CBOE presentation – September 2016

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A good time to be long protection?

S&P 500 3-month at the money implied vol
(last 10 years until end of august)

Series	Last	Min	Max	Avg	Z-Score	%-ile
SPX 3m ATMF Implied Vol	12.65	9.92	63.81	19.15	-0.83	14.36

- S&P 500 3m implied volatility at 13.6 vol on August 30th
- 15th percentile over past 10 years!

Source: Morgan Stanley Iris

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S&P 500 vol is lower, not necessarily cheaper

S&P 500 3-month at the money implied vol vs. 2-month realized vol
(last 10 years until end of august)

Series	Last	Min	Max	Avg	Z-Score	%-ile
SPX 3m ATMF Implied Vol	12.65	9.92	63.81	19.15	-0.83	14.36
SPX 2m Realized Vol	6.44	6.44	78.87	17.29	-0.97	0.00

- 2 months realized vol at 6.5 – 6 vols below implied!
- Over 10-year period, implied 2 vol premium to realized
- How to be long vol while minimizing this cost of carry?

Source: Morgan Stanley Iris

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Structural inefficiencies create opportunities in vol products

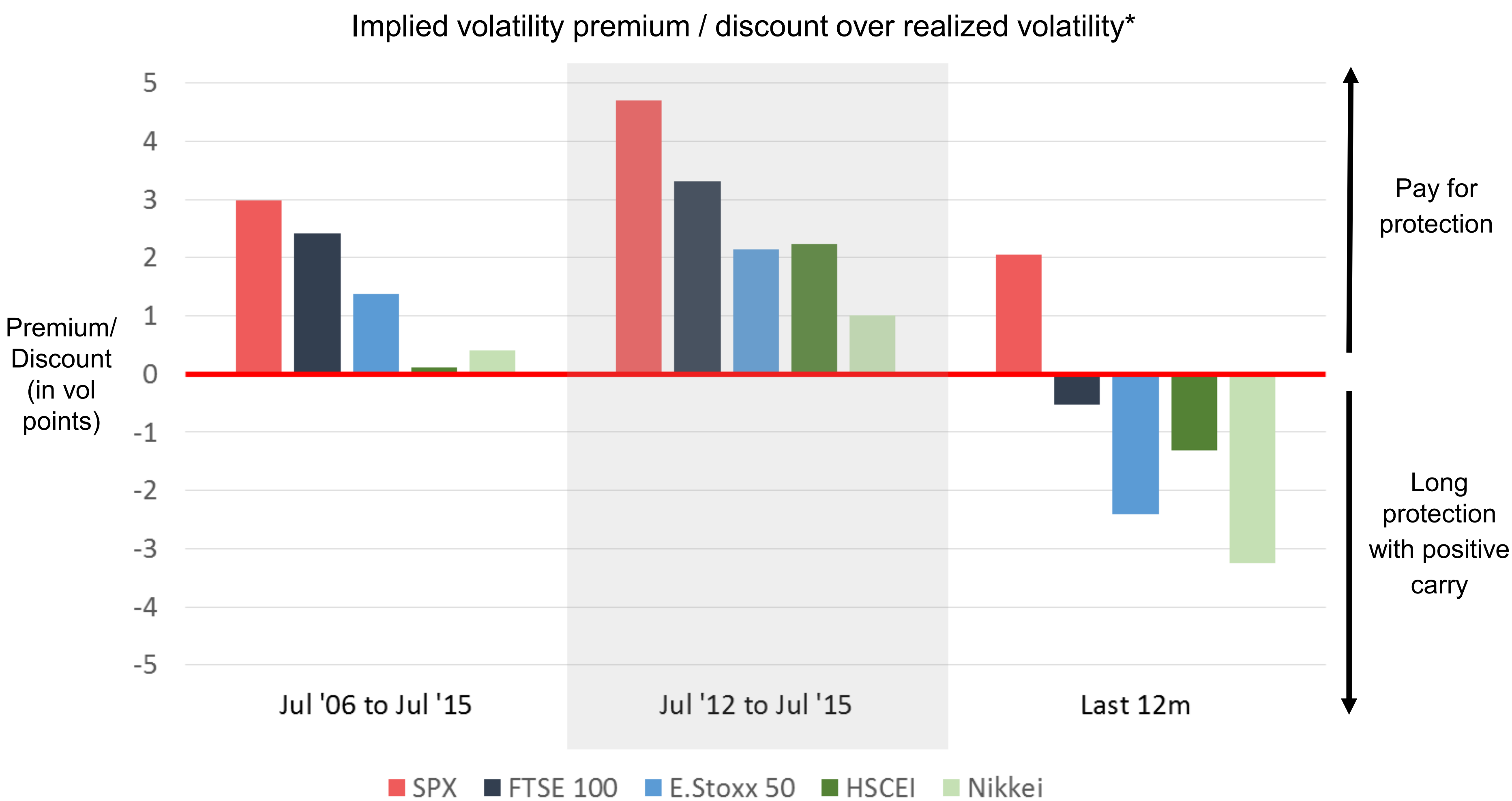
Supply ↑ Low yield environment creating large demand for yield enhancement through structured products

