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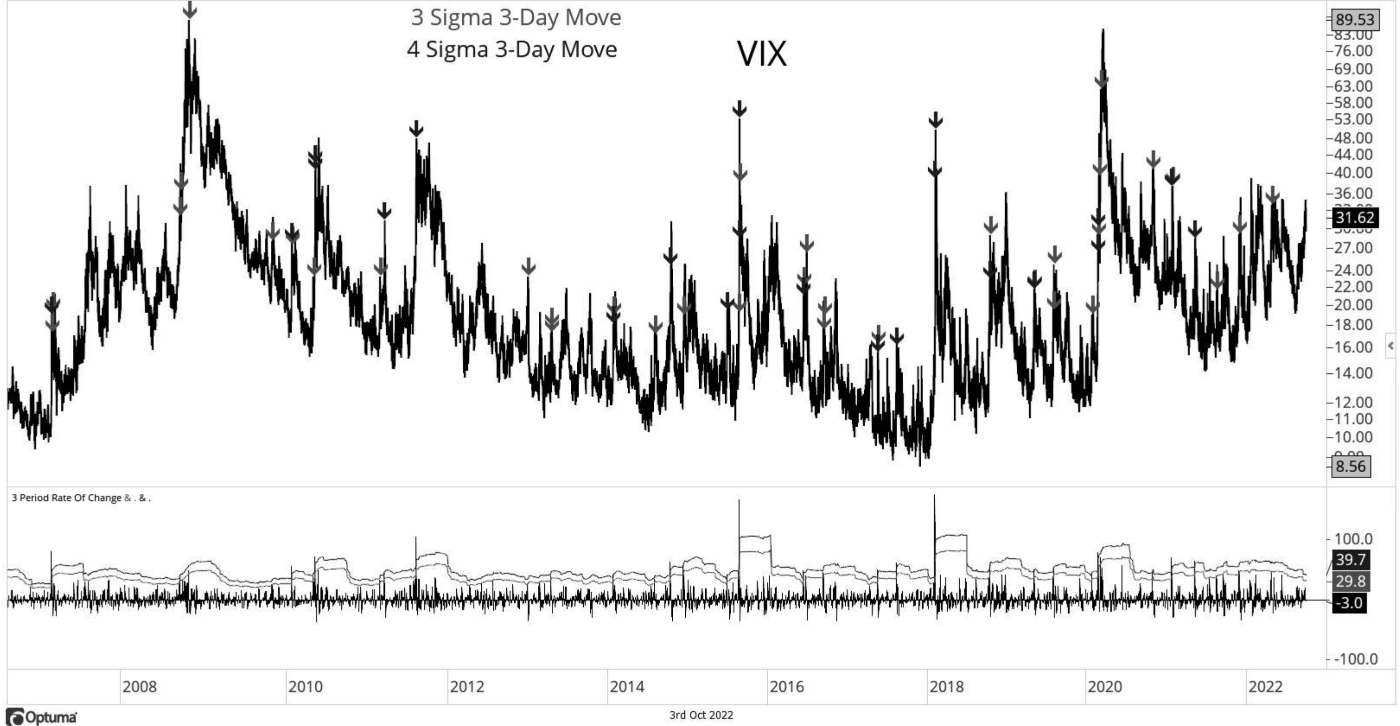
TA THRASHER ANALYTICS

Why I Think The VIX Hasn't Spiked & Quick Market Update

In mid-Aug. when spot VIX was at 20 I sent a special update that a spike was likely based on intraday setups and not based on the VRT. That marked the latest low and we saw the VIX immediately rise to its current level, just north of 31 as of Friday’s close. While we’ve seen some degree of movement in volatility, one of the questions that seems to be asked is why the VIX hasn’t spiked and many traders are patiently waiting for that occurrence or a specific level of volatility before marking the ultimately low in the U.S. equity market. While there’s of course no definitive answer to why anything in the market happens – or I this case – hasn’t happened. I wanted to share my personal thoughts on what’s happening in volatility.

