The Correlation Paradox: High Correlation is a "Risk-On" Signal, Not a "Crash" Signal

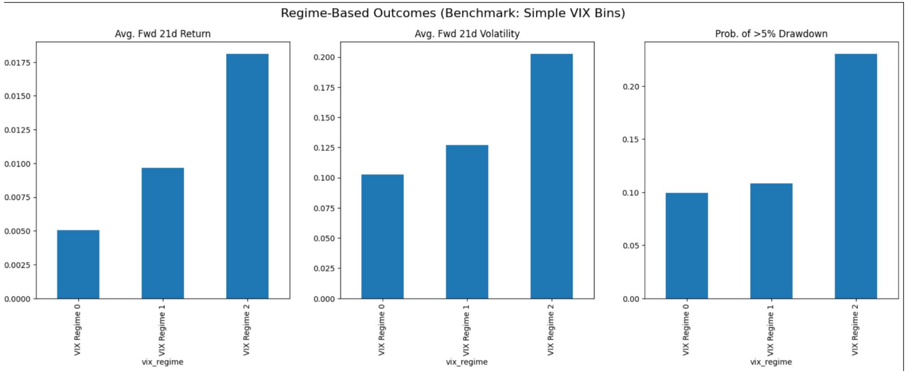
Common Assumption:

Common market wisdom assumes that when all assets (stocks, sectors, etc.) move together, it signals systemic risk and an impending market crash.

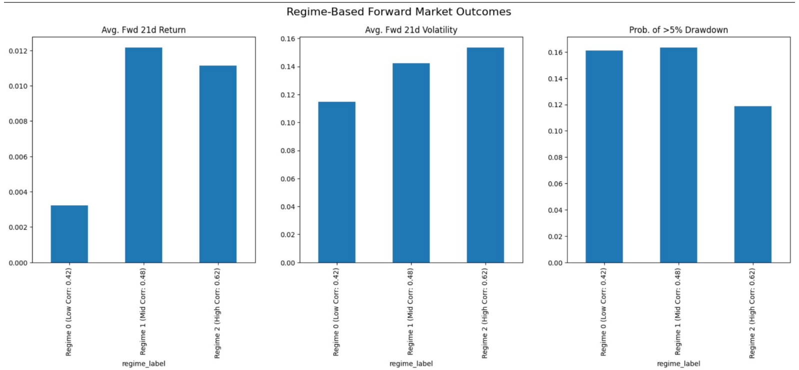
Key Takeaway: Not All Volatility is Created Equal

My model found that "high correlation" and "high fear" (VIX) are two different signals with opposite outcomes. The high-correlation regime identified by the model was not a "pre-crash" state.

Classic VIX-Only Model (The Old Rule):



HMM Correlation Model:



This model's most valuable insight is its ability to differentiate between "Good Volatility" and "Bad Volatility."

- "Bad Volatility" (High VIX / Low-Mid Corr): The classic "fear" signal holds true. The model confirms this is the highest-risk regime.
    - Action: DE-RISK / SELL.
- "Good Volatility" (High VIX / High-Corr): This is the project's key finding. It's a "Volatile Risk-On" rally.
    - Action: STAY LONG (to capture high returns) but HEDGE (to protect against the chop).