Demand ↓ Regulations limitting ability of banks to take on inventory of derivative risk

Creating imbalances in supply and demand of volatility cheapening vols

BUT these effects differ massively across various regions and indices

Long vol can be a positive carry strategy

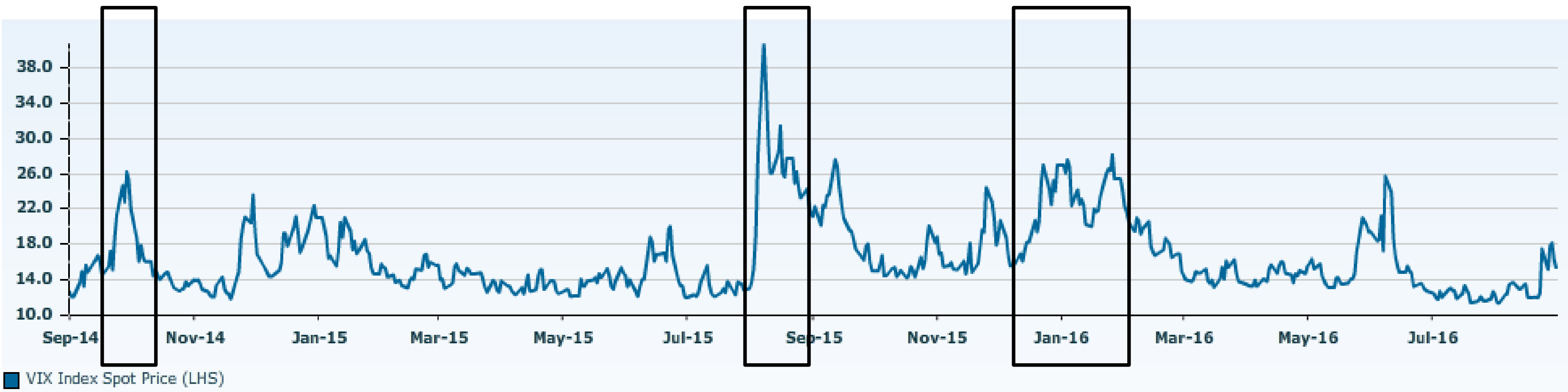


- Capture of this realized volatility through variance and vanilla structures hedged daily
- Intensive position management required

* Average over the period of difference between 9m implied vol and 3m realized vol
Source: Morgan Stanley IRIS

What about VIX? Efficiency as a hedge in sell-offs has varied

VIX index since Jan 2015



Series	Last	Min	Max	Avg	Z-Score	%-ile
VIX Index Spot Price	15.37	11.34	40.74	16.53	-0.28	53.35

	Oct '14	Aug '15	Jan-Feb '16
▪ SPX peak to trough	-5.5%	-11.3%	-10.5%
▪ SPX 1m vol move	+ 8.3	+ 19.5	+ 11
▪ **VIX move**	**+ 11**	**+ 28**	**+ 11.4**

Source: Bloomberg

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What VIX strategy to pick? Long VIX future

Structure

- Long front-month VIX future

Cost of carry (nothing happens)

