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Special Update

Recap From Sunday's Letter:

- Based on its bearish chart, Tesla became a large risk to the market as its size grew to be the largest in XLY and in the top 5 for the S&P 500. Tesla has now fallen 16% from its high set last week, dropping 12% yesterday alone. This was the largest one-day decline for the stock since Sept. '20.
- Sentiment became frothy with S&P 500 and Nasdaq 100 showing 93% bullish Daily Sentiment Index (DSI) readings.
- Breadth remains strong and improving with expanding new highs for 3-, 6-, 12-month lookback periods. Suggesting any weakness we do see may present as a buyable opportunity should the strength in market internals remain.

VRT Signaled

As of Tuesday's close, the Volatility Risk Trigger has signaled. This is a result of extremely narrow compression in volatility dispersion as well as several other market-based indicators. This now opens the proverbial door for volatility to move materially higher.

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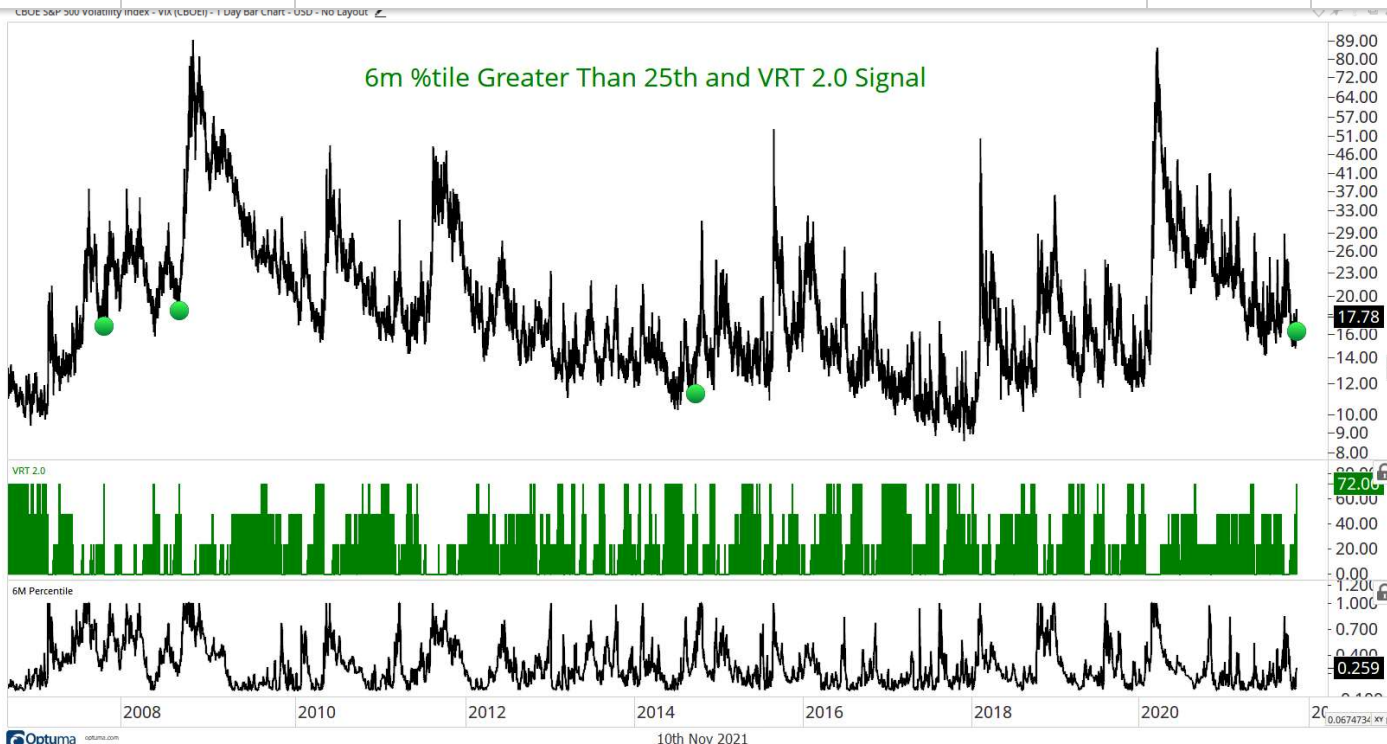
For long-time readers you'll remember I've said many times that we rarely see volatility spike higher from a major low. Instead, it begins to slowly climb before a final crescendo. For example, in February '18 spot VIX had risen 4 points before the major move higher. In Sept. '20 when the S&P 500 slid 10% in just a few days, VIX had risen roughly 4 points as well. In today's market, spot VIX is up almost 3 points from its low. Looking back at history for when the VRT 2.0 signaled and the VIX had moved off its low, specifically above the 25th percentile we have three prior instances since 2007 - shown on the chart below with green dots. While this sample size is obviously extremely small, the takeaway here is to show when volatility begins to climb higher, increasing its correlation with equities (like it's been doing for the last couple of weeks), that is not a bullish setup for risk assets in the short-term as we often see a material move higher in volatility soon follow.

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I'll be back Sunday evening with next week's letter.

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