HOLIDAY/END OF MONTH GAMES OVER AND VOL PREDICTABLY IS BACK – TRADE FOR FED DAY

VOLATILITY SUMMARY

Aug 30th note:

As vol declines into the end of the month and into the Labor Day holiday, it is once again offering the opportunity to get long volatility for very low prices. Looking at the implied volatility of the VIX, it has dropped to levels from March!

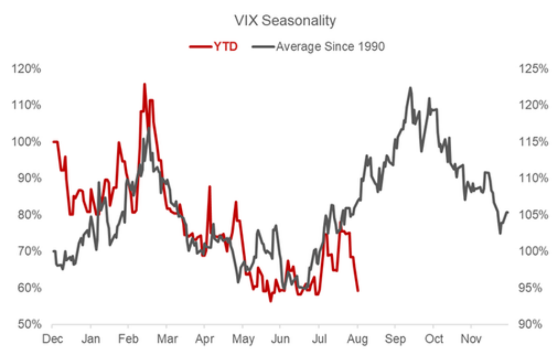
So, while the market sleeps again on the numerous/various economic risks that are about to come into play the next two months, we will start taking advantage of the low vol pricing again.

Well, that didn't take long. Holidays are often great times to get long volatility; it generally gets overly smashed to the point where the lack of premium opens up a trading range. Like a quasi-unclench perhaps.

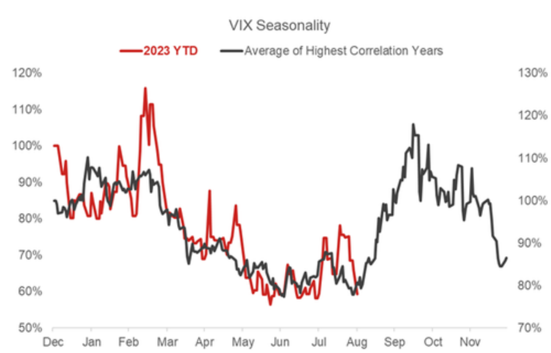
And Charlie the celebrity quant decided to weigh in yesterday on how this vol situation was setting up for a potential vol squeeze:

Indeed, as McElligott warns there are **three strong reasons to fear a vol squeeze**:

*1) this **"low absolute level of Vol"** (VIX on Friday under 14 on the lows, which is the 7th lowest print on the first trading day of September since 1990)...*



*...and 2) into **seasonality which tends to show VIX grinding higher into mid-October**,...*



*...we have to again watch the 3) **VIX Dealer "Short Calls" dynamic** on any potential catalyst for a Vol squeeze...*

VOLATILITY ANALYTICS NEWSLETTER – SEPTEMBER 6TH

Source: https://www.zerohedge.com/markets/nomura-warns-watch-vol-squeeze-event-risk-cluster-looms

Now with ISM services for August coming in quite nicely thus markets disappointed with good economic news (feels like the Fed has permanently warped several markets' natural functionality) vol is now opening up with a host of events next week:

-CPI (base effects gone and should tick higher) 9/13

-PPI 9/14

-Retail Sales (retail companies' earnings were just a disaster with poor guidance) 9/14

-Larger Treasury auctions (*10-yr on Sep 12th the day before CPI*)

-ECB Meeting 9/14

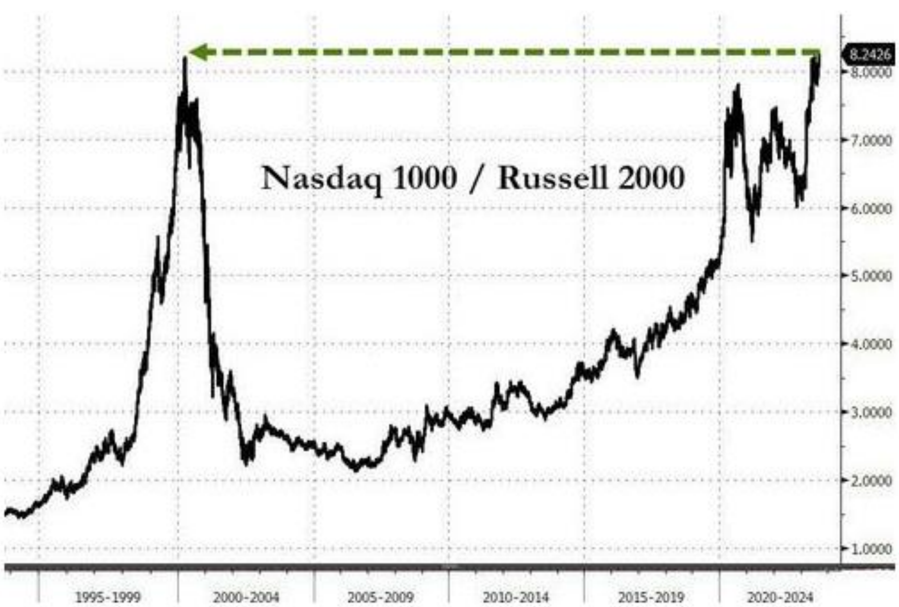
-Fed Meeting 9/20

What's interesting/comical about this level in SPX is that we have basically returned to when everyone rolled out their quarterly trades at June opex:

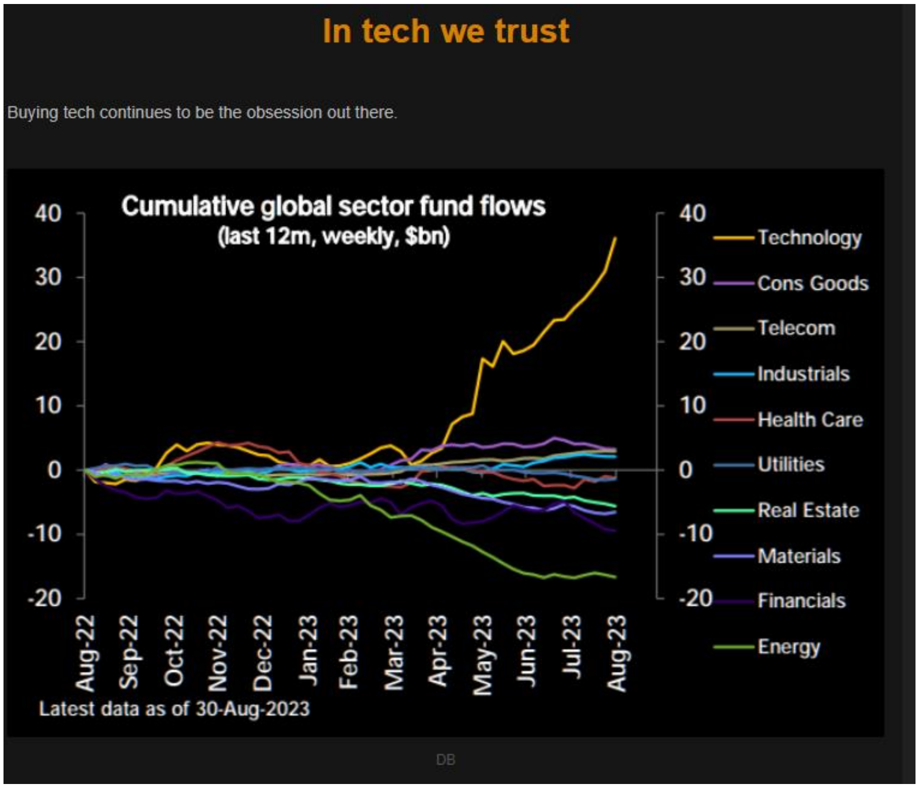
Hanging around this area ruins the sport of watching the giant JPM collar lose money, their levels not not really in play for end of this quarter:

Yesterday's divergences were comical, to the point that giga tech versus small caps was borderline absurd:

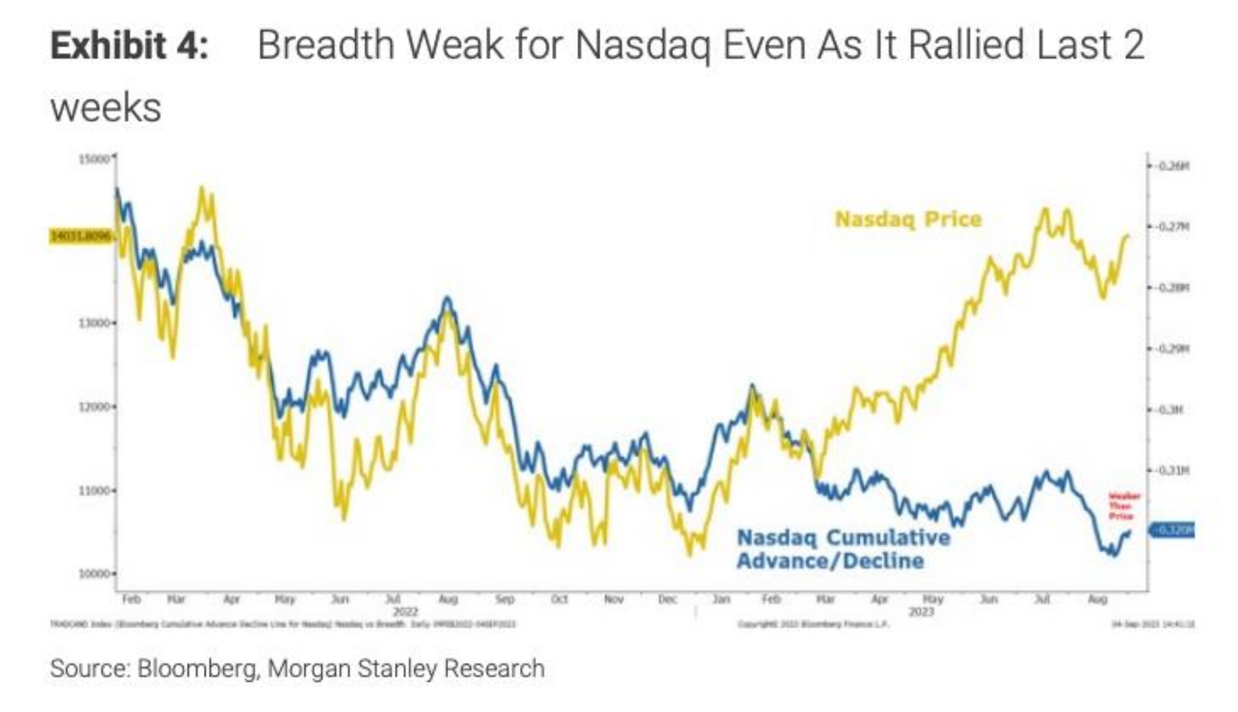
This was the Nasdaq's second best performance relative to the Russell 2000 since Nov 2021, breaking out to a new cycle high. The last time Nasdaq/Russell 2000 traded here was March 2000 - the very peak of the dotcom bubble...



You get the feeling that after witnessing the endless June/July ramp, you are going to have to pry their beloved giga tech from them with a crowbar before they report in October. And flows into the space show how full the clown car is getting; inflows into tech last week were the largest since May:



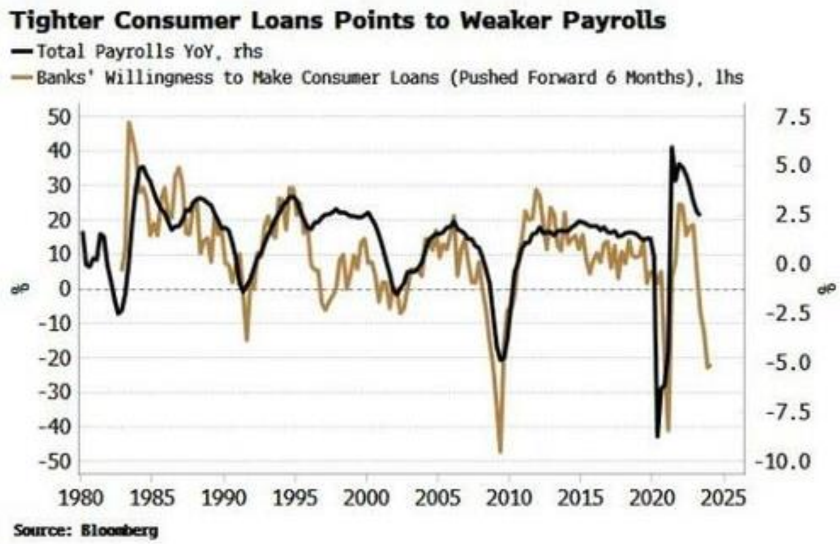
And in this chart, you can see how it's really just the top names doing all the work as their P/Es show absolutely no conscience, AI'd to oblivion:



But waiting for breadth to matter or a bubble to burst, well, feels like sitting at the RMV; the number just isn't going to come up anytime soon.

Meanwhile, still plenty of charts around that don't seem to be feeling current GDP/ISM services/soft landing scenarios:

For instance, **the sharp drop in banks' willingness to extend consumer credit is a building headwind in the coming months.**



If payrolls growth continues to decay at the rate it has over the last six months, we would get the first negative monthly change in December. However, it could come quicker if the decay rate increases (as the chart above suggests could happen).

In the meantime, when IV gets stupidly oversold, you can simply grab insanely cheap puts in giga herd stocks like AAPL. I was going to put a bearish long put spread trade of some sort in today's note for after the Iphone event. And then, it has a -3% day and I missed the trade. Look at how stupidly low priced the puts for this week were:

Oh well, I'm sure there will be more opportunities like this as folks continue to offer vol and the opex cycles/0DTE/systematic funds continue to do their thing.

Volatility Trades:

SPX Fed day put calendar spread

Sell $4450 Sep 20th put

Buy $4450 Sep 22nd put

Net debit: $2.80-3 (2.80 filled)

We did our SPX Fed put calendar trade a couple weeks ago, Sep 18-22s on a cost of $6, those are trading for $8.50 or so, and this is another classic Fed trade I like to do, selling the meeting day vol and owning the reaction days. The premise is pretty simple, by the time Jay takes the stage, it's 2:30pm, and the vol will slide into the back leg as we get closer to the event. Target $6.

ANOTHER CRASH UP HIGHLIGHTS TYPICAL END OF MONTH PRICE ACTION – VOL OF VOL IN THE BASEMENT – TRADES FOR SPY EX-DIVIDEND/QQQ FOR CPI/ECB

VOLATILITY SUMMARY

They say you can't time the markets. Those are the lazy or willfully ignorant managers; I expected this price action/end of month ramp and highlighted the tendency here a couple notes ago:

And, as the end of the month comes along with a holiday shortly after, vol burn/vanna/charm, whatever term you like is upside market fuel, and Charlie the celebrity quant makes that plainly clear, the last sentence the key:

Crucially, additional downside probably needs to materialize soon, otherwise the pullback window mentioned above will close — and reopening it will require a macro catalyst.

