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Nasdaq

Data-Driven Thought Leaders: A Conversation with Tier1 Alpha and Simplify

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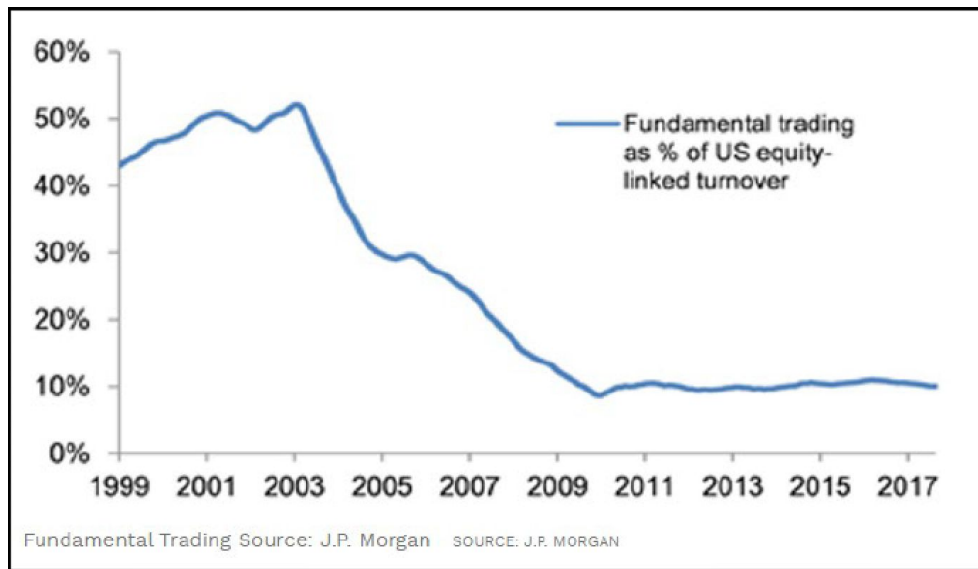
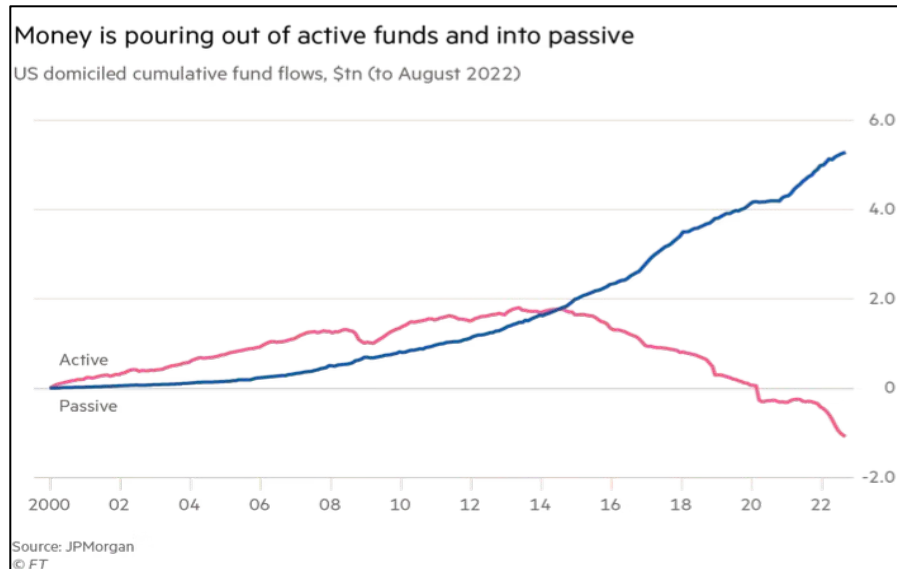
Harnessing The Power Of Market Structure

Strategic Allocation For Regime Based Investing

A Fundamental Shift From Active To Passive

“I view the markets as fundamentally broken. Value is not a consideration for most of the investment money that’s out there”

-David Einhorn, Greenlight Capital



A Fundamental Shift From Active To Passive

Figure 1: Who Clears the Market for 1 pp of Index Fund Demand?

