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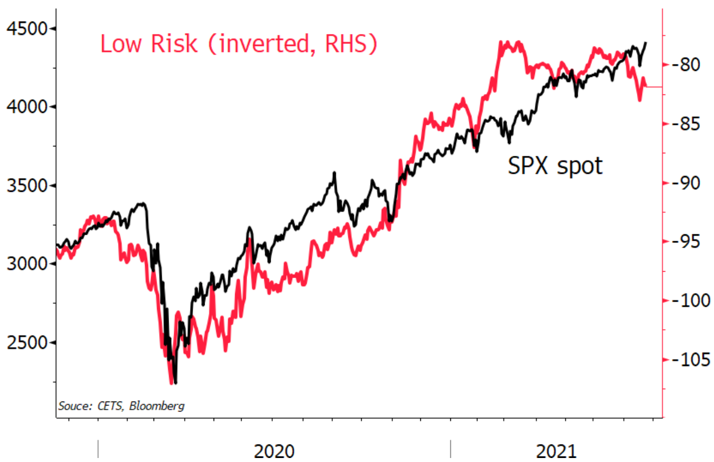
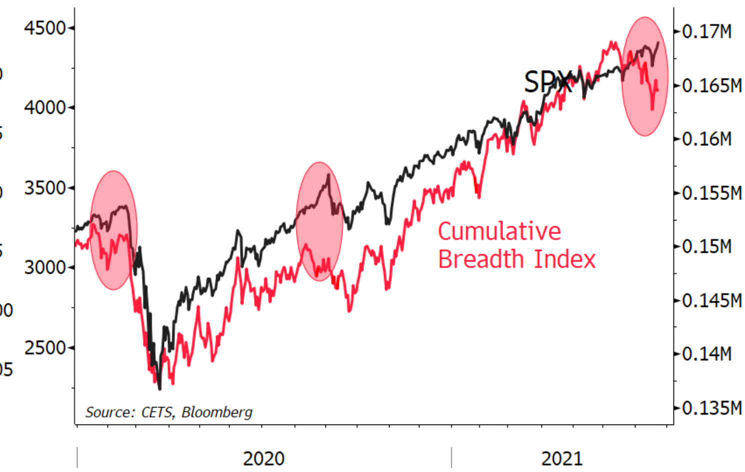
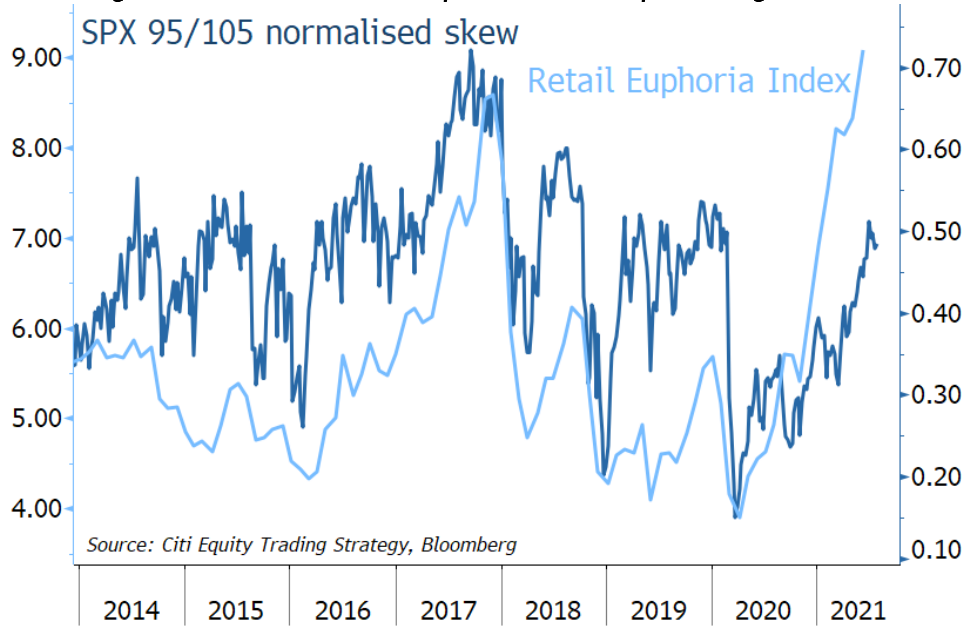
This EOD is a little all over the place for a couple reasons: 1) a heavier in-person client schedule this week illustrated that there are many themes being thrown around, but conviction in most of them is relatively low; and, 2) the week itself was extremely Dr Jekyll and Mr Hyde given we started the first half touching 1.14% in 10yr and many concerned about virus acceleration, yet ended the week back at 1.30% and SPX printing new all-time highs without much of a mention of the delta variant (*see point 1 regarding conviction levels!*). Low Risk (CIISLRUT Index) ended the week down 85bps, but Probability of Default (CGPRPROB Index) was actually flat, and I've addressed the weakness of breadth incessantly within these columns, which has thus far completely failed to make new highs despite SPX once again doing so… In other words, we are not out of the woods unless there is more evidence of a broadening of the rally, and that sets up for an interesting August when liquidity is typically diminished, and many market participants have committed to taking time off. The two charts below illustrate the precariousness of headline indices at present, without giving any strong signals on timing a pullback.



