
From: Stewart Oldfield [REDACTED]
Sent: 10/11/2018 1:43:27 PM
To: Andrew King [REDACTED]
Subject: FW: [/] DB Equity Derivs: vFLARE - Where are we now

From: Nadean Novogratz
Sent: Thursday, October 11, 2018 8:01 AM
To: Paul Barrett <[REDACTED]>
Cc: Martin Zeman [REDACTED]; Stewart Oldfield [REDACTED] Xavier Avila [REDACTED] Davide-A Sferrazza [REDACTED]
Subject: [/] DB Equity Derivs: vFLARE - Where are we now

Good Morning, Paul.

Interesting markets yesterday. Below is a piece our desk just published and thought it would be helpful to you. I will send you these types of notes on an ad hoc basis when they come out.

Please look at vol control point below: **These funds likely have to sell ~\$40bln of SPX over the next 1-2 days.**

Kind regards,
Nadean

From: Karthik Nagalingam [REDACTED]
Sent: Thursday, October 11, 2018 7:51 AM

vFLARE (Volatility, Feedback Loops, And Risks to Equities): Systematic strategies were highly allocated to equities, that will change for 1 of 3

The SPX finished down >3% yesterday after not recording a close-to-close 1% day since June. A lot has been made of the market's uneasy internals: IWM/SPY weakness, limited breadth, weakness abroad (Italy, EM), etc. This felt in some ways a cleansing of that, but does it continue or do we revert back higher?

- **Vol control:** The vast, vast majority of vol control strategies track an exponentially-smoothed SPX realized vol that approximates 1M breaking to 10, which is why I was highlighting that level midday, but we went from realizing under 10 to finishing with a 1M RV of 13, and that means these some of these funds hit their initial triggers. **These funds likely have to sell ~\$40bln of SPX over the next 1-2 days.**
- **CTAs:** Other than some CTAs having likely already sold some small-cap exposure, there is nothing to indicate CTAs are de-risking in broad SPX yet (their largest equity weight). While spot is breaking through trend-lines (bouncing off 100 DMA today) and 50DMA is rolling, we haven't seen classic triggers like crossing averages or breaks in trend-channels. Our model shows that SPX has seen constant leverage through yesterday. We will have more to say on this as it develops over the next few days.
- **Risk parity funds** are definitely feeling pain in the current bonds-equities down environment, but we haven't seen anything in their theoretical portfolio vol that would trigger selling currently. **Risk parity would be the last systematic strategy to sell, and we are still a leg lower away from CTAs and then Risk Parity selling.** Bond vol and equity vol is picking up, but long run correlation is still negative, the large risk is still vol increasing not correlation signs switching around.

Vol control selling can cause a weak open to get messy, but 40bln should also be able to be easily digested if the market sees even a moderate open given average daily volumes, but in a sliding market (with worse-than-average liquidity) 40bln to sell can be an impact.