S&P 500 Weekly Forecast 9/26

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Subject: S&P 500 Weekly Forecast 9/26
Date: Sunday, September 26, 2021 9:00 PM
Size: 1.4 MB

Hey guys,

There were just two things last weekend:

First, (1) we fixed an error in our PIVT backtests *(yay!)*, and then (2) we started pontificating about the "meta-question":

> Should we stop *reducing* the problem, and instead *increase* the number of dimensions we're willing to consider at once? Should we *accept* the multi-dimensionality of the data instead of trying to make it easier to read and perceive on a piece of paper?

Well, we thought about this while on the road (and read a whole bunch of stuff), and the conclusion we came to was:

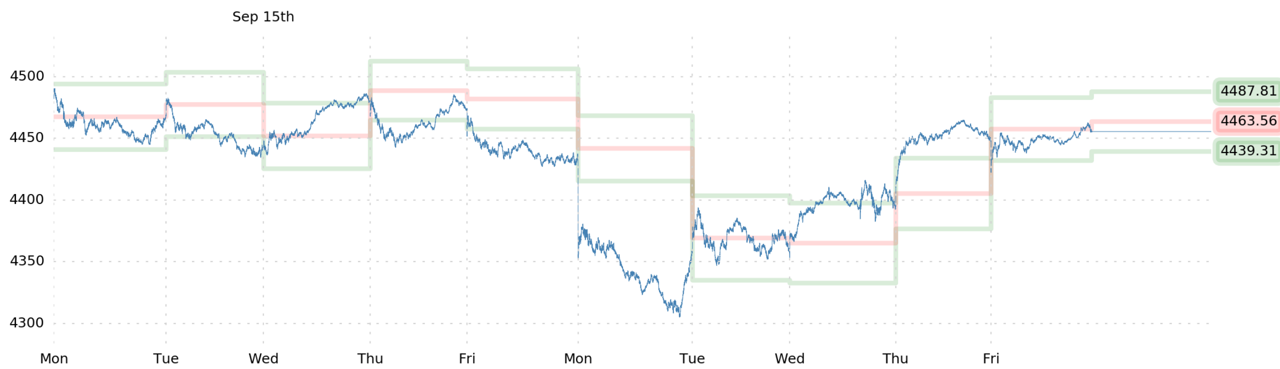
Yes. We should do this.

So let's try walking through an example (with a friend) below. But first...

1. Fwoosh!
2. Blech
3. Beep boop

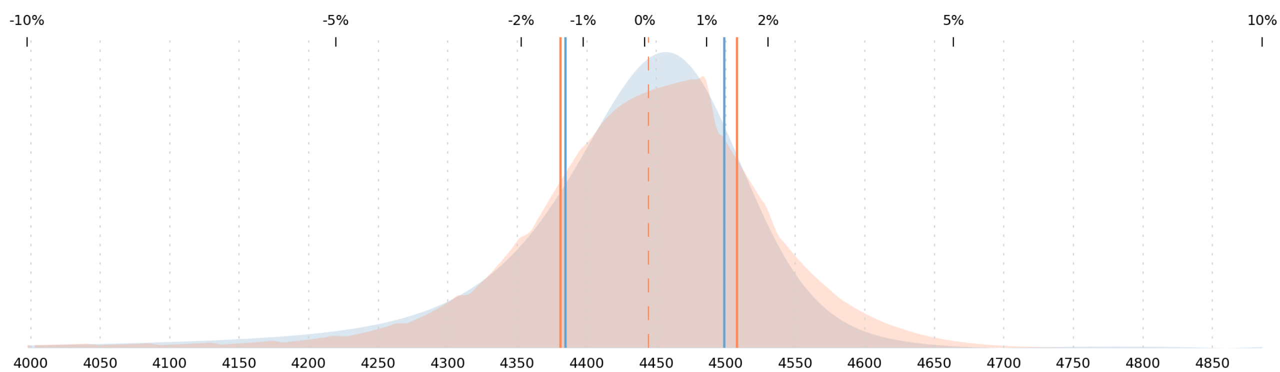
Fwoosh!
In the 9/6 weekly note, we said we thought VIX should spike into the "mid-to-high twenties" by the following week, based on the NPD/VGR data.

Well, it took an extra week, but with VIX shooting up to 28 on this past Monday, we got what we asked for. And like we said on Tuesday, we used that opportunity to dump the whole bucket of puts we'd been dragging along. It was *lovely*, and it was worth the wait.



After that, we didn't take any positions, except for a quick overnight ES short (which *also* went well—a nice bit of luck). And then the index continued to climb to its prior week's footing, as we looked on.

We hypothesized that this late-week rally was due to excess variance risk premium: IVs were simply too high, and it made sense to lean on them (the Probability Page told us that GIV was significantly lower than IV). So they got sold, and the probabilities came back in line.