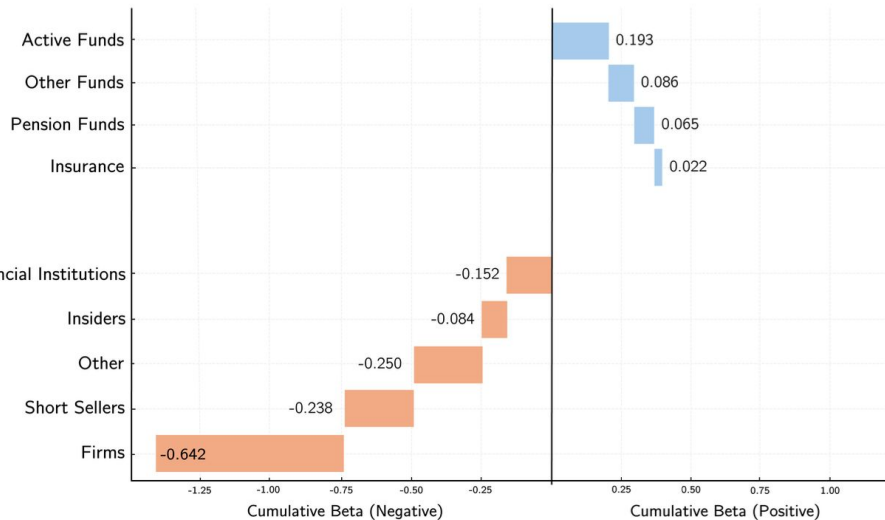
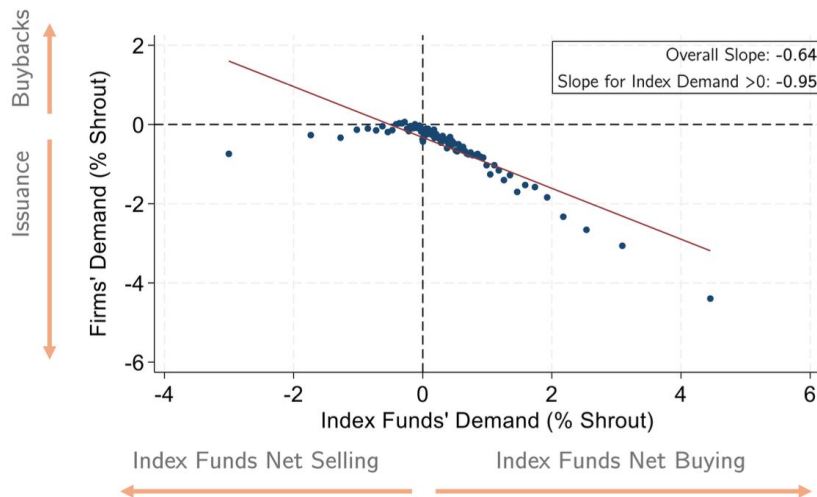
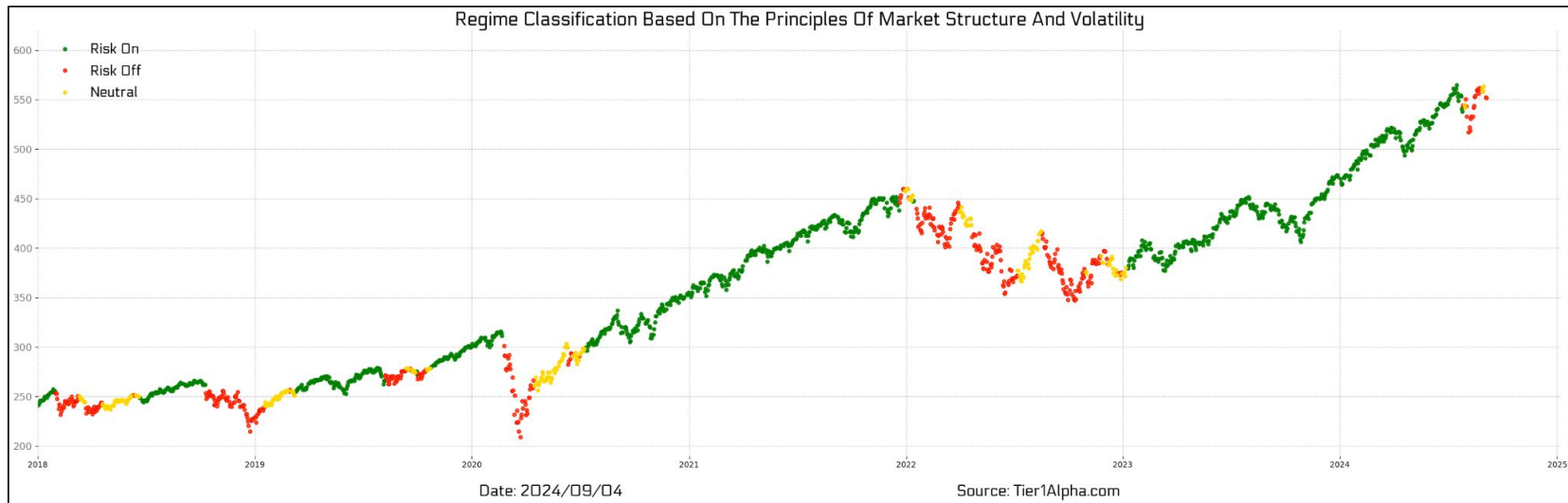


