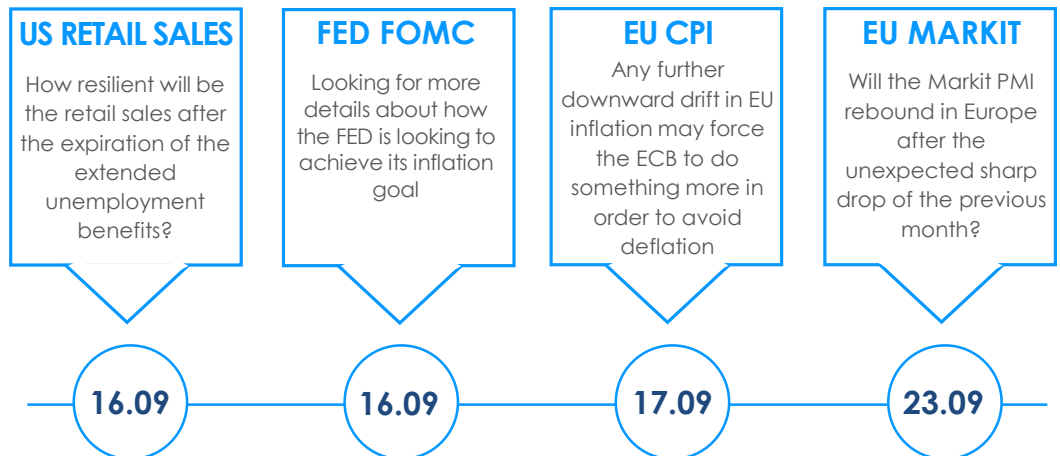


Main Events

Azimut Global Network

- * **Milan**
- * Abu Dhabi
- * Cairo
- * Dubai
- * Dublin
- * Hong Kong
- * Istanbul
- * Lugano
- * Luxembourg
- * Mexico City
- * Miami
- * Monaco
- * New York
- * Santiago
- * São Paulo
- * Shanghai
- * Singapore
- * Sydney
- * Taipei



OPTIONS STRIKE BACK

The Nasdaq and some tech stocks in particular started to rise exponentially and in isolation from the rest of the market in August. The FAAMG (Facebook, Amazon, Apple, Microsoft and Google) was +35% YTD at the end of August, whilst the rest of the market was down 5%. Even within Nasdaq, the polarization started to become unsustainable as shown by the below graph on the right, where the Nasdaq (in red) had number of stocks reaching new yearly highs. Beginning end of July the index continued its impressive advance (see red arrow), while the number of stocks reaching new high were falling precipitously (yellow arrow).



Source: Factset, GS Global Investment Research



Source: Bloomberg

The reason behind this move lies in the option markets. If it was well known that a peloton of newly self-educated daytraders was underpinning the markets since March, there would have been an evidence that some of them started using call options in order to leverage their trades.

The presence of retail investors in the option markets could be demonstrated by judging the size of their orders: lately 13% of the trades involves only 1 contract, and with some tech names the percentage is much higher. The volumes traded on options increased by more than 100% YTD and 35% in July only. Also, in July for the first time ever single stock options volumes were higher than the volumes on cash stocks (all graphs on the next page).

(continued)

Exhibit 5: Stocks where small trades account for a large percentage of options volume
 % of options volume from 1 contract trades

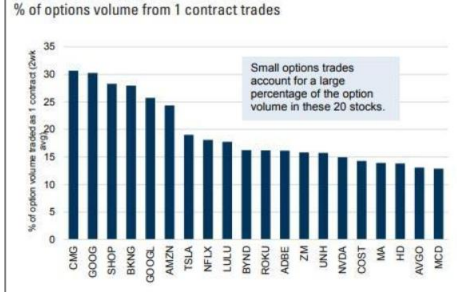


Exhibit 2: Single stock options notional ADV has increased 129% YTD, and 35% MoM
 All US single stocks, as classified by Option Metrics

