Losses in short positions during the recent equity market rebounds were simply routine. They were predictable and controllable.

Equity Market Rebounds

In the aftermath of the mid-October market downturn, *"What Just Happened?"* pointed out that, far from marking the end of the current boom, the losses in major equity markets were routine events judged by Omega Metrics® multi-day VaR and ES measurements. This sequel looks at the subsequent bounce backs in US and Japanese equity markets.

When the S&P 500 Index dropped to 1863 on 15 October, many thought this signaled the end of the boom that began in 2009. Since then equity markets worldwide have bounced back. European markets have yet to recover their 2014 peaks but US and Japanese equity indices have rebounded to new highs.

The boom which began in 2009 *will* produce a correction. Our predictions[1], made in January 2014 for the levels that major markets will fall to, are unchanged. As we observed in *"What Just Happened"* however, the past century of market history shows that the correction won't happen before multi-day risk levels rise significantly from their current levels.

In the meantime, our risk technology puts the current rebound–and the losses which short positions in the US and Japanese equity markets have been exposed to as a result of it–into context.

Risk Predictions and Daily Returns for Short Positions

Omega Analysis' advances in statistical technology allow risk measurements of unprecedented accuracy in financial data series. 1-day Value at Risk (VaR) and Expected Shortfall (ES) measured from short samples of historic data have a high degree of predictive power out of sample. Over extended time periods, VaR breaches are in excellent agreement with the target frequency and ES breaches are consistent with the (time varying) tail model's predicted frequency. Because it is breached relatively rarely, ES can be used to size market exposures with a high degree of confidence.

Since 15 October there has been only one breach of our 1-day 99% VaR levels for a short position in the major US equity indices–in the Nasdaq 100–and no breaches of the short 1-day ES. Even the Bank of Japan's shock announcement only produced a 1-day breach of the short VaR. The 1-day short ES was 5.8% prior to the 4.8% spike in the Nikkei 225.

Of course, for a short seller, even in the absence of large one day losses, the constant gains in the market led to significant drawdowns. But these were well within the limits of our 5, 10 and 15-day VaR predictions and have been easily contained by the corresponding ES levels.

Multi-Day Risk Measurement

Recent advances have allowed Omega Analysis to extend to returns for 5,10 and 15 day periods the same out of sample predictive power which Omega Metrics VaR and ES provide for daily returns.

Our technology shows that recent 5, 10 and 15-day losses recorded by short positions in the S&P 500, Dow Jones Industrial Average and Nasdaq 100 were VaR breaches at the 99% level. These were far from being ES breaches. In Japan, shorts experienced 5 and 10-day breaches of the 99% VaR in the Nikkei 225. The 5-day breach also produced a 50 bps ES breach, however the 10-day ES comfortably contained the worst 10-day loss.

Losses in short positions from the recent market bounce backs in the US and Japan were all quite routine.

They were predictable–and hence controllable.

[1] Market Cycles, Risk Measurement and Early Warning of Asset Price Bubbles, W. F. Shadwick, Fields Institute Quantitative Finance Seminar, 29 Jan 2014. http://www.fields.utoronto.ca/programs/cim/13-14/finance_seminar/Shadwick.pdf

Omega Analysis

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