

S&P 500 Weekly Forecast 5/10

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Hey everyone,

Shorter note for once.

It was another calm, positive, and gappy week. Peak bearish indignation finally seems to have given way to bullish resignation -- which is perhaps characterized best by VIX closing the week with a 27 handle.

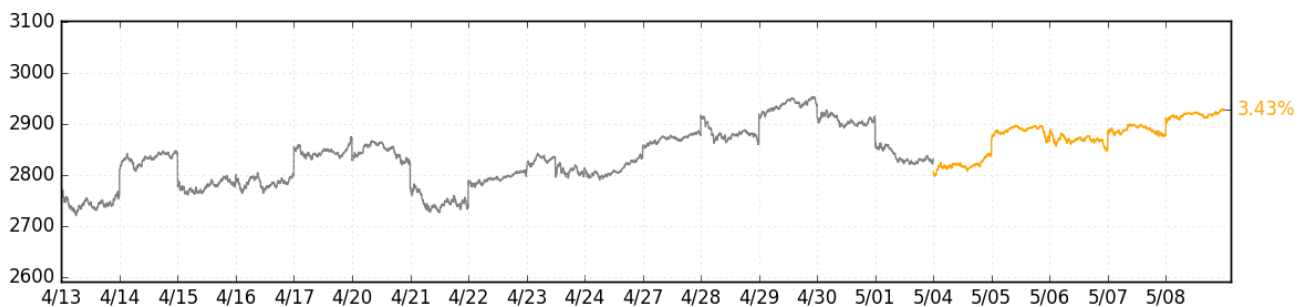
From our point of view, VIX ought to have been in the 20s for quite a while now -- but that's not how things work. Incidentally, we expect that the edge we've had over the past month will begin to decay even faster (near-term vols have already come down a lot). It was more fun when VIX was 40 and we thought it should be 20.

Anyway...

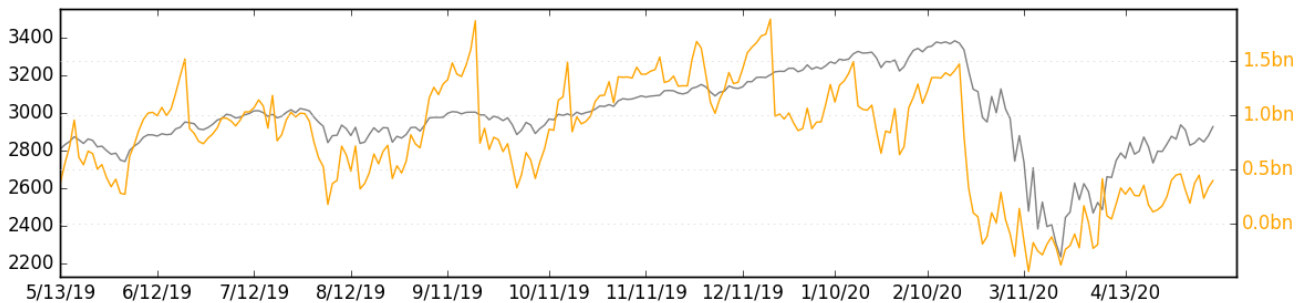
1. Past
2. Future
3. Present

Past

This last week was pretty much everything you thought it would be. There were tight intraday ranges, there were overnight gaps, and there was a tendency toward mean-reversion. Sadly, that mean-reverting tendency didn't come to the rescue of our iron flies this time, though -- upward drift dominated.



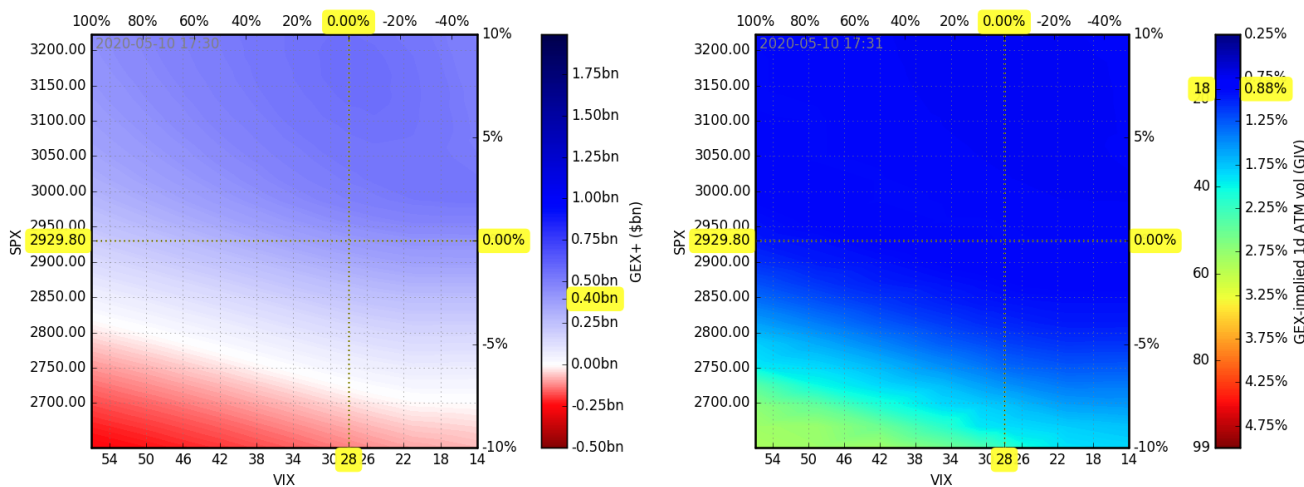
But hey, that's what happens when liquidity is abundant. Volatility falls and the index does what it's supposed to do: Go up! But don't be fooled -- this isn't a high-GEX market (in case you forgot what that's like), and it doesn't look like it will become one any time soon. See where GEX+ ended the week? A mere \$400mm. The market's going up... but GEX+ isn't.



