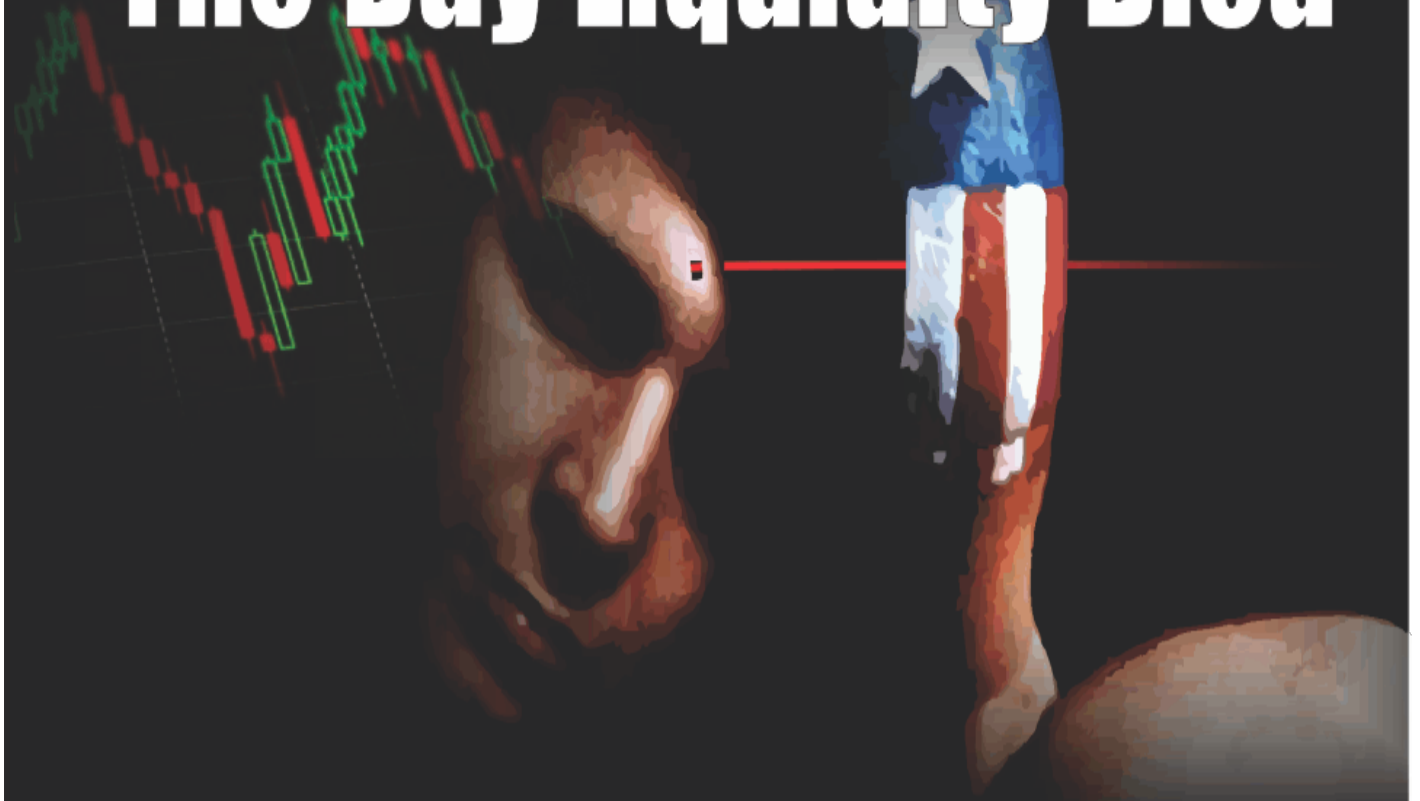


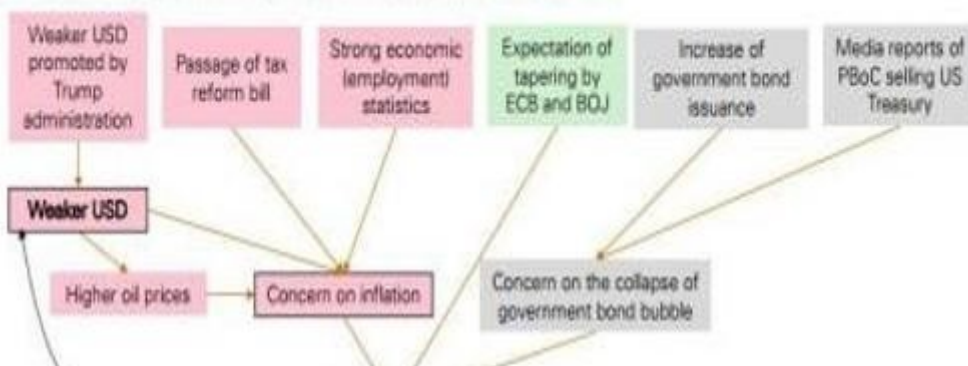
Doug Kass

# The Day Liquidity Died



*\* A little discussed issue is the loss of market liquidity since the end of January \* This is one of the reasons I see more volatility