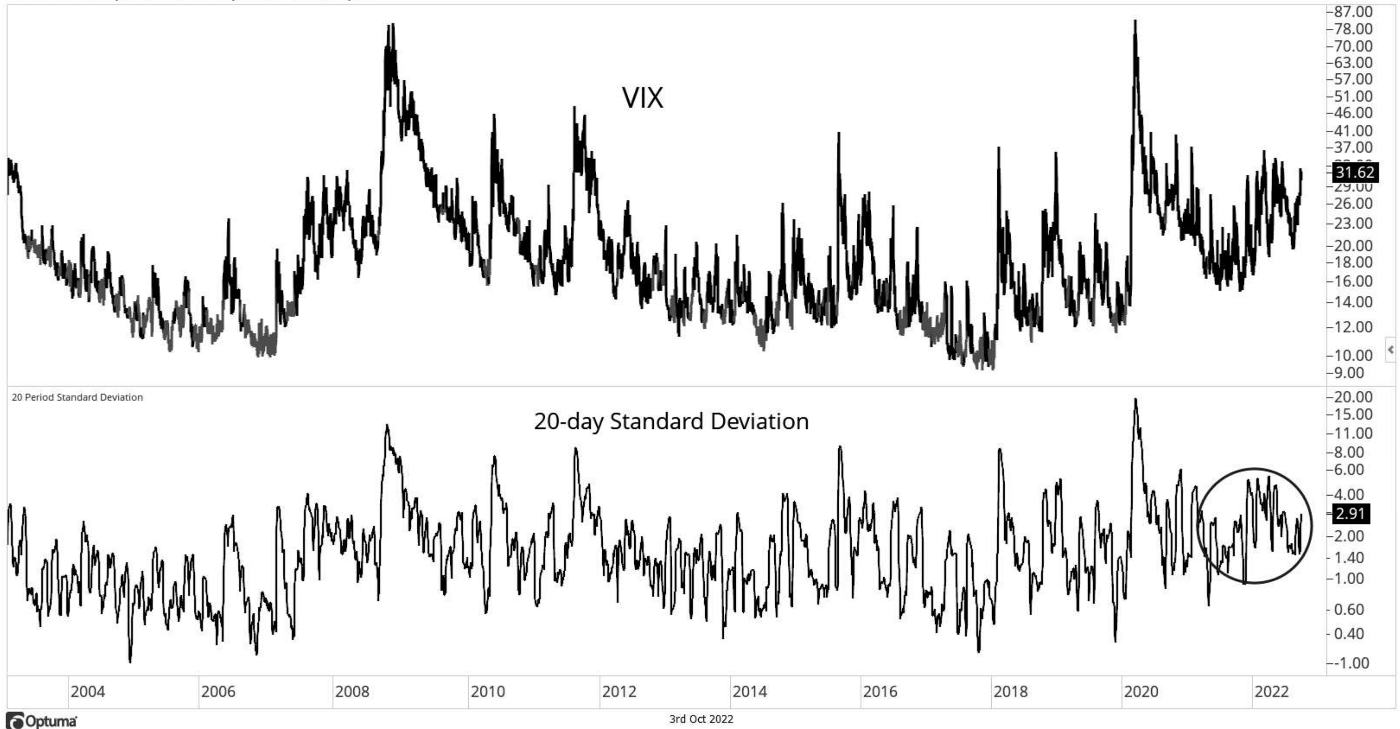
First, I’d encourage reading the blog post I posted on my personal site as it relates heavily to this very topic. The post is titled, “Daily Volatility Needs to Calm To Draw Back Equity Buyers” and I share that we have seen (at the time of writing) 60 days of the S&P 500 rising or falling by at least 1% and how that is more important than what the actual level of the VIX is.

Volatility spikes are fairly normal for markets each year. There's of course been some standouts, notably 2017. Below, we can see the VIX has seen plenty of 3- and 4-sigma advances based on 3-day change. So far in 2022, we've had just one such occurrence - even with broad indices down 20% and many individual stocks off by over 30% from their 52-week highs. Why has this year been unique? Let's dive into a few possible answers.