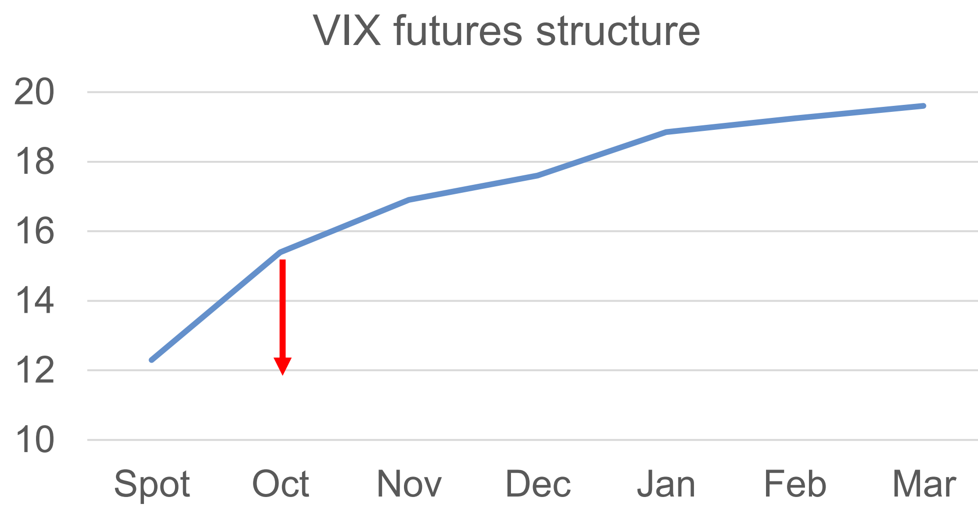
- VIX roll down
- 5y avg 1.5 vol points per month!
- today 3 vol points

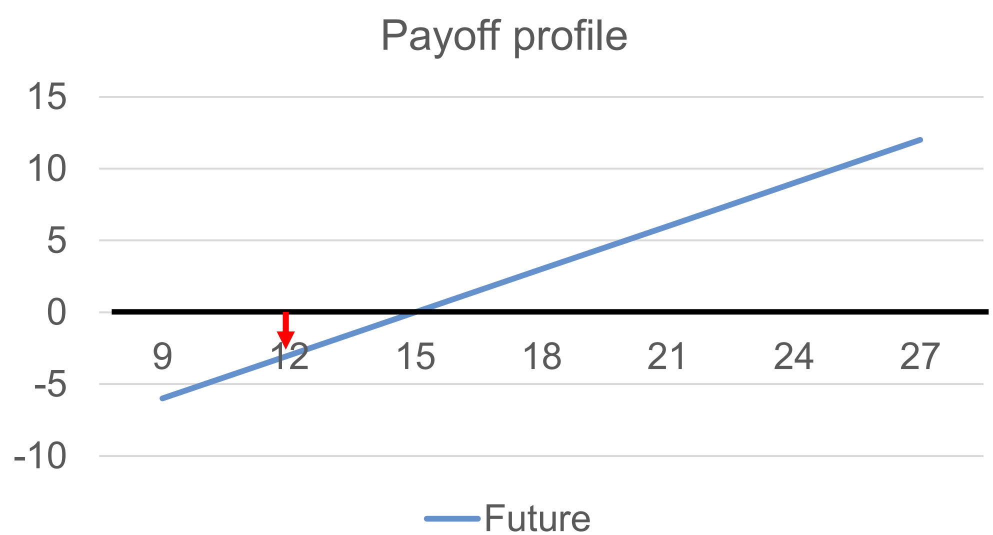
Payout profile

- Linear with VIX

When to use

- When vol of vol is high or curve is flattish
- Use for easiest implementation





Source: Bloomberg

What VIX strategy to pick? Long VIX call

Structure

- Long ATM 1 month VIX call

Cost of carry (nothing happens)

