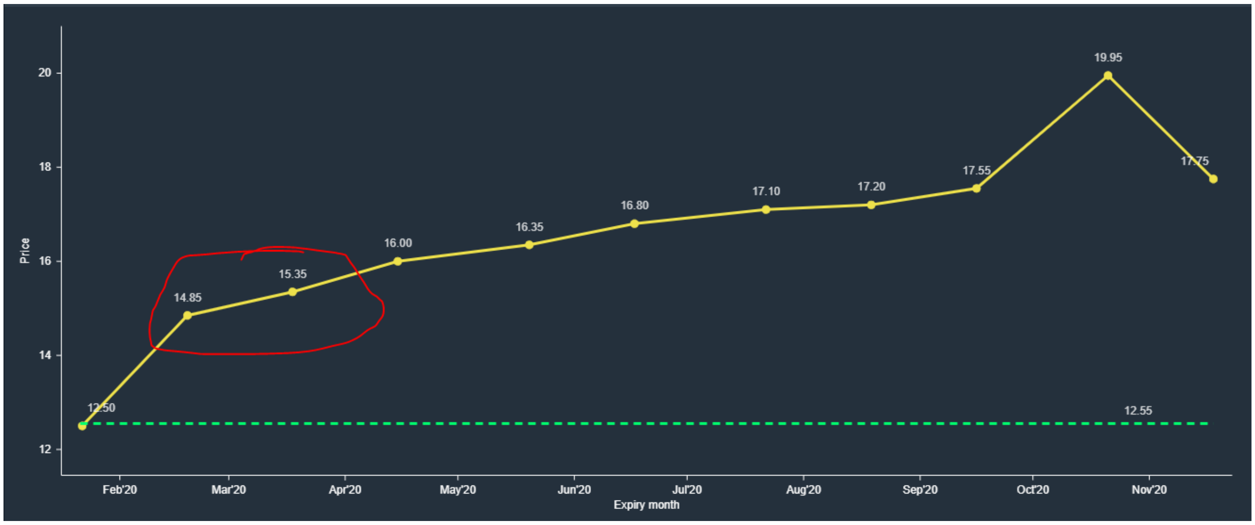
Listen to these three statements:

1. Citi is going to pay a .51 Dividend on the 31st.
2. Citi is buying back stock
3. Citi is borrowing short term operating cash in the REPO market.

In the short term, the conversion of long term debt into cash has moved dollars into the market. In the long term, one has to wonder what the effects of REPO are going to be.

Looking at the VIX, it is still only 12.55 and is lower adjusted for the weekend. A lot of talk has been conflated around the VIX. There was a VERY large buyer of the VIX Feb 22 calls....why?

The answer is now that the VIX is 12.55 and the FED is engaging in REPO the famed '50 cent' hedger is back buying cheap upside calls in VIX. This is being done against a credit portfolio. However, this activity has only added to the 'kink' in the VIX curve.



The kink was initially pushed by Ray Dalio and his hedging which was done in late 2019. The activity by this hedger has only added to the kink. As it stands, January VIX futures expire tomorrow. Feb is overpriced by about $.30 or so. March might actually be too cheap.

You may hear some noise about Super Tuesday as it relates to VIX, I think it is all earnings. That said, the CURVE is still saying UP, not down, and the VIX-SPX correlation we look at is also saying we go higher.

OPTION PIT TRAFFIC LIGHT:

SPX: GREEN

VIX: RED

SPX IV: RED

VIX IV (VVIX) GREEN

Bank earnings have been GREAT!!!!...

