Subject: [/] Vols & Strikes - DB's Equity Derivatives Weekly
From: Nadean Novogratz <[redacted]
Date: Sun, 28 Oct 2018 17:54:46 -0400
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Hi Paul,

I hope you've had a nice weekend. Please see below our weekly derivatives commentary and trade ideas.

Please let us know if you have any questions.

Thank you,

Nadean

From: Karthik Nagalingam [mailto:karthik.nagalingam@db.com]
Sent: Sunday, October 28, 2018 4:37 PM
To: Karthik Nagalingam
Subject: [/] Vols & Strikes - DB's Equity Derivatives Weekly

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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 Commentary – Not a Product of Research.

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I. vFLARE – Vol control and CTA strategies have de-risked, risk parity funds have started selling

vFLARE (Volatility, Feedback Loops, And Risks to Equities): Coming into October Systematic strategies were highly allocated to equities, only Risk Parity funds remain highly allocated

· The SPX is down over 10% since the start of October, and realized vol on the SPX has steadily increased since the initial spike on Oct-9. These funds rarely sell at the same time, but cascade as different triggers are hit. Vol control had it's moving party first, then CTAs slowly reduced SPX exposure, and are currently near the levels they would flip to a seller. Risk parity funds are seeing their portfolio vol trade higher, we are increasingly getting to levels they have reduced equity exposure in the past.

Risk parity funds starting to sell and have definitely felt the pain in the current environment, and by measuring their theoretical portfolio vol they have entered the range they have sold equities exposure in the past (4.5-5% portfolio vol). Risk parity are the last systematic strategy to sell, and we just started seeing selling late this week following the large back and forth swings Wed-Fri. Risk Parity funds likely had ~50-70 bln to sell in aggregate, and likely have started selling ~10 bln this week. The risk to markets here is a large increase in their portfolio vol – still driven by vol increasing not correlation signs switching around.

Source: Deutsche Bank, Bloomberg Finance L.P, Vol control: Majority of selling done, even considerable volatility from here will only create marginal selling. This week saw roughly an additional ~5-10bln over the week. While the threat of a large spike of selling is over, the longer realized vol remains high the longer it takes them to become an buyer of equities.

Source: Deutsche Bank, Bloomberg Finance L.P, SEC Regulatory Filings

CTAs: CTAs have likely already sold down the majority of SPX exposure, there seems to be a slight uptick midweek due to the oversold conditions. However, the increasing realized vol and plateauing/downward-trending moving averages are going to mean that CTA sell signals will stay on. There is currently less instantaneous sell risk from CTAs, but increasing risk of funds going net short. The funds haven't been net short since the market routs in 2015 and early 2016, but they are approaching that switch point.

Source: Deutsche Bank, Bloomberg Finance L.P

II. History Doesn't Repeat, It Rhymes – SPX May Have Further to Fall

SPX Down 3% and then a 1.5% "Relief Rally" – What has happened before?

Recent high market volatility has caused us to look back and see what current price action has preceded in the past… and it's not a pretty picture, but the path from there diverges.

Buy protection in the short term if you have not de-risked, and if you are taking a shot at upside look further out the curve.

Looking at instance of the market down 3% and then rallying 1.5% - the average intraday drawdown over the next 5 days was -7.4% (median: 7.9%) , with a close to close average mark down 4% on average. The instances are clustered as expected in other high vol periods; Feb 2018, Summer 2011, 2008/09, 02-03, 97, etc. It is not only that you average a drawdown, it's the fact that there are no positive observations since the 50s.

Where we go from there becomes less certain, as the market both rallied and sold off even further in different instance, and in many instance in massive ways. If you have not de-risked, consider adding protection and if you have, looking past this, there may be opportunities further out the curve.

III. Week Ahead Earnings Calendar

SPY and NDX stock reporting this week – w/ ADV of options > 500

Source: Bloomberg, Deutsche Bank

Thank you,

DB Derivs Team

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