

Subject: [/] Vols & Strikes - DB's Equity Derivatives Weekly
From: Nadean Novogratz <[REDACTED]>
Date: Sun, 04 Nov 2018 16:27:41 -0500
To: Paul Barrett <[REDACTED]>
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Stewart Oldfield <[REDACTED]>,
Alan Brody <[REDACTED]>

Classification: Public

Hi Paul,

Please see below our weekly piece primarily focusing on mid-term elections.

Would you like to continue receiving this weekly piece? If so, Karthik will add you to the distribution so you automatically receive it from him.

Kind regards,

Nadean

From: Karthik Nagalingam [mailto:[REDACTED]]
Sent: Sunday, November 04, 2018 11:28 AM
To: Karthik Nagalingam
Subject: [/] Vols & Strikes - DB's Equity Derivatives Weekly

Classification: Public

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VOLS & STRIKES – DB's Equity Derivatives Weekly

Best Ideas of the Week

For Institutional Clients Only – Not for Retail Distribution. Market

Table of Contents:

- I. What are Midterms Pricing In?
- II. Midterms Keeping Near Term Vols Bid – Sell to Fund Year End
- III. Week Ahead Earnings Calendar
- IV. Index Vol Change

I. What Options are Pricing in for Midterm Elections

Options are implying the biggest moves to Financials and QQQs, both are outsized vs. their RV, but Fins are considerably more dislocated.

- Banks saw massive moves on the 2016 election, with the promise of tax reform/deregulation for financials, there may be concern of a pullback if Dems take the house. Financials also have their own idiosyncratic risks currently with poor loan growth etc.

- Also only SPY and EEM are near to sitting on the 16vol = 1% move heuristic line, so most assets/sectors are assigning some vol premium into the event.

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Source: DB, Bloomberg L.P.

Historically, equity performance following US elections looks to have a USD-sensitive tilt.

- The best performing sectors on average have been Energy and Materials, while some of the worst performing assets t+1 were gold, emerging markets, and Treasuries. Over the following month, smallcaps have outperformed on average.

- Lastly, as expected VIX futures fell the day after the election, but also remained lower in the following month in every instance except 2008, in the middle of the Financial Crisis.

Median Election Moves Since 2000

Implied Move on Midterms

T+1 Move

1M Return

SPY

1.0%

0.4%

1.9%

QQQ

2.4%

0.5%

1.6%

IWM

1.6%

0.4%

2.3%

EEM

1.8%

-0.9%

-0.2%

TLT

1.3%

-0.9%

-0.2%

GLD

1.0%

-1.1%

2.0%

XLK

2.2%

0.1%

0.9%

XLF

2.3%

0.4%

2.7%

XLE

2.0%

1.0%

2.2%

XLV

1.7%

-0.1%

-1.3%

XLI

2.1%

0.2%

3.3%

XLP

1.5%

0.3%

0.3%

XLY

1.9%

0.4%

2.4%

XLB

2.2%

1.0%

3.6%

XLU

1.9%

0.5%

-1.4%

1st VIX Future

-
- 3.5%
- 3.8%

Source: DB, Bloomberg L.P.

Our Macro Strategy teams are out with their midterm preview and one thing they have seen is dollar strength surrounding US elections.

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Here are select notes from DB's Midterm conference call with Quinn Brody: Macro Strategist, Frank Kelly: Head of Government Affairs, and Mark Chen: Co-Head GED

Quinn Brody: Macro Strategist

- Midterm election result expectations: Base case: 60% probability is Dems take House, but not Senate
 - o Split legislature might have focus on infrastructure, new regulations to limit drug price increases but nothing too wild
 - o Historical experience back to 1800s shows the current president's party tends to lose seats in midterms
 - o Dems need 24 seats take House, 2 seats to take Senate: Dems likely to take 37-44 seats in House as a function of generic ballot and the president's approval rating
 - o Senate is trickier to predict – betting markets price odds of 88% GOP holds Senate
- Markets: equities historically rally around midterm elections
 - o Given this removal of uncertainty, we like owning equities into year-end despite recent volatility
 - o Treasury yields historically rise when republicans retain control of both chambers and presidency

