



Oxeye POP Strategy Stop Loss Explanation & Performance of Backtest October 2009

BACKGROUND

Since inception in August 2000 Oxeye managed accounts employing the Oxeye Protected Option Premium strategy have produced an average annualised return of 6.5%(see Appendix 1 - Flyer POP). The problem has been that the cost of insuring the portfolio has been too great a drag on the performance of the strategy.

We decided to test various measures of stop loss policy to see if the results would improve if we restricted the potential loss of individual positions to certain levels.

The aim of this note is to explain how we performed the back-test and to compare the results with our actual performance.

BACKTEST

We performed two types of test.

Mathematical

- Systematic testing to find the 'stop loss' policy which provided the best risk / reward ratio. This indicated that using a stop loss based on a multiple of written premium would maximise profitability.

Manual

Based on the findings in the mathematical test:

- Day by day recreation of positions, using daily option price database back to 1997
- Scrutiny of daily index moves to ensure all stops were recorded accurately.
- Record maintained of monthly portfolios
- Slippage built in on all prices
- Comprehensive set of rules created for going forward

RESULTS

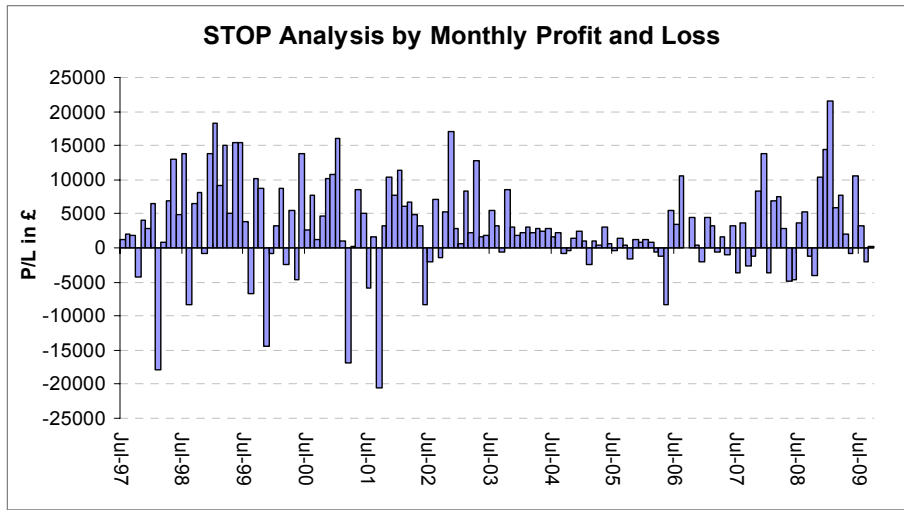
Performance . The test produced an annualised return of 27% between July 1997 and October 2009. Specifically 2006 9.2%, 2007 21.5%, 2008 24.1% and 2009 36.1% (to date). The following table compares the annual % P/L for each strategy and the overall performance. STOPS clearly outperforms for 2 reasons:

- 1) There is no continual cost for downside insurance.
- 2) The stop loss policy reduces losses during the drawdown periods.

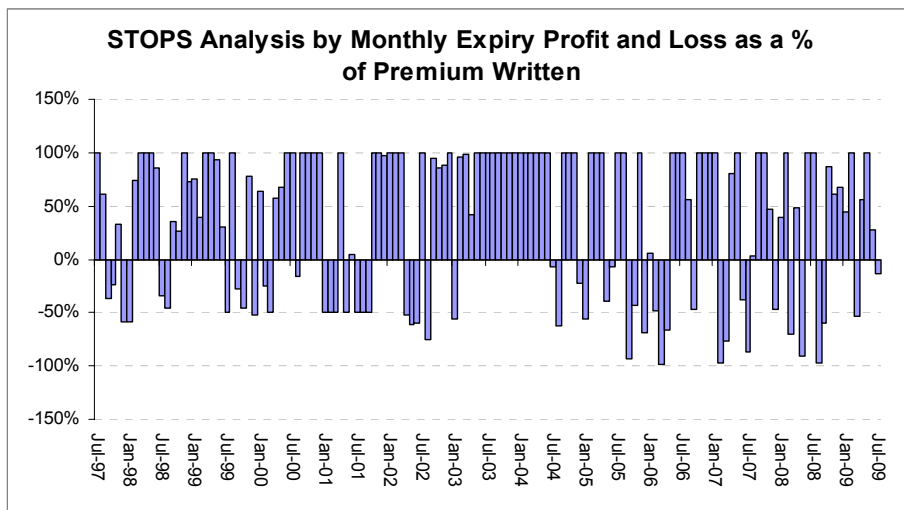
DATE	STOP	POP
1999	-3.1%	-6.0%
2000	46.8%	50.5%
2001	5.7%	6.8%
2002	49.1%	15.3%
2003	37.0%	12.3%
2004	15.9%	9.7%
2005	2.9%	-9.1%
2006	9.2%	3.7%
2007	21.5%	6.7%
2008	24.1%	-8.1%
Total Cumulative	721.2%	92.3%
Mom	-0.2%	-2.5%
YTD	36.1%	-3.1%
Annualised Return	20.8%	6.5%



- Analysis by monthly profit and loss bar chart. This shows the high degree of profitable (70%) to losing (30%) months.



- Analysis by monthly expiry profit and loss as a percentage of premium written. This shows that on the majority of occasions most of the premium written expired worthless and therefore profitably. The average retention rate was 38% of the premium written.





CONCLUSION

Premiums and implied volatility are still sufficient to enable similar returns to the backtest and so for POPS managed accounts we will adopt this new approach using stop losses instead of rolling downside insurance. We will also discontinue 3 month duration option writing as the test shows there is a disadvantage to selling more than 2 month time horizons.

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