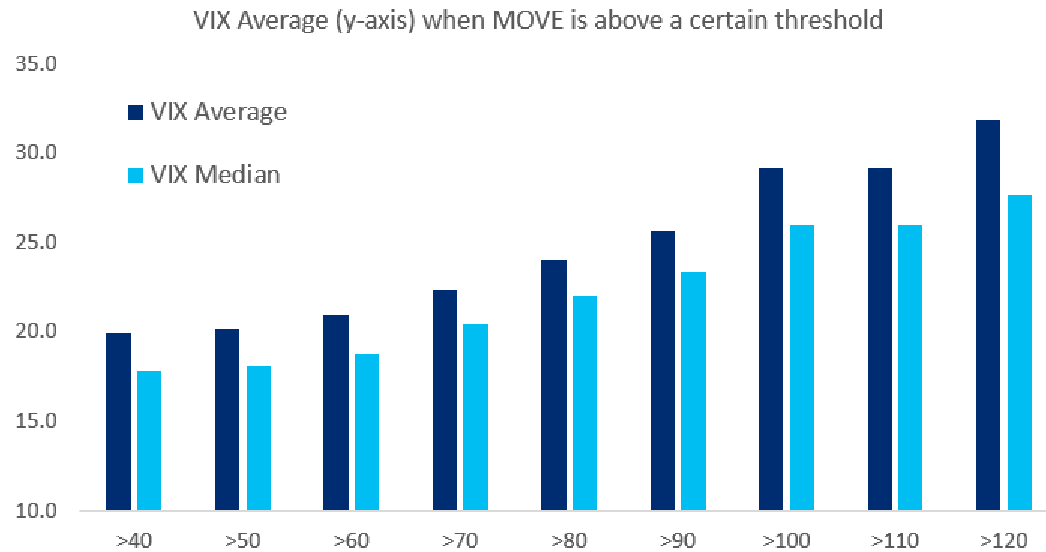
One day of absence in this market has the feeling of missing a month's worth of data, and when rate vol is currently in the 94th percentile of observations going back to 1990 it is hardly surprising that investors may blink and feel they missed a headline (or six). On that note, and given the MOVE index hit not only the highest level since March 2020 yesterday, but also only during periods of serious crisis, it felt appropriate to update a bit of analysis done a few weeks ago with regard to the regime for equity volatility too (see **Why is it so hard to short equity volatility here?** – 16th Feb 2022), only this time to extend the range of outcomes for the VIX, as well as include the *median* vol moves as well as averages:

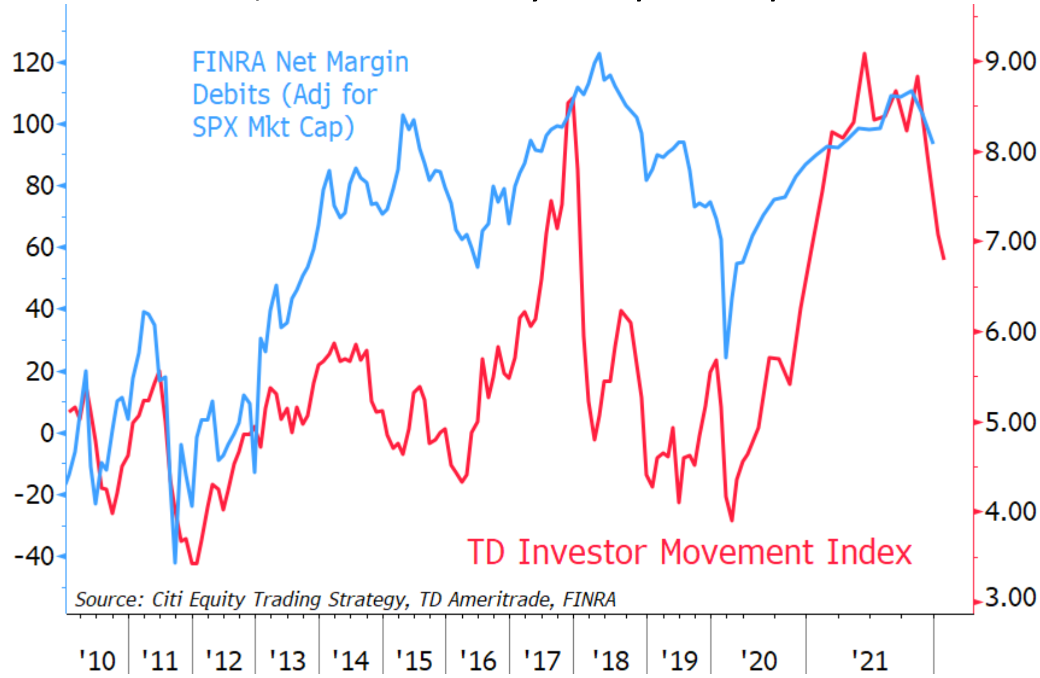
With rate vol continuing to rise, equity vol remains tricky to sell



