Nomura Cross-Asset: BUILDING

1 message

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- **USD Rates more of the same "heaviness" in the Long-End, as the crowded *(for the right reasons)* Steepener continues to work** on the "term-premium rebuild" –theme remaining intact, in-addition to the Trump rope-a-dope denial to the earlier WaPo "tariff walk-balk" story, strong US "Risk-ON" sentiment as we begin the new year, as well as the **high-key January supply overload likely playing a large part via heavy UST *(10Y today, 30Y bond tomorrow)* and IG Corp paper coming to market *(~$59B of deals incl SSA yday, now ~$76B MTD, and on estimates for ~$150-200B for the total month of January)***

- Piling-on with the overall Rates selloff is of course the **US ISM Services Prices Paid upside blowout to highs since 2023 and further contributing to that "upside inflation risk" –Tail** *(even though the JOLTS "Quit Rate" decline offers some much smaller respite)*

- **The fact is that UST curves are finally exiting 2.5 years of inversion, and that the siren song of owning Duration *(and Long back-end Receiver Spreads as preferred Tail hedges)* for a "Hard-Landing that never comes" has been a painful trade,** against a backdrop where US data has remained generally front-footed with <u>no signs of anything close to "Recession Risk"</u>—**especially with the investor perception of pro-growth Trump policy "animal spirits" waiting in the wings and aforementioned inflation staying dangerously "sticky" *(with Fed's 50bps kick-off cut now pretty clearly looking like "policy error")***

- Conversely, and even as the market has reset 2025 "Fed cuts" probabilities powerfully lower against this "still resilient" economic backdrop, with now only a miserly ~40bps of implied Fed cuts remaining across the next 1.5 year distribution through mid / late 2026, **it's difficult to argue with the view that *(back)* Red- and Green- SOFR Upside is probably the best *Long* around from a 'risk / reward' perspective—especially as they help to hedge out some of the beaucoup "Long Equities" exposure for the multi-asset Real Money set—if and when the eventual payback from "high for longer" hits the economy looking out beyond 2025 and instead, further into 2026**

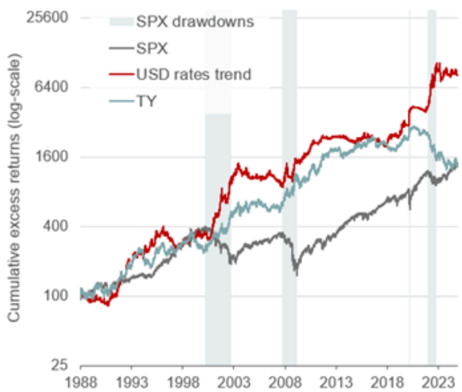
- Alternatively, but as **a dovetail off the back of my point made above regarding "Duration" not working whatsoever right now as a "Risk Hedge" due to the UPSIDE RISKS in inflation- and growth- being perceived in US** *(and as an alternative to my simple "Red / Green STIRS Upside" observation ONLY IN the case of eventual economic "slowdown" -scenario)*—**My Nomura QIS colleagues Simon de Fauconval, Ross French, Anthony Morris and Lai Wei shared a BRILLIANT piece of work at the end of December which I want to circle back upon,** as somebody who remains a prolific Managed Futures CTA -watcher and massive advocate for **<u>"Trend" strats being elite diversifiers and Tail-Hedges due to their "Positive Skew" attributes thanks to their dynamic correlation -profile</u>**

- **The QIS piece punchline is something that heavily resonates with messages delivered here since the 2022 hiking cycle began, and again highlights this very-real issue for Investors who remain embedded in a "Duration as your Hedge" / "Old-world of Inflation & Fiscal Policy" perview…instead making the case for Interest Rate TREND allocation:**