Future

What's even more interesting than our \$400mm GEX+ is what the heatmaps below are implying. You see, we've been talking about downside for so long that we've ignored "upside risks." And in a way, the upside risks are actually *more* interesting than the downside risks right now.

First, examine the map on the left. Sure, the red zone is far away. We knew that already -- there's no crash risk. But look at how *weak* the blue liquidity zone is (and has been). That faint blue means that, in the event of a 7.5% rally in the S&P 500, GEX+ would still be *only* \$500mm or so. To translate that into volatility, look at the map on the right. At a glance, it looks like GEX-implied average daily moves can't get any lower than 0.75% (15 vol).



That suggests to us that we're stuck firmly in a moderate volatility regime, where IVs/VIX will be unable to fall below 15. (This may sound trivial, but it's not. The market is not, *per se*, "rational" enough to keep VIX above 15 in a global crisis. Only option positioning determines that.)

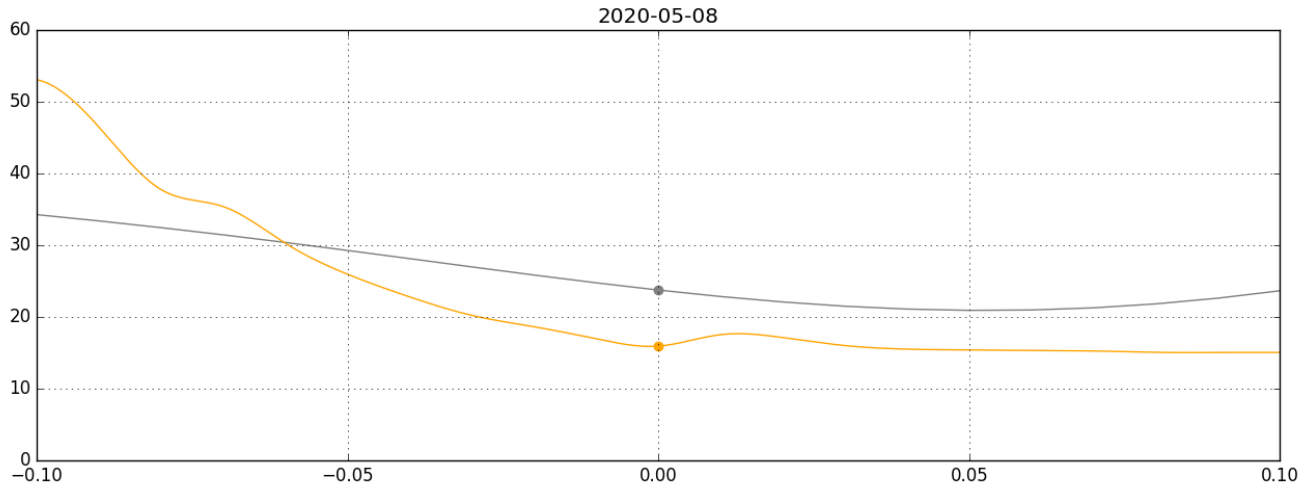
With weekly ATM SPX vols around 22-23%, the iron fly feels like it's finally no longer the right thing to do. So what is? We're leaning toward betting on a repeat of this past week: A slight upside bias. So maybe a weekly bull call vertical. Or how about a risk-reversal? Selling skew has been a great trade for a few weeks running -- we've only chosen the iron flies since they were meatier. And now that they're not so meaty anymore, the risk-reversal looks nifty.

In any case, don't buy puts. There has never been a worse time to buy puts than these last five weeks. Don't worry, we'll get there again, just not now.

(Oh, also, expect less-dramatic overnight gapping this week. Vol is down, so dealers won't feel quite as intensely the need to let overnights run.)

Present

We've been wrapped up in less-fun things in the past week, mostly staring at these skews.



The one above is from Friday, and it's a super-safe skew. Compare it to some historical skews that we've been looking at [\(here\)](#). Yeah, stare at that for a while. One of the biggest risk factors appears to be a steep sloping GEX-derived (orange) skew between 0% and -5%. This is intuitive, since it means that there's an immediate risk of skyrocketing vol.

We'll have some probability densities to show you next weekend. Hopefully that starts making some things come together.

Enjoy another breezy week.

The SqueezeMetrics Team