Figure 2: Firm Demand vs. Index Fund Demand



Source: Sammon, M., & Shim, J. J. (2024). Who Clears the Market When Passive Investors Trade? Working paper, August 19, 2024.

Strategic Regime Model



Our Strategic Regime model was designed to exploit the dynamics of a market increasingly driven by mechanical flows.

By monitoring the interaction between the options market and systematic strategies, our models can anticipate shifts in volatility that trigger large-scale buying or selling. This positions us to capitalize on the resulting trends, whether by aligning with or countering these flows.

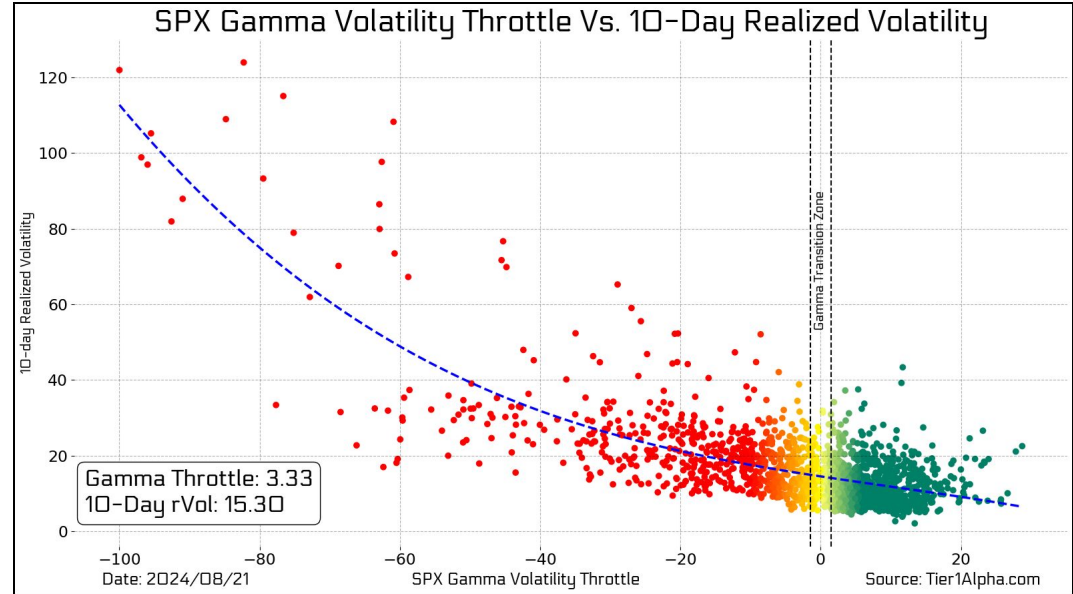
In a market that is increasingly inelastic and prone to outsized moves due to passive investing and liquidity constraints, our approach leverages these exaggerated price shifts, providing a strong framework for consistent returns in today's complex environment.

