S&P 500 Weekly Forecast 5/16

From: SqueezeMetrics <info@sqzme.co>
To: SqueezeMetrics <info@sqzme.co>
Subject: S&P 500 Weekly Forecast 5/16
Date: Sunday, May 16, 2021 8:58 PM
Size: 1.3 MB

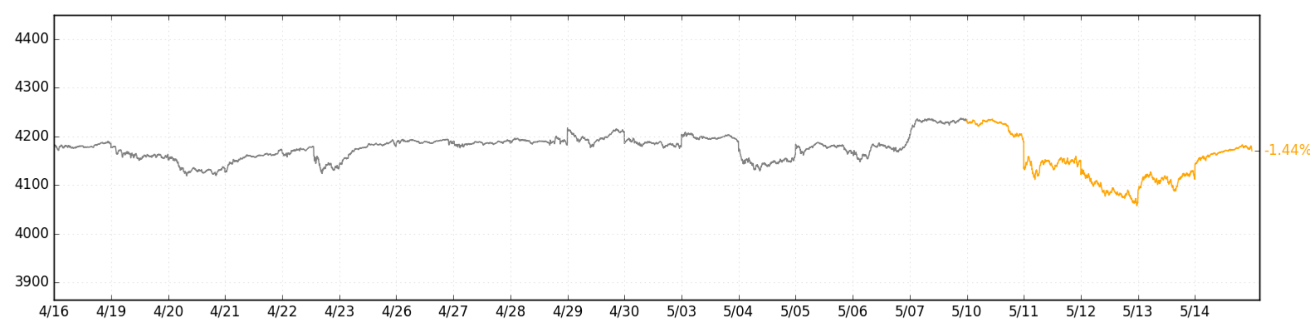
Hey everyone,

It was such a fun-filled week that we hardly had any time to think about our mess of vol-tension triangles and colorful 3D scatter plots.

So let's just try to get some good color on this past week, and what it means for the coming week.

1. A tale told by an idiot
2. Full of sound and fury
3. Signifying nothing

A tale told by an idiot
More often than not, volatility is fleeting. It "struts and frets its hour upon the stage, and then is heard no more." Sometimes it isn't fleeting, though. If we can learn to predict when it *is or is not* going to be fleeting, then we have something very useful.



This week's increase in volatility, spiking VIX to 27 was an example of "fleeting." Option customers were positioned in such a way that, for the past month or more, it has been hard for volatility to fall (i.e., a shallow negative VGR). VIX *wanted* to go up -- we were waiting for it. And it finally happened.

But big volatility *follow-through* only happens when people are ill-positioned to handle the vol. And since folks have been generally net buying SPX puts, they're pretty well insured against volatility (we've had mostly -5 NPD or lower). So, y'know. Reflexivity. When people have insurance, the "event" doesn't end up happening. You end up with a left shoulder, but not a left tail.

So when VIX topped 27 -- far exceeding recent realized volatility -- we pegged it as an overreaction caused by VGR finally coming home to roost. And so when NPD remained stable, VGR became stable, and GEX+ suggested that the VIX was too dang high, we sold the June VIX expiration in size.

And speaking of "fretting [one's] hour upon the stage," we spent Wednesday and Thursday rather preoccupied by the size of this position.

> We sold June VIX at 23.70, then again at 25.50, then *again* at 27.00, adding up to a very large position with a weighted average price of 25.70.

But June VIX settled on Friday at 21.20. So the trade worked, and quickly -- prompting us to bring our exposure from "very large" back to "small."

Now what?

Full of sound and fury
In retrospect, the winning-est trade over the past month was to be short gamma (short IV-to-RV) and long vega (long IV-to-IV). So, something like selling a near-term delta-hedged option, or a straddle; versus long VXX, or long some options further out on the curve.

