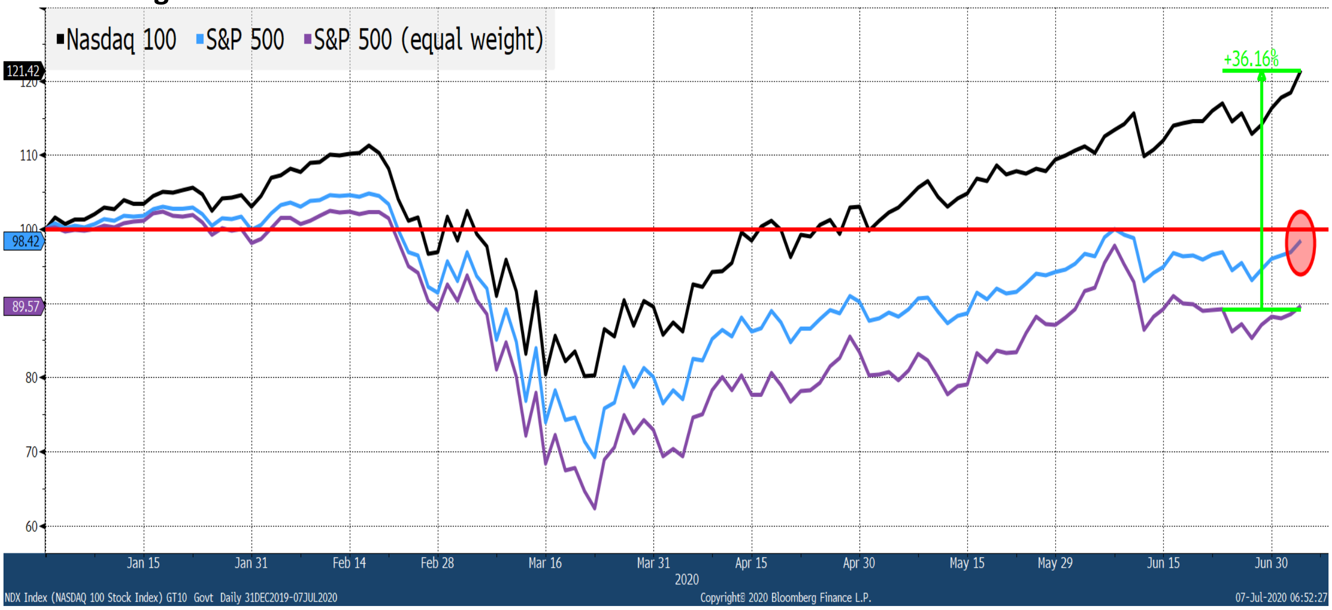
Fundamentals Do Matter

Before I lay out my thesis of price becoming "just" a number and why that might be occurring, I wanted to point out that much of what the market is pricing in is based on fundamentals. On the fundamental side, I'm mostly at odds with how certain the market is that we will get more stimulus without a hitch.

Stock Divergence is Extreme



The Nasdaq 100 is 36% higher than the S&P 500. Despite all the talk about how bullish the market has been, **the S&P 500 is below where it started the year and below its June 8th closing price.** I am not sure when the Nasdaq 100 became the only benchmark people cared about or were benchmarked to, but away from that index performance, it has been okay, but not great. It hasn't even been costly to be short for the month of June if you started with the S&P 500 around the 3,200 level.

But, I would argue that the divergence is driven by fundamentals. When you look at companies like Amazon that are driving the returns in the market, they are clear beneficiaries of a shift in how we purchase products. The recent rise makes sense in terms of COVID spikes and fears that the reopening is losing some momentum. On the other hand, $200 billion in market cap in a week is a pretty large surge (to put that in perspective, Pfizer is the 25th largest holding in SPY, an S&P 500 ETF, and it has a market cap of "only" $192 billion – basically what Amazon added in a week). **Tesla**, which isn't in the S&P 500, now has a market cap of $254 billion, up from $75 billion at the start of the year, and just passing Intel Corp.

At the other end of the spectrum, **Hertz** has returned back to earth and had to shelve its secondary issuance of shares (the first time I can remember a bankrupt company contemplating issuing shares).

When Price Becomes "Just" a Number

This brings me to my view that we may have entered a stage where price is "just" a number. This means we lose some focus on valuation and traders are just left chasing the last price. All that matters is where you bought it and where you sold it and the concept of value drops to the wayside.

It is a relatively rare occurrence.

I remember **back in 2000** trading credit default swaps and all the CDS traders were constantly pestering their convert arbitrage clients for good stock picks (the convert arb traders were big users of CDS, but at the time, they knew all the fun and exciting stocks). I remember it hitting a point where a bunch of us on the CDS desk made some very quick returns on a stock and went to thank the convert desk for the idea. They laughed at us, as we had bought the wrong ticker, but weirdly, at the time, the ticker mattered very little so long as it was something in the right space (i.e. "just" a number).

In early 2007, CDS just went tighter and steeper every day. There was no such thing as a good 'buy' of protection. Eventually the CDX trader who reported to me got stopped out. I think CDX was 28 and the 5s vs 10s curve was 30. It widened and then hit all-time lows in June as selling protection was remorseless. Of course, by the end of the summer it was 100 and the curve was inverted, but people selling protection (especially bears getting stopped out) didn't care about the risk reward, it had all just become a number.

There are some other times (European debt crisis as another example) where I have experienced this phenomenon where price seems to be "just" a number and I think we are starting to experience it.

What is the Driver?

We don't get to the point where price is "just" a number without a reason. **Greed is always a big part**, but it is usually **accompanied by some innovation**. In 2000, the internet itself was the innovation. In 2007 we had CPDO (Constant Proportion Default Obligations) and LSS (Leveraged Super Senior). Two of the worst products ever invented and rated, but that helped fuel the "just" a number trading.

I believe that the incredible rise in weekly option trading by new accounts is a driver.

We have seen:

- A record number of new accounts opening.
- Big increases in single stock option trading and weekly option trading.

The accounts (let's use Robinhood as an example) simply don't have enough cash to be causing the moves to occur by simple buying and selling stocks. To keep stocks rallying like they have, there would need to be huge inflows into those accounts week after week and for those funds to be invested in the same stocks. That just doesn't seem feasible.

On the other hand, let's assume that many of these investors are risking large portions of their account on weekly call options or short dated single stock options. When those pay off, they can reload their profits in new options. **Buy options. Make money. Buy more options the next week.**

That behavior is consistent with some volume activity we are seeing. It is consistent with put/call ratios. It also might explain why early in the week seems so strong (buyers of options) while the end of the week has struggled in comparison (taking profits on those options). It would also explain why such a relatively small pile of cash could move markets using options as leverage.

It would explain the "just" a number concept as well, as the option sellers wind up buying delta to offset their losing gamma positions.

This is all slightly weird, but I think it is a bigger driver than many believe and relatively few are talking about it. This leads to the question of "when does it end?"

I am not sure when it ends, but from experience, when the "just" a number trading ends, it ends

abruptly and painfully.

Bottom Line

Still bearish S&P 500, target 2,800. Main concern is that the market is too confident D.C. won't let us down, or at least not stumble enough to let us down.

Slightly bearish credit, as it remains a very crowded trade and even my mother knows the SMCCF is buying bonds and that is usually a pretty strong signal.

The Fed has not instituted yield curve control, but with the 10-year treasury closing at 0.66, 0.68, 0.67, 0.67, 0.68, and 0.68 respectively, it is hard to get too excited in either direction.

Be cautious here.

Disclaimer