Harnessing Market Structure: The Power Behind Our Regime Model

Our Strategic Regime Model leverages a modern market structure increasingly dominated by mechanical processes, where algorithmic strategies, rather than fundamentals or investor sentiment, drive price movements.

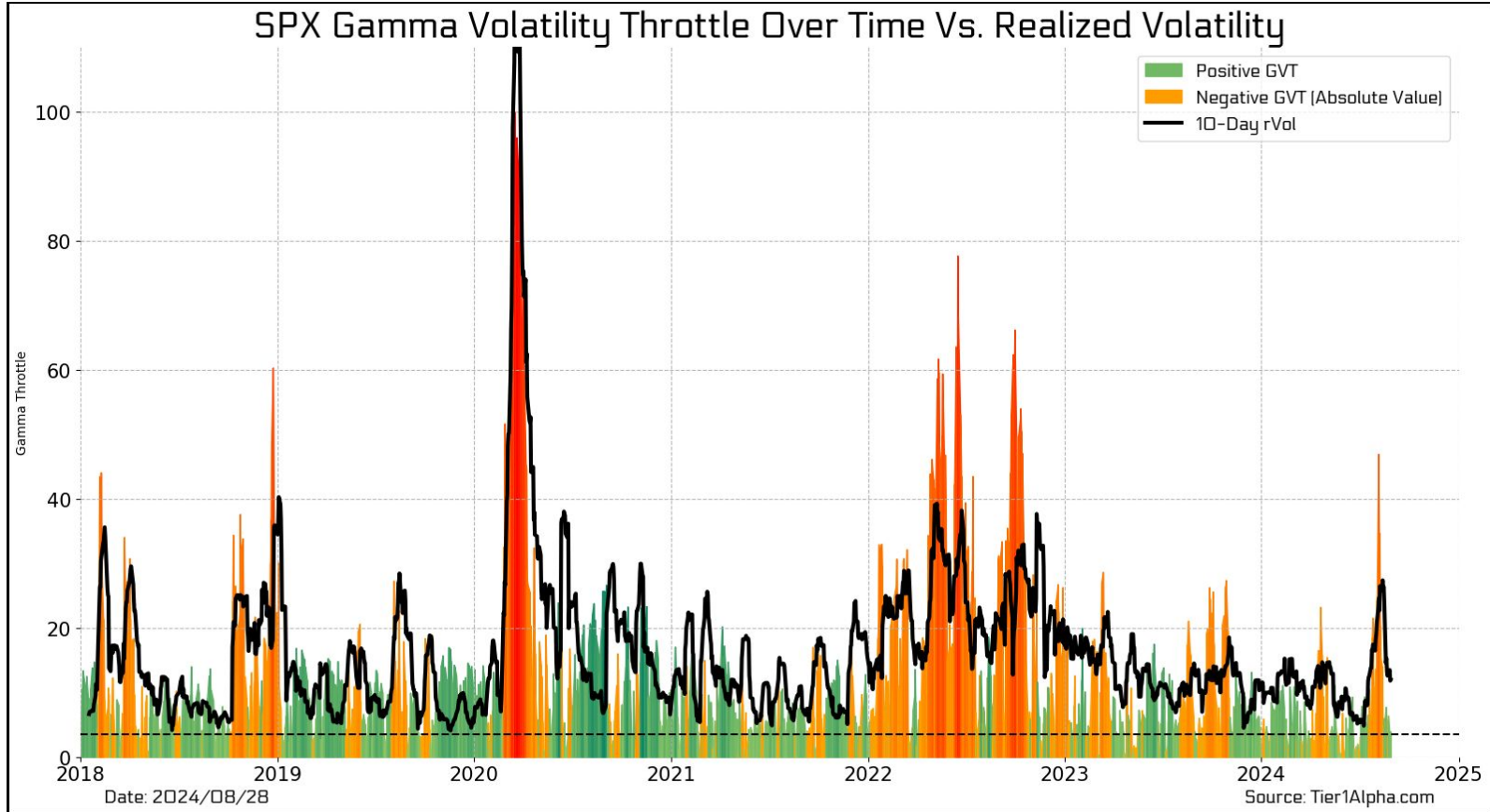
Central to this structure is the options market, where market makers, through delta hedging and gamma exposure management, dictate broader market volatility.