"Anytime you get UX1 moving up five vols in the course of five days, vol needs to be fed with movement in order to be sustained," McElligott reminded market participants. Otherwise, it'll "mean-revert under the weight of its own expectations."

BBG

The simple figure above illustrates the point.

Friday's high print for VIX futures was 19.6. The implied daily change was 1.2%, but when the dust settled, stocks were unchanged. That, Charlie remarked, "is an absolutely brutal realized vol bleeder."

https://heisenbergreport.com/2023/08/21/window-for-stock-pullback-may-close-without-more-fireworks/

Add to this the fact that the 10-yr futures options expire with a pointless exercise in Jackson Hole on Friday and the 0DTE crowd could be right back to their call sweep playbook into month end.

As usual, the opex cycle and options are the market's bosses when liquidity is low and real buyers/sellers are on vacation.

Now, it will be curious to see if we get the 3:30pm last day of the month, end of day gamma ramp that was egregious the last day of July. I highlighted that at the time:

Have you ever made 1000% in 10 minutes? Well, you could have by simply buying an at the money call at 3:50pm:

Source: Aug 2nd newsletter

VOLATILITY ANALYTICS NEWSLETTER – SEPTEMBER 6TH

As vol declines into the end of the month and into the Labor Day holiday, it is once again offering the opportunity to get long volatility for very low prices. Looking at the implied volatility of the VIX, it has *dropped to levels from March!*

That is pretty comical, considering we just got higher than expected inflation in Spain and Germany today, and the market events in this window include:

-CPI (base effects gone and should tick higher) 9/13

-PPI 9/14

-Retail Sales (retail companies' earnings were just a disaster with poor guidance) 9/14

-Larger Treasury auctions (*10-yr on Sep 12th the day before CPI*)

-ECB Meeting 9/14

-Fed Meeting 9/20

Let's be realistic, the news yesterday was terrible regarding job openings and consumer confidence, and the market relief rallied on rates coming in, which (at the risk of repeating myself for the third time in this note alone) had more to do with the 10-yr futures expiration than the economy or treasury supply/demand.

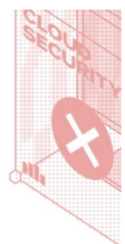
In fact, Bloomberg today highlighted a large seasonal arbitrage trade around 10-yr futures that occurs at the end of these cycles and had a lot of hedge funds shorting 10-yr futures which drove up yields:

Surge in Hedge-Fund Treasury Shorts Hints at Rise of Basis Trade

- Short positions in futures rose as recent bond selloff crested
- Indicates increasing leverage that raises volatility risks

By Edward Bolingbroke
August 29, 2023 at 4:46 PM EDT

Listen 3:35



A surge in short sales of US Treasury futures suggests hedge funds are expanding basis trades, a popular tactic that may be injecting leverage into a bond market whipsawed in the wake of this month's selloff.

The revival of the trade – which exploits price differences between futures and underlying bonds – was likely behind the positioning by hedge funds up to Aug. 22, when the latest Commodity Futures Trading Commission data shows their short positions swelled to over 6 million 10-year-note futures equivalents. Asset managers are net long to a similar degree.

The positioning data indicates an inrush into basis trades just as the most recent Treasury selloff was cresting, pushing 10-year yields to the highest since the before 2008 credit crisis. The proliferation of such leveraged strategies could exacerbate the market's volatility, as happened in previous cases when they were rapidly unwound.

https://www.bloomberg.com/news/articles/2023-08-29/surge-in-hedge-fund-treasury-shorts-hints-at-rise-of-basis-trade?sref=1zxv5xkq

So, while the market sleeps again on the numerous/various economic risks that are about to come into play the next two months, we will start taking advantage of the low vol pricing again.

Volatility Trades:

SPY Ex-Dividend put calendar spread

Sell Sep 12th $445 SPY put

Buy Sep 15th SPY $445 put

Net debit: .86-90 (filled)

The beauty of this trade is that the back leg holds SPY ex-dividend, and that includes 1.60 of pricing (the SPY dividend, approximately) that won't leave the back leg easily, unless we ramp hard back to the highs from here. I set these at both 445 and 450 because if it goes ITM, that dividend helps insulate the trade unlike a typical in-the-month calendar spread. It has the ex-dividend vol in the back leg. You can see it in prices from June's equivalent spreads, with the vix at 14 or so then, so the implied vols on this equivalent trade were roughly the same:

June 12/16 put calendars quoted on 6/12 3pm

Strikes: 20

PUTS

Strike	Bid X	Ask X	Net Chng	Delta	%Change	Impl Vol	Volume	Open.Int	Last X
424 / 424	.74	.76	-.38	-.16	-33.63%	17.73%	5,763	14,022	.75
425 / 425	.89	.91	-.44	-.19	-32.84%	16.71%	14,699	26,028	.90
426 / 426	1.07	1.09	-.51	-.22	-32.48%	15.68%	2,869	15,431	1.06
427 / 427	1.28	1.30	-.53	-.25	-28.96%	14.65%	3,029	19,176	1.30
428 / 428	1.54	1.56	-.50	-.29	-24.27%	13.64%	4,772	26,293	1.56
429 / 429	1.84	1.86	-.41	-.33	-18.06%	12.63%	4,383	16,593	1.86
430 / 430	2.19	2.21	-.18	-.38	-7.53%	11.61%	21,647	18,951	2.21
431 / 431	2.58	2.60	.21	-.40	+8.79%	11.03%	6,778	10,072	2.60
432 / 432	3.02	3.04	.62	-.40	+25.62%	10.20%	4,244	5,207	3.04
433 / 433	3.31	3.35	1.13	-.11	+51.13%	10.00%	1,345	1,748	3.34
434 / 434	3.16	3.26	1.01	.25	+45.50%	10.34%	426	564	3.23
435 / 435	2.86	3.00	.97	.37	+50.52%	--	522	140	2.89
436 / 436	2.49	2.69	.74	.32	+41.81%	--	155	51	2.51
437 / 437	2.21	2.48	.58	.28	+30.21%	--	12	1	2.50
438 / 438	1.95	2.29	1.74	.25	+122.54%	--	14	7	3.16
439 / 439	1.74	2.10	1.44	.21	+175.61%	--	1	2	2.26
440 / 440	1.59	1.91	.31	.18	+25.00%	--	4	19	1.55
441 / 441	1.46	1.82	.62	.16	+238.46%	--	0	7	.88
442 / 442	1.38	1.73	1.60	.14	+26.02%	--	0	1	7.75
443 / 443	1.31	1.66	1.85	.12	+142.31%	--	6	24	3.15

SPY was 433, and 50-100 SPX points (5-10 SPY points) ITM and the trade was still quite profitable. Target - $2+.

QQQ CPI/ECB/Retail Sales/10-yr auction put diagonal spread

Sell Sep 12th $365 QQQ put

Buy Sep 15th $364 QQQ put

Net debit: .36-.38 (.37 filled)

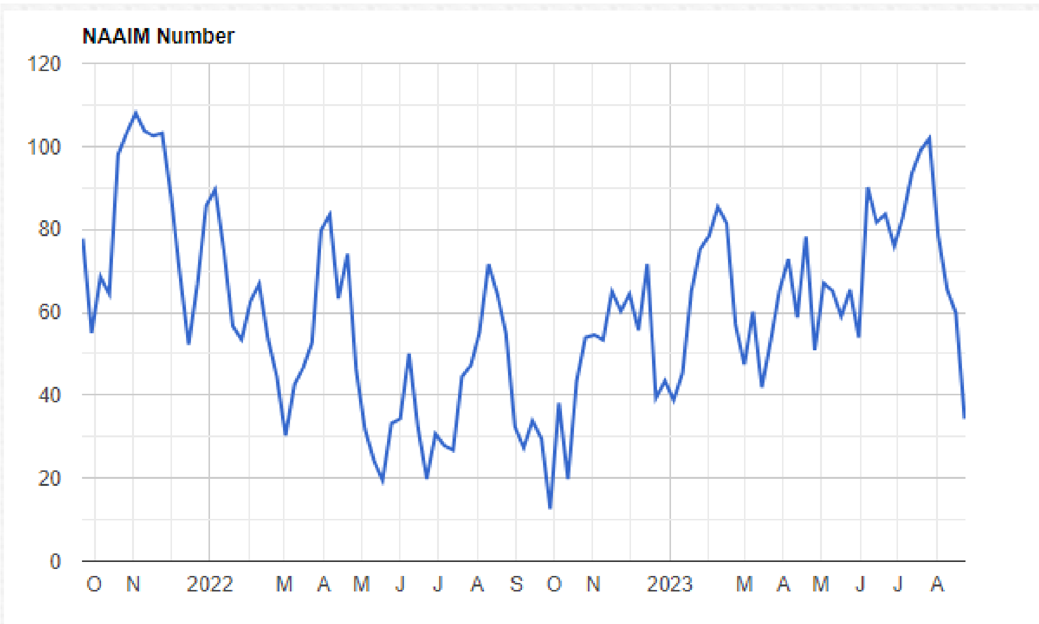
A bevy of risk events in the back leg, for .1% of the underlying, it's incredibly cheap. Target .75.

If we get another comical end of month gamma ramp, I'll do a quick note with an SPX put butterfly spread for September opex, since it will be even cheaper than today.

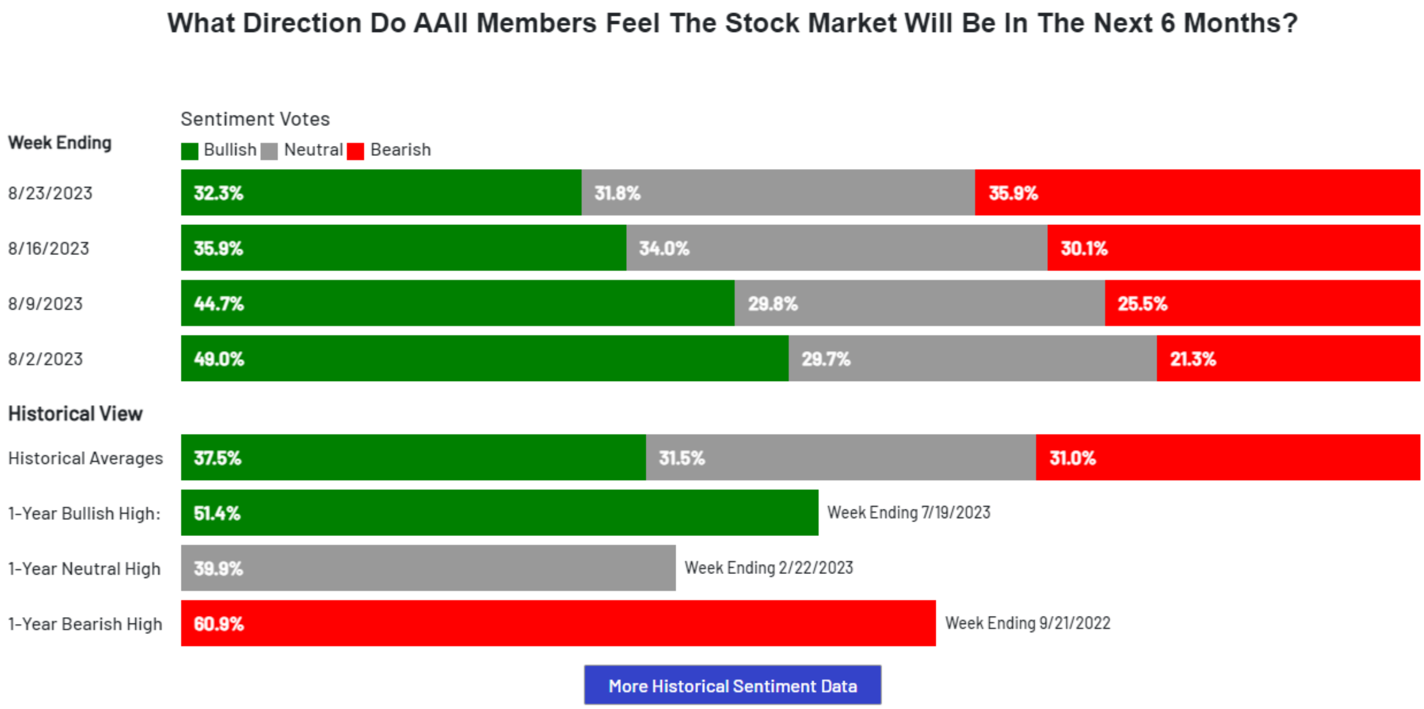
DE-RISKING CONTINUES – A TASTE OF SEP OPEX WEEK? – VOL CONTROL HAS ARRIVED TO SELL FINALLY – TRADE FOR FED MEETING

VOLATILITY SUMMARY

What a difference a month makes. Without the cover of earnings anticipation, folks are suddenly not interested in stocks and sentiment has taken a nosedive. Individual active manager exposure is the lowest of 2023, even while the S&P is nowhere near where it was when exposure was this low prior:



Individual investors continue to become more bearish as well:



The markets were able to casually brush off the negative post Jackson Hole reaction today, even though literally nothing new came out of it as expected. If anything, it seems like the bar for another rate hike is getting higher.

