MACRO Voices
with hedge fund manager Erik Townsend

Charlie McElligott: The opportunity will be found selling puts. But not yet!

May 9th 2019

Erik: Joining me now is Charlie McElligott who heads up the global cross-asset macro strategy group for Nomura and is extremely well known for the CTA model which predicts when algorithmic traders will change their positioning.

Charlie put together a fantastic slide deck in support of today's interview. Registered listeners can find the download link in your Research Roundup email. If you're not yet registered, just go to our home page at macrovoices.com and look for the red button that says Looking for the Downloads? next to Charlie's picture.

Charlie, it's really great to have you back on the program, especially this week. There is so much to talk about that's going on tactically, with moves in the market and fears about what might or might not happen with this trade deal and so forth.

But why don't we start at a high level and begin with the big picture?

Last time we had you on the program, you told us to watch carefully as to what the market did in March. You said around the beginning or middle of March there was a risk that we might see a big selloff if we hit certain trigger levels. We started to see that start to come true.

But you also told us if we managed to get through the end of March and we still hadn't gotten closing prints below those trigger levels, that it was a setup for a melt-up. And, of course, that's exactly what has happened.

So, in terms of the big picture, late-cycle dynamics, and so forth, why don't you give us an update on big picture macro landscape? And from there we can start to go deeper into this week's tactical issues.

Charlie: Absolutely, Erik. I would say that the six-month world view into March is important to set the table here because, as aligned with my core thesis last year was that, starting last summer, this view that the yield curve was going to steepen.

And, depending on the catalysts, it could be both a bull steepener and a bear steepener – meaning that the curve is steepening while Treasuries are rallying, or the curve is steepening while Treasuries are selling off.

I would say that the best setup for the bull steepener, which was that October through March window, was the fact that my long-held view that the market smelled the slowdown. And into the back half of last year in the US, and certainly the financial conditions tightening tantrums that we went through last year, the market sniffed the slowdown before the Fed.

And thus the curve began to steepen based on anticipated policy change. Not only the removal of future hikes that had been priced into the short-term interest rate curve, but then, ultimately, going all the way from removing those hikes to then pricing in easing – based on the extent of both the economic slowdown and, certainly, the tightening of financial conditions into Q4 of last year. And frankly into Q1 of this year.

That was a bull steepener. And that was important, because this is such a change from this kind of perpetual decade-long flattening that we've experienced that has built so many of the thematic trading themes and narratives that have been built around this never-ending flattening of the yield curve story.

What ended up happening in March, at the peak of this bull steepener, was that we had a quick scramble of negative global growth data. And, at the same, time there was a real significant capitulation within the rates complex – legacy kind of bearish rates trades that were out there that hadn't been fully cleared out during the growth scare of Q4 and the growth scare into Q1.

And that was really exacerbated particularly – we kind of hit the lows in Treasury yields, the highs in rates on March 27 – that last blast of rate volatility actually was driven by convexity hedgers. So, primarily, mortgage-backed security types of players who – those are negatively convexed products.

So you had technical factors that really created this false optic with regards to the extent of the global growth slowdown. And the crazy thing was – and thus the opportunity – was that it was happening at the perfectly wrong time. It was happening at the perfectly wrong time in the context that the lagging benefits of the Chinese stimulus, Chinese easing, and Chinese deregulation, was really starting to kick in.

And, at the same time, the Fed was discussing more openly now this more pro-inflationary stance as part of their overall inflation strategy rethink.

So you had this setup where I saw very long capitulated into rates and Treasuries positioning. You had this really long bullish view on the overall Treasury rates complex. At a time where you had a beautiful entry point in a more bearish more pro-growth trade. At the same time, you had a flurry of data coming over the next week's span, led by Chinese credit and new loan and credit, social financing data.

And what you ended up getting over the course of the week was a massive kick-down-the-doors positive Chinese credit impulse set of data: New loans, shadow financing, social financing, big China pumping credit, pumping liquidity in the system.

And, during the same time, you had announcements of property regulation easing, which I believe we currently discussed as being the area that matters most to the Chinese economy with regards to all the peripheral positives based around the housing industry and how important it is for the Chinese economy overall.

