Title: The Law Of Unintended Consequences pt. 2
Author: disoriented_llama
Created 2022-10-20 18:38:52 UTC
Permalink: /r/TheGloryHodl/comments/y967h4/the_law_of_unintended_consequences_pt_2/
Url: /r/FWFBThinkTank/comments/y95eac/the_law_of_unintended_consequences_pt_2/

Linked Post Content:
Good Afternoon,

https://preview.redd.it/2pp2c1bsjzu91.png?width=1600&format;=png&auto;=webp&s;=35d960ae5d92b6b5c8cd471f6b744f01d9b35845

Repositioning?

The impact of ETF trading on baskets of stocks is well documented, though I would like to dive into some recent re-positioning by major ETF's that may have contributed to much of the extended tight range sideways trading in GME. First, I want to go over a few potential misconceptions with ETFs, the difference between closed-end funds and open ended funds (XRT) and how traders and market makers (Authorized Participant's) interact with them.

Liquidity:

Market participant's continue to search for liquidity on GME. As many of us would speculate it's due to the further deceasing of the float size being closely held. There is also another alternative to consider.. I think it's no secret that institutional traders engage in arbitrage on the underlying security (GME) and constituent ETFs. Research shows that an increase in statistical arbitrage increases the illiquidity of underlying assets. ETFs could distort the pricing efficiency of underlying securities, because market makers in individual securities learn from ETF prices, which include idiosyncratic information of other securities. In addition, ETFs can attract short-horizon uninformed traders, which increases the non-fundamental price volatility of the underlying stocks.

Arbitrage: In the case that the share price of an ETF exceeds the Net Asset Value (NAV) of the fund a trader could purchase the securities that make up the index the ETF tracks. At the same time the trader would also sell short the ETF share. This action would lower the ETF price and raise the NAV, pushing the two prices back into alignment. At the close of business the trader would then redeem the basket of securities with the ETF sponsor and they would issue a new ETF share. In the case there would be the “creation” of an additional ETF share. This process can work in the reverse, however, as the ETF sponsor would “destroy” an ETF share in order to return to the trader a basket of securities used to represent the index tracked by the ETF. For the ETF sponsor, who takes a small fee for redeeming shares, this is a zero-sum game. There are two important facts about this process. First, only those deemed an “Authorized Participant” (AP) could redeem shares with the ETF sponsor. APs are usually large market making firms. Second, these transactions typically involve a minimum of number of units to be redeemed at one time, for most ETFs this number is 50,000 units. With the possibility that ETF funds are being rebalanced throughout the day and that these redemptions are done in such large numbers, is likely that ETFs can have some impact on the market as a whole

[ ](https://preview.redd.it/gkdhc51pozu91.png?width=1037&format;=png&auto;=webp&s;=fe665d244bb4cb0ab749112db57cac42d45f1096)

Arbitrage Continued:

Arbitrageurs create and redeem ETF shares in exchange for pre-specified baskets of constituent securities. Each ETF establishes contractual relationships with a set of trading firms, known as Authorized Participants (APs), specifying the process for creating and redeeming ETF shares. But, any interested arbitrageur, like broker/dealers or trading firms, can place creation and redemption orders through APs, so in our analysis we consider that these creation and redemption orders are placed by generic arbitrageurs, as opposed to solely by APs. Some aspects of this process are common across ETFs. For instance, ETFs are required, before each trading day, to make available a portfolio composition file that describes the makeup of the creation and redemption baskets during the trading day. So, the composition of the creation and redemption baskets is known in advance to arbitrageurs By contrast, other aspects of the creation and redemption process are ETF specific. For example, when most constituent securities are eligible to settle through National Securities Clearing Corporation (NSCC), creations and redemptions are settled through NSCC, who acts as the central counterparty. Alternatively, creation and redemption orders can be settled directly between APs and ETFs, in which case APs may be required to pledge collateral while the order is being settled.

https://preview.redd.it/b1e3kbompzu91.png?width=551&format;=png&auto;=webp&s;=fcd2f9bf73fc454bcf434235f8e7d35b36467e91

https://preview.redd.it/tiv92yirpzu91.png?width=571&format;=png&auto;=webp&s;=5ada26773a165cf908cff34ddef00f5cbd5e997f

Futures or ETF's: Costs & Considerations?

https://preview.redd.it/z4jhz4dyrzu91.png?width=931&format;=png&auto;=webp&s;=71a03eb393657be43eaacd550e330378fe296307

Current Cost of using Futures or Index to hedge (Consumer Discretionary Futures)

[https:\/\/www.cmegroup.com\/tools-information\/quikstrike\/big-picture-tca-tool.html](https://preview.redd.it/azk7dgcdrzu91.png?width=1083&format;=png&auto;=webp&s;=1fb195a53ef97797db82c037650ae9df77e70047)