- Option premium
- 5y avg: 1.6 vol points
- today: 1.3 vol points

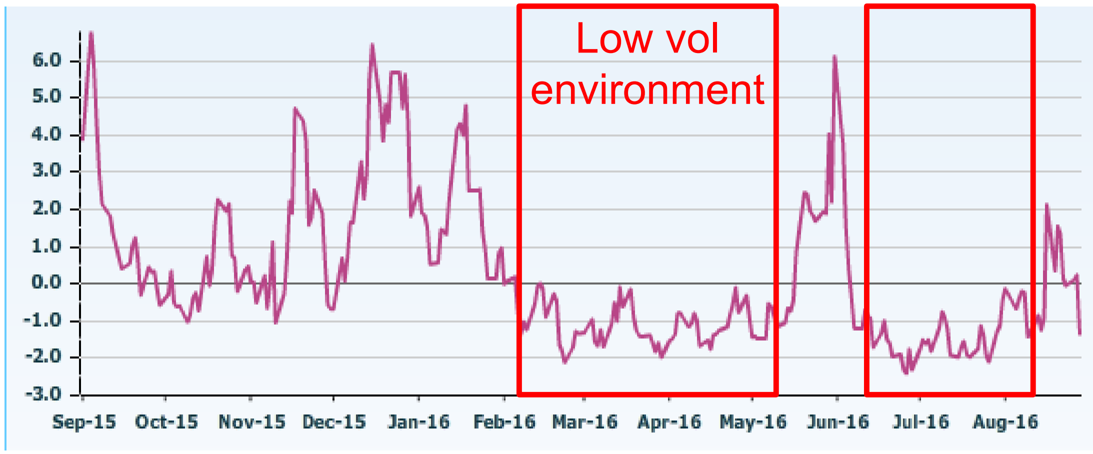
Payout profile

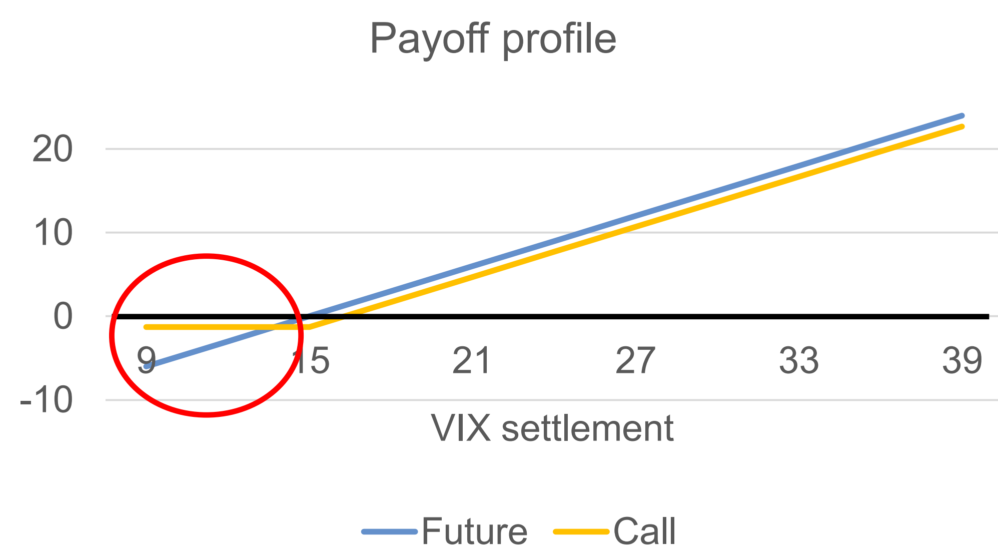
- Linear with VIX

When to use

- When vol of vol is low – usually the case when VIX is low
- Compare call premium to future roll down

Price of 1m atm call – 1m future roll down





Source: Morgan Stanley IRIS

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What VIX strategy to pick? Short put vs. long call spread

Structure

- Short 1m 15 delta put (here 13)
- Long 1m 40 delta call (here 17)
- Short 1m 15 delta call (here 23)

Cost of carry (nothing happens)

