

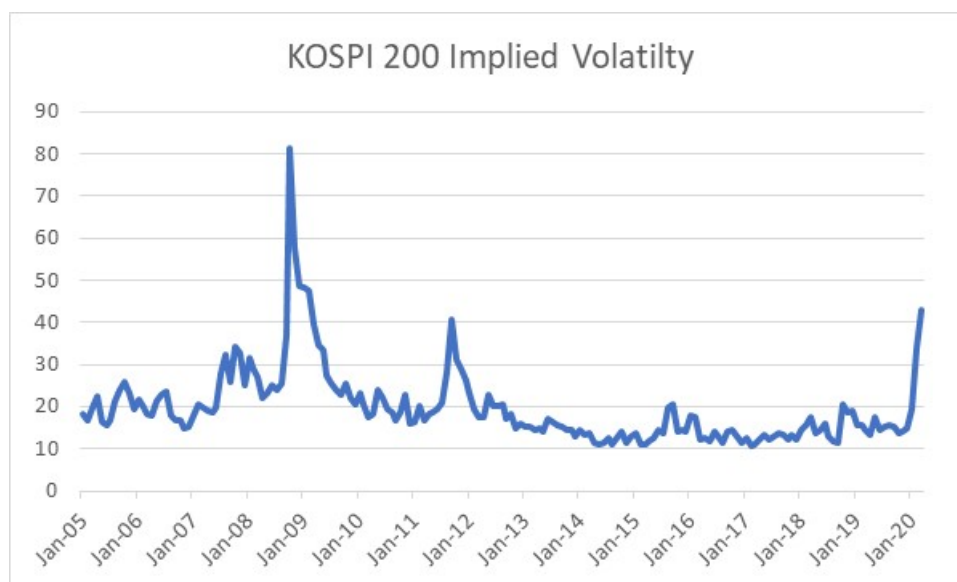
**AUTOCALLABLES AND CLEARINGHOUSE UPDATE**



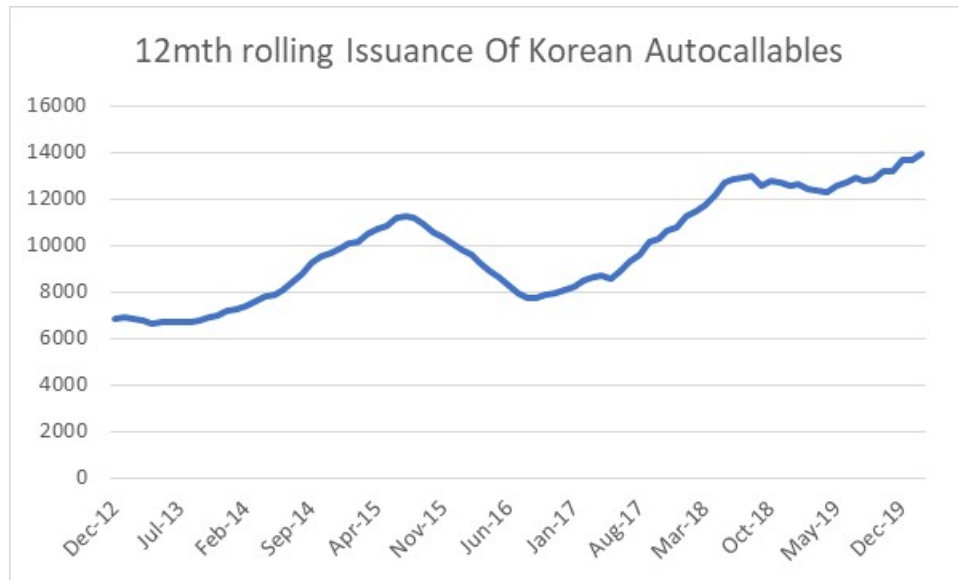
Russell Clark's  
Market Views

“The continued issuance from Korea suggests that autocallables have not yet been knocked in, and in fact investors are taking advantage of higher volatility to get higher yields.”

Korea and the KOSPI 200 are the spiritual home of autocallables. Historically, the KOSPI 200 was a highly volatile market but the long bull market in semiconductors, combined with rampant volatility selling, caused market volatility in the KOSPI 200 to collapse. Even the collapse in memory prices had little effect on KOSPI 200 volatility in 2019. However, the KOSPI volatility has recently broken out to levels not seen since 2011. (Price as at 10.00 GMT – 12 March 2020)



