

Volatility Strategy— Long Mini-NDX (MNXSM) Straddle

Situation

Assume that it is June and that in recent weeks the CBOE's two Volatility Indexes had their lowest daily closing prices in eight months, with the CBOE Nasdaq Volatility Index (VXNSM) declining to 52.5, and the CBOE Volatility Index (VIXSM) falling to 22.9.

Outlook

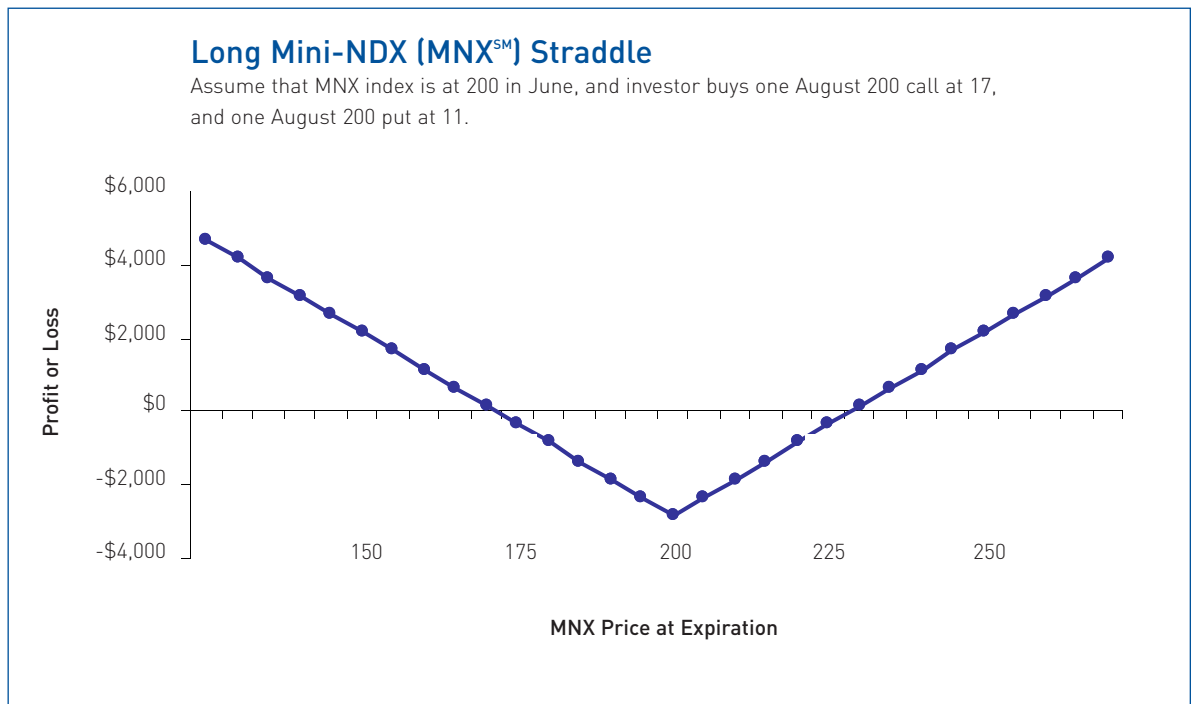
The investor believes the volatility of the Nasdaq-100[®] (NDX) Index will increase over the next eight weeks, but is unsure of direction. Investor might want to take a position that may profit if the Nasdaq-100[®] (NDX) Index moves significantly up or down.

Possible Strategy

Long Straddle on Mini-NDX (MNXSM) options. Buy 1 MNX August 200 call at 17 and Buy 1 MNX August 200 put at 11. (Net debit of 28 or \$2,800.)