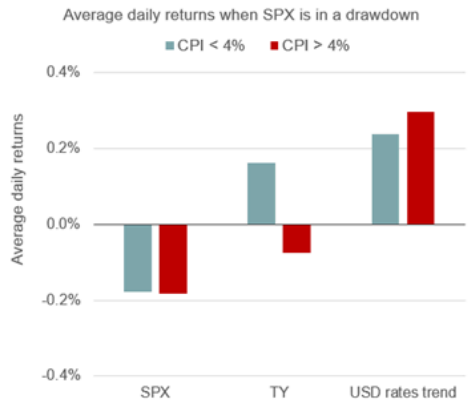
When inflation is a problem, interest rate trend is safer than long-only duration

- While it is common to believe long-only bonds (along with equities) should be the foundation of asset allocation, more investors are starting to doubt this idea, especially since 2022, when both equities and bonds experienced drawdowns as inflation surged. In fact, over the last 10 years, all major points of the USD curve have underperformed cash.
- What did not fail in 2022 was interest rate trend strategies. They made gains and delivered diversification while long-only duration failed to do so, as shown in the chart on the top right. And that was not the first time. During the Great Inflation from 1965 to 1985, rates trend also delivered gains. During the inflationary periods following World War I and World War II, interest rate trend also worked as long-only failed, [as we wrote about previously](#).

Trend delivers better diversification than long-only



Long-only fails when inflation is high, trend delivers



Source: Nomura, Bloomberg. Past performance is not a reliable indicator of future returns. All the returns are in excess of cash. USD rates trend is Nomura US Short Tenors Futures Index (NMIRTSU Index). The index trades SOFR futures across delivery dates shorter than 12 months.

What faulty expectations mean for asset allocation—interest rate trend is a better diversifier for equities

- As interest rate trend outperforms long-only duration in risk-adjusted returns, it should come as no surprise that interest rate trend is a better match for long-only equities than the usual bond allocation. We can see this in the top left chart. The vertical blue bars represent large equity drawdowns over the sample period from 1988. The grey line shows the unfunded returns of the S&P 500 futures. The light blue line shows the unfunded returns of the US 10y Note futures. The red line shows the unfunded returns of a STIR trend strategy in USD.
- We can see that the interest rates trend strategy outperformed US 10y during the tech crash from 2000-2003 and during the inflation shock of 2022 in particular. We can understand this better by looking at the chart on the top right, which shows the average daily returns during S&P 500 drawdowns, but highlighting the difference between drawdowns when US inflation is less than 4% (the blue bars) and greater than 4% (the red bars).
- It is clear that long-only duration, the TY contract linked to 10y futures, was only helpful when inflation was relatively low. When inflation was higher than 4%, long-only duration was not helpful, losing money at the same time that SPX was in a drawdown. In contrast, USD rates trend made positive returns both when inflation was high and when it was low. In fact, even during the lower inflation period, USD rates trend outperformed long-only duration.

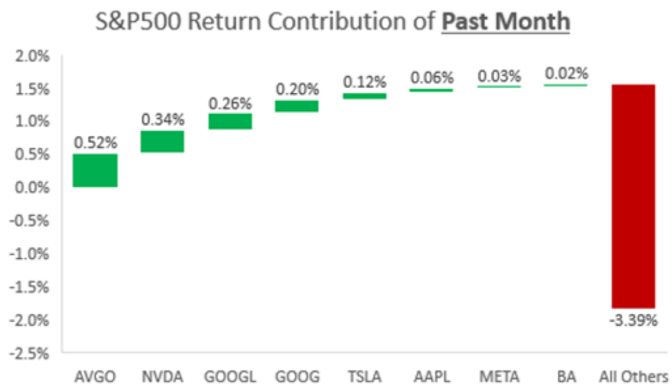
Source: Nomura QIS (Simon de Fauconval, Ross French, Anthony Morris and Lai Wei)

- ***PLEASE REACH OUT if you'd like me to connect you with our Nomura QIS team to discuss their offering—****full note is attached…*

