Citi Global Wealth Investments

CIO Strategy Bulletin

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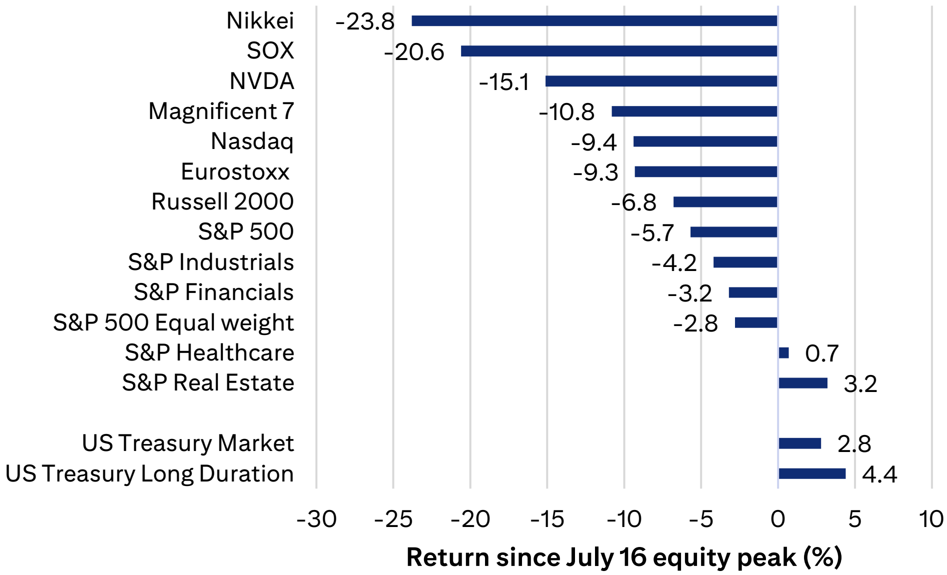
Volatility Playbook: Fear = Fast Reset, And Improved Opportunity

- Positive equity market momentum – centered in global tech shares – has quickly reversed. We believe the speed of the unfolding correction suggests a selling crescendo will take place fairly quicky.
- **The VIX index has tripled in just 3 trading days. At ~50, implied volatility is suddenly at the highest level since April 2020 (pandemic shock). We would take advantage of this high volatility to earn income rather than enter hedges at these levels.**
- We do not believe the market panic signals an inevitable economic collapse. As the table below shows, economically-sensitive sectors have fallen less than global tech-related markets and groups such as semiconductors.
- US earnings per share (EPS) gains have accelerated to a 10.2% gain in 2Q 2024 and we are not reducing our estimate for a near 8% full year 2024 gain. A sharp drop in share prices in the US and Japan would make for a potential renewed opportunity.
- **Asset allocation – through broad sector diversification and bond holdings – seeks to hedge portfolios with yields at attractive levels. Long-term high quality bonds have offset some losses with yields falling 50 bps since US equities peaked on July 16.**
- Recurring weak economic data in the summer and the close US Presidential election are catalysts for "fast money" and leveraged investors to reverse course. US employment gains in the 3rd quarter have been 13% below the full year average since the Global Financial Crisis (ex-pandemic of 2020-2021).
- A record one day decline in Japan shares (-12.4%) has come after a second Bank of Japan (BOJ) rate hike. We have long expected a yen rebound, but unwinding "carry trades" can only explain a portion of the global turmoil. Japanese investors own 0.9% of US equities but a larger 3.9% of US Treasuries. US Treasuries are rallying despite likely Japan deleveraging.
- What would mark a greater deterioration in markets and the economy? A break down in the functioning of credit markets (weakness more severe than credit spread widening). We will monitor credit market and bank lending statistics for signs that panic will generate fundamental weakness.
- The average annual drop in the S&P 500 inter-year is about 12%. A bottom in equities would likely be marked by losses far more widespread across sectors. At the present pace, this might come in just a few days.