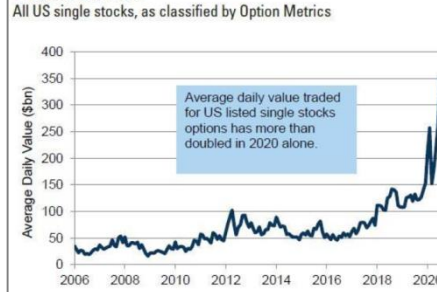


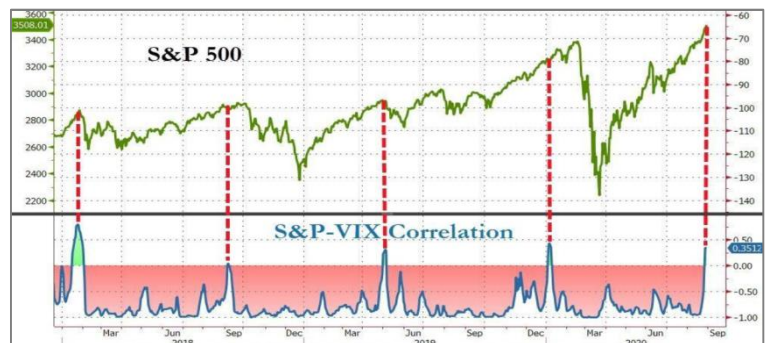
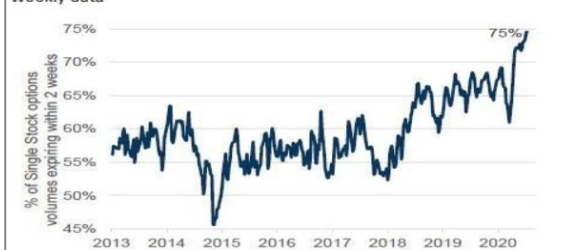
Exhibit 1: Single stock options trading volumes are bigger than shares volumes for the first time
 Average daily notional traded for options vs the underlying stocks



Source: GS Global Investment Research, OptionMetrics, Zerohedge

The explosion in option volumes was concentrated on call options in particular, as shown in the below graph on the left. The increased purchases in call options lead to upward pressure on stock prices, which in turn causes the delta of the options to increase forcing those who sold the call to hedge their positions by buying the underlying stocks, reinforcing the uptrend in the underlying stocks. Each time this happens, the volatility tends to increase in sync with the equity indices. The VIX moved from 21 on August 17th to 33 on September 3rd, and within the same time period the S&P500 increased by 6% and the Nasdaq by 10%. This behavior is abnormal as volatility and equity indices should be negatively correlated, and this is usually a warning sign. As shown by the below graph on the right, each time this has happened in the past three years it was preceding at least a short term market correction.

Exhibit 3: Volumes for single stock options with less than 2 weeks to maturity now comprise 75% of total option volume
 Single stock options volumes for Top 100 S&P500 stocks by market cap; options with less than 2 weeks to maturity as a percentage of the total; weekly data



Source: GS Global Investment Research, OptionMetrics

Source: Zerohedge

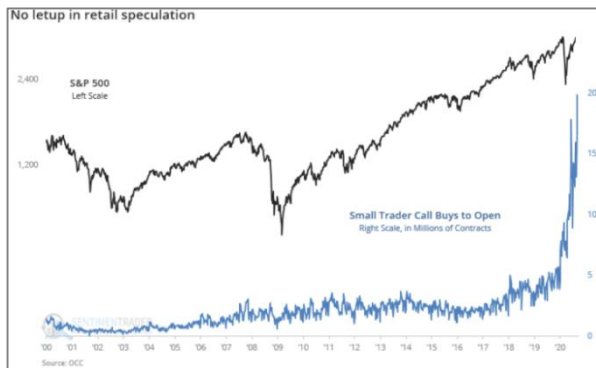
In addition to the retail investors, another big player jumped in the call buying frenzie. Softbank, a Japanese conglomerate that was previously operating only in the private markets (and was already involved in questionable investments like WeWork and WireCard) said in August that it was starting a new unit to trade public securities. Through this unit they bought the call options, spending about US\$4 billion on options premiums, equivalent to an estimated amount of \$30/\$50 billion in notional exposure. Those purchases were concentrated mostly on few names, usually tech companies, also preferred by the daytraders.

If buying calls was a profitable-only strategy for the past few weeks, suddenly in September the momentum was lost and, with the reversal in equity prices, call options stroke back. The positive loop of increasing prices prompting more buying reversed as stock prices started to correct. Those who bought call options may have had margin calls and forced to sell, and those who were short the calls, started selling the stocks they bought for hedging because of the lower option delta.

The Nasdaq Index, where most of those tech companies have large weightings, entered in a correction (-10% from the top) in just 26 hours. One month of positive performance was cancelled in less than two days.

(continued)

Is it all over after the correction and the market is no longer vulnerable? Unfortunately it may not yet be the case. Apparently retail long positions in call options started to increase again after the sell-off, with daytraders piling on long positions thanks to the lower prices. As Francesco Caruso reports, the retail participation into the equity markets is at all time high, measured both in terms of number of call contracts open (below on the left), and in terms of premiums paid (below, on the right).

