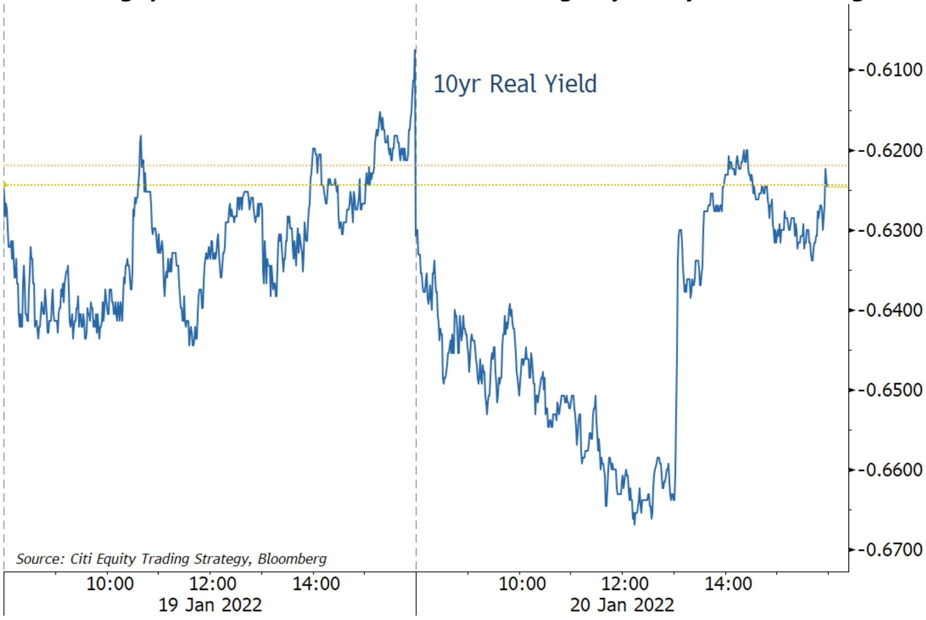
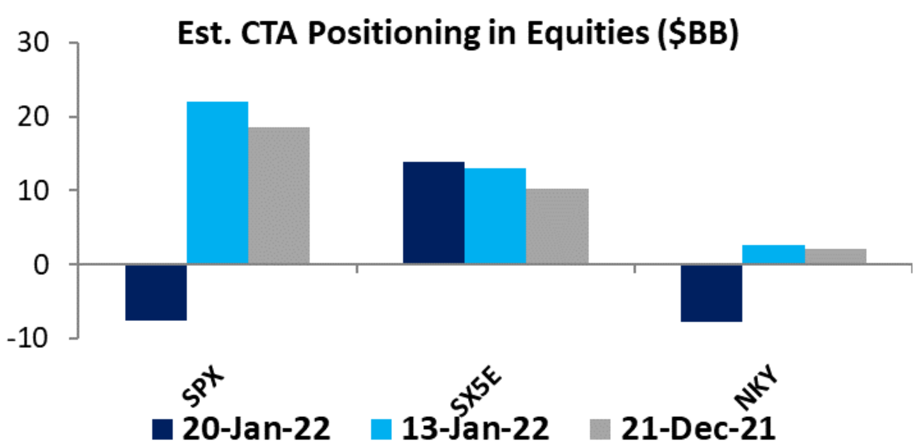
If yesterday was ugly, then today said "hold my beer" as the peak-to-trough intraday reversal notched up to 275bps in ES1s during the session (versus yesterday's 'paltry' 175bp turnaround). What started out as a benign bounce had hallmarks of instability given Low Risk had only retraced 35bps of the 2.6% prior two-day rally, and it only took the 10y TIPS auction that tailed by several basis points to slam the brakes on the fragile rally. By the close – exacerbated by some levered ETF rebalancing – approximately $2bn based on CETS' calculations – we had definitively broken through the CTA level mentioned several times this week already (4525 in ES1s), which if it holds overnight would imply that CTAs will be flipping short US equity risk for the first time since May 2020.