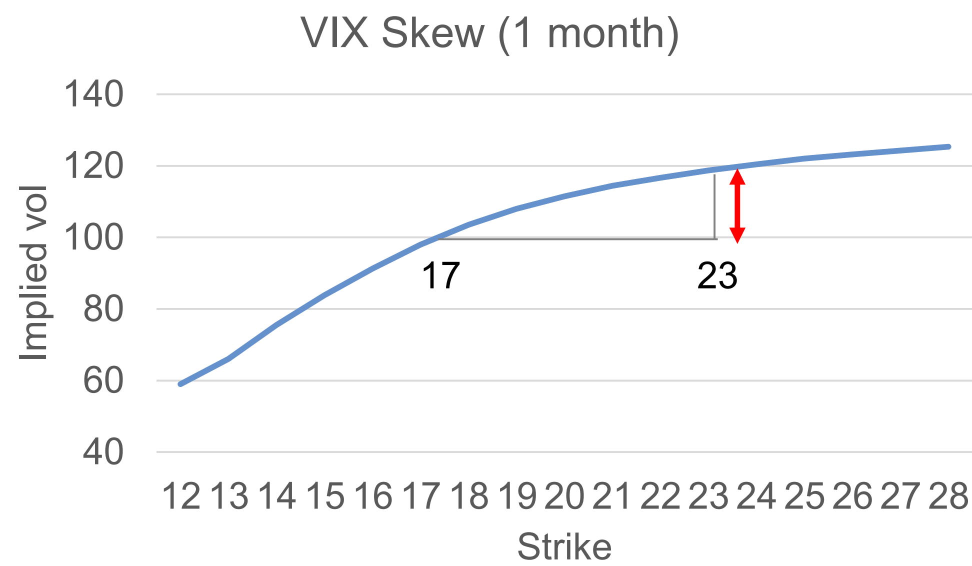
- Premium + VIX roll down effect on the put
- Premium worth 40c
- VIX roll down effect on the put: 1$

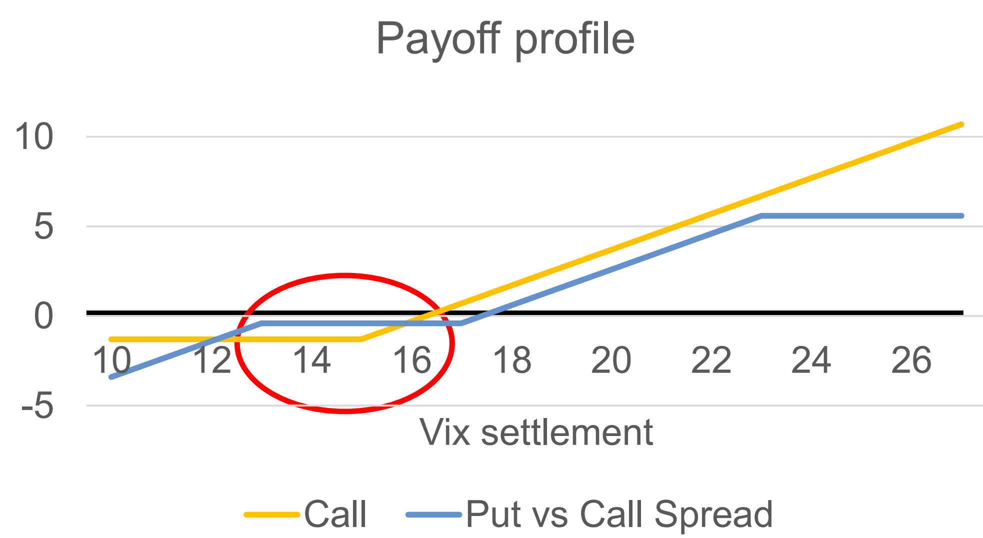
Payout profile

- Protection between 17 and 23

When / How to use

- Best when vol is very low (selling 12 put) and skew on VIX is steep
- Buy back put if near zero





Source: Bloomberg

What VIX strategy to pick? Short call ratios

Structure

- Short 1x 1m 40d Call (here 17)
- Long 2.5x 1m 15d Call (here 22)

Cost of carry (nothing happens)

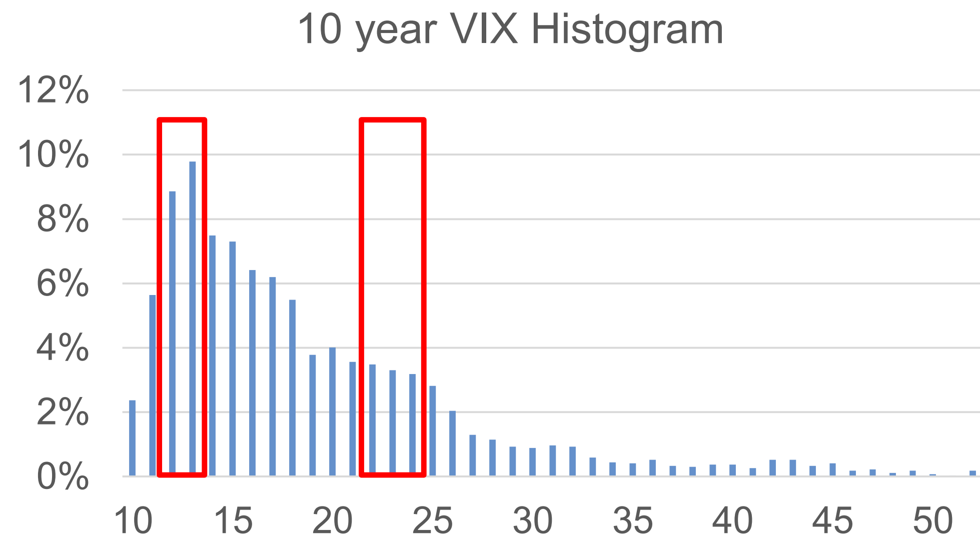
- You lose only premium
- cost 16-26c on average last 12m, now at 18c