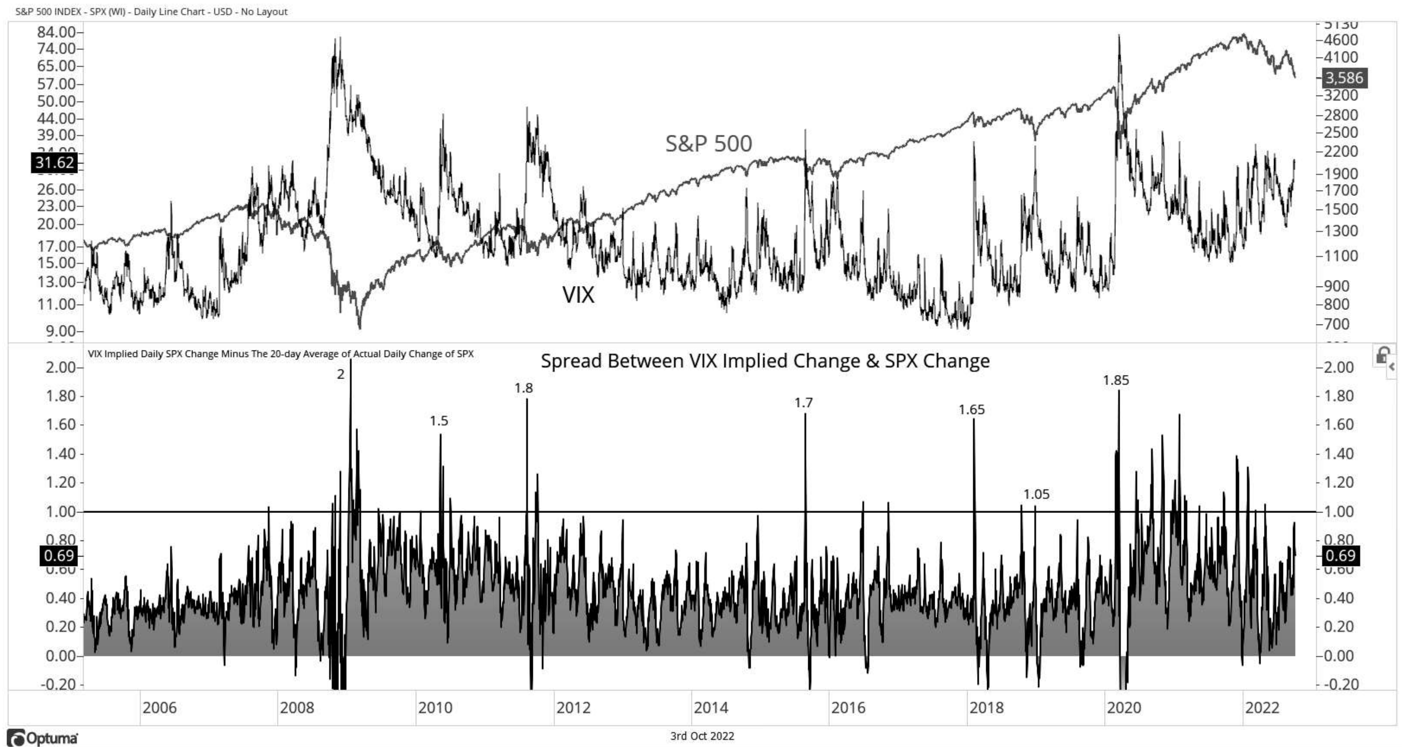


Lack of Narrowing Dispersion

Now moving to the VIX itself, and the spikes we so often see when markets decline. In the paper I published in 2017 titled, "Forecasting a Volatility Tsunami" which won the Charles Dow Award, I discuss the extremely frequent market characteristic of narrowing dispersion within the VIX that precedes spikes. I show that almost every spike in volatility is preceded by this development (while not every narrowing of dispersion precedes a spike). So far in 2022, there's been just 5 days where standard deviation has gotten under 1.5, much less to a meaningful level that could be classified as "narrow." I would argue, the lack of calm within the VIX, ironically, is what's prevented it from spiking.