My prediction is that they are done; assuming they skip on September 20th, by the time the November meeting rolls around, things will by then have deteriorated more than the cracks we are already seeing. And these are legitimate cracks. Did you see the roadside bombs in consumer cyclical this week? Very few retail stocks escaped earnings release carnage, not even Dollar Tree, a trade-down retail favorite:

Earnings reports this week in retail:

Filters: 2 | Descriptive (2) | Fundamental | Technical | All (2)

Exchange	Any	Index	Any	Sector	Consumer Cyclical	Industry	Any	Country	Any
Market Cap.	Any	Dividend Yield	Any	Float Short	Any	Analyst Recom.	Any	Option/Short	Any
Earnings Date	This Week	Average Volume	Any	Relative Volume	Any	Current Volume	Any	Price	Any
Target Price	Any	IPO Date	Any	Shares Outstanding	Any	Float	Any		Reset (2)

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No.	Ticker	Company	Sector	Industry	Country	Market Cap	P/E	Price	Perf Week	Volume
1	LOW	Lowe's Companies, Inc.	Consumer Cyclical	Home Improvement Retail	USA	130.06B	21.72	223.18	1.84%	960,627
2	ULTA	Ulta Beauty, Inc.	Consumer Cyclical	Specialty Retail	USA	20.09B	16.64	409.02	-9.69%	1,710,285
3	HTHT	H World Group Limited	Consumer Cyclical	Lodging	China	13.68B	-	40.47	-7.87%	1,300,031
4	BURL	Burlington Stores, Inc.	Consumer Cyclical	Apparel Retail	USA	9.86B	40.88	154.11	-10.53%	1,109,496
5	DKS	DICK'S Sporting Goods, Inc.	Consumer Cyclical	Specialty Retail	USA	9.60B	9.83	113.16	-22.87%	2,060,659
6	WSM	Williams-Sonoma, Inc.	Consumer Cyclical	Specialty Retail	USA	8.82B	9.21	140.25	4.32%	1,070,416
7	TOL	Toll Brothers, Inc.	Consumer Cyclical	Residential Construction	USA	8.51B	6.20	77.75	1.92%	2,431,016
8	BBWI	Bath & Body Works, Inc.	Consumer Cyclical	Specialty Retail	USA	7.89B	11.11	34.85	-4.57%	2,347,103
9	MNSO	MINISO Group Holding Limited	Consumer Cyclical	Specialty Retail	China	7.23B	35.90	22.51	11.64%	808,717
10	AAP	Advance Auto Parts, Inc.	Consumer Cyclical	Specialty Retail	USA	3.79B	9.55	64.15	-8.16%	4,007,745
11	GPS	The Gap, Inc.	Consumer Cyclical	Apparel Retail	USA	3.67B	-	10.19	-1.55%	13,104,823
12	M	Macy's, Inc.	Consumer Cyclical	Department Stores	USA	3.28B	3.31	12.10	-20.01%	12,471,816
13	URBN	Urban Outfitters, Inc.	Consumer Cyclical	Apparel Retail	USA	3.04B	17.30	33.46	-6.37%	1,326,295
14	KSS	Kohl's Corporation	Consumer Cyclical	Department Stores	USA	2.57B	-	24.09	-14.36%	4,853,505
15	JWN	Nordstrom, Inc.	Consumer Cyclical	Department Stores	USA	2.50B	141.14	15.52	-18.76%	16,950,152
16	ANF	Abercrombie & Fitch Co.	Consumer Cyclical	Apparel Retail	USA	2.39B	81.90	50.21	16.26%	1,771,949
17	PTON	Peloton Interactive, Inc.	Consumer Cyclical	Leisure	USA	2.04B	-	5.86	-16.48%	12,255,792
18	FL	Foot Locker, Inc.	Consumer Cyclical	Apparel Retail	USA	1.62B	6.63	17.32	-31.47%	6,330,215
19	LZB	La-Z-Boy Incorporated	Consumer Cyclical	Furnishings, Fixtures & Appliances	USA	1.28B	8.50	29.59	-3.90%	141,909
20	GES	Guess?, Inc.	Consumer Cyclical	Apparel Retail	USA	1.20B	11.97	22.74	13.56%	1,890,958

Filters: earningsdate:thisweek sec:consumercyclical export

Overview | Valuation | Financial | Ownership | Performance | Technical | Custom | Charts | Tickers | Basic | TA | News | Snapshot | Maps | Stats

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No.	Ticker	Company	Sector	Industry	Country	Market Cap	P/E	Price	Perf Week	Volume
1	DLTR	Dollar Tree, Inc.	Consumer Defensive	Discount Stores	USA	27.26B	20.09	124.22	-13.02%	2,730,407
2	COTY	Coty Inc.	Consumer Defensive	Household & Personal Products	USA	9.36B	59.39	11.10	-1.55%	1,645,812
3	BJ	BJ's Wholesale Club Holdings, Inc.	Consumer Defensive	Discount Stores	USA	8.62B	17.06	64.82	-6.48%	1,059,843
4	LANC	Lancaster Colony Corporation	Consumer Defensive	Packaged Foods	USA	4.54B	34.75	165.50	-9.53%	95,164
5	JBSS	John B. Sanfilippo & Son, Inc.	Consumer Defensive	Packaged Foods	USA	1.15B	17.57	99.15	-3.05%	52,613
6	HAIN	The Hain Celestial Group, Inc.	Consumer Defensive	Packaged Foods	USA	1.04B	-	11.94	-3.16%	843,439
7	YSG	Yatsen Holding Limited	Consumer Defensive	Household & Personal Products	China	580.96M	-	1.03	2.88%	753,894
8	DAO	Youdao, Inc.	Consumer Defensive	Education & Training Services	China	483.11M	-	3.70	5.11%	109,986
9	COE	51Talk Online Education Group	Consumer Defensive	Education & Training Services	Singapore	44.02M	-	7.78	2.98%	13,908
10	BSFC	Blue Star Foods Corp.	Consumer Defensive	Packaged Foods	USA	1.81M	-	0.66	-24.80%	152,779

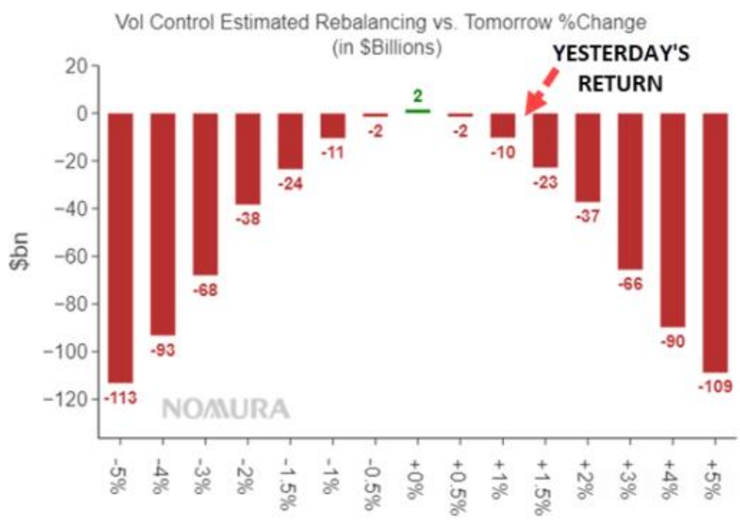
Filters: earningsdate:thisweek sec:consumerdefensive export

In this note, I've continually highlighted extended positioning with regard to systematic strategies, and last Friday showed a large degrossing in the CTA arena. And, we knew vol control strats were just sitting there at their near maximum long exposure even as market volatility was increasing, which if it continued would force them to change that. Well, they finally showed up to do some rules-based selling:

"Due to the 'poor man's crash-up' move [on Wednesday] as well as the fuel from the week-long, high-conviction rally into the NVDA print… the expanded index range from Wednesday's +1.1% move actually meant that vol control funds needed to de-allocate," Nomura's Charlie McElligott said late Thursday. On Wednesday afternoon, Nomura's models tipped nearly $20 billion for sale today.

Vol Control Implied Rebalances as of: 8/23/2023

SPX Index 1d Change	1.1%	**Assumed**	$bn	**Assumed**	%
Est. Vol Control Chg $bn	-19.9	**AUM**	250	**Target Vol**	10

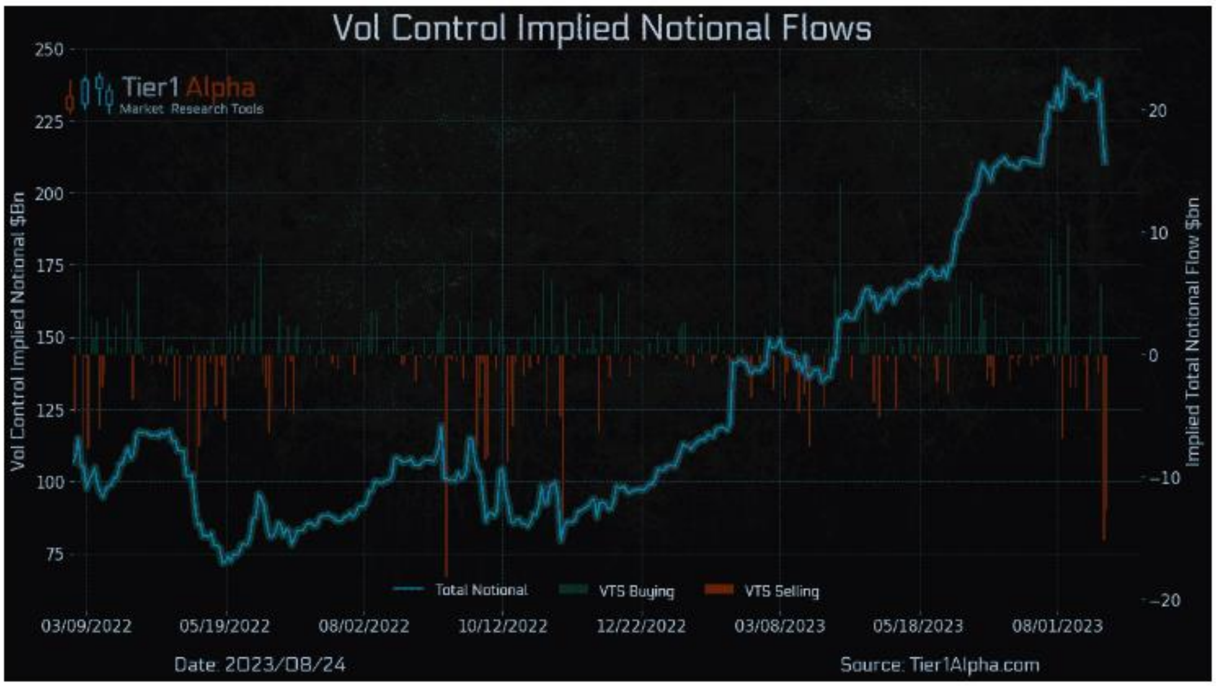


Source: Nomura Vol

Source: https://heisenbergreport.com/2023/08/24/the-20-billion-sell-flow-behind-thursdays-counterintuitive-stock-plunge/

Tier1Alpha supports this conclusion yesterday as well, as the market viciously reversed NVDA induced euphoria:

The 1-month realized vol shot up into the high 11s yesterday, which caused another substantial selling event from the vol control space. We estimate that these funds had to mechanically sell around $13 billion in equities on the move, bringing the two-day total to around $28 billion in selling flows. In the context of an inelastic market, that means this selling has wiped out hundreds of billions in market cap, putting considerable pressure on the equities market.



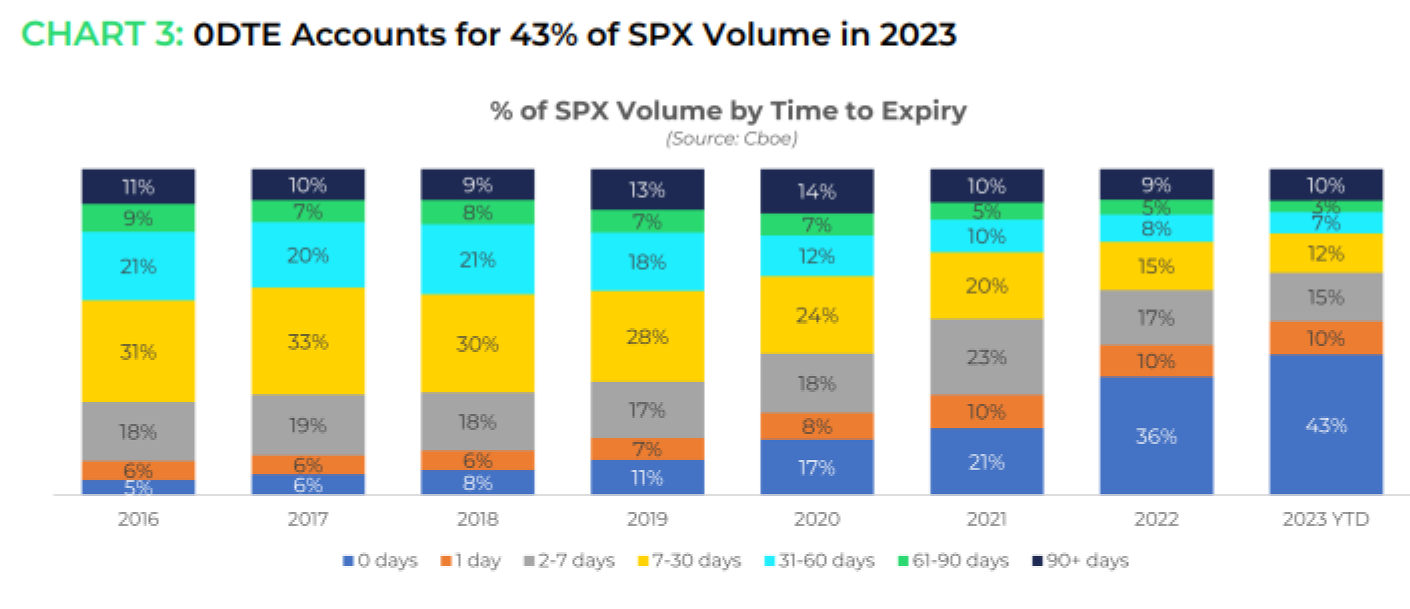
Source: Tier1Alpha **MARKET SITUATION REPORT**

08/25/23 08:33 AM EDT

The close today told you nothing if you didn't see the road the market took, at least a 120 point round trip on the S&P 500, that is a lot of intraday volatility and once we get closer to quarterly opex, you can probably expect more of that.

Just consider what is coming in early September: CPI, retail sales and the ECB meeting, all right before quarterly OPEX. Vixpiration comes the day the Fed meets the week after all that. A nice recipe for more volatility.

Speaking of vixpiration, I can't go a note without mentioning 0DTE, and if you wonder why the VIX itself has so much less relevance these days (don't say it's broken, it does what it was designed to do, measure implied vol in a certain window, 25-39days out) here is a chart of the change in tenor in options traded:



Source: https://www.bloomberg.com/news/articles/2023-08-24/retail-traders-are-driving-up-to-40-of-zero-day-options-boom?sref=1zxv5xkq

There is probably value in unloved longer-dated options with stubbornly low implied vol. And as we have shown, there most certainly is when you do creative hedging, like long put butterfly spreads set 5% out of the money when IV is low at the end of an earnings season, for example.