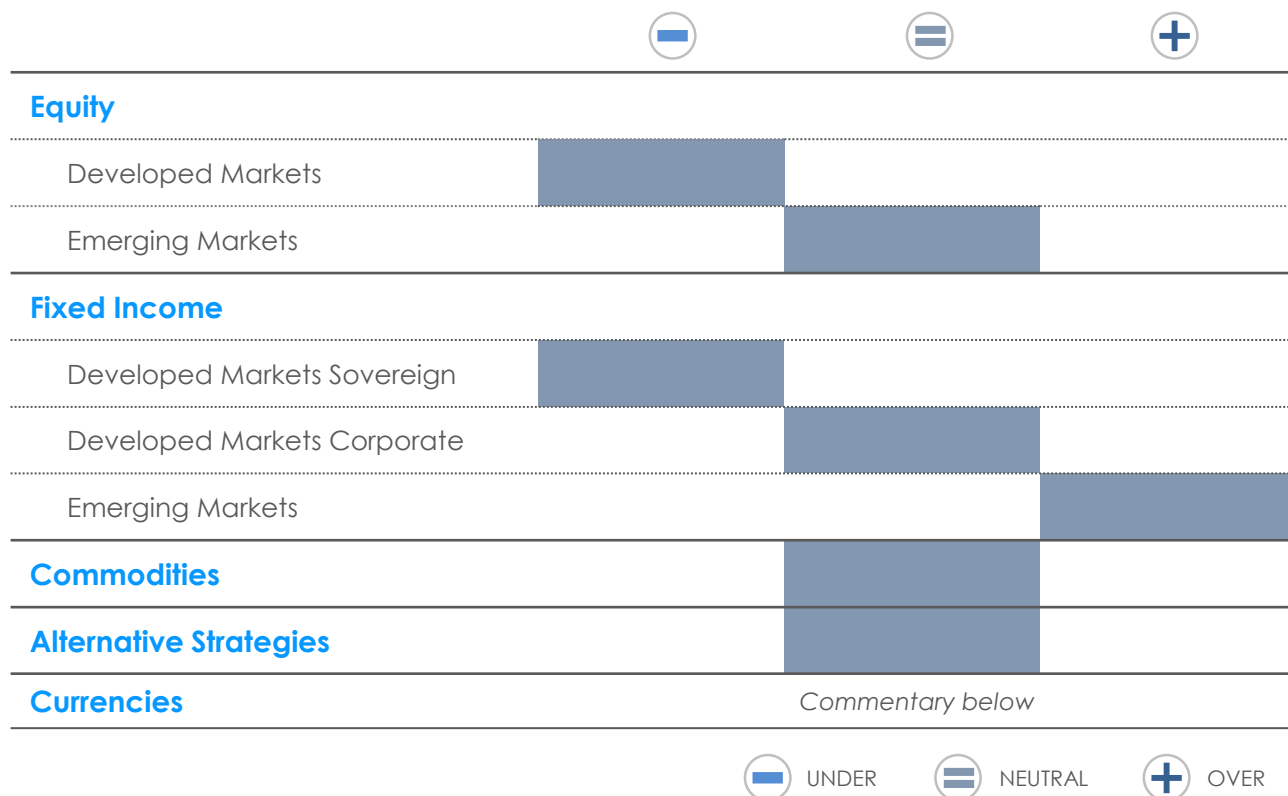


Source: www.francescocaruso.net

These graphs cover a period that also includes the year 2000, the period when there was a massive retail participation in the equity markets.

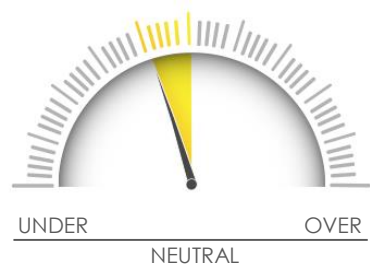
Thanks to the use of leverage (options) the retail investors are distorting the market dynamics much more than was previously anticipated. But the early days of September are a warning that the markets may also be vulnerable to sudden drops that could occur with no particular reason, and that could be much longer before any buyer jumps in.

Asset Allocation View



Equity

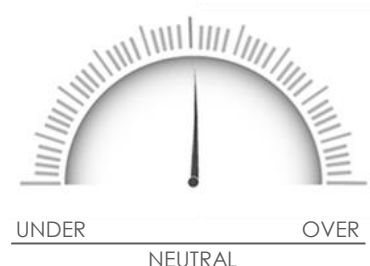
Developed Markets



We kept our slightly underweight recommendation unchanged. In light of the recent correction in the main US equity indices, which removed the overbought condition and brought back valuation to more acceptable levels, we are again favoring US Equities. Europe is maintained in a neutral position as the market did not correct in past days, and because of the strength of the Euro (which is denting on the EU competitiveness) is not expected to be reversed in the short term, after the comments from Mrs. Lagarde who said that the ECB is just monitoring the cross rate, but no immediate threats/actions have been announced.

