

How Bi-Modality Is Percolating Up Into Macro Markets

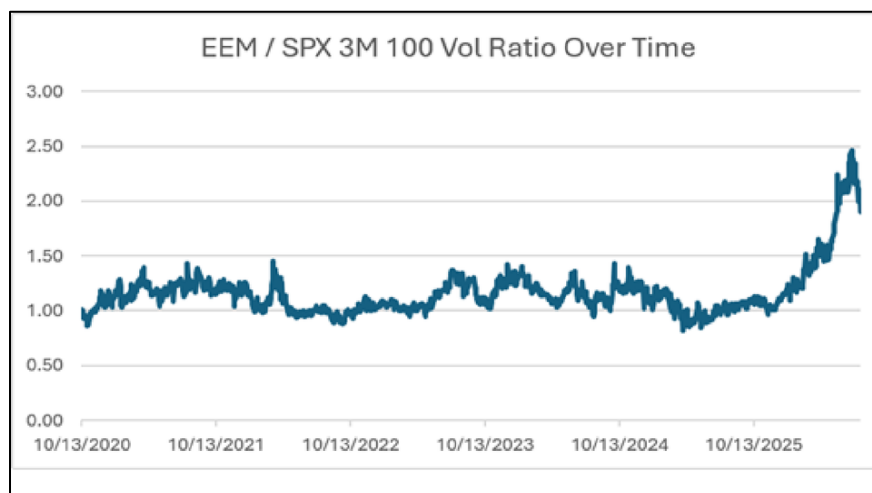
By Vineer Bhansali | August 5th, 2026

The following article was published [here](#) on forbes.com

Last month in this forum I alluded to “canaries” in the coalmine (see [here](#)), referring to the high implied volatility on options of stocks like Micron (MU) and SpaceX (SPCX). One working hypothesis was that assisted by leverage (both direct and via ETFs that provide this leverage) the market is currently amplifying “bi-modality”, which basically means a schizophrenic pricing of return outcomes that differ significantly from each other- akin to the outcomes of a coin flip. The high implied volatility for these stocks, we think, can be explained by simply observing that the expected returns in a “good” state (melt-up) and a “bad” state (melt-down) are very different. Say something like +200% in a good state and -50% in a bad state.

More importantly for investors, such canaries usually signal something more consequential and larger than a few single stock curiosities. They can be precursors to macro behavior, and start to influence, albeit indirectly, the global economy that clearly is levered up to the stock markets.

An inkling of this phenomenon has already begun to start showing up. As my colleague Linda Chang illustrated in the chart below, the implied volatility of the emerging markets ETF EEM (iShares MSCI Emerging Markets ETF) has suddenly spiked up relative to the implied volatility of the US large cap ETF SPY (State Street SPDR S&P 500 ETF Trust). The last time the ratio of the two implied volatilities was in this region (not shown) was just before the tech crash of 2000.



We can trace this observation back to our canaries.

Since the holdings of every ETF have to be disclosed by regulation, we can poke inside them: the three largest holdings of the EEM ETF are: TSMC (Taiwan Semiconductor), Samsung and SK hynix. The first is the market leader in chip fabrication, and the other two are leaders in memory, which is the hot commodity given the requirements of AI models that have to load them up in their “brain” to answer our most random queries in real time.

Interestingly, the EEM ETF has an exposure of almost 27% to Taiwan, and 20% to South Korea. All the other “emerging markets”, including the next largest, China (at about the same weight ~21% as South Korea), make up the rest (all data from Bloomberg as of August 4, 2026). I don’t have to remind the readers that these three stocks, and the stock markets they belong to, have been on a tear recently. And they have not lacked for volatility – the trailing volatility of Taiwan has been in the 50% annualized range, and that of the Korean market has been close to 100%! So, we can see that the exploding volatility of the EEM, and emerging markets broadly, is a function of the exploding volatility of our canary stocks, that, for better or worse, are levered plays on AI. Interestingly, the other large EM ETF (almost 5x the size of EEM) is Vanguard’s VWO (Vanguard FTSE Emerging Markets ETF), but it has almost no exposure to Korea or to two of the three stocks in the EEM. Not surprisingly, its volatility (both realized and implied), is a fraction of the volatility of the EEM. Different strokes...