So you have the Fed messaging changing on a more pro-inflationary dialogue back in our end of the universe. And what you end up getting after you got that big Chinese credit growth data, you had a big set of US data, you had a big ISM beat, I believe we had some PMI beat, you had European retail sales beat – which was Europe has just been a one-way economic surprise miss. We had some beat there.

And, all of a sudden, what ended up happening was this catalyst for this overshoot. And the rates market overshot. And then you had this all-of-a-sudden awareness that, hey, you know what? We might have overshot with regards to how negative we are on the overall health of the global economy and now we have to reprice growth higher.

So, Boom! Pow! April became the month of the bear steepener. And, as part of that thesis, I went out with – a bear steepener is my bread and butter with regards to reflationary types of trades. April was pure reflation. It was long tips over short nominals, meaning just long inflation break-evens.

It was long value over short momentum within equities. You know synonymous – another way of saying long cyclical short defensives. And part of the catalyst of this whole concept was how crowded the slowflation positioning has been as a narrative within investors.

So we really wiped that out over the course of April. And then we got to last week's Fed meeting that changed the dynamic again and is causing a meaningful rethink.

Erik: Let's go a little deeper on this bread-and-butter trade. You have written quite a bit in your daily letters over the past several months about the advantages of the curve steepener. Because, as you've described just now, it can play either as a bear steepener or a bull steepener, and there's arguments for both.

So, originally, I think it was 5s30s steepeners that you recommended in one of your more recent letters in the last few weeks. I believe that you changed your positioning to be long the 2s10s curve.

Is that still the position? And what's your outlook? How long do you see that trade continuing to be the bread and butter that it's been for you?

Charlie: The curves capped, which is an option, basically, on the shape of the yield curve. And it's playing swaps – has been a great trader. We talked about it since advocating it, starting last summer.

The 5s30s cash curve has tripled, kind of gone from 20 to 60 let's say. Right now I'm looking at it – it's 60.3 bips. So it's been a home run. I think part of the idea with regards to – and also, too, we've seen a doubling in the 2s30s cash curve.

This is – the front end of the curve is more reflective of central bank policy. And clearly that has inflected, after what happened in January. The Fed had to catch up with the market and catch up with the deteriorating data and deteriorating financial conditions.

The long end has been stickier and harder to move. And that's really the difference between the bull and the bear steepener. The long end is the part that is going to be most responsive to actually a forward view on growth and a forward view on inflation.

Which is why, in April, you had this narrative changer into the bear steepener, which really boosted that long cyclical short defensives trade. And even not just short defensives, but short tech. Tech is a long-duration asset. Expensive growth stocks are long-duration assets because they need lower rates to justify their valuation.

The 2s10s switcheroo was really about a more attractive entry point and the idea that the others had participated, whereas the 2s10s had not yet broken out. I think the thing here, too, is that I really saw a massive long accumulating in the Treasury space.

And the best proxy and the thing that everybody owns for that long, of course, is TY, the 10-year future. So I liked the fact that the 10-year in particular could reprice and make the 2s10s more attractive.

What I would say, Erik, with regards to the game changer – even though it was a very incremental, nuanced message – the game changer that was last week's Fed meeting has put this thing on ice for the near term. And that's because into extremely dovish expectations built into the market, due to the Fed's own position pivot, starting since January, Jerome Powell came out and spoke from a much more balanced perspective.

And that balanced perspective was best exemplified by his focus on transitory inflation weakness. And that move that, you know what, we're not going to be super-reactionary with regards to the inflation issue that they're having with regards to the forever grinding lower inflation is a big part of what this repricing of growth, higher reflation type of a trade is.

So he just bought some time.

But in the meantime, this very profitable bull steepener of the prior six months and then this big bear steepener – and, again, all I care is that the curve is going steeper, not whether it's a bull or a bear necessarily – is kind of on ice, as I said, simply because some folks were taking money off the table. Which, unwinding the steepener means you're going to flatten for a little bit.