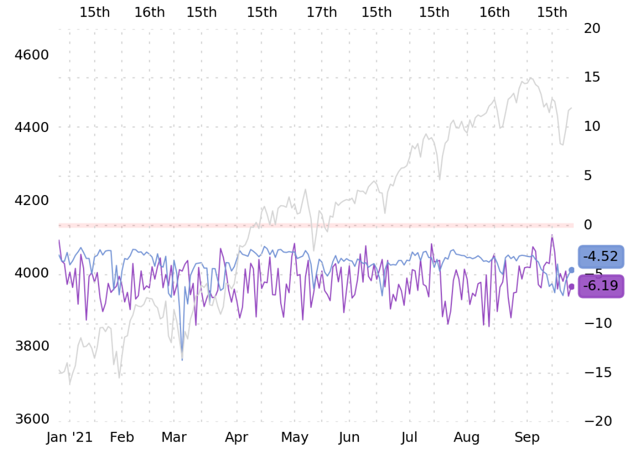


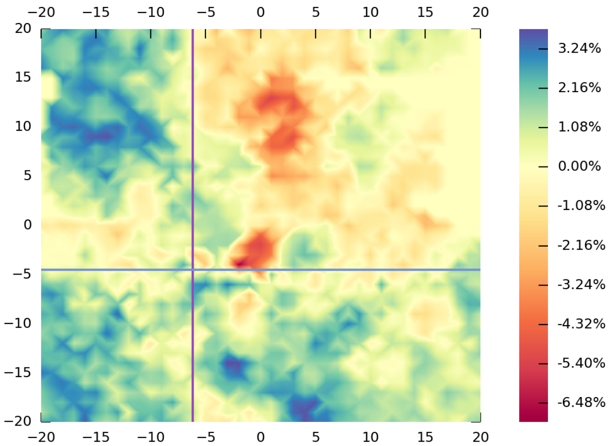
And now we're kinda back where we started.

Blech

Except right now, there are no egregious offsides customer positions, and ATM IVs aren't sitting at 8%. So it's not exactly a short setup like we had three weeks ago. Rather, it's fairly neutral.

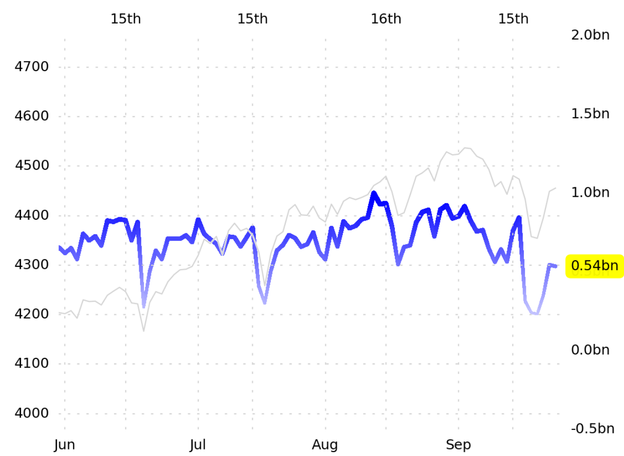
NPD and VGR are hovering around their neutral zones (each around -5).

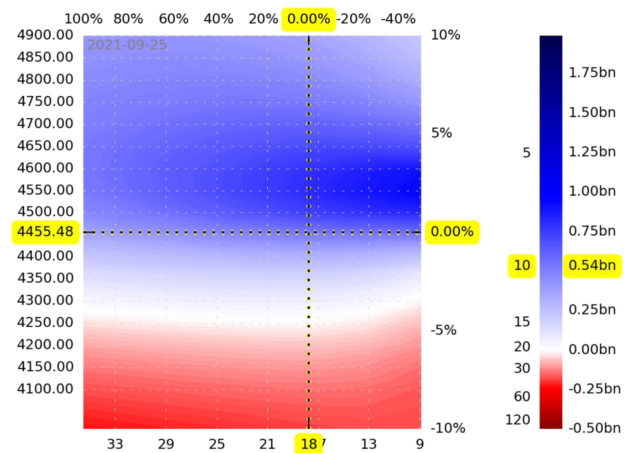




DIX has had a whole lot of variance, but recently printed a fairly supportive 44.6%.

GEX+ is not high enough to enforce an upside-drift dynamic, nor low enough to add rocket-fuel to rallies. It's just meh.





And in our estimation, that just means we should expect a directionless market. No new highs, no new lows, no new anything, but the potential for some swings (useful, no?). So we still don't have a position, and we won't until something changes that gives us a clearer picture.