More Discussion

After considering the recent trends of VXN and VIX, and recent comments by the Chairman of the Federal Reserve, let's assume that the investor believed the market was poised for a major move in the two months but was unsure of the market's direction. One strategy that the investor might consider is a long straddle on index options—a long straddle involves holding both a long call and a long put position with the same strike price and time to expiration. Below is an approximate profit-and-loss diagram for a long straddle on the Mini-NDX (MNXSM) options, which have a price based on 1/10 the value of the Nasdaq-100[®] (NDX) Index. In this example the investor could pay a total of \$2800 in premiums (\$1700 for an MNX call and \$1100 for an MNX put)—this entire \$2800 would be at risk to the investor unless the market made a significant move prior to expiration.





(DJX) Dow Jones Industrials
(QQQ) Nasdaq-100 Shares
(OEF) iShares S&P 100
(VXN) CBOE Nasdaq Volatility Index
(VIX) CBOE Volatility Index

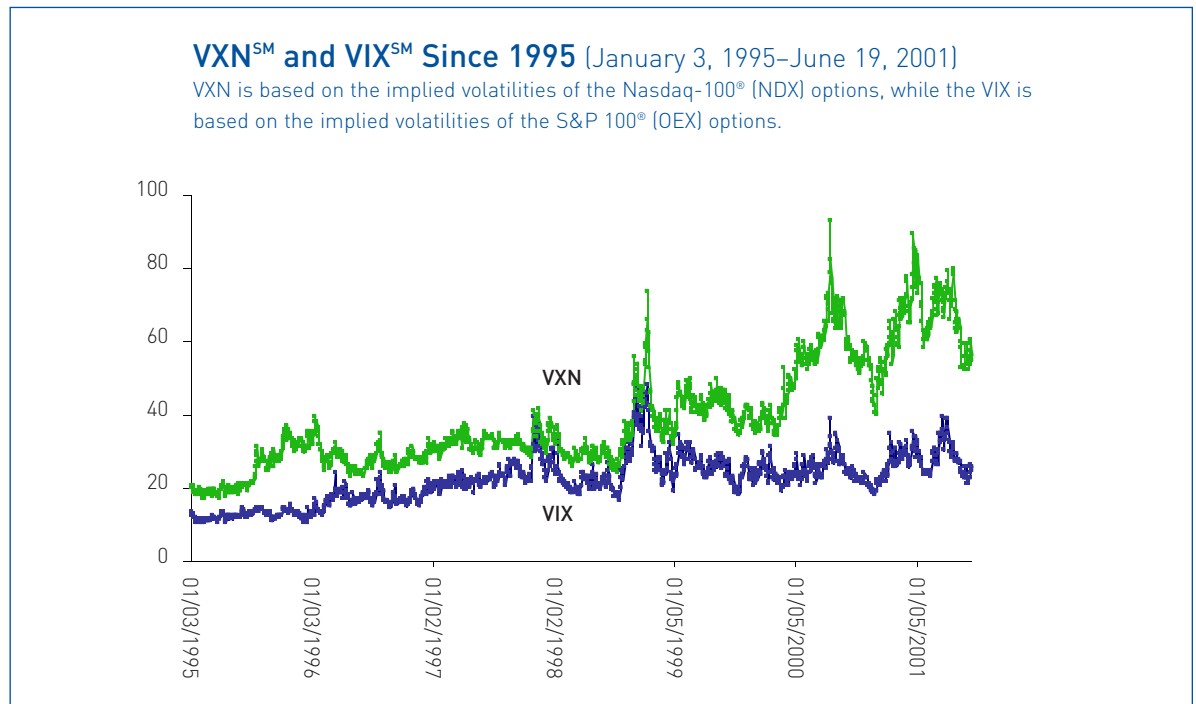
(SPX) S&P 500
(OEX) S&P 100
(RUT) Russell 2000
(NDX) Nasdaq-100
(MNX) Mini-NDX

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Volatility Indexes

VXN and VIX are called “investor fear gauges” because the indexes reflect the implied volatility of Nasdaq-100® (NDX) and S&P 100® (OEX) options—the indexes reflect the consensus view of investors about expected future stock market volatility. Below is a chart of VXN and VIX prices from 1995 through June 19, 2001.





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Is There a Seasonality Phenomenon for Volatility Indexes?