Mind the gap as the TIPS auction tailed leaving 10y real yields unchanged over 2 days



That would suggest another $50-60bn of <u>levered</u> selling by the systematic community tomorrow, **but I stand by my previous comments that it would reflect a more cathartic flush of selling pressure in the equity market short term, and present a better positioning starting point to turn tactically more constructive on risk**. I had previously highlighted that 4450 represents a more reasonable entry into SPX given that would put us on 19x consensus 2022 EPS, which is at least less eye watering given the prevailing inflationary backdrop.

CTAs are now likely flipping short SPX for the first time since May 2020



Source: Citi Equity Trading Strategy

There are of course some caveats. Notwithstanding ongoing headline risk such as an uncontrollable omicron flare up in China, or Mr Putin throwing caution to the (sanction-related) wind and putting boots on the ground in Ukraine, investors will undoubtedly be unnerved by the 18% drop in NFLX after hours in a Q1 guidance whiff, and of course the overhang of

Wednesday's Fed meeting as well as the deluge of bellwether Tech market cap that is reporting next week (highlighted in yesterday's EOD). Will fast money want to step in to catch a falling knife ahead of a catalyst-heavy week? **Perhaps the most discouraging factor is that POLLS *still* remains at a very elevated level of 18 in spite of the now 10% correction in Nasdaq and the 6.5% drop in SPX. This is now driven less by positioning, but more that our vol models have moved into extreme territory, whilst the quantitative inputs like Low Risk and real yields are at elevated levels. It also doesn't help that liquidity is atrocious at present – again mentioned in yesterday's note – and that is likely exacerbating the volatility backdrop too.**

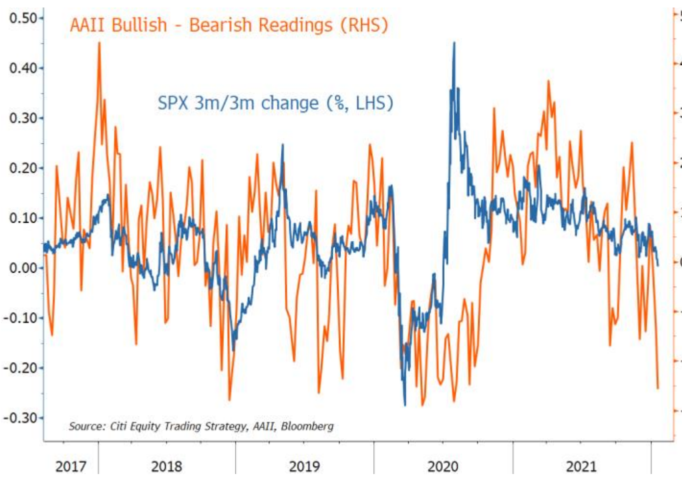
POLLS continues to show heightened caution, although this is being driven less by positioning than a week ago

