S&P 500 Weekly Forecast 5/31

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Hey guys,

It's been around two months now that we've been able to watch, in real-time, the way the market responds to GEX+, all while trying to place what's going on right now in the historical context of the last 15 years.

That investigation has so far found lots of similarities between now and 2008: The customer net short put positioning, the high degree of crash risk, and then after the crash, the relative calm brought about by benign option positioning. And now, with historic unemployment rates, lockdowns, and looming bankruptcies (and now, anarchists burning stuff across the country), the S&P 500 looks us all right in the eye and says, "liquidity is all that matters."

And to the extent that liquidity is impacted by "events," those events do matter, and will indeed be weighed by VIX and SPX. But still, there will be few events that matter more than a trillion dollars in swap lines from the Fed, or billions of dollars in guaranteed intraday SPX liquidity from positive dealer gamma and vanna exposures. We've had a number of conversations recently where a portfolio manager expresses that all they want to know anymore is (1) what the Fed will do next, and (2) where SPX option dealers have long or short gamma.

There's a continuum of opinions on this: From "well that's cynical," to "well that's obvious." Regardless, we think we have our eyeballs on the right stuff right now, and hopefully you agree.

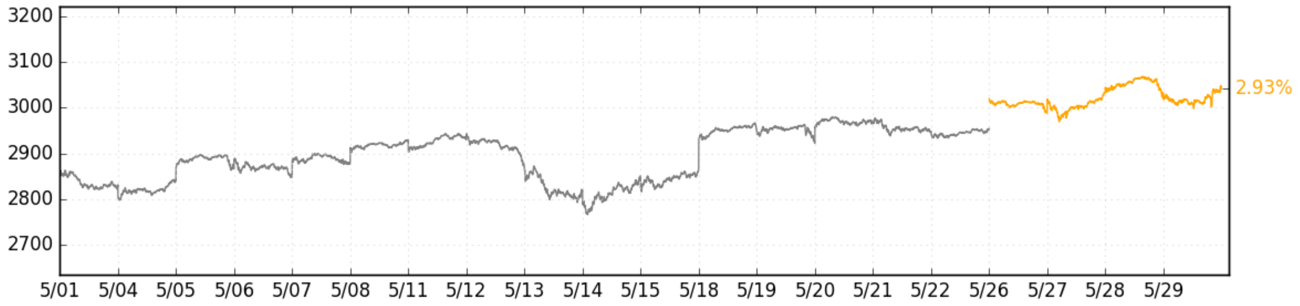
Somewhat tangentially: One aspect of the last couple months that we've neglected to comment on in these notes is the Dark Index (DIX). We don't say a lot about it because there's not much to say that the white paper hasn't said already. But with the highest DIX print in history on Friday, we think it's worth a few words.

But first...

1. The last four days
2. The next five days
3. The next three months

The last four days
Rather than saying the same thing again, we're just going to quote ourselves from last weekend:

> The setup for this coming week is pretty darn similar to last week, and there's no reason to believe that the patterns of the last 1.5 months won't continue to repeat: A 0-3% weekly move, one or more significant overnight gaps, mean-reversion, etc.