Another factor that one might take into account when trying to anticipate whether or not there might be a major move in stock market prices is any possible seasonality phenomenon for the volatility indexes. One might note in the chart below, for example, that the average price for VXN in the fourth quarters (October–December) from 1995 to 2000 is 41.3, more than six percentage points higher than the 35.1 average for June through August in 1995–2000.

Monthly and Yearly Averages —VIX and VXN 1995-2000

| CBOE Volatility Index (VIX) (based on implied volatility of S&P® 100 (OEX) options) | | | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|---------|
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | Average |
| Jan | 11.3 | 14.2 | 21.0 | 24.4 | 28.6 | 25.1 | 20.8 |
| Feb | 11.2 | 16.2 | 21.6 | 20.4 | 29.9 | 25.5 | 20.8 |
| Mar | 12.0 | 19.1 | 22.3 | 20.5 | 26.5 | 24.8 | 20.9 |
| Apr | 12.5 | 17.5 | 21.5 | 22.5 | 24.7 | 29.8 | 21.4 |
| May | 12.5 | 17.0 | 21.9 | 21.4 | 27.4 | 29.4 | 21.6 |
| Jun | 13.2 | 17.7 | 22.7 | 22.1 | 24.1 | 24.3 | 20.7 |
| Jul | 14.1 | 19.3 | 23.2 | 20.3 | 21.5 | 22.7 | 20.2 |
| Aug | 13.3 | 16.5 | 25.1 | 31.5 | 23.2 | 20.5 | 21.7 |
| Sep | 13.0 | 17.3 | 25.6 | 39.2 | 25.6 | 22.3 | 23.8 |
| Oct | 14.2 | 17.4 | 25.6 | 37.5 | 25.4 | 28.2 | 24.7 |
| Nov | 13.0 | 17.2 | 31.5 | 25.0 | 22.2 | 29.2 | 23.0 |
| Dec | 12.3 | 20.3 | 26.5 | 25.5 | 23.2 | 30.1 | 23.0 |
| Average | 12.7 | 17.5 | 24.1 | 25.9 | 25.2 | 26.0 | |

| CBOE Nasdaq Volatility Index (VXN) (based on the Nasdaq-100® (NDX) options) | | | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|---------|
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | Average |
| Jan | 19.2 | 34.0 | 30.8 | 32.2 | 43.3 | 56.7 | 36.0 |
| Feb | 18.8 | 27.3 | 32.9 | 28.2 | 45.7 | 55.8 | 34.8 |
| Mar | 19.0 | 30.0 | 33.7 | 29.0 | 42.4 | 59.3 | 35.6 |
| Apr | 19.8 | 26.5 | 34.0 | 30.1 | 42.9 | 73.3 | 37.8 |
| May | 19.7 | 24.8 | 31.1 | 28.9 | 45.5 | 68.4 | 36.4 |
| Jun | 21.1 | 26.5 | 34.2 | 29.2 | 42.3 | 58.2 | 35.2 |
| Jul | 25.7 | 30.0 | 32.8 | 28.1 | 37.0 | 54.8 | 34.7 |
| Aug | 27.6 | 26.0 | 32.4 | 37.5 | 38.6 | 50.4 | 35.4 |
| Sep | 23.9 | 26.4 | 32.6 | 47.0 | 38.3 | 50.5 | 36.5 |
| Oct | 34.4 | 28.5 | 32.1 | 51.6 | 38.8 | 60.7 | 41.0 |
| Nov | 32.3 | 27.8 | 36.1 | 36.5 | 40.1 | 67.7 | 40.1 |
| Dec | 32.7 | 30.2 | 34.7 | 36.3 | 47.6 | 75.2 | 42.8 |
| Average | 24.5 | 28.2 | 33.1 | 34.5 | 41.9 | 60.9 | |



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(SPX) S&P 500
(OEX) S&P 100
(RUT) Russell 2000
(NDX) Nasdaq-100
(MNK) Mini-NDX

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