and a widening trading range \* I offer this opener with sincere apologies to Don McLean (and "American Pie")... but I hope you enjoy it!*

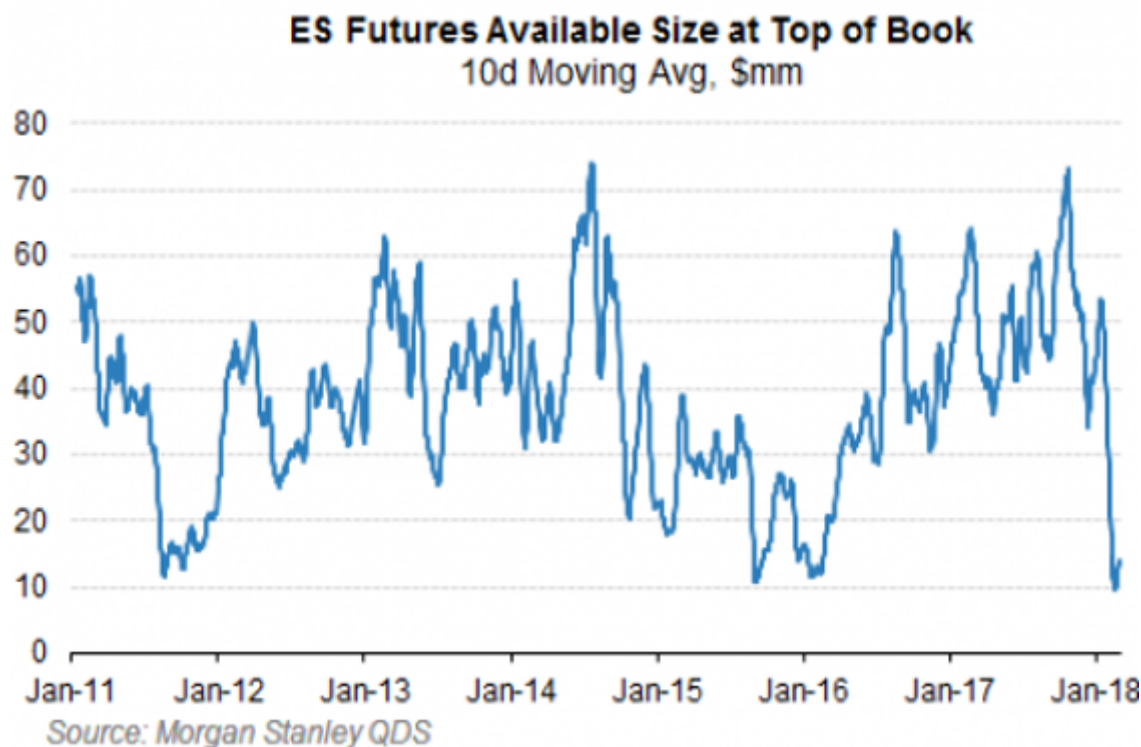
Figure 1: Risk-off development caused by unfavorable interest rates hike