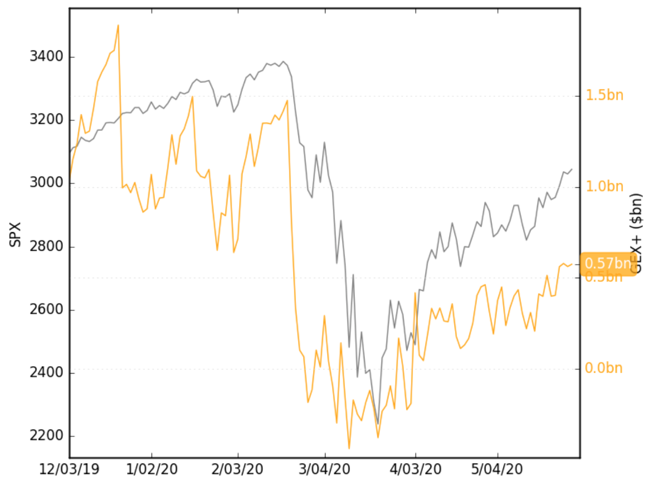


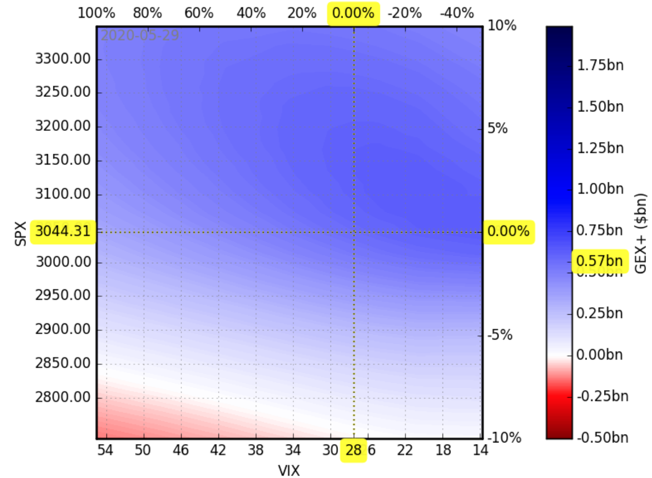
The average close-to-close return in the last four days was 0.85%. VIX at 28 implies average close-to-close moves of 1.40%. VIX remains overpriced, as it has predictably been. Short volatility, in its many forms, continues to perform reasonably well. Nothing new.

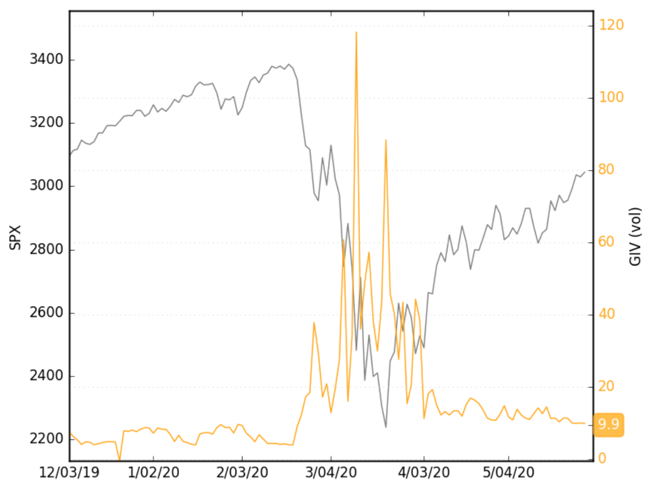
The next five days

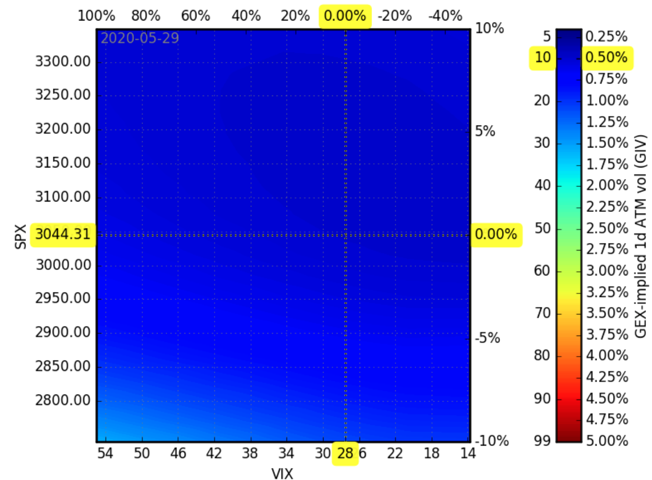
You can probably guess that not much has changed in the last week. Our prediction that GEX+ would be unlikely to top $500mm this past week seems to have been misguided, as call overwriters continue to do what they do best. The effect of dealer long calls have become more and more apparent. GEX+ is now $570mm.

Below, you'll find a slightly different orientation of the same data. In the first row, we see that GEX+ is higher than it's been in months, and also pretty far away from zero; and in the second row, we see how this translates to gamma-implied vol (GIV), which promises to remain tame.



