Twitter Thread by Harel Jacobson



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My take on YOLO short squeeze and volatility..

I guess much has been said/written/memed about the most recent r/WSB YOLO short squeeze, and tbh have nothing really smart to add... but i'm puzzled by the pro-investment community reaction to this (namely HFs, bank sales desks

and prop traders)...

While squeezing traders position has long been a guilty pleasure of the Hedge Fund community (and few aggressive banks, with questionable motives to skew prices), everybody seem to be shocked that retail traders do that, and running a decent risk management

scheme...

My best recollection of a brutal position squeeze was the $12bn JPM lost on CDX spread (aka, the London Whale)

https://t.co/bDHAL2UwpX

Back in these days the entire market knew that JP's trader was, in fact, the entire position in the illiquid index (off-the-run)

so almost every credit trader that I knew traded against that position... Now, that's perfectly legal right? it's not crossing any legal boundaries of price manipulation, so why is it ok for pro traders to do that but it becomes shocking when your neighbor's kid does that?

and the CDX example is only one of a handful of examples of skewed position that got squeezed hard, the only difference is the orderbook distribution...

While in "normal" markets orderbook distribution oscillates between normal to slightly skewed, in the YOLO case I think that

orderbook is anything but "normal" (perhaps somewhere between lognormal to pareto distribution, of not Log-Cauchy distribution), so this is where things get really interesting imo - The volatility

If you trade options on YOLO stocks you DON'T trade vol, you trade hype...

volatility (in B-S world) implies :
1. some kind of continuous distribution
2. ability to dynamically hedge your delta exposure continuously

If your favorite YOLO stock don't hold these conditions, the implied vol is just a derivative of your MM risk tolerance...

especially when you buy 1-week 2dte call

Lastly, it seems like that as RH favorites loose their appeal (see $TSLA, $GLD, $AAPL) their vol drops significantly, so the only smart idea I have at the moment is to try and detect when they stop playing with their flavor of the week

and move on...

This could go on and on until something changes in the risk environment (or any other geopolitical event happens).

Trade safely