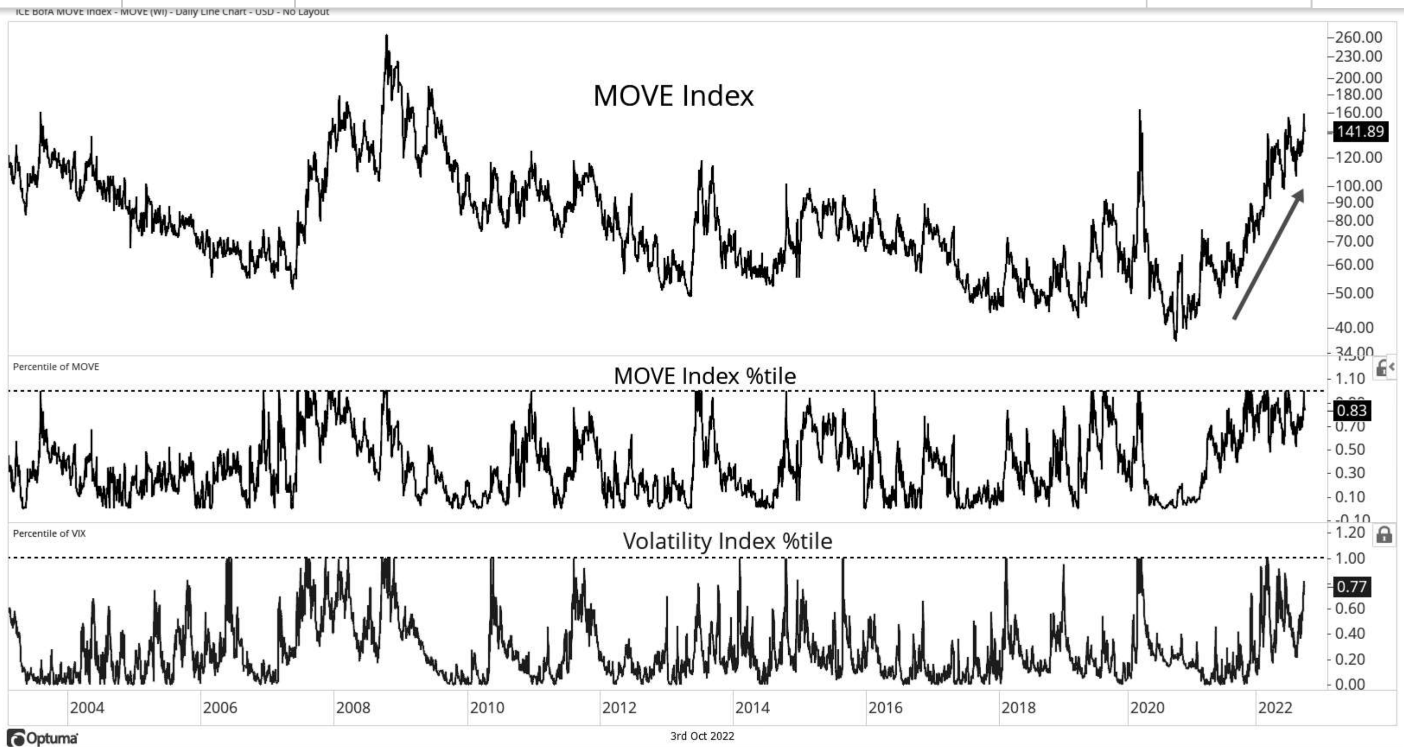


orderly market that still has large daily moves! This can be seen by what the VIX implies the S&P 500 should be moving on a daily basis and what the equity index is actually doing. The chart below shows the VIX implied change minus the actual change of the S&P 500. So far this year, there's been just three periods of time where the level of the VIX suggested the S&P 500 should be experiencing a greater degree of daily volatility. Compare that to the prior downturns… In January 2009 the VIX was at a level that implied the S&P should be seeing twice the daily volatility; After the Flash Crash in 2010 the VIX implied 1.5x, the Covid Crash saw a move to 1.85x. This suggests the equity and volatility markets aren't surprising each other. For the most part, they are confirming each other's moves and the options data that flows into the spot VIX is "in sync" with the large cap index.