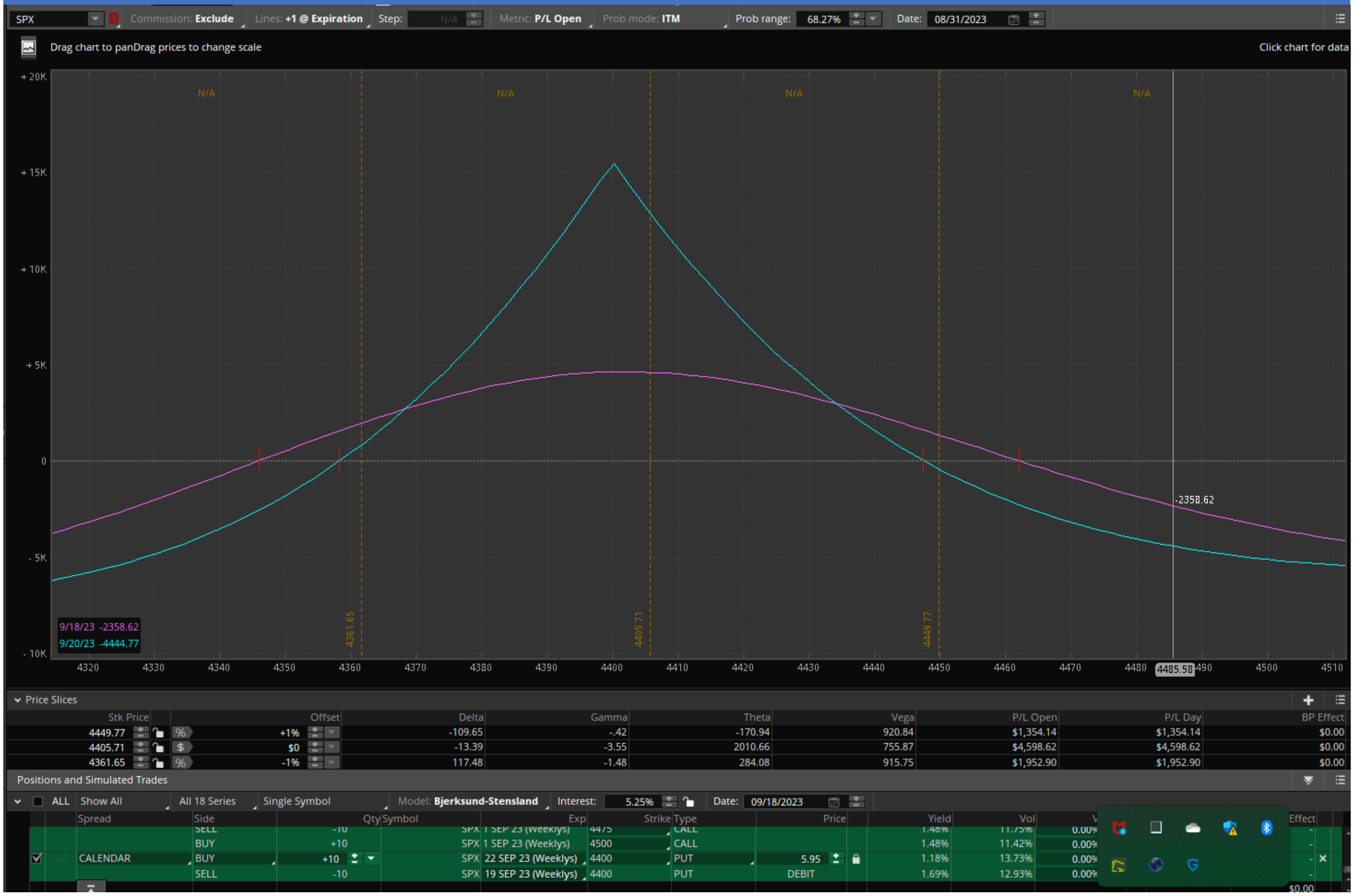
Volatility Trade:

Fed Meeting SPX put calendar spread

Sell $4400 Sep 18th put

Buy $4400 Sep 22nd put

Net debit: $6



Skating to where the puck will be has its benefits. Only 6 SPX points/.13% of the index to own 3 days with the Fed meeting in the back leg. Target $12.

BIZARRE UNCLENCH PRECEDES POTENTIALLY BINARY NVDA REPORT – OLD FASHIONED 0DTE RETURNS – END OF MONTH/SEP OPEX TRADE IDEAS

VOLATILITY SUMMARY

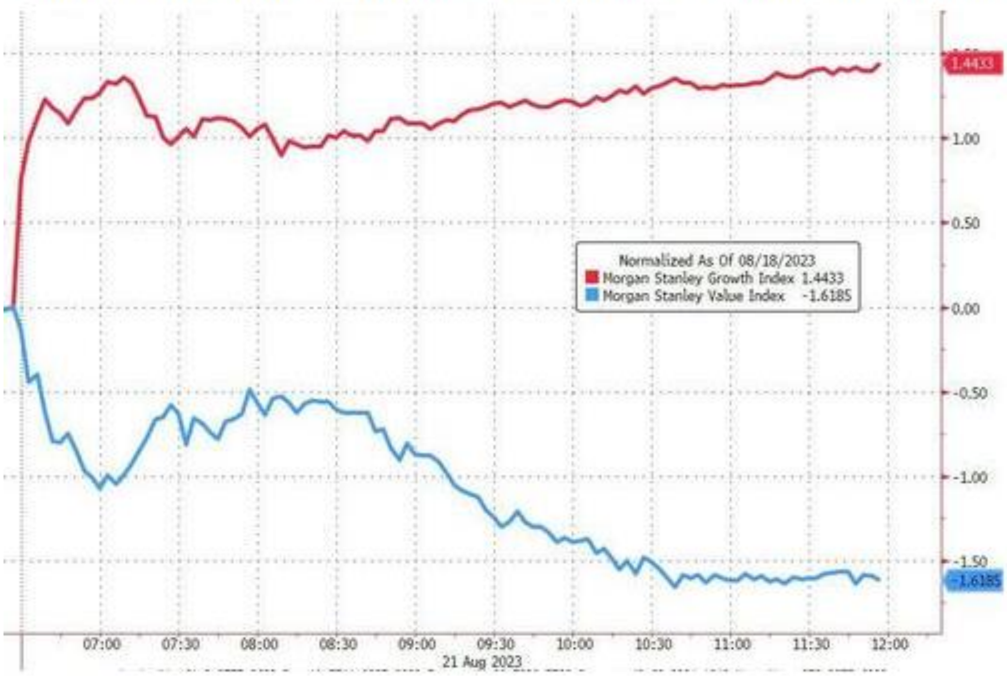
Unclench arrived, at least for a few things. While breadth yesterday was pretty much horrible, the general market of stocks acting as if rates had a foot on their underwater heads, a few stocks (if you didn't know what they were, blindfolded you could have guessed) surged yesterday in comical fashion.

I was tempted to put a trade in the note on this one, because the technicals were kind of screaming, and unclench delivered over 7%:

A simple call butterfly for September 1st would have worked quite well. I will have a trade for TSLA in the coming notes around quarterly deliveries vol again.

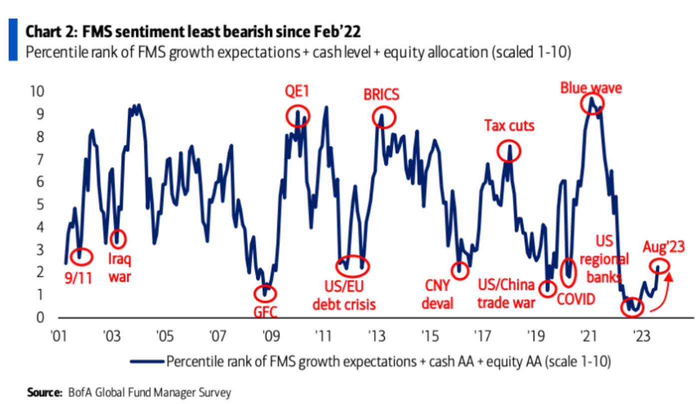
But this was basically the theme of the unclench:

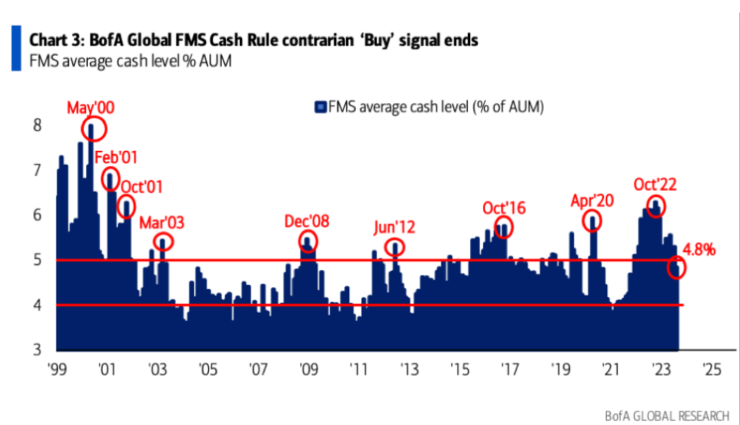
Today was the biggest 'growth' outperformance of 'value' since March 2023...



Source: Bloomberg

In the last note I mentioned how some systematic investors have shed billions, but the flows lately have been moving in different directions. The global fund manager survey showed lowest cash levels in a while as they were dragged in, I mean, December is coming quickly and they were being too responsible right?





Meanwhile active managers played it just right again, long into earnings season and dumping at the end of it:

NAAIM Exposure Index

The **NAAIM Exposure Index** represents the average exposure to US Equity markets reported by our members.

The green line shows the close of the S&P 500 Total Return Index on the survey date. The blue line depicts a two-week moving average of the NAAIM managers' responses.

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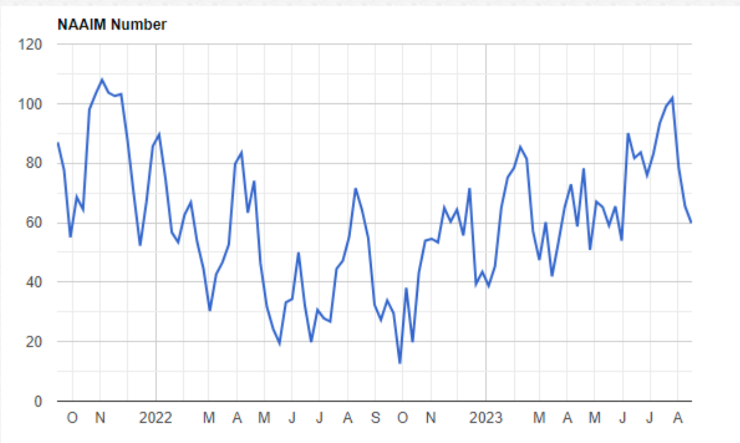
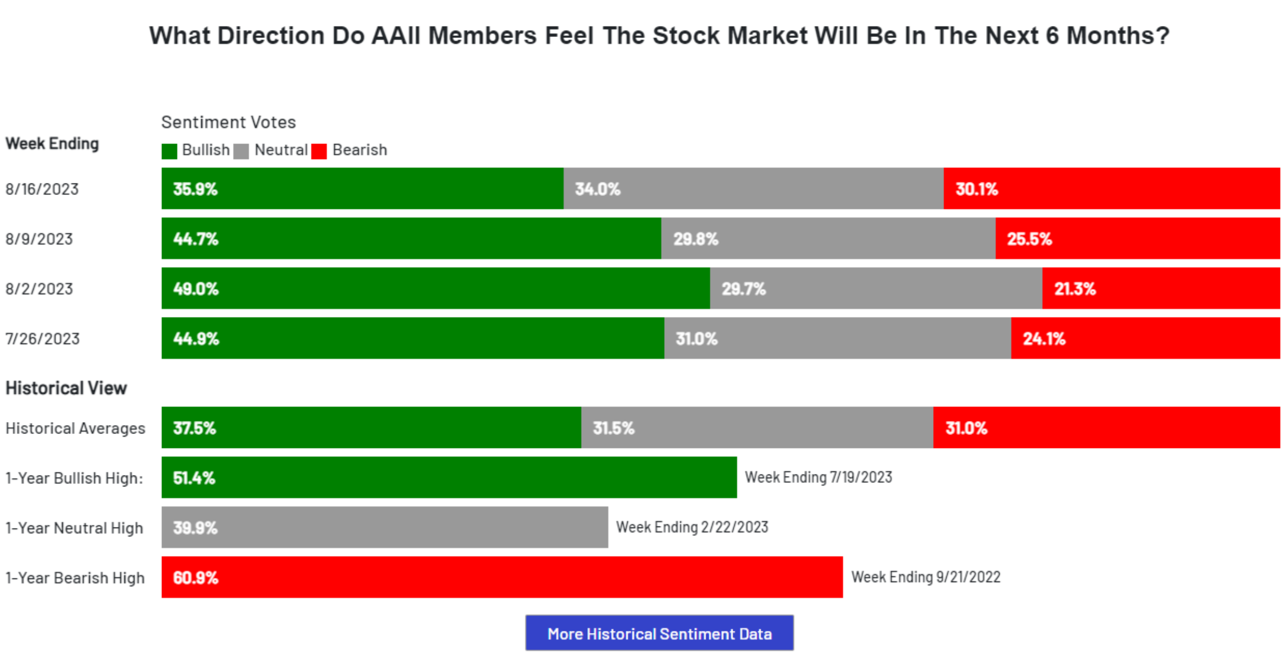


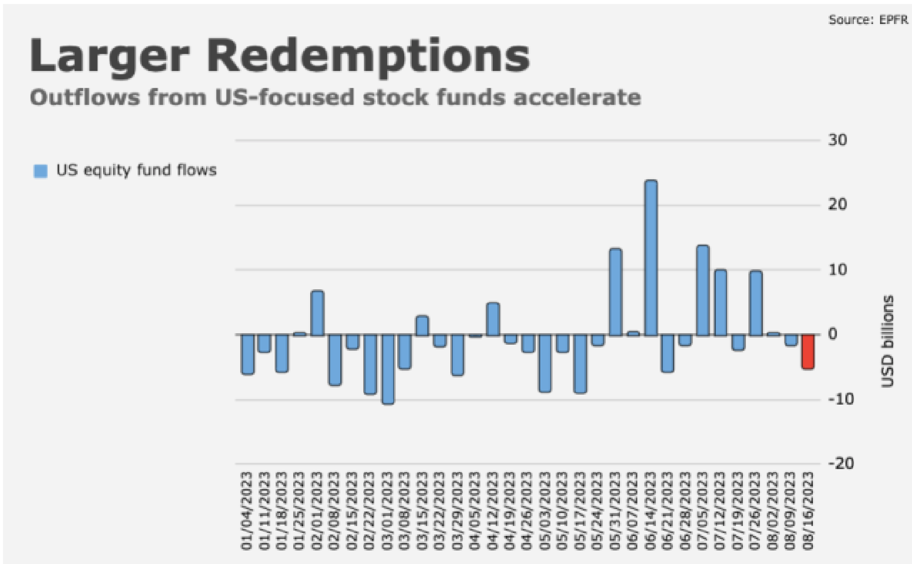
And individual investors did a lot of the same, sentiment is now much cooler:



And thus, we saw the largest outflow from equity funds since June:

The $5.522 billion exodus was the second consecutive, and coincided with deteriorating sentiment and mounting losses for US shares, which are on track for their first monthly decline since February.