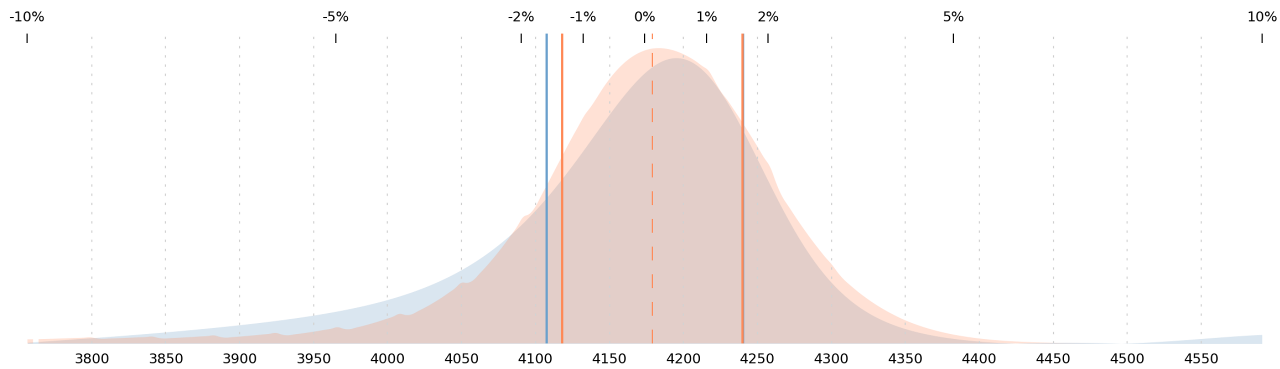
According to our SPX vol-tension data at EOD Wednesday, realized vol had "lost" by 0.20% and implied vol had "won" by 0.45% over the prior month. Expressed differently: RV was, on average, 0.20% lower, per day, than what was implied for the underlying over the course of the month; and Wednesday's 1-month IV implied a daily range 0.45% higher than what had, on average, been implied over the course of the month.

If we were real vol traders, we might have made the aforementioned trade (*alas!*). According to our new vol-tension model, the IV component was near 0.00% -- which is, if you recall, when things get hairy, because it's where people who are long/short vol (directly or implicitly) aren't making money. A small rise in vol and some folks suddenly have to re-adjust positions. High vol-of-vol!

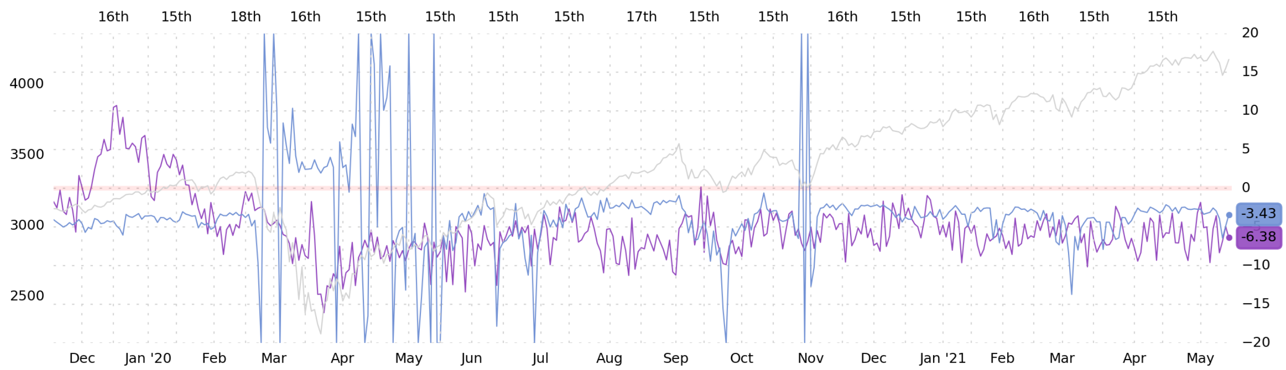
Nerd Note:
*Hear that? We just attributed to "vol-tension" something that we always attribute to VGR. We're always saying that VGR (the customer ratio of vanna to gamma exposure) is our favored measure of whether VIX is primed to flatten out or go up. Because when VGR is in the low negatives (-2, -3), that means that people have relatively more exposure to vanna (which is exposure to changes in IV) than exposure to gamma (exposure to the relationship between IV and RV). The reason that we formulated this vol-tension model to work the way it does is *because* of the way we see NPD and VGR working. NPD and VGR tell us about how folks are positioned, by looking at flows. But what if we can have a model that uses simply prices (vol-tension) to try to show us the same thing (because flows ought to show up in relative pricing, at least to a large extent). Wouldn't that be more robust? Totally? Would it also make all of our fancy data worthless? Quite likely. If we're right, anyway. So yes, we are currently in the process of attempting to drive our data, and thereby ourselves, to extinction. You might as well unsubscribe right now. It's over.*

Anyhow, what's interesting about all this is that after the mid-week craziness, we're pretty much back to where we were before.