As they adjust positions to remain neutral, they create the conditions to either amplify or suppress volatility in the equities market.



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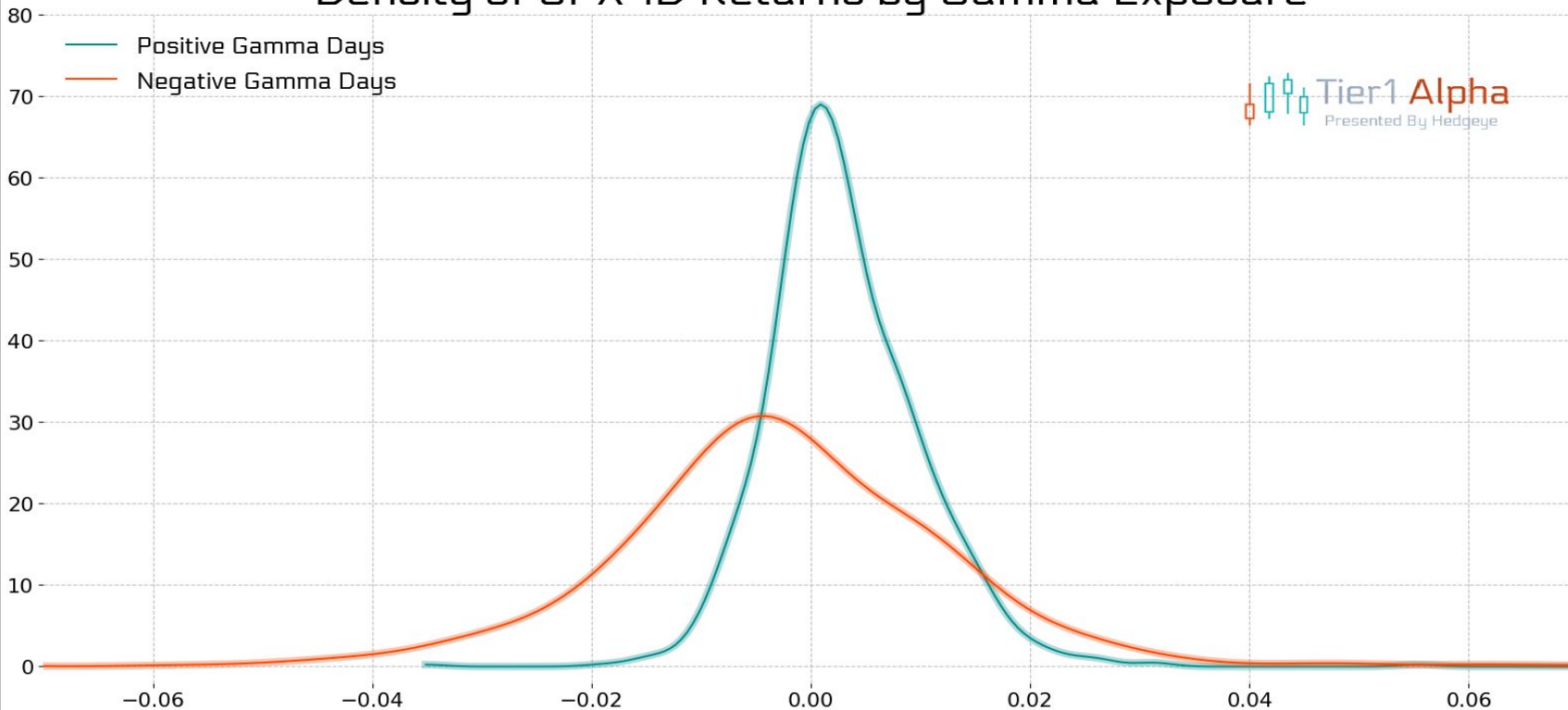
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Harnessing Market Structure: The Power Behind Our Regime Model