Regular readers can (hopefully) recite the 2023 history of US equity fund flows from memory by now. Net flows were negative to the tune of nearly $70 billion through late May, before Nvidia's blockbuster beat and raise turned the tide. Days later, the debt ceiling standoff in D.C. was resolved, adding to the good vibes.



https://heisenbergreport.com/2023/08/18/us-stock-funds-see-largest-outflow-in-months-as-sentiment-turns/

So, you get the idea that a lot of froth has been scraped off the top, so to speak. Just in time to prepare for the NVDA report, and the stock had a spaz attack yesterday as a host of 'analysts' rushed to upgrade before earnings so they don't look stupid (insert your own joke):

And, as the end of the month comes along with a holiday shortly after, vol burn/vanna/charm, whatever term you like is upside market fuel, and Charlie the celebrity quant makes that plainly clear, the last sentence the key:

Crucially, additional downside probably needs to materialize soon, otherwise the pullback window mentioned above will close — and reopening it will require a macro catalyst.

"Anytime you get UX1 moving up five vols in the course of five days, vol needs to be fed with movement in order to be sustained," McElligott reminded market participants. Otherwise, it'll "mean-revert under the weight of its own expectations."

BBG

The simple figure above illustrates the point.

Friday's high print for VIX futures was 19.6. The implied daily change was 1.2%, but when the dust settled, stocks were unchanged. That, Charlie remarked, "is an absolutely brutal realized vol bleeder."

https://heisenbergreport.com/2023/08/21/window-for-stock-pullback-may-close-without-more-fireworks/

Add to this the fact that the 10-yr futures options expire with a pointless exercise in Jackson Hole on Friday and the 0DTE crowd could be right back to their call sweep playbook into month end.

Volatility Trades:

QQQ SEP CPI/ECB/OPEX put calendar spread

Sell $370 Sep 8th put

Buy $370 Sep 15th put

Net debit: .90-.95

There is a lot going on in the back leg, so to get that week for .25% of the underlying is a terrific price. Being early often matters a lot with these time spreads. $370 is a logical level to set these at the outset:

Equivalent spreads this week are pricing $1.50-2 at the moment, so that's a more than reasonable target.

End of month SPX call condor spread

Buy $4425 Sep 1st call

Sell $4450 Sep 1st call

Sell $4475 Sep 1st call

Buy $4500 Sep 1st call

Net debit: $4.70-4.90

If you believe that the end of the month will be kinder and upward drift returns, here is a trade that for less than 5 SPX points you can get 4-1 leverage on the debit from 4425 to 4475, an area where the index broke down from. Target $10.

OPEX WEEK AND ZERO DTE INCITE DOWNSIDE REALIZED VOL – TREASURY FUTURES HINTING AT ANOTHER CAUSE – TRADE FOR CPI/ECB

VOLATILITY SUMMARY

(While realized volatility is high, I will do shorter but more frequent notes, the next note will be Monday night after opex unclench.)

Well, things quickly got a bit unhinged, and I certainly didn't expect it this week. Sure, there was some news about China issues that have been on simmer for what seems like two decades now, and useless ratings agency threats, but, let's be honest, that's not what's going on.

J'Accuse 0DTE! was the cry from the many Muppet peanut gallery critics, on why all things were falling this week:

They're options tied to S&P 500 with a maturity less than 24 hours. A flurry of trading in the contracts known as zero days to expiration, or 0DTE, was the backdrop to a jarring acceleration of the day's decline, one in which the equity benchmark slid roughly 0.4% in 20 minutes, according to Goldman Sachs Group Inc.'s managing director Scott Rubner.

According to Rubner, market makers, whose need to keep books balanced often means they must buy or sell stock en masse when options orders cascade in, were forced into action by furious trading in bearish puts with a strike price at 4,440. Those options saw almost 100,000 contracts change hands during the session, or $45 billion in notional value.

As their cost spiked to $9 from 70 cents in a short span near the session's end, it sent market makers on the other side of transactions in a dash for hedges to stay market neutral. In this case, that meant an exodus from equities.

"There is not enough liquidity on the screens to handle market makers delta hedging such a dramatic move over a short 20 minute period," Rubner, who has studied flow of funds for two decades, wrote in a note Wednesday.

https://www.bloomberg.com/news/articles/2023-08-16/goldman-sachs-blames-zero-day-options-for-fueling-s-p-500-selloff?sref=1zxv5xkq

So, ‘fueling selloffs’ right? The drive by shooter. Ok, so most certainly these folks (quants, code, machines, retail, it’s a motley crew) are a factor, but where was this lynch mob of critics when we were crashing up because the same and growing faction was jamming calls?

Crickets, a crazy sweet free lunch higher on your tech darlings for months, but hypocrites when the move is lower. Sort of like how Congress operates, am I right?

But just because the gun has been planted means they are the only guilty ones. (If the market actually going down once in a while is a crime d’etat.) How about the strats crowd? CTA’s, vol control etc, they are most certainly doing some dumping:

https://www.zerohedge.com/markets/real-money-wrecking-ball-looms-negative-gamma-market-threatens-bonds-stocks

I’ll have more on this topic next week, but let’s move onto another cohort in this crashy crime, rates. You know what’s coming up, and is coincidentally on the date of Jackson Hole? Treasury note futures options quarterly expiration, a biggie, and specifically the 10-yr note futures contract. Just like everything else these days, it has large open interest and, well, look at this:

When these are falling it means that the 10-yr yield is rising, consider it a sort of inverse chart. So, there is a lot of options gamma in these right now, all those open and traded options have to be dealer hedged, just like stocks and indices options and this often forces rates higher during high gamma time periods. And we all know that a rising 10-yr causes stress in just about everything, and yes, in the tech stocks everyone loves.

So, we will see what happens when this period passes and we near the end of the month. Probably rates will chill out and so will the markets somewhat. Obviously, fresh news is a wildcard that can cause more upheaval, since managers are very long and shorts have covered and vol control is still a huge factor, etc, etc. But I bet we cool off a bit post Jackson Hole.

Volatility Trade:

CPI/ECB SPX put calendar spread

Sell \$4400 Sep 12th SPX put

Buy \$4400 Sep 15th OPEX SPX put

Net debit: \$3.50-4

So, by getting way ahead of this, we can own the last CPI release before the Fed on the 13th and the ECB meeting on the 14th, two events that most certainly will have market implied vol taking notice. For 4 SPX points, owning this period in the back for that price is a steal.

RANGEBOUND CHOP CONTINUES – 0DTE GETS LARGER – TRADES FOR JACKSON HOLE

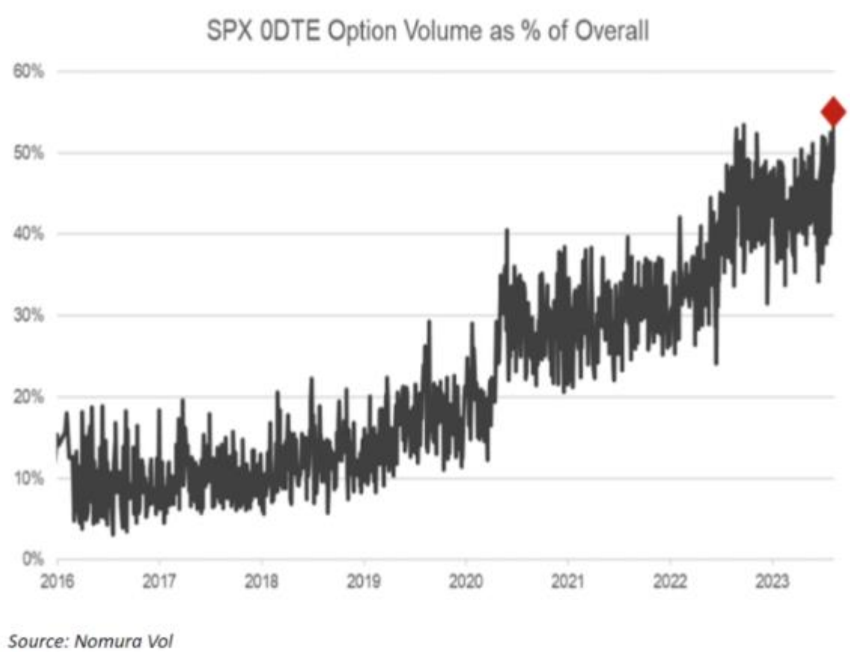
VOLATILITY SUMMARY

It’s OPEX week again, a time when things seem to magically get fixed (two ways to take that, fixed as in repaired and fixed as in fixed to levels), in beaten down stocks anyway. So, rangebound chop, as anticipated, is dominating the post-earnings market world, which is about as benign an environment vol spread traders can enjoy. And the trades in recent notes have proved that out.

So, more of the same with the trades, eyeing the next event; Jackson Hole.

In the meantime, 0DTE options mania is slapping the market around, up opens are trashed, and down opens are smashed. As real investors stand aside during post-earnings summer’s light volume, the mice will play, and 0DTE is in full control of the market it appears:

> The intraday selloffs have “driven a behavioral change in 0DTE space vs what we have seen largely during the rally,” said Charlie McElligott, Nomura’s cross-asset strategist. “It’s an environment ripe for 0DTE trading swings, ranges or overshoots as the perfect vehicle. But then too, it’s feeding such moves.”



Source: Nomura

https://www.bloomberg.com/news/articles/2023-08-14/zero-day-options-cement-presence-in-reversal-ridden-stock-market?sref=1zxv5xkq

And the more success folks have with these, the more they will do it of course. Remember my money at the street corner allegory from the last note, if you hand it out, they will *not* stop coming to collect because they are fearful of being greedy:

> About 1.86 million so-called zero-day contracts – those tied to S&P 500 with a maturity less than 24 hours – changed hands on Thursday, making up a record 55% of the index's total volume, according to data compiled by Nomura Securities International. Halfway into August, the options known as zero days to expiration, or 0DTE, have seen four of their top 10 most-traded sessions ever.

You can hate the game (and the players) but until they are cracked in the head with a 2x4 a few times, they won't think twice about doing even more. It's like global warming, the hotter it gets means it's only going to get even hotter.

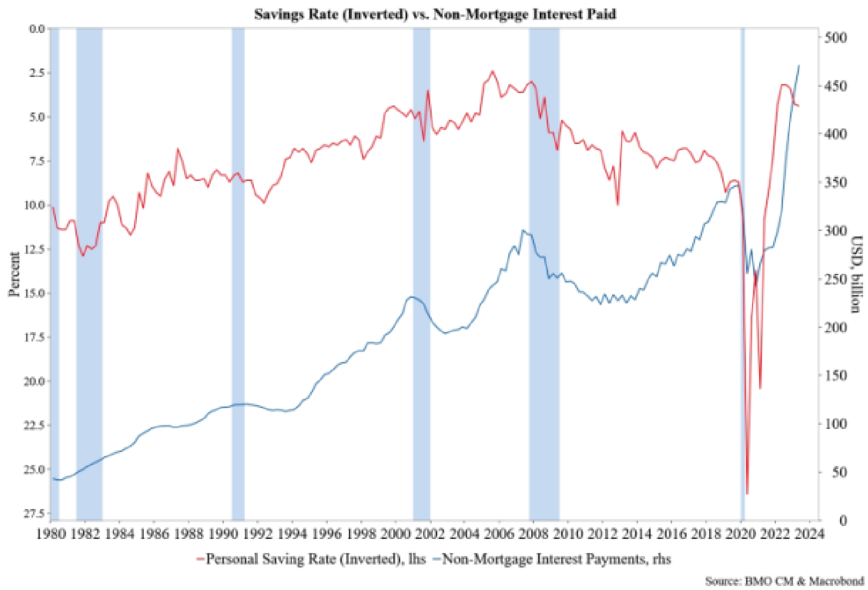
Finally, puts are outnumbering calls, because forcing dealers to hedge downside gamma works too, you know, and puts have been so cheap lately, call skew has been pretty much at record highs:

> Also notable has been a turn in the type of options traders have favored – from bullish to bearish. Over the past 20 days, puts outnumbered calls by almost 10%, according to data compiled by Kaiser. That's a departure from the previous two months, when flows were dominated by calls.
>
> "You could argue with implied volatility low, the 0DTE options are an alternative to trading equity futures tactically," he said.

Source: Citi

So, at the risk of saying this for the 100th time, this environment has the potential to light the house on fire, and some sort of economic shock into the fall when everyone expected to be riding huge, large cap equity gains into the sunset of 12/31 statements, that's the combination. So here's a chart that should interest (re:alarm) you:

But there are signs of strain or, at the least, reasons to believe the consumer will eventually pause, if not retrench. Credit card debt in America topped $1 trillion for the first time in Q2, and credit card rates are at record highs. In addition, "interest costs on other loans [are] detracting discretionary dollars," BMO's Ian Lyngen and Ben Jeffery remarked.



