S&P 500 Weekly Forecast 1/20

From: SqueezeMetrics <info@sqzme.co>
To: SqueezeMetrics <info@sqzme.co>
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Hey guys,

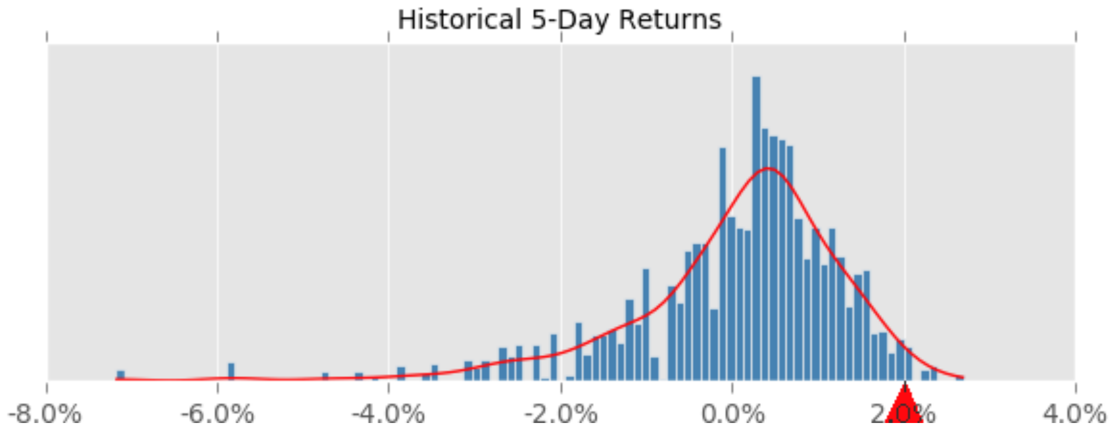
Gamma Week did not fail to disappoint. Monday, Tuesday, and Wednesday were a textbook example of high GEX, no frills. Thursday and Friday, though, with their gap-ups and ramps into the close, were examples of why high GEX can be a bit scary -- at least for some people. Just like the action in January of 2018, this was a modern example of a short squeeze.

If you don't recall: January of 2018 was when the S&P 500 went up in a straight line, before plopping down in February and ruining the hopes and dreams of anyone who was caught short volatility. Why did this happen? Because of GEX, of course! As the market moved higher toward sold call strikes (higher GEX), the investors who sold those calls were compelled to roll them up and out to reduce their newfound gamma risk. When you roll your overwritten calls, though, you force an option dealer into buying back the difference in deltas between the option you bought back and the new one you're selling. This causes a true short squeeze. In this case, in the largest equity index in the world.

This squeezy action, with investors rolling their sold calls, brought the index to a **2%** gain -- an unusual outcome. We were implicitly betting on the index reaching 3300 when we suggested a 1-week straddle or iron fly centered on the 3300 strike last weekend.

> If you take a look at the vertical skew charts at the bottom of the attached PDF, you'll see that the 5 DTE options encourage us to sell a straddle above the market. E.g., we could sell a call and put around 3300. According to the plot, both call and put are overpriced by the market (the put, specifically, is priced around 9% IV, even though we believe it's *really* worth more like 6.5%). What we'd prefer to do is to turn that straddle into an iron fly or something like that [...]

This was betting on a 1% gain, but not more. The index, it seems, had a different plan.

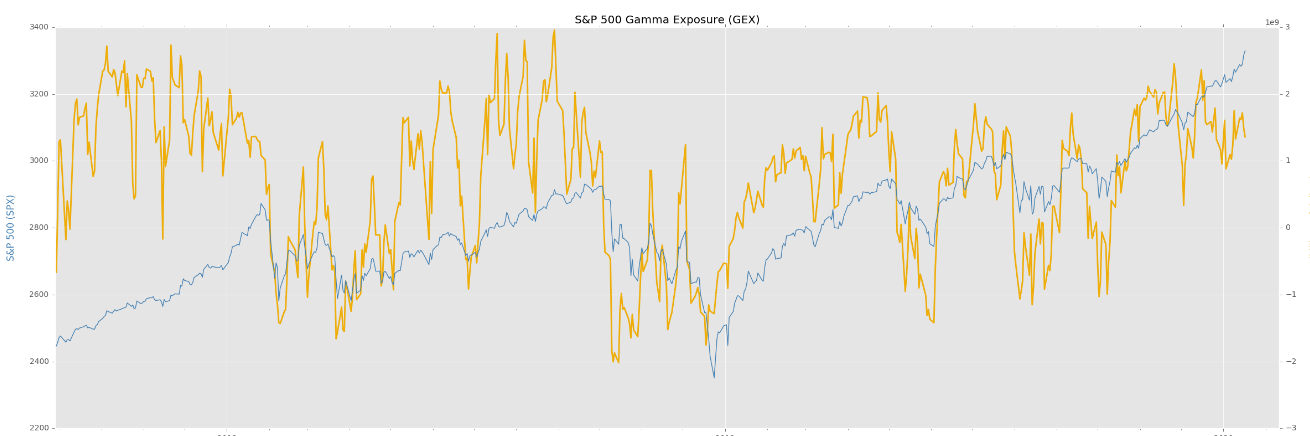


And so where this gets extra interesting is in the fact that those two days of squeezing brought us even closer to new sold call strikes, raising GEX once again. If you recall, our Thursday afternoon note predicted, *ceteris paribus*, that GEX would be just below $1bn over the weekend.