For more analysis, see our latest CIO Bulletins:
Top Five Questions We're Getting (With Answers) – August 3, 2024
US Election: Looking for Risks Hiding in Plain Sight – July 27, 2024

KEY CHARTS FOR PERSPECTIVE

FIGURE 1: Market returns since July 16 equity peak



Source: Bloomberg as of August 5, 2024. Note: Nikkei and Eurostoxx returns are in local currency. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

FIGURE 2: The VIX index has tripled in just three trading days

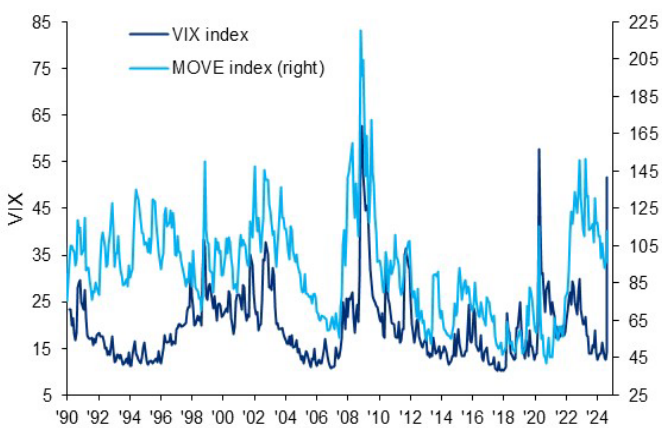


FIGURE 3: High yield CDS spreads jump

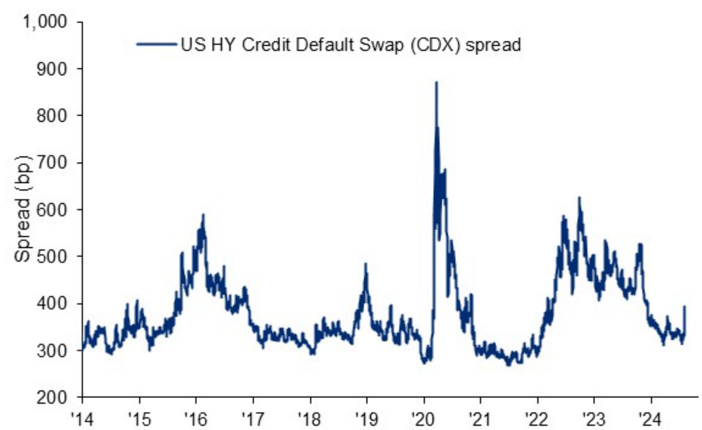


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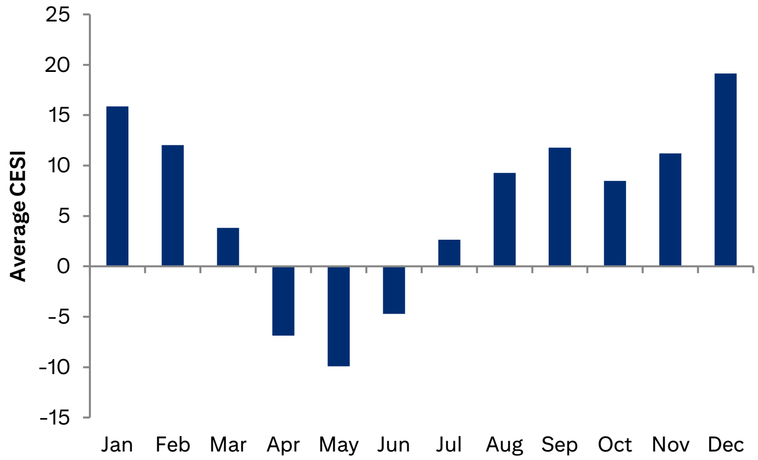
FIGURE 4: Citi Economic Surprise Index by month



Source: Haver Analytics as of July 30, 2024. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.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Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

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- restrictions on transferring interests in the Fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
- absence of information regarding valuations and pricing;
- complex tax structures and delays in tax reporting;
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