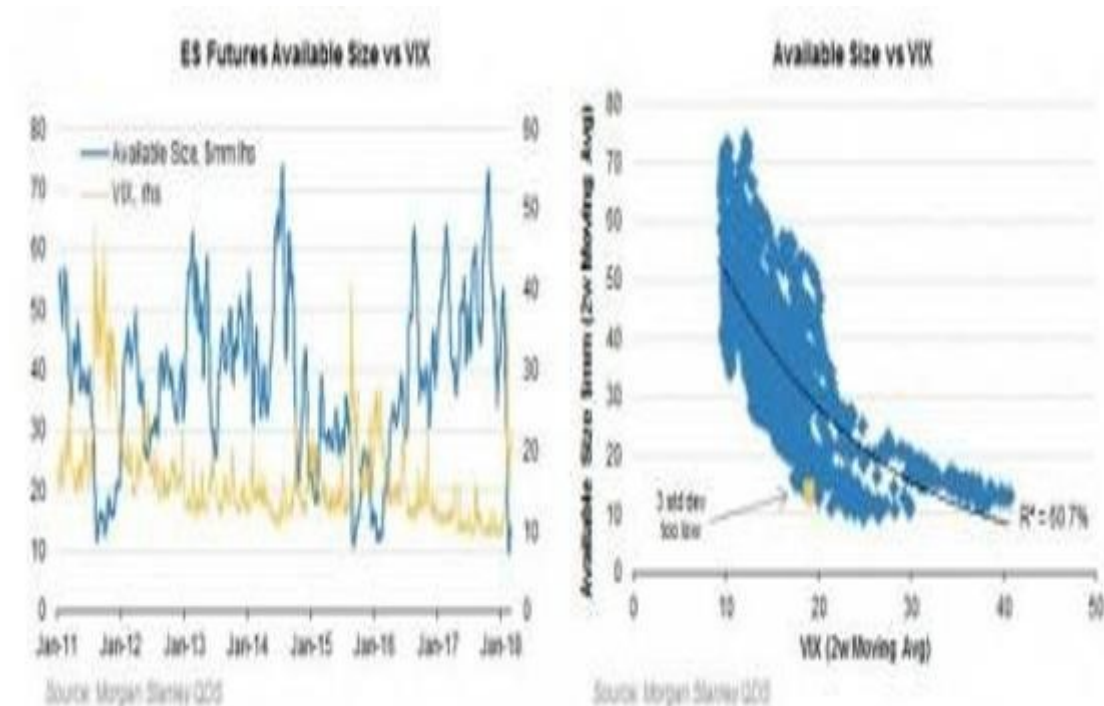
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[content](#) In, "Beware, There Is No Liquidity"[Zero Hedge](#) highlights the markedly reduced liquidity that now exists. Here is a summary:

***\* With reduced size available and widening spreads (in equity futures and cash market) since early February -- liquidity today is as poor as that existed in the center of the financial crisis.***

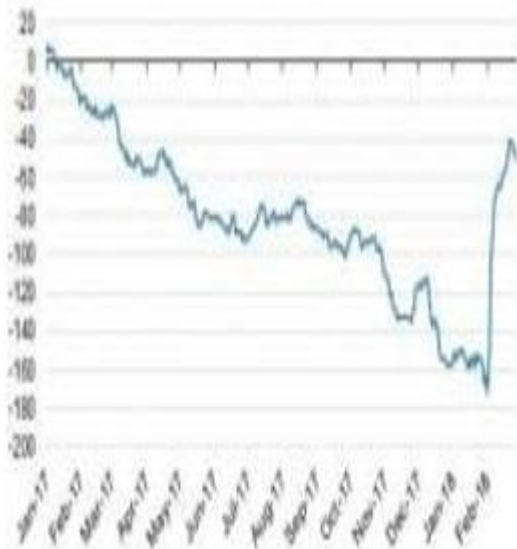


***\* The February drop in liquidity is greater than is typically seen when volatility spikes. "Available size" in e mini futures are three standard deviations too low relative to VIX.***