> Specifically, with SPX trading around 3300, we expect GEX to fall to **$956mm** by Friday's close as the SPXAMs and Friday SPXWs both expire.

But the *ceteris* were not *paribus*, and due purely to the price action bringing SPX to 3330, GEX stayed well above $1bn. Indeed, if you take a look at the "GEX by S&P 500" plot on the attached PDF, you'll see that even now, if SPX were to fall to 3300, GEX would be just below $1bn, as predicted.

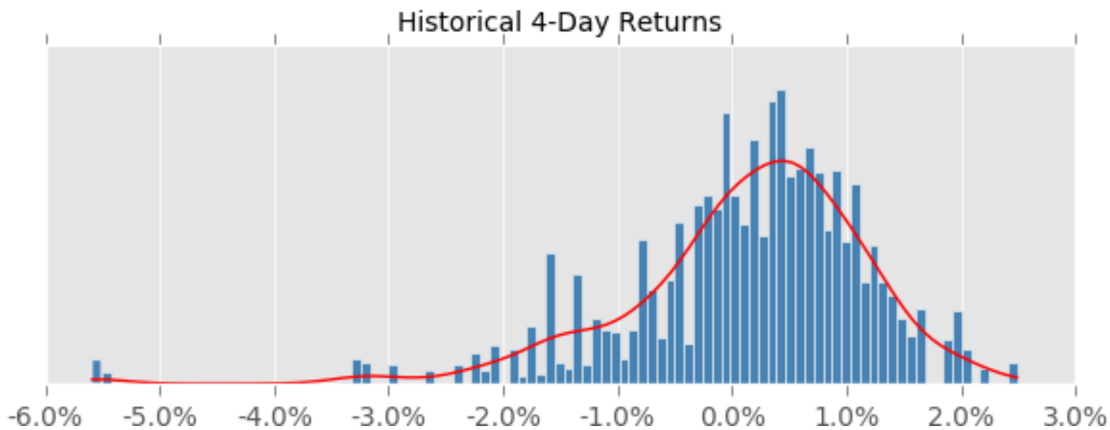
Right now, GEX stands at $1.36bn. This is still "high GEX." But boy, it sure feels like it's trending down, doesn't it? Although intraday GEX has been able to touch $2bn recently, the index hasn't been able to *close* that high in several weeks.



In fact, if you take a peek at the GEX plot on the attached PDF again, you'll see that GEX, right now, is as high as it can *possibly* go unless new calls are originated or implied volatilities drop even more (and is that likely?). The potential for GEX to reach $2bn is gone, and that means that the GEX floor can't get back the strength it's experienced in the last quarter. Not even *if* SPX keeps rising from here.

And when we combine that with the fact that Thursday and Friday's action were ostensibly a squeeze, we have to finally get a *tad* skeptical about the future, and about the potential for the index to continue its diagonal mission to the stars.

With that said, remember that GEX is still high, and that DIX is supportive of prices not far below where we are right now. Yes, it might be time to slow down. No, there will be no Volpocalypse. The distribution below still tells us of mostly calm and mildly bullish things. We just think that we should start tempering the most bullish of those expectations.



In numbers, this 4-day distribution has a mean return of **0.12%**, a median of **0.29%**, and a standard deviation of **1.07%**. In vol terms, that's a 1-week vol of **8.49%**. Further out, on a 1-month timeframe, we extrapolate it to **8.93%**. Meanwhile VIX continues to price in a premium, though it barely holds the 12 handle. Not a whole *lot* of premium.

According to the vertical skew charts on the PDF, there is still a tenuous edge in selling ITM puts as we've been doing for what feels like forever now. We say "tenuous" because the closing prices of SPX options were weird. Note that the market IVs of puts were uniformly *much* higher than calls, suggesting that there was a lot of demand for puts into the end of the day, and/or a finicky unwillingness to quote them. So it's kind of tough to tell what prices the market is willing to offer you right now. If you can indeed sell any near-term ITM puts for 8% IV or higher, then it may be worth a shot. Otherwise, we'd stand back and wait for more data.

The same caution goes for the long SVXY / short VXX crowd. Yes, VIX is higher than GXV, and yes, you should stick to the plan. But it's time for a bit of caution. The next few weeks promise to have a *bit* more danger under the surface. It's been a riot to be long SVXY in the last quarter, but it can't go on forever.

Fresh Picks

The 93 low-GEX picks have a mean 20-day projected return of **1.30%** and a standard deviation of **7.91%**. The 13 high-GEX picks have a mean 20-day projected return of **1.42%** and a standard deviation of **7.37%**. Snippets of charts are attached, as always. Now that Gamma Week has passed, it's slim pickings. The best trade in this scenario is to look for a stock that's been riding high on high-GEX, but recently had all of that gamma disappear, opening up potential, and unexpected, downside.

The only stock that fits this bill is **Booking Holdings** (BKNG). Its GEX was recently >200k, which is easily more than *half* of daily volume. This kept things pretty tight. And now, after Friday, GEX is close to zero. Options, meanwhile, haven't gotten any more expensive. Worth a shot? We think so -- how about a tiny OTM put position?

But that's all we got. Hopefully you enjoyed Gamma Week. Now stay safe out there!

The SqueezeMetrics Team

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