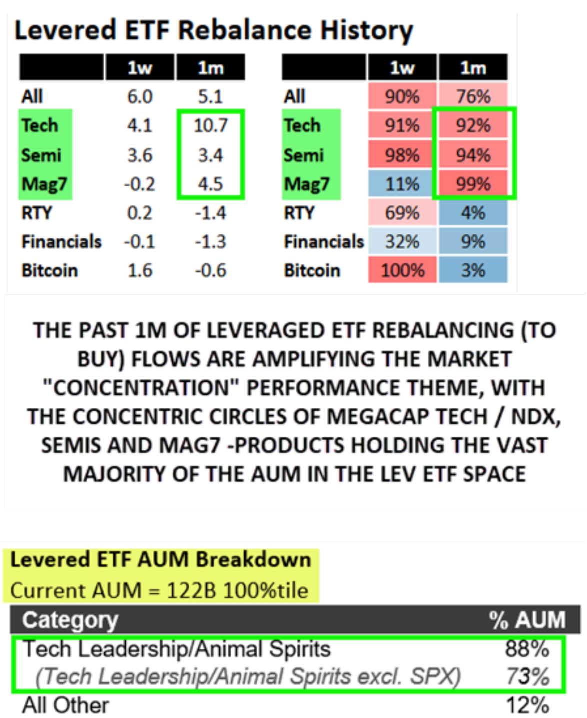
- Turning elsewhere, the same **US Equities dynamics** I've been speaking-to for months are are once-again rebuilding steam into fresh risk-budgets / 2025 PNL turn…

    ○ **US Stocks leadership concentration into "Mag8 / AI" –themes—which is coming out of the gates "euphoric" via more NVDA bullishness from CES—is being further fed by the "Synthetic" Negative Gamma of the Leveraged ETF space then "amplifying" the rally,** with vast majority of the Lev ETF AUM located the concentric circles of MegaCap Tech, Chips / Semis and Mag7 -names, which are already enormous weights of SPX and NDX = **virtuous feedback loop of performance and flows,** for now at least

MAG7/8 PRIMARILY HOLDING THE S&P 500 UP LIKE A TROPHY:



Source: Nomura Vol / Joanna Wang



Levered ETF Rebalance History

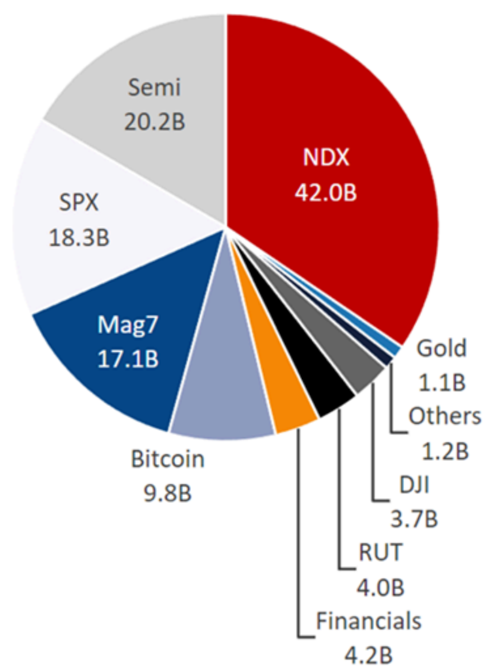
	1w	1m
All	6.0	5.1
Tech	4.1	10.7
Semi	3.6	3.4
Mag7	-0.2	4.5
RTY	0.2	-1.4
Financials	-0.1	-1.3
Bitcoin	1.6	-0.6

	1w	1m
All	90%	76%
Tech	91%	92%
Semi	98%	94%
Mag7	11%	99%
RTY	69%	4%
Financials	32%	9%
Bitcoin	100%	3%

THE PAST 1M OF LEVERAGED ETF REBALANCING (TO BUY) FLOWS ARE AMPLIFYING THE MARKET "CONCENTRATION" PERFORMANCE THEME, WITH THE CONCENTRIC CIRCLES OF MEGACAP TECH / NDX, SEMIS AND MAG7 -PRODUCTS HOLDING THE VAST MAJORITY OF THE AUM IN THE LEV ETF SPACE

