

S&P 500 Weekly Forecast 8/8

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Hey guys,

They say that you shouldn't allow the beauty of an idea to influence your estimation of its truth-value. Yet, we've been chasing down the same fantastical concept of a "vol triangle" *since late March (3/21)*. Why? Because *if it's true* that there's some consistent and meaningful way to express the relationship between spot price movement and volatility, that would be... *beautiful*.

Well, now it's August. And like other explorers who've gone out in search of something mythical, we've begun to wonder if the reason that we can't find this "tension model" is that it's nothing more than a pretty idea. A siren song, designed only to moor us on the sharp rocks of PnL misattribution—or worse.

See, initially, we were anchored on "past implied volatility" (PIV) as the key to the model. Everything else revolved around it, since everything else (IV, RV, and change in spot) had a natural and necessary relationship to it. A *money* relationship. We envisioned this as the internal angles of a triangle, and then as four nodes in a graph. We made four-dimensional plots. Then we scrapped those and started wondering if (by some irony) GEX held the key all along. So we examined the relationship between gamma exposure and implied volatility, turning GEX into zomma (ZEX?).

Five months of wandering, and our last letter home was more hopeless than ever:

*Unfortunately, zomma has proven to be a tough nut to crack. That chart up there appears to be either telling us the exact *opposite* of our hypothesis, or telling us that whatever we're looking for is such a tiny effect that we're not going to see it in the data. [...] So that plot basically just tells us, "buy the S&P 500 on dips." And, by extension, "your zomma idea is stupid."*

And yet, we still feel so close to The Answer. Is this what it feels like to be crazy?

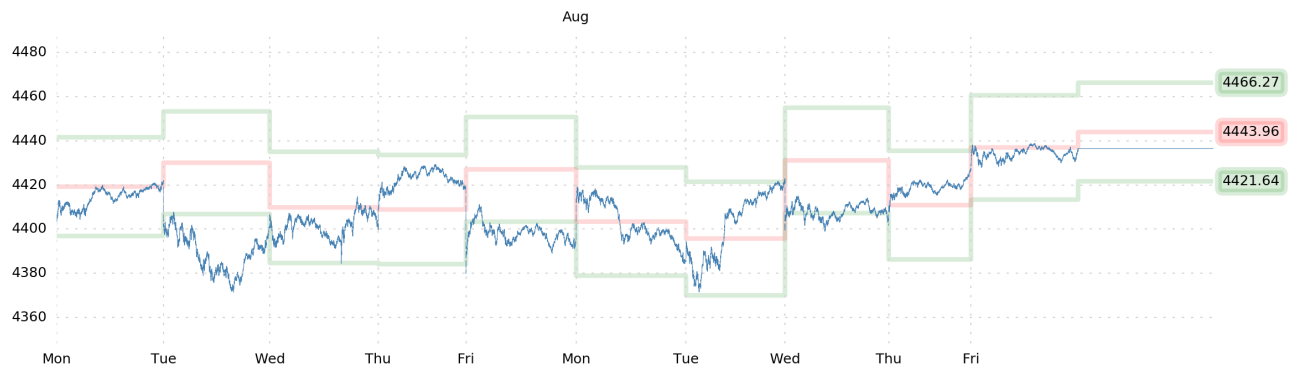
Mutiny is in the air at the Yacht Club.

1. When life gives you lemons...
2. ...you don't get scurvy!
3. Land ho?

When life gives you lemons...

We spent all week waiting. Our thesis didn't change, and neither did our positioning: All we wanted was for VIX to adjust lower, and for August VIX to slip down with it. And for SPX not to shoot straight up. It didn't feel like much to ask for, but apparently it was.

Lucky for us, after a week of waiting, a meaningful decoupling occurred on Friday. The S&P 500 was stuck at its Mid band all day... but VXX took a nice dive (-2.58%).



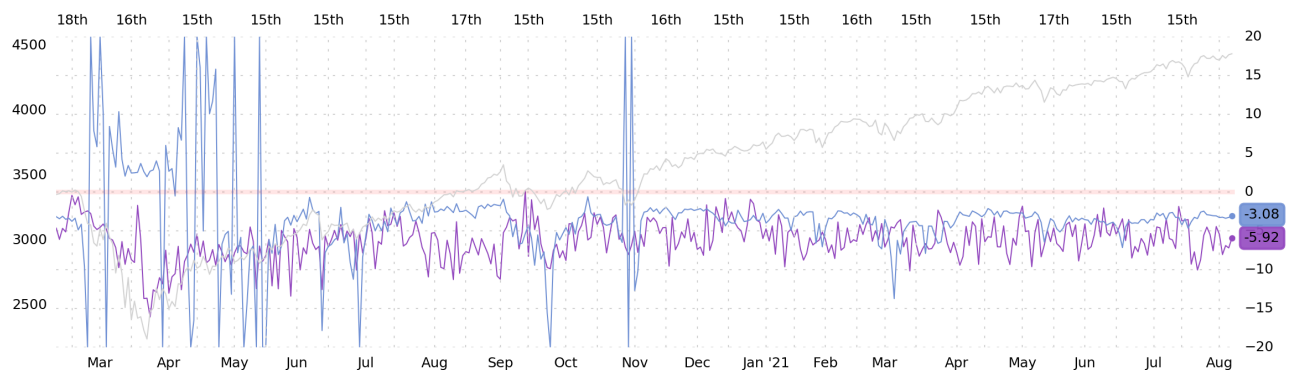
So the week ended up productive for our positioning—but can you really brag about it when you waited two weeks for it to play out?

But sometimes it's more about avoiding the bad trades than catching all the good ones, no?

...you don't get scurvy!