I think from here, to really tie this all up, it's going to come down to the Fed language as we head into their big June inflation symposium where they're going to have to come out and crystallize where they stand on policy – as well as a second Fed center-point, which is what they're going to do with their balance sheet as QE-Lite (as I like to call it) begins in October as they take their mortgage-backed security reinvestments and begin buying Treasuries again (thus QE-Lite).

Erik: Charlie, you mentioned the Fed's inflation symposium that they're having in June. Help me understand this. Because, as I understand the Fed's messaging, there's absolutely no problem with inflation.

They've got it all under control, but somehow they need to have a symposium all about it in June. What's going on here?

Charlie: So, the Fed has announced a year-long review of policy. And the one part of the policy that matters right now – and, essentially, coming out after that January pivot from the Fed, I went out and basically said, look, the Fed has torched any misconception. They are strictly a one-mandate institution now.

And that's basically – the mandate has become not just a one mandate around inflation but it's become asymmetric around inflation – meaning that the lower it goes the more reactive they're going to be with regards to cutting, with regards to trying to stimulate inflation – then the opposite, which is much less likely to hike in the event that inflation overshoots.

And that's a very big deal, because the language that helped really trigger so much of that April reflation phenomenon from the guys that matter most – Clarida, Williams, Evans – taking this message too was the idea that the trajectory of core PCE year-over-year is a real concern, it's a problem, it's got to be addressed.

And that's why this June symposium – it's a research symposium – is super-important.

And one of the things, actually, that I think was a clue for us with regards to the future read of where this policy is heading was that multiple speakers spoke about the potential that NAIRU is below the U-rate.

And basically this is telling us that – the Fed is acknowledging that they need to run the jobs market hot, and asymmetrically hot, really message forward guidance wise that you are going to cut rates in the event that inflation slows more so than the opposite to stimulate inflation, to stimulate the Phillips curve.

And this problem of the zero bound, as we near the zero bound. And certainly the lower bound of where we are right now.

So I think that this then came out along the same time that we got the agenda for the June meeting. And about a third of the meeting is made up of labor discussions, labor working groups, labor research papers.

Which tells us that, at the same time that some Fed speakers are talking about looking at jobs as a vehicle labor market, as a vehicle to run to try to play catchup in this inflation-averaging framework that everybody has spoken about from Janet Yellen to Jerome Powell himself, that then too – if you're willing to run hot through potentially cutting rates to stimulate the labor overshoot here – that that's probably where the future state will be.

At the same time, too, they even began piling on with the discussion of "insurance cuts." And Clarida specifically mentioned that, into a still-strong economic backdrop in '95 and '96, the Fed cut rates under weakening price pressures, which is similar to where we are now. And even highlighted in '98, cutting into a still-strong economy on account of external factors, which was the emerging markets crisis and the long-term capital management crisis.

So they really set the table for this asymmetric overall policy far more likely to ease than the bar it would require for them to jump over to hike again.

And that's a big deal when we're talking about not just the Fed June symposium, but the Fed having to update both the composition of their balance sheet into QE-Lite – meaning that our view that they're going to be buying more bonds in the front end, which steepens the curve, which is actually a catalyst for a lot of this reflationary thematic trade that we're talking about – as well as the third point, the third leg of this stool, that China is still in no position to scale back their stimulus.

In fact, and even up to the overnight data that we've got (and ex any of the trade war tariff discussion), [they have] very ugly export data again. So they're going to keep the pressure down there. Which is inherently going to be a positive for inflation-sensitives, cyclicals, things of that nature.

So I think that's the view that I want to leave with regarding the structural stuff.

Erik: Well, Charlie, I know that our listeners are dying to hear you get into the tactical outlook because it's been quite an interesting week. I can certainly say that when I saw "Charlie McElligott" in my inbox on Sunday I knew something was up. And, sure enough, we've seen that there was a triggering of one of your CTA levels on Tuesday, I believe.

So give us a rundown of how we got here and what comes next.

Charlie: So, obviously, as the tariff news came out, something that I have been increasingly aware of – you know I love to highlight asymmetries in the market and imbalances, crowding risks, especially when there is a narrative behind them – one of the things that I think we keep seeing with regards to some of the successes that we've had, capturing or flagging these directional shifts ahead of time, are the convergences of a few different indicators.