The chart above, from Lyngen and Jeffery, shows that interest costs ex-mortgage payments have "increased in a way that has typically only been seen in the final innings of any given cycle," as they put it, adding that when you throw in the resumption of student loan payments, "there are headwinds to consider in evaluating the durability of the domestic consumer… even before the labor market starts to turn."

https://heisenbergreport.com/2023/08/13/between-cpi-and-jackson-hole/

https://heisenbergreport.com/2023/08/08/congratulations-america-you-now-have-1-trillion-in-credit-card-debt/

Volatility Trades:

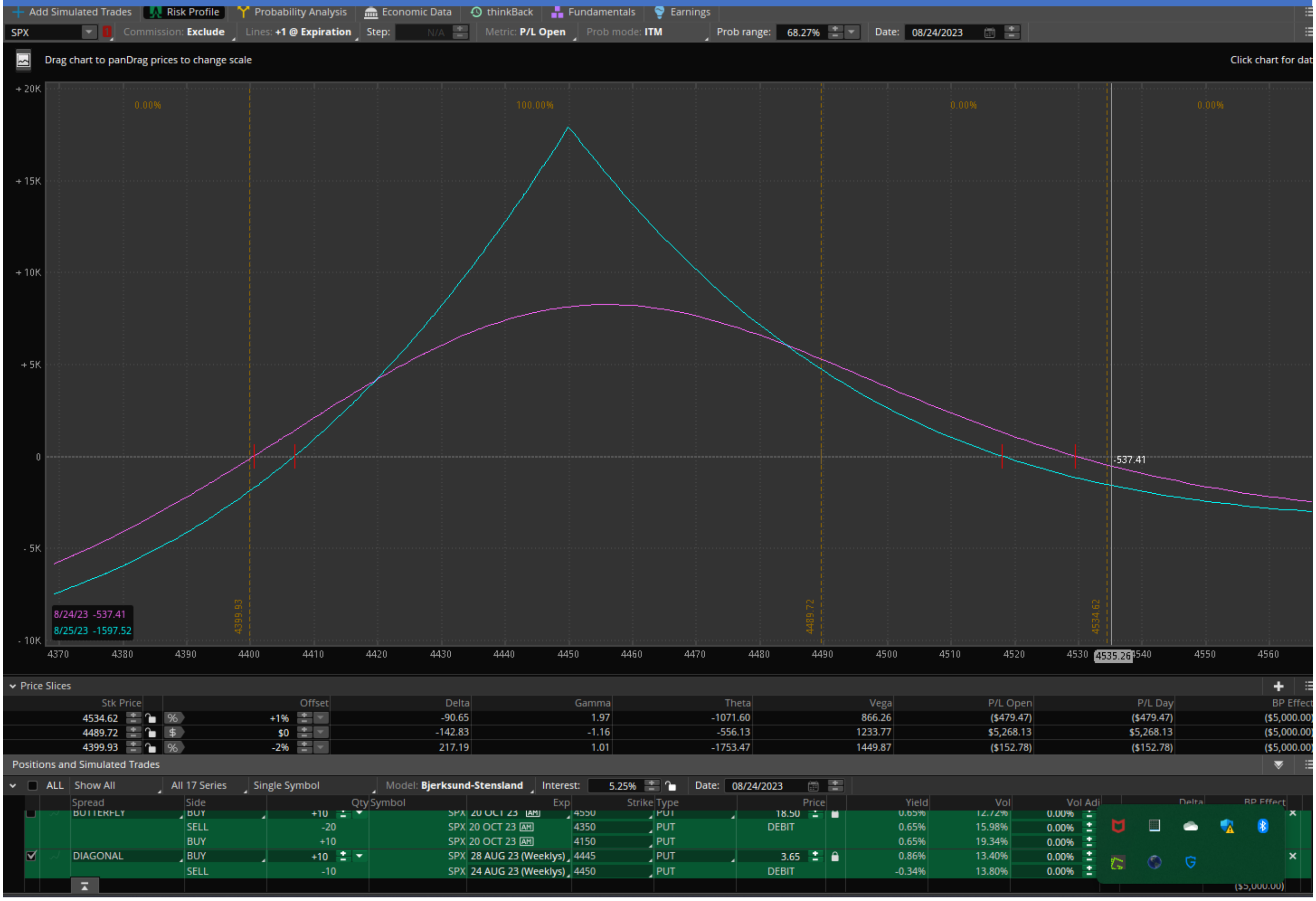
SPX Jackson Hole put diagonal spread

Sell 4450 Aug 24th put

Buy 4445 Aug 28th put

Net debit: $3.50

VOLATILITY ANALYTICS NEWSLETTER – SEPTEMBER 6TH



Selling vol just before Jackson Hole, the speech is Friday the 25th and owning the speech and Monday for only 3.5 SPX points, less than .1% of the index. A steal. The short leg is the recent low for SPX. Target $6.50-7.

You might be able to use declining vol around vixpiration to get this at a better price through Wednesday morning or move the strikes up a bit.

Russell 2000 Jackson Hole put diagonal spread

Sell 1900 Aug 23rd put

Buy 1895 Aug 25th put

Net debit: $1.25-1.35

Same premise, just moving this up to a Wednesday/Friday combination, it doesn't have dailies so the trade can't be done Thursday/Monday nor in IWM 5 points apart. And this offers 60/40 tax treatment like SPX, so using RUT over IWM has multiple benefits.

If the market has a down day early next week, getting 7-8 for this is entirely reasonable, and you're paying less than the SPX diagonal, .06%.

QQQ NVDA earnings/Jackson hole put diagonal spread

Sell Aug 23rd $370 put

Buy Aug 25th $369 put

Net debit: .20-25

Again, we have lowered the bar for this trade versus SPX, because it has NVDA earnings reaction in the back leg along with the speech. Obviously, NVDA/Semis are sizeable chunk of QQQ and there will be implied vol in the back leg. Target, .75.

GOOD RIDDENS JULY VOL – HELLO AUGUST POST-EARNINGS EKG VOL – RATES/CPI INDUCED VOL POTENTIAL NEXT WEEK – CPI/QQQ/AAPL TRADES

VOLATILITY SUMMARY

There isn't a whole lot to say this week, as the last two notes summed up the expectations of what we are now seeing, a return to some kind of normalcy, where down days actually happen once in a while. The S&P 500 hasn't touched the 20-day moving average in ages and hasn't closed below it since May 24th, one day after the last -1% day in SPX.

I highlighted last week how AAPL earnings in January seemed to be the dividing line between a seemingly endless ramp and a return to volatility. But volatility doesn't mean straight down, we are probably entering the 'EKG' market for a while:

The markets didn't really head down in a significant way until late in February OPEX week. Makes sense. A sentiment shift isn't going to happen overnight and not on news that some agency ticked down the U.S. credit rating. Vol sellers and gamma Thursday/Friday folks have had way too many wins in succession to just stop doing it.

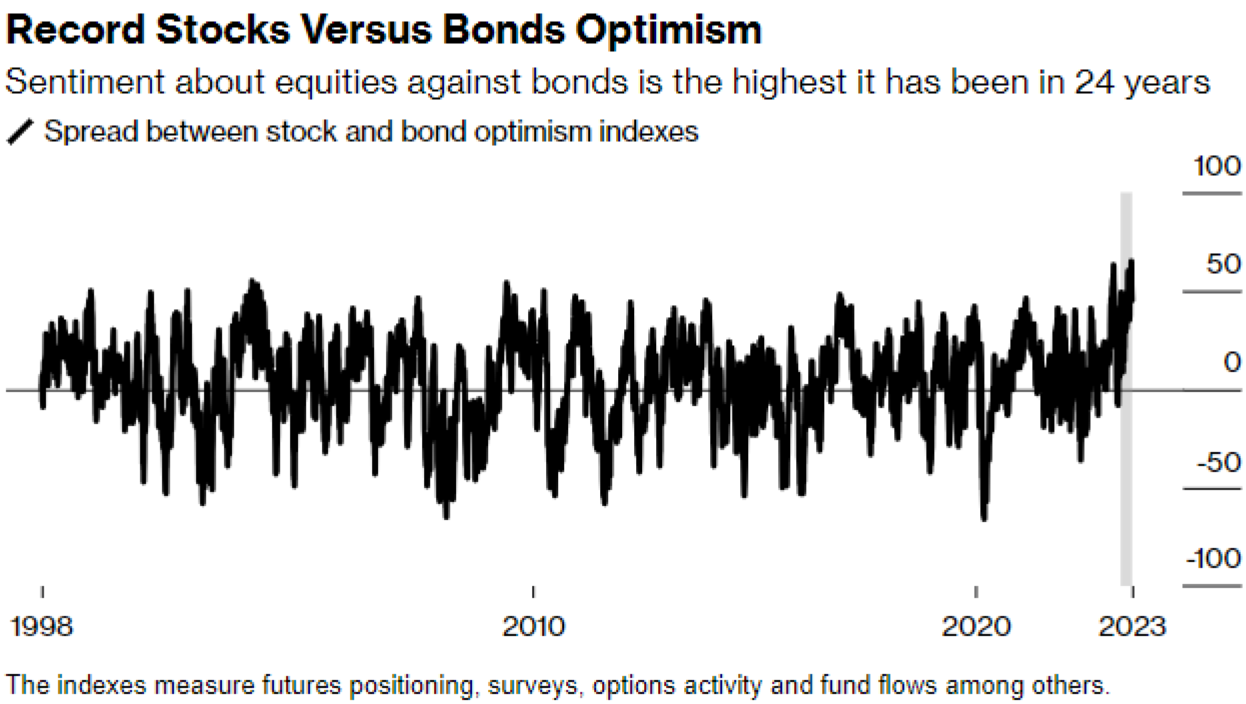
They will do what's working until an unforeseen event/big drop stops them. It's not greed, as the inane punditry's trite blather suggests. *If someone hands you $100 every day on the street corner, are you going to stop showing up to get it because you feel greedy? You'd be crazy to!* I'd wonder if you were ok if you didn't show up.

Post-earnings in May was somewhat the same, the markets chopped around for a while. And what kind of vol is the best vol? It's heavy chop going nowhere. Options are bid, you set your strike, time goes by, and you collect. (In time spreads ((calendars diagonals)), and butterfly spreads, the stuff this letter is about with regard to vol trading.)

A few interesting charts I came across, first, remember the endless commentary on rates and durations stocks last year? Well, just another correlation to toss in the dustbin:

(10-yr yield vs. NDX)

Right on cue, at the end of earnings season and after a huge extended market ramp, the optimism for stocks versus bonds is about as high as it's ever been:



Option hedges/puts 5% out of the money are at a record low implied vol:

> Wall Street traders eventually got the memo, ditching downside protection and pushing the cost of hedging against drops to fresh lows. For every $100 in notional – the value an options contract covers – investors now pay only $3.50 for an S&P 500 put option expiring a year from now with a strike price 5% below current levels, data compiled by Bank of America show. That's the least in the bank's data going back to 2008. (Between the premium and the strike price, the contract will be profitable if the S&P 500 falls at least 8.5% a year from now.)

https://www.bloomberg.com/news/articles/2023-07-30/stocks-are-doing-so-well-that-it-may-be-time-to-start-worrying?sref=1zxv5xkq

> At the same time, a wide array of hedging metrics is showing low demand for downside protection. Put premiums for both Invesco QQQ Trust Series 1 (QQQ) and the SPDR S&P 500 ETF Trust (SPY) are hovering around the lowest levels in at least a decade, according to RBC Capital Markets. Additionally, investors are buying more calls to chase the rally while spending less to protect their gains.

https://www.bloomberg.com/news/articles/2023-07-28/-dangerous-consensus-has-investors-betting-it-all-on-buoyant-markets?sref=1zxv5xkq

And, speaking of cheap options, I completely forgot the gamma gaming that occurs at the end of months and quarters. Kicking myself really, because I have a catalyst spreadsheet, with observations gleaned over the years and this is on there:

15	EOM/EOQ	last day	EOD gamma ramp
16			

Very clearly stating, to watch at end of quarters and months for the end of the day gamma ramp. I was asleep at the wheel and look what happened:

Have you ever made 1000% in 10 minutes? Well, you could have by simply buying an at the money call at 3:50pm:

Volatility Trades:

QQQ CPI/10yr auction put calendar spread

Sell Aug 9th $370 put

Buy Aug 10th $370 put

Net debit: .25-.28

So, the 10-yr yield almost broke out today:

If it does, the profitless tech stocks should be most vulnerable. And, what happens next week? A combination of a 10-yr auction midday Wednesday, followed by a CPI report on Thursday morning that will most certainly not be as kind as June's report.

I'm going to expect the typical Thursday/Friday gamma bounce in giga tech and vol to come in a bit, so current prices at .38 or so aren't attractive enough. If the bounce occurs and vol is smashed, I will add this spread for around .25-28, with a target of .50 on Wednesday.

AAPL IPhone event calendar spread

Sell $190 Sep 1st put

Buy $190 Sep 15th put

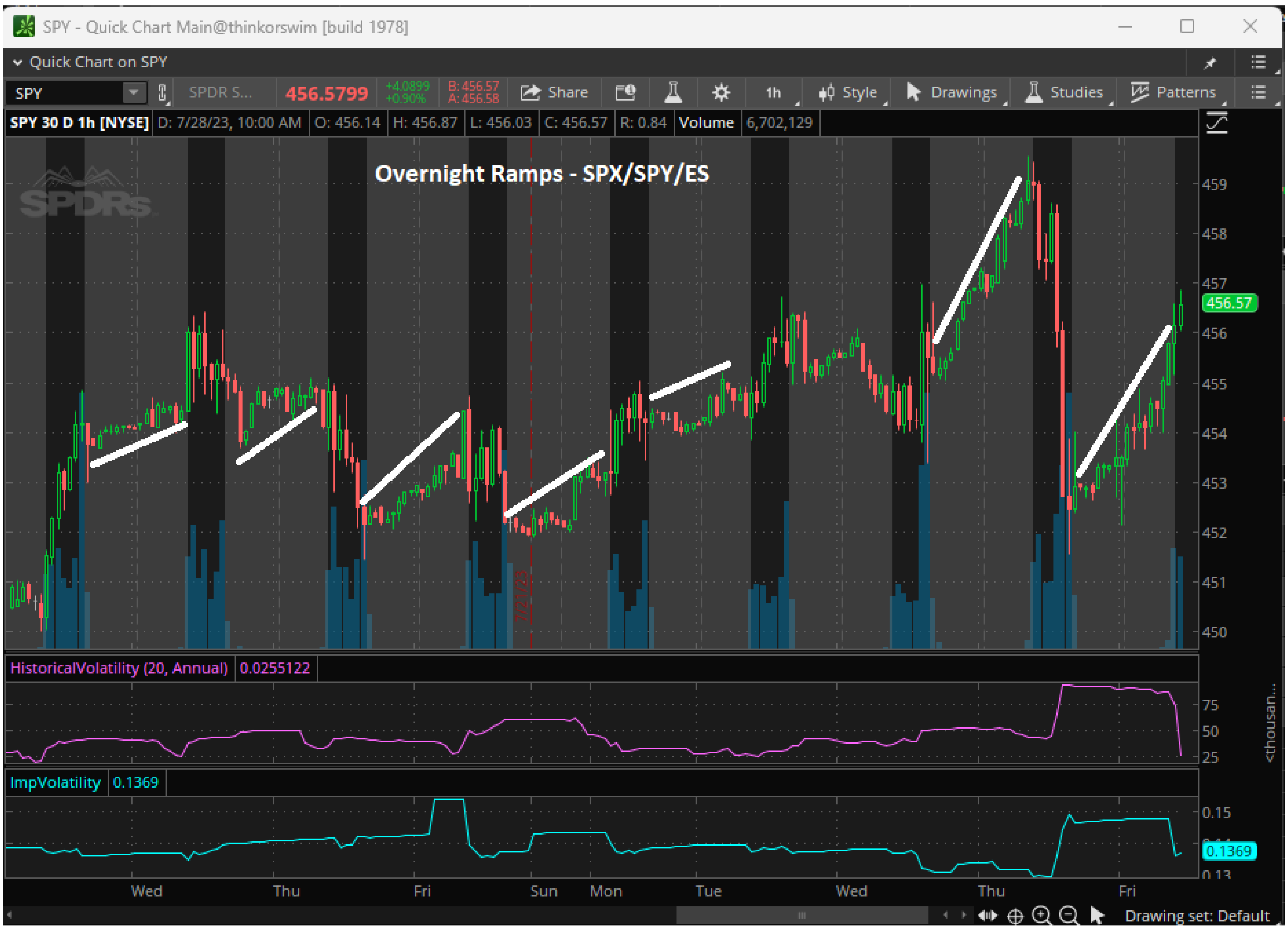
Net debit: .60 (filled)