Density of SPX 1D Returns by Gamma Exposure



Date: 2024/09/03

Source: Tier1Alpha.com

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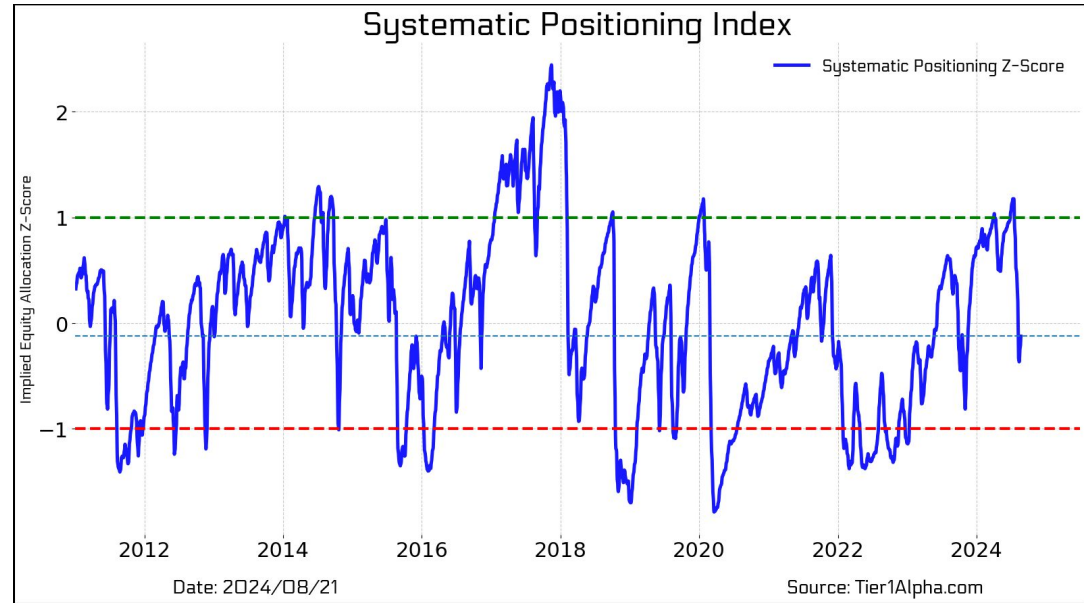
Harnessing Market Structure: The Power Behind Our Regime Model

These changes in volatility, driven by the options market, acts as a signal for systematic funds, including volatility control, CTA strategies, and risk parity funds, which respond reflexively by adjusting their equity exposure.

