S&P 500 Weekly Forecast 1/5

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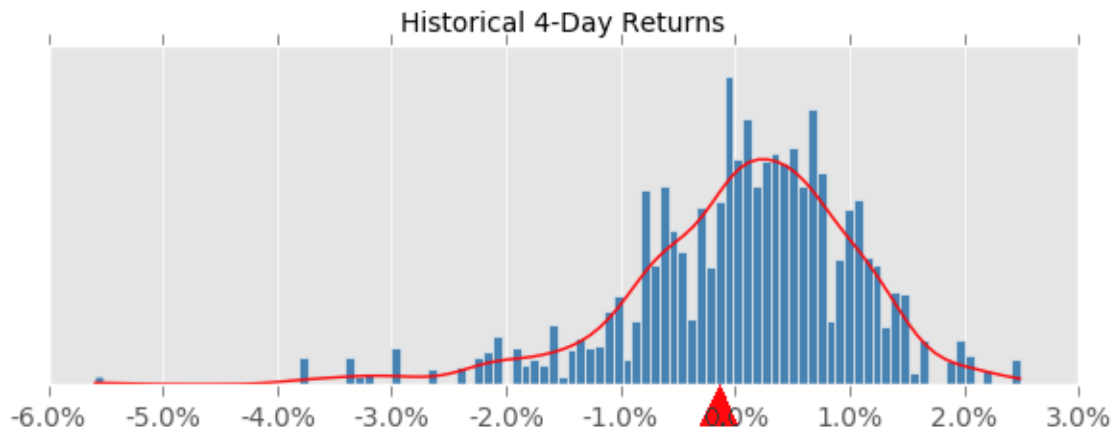
Hey guys,

Naturally, we have to start off the new year with a brief reflection -- a ten-thousand foot view. So humor us for a few paragraphs.

Seeing the market through the lens of GEX is interesting. It's interesting because it tells us more about the future of S&P 500 prices than any other metric, and because it has an immediate and tangible effect on price paths. It's interesting because its implications are often at odds with the market's option prices and volatility expectations, and that gives us an edge.

But in light of this past week, what may be *most* interesting is how it has the power to reshape the perception of risk phenomena, broadly, including geopolitical risk. In other words, if *you* were to look at Friday's price-action, you'd probably shrug. It looks like any other day in a high-GEX market (inexplicable, small gap down is bought due to GEX floor). But when many others -- traders and politicos alike -- view Friday *without* reference to GEX, they will assume that the market places little weight on U.S. escalation with Iran, which was the flavor of the day. After all, the week ended down just **0.1%**, moving well within a 1% band for all four days. And Friday's trading was *calm,* too.

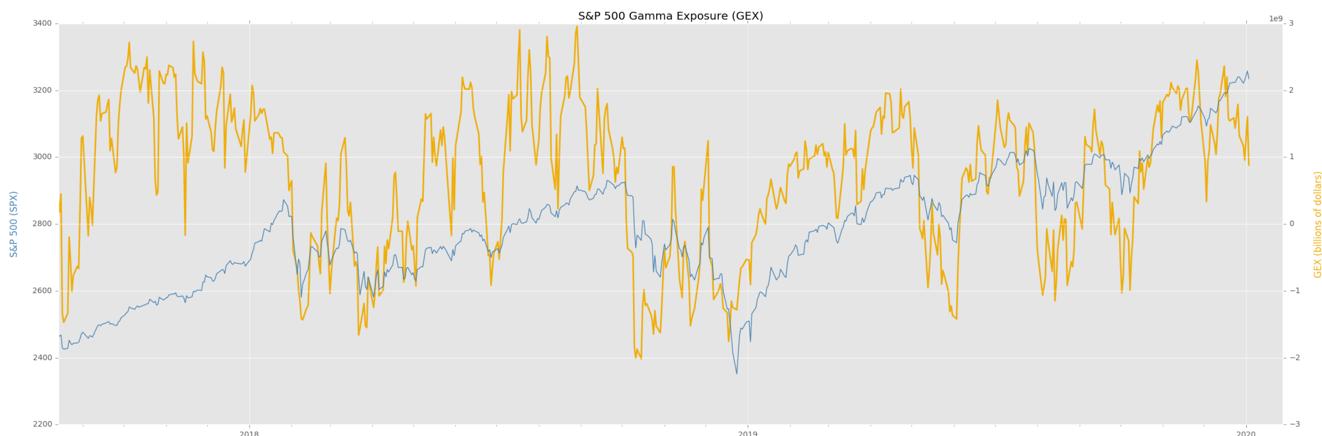
Yet, had GEX been sitting just above *zero* when the U.S. military went about its, um, unusual assassination of Iran's top brass, we know that there would have been a gap down and then a follow-through. Probably a 1.5% loss or more on the day. And this would have given people the feedback-looping impression that this really *was* a scary, DEFCON 3 scenario -- because for whatever predetermined reason, the S&P 500 and the VIX are considered important barometers of Western prosperity and geopolitical risk at any given time. Anecdotally, you may have noticed that The Donald touts the indices almost exclusively as his yardstick of success.



For this reason, the fact that GEX is very often *the proximate reason* for movement (or lack thereof) in the S&P 500, is really fascinating. Because it means that a humble matter of equity market plumbing is indirectly shaping the opinions of everyone, about everything, all the time. Put differently, if "in the short term, markets are a voting machine" (*a la* Munger), then our votes are definitely getting tampered with by GEX, and sometimes that's going to have interesting consequences. Cool, right?

Now before we start going off on a tangent about low-volatility feedback and the future inevitability of excess kurtosis in returns distributions and the inadequacy of current option pricing mechanisms and the inappropriateness of current broad market volatility measures and, and, and other stuff like that, let's... take a breath, and come back to Earth.