And particularly where we were last week – there were two really big observations – in, frankly, recent weeks.

[See Slide 5] We saw the overall scale of the market gamma position, the gamma profile – in both S&P futures and SPY ETF options – the combined gamma profile reach some serious extremes. Both S&P, SPY, QQQ –representing the Nasdaq side – as well as the delta in the market.

And, really, what was critical for me was that, when I see 99th percentile, 100th percentile gamma in the market, the next thing I do – and I know that we have extreme sensitivity to changes in underlying, let's say.

From there, when I see that point in our, using our internal estimations, when the long gamma that's been built into the market – and the long gamma is built into the market because in a trending, grinding, higher type of a market, generally speaking, you can assume that short-volatility strategies are proliferating, are growing.

More people are doing systematic roll-down. More people are selling condors. More people are selling straddles. All sorts of yield-enhancement strategies. You can call overwriting, put underwriting. You can assume that dealers are getting long gamma.

The key for me, though, is where is the point that we actually inflect towards short gamma? And knowing the scale of what Trump tweeted, I knew at an approximation on where we – calculating a flip to short gamma, which means that (I think most readers know), as the market goes lower, dealers are getting wrong-sided and have to actually keep selling more to maintain their hedges.

So that's where you can get in a short-gamma environment, get these really slippery moves. The convergence that I talked about, though, was the fact that on a gap move lower, which I knew we were going to get – generically I "finger in the air" assumed a 1.5% selloff for the Monday – was that that gap lower was going to gap us down to where our momentum trend, CTA trend model, actually was roughly anticipating the next deleveraging levels.

[See Slide 9] And when you pile those two factors together, on top of what then becomes an almost inevitable VIX curve inversion – so for all of these people that have been shorting volatility, even though there was an offsetting long in the VIX ETN complex, the VIX curve will invert as a lot of these roll-down strategies are then forced to cover their short. Those three things converging, then you're going to see fireworks.

And that's exactly what happened Monday.

There was a reason on the follow-through on the Tuesday that we actually closed back up, that we rallied, which is not for any trade talk optimism but instead almost completely based around options-related behavior. Both from dealer desks – people that were long VIX ETN – that we still had a wave of systematic deleveraging as well as a catalyst, too, for a very fundamental part of the universe, the sell.

And that was the fact that asset managers had accumulated almost $130 billion of US equity futures longs in recent months. And, even in just the year to date alone, it was like $65 billion.

So they finally had this catalyst to be in this even risk. And Boom! You get the asset managers kind of taking down this exposure. Boom! You trigger dealer negative gamma on the gap lower.

Boom! You get the CTA trend deleveraging level, which in S&P did actually go from the plus 100% signal to selling down to a plus just a 60% signal. And you got the VIX curve inversion. That's how we've driven this incredibly volatile two-and-a-half-session environment of the past few days.

Erik: Charlie, for our listeners' benefit, as you're talking about the gamma, some of that's on Slide 5 and the VIX inversion is on Slide 9. I think we may have lost a few people on the slides there.

Let's go back to Slide 1 in the deck. Why don't you talk us through how you knew that this was going to be futures-driven and what you saw next? And just talk us through the slide deck here.

Charlie: There was this qualitative observation that, for sure, we knew asset managers have gotten this trade right. They bought the dip in December. They kept loading up January, February, March. That they were going to be incentivized to take some risk off the table. So that kind of got this ball rolling.

We knew that as part of that overall $130 billion of US equity futures length – and $65 billion just year-to-date alone – that that was going to drive a significant uptick in futures buying, because that's where they held the position. Additionally, though, was this understanding of course that the CTA trend, per our model, was going to be de-levering.

So what we looked at then was this confirmation of this view where we just took a look of the percentage of notional futures uptick versus the overall cash notional uptick. And what it showed you was this 1.3 times behavior, which is the single largest overshoot, let's say, of the past nine years. It was a 3 z-score event.

Which really just confirms that yesterday was about likely confirming that this was a futures-led move and that the two real inputs here, besides dealer gamma hedging, were the asset manager de-risking as well as the deleveraging from the CTA universe.