The consequences for investors are quite apparent. Since both EEM and VWO are benchmarks of sorts for emerging market equities, if one wants a higher volatility version, one can buy the EEM. On the other hand, if one wants a lower version, one can buy the VWO. Now why would one ever want a higher volatility version (i.e. EEM) than a lower volatility version (VWO)? The answer is similar to the one when asking the question about buying 2x or 3x levered ETFs – the potential of magnifying and obtaining outsized returns (and of course losses) that higher volatility can generate!

We can think of the investment ecosystem like we think of the food chain in the ocean. At the smallest level we have plankton (think of these as the stocks mentioned above). Above that are larger sea creatures, like small fish (think of these as the ETFs, which are packages of the stocks mentioned above). Stretching the analogy further, we have even larger fish, octopuses etc. (think of these as mutual funds that use some of the EM ETFs but possibly other assets as well). Further up the food chain are large fish (akin to endowments and pension funds). Perhaps in the middle there are predators such as sharks (hedge funds?), and then at the topmost layer we have governments and sovereign wealth funds (whales?).

The last time I had a chance to use this imagery was right before the 2018 XIV debacle in a paper I wrote with Larry Harris in the Financial Analysts Journal called “Everybody is Doing It” (see [here](#))

related to short volatility strategies and “shadow” financial insurance. I am not sure if the canaries are telling us that a similar story is likely to transpire in markets, but certainly I am paying attention. The big difference, this time, however, is that volatility may not simply be signalling a market crash, but maybe an unprecedented melt-up on the “right” tail before the inevitable crash. We simply don’t know the immediate timing or the direction.

To see further how the percolation up the food chain might evolve, note that for the US market, amongst the top 10 holdings of the SPY ETF are NVDA, AAPL, MSFT, AMZN, GOOGL, MU, META, AVGO. It would be hard to argue that these stocks are not somehow related to the canaries in EEM. If the ratio of emerging markets volatility to developed markets volatility were to mean-revert back to its long-term history, it could happen because the volatility of the numerator (EEM volatility) falls, or the volatility of the developed markets (SPY) volatility rises. The percolation hypothesis says that the latter, i.e. increasing volatility of developed market equities, is more likely. Increasing volatility means larger movements in the underlying markets, either up or down, melt-ups or melt-downs are both possible.

Given this bimodality and the potential for large moves, one wonders why the VIX -- aka the “fear index” -- a commonly used barometer of market volatility, is still at such historic low levels (as of this writing around 16%, source Bloomberg). There are many explanations, of which one is as simple as demand-supply mismatch. More wonky explanations point to the collapse in the correlation amongst the constituents of the S&P 500, which is partly fundamental and partly due to the popularity of so called dispersion strategies that sell index volatility and buy single name volatility. Either way, there are eager sellers but not many eager buyers of volatility. Sometimes things are actually that simple.

Given the potential of large moves in either direction, buying volatility aka the “tails” is the simplest way today to be ready for the percolation of bimodality up the market ecosystem. It’s good preparation no matter which way the canary flies.

Important Disclosures

Vineer Bhansali, Ph.D. is the Founder and Chief Investment Officer of LongTail Alpha, LLC, an SEC-registered investment adviser and a CFTC-registered CTA and CPO. Any opinions or views expressed by Dr. Bhansali are solely those of Dr. Bhansali and do not necessarily reflect the opinions or views of LongTail Alpha, LLC or any of its affiliates (collectively, "LongTail Alpha"), or any other associated persons of LongTail Alpha. You should not treat any opinion expressed by Dr. Bhansali as investment advice or as a recommendation to make an investment in any particular investment strategy or investment product. Dr. Bhansali's opinions and commentaries are based upon information he considers credible, but which may not constitute research by LongTail Alpha. Dr. Bhansali does not warrant the completeness or accuracy of the information upon which his opinions or commentaries are based.

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