Levered ETF AUM Breakdown
Current AUM = 122B 100%tile

Category	% AUM
Tech Leadership/Animal Spirits	88%
(Tech Leadership/Animal Spirits excl. SPX)	*73%*
All Other	12%



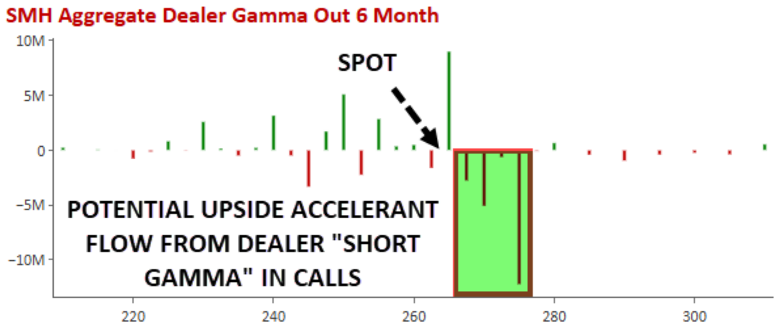
Source: Nomura Vol, Bloomberg, Optionmetrics

○ And FWIW, **we see a similar but "REAL" Negative Gamma in said AI / Chips –plays, e.g. SMH 3m Call Skew at 97%ile since 2011, which adds further "accelerant flow" potentials into rallies, due to hedging needs off the back of unabating "chase" demand for Upside Optionality in the Semis / AI -theme**

Vol Levels

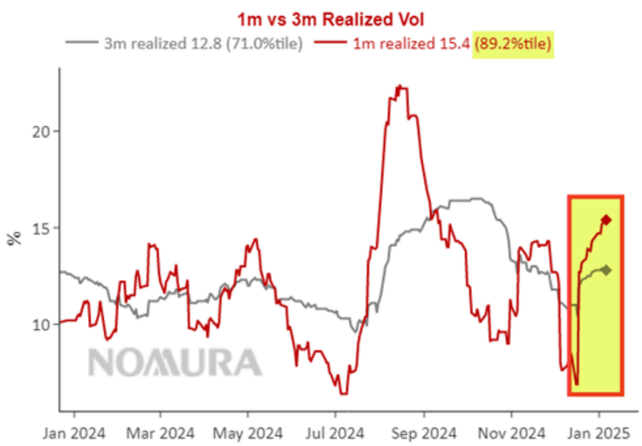
	At the Money Vols				Implied/Realized				Skew, Call Skew, Put Skew											
	1m atm	1m atm %tile	3m atm	3m atm %tile	1m iv/rv	1m iv/rv %tile	3m iv/rv	3m iv/rv %tile	1m Skew	1m Skew %tile	3m Skew	3m Skew %tile	1m Call Skew	1m Call Skew %tile	3m Call Skew	3m Call Skew %tile	1m Put Skew	1m Put Skew %tile	3m Put Skew	3m Put Skew %tile
SMH	30.7	77.9	32.8	84.2	1.04	52.9	1.14	71.9	1.08	4.9	1.1	3.5	0.98	94.3	0.98	96.6	1.07	5.6	1.07	4

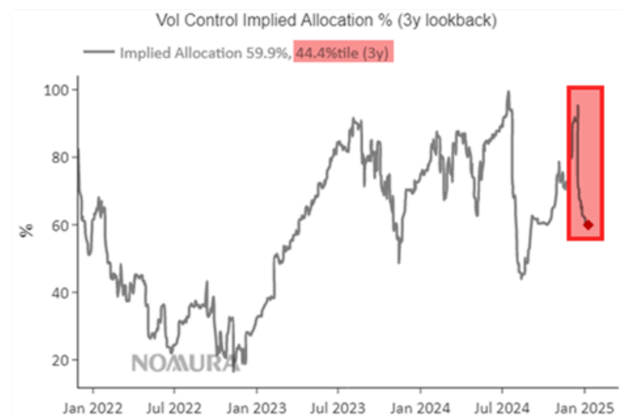
Source: Nomura Vol



Source: Nomura Vol

○ This demand for Equities is then being somewhat offset on the Index level by **Target Volatility "mechanical" sellling / deallocation** ***(we estimate -$60B SELLING of US Eq futures from Vol Control over the past month)*** **off the back of the recent "true-in" in Realized Vol since mid December, with 1m SPX rVol going from 6-7 vols on 12/13/24 now to 15-16, which is the high for SPX trailing 1m rVol since the August "vVol / Tails Shock"**





