



Time to Start Selling Volatility

The Long Volatility Opportunity Revisited- February 2018

In December 2017 we advised going long of volatility because “in our view, sometime in the next twelve months volatility will rise sharply again” .¹ Since we wrote that note UK Equity Index has fallen approximately 10% (Figure 1) and Implied Volatility (IV) (VFTSE) has risen from a low of 10% to 20% (after spiking to a 29% intra-day high) (Figure 2). The US VIX has seen an even sharper move spiking from below 10% to 50% before subsiding to the current level of 25% (Figure 3). IV has now risen to a level where we believe it is good value to start shorting volatility again.

Figure 1: Daily UK Leading Index 2017/18



Figure 2: UK Equities Daily IV 2016-2018

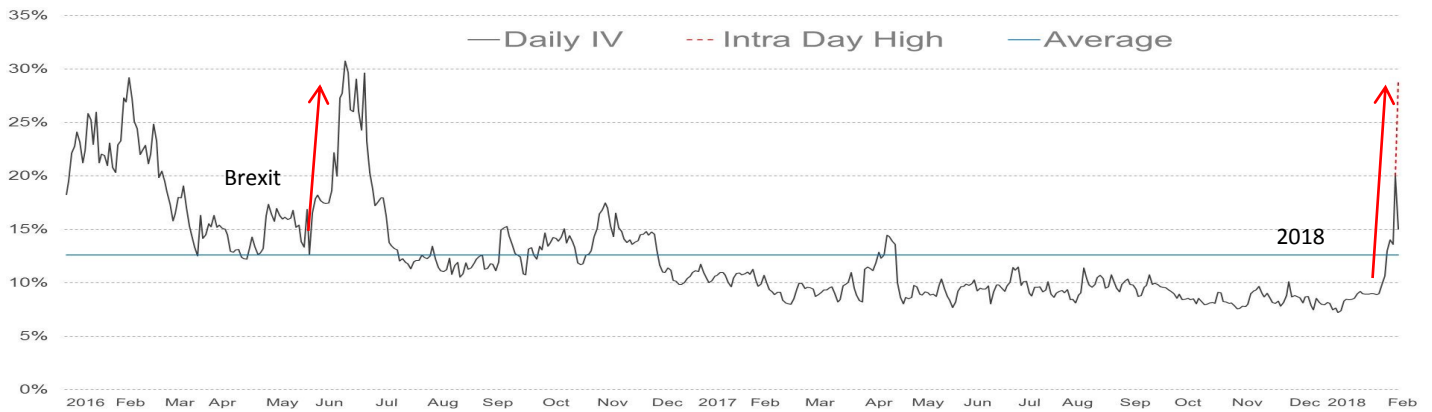


Figure 3: 240 minute VIX

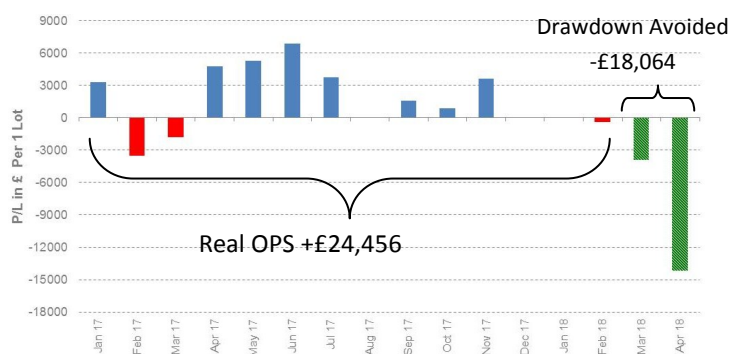




OPS Performance 2017-2018

OPS has been running a light book for much of 2017 and 2018.² This was because premium levels were below £150, our cut off level for a three month strangle. If we had a full book, it would currently be experiencing a significant drawdown on its March and April positions, which as of 6th February would be losing £18,064, see Figure 4.

Figure 4: Real OPS P/L by Expiry 2017/18



Now is the time to Short Volatility

The spike in IV has significantly improved option premium levels, as seen in Figure 5. Premiums are once again above the long term average, as highlighted in Figure 6. A 3 Month strangle which was selling at £140 (less than our cut-off level of £150), is now selling at £280. These are the best premium levels we have seen since February 2016.

Our research shows that building up exposure systematically (over several months) after a volatility event is the optimum approach as too fast an increase in exposure runs the risk of being left stranded by a further sharp drop in the market. We recommend steadily increasing exposure per our OPS strategy.³

Figure 5: Oxeye UK equities Premium Vs Implied Volatility

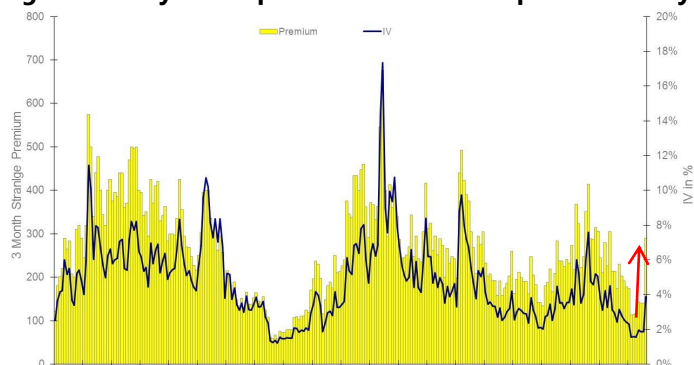


Figure 6: Option Premiums

	Date	Strangles	IV on Expiry	Premium	Breakeven Bands
Current	May-18	7300/6900	15.00%	280	13.50%
High	Oct-08	3850/4250	52%	610	40.00%
Low	Apr-05	4525/4925	9%	57	10.88%
Average	N/A	5150/5550	18%	227	13.78%

“Buy When There Is Blood On The Street”

The famous quote by Rothschild in the panic that followed the Battle of Waterloo reminds us of the blood bath recently seen in short volatility ETFs & ETNs such as XIV, where retail investors who thought they were investing in a ‘stock’ effectively profiting from low volatility were wiped out over night. Credit Suisse inverse VIX fund lost 93% of its 2bn managed, just one example of the losses incurred.

This shows that careful management of inherent risk in short volatility is essential. When IV falls below a cut off level we reduce exposure accordingly. This has helped us avoid losses in the last few days.

Our experience shows that the time to sell volatility and write option premium is after a big move in the market. Hence our recommendation to recommence trading, per our 20 Year note.³

¹Please see *The Long Volatility Strategy—December 2017*: <https://static1.squarespace.com/static/59e1d4d59f8dce639786d4b8/t/5a3401e4ec212d3032dd8a5f/1513357804299/The+Long+Volatility+Opportunity+December+2017.pdf>

²Please see *Low IV: Why Oxeye Strategies Have A Light Exposure* <https://static1.squarespace.com/static/59e1d4d59f8dce639786d4b8/t/59f0cefd2aeba54873f4ab39/1511438346691/Light+Exposure+July+2017.pdf>

³Please see *Twenty Years of the Oxeye Option Premium Strategy* <https://static1.squarespace.com/static/59e1d4d59f8dce639786d4b8/t/5a7d83e0e2c4835168fb9c32/1518175208676/20+Years+of+OPS+Note+Jan+18.pdf>

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