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It's better to be the house

Key Takeaways

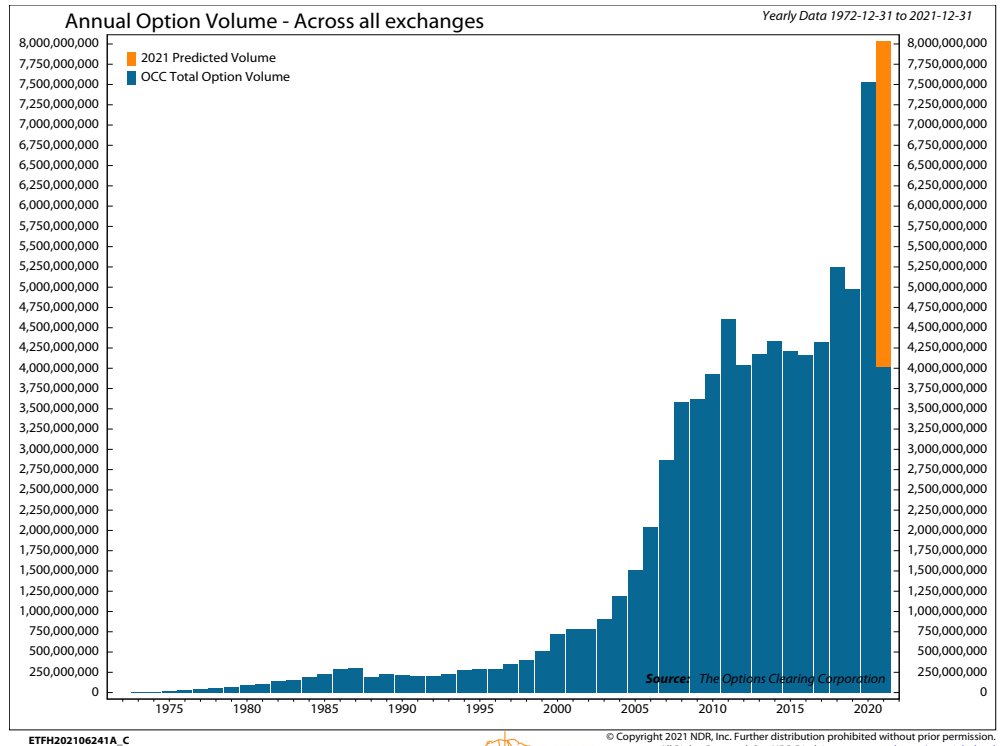
- Option volumes set a record in 2020. This year is on pace to break that record.
- The iShares Broker Dealer ETF (IAI) holds the stocks of companies that benefit from increased option trading and market volatility.
- Almost 40% of IAI is two investment banks. Further flattening of the yield curve represents a risk for holding such a large, curve sensitive position.

We've received questions from clients and colleagues regarding the popularity of 'meme' stocks like AMC and GameStop (GME) and, frankly, never felt we had a good answer. We thought the iShares Broker Dealer ETF, which holds stocks in the capital markets industry, looked like an interesting solution but had concerns over the two largest positions. Goldman Sachs (GS) and Morgan Stanley (MS) make up about 40% of the fund and both are highly sensitive to a flattening yield curve.

Rocket ship

The Option Clearing Corporation, the central clearing facility for exchange and OTC options, reported a record volume year in 2020 — fueled, at least in part, by increased

Another record year for option volume?



retail participation. With almost half of 2021 over, the volume reported by the OCC looks to be on pace to exceed 2020's volume (chart). This volume has pushed both the CBOE and Nasdaq (NDAQ), which operate 10 option exchanges between them and represent almost 10% of IAI, to recent 52-week highs.

It's going to be lit

In [his remarks](#) at Piper Sandler's Global Exchange and FinTech Conference, SEC Chairman Gensler made it clear that revamping equity market structure will be an SEC priority during his tenure. Two points

caught our attention — a significant amount of trading volume (47% in January) occurs away from 'lit' markets (exchanges) and payment for order flow (PFOF) may obscure the true cost of trading. Moving equity volume from 'dark' venues to exchanges would benefit NDAQ and ICE (parent of the NYSE and almost 5% of IAI).