Source: Citi Equity Trading Strategy, Bloomberg

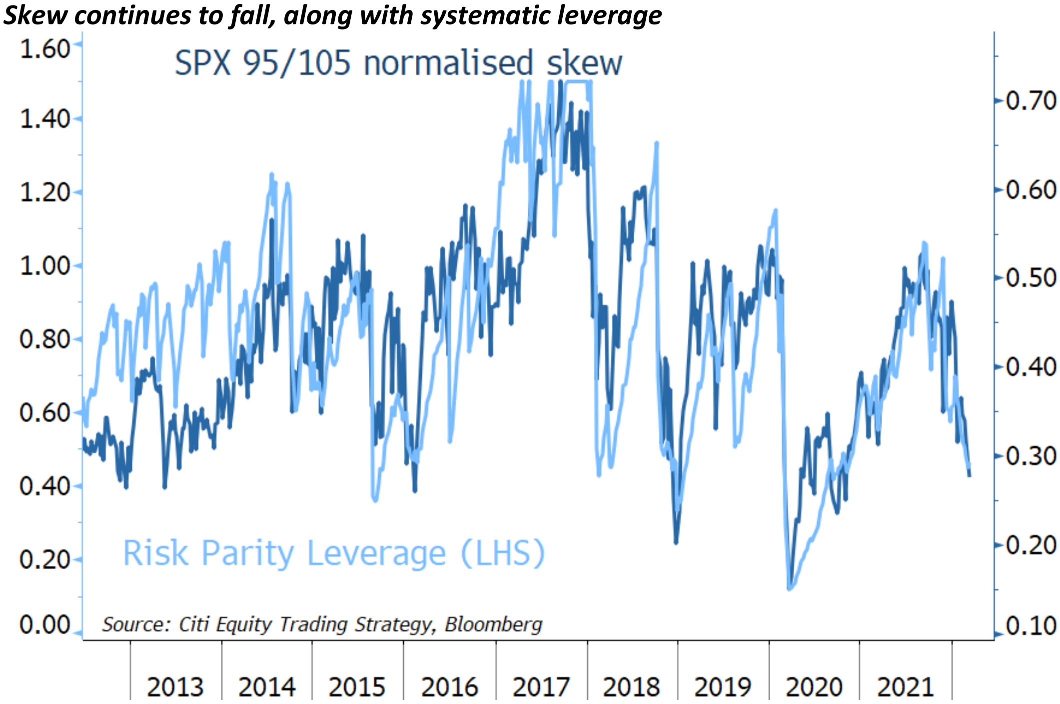
With rate vol this elevated, the VIX has historically averaged almost 32% and median 28%, so it remains difficult to present a compelling framework to be short volatility when risk free rates are moving around as much as they are. In fact, if we take this analysis back to the start of the 1990s when both the VIX and MOVE were introduced, there are only 12% of daily observations where rate vol has been this high, which I suppose we could infer as ultimately *good* news insofar that this regime is unlikely to be sustainable over the long term. But in the near term it again reinforces the complication that all investors reading this will acutely understand: **higher regime volatility denotes difficulty in deploying capital when PnL vol is so high.** I mean, to think that HFs degrossed substantially in Q4 last year only to see the VaR double in Q1, resulting in further degrossing… and then VaR still didn't budge because vol doubled *again*! **Compound on top that the current market is not just about levered money degrossing, but equally an ongoing unwind of institutional risk and indeed small investor exposure as well. This means that it is hard even with all the tools at our disposal to accurately decipher when unwinds come to an end simply because there are multiple verticals of investor money unwinding simultaneously.** One example of this is that on a day such as today, TRF (i.e. small investor) volumes as percentage of total turnover was unimpressive at 39%, but if you consider the fact that almost 20bn (!!!) shares turned over across A+B+C tapes – the highest since the GME fiasco in January 2021 – is evidence that plenty of investors (small or large) are active in the current tape. One thing that has been evident, however, is that small investors at the margin have not been buying the dip, as per TD Ameritrade's latest IMX data for February that showed a continued unwind of retail positioning from still elevated levels.