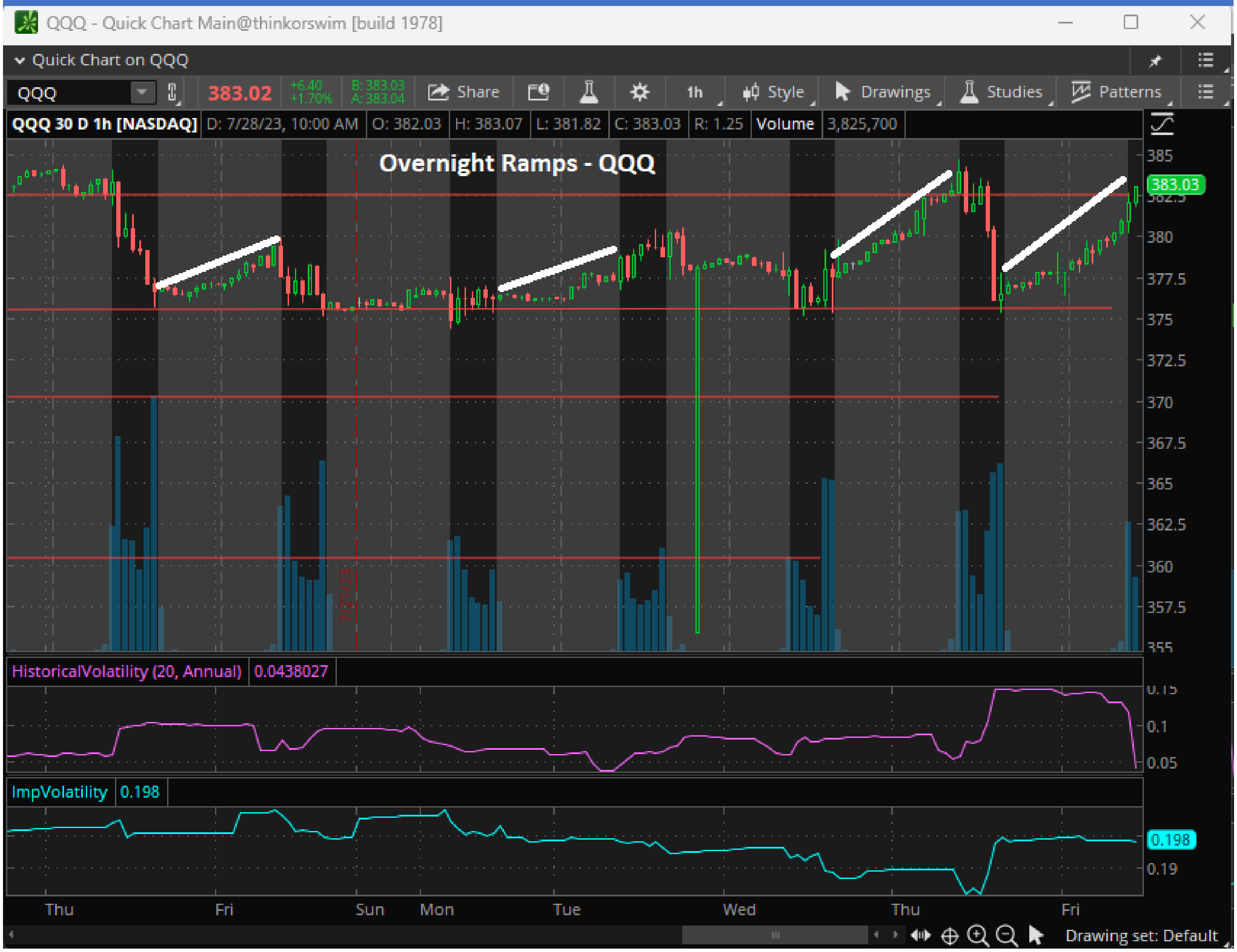
I'm amazed at the cheapness of this calendar spread. Sure, Labor Day is in the back leg, reducing the price a bit, but 60 cents / $192 = .3%. That is the cost to own two weeks and the Iphone launch event. Target $1.50.

OVERNIGHT RAMPING APPROACHING COMICAL – VOL MAY INCREASE POST AAPL/AMZN AS CORRELATIONS RISE – TRADES FOR NFP/CPI/POST TECH EARNINGS

VOLATILITY SUMMARY

I'm trying to remember when I last saw this, probably October into November of 2021, when every night it seemed the futures just seemed to be caught in a tractor beam higher, down wasn't an option, and it's happening again:





I'm sure there is something to this, could be mechanical delta hedging of short calls by dealers. But whatever it is, it does make buying any dip before bed and waking up to homemade QE interesting.

I don't do this naked, I've got asymmetrical downside gamma in case a miracle happens, and the market opens lower, so I won't say don't try this at home…. but like every other time when vol is suppressed, there is that one day when the pain comes for those that were trying to pick up nickels of premium. You know, because it works every day.

In the meantime, folks keep getting longer, they can't help themselves. NAAIM hit another high going back to 2021:

NAAIM Exposure Index

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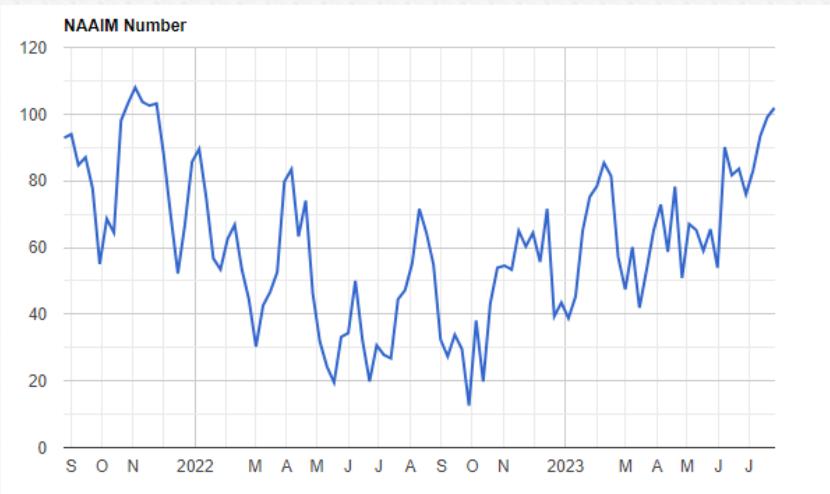


Lance Roberts @LanceRoberts · 3h

The #NAAIM index hit 101.82 this week. As shown, whenever professional managers net exposure is 97% or above, such is historically near short-term #market peaks. #ContrarianIndicator

5 8 54 4,122

And, if you recall my short memories rant, well, it was only recently that folks were thinking about stuff like this, important economic turning points that are dead ahead now:

Business | The Big Take

A $500 Billion Corporate-Debt Storm Builds Over Global Economy

Concerns of a credit crisis have receded. But a wave of corporate bankruptcies is building now that an era of easy money has come to an end.

By Jeremy Hill and Lucca De Paoli
July 18, 2023 at 7:00 PM EDT *Updated on July 19, 2023 at 1:06 PM EDT*

Richard Cooper's phone is something of an early alarm bell for the global economy. Lately, it's been ringing a lot.

A partner at Cleary Gottlieb, a top law firm for corporate bankruptcies, he's advised businesses worldwide for decades on what to do when they're drowning in debt. He did it through the global financial crisis, the oil bust in 2016 and Covid-19. And he's doing it again now, in a year when big corporate bankruptcies are piling up at the second-fastest pace since 2008, eclipsed only by the early days of the pandemic.

"It feels different than prior cycles," Cooper said. "You're going to see a lot of defaults."

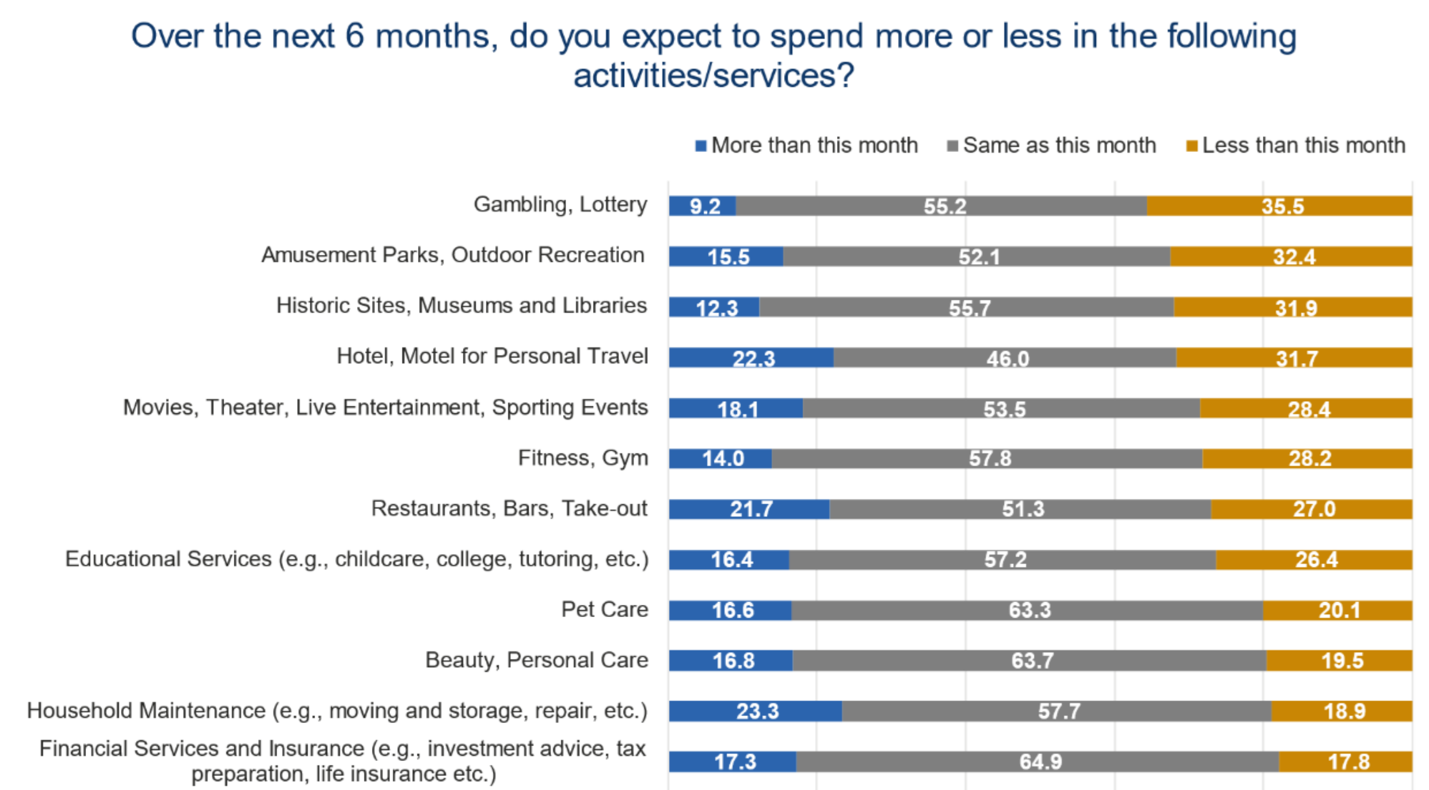
https://www.bloomberg.com/news/features/2023-07-18/billions-in-corporate-debt-wave-of-bankruptcies-threatens-global-economy?srnd=premium&sref=1zxv5xkq

Do you think a corporate bankruptcy lawyer is making this up? A week ago? Well, what are investors doing, *thinking only that the Fed is done*? Not considering anything else, they are buying the junk credit of course, just like in equities:

> On the surface, investors are showing confidence that companies will keep defaults at bay as inflation eases and central banks engineer economic soft landings. The shift in mood in July has been swift: The spread above Treasury bond yields that investors demand to hold US junk debt has narrowed more than 100 basis points to about 370 basis points since the start of May, paving the way for a borrowing spree .

https://www.bloomberg.com/news/articles/2023-07-28/surprise-junk-bond-rally-has-flipside-7-billion-of-shorts?sref=1zxv5xkq

And, curiously, when the consumer confidence data came out a few days ago, folks cheered the current conditions, but ignored what their plans actually are after the summer sprees are over:



VOLATILITY ANALYTICS NEWSLETTER – SEPTEMBER 6TH

This is July being July again. Short memories, drunk on summer rallies when option traders play with the indices on light volume days. We will see how things look in late September into October.

I'll leave the positioning kindling for quant celebrity McElligott to describe, this is all you need to know about how 'stuffed' and 'impulsive' it has gotten:

The "complete flipping of the equities positioning script is occurring against the exact same skew profile seen in late 2022," Nomura's Charlie McElligott said Wednesday. That "speaks to complacency," he cautioned.

Skew and put skew currently rank very low on a historical percentile basis, indicative of subdued "relative demand for downside," McElligott wrote, adding that call skew is still lingering with mid-90%ile rankings, suggesting market participants are far more concerned about crash *up* risk into a rally that refuses to abate.

That under-hedging on the downside juxtaposed with what Charlie described as "stuffed overall positioning across various strat types," looks "unstable."

Remember: A "too low" VIX, or other evidence which ostensibly hints at a lack of concern for a potential drawdown, makes sense (and is rational) if you don't have anything to hedge. That is, if positioning is bombed out and cash levels are elevated, a lack of demand for downside hedges can be explained by a lack of exposure that needs hedging.

But that explanation doesn't work when positioning is, on many metrics, stretched. Charlie called recent exposure adds "impulsive."

Given that, "it makes some sense that the market has finally seen a notable S&P tail-y downside buyer over the past two days," he wrote, flagging September puts on the S&P, which capture the post-Jackson Hole trade and VIX seasonality.

He went on to emphasize a familiar talking point which I actually reiterated first thing Wednesday morning in "Make Vol Great Again." "It wouldn't require a massive move higher in vol to elicit a substantial mechanical deleveraging," Charlie said.

Source: https://heisenbergreport.com/2023/07/26/mcelligott-sees-spooky-dangerous-contrast/

It's still summer, the party isn't over til it's over.