The second slide captures exactly what I spoke about, the scale of that US equities futures long from asset managers. You can see some of that accumulation, which has continued all the way up until this last month, still buying an additional $9 billion across S&P, Nasdaq and Russell. So you just knew they were long and it made sense for them to take some chips off the table under this kind of risk event.

The third slide – this is what I know a lot of folks care about. As a word of caution, these are not static. These change based on both the new price levels on a daily basis plus the realized volatility profile over a trailing window. So these cannot be treated as static.

But you can see on that move, let's say, from 2,897 – if you see that position column, the multicolored position column, where we went from in the same span of two points basically 2,897 and down – we went from that 100% signal to the 60% signal.

And what you can then see – if you move back left, you see that two-week column and that one-month column – those are the two windows of our model that flipped short. The price momentum signal for S&P lost its strength and actually flipped. So that's capturing where the pain points were for the model.

I think this [Slide 4] is actually one that gets people very interested. And, again, a snapshot in time, but it's a forward look of our trigger levels. You can see this dynamic where, because of the environment, generally speaking, of a year ago that has those days that were in our one-year sample lookback set dropped in or out of the picture, our pivot levels change.

And what you see – the top is S&P, the middle is NASDAQ, the bottom is Russell – is that those pivot level numbers really jump up.

So what that means to me is that the pressure is going to be on to stay at this lower overall signal weight for both S&P and even NASDAQ. NASDAQ had so much wiggle room for the longest time because of the year-to-date performance and the explosive moves in tech. Even NASDAQ is now at risk of deleveraging, even if the market just holds sideways from here.

And at the very bottom you see that Russell is nearing a point of going outright short again. And, for what it's worth, Russell has been a great indicator with regards to periods of volatility. So that's just one to keep on the radar.

Erik: Okay. So, as we interpret this chart on Slide 4, I want to remind our listeners **this is a moving target**. You recalculate these numbers every day and it depends on the tape action and what the price is.

But all other factors being equal, if we just assumed a flat return right now, it looks like, as we get about two or three weeks out, the market has to be above 2,940 or so in order for this signal not to be triggered, which would start more selling.

So do you think we're headed back up to those levels? Or do you think we're going to be triggering the selling before we even get to two weeks out?

Charlie: It's really just about maintaining this current 60 level, let's say, for the S&P as our example here. The good news is that, at least from the perspective of CTAs, for the S&P we've already deleveraged.

And the next level to actually see more selling and actually more outright short is way below the market.

So to get there we would probably need to see a pretty negative outcome into – by tomorrow at midnight into Friday – the re-imposition of tariffs.

If it came out that talks had broken down, the tariffs are back on, in no confusing terms the market is going to be down 2% or 3% that next day, for sure. Even with this kind of next move.

And then, all of a sudden, that next level of deleveraging happens.

I happen to believe that we understand how much Donald Trump loves the stock market as a weather vane, as a scoreboard for him. He had 500 points of S&P in his pocket since the last time he talked this up.

The Reuters article today spoke to an almost disrespectful Chinese dismissal of previously agreed-to terms across the board, across all of the key talking points. I think he has gotten their attention.

And all it takes for him is to say, look – and for him to dictate to Lighthizer and Mnuchin to a lesser extent, that, hey, roll back the tariffs. Let's tell them we delay the tariffs, we're making a lot of progress in these talks.

And then, all of a sudden, I think we're retesting our prior highs. Even just on the idea that we're going to keep kicking the can, we're going to keep extending and pretending to get this thing right. We just needed to get them honest and get some concessions from them again.

I personally think that they will kick off the tariffs. Tomorrow night at midnight, I think those go through. I do think, too, they will counteract that with some language about ongoing discussions.

And maybe they put a limit on those tariffs. Maybe they say, we've made a lot of progress, there's a possibility that we take the tariffs off in two weeks or one month out from now.

I think it's going to be a more nuanced message. And I think that's important with regards to knowing that it would take a pretty meaningful negative outcome from these events to get anywhere close to that next level of deleveraging.

The one thing I would like to add though, Erik – and I always talk about the CTAs because that's kind of been our bread and butter, and my view that it's not simply a discussion of commodity trading advisors.