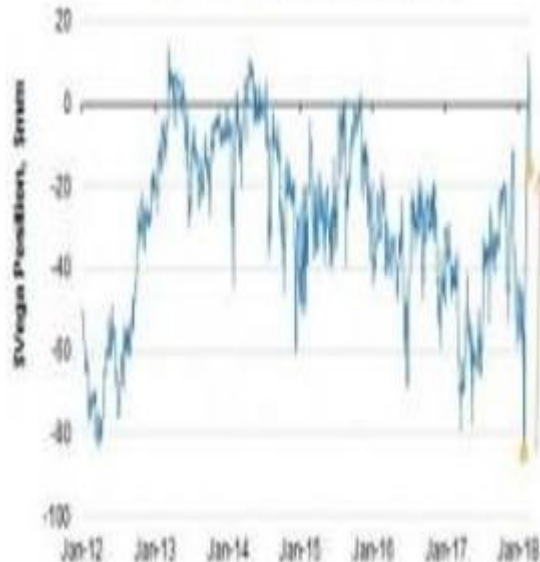
**\* There are four principal causes of markedly lower liquidity -- Market makers losses have caused dealers to step back, less supply ("volatility moves higher faster as spot declines), a volume shift to closing auctions, tighter financial conditions (I recently highlighted the widening of FRA-OIS) principally due to a tightening in monetary policy. Here are some charts to support these observations:**

