S&P 500 Weekly Forecast 2/2

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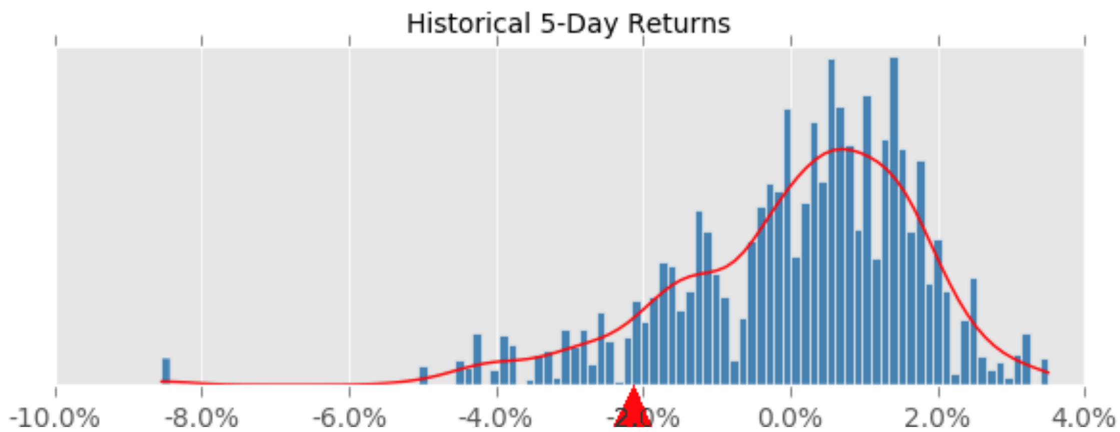
Hey everyone,

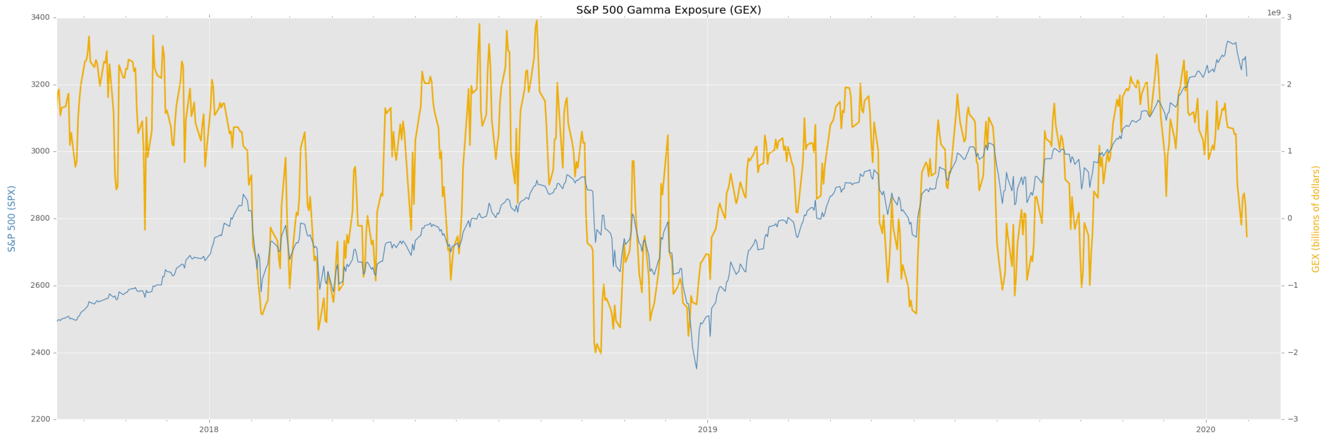
Last weekend, we noted that -- with the GEX floor finally weakened -- some risk was finally present:

> Even if you don't want to think in terms of the extreme tails, it's notable that the probability of a ~1.75% weekly loss is reasonably high. This has *not* been the case for a very long time. In other words, this distribution actually has *some* risk. Fancy that.

That risk *did indeed* manifest itself in a **2.1%** loss for the index, a reasonably high-probability "left shoulder" event.



But, as is so often the case, the event itself wasn't as interesting as where that event has left us in GEX terms. And in GEX terms, that -2.1% event left us with a negative SPX GEX (-$267mm) *for the first time since mid-October.* That was last year! We were so young...



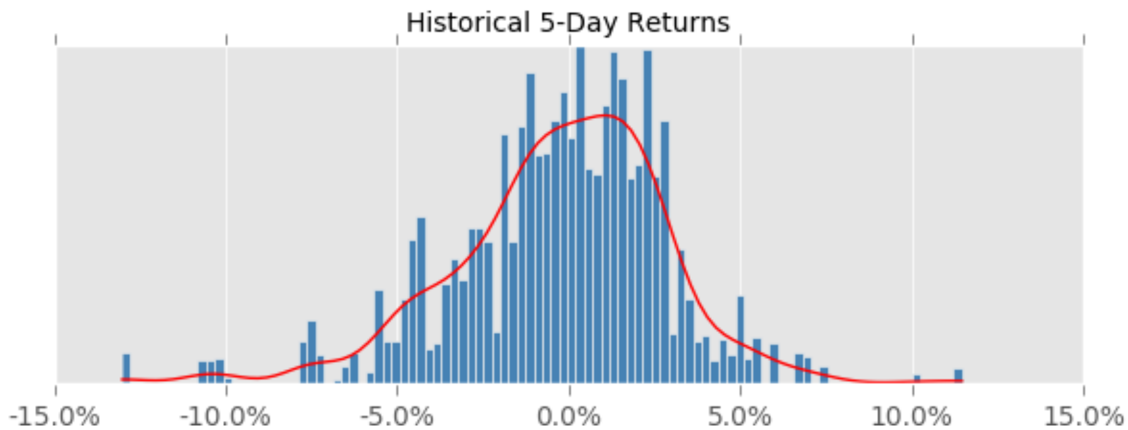
GEX near zero always warrants our attention. GEX near zero is where the market changes gears, and where the volatility-of-volatility is highest. GEX near zero is where the market can move so quickly that your tactical outlook is stale by mid-afternoon. And perhaps most tantalizing, it's where anything could happen, or *nothing* could happen.