In-Kind Exchange: Securities or Cash

https://preview.redd.it/rhoreb8nszu91.png?width=831&format;=png&auto;=webp&s;=edb459eaf038697fa242f70a99be0d574161d469

https://preview.redd.it/x6hiurhzszu91.png?width=876&format;=png&auto;=webp&s;=d1f5a6b58d230e99cc3a408367c80243828053fa

Liquidity Continued: As I had stated before as markets continue to become more illiquid so do the underlying securities within ETFs as arbitrage trading creates a feedback loop. This potentially can explain one of the reasons for the extremely low volume on GME.

https://preview.redd.it/vjvzi762uzu91.png?width=1003&format;=png&auto;=webp&s;=dd015c0f44b78f9375378b80df831fa87f8fc6e5

https://preview.redd.it/x2ihnr89uzu91.png?width=1003&format;=png&auto;=webp&s;=d4da03c5c594512a

1eff356106e577699432f113

Observable Borrow Rate: Fintel Data

Obviously this borrow rate is likely not what institutional traders are paying to borrow these ETFs, but it does give us a look into why or when high borrow rates started occurring. Check out StockSera or IBKR for their history. This was accounted last month so borrows and GME shares have changed. Overall the average borrow rate in ETFs was 6%.

https://preview.redd.it/2xceqs90vzu91.png?width=1129&format;=png&auto;=webp&s;=17264db80907dfae1db78c6f2d569b929ad792f1

https://preview.redd.it/wykat452vzu91.png?width=1183&format;=png&auto;=webp&s;=33442155bb50cadc3d1bbcc9605c0e71bc4ca859

Options Open Interest Data: ETFs

Red Line: ETF Put Open Interest

Yellow Line: ETF Call Open Interest

Bars & Orange Line: GME Price Action

XRT:

[ ](https://preview.redd.it/2xtc8bn3xzu91.png?width=2715&format;=png&auto;=webp&s;=88c125fd7d83a3b8312f19f08cb7aae3961c7c1e)

IJH:

https://preview.redd.it/kvwz7557xzu91.png?width=2698&format;=png&auto;=webp&s;=f7d669b51bbd64305fdc0abeecf646734ad1ac47

VTI:

https://preview.redd.it/sl9o9vohxzu91.png?width=2709&format;=png&auto;=webp&s;=c829cf658751c78ddd9e545185f5eeb68a333196

**There are many others that also depict strong repositioning of hedges mostly the unwinding of put open interest. PM if you would like to see more data.

Address to the sub:

It seems since opening the sub to commenting we've obviously seen an uptick in comments & posts, which participation is great to see folks discussing the markets. We decided that in order to not become overrun with low quality posts, users that singularly subscribe to a mantra & are not open to discussion, and an outright bot farming trap we would conduct somewhat of a test. Now, yes you've seen some "edgy" posts about DRS or options to open real discussion, but also to simply test to community's ability to have depth in their conversations & continuously be open to new ideas. We have established who're bots, identified specific users and will clean the sub. Opening the sub was a decision made collectively and we knew some issues would arise with that. The DD is NEVER done. Markets are constantly evolving. If we've learned anything in this saga it's that there is no one single answer to the markets or cornering your opponent. As gamers or traders it's natural to look for the game bosses weak points and exploit them. As we continue on, we must be open to learn as we've had almost 2 years of consumption of all things financial data. Markets are not without risk some traders have different risk appetites' than others and that is okay! No one single trading strategy is like the other. Things we can diametrically agree on is that buying of stock via IEX or DRS can have an impact on stocks as it hits the lit exchange. Options can increasingly also have an effect on the stock with leverage as you enter into a contract with a market maker.

****A few parting memes**

Testing 1..2

https://preview.redd.it/ce3ovv8320v91.png?width=857&format;=png&auto;=webp&s;=0db7d1f4af7e0918a422020b4c5484808c1d0c16

You know the phrases: Insert here

https://preview.redd.it/fuowq38m10v91.png?width=500&format;=png&auto;=webp&s;=29e1dfe769bb2000508258714a93839e8f89603f

Anti DRS Shill Options Pushers!: Well Actually..

[Yea I was first on posting about DRS.](https://preview.redd.it/9ino0ep430v91.png?width=1222&format;=png&auto;=webp&s;=485338afdcad91fbf8c6673924e876cb77fac7ac)

Sources of the full articles from the screenshots above

[**https://www.kauffman.org/wp-content/uploads/2019/12/etfsandthepresentdangertocapitalformation.pdf**](https://www.kauffman.org/wp-content/uploads/2019/12/etfsandthepresentdangertocapitalformation.pdf)

[**https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3281384**](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3281384)

https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=6314&context;=lkcsb_research

https://www.willkie.com/-/media/files/publications/2019/10/sec_adopts_rule_modernizing_etf_regulation.pdf

https://www.ici.org/doc-server/pdf%3Appr_17_etf_listing_standards.pdf

https://www.cmegroup.com/trading/equity-index/report-a-cost-comparison-of-futures-and-etfs.html