

OXEYE DIVERSIFIES ACROSS ASSET CLASSES

Wiltshire-based Oxeye Capital Management Ltd, which since 1997 has been managing volatility arbitrage strategies based on FTSE 100 Index, is introducing new asset classes and a multi-asset allocation approach, and researching a variety of other markets. “For the past 18 months we have been testing similar strategies in government bonds, currencies, commodities, individual stocks as well as other stock indices,” says Oxeye founder and director Martin Petherick. “The next stage of our development is to widen the number of asset classes trading the basic Oxeye VolArb strategy so that our clients have greater choice when building a diversified risk profile, and exposure to largely uncorrelated implied volatilities.”

As well as its original stock index FTSE program, Oxeye now has programs based on Eurex German 10 year Bund; CME dollar/euro; and Nymex crude oil contracts. Consequently, Oxeye can offer an alternative strategy-based overlay for traditional strategies focused on diverse asset classes and a stand alone multi-alternative asset allocation strategy which has low correlations in both price action and implied volatility histories. As Oxeye finds that currently the euro demonstrates the best risk/reward parameters, whilst crude has the most attractive absolute premium levels, it would allocate more to those two strategies than to the FTSE or Bund strategies.

Oxeye's trading philosophy reflects the premise that implied volatility is falling or moving sideways most of the time, while volatility spikes from unusual or 'fat tail' events are rare, and that time erosion of options favors the seller and works against the buyer. This makes selling implied volatility by writing options, and buying historical volatility via exposure to the underlying index or security when the value of the former is greater than the latter, the best way to produce consistent absolute returns.

Oxeye's FTSE program recently indicated that in periods of very low implied volatility the available arbitrage can break down, whereby the underlying market moves turn out to be larger than implied volatility predicted, in which case a long volatility arbitrage approach is more relevant, that is buying the options and selling the underlying index. This is because the approach allows for wider use of trend following opportunities, net gearing management and the buying of cheap long dated options with which to exploit time erosion or theta opportunities.

Such considerations prompted Oxeye to develop its new multi-asset allocation approach which allows for reduction of exposure to any asset class where implied volatility remains below a predetermined threshold. Oxeye can sell options to create a range around the market based on parameters dictated by implied volatility and, providing the underlying market move is not greater than the range over the life of those options, Oxeye keeps the premium income from the options sold.

Oxeye's system also focuses on managing related risks, for example, when the absolute level of implied volatility is low in comparison to the asset's history there is a greater probability of historical volatility becoming higher than implied volatility. The system also manages volatility risk, or vega, that is when the price of options rises in response to increasing implied volatility which Oxeye finds will happen most dramatically on fat tail events.

After identify a ranging or trending environment, Oxeye maintains net gearing within limits, keeps gross gearing low in low implied volatility times but keeps it high above a certain mean level of implied volatility.

As Oxeye has learned that in a high volatility environment buying options for insurance reasons, can be dangerous because of time erosion, it has developed a hedging overlay using futures, which can produce strong returns on a stand-alone basis and has a negative correlation to the option-writing program.

Oxeye strategies can be accessed either by managed account or through the Oxeye Growth Fund which is diversifying across the strategies. Managed accounts have a minimum investment of £500,000 for the FTSE strategy, \$500,000 for crude oil, and \$250,000 for the FX strategy. The fund's minimum is currently \$50,000 but this will soon increase to \$100,000. All fees are 2/20. Oxeye's total under management stands at \$40 million.