**Estimated Dealer SPX Vega Traded, Cumulative \$mm**



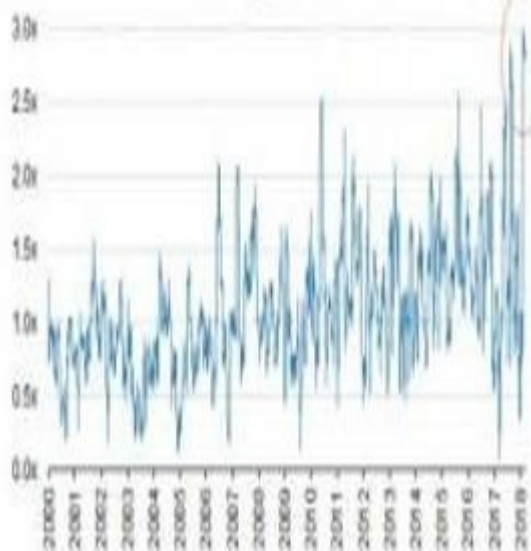
Source: Morgan Stanley QIS

**Estimated SPX Dealer Vega Positioning**



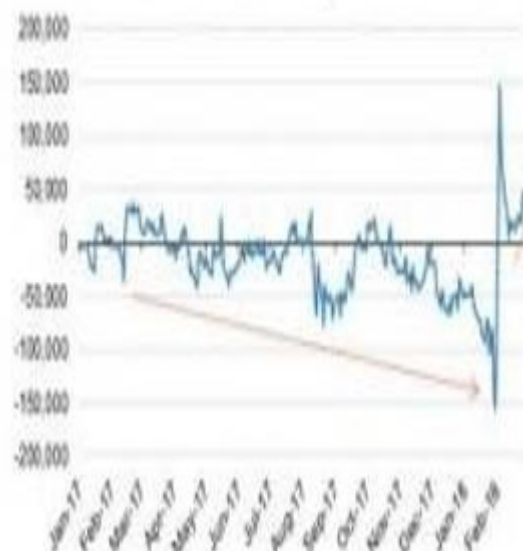
Source: Morgan Stanley QIS

**VIX Rolling 1m Beta to SPX**



Note: -VIX pos/SPX return, Source: Morgan Stanley QIS

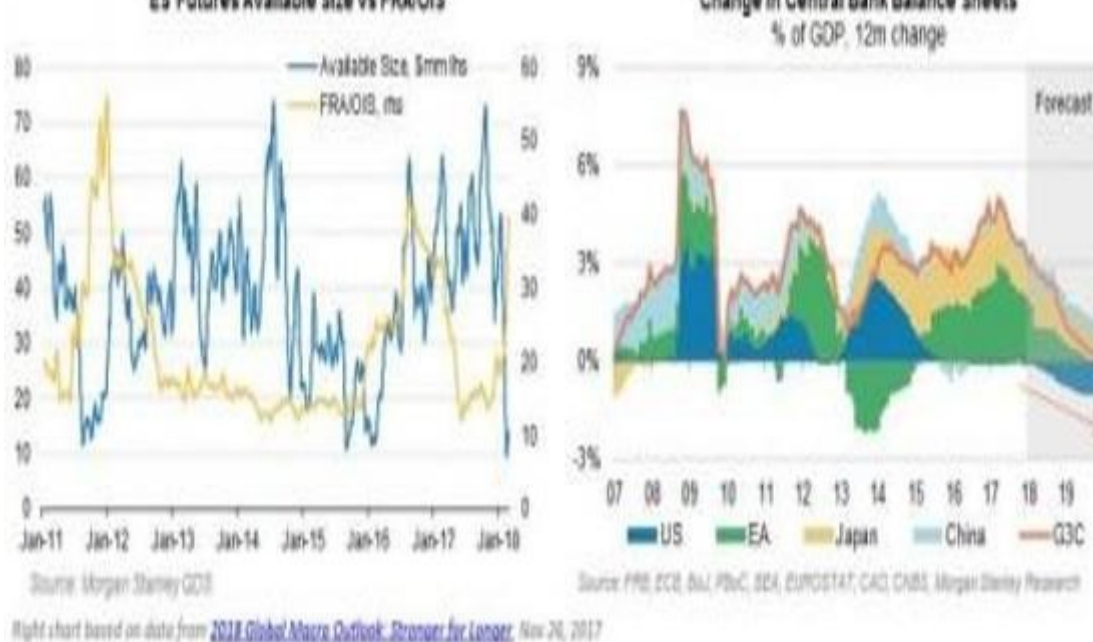
**Cumulative VIX Futures to Buy/Sell from VIX ETPs**



Source: Morgan Stanley QIS

**% of S&P 500 Member Volume Traded in Closing Auction (1m Moving Avg)**





Here is

ZeroHedge's summary of a recent Morgan Stanley report:

*"... to some extent this selloff is following the usual playbook - when market participants feel enough pain from the initial shock, markets retest the lows and volatility stays higher for longer. The path forward in spot will be driven by:*

- How fundamental investors weather this storm - no signs of panic yet, but as they give up more and more performance their resilience will be tested*
- Financial conditions and whether market makers can get some relief*

*... given the instabilities and lack of liquidity in the market, investors should be wary to catch a falling knife and wait for some stability before aggressively buying. With VIX already in the high 20s, QDS continues to think longer-dated and forward volatility is a better buy."*

## My Real Money Pro Diary

For two decades my Diary has been committed to contributing hard-hitting, logically reasoned, analytically thorough and, at times, unpopular and outside of consensus analysis and commentary. My primary objective is to make the column value-added, informative and *fun to read*. Importantly, I try to deliver my messages and views in a style and format that is combined with pop culture and humor -- and, hopefully, in an honest, transparent and self-deprecating way. My columns, especially my opening missives, are often integrated with references from comedians, philosophers, poets, lyricists, etc., and include parodies and metaphors to slam home my views. I do this in an attempt to differentiate my output from the typically dry and commonplace commentary on the economy, individual companies and investment themes. Having been the son of an extremely hip and complex jazz musician -- secondarily, he was a doctor! -- and having produced some rock and roll concerts, I have been especially drawn to music and their lyrics, and I often integrate the message of a song's lyrics with an investment theme. Here is my latest: "*The Day the Liquidity Died*" (to be sung to the tune of Don McLean's "*American Pie*".) Have some fun and sing along!

