FOMC Trade

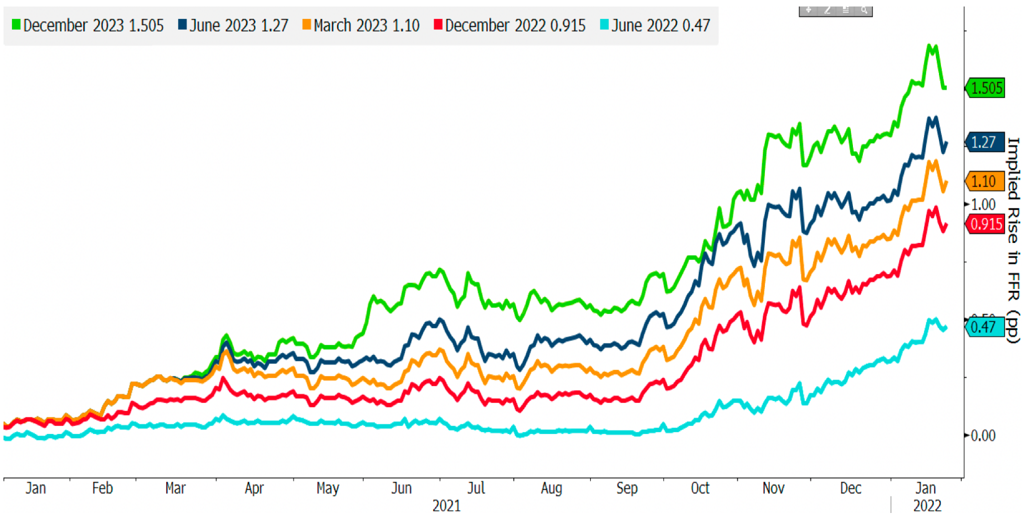
It's FOMC week and with VIX spiking to 38 and VVIX (the vol of vol) closing at 154 on the day, we have a good setup for our FOMC Fade Trade going into Wednesday.

For those of you not familiar with this one. It's essentially a short vol trade to play the strong tendency of volatility to compress immediately following the release. Since the FOMC is a significant market event, players bid up insurance (VIX up) heading into the release in order to hedge their long book. They then sell this insurance as soon as the uncertainty is settled.

You can read more about the strategy and it's returns here.

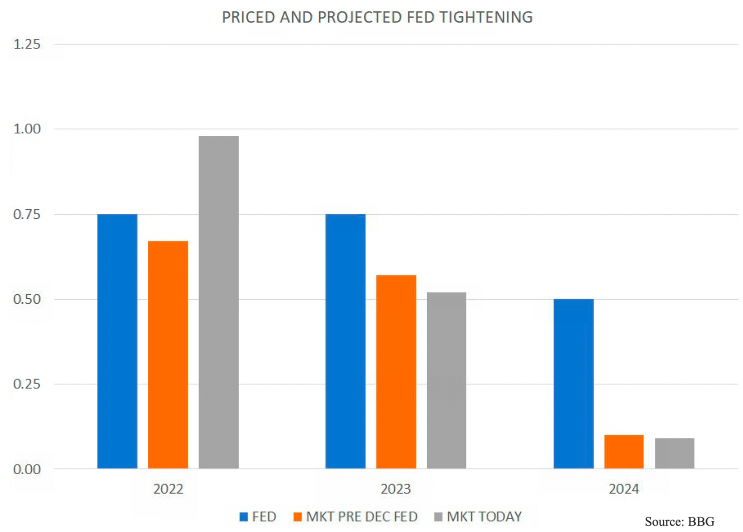
We typically put on the trade hours before the release and then close it out before the day's close. But when vol gets bid up in the day prior, we'll often put it on when it looks like we're near a temporary bottom in the equity market. Depending on how tomorrow morning looks, we may put this trade on near the open or later in the day.

We'll send out an alert when we do.



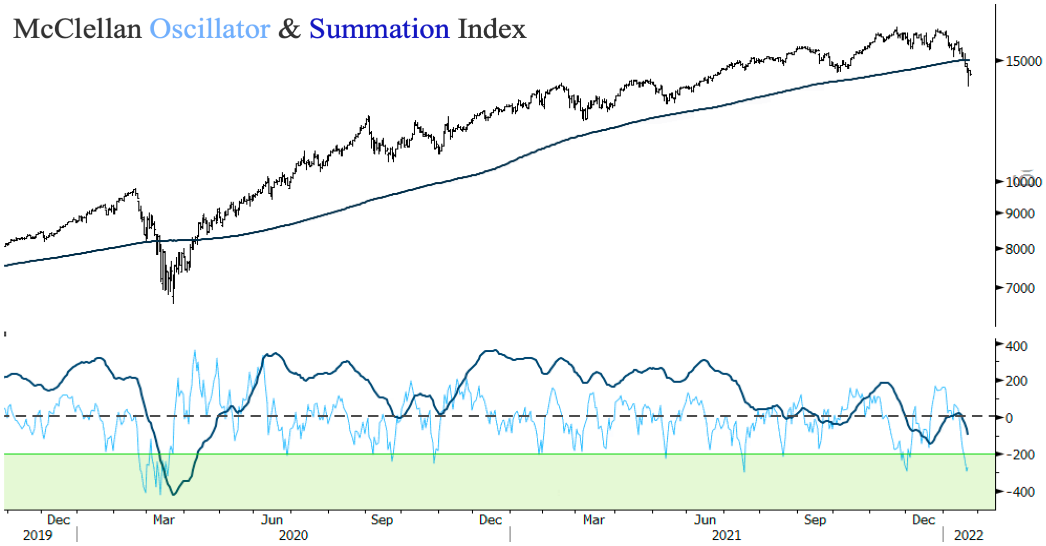
The market is currently pricing in roughly four hikes this year (see red line). This is above the Fed's projection for three rate increases. So there's quite a bit of hawkishness being price in at the moment, which makes it improbable that the Fed can hawkishly *surprise* the market this week.

This chart from BBG shows how much market expectations have shifted since the December Fed meeting.



The market is probably near a temporary bottom. But it's too soon to be backing up the truck and going shopping. Inflation prints have the Fed by the tail which in turn is driving major repositioning and the taking down of risk in markets right now. And this will continue until either (A) there are convincing signs that inflation has peaked and/or (B) over positioning gets more fully cleared out. I wrote about the likelihood of this in December's note *A Big Deal…*

Our current base case is for another few weeks of volatile chop with risk to further downside before a more defensible bottom is in. There's quite a bit of speculative positoining that still needs to be wrung out beforehand.



I'd like to see the McClellan Oscillator (a favorite oversold-reversal indicator of mine) flip back to positive and a Buy signal to trigger on the weekly Nervous & Numb chart as well, before we start positioning more aggressively to the long side again. Until then, it's a tactical environment to play with small size, tight stops, and quick targets.

Your Macro Operator,

Alex