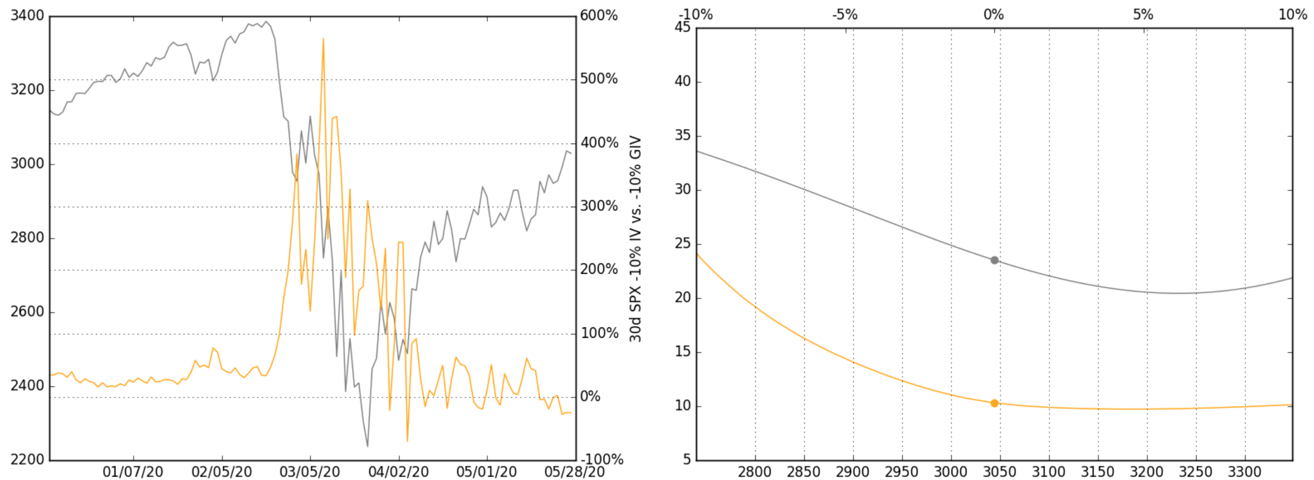






So keep doing whatever you're doing. Long SPX is as safe as it was two months ago, if not safer (though that's more a function of crash risk than anything else). VIX continues to be overpriced, as do near-term vols. We're still proponents of the iron fly here, but you do you.

Also, speaking of crash risk, on the left is the data we showed you last weekend (-10% GIV versus the -10% SPX 30d IV), and on the right is the current GIV and IV skew. Obviously, there is no crash risk here -- at all.



Sorry if that's not exciting enough for you.

The next three months

Since not much new is going on, let's talk about DIX for a moment. On March 27th, after a couple days of really high prints, we finally thought the market was likely to have some serious support. It came right after the Fed essentially pledged its support of market-makers via the opening of enormous swap lines and, by bidding on junk bond ETFs, threatened those who would bet on near-term U.S. mid-cap bankruptcies (probably more of a national security issue, really). Unprecedented guarantees of liquidity and quite a show of strength.

So it makes sense that we saw DIX print successive 45%+ readings, because it made sense to be more bullish after that. But we've always noticed that when smart people look at DIX, there's an undercurrent of skepticism and disbelief. Why? Because people who know stuff about the market (like you, dear reader) have a hard time believing that there are "smart-money stock-pickers" out there driving the S&P 500 by buying stocks in dark pools. That's just not the way the world works anymore, right? Yet, DIX seems to be a valuable signal... so what gives?

The answer is that DIX, like everything else, is telling us more about centralized market-making than it is about anything else. The majority of "dark pool" volume is actually volume that's internal to firms like Citadel and Virtu, and firms like Citadel and Virtu have their fingers in every financial product known to Man. So, when someone wants to buy shares of SPY, or S&P 500 futures, the burden of facilitating that transaction is going to fall, in one way or another, in these big firms. And the means by which these index products are facilitated is always by arbitraging baskets of the components stocks of the index.

See where this is going? A high DIX print doesn't mean that some Warren-Buffettish discretionary manager decided to buy lots of shares of stock in a dark pool -- it means that someone bought so many E-minis, or SPYs, or VOOs, that a market-maker had to go out and assemble a basket of S&P 500 stocks to create ETF shares, or to hedge away the exposure of a futures contract. And nobody in their right mind would do this on a lit exchange if they could help it (much too expensive), so the market-making firms will do as much

internally as possible, which happens to be off-exchange (OTC), or "dark." That's it.

So when the "theory" of the Dark Index doesn't jibe with your understanding of the world -- fear not. It was never about "the smart-money" or actual "dark pools." It's about big, central market-makers creating and arbitraging index products (this is why we wanted the DIX to track the S&P 500 and not the "whole market," or some other index). It's just a different angle on something that you already knew was going on.

Enjoy the week!

The SqueezeMetrics Team

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