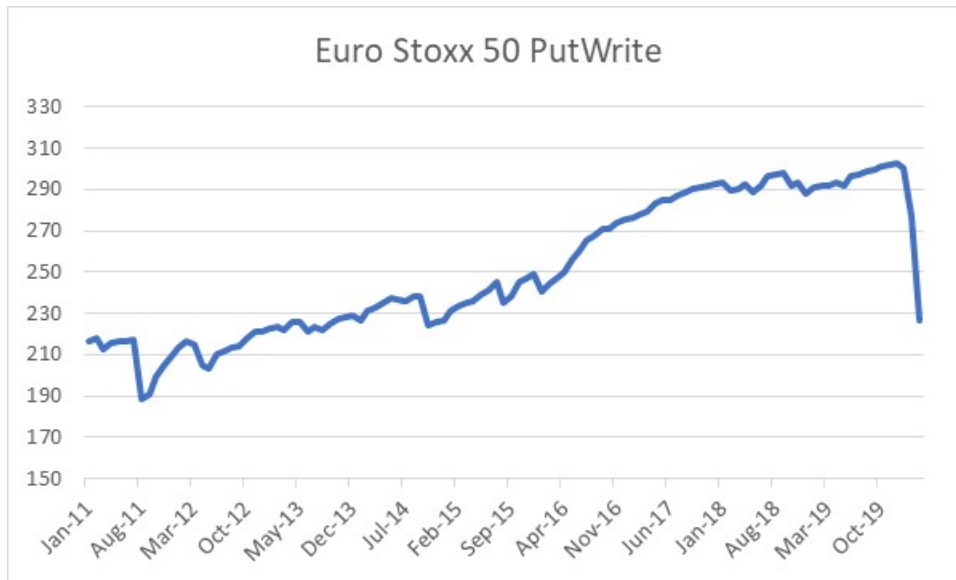
Despite the breakout in volatility there has been no reduction in the issuance of autocallables. In 2015, HSCEI based autocallables were knocked in causing issuance to collapse. The continued issuance from Korea suggests that autocallables have not yet been knocked in, and in fact investors are taking advantage of higher volatility to get higher yields.



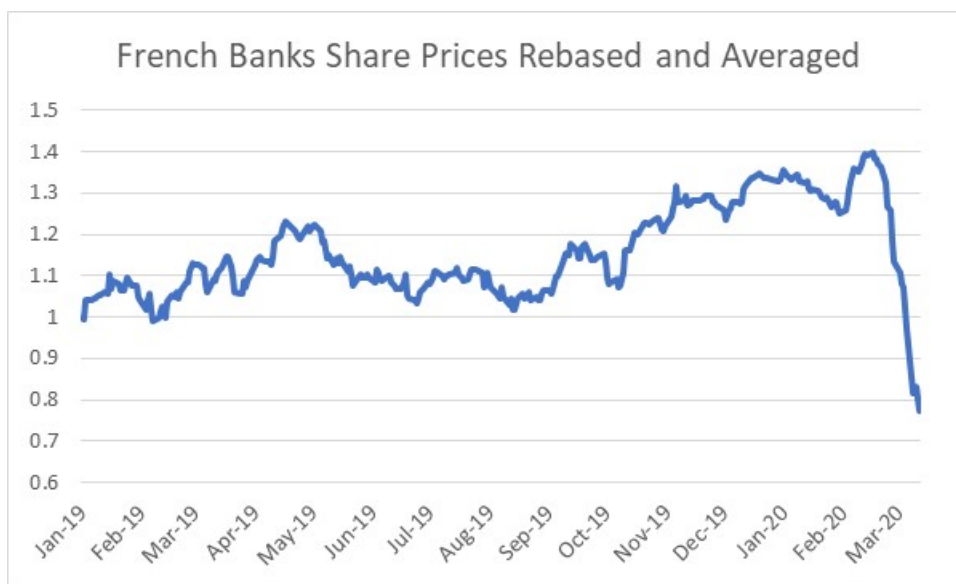
The KOSPI 200 is still above levels that have held since 2011. It is likely the most KOSPI 200 strike prices are set somewhere below the 230 price that has held since 2011.