Bond Volatility

Finally, I'd note that we have seen volatility spike, it just hasn't been in equities. Instead, it's been in the bond market and can be seen in the MOVE Index, the Volatility Index for Treasury bonds. I don't need to remind you of the massive declines experienced in bonds, which some note have been the worst since the civil war (not sure who was trading bonds during the civil war, but I'll take their word for it). Financial market volatility is like a pressure value, it needs to be released somewhere and most often we see that release take place in equity markets. But it can also be released in forex, commodity, and bond markets. Currently, the MOVE Index is at the highs seen during the Covid Crash and isn't too far from the peaks touched during the Financial Crisis.



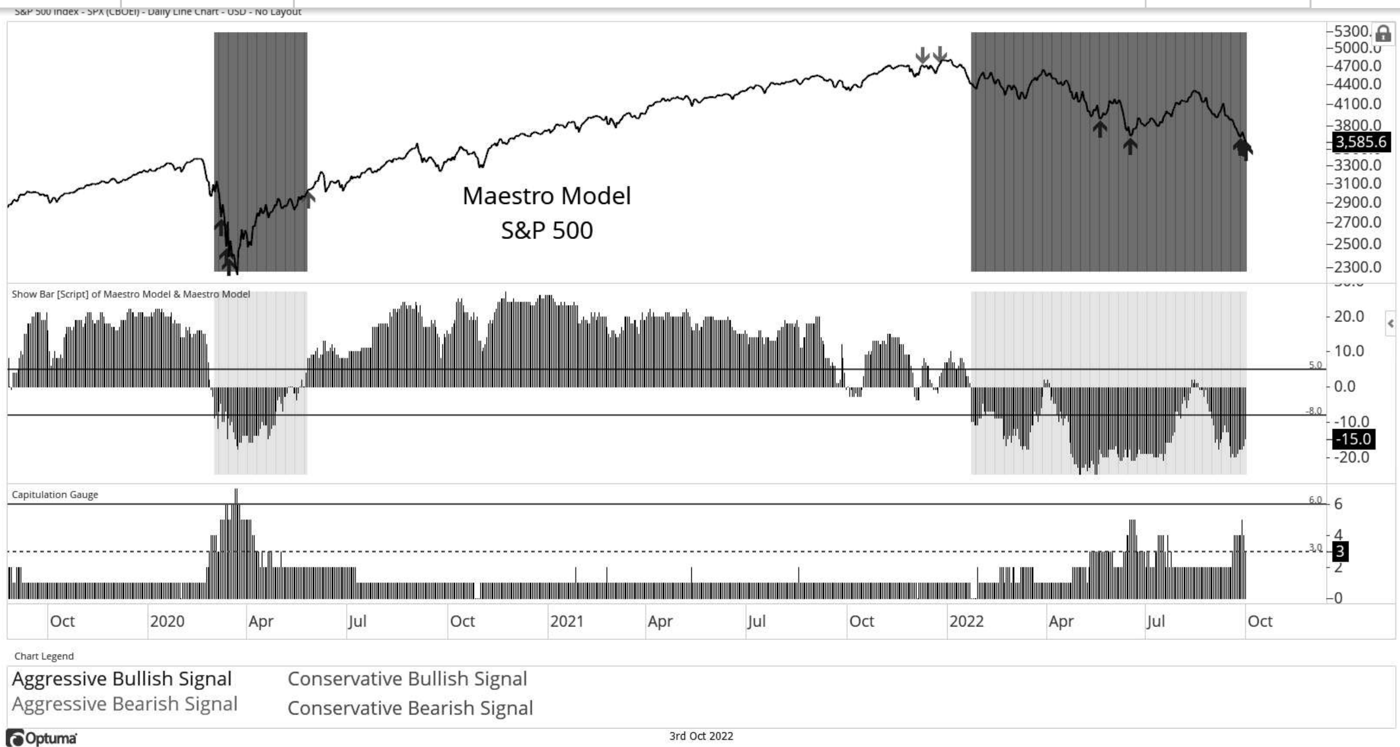
In conclusion: Nearly all volatility spikes are preceded by a narrowing of dispersion, something we aren't seeing in the current market outside of intraday charts as I flagged in August. This lack of dispersion prevents a build up of "pressure" that sends the VIX spiking higher. The market instead has performed in an orderly fashion with the VIX and SPX confirming each other. And the bond market has been area du jour for volatility spikes, with the MOVE Index near 2008 levels.