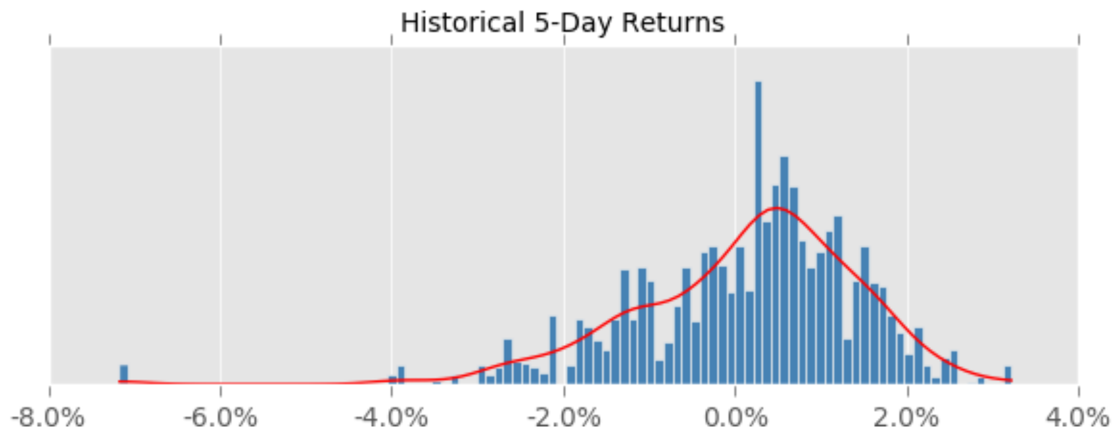
GEX has been falling. Bit by bit.



Over the last couple weeks, SPX GEX has moved from above $2bn to below $1bn. As of Friday at the close, it was $883mm. Since we tend to use $1bn as a casual demarcation of "high" GEX, we're always interested in a movement below $1bn, because it means that volatility potential has risen.

And that rise in volatility potential is reflected in the forecasted distribution of returns below. If we were to point out a specific *part* of the distribution to pay attention to, it's the space from -1% to -2%. See how meaty that left shoulder is in the distribution below? Now compare that to last weekend's distribution, and forecasts from weeks prior.

At below $1bn, the GEX floor isn't strong enough to make those moderate losses super unlikely, as it does when GEX is high. And so, compared to what we've been dealing with in the past couple months, the distribution of returns below isn't all that friendly.



In numbers, this 5-day distribution has a mean return of **0.12%**, a median of **0.31%**, and a standard deviation of **1.32%**. In the language of volatility, that's a 1-week vol of **9.4%** (last weekend was 7.98%). Further out, we project a 1-month vol of **9.26%**. Since this distribution of returns is a bit broader, and has that big chunk of potential ~1.5% losses, our strategy has to change a bit. Sure, VIX is still in the 14s, and that's objectively too high, but we can't necessarily do what we were doing when GEX was >$1bn.

For the SPX/SPY option traders, this all means that the ITM put sale just isn't nearly as appealing as before. Take a look at the vertical skew charts on the attached PDF, specifically the 5 DTE chart in the middle. Sure, puts are still broadly overpriced. But when you look more closely, you'll see that GEX prices an ATM put at just above 8%, whereas the market prices it just above 10%. When we're selling puts, we're usually enjoying a much better edge than that (often, we'll be selling for 10% what we believe is worth 5%, which is a lot of edge). So while selling puts is a still a decent bet, much smaller sizing is definitely in order this week.

For the long SVXY / short VXX crowd, you should still be in the trade (VIX is still quite a bit above GXV, which is now 9.24), but it's time to be a bit more watchful. Zero GEX is somewhere around 3175, and that's not all that far away anymore. So stay alert and ready to sell or hedge your position if GXV ultimately rises above VIX.

A reminder, since we're not talking all bullish like we have been for months now -- DIX is still indicating that there's strength under the market. So if we had to guess, that 1.5% loss in the shoulder of the distribution is possible, but the far left tail probably isn't going to come up. As much as people like to compare them, this current rally is nothing like January of 2018.

Fresh Picks
The 71 (+23) low-GEX picks have a mean 20-day projected return of **1.34%** and a standard deviation of **7.09%**. The 26 (+4) high-GEX picks have a mean 20-day projected return of **1.16%** and a standard deviation of **7.04%**. Snippets of charts are attached, as always. Much like last weekend, we're not in love with any of these, but let's try anyway.

Lockheed Martin (LMT) has been having an interesting time as a result of the last few days of "Yay, war!" Its GEX, after a powerful momentum rally, is now 132k. Compared to average daily volume of ~1mm, that's quite a bit (13% of daily volume would be pushing against the prevailing motion in the event of any +/-1% move). But we have to bear in mind that volume may be staying a bit higher than 1mm shares for a few days, and that other weird stuff may happen. But still, it's an interesting possible opportunity to bet against volatility with something like a butterfly spread. During the rally, 30-day IVs rose into the low 20s from a modest 17%. With GEX fairly high and IVs high as well, a fixed-risk short vol spread seems appropriate (fixed-risk because there's too many unknown unknowns!).

That's the high GEX highlight. As for a low-GEX highlight we weren't too inspired. **Bristol-Myers Squibb** (BMY) had a sudden dip in GEX, and may be worth buying a long vol position of some kind, but it doesn't really tickle our fancy. **JP Morgan** (JPM) had a similar phenomenon, but it's not a big deal. If you run across something more interesting, let us know!

Whether 2020 is ultimately more or less volatile than 2019, here's to staying ahead of the curve!

The SqueezeMetrics Team

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