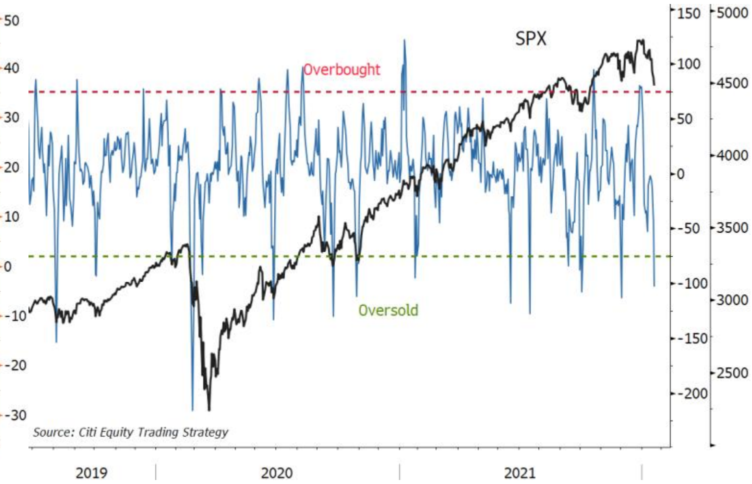
Current Level: 18			Recent Market Peaks				
	20-Jan-22	13-Jan-22	Oct '20	Mar '20	Caution	Danger	Description
Market Indicators							
% Rally in 21 Days	-1.9%	0.5%	3.8%	-1.4%	2.2%	5.9%	
Vol/Spot Correlation	0	0	5	3	3	5	# of vol up spot up days in last month
ToB Liquidity % Rank	10%	14%	50%	14%	20%	10%	Percent rank based on 12-month lookback
CDX HY % Rank	97%	86%	17%	45%	20%	10%	Percent rank based on 6-month lookback
Probability of Default % Rank	42%	21%	3%	100%	70%	85%	Percent rank based on 6-month lookback
Real Yields % Rank	98%	98%	33%	14%	80%	90%	Percent rank based on 6-month lookback
Low Risk Factor % Rank	93%	36%	6%	90%	80%	90%	Percent rank based on 6-month lookback
Data							
US Soft - Hard Data	Positive	Positive	Positive	Negative	Negative	Negative & Falling	Differential between CESI Hard - Soft dataset
Sentiment							
Levkovich Index	0.58	0.49	0.69	0.25	0.3	0.38	Research Strategy Composite Market Indicator
VXX Rolldown	0.0625	0.5625	0.25	0.25	0.5625	0.25	Does not prefer rolldown
Vol Indicator	50	17	-33	50	-33	0	Neutral
CGUSOVER	-103	-2	-1	44	60	75	CETS Proprietary Overbought/Oversold Indicator
Positioning							
Mutual Fund Beta	0.99	0.99	1.06	1.04	1.1	1.2	Beta of Aggregate Mutual Funds to SPX
Hedge Fund Beta	1.32	1.35	1.16	1.16	1.15	1.25	Beta of top HF holdings to SPX
Short Interest	0.7%	0.7%	0.8%	1.0%	1.4%	1.3%	% of SPX Market Cap that is held short
CTA Positioning	-7.6	21.9	18.0	13.4	15	21	$ Notional SPX Length
CTA Distance from Sell Signal	1.1%	0.2%	3.0%	0.2%	3.0%	1.0%	% move lower required to trigger CTA selling
Financing Rate	30	31	14	26	20	30	S&P 3mL financing rate
Net Short Vega Positioning % Rank	26%	25%	100%	61%	80%	90%	CFTC Net Non-Commercial VIX positioning
Signals							
Caution	2	2	6	5			
Danger	16	16	10	12			
Total Warnings	**18**	**18**	**16**	**17**			
Total Warnings %	**47%**	**47%**	**42%**	**45%**			

Source: Citi Equity Trading Strategy

What is the play here? Another day like today and our oversold signal gets officially triggered, and at the time of writing the after-market futures are already breaking down through the aforementioned 4450 level, so it's fair to say that markets are stretched to the downside. Our FX Strategists put out a timely note overnight highlighting that the FOMC next week will likely be reasonably balanced and may drop less-than-subtle hints that a 50bp hike is *not* on the table. Coupled with even inline EPS prints for some tech heavyweights and I believe that should be sufficient to cauterize the bombed out sentiment short term. **If indeed we do trigger oversold conditions tomorrow, then playing Wed 26th SPY 458/460 vanilla 'digitals'** begin to line up a right-tail hedge to play a sharp index squeeze either into or over the FOMC meeting. At the close (off a 466.75 ref) they cost c35c, but with the futures moving so much these level, and option strikes for that matter, are probably redundant. **But the point being that the magnitude of market sell off and size of systematic selling means investors should consider ways to play very short-dated tactical bounces too.**

Sentiment is as bearish as peak COVID in 2020





I still believe we are towards the <u>end</u> of this phase of a market pullback, and investors will have to remain nimble to exploit a potential bounce and future gyrations in equity risk. Happy to discuss/clarify the above points this evening.

Alty

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