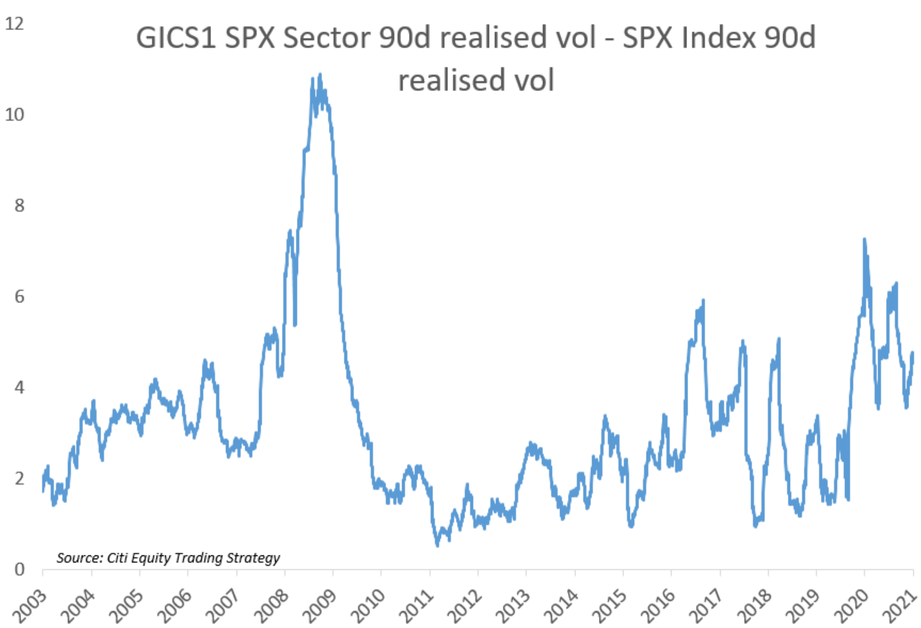


Are investors bearish? Based on the meeting feedback, no – gross exposures have been trimmed due to sizeable PnL volatility – but there is a broad degree of reticence to trade the market short when sell offs YTD have not lasted more than three days (*or two, in the case of this week*). With the emergence of a robust earnings season to boot, there is little appetite for investors to stand in front of the one-way liquidity train driven by $1.5-2bn of retail inflows *every day*, and real yields still hovering close to all-time lows. SPX vol skew is back close to pre-crisis highs – something that I have mentioned previously may be in part driven by risk-parity releveraging, or that fact that overall market positioning is high (as evidenced by the magnitude of retail length) – and with index gamma still relatively elevated, this adds emphasis to investor views that markets cannot have a protracted down move at present.

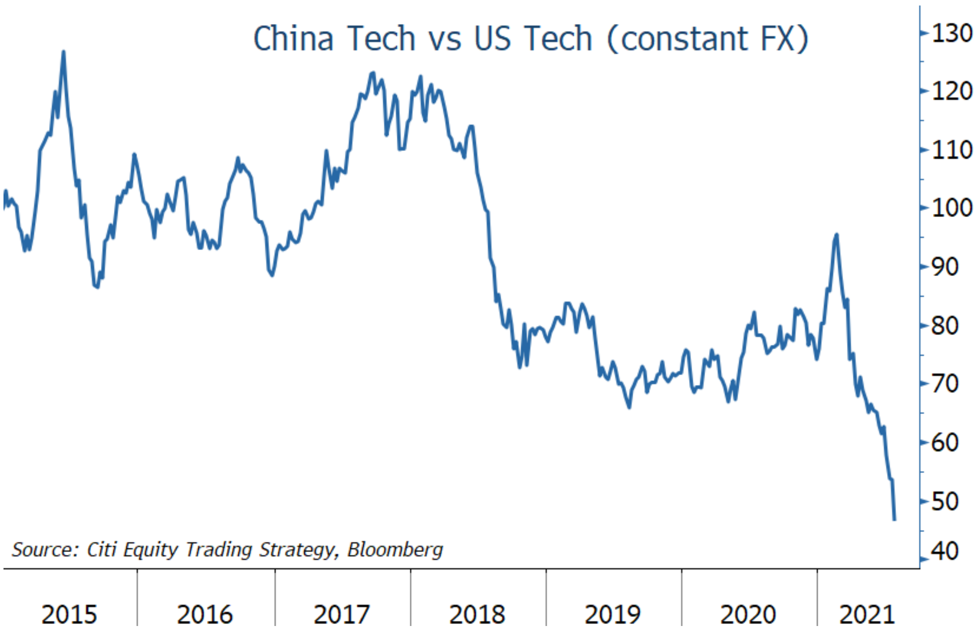
Is skew high because there's more capital that needs protecting?