I returned home from vacation with my family late last night but I want to give a brief update to a few of the models and share a couple charts....

Now for a few charts...

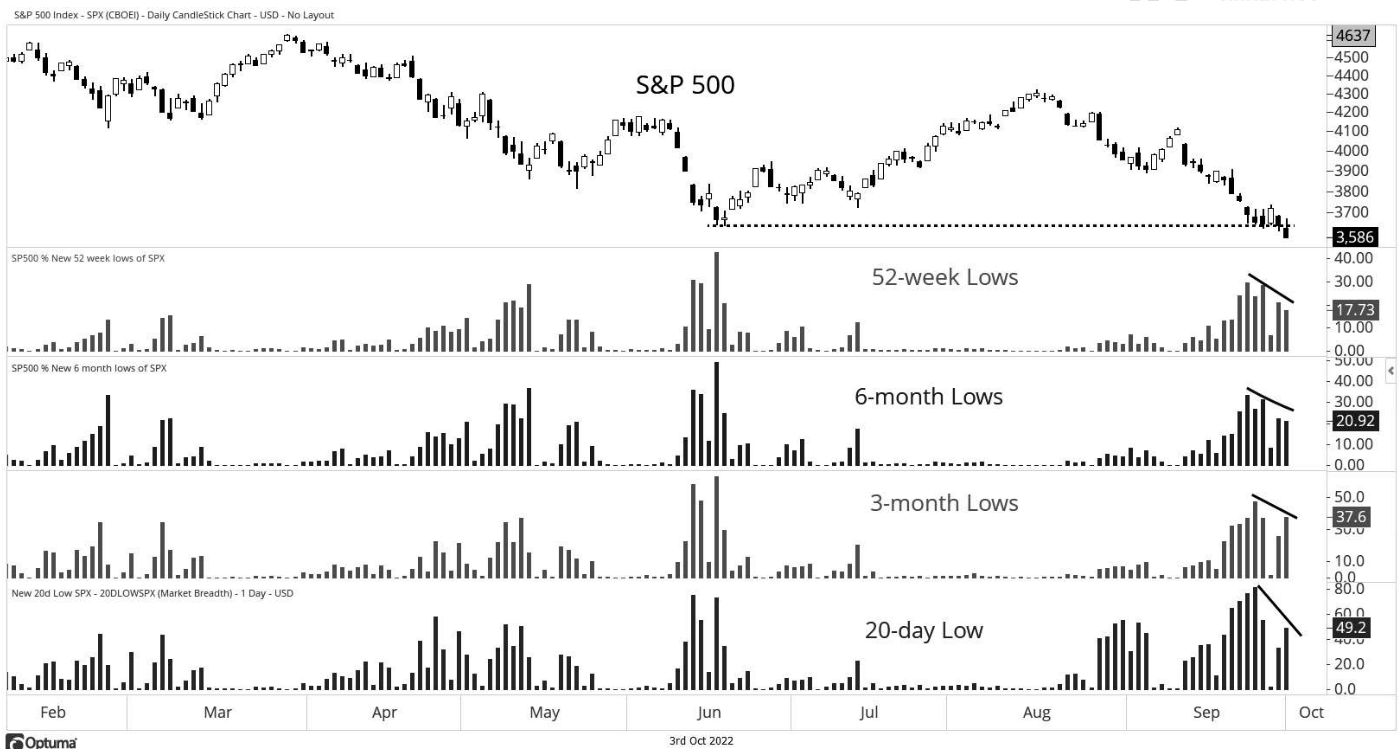
Maestro Model

The Maestro Model has seen some improvement in recent days, giving some Aggressive Signals at the end of last week as a result of the market moving lower and the model increasing in value. We've also now seen a +4 on the Capitulation Gauge, which is still below the +6 we've seen at most major lows but matches the level from last June.