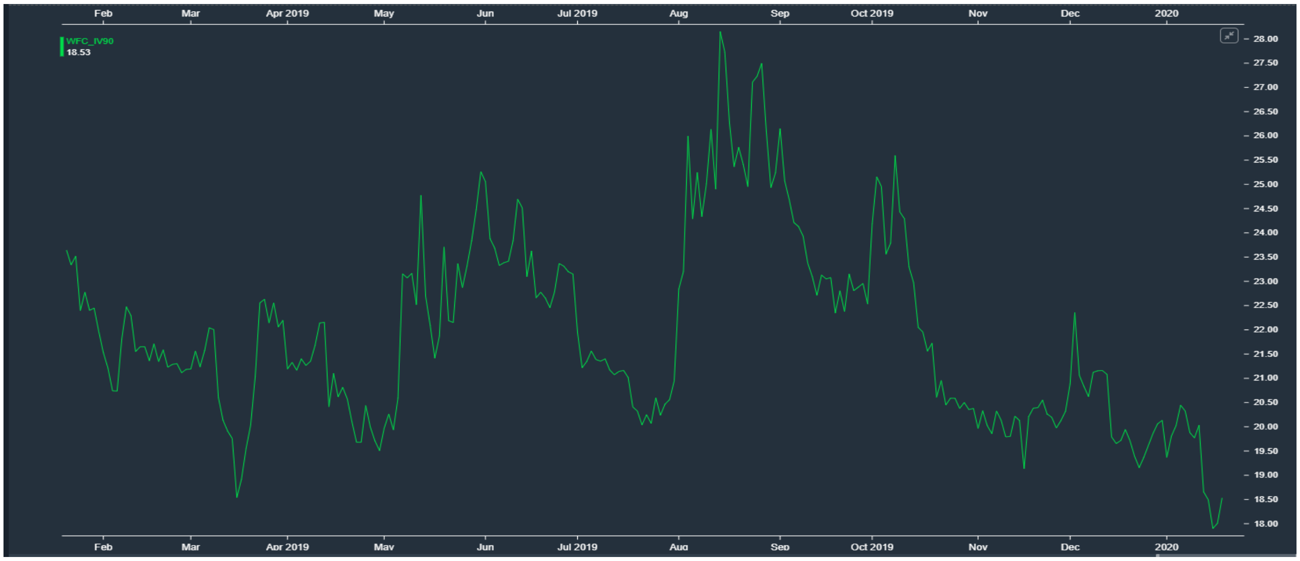
Except WFC. Wells Fargo continues to be mired in a host of problems produced by the PR nightmare that was the Fake Account Scandal from late 2016. That said there are a lot of reasons the stock is interesting both from a vol and fundamental perspective.

From a traditional perspective, the stock bounced of the 200 DMA (the grey line).

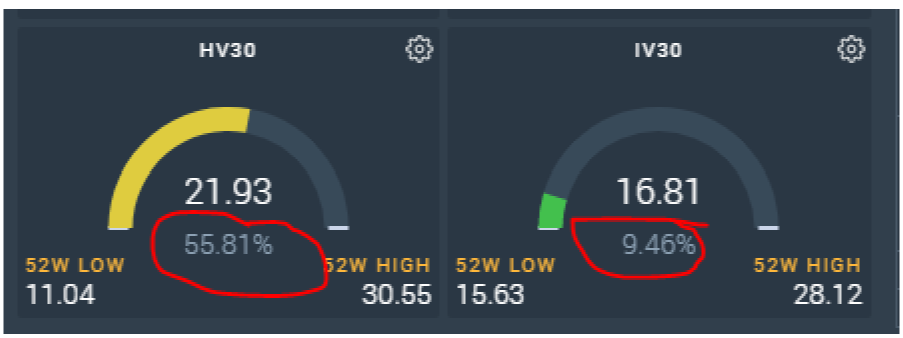
It also happens to have a dividend on Feb 6 that is going to be more than 1% of the value of the stock. The Dividend hawks are going to be all over this one as it moves. With rates at zero, who does not want a near 5% Div?

More importantly, I think this story of trouble for WFC has to come to an end at some point. As the banks go up, and make more money trading, WFC is going to participate. Looking at the Vol, I will say that the premium is WAY too cheap in these options.

90 Day IV in WFC is JUST off the lows for the year, which were set in on Friday.



With IV low I would lean toward buying options, the fact that HV (yes it does include earnings) is trading at such a big premium to IV as a percentile basis confirms this for me.



The option price relative to real movement confirms to me that I am an option buyer, the question now is when?

In addition Term structure is about as flat as it gets.

Options Chain

Jan24(W)	Jan31(W)	Feb07(W)	Feb14(W)	Feb21	Feb28(W)	Mar20	Apr17	Jun19	Jul17
18.04	16.43	18.94	17.40	16.61	16.36	17.71	18.55	19.06	19.27
4.50	2.00	1.40	0.90	-1.70	0.80	0.50	0.50	0.40	0.20

Going out all the way to July, the IV of the options does not get over 20. In the very near term it's less than 17. One could make a really strong case to buy Feb options, and I do think there is an easy case to be made to own the Feb28 calls for next to nothing. However, I do like longer dated options where I think I have a real chance to make money as WFC makes a run back to the 50 DMA.