# The Day The Liquidity Died

*A long, long time ago I can still remember How liquidity and an orderly market used to make me smile. And I now know what investors do at any chance Is to get themselves a margin loan in advance And maybe add some more RIOT to the pile But systemic strategies made me shiver With every basis point the bond market delivered A short volatility bubble and risk parity on the doorstep Still the traders couldn't keep from taking one more step I can't remember if I cried When I read about last month's CPI But you could lose your capital and your bride The day the liquidity died So bye-bye, to your piece of the pie Investors poured their money into leveraged ETFs Now their equity account's dry It's just five weeks from an all-time high Singin', Could we go back where we were last July? Could we go back where we were last July? Did you buy stocks you never heard of Like Longfin at \$55 or above If the Twitter trolls told you so? Now do you still believe in Bitcoin Investment Trust? Were you in the last ICO IPO? And will you continue to ignore the lack of free cash flow? Well, I know that you were margined, too 'Cause you always take an intermediate-term view Even your Stratton Oakmont broker shut you down No more buying power could be found The traders never worried on the whole way up Buying leveraged ETFs from the back of a pickup truck But I knew some week they will all run out of luck The day the liquidity died I started singin', Bye-bye to your piece of the pie Investors poured their money into ETFs Now their equity account's dry It's just five weeks from an all-time high And singin', Could we go back where we were last July? Could we go back where we were last July?•Now for ten years we've been on our own And moss grows fat on a rollin' stone But that's not how its always gonna' be Last year when the company executives sang for the king and queen In suits they borrowed made of green And with voices that didn't•come from you and me Oh, and just as things were turning 'round The President slapped free trade down The courtroom was adjourned A guilty verdict was returned And when Jay Clayton's SEC was falling asleep Warren Buffett's cash pile kept on rising in his Omaha park While Peter Schiff sang dirges and gold came out of the dark The day the liquidity died (Refrain) Helter-skelter in the upcoming summer swelter The bulls flew off into their fallout shelter The Dow was at 22,000 but falling fast And in the business media the "talking heads" landed foul on the grass Though Belski, Golub and Jeff Saut were still trying for a forward pass With Ken Fisher on the sidelines in a cast Fox Business News' air was filled with sweet Palm Beach perfume But Mr. Market wasn't playing their marching tune The bulls all got up to dance Oh, but they never got the chance! 'Cause the risk parity traders dominated the field As the long bond climbed more than 150 basis points in yield Was price discovery ever really repealed? The day the liquidity died? (Refrain) Oh, with investment strategies and products all in one place Bill Ackman still lost in space Too old and with no time to start again So come on; Fed be nimble, Fed ease again! Is Chairman Powell still chanting amen? 'Cause more cowbell and QE is the market's only friend Oh, as we watched the Dow Jones fall Too many will receive a margin call No broker born in hell Could break that bear market's spell And as the futures dropped into the night To douse the sacrificial light I saw Boockvar laughing with delight The day the liquidity died. (Refrain) Well I met an analyst covering Facebook, Google and Amazon And I asked her to interpret the antitrust news But she just frowned and turned away The traders marched towards Morgan Stanley's store Where they made their fortune years before But the brokerage demanded to see the cash before they could play And on my Bloomberg, the ticker streamed - Bill Miller wepted and David Einhorn dreamed. But not a bullish word was spoken The market transmission mechanism was broken And the three stocks the traders acquired last Disney, Caterpillar and Comcast Couldn't catch a bid and faded fast The day the liquidity died*

*And they were singing (sing it for me now!), So bye-bye to your piece of the pie  
Investors poured their money into a broken market Now their equity account's dry  
(everybody!) It's just five weeks from an all-time high Singin', Could we go back where  
we were last July? Could we go back where we were last July? Bye-bye to your piece  
of the pie Investors poured their money into a broken market Now their equity account's  
dry It's just five weeks from an all-time high And singin', Could we go back where we  
were last July? Could we go back where we were last July?*