Retail continue to sell, but remain historically well exposed to equities

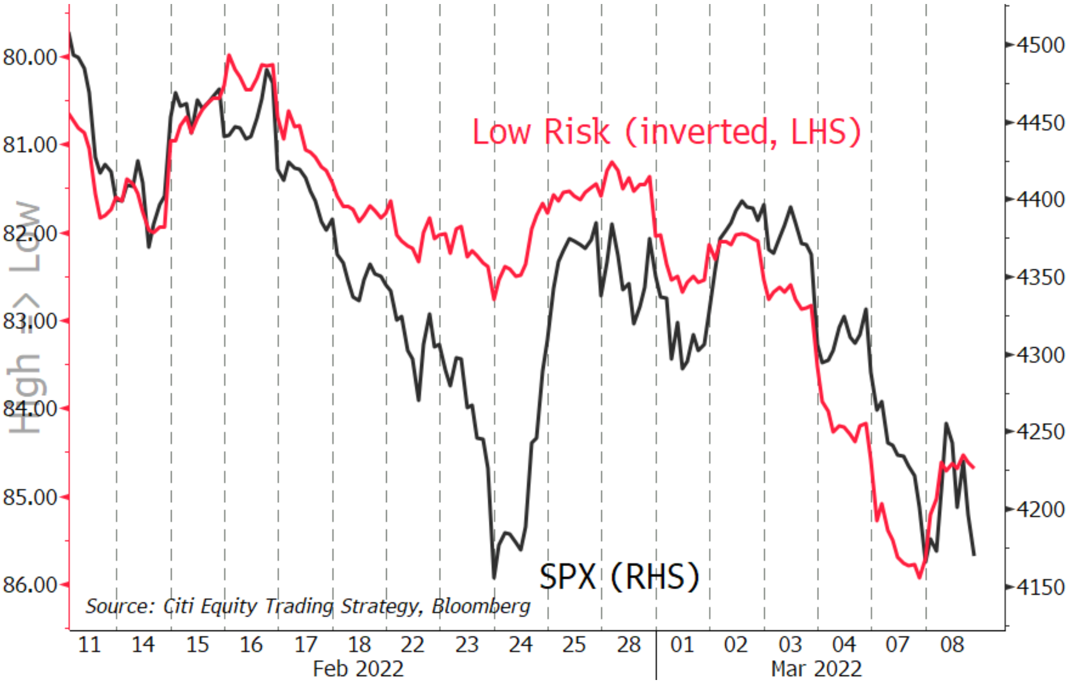


There were bright spots of activity today, and indeed signs of cathartic flush too. Beyond the aforementioned elevated trading volumes, the marked drop in skew means that convexity and crash protection is struggling to find any meaningful bid now; for example, Mar14 SPY 400 puts are trading the same price that they were Friday morning despite spot levels now being 200 points lower. And certain pockets of risk that *should* be sensitive to ongoing risk unwinds have started to lose some of their beta sensitivity to SPX: ARKK and De-SPACs have actually *outperformed* WTD, which in the context of all the bearish sentiment is noteworthy, even if some of that price action may equally be thanks to the aforementioned ongoing portfolio unwinds by the levered money community too.