According to GEX+, options are reasonably priced on a 1-week basis (left tail is too expensive though).



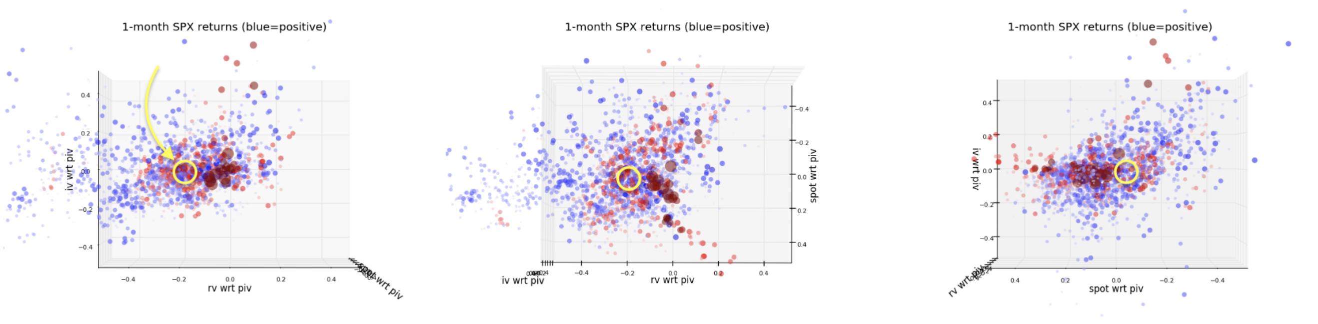
NPD is still around or below -5, and VGR is back into the -3 area.



Everything else is "meh."

But one thing that we do want to take note of is that in our current vol-tension data, the RV component is around -0.20% (as we already noted). This is the highest it's been since January of 2020, and it suggests that short gamma (short IV-to-RV) is starting to not work so good anymore, relative to the last year. (Remember back right after the crash when we were selling iron flies and raking in the dough? Yeah. The RV component was -1.00% and lower, which means that long gamma was losing [short gamma was winning] *big*. That was nice.)

At the same time, the IV component is just below 0.00% (which, as we noted above, is when "things get hairy"). Let's mark this confluence of data on last weekend's scatter plot:

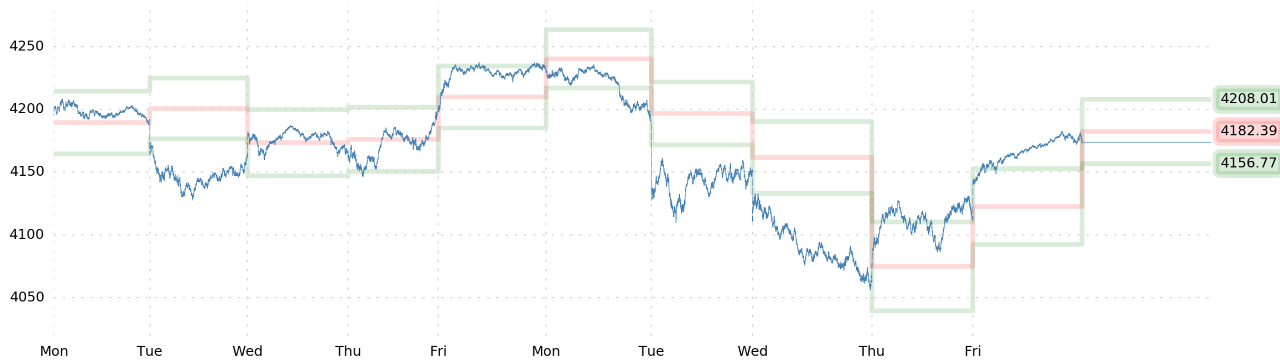


It's not the *most* bullish combination. Indeed, this appears to place us right in the thick of the historical data.

We've recently called what's been happening to volatility and option positioning / GEX a "normalization." This data seems to confirm that interpretation. And if we're honest, that makes us feel not terribly bullish.

We ended Friday with short June VIX, hedged generously with short E-minis. Boring, but not bullish.

1-week GEX+ probability density mostly favors an unusual 0% to -1.5% return for the week (where the orange peeks out above the blue). Boring, but not bullish.



So we're going to ride out a short vega, short delta bias from Friday. Small size. But we will be watching this week with interest (guessing it'll be boring, but not bullish).

Signifying nothing

This section intentionally left blank.

The SqueezeMetrics Team