And yet, investors are not particularly bulled up either (or at least not the ones I spoke to) given the perception of risks around escalating delta variant cases, peak(ing) growth, or simply because markets have rallied so much. Add in the whipsaw nature of sector moves over the past few weeks, and the fact that any theme fails to stick for more than a few trading sessions at a time, and it's small wonder that some alarm bells are ringing for risk managers. The chart below is showing the spread of SPX index realized volatility versus an equal-weighted index of GICS1 sector realized volatility currently in the 83rd percentile going back to 2004, and although I haven't drawn any specific conclusions on this yet, the fact that sectors are moving so much more than the index is likely causing a headache for many investors that are not running sector-neutral bets (and even then, with the poor performance of price momentum, sector neutralization may in itself not be sufficient).

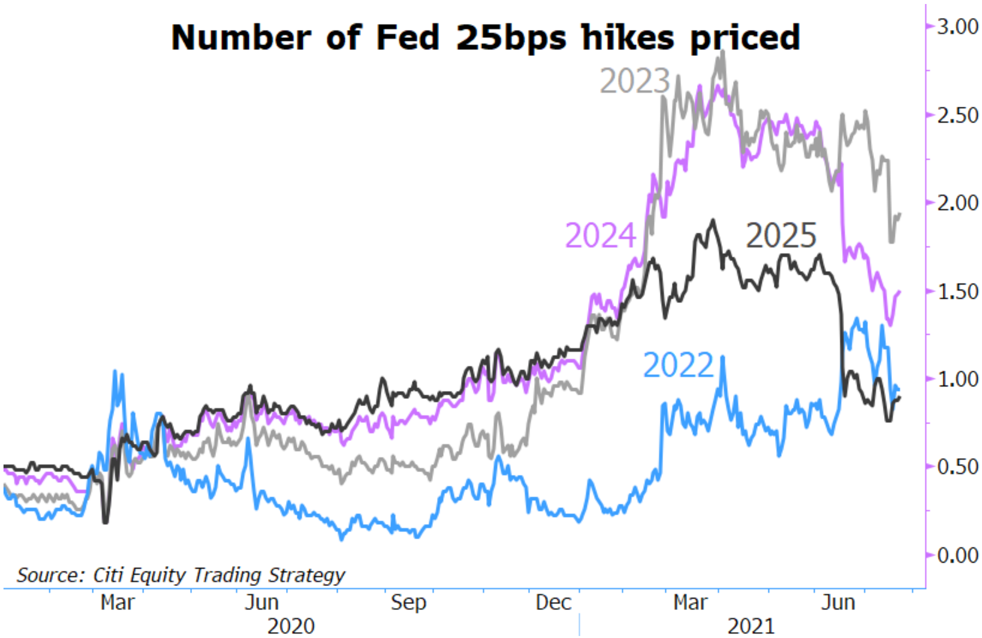


Speaking of headaches, I'd be amiss not to mention the chaos within the China ADR space today. Regular readers will recall the last time I touched on this topic, I drew the analogy to investing in emerging market E&P companies pre-GFC when the correct discount rates needed to be applied to account for nationalization risk (or whatever), and sadly that continues to hold true in this day and age. I was always taught that rule #1 of investing in EM equities was "a stock that has fallen 90% is the same as a stock that has fallen 80%, and then halved", and that's *exactly* what happened to the education sector today, with many of the names already losing three quarters of their value before today's unofficial announcement regarding a potential conversion to 'non profits'. The additional shockwaves sent through separately in a recently-IPO'd rideshare company given ongoing data concerns illustrates that the reach of interventionist policy is not confined to just the tech sector, and reinforces the message to a western shareholder base that whatever the risk premium embedded in these stocks currently, then it probably still needs to go up, even considering the magnitude of underperformance versus the equivalent US Tech universe… and that's before we even consider the unilateral actions from the US with regard to listing requirements/accounting procedures.



Lastly, a quick point on the Fed next week. Only 60bps is priced as a one-day move in SPX next week, which to me looks fair given that the recent moves in ED$ and 2s10s essentially gives the Fed a massive hall pass to do/say as little as possible next week. Why be premature on any taper talk when the market has significantly priced out hikes for you? If I were Mr Powell, I would feel reasonably vindicated that the market is now believing the 'transitory' inflation narrative (rightly or wrongly), and as such would *hope* that the FOMC statement is designed to provide little incremental information to the market, which means all eyes will be on 'Tech week' with the SPX heavyweights all reporting with a likely high bar into earnings given the *amuse bouche* from SNAP and TWTR today…

Where are the hikes…



Have a good weekend,

Alty

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