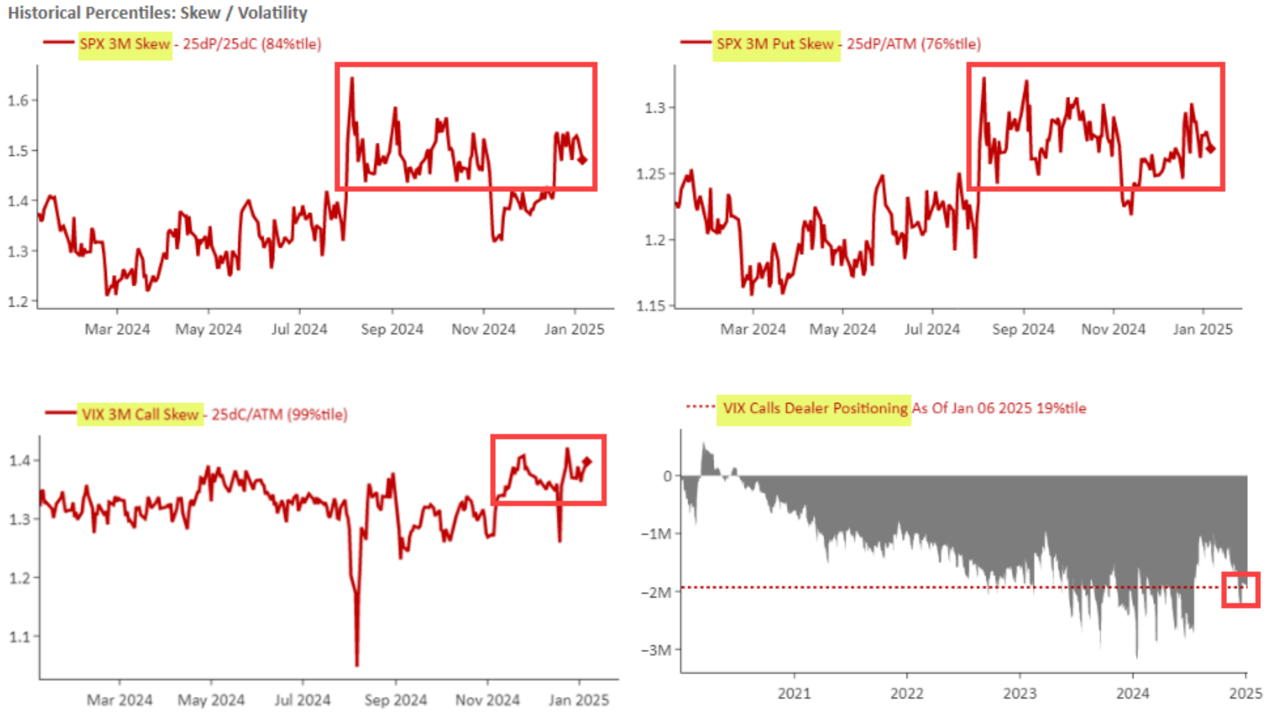
Source: Nomura Vol

○ And this "Vol Bid" into and out of the 2025 turn is only then incentivizing into **more of the same "relentless Vega supply" from VRP "Options Selling" –strats, exploiting "rich" Vol entry-points** particularly in extremely short-dated expirations *(weeklies down to 0DTE / 1DTE –space, tell-tale sign of QIS programs)*…but not just in Index / ETF, but also too Single-name Equities—this from yesterday alone:

- ABT: seller of 10k Feb 110 Puts at $1.73
- HON: Nomura client sold 10k Jan190/Feb 210 Put Spreads at $2.00, rolling an underwrite
- AMGN: seller of 5k Feb 240 Puts at $2.48
- NEE: seller of 10k Mar 80 Calls at $0.775
- NKE: seller of 10k Feb 70 Puts at $1.18
- LOW: seller of 5k Mar 230 Puts at $3.19
- CAT: seller of 5k Feb 440 Puts at $2.82
- WMB: seller of 10k Feb7th 52 Puts at $0.36
- CMG: seller of 9.4k Feb14th 51 Puts at $0.47
- GAP: seller of 5k Jan10th 22.5 Puts at $0.05
- IBM: seller of 5k Feb 200/250 Strangles at $4.56
- GM: seller of 6k Jan10th 56 Calls at $0.14
- PM: seller of 10k Mar 110 Puts at $1.38
- WMT: seller of 6.5k Feb 85 Puts at $1.06
- MRK: seller of 10k Feb 95 Puts at $1.83
- RIVN: seller of 10k Feb18 Calls at $1.11
- ABBV: seller of 10k Mar 165 Puts at $1.85
- TTE: seller of 9.5k Jan 60 Calls at $0.10
- NCLH: Nomura client sold 5k Jan 26 Calls at $0.59
- DDOG: seller of 4.5k Feb7th 130 Puts at $1.05
- GT: seller of 5k Feb 9 Calls at $0.55 vs 8.83
- KKR: seller of 3.9k Jan 162.5 Calls at $0.38
- NVDA: seller of 2.5k Mar 150/163 Strangles at $23.80
- FSLR: seller of 3k Jun 220 Calls at $14.00
- MOS: seller of 3.4k Jan10th 25 Calls at $1.03
- NVDA: seller of 2.5k Mar 150/163 Strangles at $23.80
- AVGO: seller of 2k Feb14th 200 Puts at $1.83
- CRWD: seller of 1.7k Feb7th 315 Puts at $2.34

Source: Nomura Eq Derivs / Mike Lamon

○ Yet at the same time, **we've seen ongoing demand for SPX Skew / Put Skew & VIX Upside Convexity with the Spot Equities not far from ATH's, as Vol markets remain concerned with potential for a "banana peel" accident—where the "concentration / lack of breadth" dynamic continues to make investors uncomfortable….**



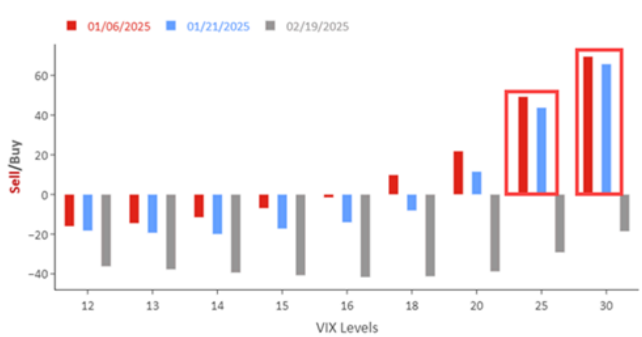
Source: Nomura Vol

○ **The nature of the persistent Vega Supply will then continue creating these conditions for occasional "Vol Squeezes," all thanks to the hedge demand noted *(Steep Skew, VIX Negative Convexity from Dealers Short Calls and BIG VIX Lev ETN –demand for Vega on Spot VIX rallies)* which is then at the core of this vicious "VIX : Spot Beta" that keeps the tension THICK and "Vol of Vol" stuck in this uncomfortable territory, still unable to signal the "all clear" from the Vol -space**