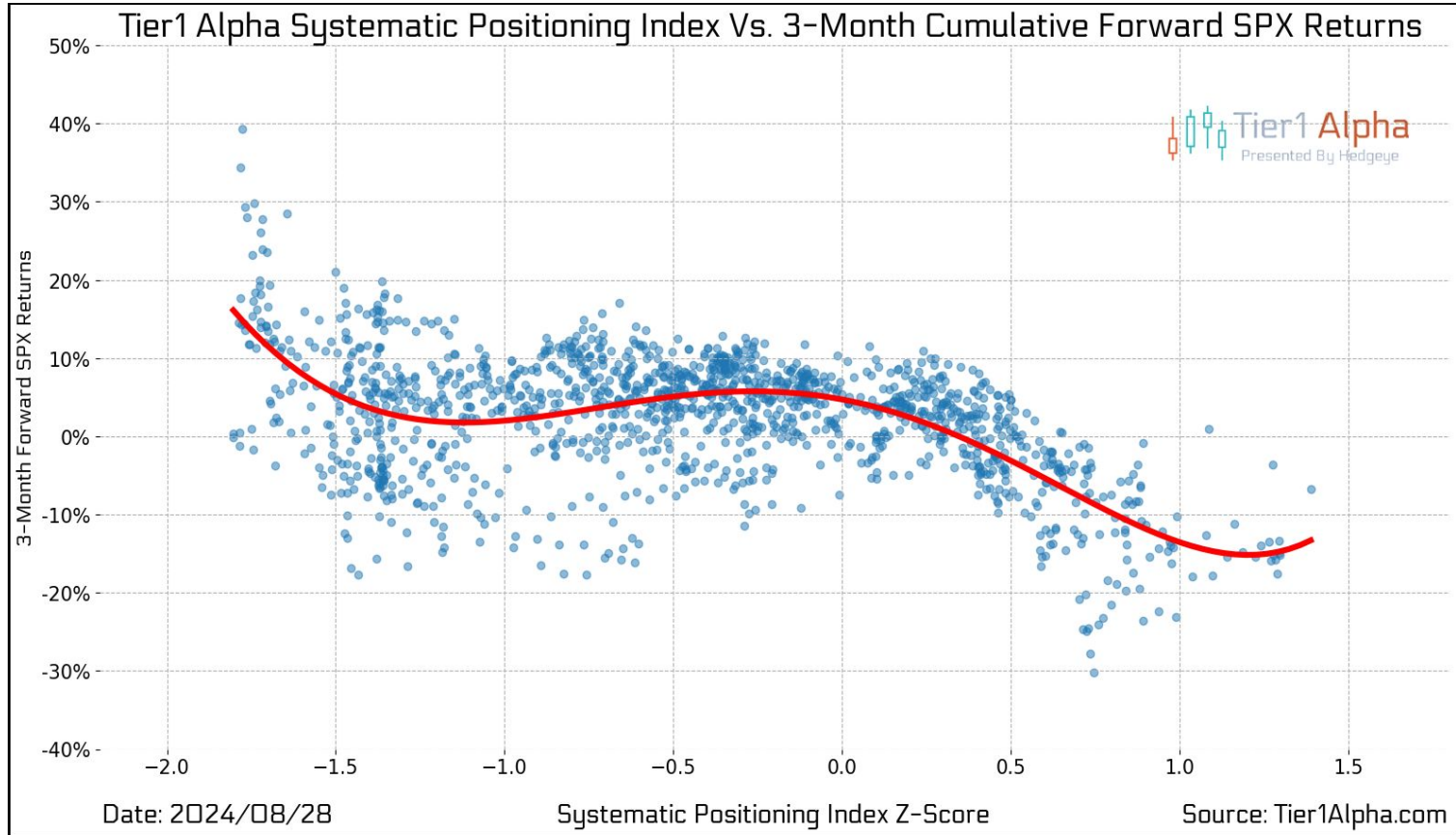
These funds operate without regard for the underlying fundamentals, focusing purely on maintaining their risk targets.

The interaction between the options market and these systematic strategies becomes even more potent in today's market, where a significant portion of trading is driven by passive investing.