Frank Kelly, Head of Government Affairs

- On the polls
 - o All over the place; seem to have gotten worse since last presidential election
 - o What's most important to note is Dems likely to win house, but real question is by what size/margin
- What's next
 - o Trump intends to sign USMCA (or NAFTA 2.0), maybe in Argentina during G20 meeting where everyone will be watching him and President Xi
 - o If we see a Democratic house:
 - § Earlier this year, Dems put out publication that outlined out what they would do if they were in control
 - § Many of these match with Trump's agenda: infrastructure spending, lowering prescription drug prices , Immigration issues, criminal justice reform, etc.
 - o The Fed
 - § The larger the margin of victory for Republicans in Senate, the better the news for Powell, If Trump continues to push on him, a stronger Republican Senate would be more defensive of him
 - o Trade
 - § Too early to know if Cabinet request is just Trump shaking the tree, or something real. Also notable-there are Dems in Senate who are strongly in opposition to China's trade policy
 - o Trump
 - § Could see him changing gears to work with Dems on infrastructure; really the only pillar of his campaign he hasn't yet addressed
 - § Mueller to report to boss on report in coming weeks-but dangerous to speculate too soon

Mark Chen, Co-Head GED

- What have we been seeing on the desk

- o Enormous sector rotation theme, bid towards sector ETF in anticipation of sector moves

- o Used to be the case that midterm elections were not events that markets priced in a move for, but given recent rally off local lows, now seeing midterm election point as the highest point across curves

- o Overall event risk is not too much higher than the general event risk priced in everyday, given volatility we've been having

- Flows

- o Notable change in sentiment over past 48 hour: Instead of rolling down puts, we are seeing a lot of upside call buying

- § Some in macro space, but a lot in single names, financials, tech stocks; wave of call buying picked up intensity yesterday

- § A lot of names being bought could potentially get boost from GOP maintaining house majority in 30% scenario, but still seeing buying across the board

- § General consensus is we probably do rally out of midterm into the year-end

- Year End

- o A lot of good academic data out there by DB research about general uncertainty effect easing coming out of midterm elections

- o Think significant probability we rally into year end and out of midterm give that positioning lighter and sentiment shifting

- § Have not seen panic from clients

- § Clearly still in high vol market and even if we were to rally, would be in straight line which points to owning optionality

- Vol regime we are in is very different from past

- o Use to be a buy dip, sell vol environment

- o This time it's a growth story, no one day will decide growth is back on, but will come over time as a result of information filtering into market

- o Will be a medium vol regime for a while, make sure can withstand drawdowns

- Slight premium to election so not anticipate vols meaningfully drop off only slightly, we are not going back to VIX sub 16 world any time

soon

- o 17-25 VIX level range into end of the year
- o Vol curve is the flattest we've seen in past 3 weeks meaning 1.25% pricing in SPX move is roughly
- o Bottom line: vol not pricing in a ton on the event

II. Midterms Keeping Near Term Vols Bid – Sell to Fund Year End

Sell SPY Nov9 280 calls to buy SPY Dec31 287.5 calls for ~\$1.11 (ref 2734) buying and selling 20d options.

· Yearend call spreads don't line up well, best way to cheapen is selling nearer dated calls that have greater headwinds.

There have been few instances since the GFC where the SPX implied vols has been this inverted for this long. SPX 1M/3M vol has only been inverted to this extent for this long 4 or 5 times since 2008, with 2 of those being the Financial crisis and the selloff in 2011, the remaining were quick one-time touches between 2015 and feb-2018. Those quick touches were in the VIX-ETP world, where front month implied vol moves would get exacerbated in both directions. That means that the quick/small spikes in 2015/16 may not have been occurred without them, making the current inversion even more of an outlier.

While the curve has come off slightly over the past two days with the market bouncing, but it has remained at high level over the last 7 trading days, the longest since the 2015/2016 sell-off, and 2011/2008 before that. This is true across multiple tenors as well. Part of this is the fact that 1M vol is elevated partly from the midterms boosting near-dated selloff vol higher, but what makes it more interesting is that the longer dated vols are higher as well (see next picture)

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Source: DB, Bloomberg. L.P.

Longer dated vol measures remain elevated, and are higher than they were back in Feb. You can see in longer term VIX futures (using the 6 month as a

proxy below) that there is higher vol priced in than on the move in Feb/-
March, although near term vols exploded back then from the ETP complex. This
sell off has seen a more steady march higher – indicating how well-behaved
vol has been during this selloff. Longer dated vol levels are roughly near
the levels markets experienced back in the elongated selloffs of late-2015/-
early-16.

Longer dated vol remaining elevated points to genuine change in fundamental/
economic growth expectations changing rather than a technical-led selloff.

{cid:image008.jpg@01D47431.6DDE6D20}

Source: DB, Bloomberg. L.P.