It's the fact that, in a post-QE world, almost any trader or fund that operates under a VaR model is a *de facto* risk-controlled, risk-targeting, target volatility fund. And that simply means that your exposures, your leverage, your sizing, are going to be dictated by the underlying realized volatility signals.

So when I talk about these numbers and these break points, I'm talking about more than just CTAs. I'm talking about where the bodies lie and where things inflect and where stuff becomes painful and where things can go wrong.

There are other systematic strategies out there, though, that matter. I have high confidence that on a 1.90 handle down-trade in a day and a half confirmed, that these flows had shifted. Asset managers started deleveraging. CTAs began to de-lever part of their long.

And then you also, too, had the VIX curve invert, which created knockoff hedging requirements – both for dealers or people short – that also bleed into S&P.

Another part of this are target volatility funds. And this might be a little bit wonky for readers, but this is almost any variable annuity. This also can overlap with CTA, with risk parity. But just to get an understanding of what that is.

And if you look at S&P-indexed 20-day realized, so a one-month lookback, which is standard – and I'd also generically benchmark the typical target volatility fund struck at a target volatility of 10 – right now that 20-day realized volatility is, say, 9.5.

Mechanically, though, upon crossing that 10, there will be unwinding flows. And what that requires are another few days, just by staying up here in realized volatility. And you can see on the day stocks are flat, VIX is flat, that's going to naturally drag up these trailing realized volatility levels.

And that's why I still feel confident that there's probably ongoing more supply than demand type flow, unless we get a positive outcome – for probably just another day or two.

Only after we clear any sort of down-trade around whatever happens with the tariffs into Friday could I then want to say, hey, let's go out and take advantage of how rich volatility is. Let's go out and sell puts. Or let's go out and buy some upside calls or call spreads to take advantage of what eventually becomes a deal.

So I think we've got to clear through some chop first, and there still is this flow out there that is deleveraging flow that's got to go through the system – before we can then get that purge and get tactically constructive again.

Erik: Okay, Charlie. So it seems like we've kind of got a dilemma here, because clearly this trade negotiation is not over yet. It's not clear, even after Friday and the deadline and who knows what happens this weekend, come Monday it's not going to be completely over then either. At least I strongly doubt it will be.

So where does that leave us in terms of being able to put a trade on that makes sense?

Charlie: I think that part of what's happening right now is that – it's twofold.

From a hedging perspective, you still have exposure on, you're not totally flat, you're still waiting long. I personally think that Eurodollar futures as a hedge, which are just a short-term interest rate product – meaning that your long rates or your long Treasuries as a de-risking hedge still works during this equity volatility spike, that risk-parity-like strategy of long low-volatility assets like Treasuries has done its job.

Plus you get the additional kicker that the more this tariff situation devolves, if it were to do so, the more likely that the market is going to price in the likelihood of an even more dovish Fed or even a rate hike.

It's that same idea. The Fed is cornered into an asymmetric policy. There's a much lower bar to ease than to hike.

Now, from an actually playing offense perspective – and it's still too early, as I just mentioned, that right now we have to see the outcome, we have to see that final purge.

We saw the first purge and capitulation in the VIX complex. You know, vVix – which is volatility of volatility – was the first signal. The VIX complex went yesterday. I think any further stuff will then be the delta one products, structured products, and things like that that were built around equities, volatility notes, things like that – would be the final thing to purge.

And we talked about this – potential that if you get a negative message out of this meeting, you're down 2%.

But I have to always look at the next move.

And the next move is that right now the market is pricing in much more crash down than crash up. And that's the opportunity. Upside skew is 3rd percentile. Downside skew is 81st percentile, meaning really rich, like people are slapping on their tail hedges.

The ratio of a 25 delta put to a 25 delta call is 91st percentile. So that's when you want to start inching closer to getting tactically offensive.

And I think, as it stands right now, that's probably through selling puts more so than calls. But when this thing turns, it's going to go. And you're going to want to take advantage of this rich volatility market.

I think the one thing that I'd want to say, and I think it's an interesting way to close the conversation, is that why does this keep happening? Why do we keep having these almost quarterly it seems like – certainly a couple of times a year – short-vol, easy-carry, momentum-type environments?