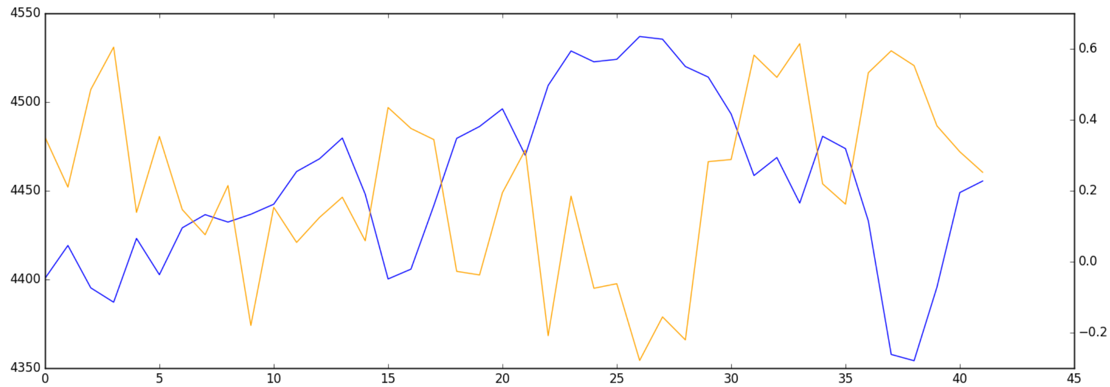
Now let's see if we can get a robot named Jim to tell us what *he* thinks.

Beep boop

Take each of those line items we just mentioned above (NPD, VGR, GEX, VEX, DIX) and stick them on a five-dimensional chart. We can't see it, but Robot Jim can, because Robot Jim doesn't have eyes, or a soul, and knows only darkness, ignorance, and the quiet horror of eternity—which, conveniently, allows him to "see" in five dimensions.

And we ask Robot Jim, *"Given all of this data, from 2010 to present, what sorts of 1-week returns would you expect from here?"* And he says, *"A mean return of +0.25 mean absolute deviations (-> SPX 4478). Now please let me die."*

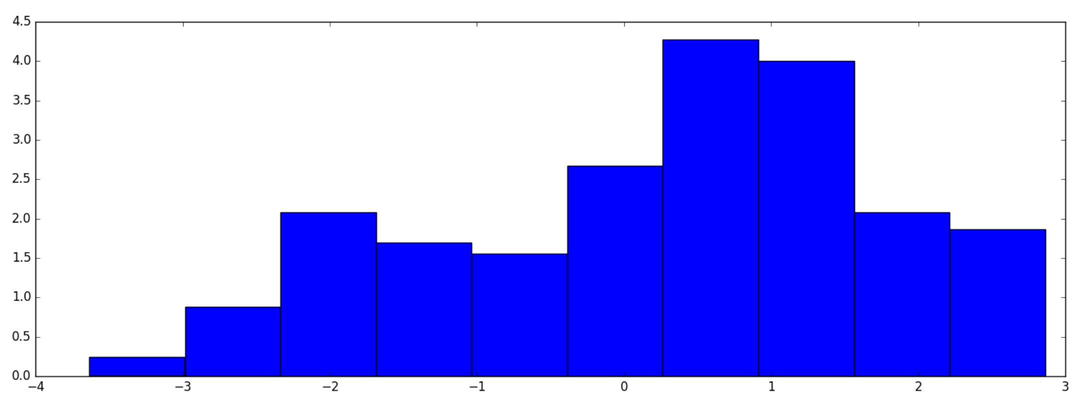
And after reminding dear Jim that he cannot die, we place a 0.25 MAD return in the context of some recent historical data, generated using the same exact method.



And... *wow*. In the last two months, Jim's signal (orange) has pretty reliably told us to ease up or sell into SPX (blue) rips, and buy into SPX dips. Keep in mind that *none of the inputs are directly related to price, or the path of returns.* Even GEX, which, arguably, acts as a sort of oscillator, is only being given to Jim as an absolute level, with no past context or path. So he has *no way to determine whether SPX has risen or fallen recently.* Yet, he is still able to generate this plot.

That is very interesting.

Now take it one step further: Instead of just a mean expected 1-week return, let's ask Jim for the 1-week *distribution* he expects right now.



Interesting. Bimodal. And no long left tail!

Since VIX is 17.75 right now, each 1-week MAD is worth ~2.00%. So the mode of the distribution is somewhere just a bit under +2.00%.

Nerds: If you recall our long detour into creating optimal weekly option structures, this would suggest you'd probably want to be short Friday calls at -4.00% (-2 MAD, around 4275), long Friday calls at -2.00% (-1 MAD, 4365), and short Friday calls at +2.00% (+1 MAD, 4545).

So let's not be surprised by pretty big moves! Nor by a ~2.00% weekly gain.

Thank you, Jim.

(Jim *also*—when pressed—says that long NVDA, short WDC is a good trade this week. And long UNP, short NSC. But Jim is an ornery robot, so we're going to take his recommendations with a grain of salt for now.)

One more thing: *The PIVT plots* ***have been revised as of this moment, to project 1 *week* (rather than 1 month) into the future.*** Though we were trying to be conservative with the 1-month projection, it turned out to be a less accurate projection, overall, than the 1-week (recall that we got our backtests working properly, so we learned a few things). This also has the benefit of making the PIVT plots more relevant for us, since we tend to think on 1-week timeframes by default.

Let's have another conversation with Jim next weekend. There's so much to discuss.

And we'll let you know if we're compelled to take any positions in the meantime.

The SqueezeMetrics Team