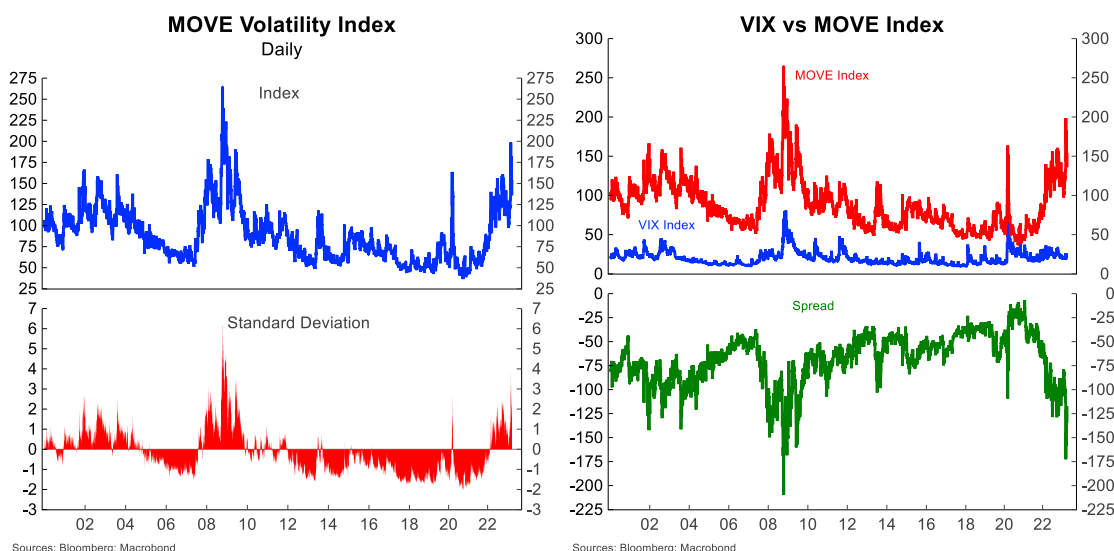


Markets Under the Microscope

Anxiety Hits Bonds, Equities Calmer For Now

- What is the bond market seeing that the equity market isn't? Price action in bond markets is sending an ominous signal for the economic outlook. Meanwhile, it appears to be business as usual in equity markets.
- Overnight, the MOVE index, which measures implied volatility in the bond market using options pricing, jumped to 153.9 - more than 2 standard deviations above its mean. That means implied volatility was in the top 5% of all readings since the index commenced in the late 80's.
- Extremely elevated volatility suggests that markets are on edge about the outlook and are increasingly pricing in the probability of 'tail-risks' or extreme events occurring. Spikes in volatility have been observed in the lead up to most economic contractions, including the GFC.
- The equivalent volatility measure for equity markets, the VIX index, clocked in below its long-run average overnight. This suggests there's something keeping bond traders up at night, while equity traders are sleeping better.
- In fact, the spread between the MOVE and the VIX indices has spiked to 135 points. It's highest since the GFC, outside of the ructions caused by the collapse of the Silicon Valley Bank earlier last month. The question is whether bond markets are overreacting or if there is upheaval looming that the equity market is ignoring.
- During the GFC, the MOVE index first spiked 2 standard deviations above its mean in late 2007. It was not until September 2008, after the collapse of Lehman Brothers that the VIX index experienced an equivalent spike. This may suggest that bond markets have a closer ear to the ground and are better at predicting turning points.
- Who is right this time around? Only time will tell. Either way, we are likely to see a steep repricing in one or both markets so that their respective outlooks once again diverge.



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