Volatility Trades:

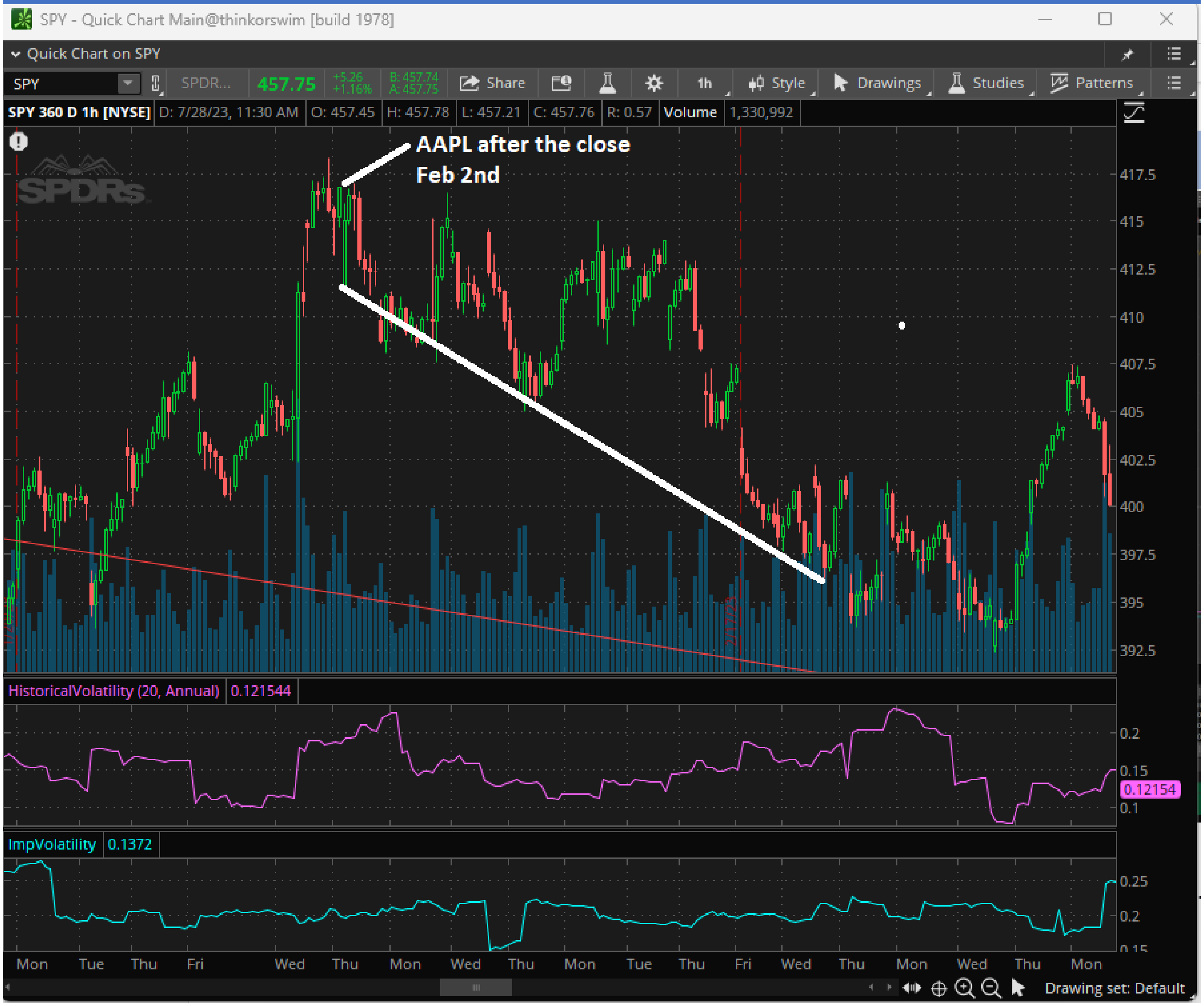
NFP/Post AAPL SPX put calendar

Sell $4550 Aug 3rd put

Buy $4550 Aug 4th put

Net debit: $2.75-3

AAPL and AMZN report after the bell on the 3rd. That's a lot of market cap, 17% of QQQ alone, and along with those reactions, the back vol has non-farm payrolls. Paying less than 3 SPX points is cheap. And, looking back at when the January int February rally ended, this was the dividing line:



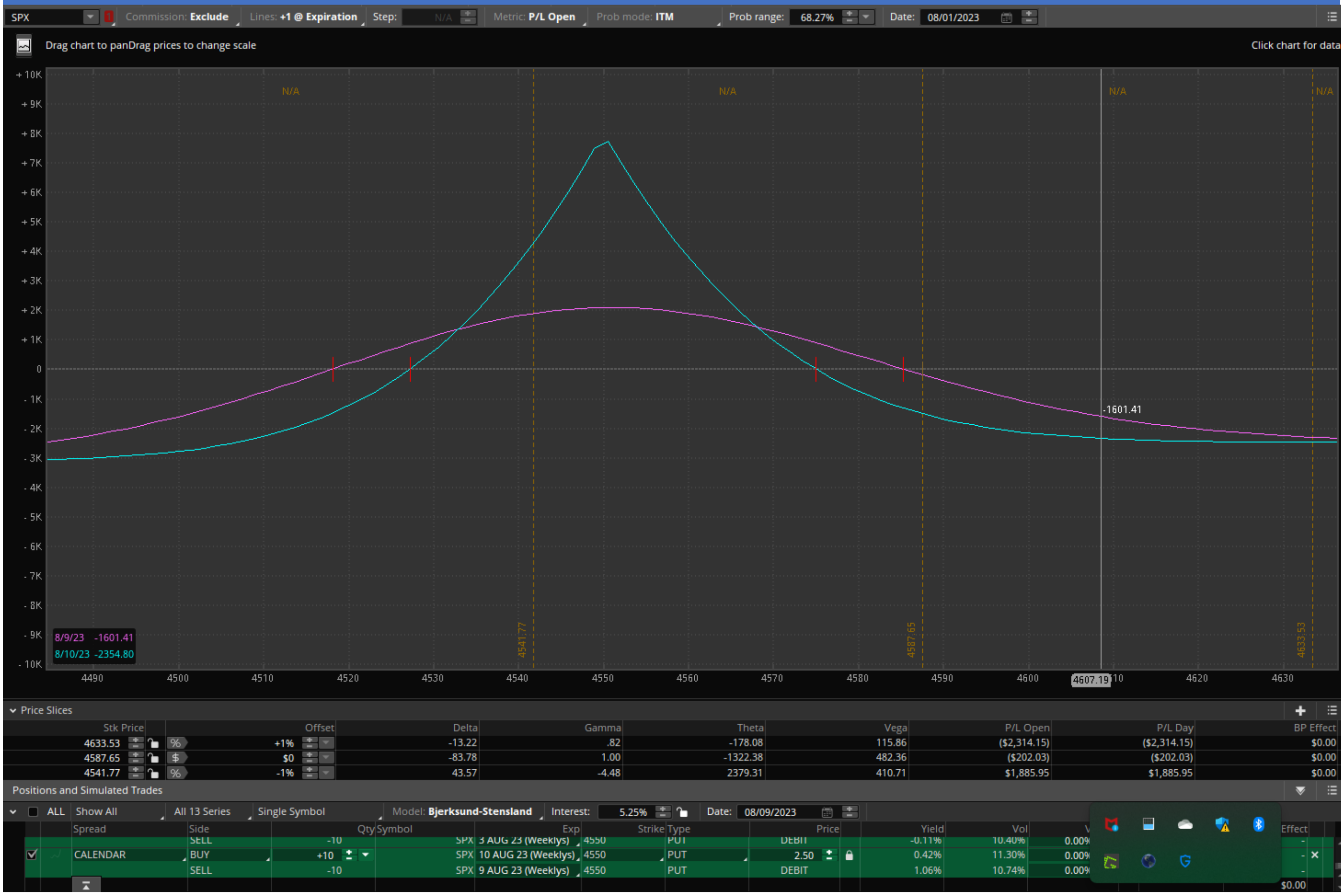
I most certainly don't expect it repeat, but it is really the end of the earnings season for the most part, so a logical turning point for some volatility.

SPX CPI put calendar spread

Sell $4550 Aug 9th put

Buy $4550 Aug 10th put

Net debit: $2.50 (filled)



Inflation data is going to have a tougher time from June's rosy goldilocks results. Base effects aren't going to help and some things like fuel and food are rising again. These reports could easily reemerge as market vol events. 2.5 SPX points is cheap to own the CPI release in the back leg.

HEDGING IDEAS WHILE IMPLIED IS LOW ANTICIPATING AN AUTUMN RETURN OF REALIZED VOLATILITY

VOLATILITY SUMMARY

While everyone waits for the A.I. mentions and resulting giga tech earning releases after hours spikes, it's probably a good time to look ahead, to potentially saner times. It certainly appears that QQQ has a date with all-time highs, not far away now, prices from early 2022 when almost everyone was thinking we were in a bubble.

You don't hear that now; you hear about future revenue boosts (sound familiar?) and that the most likely scenario for the economy is the rosiest possible outcome conceived as a low probability path only months ago.

The Fed meeting next week, well that's probably not a factor; it was a vol crush springboard last month and how often does Jay actually come out and talk things down? Quite rare. And in the midst of all the tech earnings that are being unveiled, it's probably even less relevant.

Managers are panic buying, meme stocks are on fire, folks don't dare sell in front of earnings, and speculative fervor in smashing puts every day combined with call gamma sweeps, hard to imagine a meaningful dip anytime soon, as I mentioned in last week's note.

This is the kind of thing that is happening with incredible frequency:

So, while this frenzy seems to be boiling over, the goal today is to examine a few hedging trades with three requirements. Trades that are very cheap due to low demand for hedging and low implied volatility, trades that will not bleed quickly, but ones that will pay immediately if volatility magically returns in the near term or the medium term.

Volatility Trades:

SPX September put butterfly spread

Buy SEP $4500 put

Sell 2x SEP $4350 put

Buy SEP $4200 put

Net debit: $14-15

This is an extremely cheap trade. For about 14 SPX points, you get 150 points of downside below 4500, which is only 1% below current price. That is 9.3% of the width. I have no idea why people hedge with naked puts when you can put on a structure like this and pay so little. How much can 14 points bleed? One set of these for $1400 can easily make 500% and not even have to see the market correct 4% from today's price!

Consider this. 4550 x .96, 4% lower at September expiration is 4368. That means this fly at expiration would be worth $132. That's over an 800% return.

IWM Jackson Hole put calendar spread

Sell AUG 25th IWM $185 put

Buy SEP 15th IWM $185 put

Net debit: .70-.75

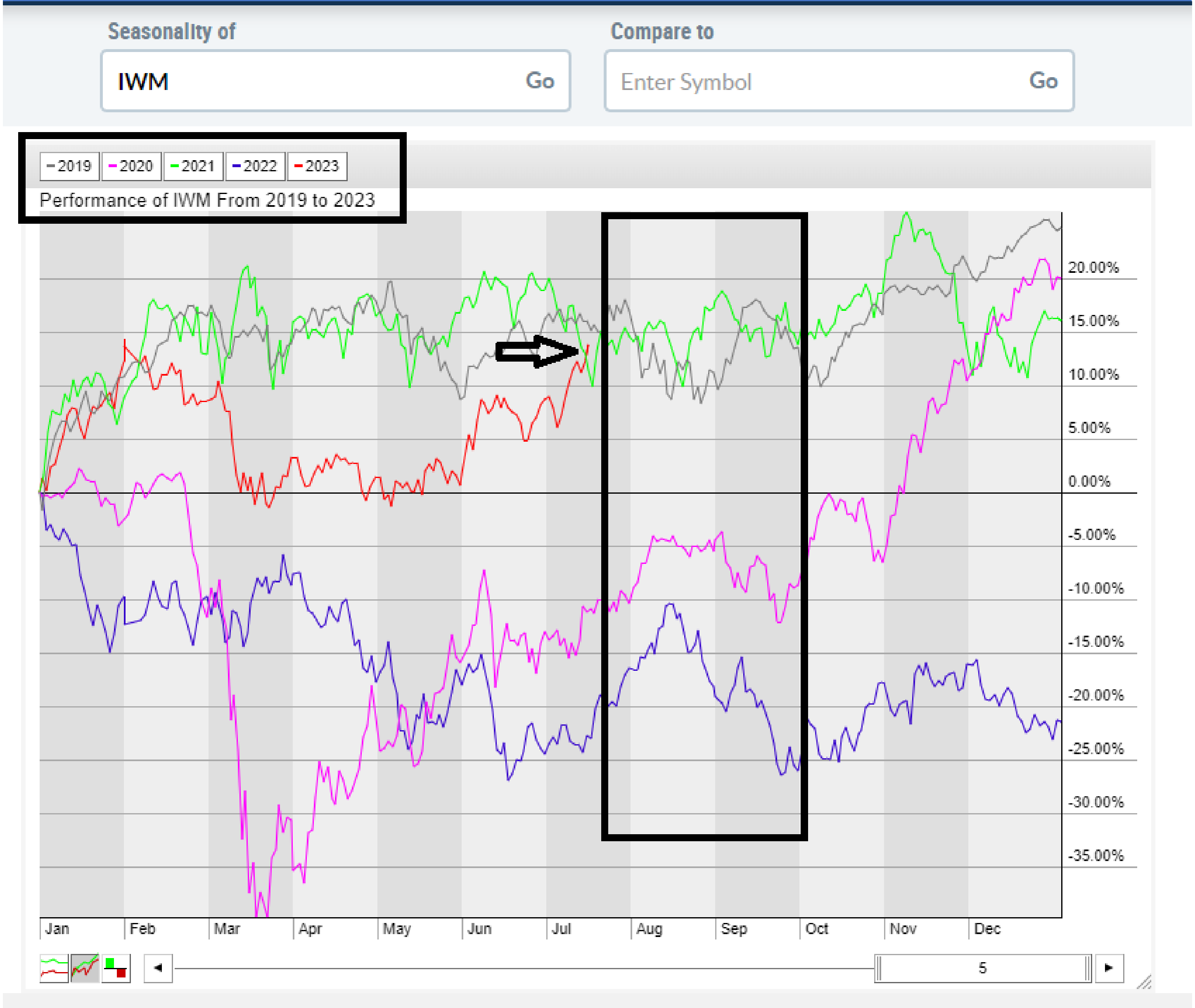
So, the short leg here is Jackson Hole, the scene of the crime last year, when Jay did the rarest of things for him, basically scolding markets that were on fire in a situation that the current fever reminds one of. When we approach, you can bet implied will rise as folks harken back to that turning point.

The second thing that this trade has going for it, is that it is a long vol trade, at a time when implied vol is about as low as it gets. Take a look at what happens to this pair, as implied vol is stepped up:

Generally, when markets fall (imagine that, hard to these days) implied rises and as you can see, every vol level higher benefits the price of these calendars. So, with three weeks in the back leg, if markets are backing off into Jackson Hole, this could easily be worth 2% of the underlying. Target, $2.50.

And, if everyone likes to lean on July as positive for seasonality, it's only proper if we look at seasonality for August and September, right?

Not exactly the best of times for IWM:



This makes sense, most of these companies report a little later than larger ones, so early August is generally the end of the line for a while, until IWM seasonality returns in October-December.