With passive funds locking up liquidity, the market has become more inelastic—meaning that even small shifts in supply and demand can cause outsized price movements.

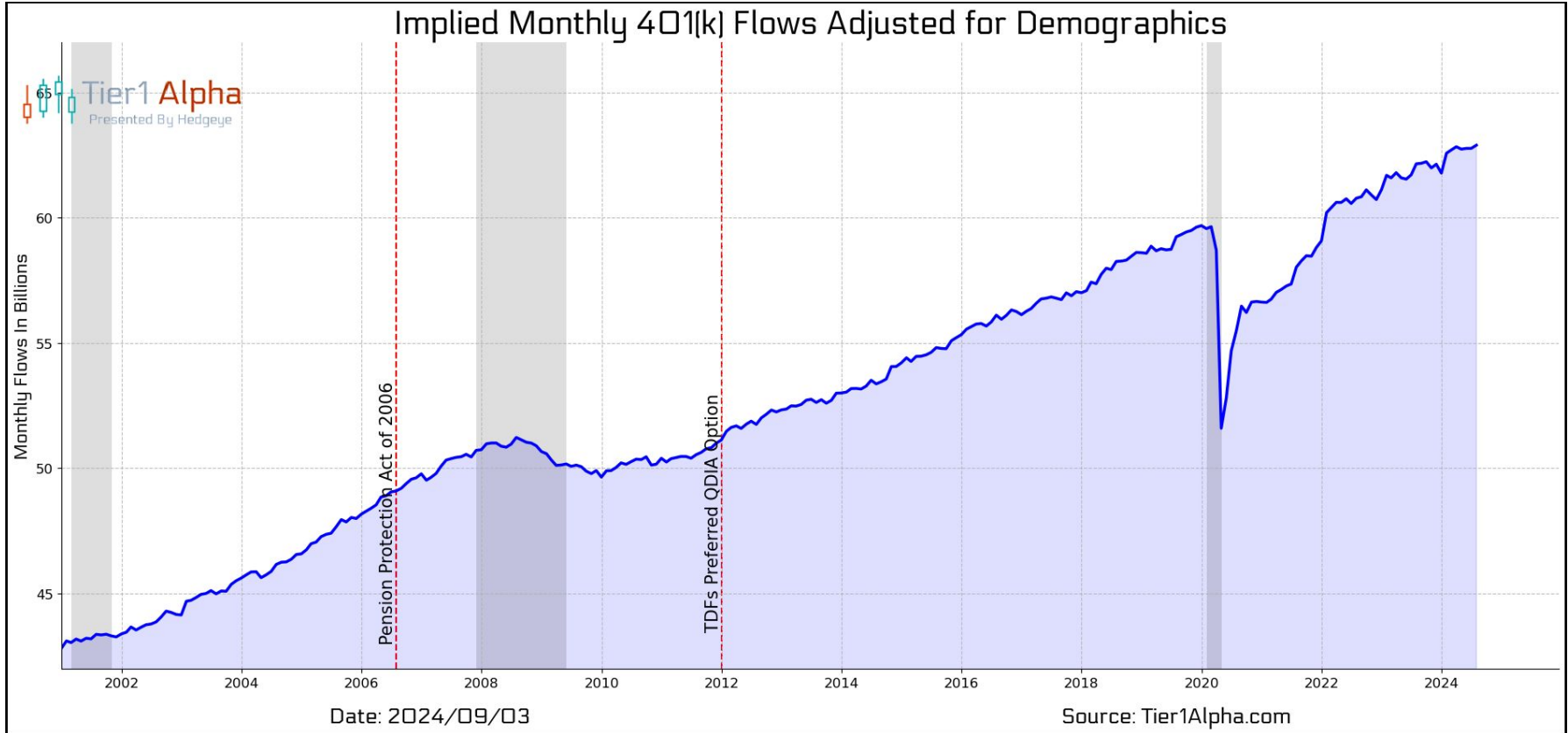


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