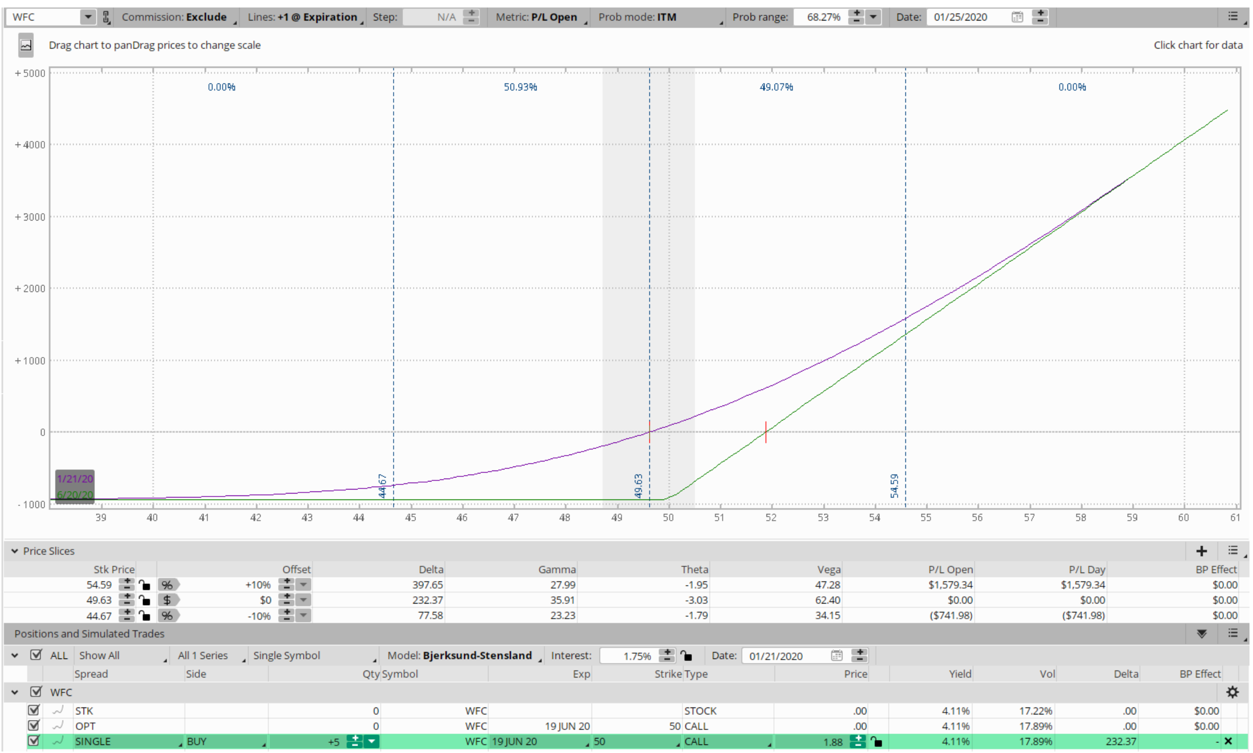
For those looking for a really short term $$$, look at the Feb28 49.5 calls for $.92. Just be aware of the Ex DIV, as if WFC makes a run these calls could get assigned. I would want to close a short term trade like this by 1-31-2020.

For me, with the IV this cheap across the board, I am going to go for a longer duration trade. I would buy the June 50 calls for $1.85-$1.90. If we are trying to spend about 1000 bucks a trade, this would have me buying 5 calls. I could reach and buy 6, but I actually want to keep some powder on the side lines because I have a couple of other banks I am watching.

Targets and Risk

I would be looking to sell my 1st calls at $2.50 or better which would be greater than a 30% win on these. With any luck, I'll get a gap, or be able to ride them up longer. On the downside, if these get to be worth less than $1.25, I am going to seriously think about closing.

Trade: I buy 5 WFC June 50 calls for $1.95



Your Only Option,

Mark Sebastian

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