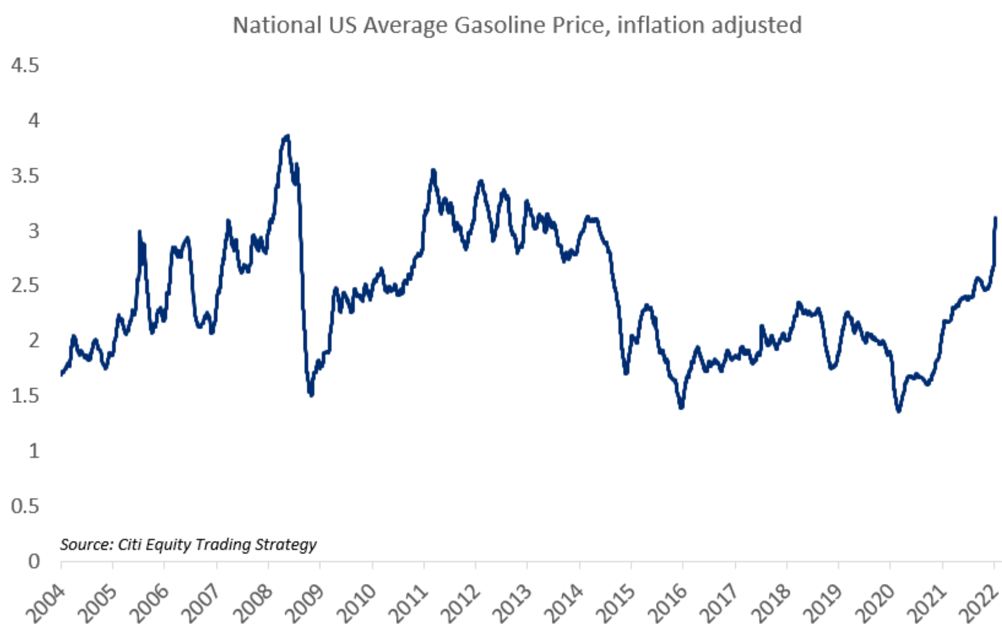
Skew continues to fall, along with systematic leverage



But perhaps the most bullish sign today – beyond the EU headlines regarding some potential fiscal progress and the fact that crude was 'only' up 4.5% on the Russian oil sanctions announcement – was the fact that Low Risk (**CIISLRUT Index**) had a substantial 1.5% drop over the course of the session and is the largest one-day drop in almost a month. But what's really interesting is that going back to the start of the time series in 2004, there have only been three occurrences in history where the factor has dropped by this much on a one-day basis and see equities fall by 75bps or more; twice in 2008 and once in 2020 (*sound familiar…?*). **Crucially, on all occasions, albeit a small sample set, the equity market was up over the subsequent five days by an average of 8.8%. Again, small sample size but not a bad hit rate to consider short-dated upside nonetheless to protect against right tail squeeze risk, be it headline driven or otherwise.**



Note that I've deliberately avoided any geopolitical narrative today. Many of you would have analysed to the Nth degree what may happen next with regard to Mr Zelenskyy's options around a negotiated deal with Russia, and whilst I have my own personal views, I am struggling to establish how anyone can have meaningful 'edge' navigating the current landscape when emotional issues around sovereignty versus the cost of human capital and a broader humanitarian crisis is at stake. Instead, I decided to take another stab at oil price considerations given the $25/bbl jump WoW in a note earlier today and the effects it may (or may not) have on the US consumer in the near term. Bottom line; Energy equities may be at the short-term mercy of where oil prices go, but given their spot contribution to SPX profits is now the highest we've witnessed in a decade (or more), investors are still going to be forced to consider whether a 4.8% weight within SPX is still too low despite the performance of the sector over the past year.



Alty

Alexander Altmann
Head of US Equity Trading Strategy
Office +1 212 723 1999

All charts/data sourced from CETS, Bloomberg and Citi, unless otherwise indicated.