III. Week Ahead Earnings Calendar

SPY and NDX stock reporting this week – w/ ADV (20d) of options > 3000

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Source: Bloomberg, Deutsche Bank

IV. Index Vol Changes

Closing Spot

Spot t-1

Spot t-5

2,723.00

2740.37

2658.69

Fixed Strike Changes

ExpiryDate

50d Strike

Closing 50d Vol

1d Change

5d Change

25d risky skew

1d Change

5d Change

Closing 50d Vol

ExpiryDate

50d Strike

5-Nov-18

2,719.87

18.38

1.16

-8.82

2.99

-0.95

-5.80

18.15

5-Nov-18

2,719.87

7-Nov-18

2,720.56

22.32

2.51

-4.20

5.52

0.11

-3.14

22.16

7-Nov-18

2,720.56

9-Nov-18

2,719.51

20.07

1.23

-5.36

5.43

-0.08

-2.95

19.88

9-Nov-18

2,719.51

12-Nov-18

2,719.85

19.88

1.36

-4.94

5.90

0.34

-2.28

19.70

12-Nov-18

2,719.85

14-Nov-18

2,719.59

19.20

1.20

-4.61

6.07

0.35

-1.81

19.02

14-Nov-18

2,719.59

16-Nov-18

2,719.35

19.00

1.35

-4.11

6.24

0.33

-1.42

18.81

16-Nov-18

2,719.35

23-Nov-18

2,720.58

17.75

1.03

-3.56

5.85

0.29

-1.54

17.65

23-Nov-18

2,720.58

30-Nov-18

2,721.00

17.29

0.78

-3.07

5.70

0.14

-1.78

17.22

30-Nov-18

2,721.00

7-Dec-18

2,721.49

17.36

0.63

-2.56

5.69

0.04

-1.63

17.31

7-Dec-18

2,721.49

14-Dec-18

2,722.69

17.45

0.57

-2.15

5.68

-0.02

-1.53

17.44

14-Dec-18

2,722.69

21-Dec-18

2,724.56

17.67

0.69

-1.70

5.76

0.02

-1.37

17.71

21-Dec-18

2,724.56

31-Dec-18

2,727.81

17.64

0.72

-1.43

5.91

0.00

-1.25

17.76

31-Dec-18

2,727.81

18-Jan-19

2,732.08

17.57

0.62

-1.25

6.31

0.14

-1.08

17.77

18-Jan-19

2,732.08

31-Jan-19

2,735.41

17.57

0.62

-1.13

6.58

0.18

-0.91

17.84

31-Jan-19

2,735.41

15-Feb-19

2,736.51

17.52

0.64

-1.08

6.88

0.17

-0.77

17.81

15-Feb-19

2,736.51

28-Feb-19

2,738.18

17.45

0.61

-1.09

7.03

0.11

-0.72

17.77

28-Feb-19

2,738.18

15-Mar-19

2,740.14

17.41

0.57

-1.05

7.23

0.15

-0.74

17.76

15-Mar-19

2,740.14

29-Mar-19

2,743.71

17.32

0.52

-0.97

7.26

0.12

-0.69

17.72

29-Mar-19

2,743.71

21-Jun-19

2,758.97

17.00

0.45

-0.83

7.48

0.13

-0.66

17.59

21-Jun-19

2,758.97

28-Jun-19

2,760.58

16.98

0.52

-0.79

7.44

0.10

-0.64

17.58

28-Jun-19

2,760.58

20-Sep-19

2,777.66

16.97

0.42

-0.62

7.39

0.02

-0.59

17.72

20-Sep-19

2,777.66

30-Sep-19

2,779.80

16.96

0.39

-0.62

7.40

0.13

-0.52

17.72

30-Sep-19

2,779.80

20-Dec-19

2,795.88

16.72

0.33

-0.48

7.01

0.09

-0.55

17.57

20-Dec-19

2,795.88

17-Jan-20

2,802.16

16.68

0.34

-0.48

6.94

0.03

-0.53

17.57

17-Jan-20

2,802.16

19-Jun-20

2,834.92

16.75

0.27

-0.40

6.55

0.04

-0.42

17.77

19-Jun-20

2,834.92

18-Dec-20

2,876.41

16.75

0.20

-0.39

6.01

0.05

-0.37

17.87

18-Dec-20

2,876.41

18-Jun-21

2,917.67

16.88

0.17

-0.38

6.18

0.06

-0.11

18.22

18-Jun-21

2,917.67

17-Dec-21

2,961.58

17.04

0.16

-0.35

6.18

0.05

-0.10

18.52

17-Dec-21

2,961.58

16-Dec-22

3,055.17

17.50

0.13

-0.29

5.93

0.04

-0.08

19.16

16-Dec-22

3,055.17

Source: DB

Thank you,

DB Derivs Team

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