So, looking on the bright side... it looks like our current positioning (short vol) is still the right place to be. But even now, we're sizing down a bit, and getting rid of some of the short ES (nice overnight dip here). Because while capturing some of the latent contango in the VIX term structure sounds good, we feel less strongly about being short the S&P here.

Part of the reason is that this past week featured quite a lot of SPX put-buying, and that's bullish.



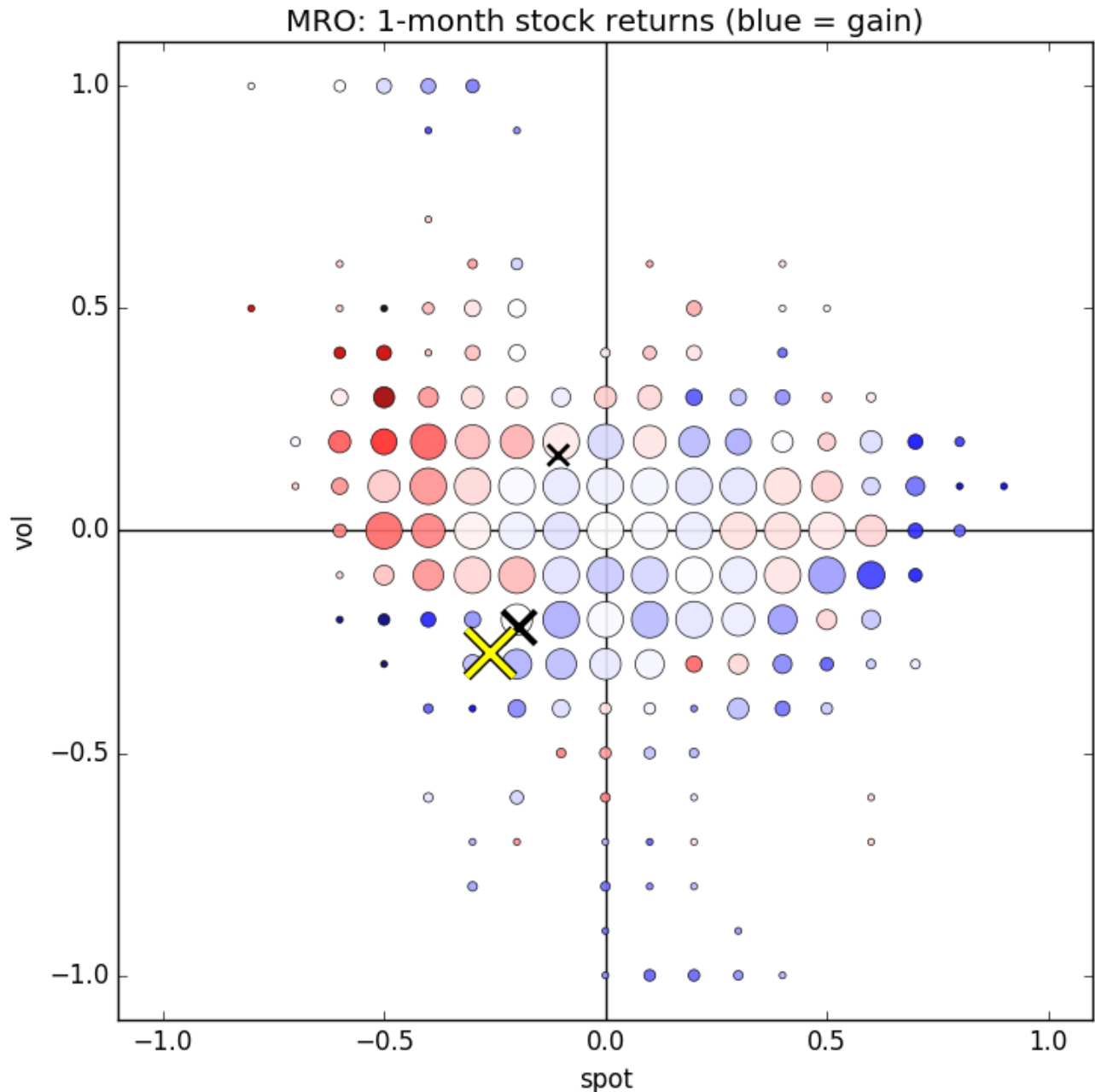
But another part is a sort of general feeling that the last two weeks have been "cleansing," and that the combination of priced-to-perfection near-term vols, stable-and-high DIX, GEX+ nearing \$1bn, stable NPD, and the way the SPX chart looks, all add up to a situation where it's more likely for SPX to resolve to the upside—and perhaps meaningfully.

If that sounds like a hunch, that's because it is. We just like to think our hunches come from squinting at data all day.

Land ho?

Last weekend, we shared a plot of *zomma against change in IV*, determined that we needed to add one dimension back to our model (which had been culled straight from 4 down to 2 dimensions). Good things come in threes, right? We produced a colorful dot plot that, if you squint at for long enough, might show you something about the relationship between zomma and changes in IV.

We squinted for a long time. A whole week, actually. And when we were done squinting, we created a plot that basically does all the squinting *for* you (the dots all get squished together so you can see better what's red [bearish] and blue [bullish]). Here's a squished-squint-plot of Marathon Oil (MRO) right now.



The gold X is where we were at Friday's close. The biggish black X is from a week prior. The *small* black X is from a month ago.

This plot suggests that the combination of spot and volatility moves in MRO over the past month has brought the stock from a bearish position to a now-bullish one.

This is interesting.

So we made more of these plots. And we put them all together, into a sort of "dashboard" that we think you might like.

More work to do, but we like where this is going.

Maybe this thing exists after all.

Enjoy the week!

The SqueezeMetrics Team
