The Damped Spring Report

"Shifts in growth, inflation, risk premium and positioning all lead to opportunities in markets"

9/13/2021

On September 30th a $25-30BN of hedges for the JHEQX fund complex will be rolled to Dec 31st. Through the close on 9/30 the dynamic hedging by dealers of the existing hedge and the resetting of the new hedge will generate flows which will grow, ebb, and flip depending on the proximity to the existing hedge strike price and the expiration date. Currently the flows are slightly bearish as dealer hedges rise. As the market sells off the flows flip to buys as the dealers unwind hedges. These flows are moderately large but will not overcome macro news unless the macro drives the market down or the calendar ticks closer to 9/30. We are adding long positions in USD against Yen and EUR based on last weeks note. We will also go to max long SPX by month end.

Pay attention to 4430 on the SPX through 9/30

The JPM product suite with ticker JHEQX is an active SPX benchmarked fund with an SPX collar overlay to hedge market downside while capping market upside. That hedge is rolled each quarter at the end of the month. The hedge is a costless collar with a 95%/90% put spread protecting some of the downside and a call with a strike that makes the hedge have a zero premium. The current collar has a strike of 4430.

The hedging of this collar has daily impact on market prices

Currently the puts are way out of the money and the call is modestly in the money. The dealers who provided this hedge at the end of June have sold off some of the hedge to manage risk and they and those who took on the risk are dynamically hedging this position. Currently the delta on the call is 61% which means that hedge providers and their agents (Hedgers) are short $15BN of SPX futures. This will remain a dynamic process until the roll on 9/30. As the market rises the hedgers will sell, as the market falls, they will buy back the short. As time moves on assuming no change in price of the index the hedgers will sell $10BN. This is how a dynamic process works. On the last day, if the SPX is at exactly at 4430 the hedgers will be 50% hedge and will sell $12.5BN above 4430 or buy $12.5BN below. This is the black hole. It is a magnet which can at the time overcome fundamental and macro directional flows.

The Roll on 9/30 of this hedge will have a profound impact on that day.

Ignoring the pinning scenario mentioned above if the SPX is exactly at 4430 where Hedger activity on 9/30 will pin the price to that strike there are two scenarios worth noting for the roll.

If the market is above 4430 the dealer delta will be 100% short on the old collar and will need to be approximately 50% on the new collar which means that hedgers will buy 12.5BN on that day

If the market is below 4430 the dealer delta will be 0% short on the old collar and again will need to be approximately 50% on the new collar which means that hedgers will need to sell 12.5BN on that day.

We will be more specific about the market impact of this roll as the EOM approaches