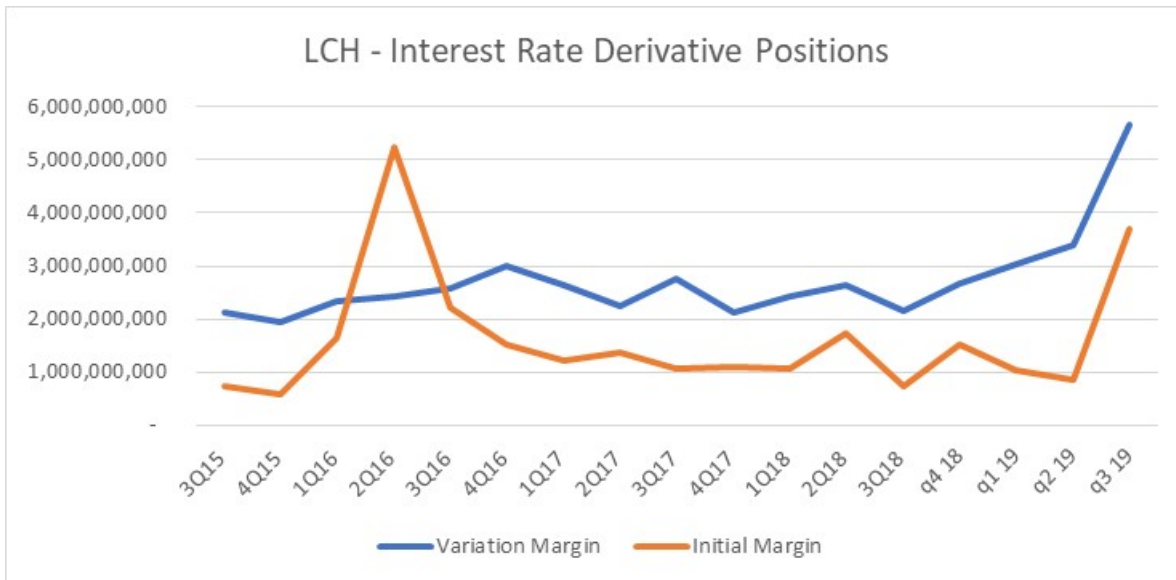
Autocallables issued in Korea will often include Euro Stoxx 50 in a “worst-of structures” market. A good proxy for the performance of this strategy is the Euro Stoxx 50 PutWrite Strategy. This has recently deteriorated sharply.



The spike in volatility has coincided with a steep decline in the share prices of French banks that structure many of the autocallable products.



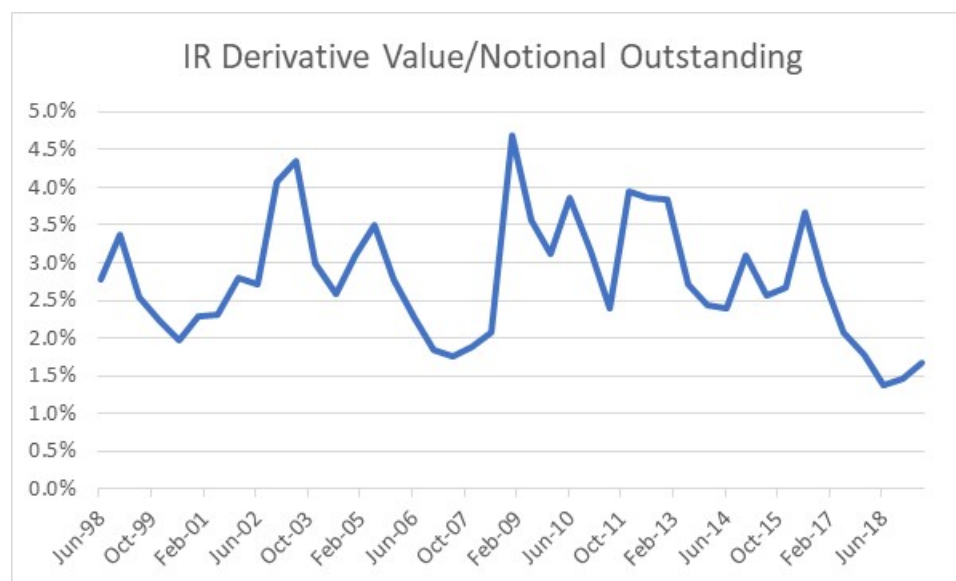
If autocallables are triggered, then implied volatility should move even higher from current levels. For clearinghouses, the high level of both implied and realised volatility should lead to increased margins. As a reminder, LCH as per its Q3 2019 disclosures was still running at initial margins at very low levels to variation margins, although both rose significantly. During the strains of Brexit initial margin rose to be multiples of variation margin.



One more timely way to monitor margins is to look at initial margins for large index futures. With rising volatility, margins have been increasing even as the S&P falls. To normalise over time we divide the amount of margin for trading the future by contract value. Cost of trading has recently risen to 6.4%, the highest level since 2011.



For OTC options, we can use BIS data to get an idea of initial margins. Taking the gross value of margins and dividing it by outstanding notional we can see that values were at a level seen before the global financial crisis and the dot com bubble.



Market volatility has risen significantly, but margin and collateral in the system still looks too low. Should autocallables break barriers in the KOSPI 200 or the Euro Stoxx 50, then the structurers will turn into volatility buyers, not sellers. Higher volatility leading to margin calls look likely, which could drive the market lower.

## INFORMATION

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