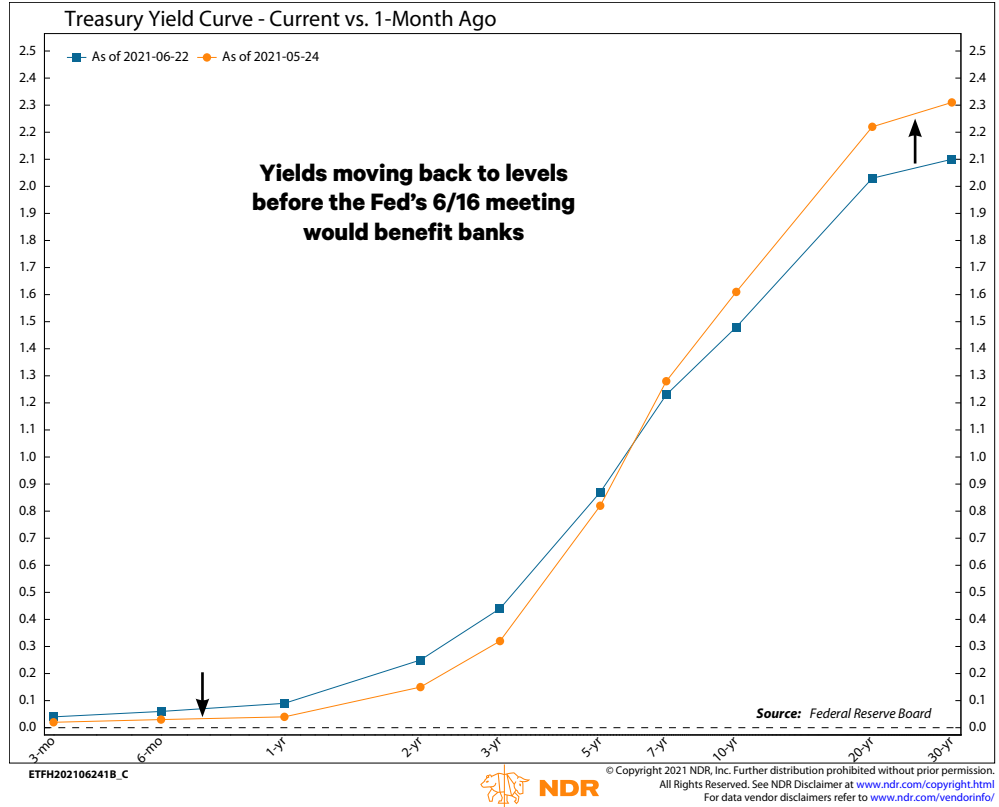
IAI also holds Virtu (VIRT, about 1%) which is the second largest wholesaler and would likely be negatively impacted by moving trading to exchanges.

Banks like it steep

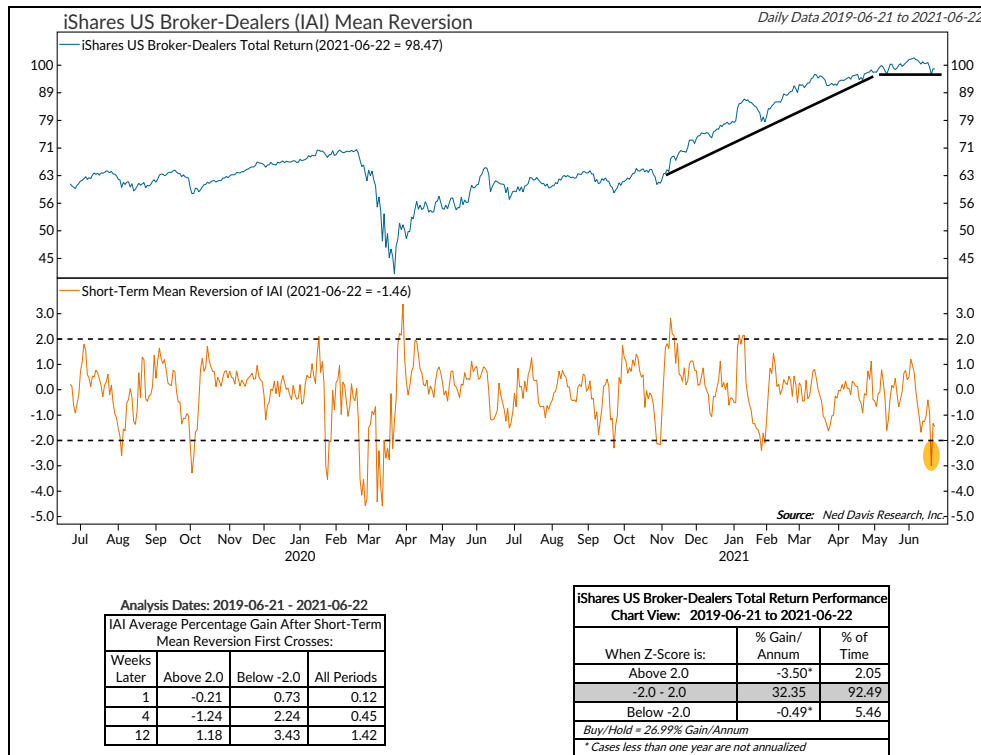
A simple, though not comprehensive, way to explain much of an investment bank's business is maturity transformation — borrowing short-term to invest long-term. This makes them sensitive to the slope of the yield curve — the steeper, the better. Separately, a portion of their business can be thought of as a tail-risk hedge — trading/market-making should be more profitable during periods of volatility or increased client activity.

Joe Kalish [described last week's action](#) as a 'violent flattening of the yield curve' and suggested the curve could re-steepen in coming months as treasury supply increases — which would benefit GS and MS.

Steeper curve benefits the banks



Short-term oversold bounce or trend change?



Slow growth is another risk

IAI remains sensitive to a further flattening of the yield curve and Financials are a cyclical value sector. Ed Clissold warns of a [potential shift away from Value](#) in the second half of the year as 'super charged growth' subsides. Last week's curve induced selloff was sufficient to push IAI to short-term oversold and could mark a change in trend (chart, left).

However, if trading volume continues at the same elevated pace and the curve steepens, IAI should rally and this pullback offers an entry point with well-defined risk.

Customized version of ETF_400.RPT_IAI



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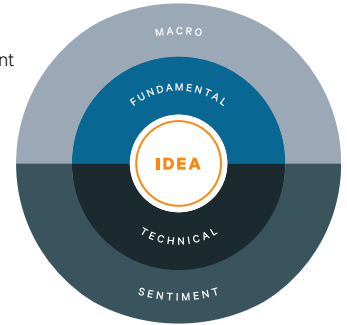
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