If there's one thing that fascinates us most about zero GEX, though, is that it's where excess kurtosis goes to die *(Nerd Note alert!).*

So, by now you recall that we often make a big deal about kurtosis -- how the essence of the high-GEX trade is that it brings about an extremely leptokurtic distribution of returns (super-peaky, with a long left tail). It's leptokurtic because it's hard for price to move far away from spot, although if price does *break free from dealer hedging, it can fall far and fast. But around zero GEX, all of that excess kurtosis is gone. Nothing holds the index back from moving up or down 2%. Indeed, if you look at the distribution below, you'll see that the raw data implies that a 2.5% weekly gain is just as likely as a 2% loss -- both of which have the same probability as landing at 0.0%. That's crazy.*

The word for a flat-topped distribution is "platykurtic." And while the below may not truly qualify as platykurtic to a statistician, for S&P 500 returns it has a veritable pancake-top.

So, in other words, it looks like we should expect 2% gains or losses to be quite the norm this week.



In numbers, the above 5-day distribution has a mean return of **-0.26%**, a median of **0.08%**, and a standard deviation of **3.10%**. In vol terms, that's a 1-week volatility of **22.03%**. Further out, volatility remains elevated, with a **19.45%** 1-month forecast.

Two things to unpack, then on to strategy:

1. Yes, mean returns are negative at this level of GEX. If a long/short SPX strategy ran on GEX data alone, that strategy would be neutral, or modestly short (though since we still see recent strength in DIX, we have trouble believing that the 10% left tail is plausible).

2. 1-day (GXV1D), 1-week (GXV1W), and 1-month (GXV1M) volatility are *all* above VIX (which is 19) right now. Look at the time skew of GXV at the top of the attached PDF to see what we mean. This means that VIX is underpriced, and whenever VIX is underpriced, the market is susceptible to shocks. Since the underpricing isn't truly dramatic (on 2/2/18, GXV was 24.92 and VIX was 17.31, which *is* dramatic), we don't expect any real vol shocks, but you certainly don't want to be "short vol" either.

Ok, so now what do we do with this?

The long SVXY / short VXX crowd should already be out of the trade or totally hedged, and staying away until GXV1D gets back below VIX. Whether you're executing on this on a close-to-close basis or an intraday basis, that's the rule.

The SPX/SPY option crowd, meanwhile, needs to get tactical, so let's consult the vertical skew charts at the bottom of the attached PDF. Look at the 5 DTE (middle) plot. Whenever the bold red lines are higher than the bold green lines, that means GEX is telling us the mean return is negative (i.e., puts are all-around worth more than calls). It's not common to get bearish signals from GEX, so if you're interested in the novelty and you want to partake, consider a bear put spread on the weekly timeframe. Strike the long leg ITM and the short leg OTM, and if we get a further decline, take profit.

Alternately, note that ITM calls at 5 DTE are rather overpriced (all with IV in the 20s, relative to sub-20 implieds coming from GXV). This is thanks to how expensive OTM puts have become (put-call parity demands that they be priced at the same IV, regardless of whether there's any demand for ITM calls). So sell an ITM call and delta-hedge it to tweak the delta exposure to what you really want. Maybe add a long OTM call (or several) to this as a hedge, and to lighten up the delta-hedging need.

In any case, the platykurtic distribution above is telling us to be short skew (the market is greatly exaggerating the probability of near-term left-skew), and maybe a bit short delta, too. Even if you end up wrong about being short delta, you can make up for it by being right about skew. Questions? Let us know.

Fresh Picks
The 119 (wow!) low-GEX picks have a mean 20-day projected return of **1.99%** and a standard deviation of **7.29%**. The 6 (eek!) high-GEX picks have a mean 20-day projected return of **1.23%** and a standard deviation of **5.80%**. Snippets of charts are attached, as always.

First off, we don't expect to find any good high-GEX highlights right now. The one big name with relatively high GEX is **Amazon** (AMZN). If AMZN had high IVs, we'd say it could be good to sell options. It does not have high IVs -- it's IVs are in line with historical IVs for the current level of GEX. So, that's not very interesting.

As for a low-GEX highlight, well, you have your pick of the litter. But we find **Emerson Electric** (EMR), at a glance, the most intellectually interesting. EMR spent December and January in a tight, GEX-induced range, all while dark pools hinted at steady selling beneath the surface. It was a good setup for a short, post-January-expiry, and that classic pattern indeed played itself out. But now, after a rapid expansion in realized volatility and an overdue nosedive, GEX is around zero and the nearest IVs are high, owing to earnings on deck. All of this adds up to a very rich hunting ground for a creative option trader. We can imagine time

spreads, diagonals, and other such complex structures; but we'll probably just buy an OTM call on the monthly expiration, which has much lower IVs. Because we're basic like that.

Enjoy the carnival atmosphere of the coming week!

The SqueezeMetrics Team

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