Option Dealer Vega Rebalance Projection vs VIX Scenarios

$Millions Vega

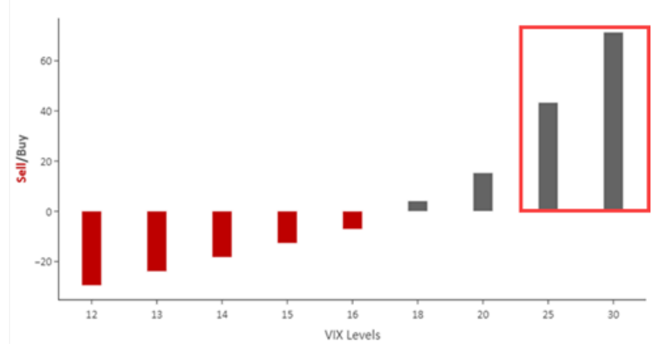
	12.0	13.0	14.0	15.0	16.0	18.0	20.0	25.0	30.0
01/06/2025	-16.0	-14.6	-11.5	-7.0	-1.6	9.9	21.9	49.3	69.5
01/21/2025	-18.3	-19.4	-20.0	-17.3	-14.1	-8.1	11.5	43.7	65.7
02/19/2025	-36.3	-37.8	-39.4	-40.8	-41.7	-41.3	-38.8	-29.3	-18.6

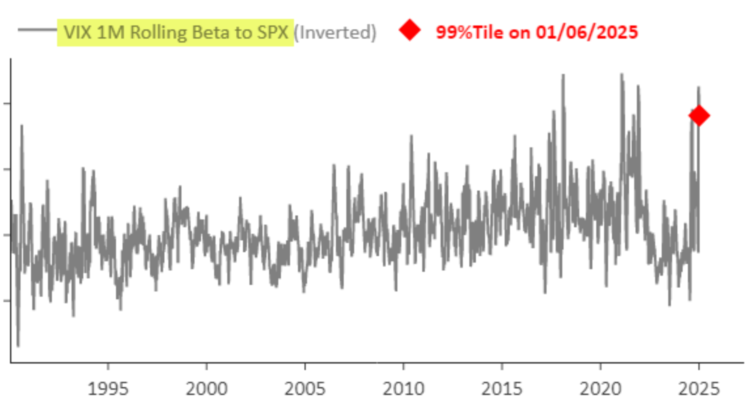


ETN Vega Rebalance Projection vs VIX Scenarios

$Millions Vega

12	13	14	15	16	18	20	25	30
-29.5	-23.9	-18.3	-12.7	-7.1	4.1	15.3	43.3	71.4





Source: Nomura Vol, Bloomberg, Optionmetrics

○ However, **we are now too beginning to see SPX CALL Skew waking-up a bit in what was a bit of a "Spot Up, Vol Up" trade yesterday, which I believe is due to some Investors who simply don't have enough exposure on and could in-fact need to chase on a break to fresh ATH's if current momentum holds** ***(Street PB data showing the fastest pace of Hedge Fund net SELLING in US Eq in over seven months seen over the past trading week)***

○ **This Equities upside / rally momentum would especially pick-up steam if all this "VRP Selling / Vega Supply" on big AUM into the new year begins to compress realized Vol again into "tighter" daily ranges in the months-ahead…where we'd estimate potential for LARGE mechanical demand from the Vol Control –universe thereafter, IF we began resume that "50bps daily SPX change" environment of old in the local forwards, with upwards of +$42.3B to buy over the next 2w alone…** ***but only if that rVol compression to said "50bps daily chg" universe did in-fact play-out***

[Average Daily Market Move +/- X% (columns)] vs. [$bn to buy/sell over period (rows)]

	0.0	0.5	1.0	1.5	2.0	2.5	3.0	3.5	4.0
+1w	6.6	1	-12.6	-29	-44.4	-57.6	-68.5	-77.5	-84.9
+2w	48.9	42.3	3.2	-33	-57.1	-73.4	-85.1	-93.8	-100.4
+1m	69.4	52.1	-7	-54.6	-78.4	-92.7	-102.2	-109	-114.1
+2m		71.4	-7	-54.6	-78.4	-92.7	-102.2	-109	-114.1
+3m		135.7	-7	-54.6	-78.4	-92.7	-102.2	-109	-114.1

Source: Nomura Vol

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