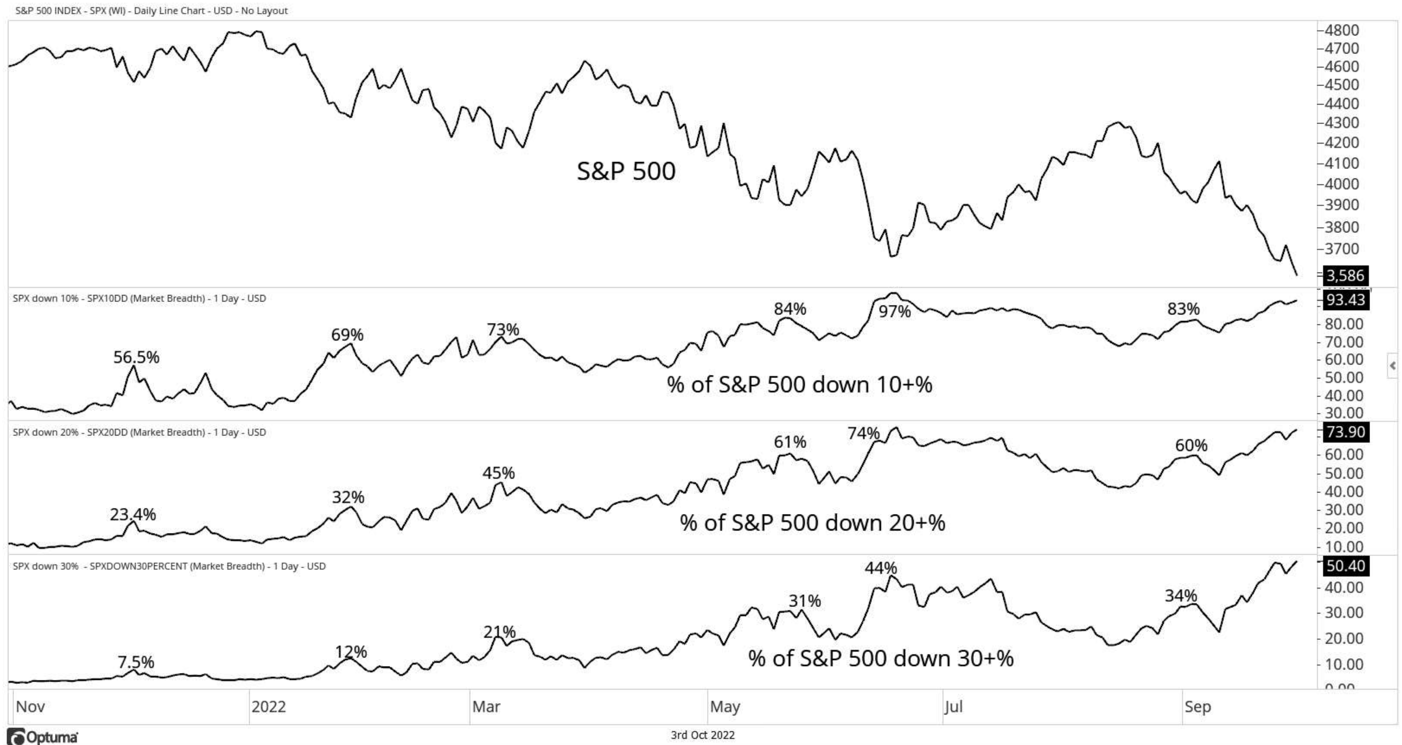
New Lows

While the S&P 500 made lower-lows last week, breaking below the June level, the internals did not show confirmation. Instead we saw less new lows across timeframes. This suggests that while equities are still largely weak, they weren't dropping to levels to match the index.



Average Drawdown

While stocks weren't making lower-lows at the end of last week they are in deep drawdown. For the first time, over half of the S&P 500 is down more than 30%, exceeding the 44% of stocks that were down that much back in June. This shines a spotlight on just how weak some of the large cap U.S. stocks are right now. This doesn't mean we can't get a bounce in the indices, but on an individual stock basis there are some massive holes



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

Sincerely,
Andrew Thrasher, CMT
Thrasher Analytics

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