Then we have a blowup and then we have a V-shaped snapback. And the V-shaped snapback, let's say, certainly didn't materialize yet today. But that last 20-point rally in the last 15 minutes of yesterday's market was certainly that.

And, as I kind of alluded to earlier, that was guys that were long-vol – whether that's retail guys, you know that were long the VIX ETN, or dealers like ourselves who were sold volatility from the buy side – or people that were short delta, so short S&P futures, either as they were dynamically hedging or even people who were trying to front-run the systematic trend inflection.

That profit-taking from those players in the last 20 minutes of yesterday was what created that big upswing in the tape.

You were unwinding profitable trades. You sold some of your long volatility and you covered some of your short delta, which is bought futures. So that's why you get these V-shaped snapbacks.

But I think from a bigger existential larger level. It's what I talk about often, which is this kind of Minsky moment type of world that we live in. Stability breeds instability.

And if you look at the central bank playbook post the crisis, the plan has been large-scale asset purchases and providing forward guidance on lower interest rates forever and flatter curves forever. And what that's done is that it suppresses cross-asset volatility because it's suppressing interest rates.

And, ultimately, you create this intentional financial repression which drives, as the Fed likes to call it, portfolio rebalancing. As I like to call it, it's pushing people out on the risk curve. It creates that risk-for-yield behavior.

So why does stuff like yesterday happen, even though these might be largely systematic strategies?

It's not some HFT brainiac quant hedge fund, necessarily, that's the issue here. Really, to me, it's real-money institutions have moved post the crisis from being before-the-crisis buyers of volatility and buyers of tail-risk hedges who are instead now vol sellers in this post-crisis period.

As I mentioned, call overwriting, put underwriting, all systematic, all rules-based, condor, strangle selling, VIX curve roll-down. They're all doing this in order to generate yield in a world void of yield.

And that's what's so insane about the world that we live in and the central bank daisy chain where vicious cycle turns to virtuous cycle and then back again. That's why I don't see this ever stopping, frankly, because the central bank policy has dictated this market structure.

And I closed my note this morning with this quote a buddy wrote on social media, as follows: *If you're short vol, you make money but eventually die. But if you're long vol, you die before you make money.*

And that's this current stasis that we're in right now where you're waiting for the next shoe to drop. But, in the meantime, you've got to dance, you've got to generate yield, you've got to short volatility, you've got to ride the momentum, grind higher – until central bank policy or some sort of a market accident tips everything ober and then we start again.

Erik: Okay, to summarize, we can expect the fireworks to continue as this trade negotiation takes whatever direction it's going to take. That's probably going to induce more fear and uncertainty and pump up those put premiums even higher than they already are. When it's finally over is going to be your opportunity to sell those puts and maybe go long indices and ride the upside of this.

Charlie, before I let you go, for our institutional listeners who already have a relationship with Nomura, which is the prerequisite requirement, tell them how they can get your daily letter, because it really fantastic. It's one of the best pieces of research. I read it religiously every day and very much look forward to.

So who is it available to and how do they get it?

Charlie: I appreciate that, Erik. You can reach out to your Nomura [salesperson], and they can reach out and we can make that happen. There are certain regulatory dynamics, with me being a desk strategist as opposed to a research analyst, on which domiciles I can send into, as well as revenue thresholds.

We want to make sure that we are incentivizing the right client behavior – people that pay for it get to read it and get it hot off the press and get to interact with me. But, if those pieces are in place, make your salesperson reaches out and we can facilitate a dialogue.

Erik: Fantastic, Charlie. We really appreciate it. And, folks, please understand that Charlie is not being a jerk. He is limited by regulations and factors outside of his control. Unfortunately, the letter is only available to institutional investors who already have a relationship with Nomura. Sending email to MacroVoices and asking us to give it to you won't help, unfortunately. There is nothing we can do about that.

Charlie, we really look forward to getting you back on the program soon. Thanks so much for a fantastic interview. Meanwhile, Patrick Ceresna and I will be back as MacroVoices continues, right here at macrovoices.com.