US	⊕	Europe	=	Japan	⊖
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Emerging Markets

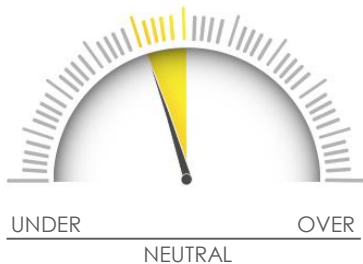


We kept our recommendation on Emerging Markets as Neutral, with a strong preference for the Asia ex-Japan region, and China in particular. The valuations of EM companies are well below those of developed markets. We are starting to take profit on Chinese equities due to the sharp re-rating earlier in the summer, and because of the mounting US & China tensions. Unchanged the view on the other regions. A weaker dollar constitutes strength for the EM equities.

Asia ex-Japan	⊕	EEMEA	=	LATAM	=
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Fixed Income

Developed Markets Sovereign



We kept our slightly underweight recommendation for developed markets sovereign bonds, after the downgrade of the previous report. After Powell's speech at Jackson Hole, also Mrs Lagarde stressed that the ECB policies will continue to remain accommodative for an extended period of time, at least until the inflation comes back towards the 2% goal. Even if QEs and short term rates close to zero will remain for an extended period of time, this push for inflation may trigger some short term steepening of the major sovereign yield curves. The underweight recommendation is therefore should be considered as a short term call, not a strategic one.

EU Core



EU Periphery



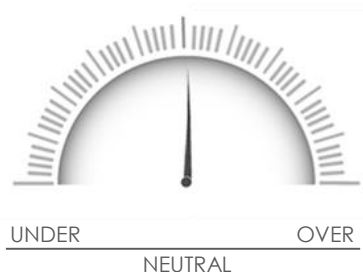
US Treasury



Japanese JGB



Developed Markets Corporate



We maintained our neutral recommendation on developed market corporate bonds. The QEs implemented by all major central banks on their sovereign and corporate bonds are compressing both risk-free rates and spreads. Monetary policies will remain accommodative for an extended period of time supporting the corporate bonds prices amid the hunt for positive yield. In the corporate bond space our preference remains in the investment grade. The slowdown in the real economy is weakening the fundamentals of some corporates, especially in the high yield space, where we keep the negative stance.

IG Europe



IG US



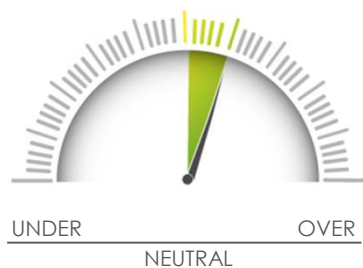
HY Europe



HY US



Emerging Markets



We maintained our recommendation on EM bonds as slightly overweight because these bonds did not enjoy the same fast recovery experienced by other credit segments. They were lagging because EM central banks are not doing QE on their bonds, therefore investors have been more cautious in buying those. Considering the low levels of the risk-free rates, the compression of the spreads in developed market corporates and the rebound of commodities, there is now room for a catch up of emerging bonds. Among them, we have a strong preference for local currency bonds and the Chinese renminbi in particular.

Local Currency



Hard Currency IG



Hard Currency HY



Commodities



We have a neutral stance with a positive bias. We continue to prefer precious metals because of the low yield environment, and as a hedge against unexpected turbulence. Because of the possibility that the Euro will continue to be quite strong in the short term for the reasons explained in the currency section, for Euro-based investors precious metals could be a less attractive investment solution as any strength in the Euro will detract from the performance.

Precious



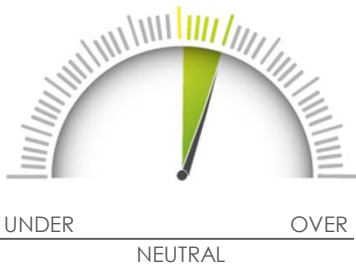
Energy



Industrial



Alternative Strategies



We keep our recommendation as neutral on liquid alternative strategies, because of the diminished expected returns on other asset classes. This implies that other asset classes have now greater downside risk and could be vulnerable to volatility as well. Therefore alternative/decorrelated strategies are more compelling on a relative basis.

Low Volatility

Medium Volatility

High Volatility


Currencies

We maintained the positive view on the Euro in the short term. Notwithstanding some comments from the ECB members regarding the importance of the currency level, the ECB seems not worried by the present level of the dollar, giving space to the markets to challenge higher levels.

We kept our negative view on the US dollar mostly due to the expected strength of the euro. No particular announcement is expected from the Fed this week, after the dovish speech of Mr. Powell in Jackson Hole.

We maintain our slightly negative view on the Japanese yen, as there are no positive catalysts in sight for the currency. The resignation of the Prime Minister Abe presents fuels further uncertainties for the country.

On emerging markets currencies, we have a constructive view as most of them appear to be undervalued and the yields offered by those currencies are increasingly attractive as YTM continues to fall in developed markets.

Euro

USD

Yen

Emerging


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