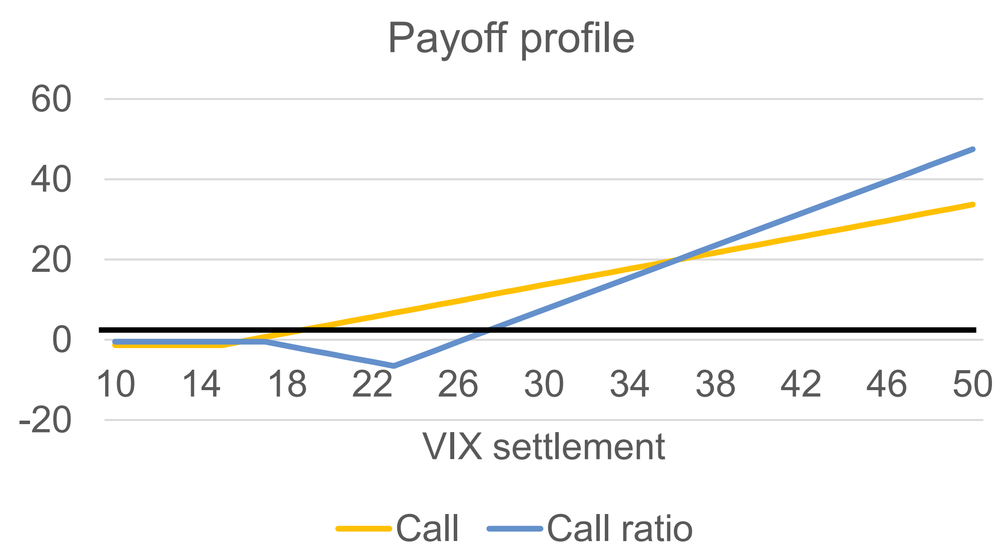
Payout profile

- Protection if vol explodes
- Path dependency with risk zone between 17 and 25

When / How to use

- Use for highly convex exposure – hedging for tail event
- Best profile when VIX upside skew is low
- Complex management





Source: Bloomberg

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Recapping a few hedging strategies mentioned today

	Short Delta	Long Vol	Long Convexity
	Make money as market moves down	Make money as volatility ticks up	Make money on severe down moves – explosive returns on crash
1 Long Put	✖	✖	
2 Long Put spread	✖		
3 Long hedged straddle		✖	
4 Long VIX calls		✖	
5 Short VIX call ratios			✖
6 Long Var vs. Vanilla			✖

Complexity of these hedges differ widely

Strategy	Overall Complexity	Structuring		Management		
		Product	Strike/ mat	Hedging	Rebal	Liquidity*
Put	**V. Low**	V. Low	V. Low	V. Low	V. Low	V. Low
Put spreads	**V. Low**	V. Low	Low	V. Low	V. Low	V. Low
Hedged straddle	**Medium**	Low	Low	High	Medium	V. Low
Vix futures/ calls	**Low**	V. Low	Low	V. Low	Low	V. Low
VIX call ratios	**Medium**	Medium	Medium	Low	High	V. Low
Variance vs vanilla	**High**	High	High	V. High	V. High	Medium
Best of puts	**High**	High	High	Low	High	V. High

- Structuring and management of the trades require various level of monitoring and systems to manage
- Liquidity can be an issue on more complex structures

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* Reversed scale. Low means low liquidity constraints

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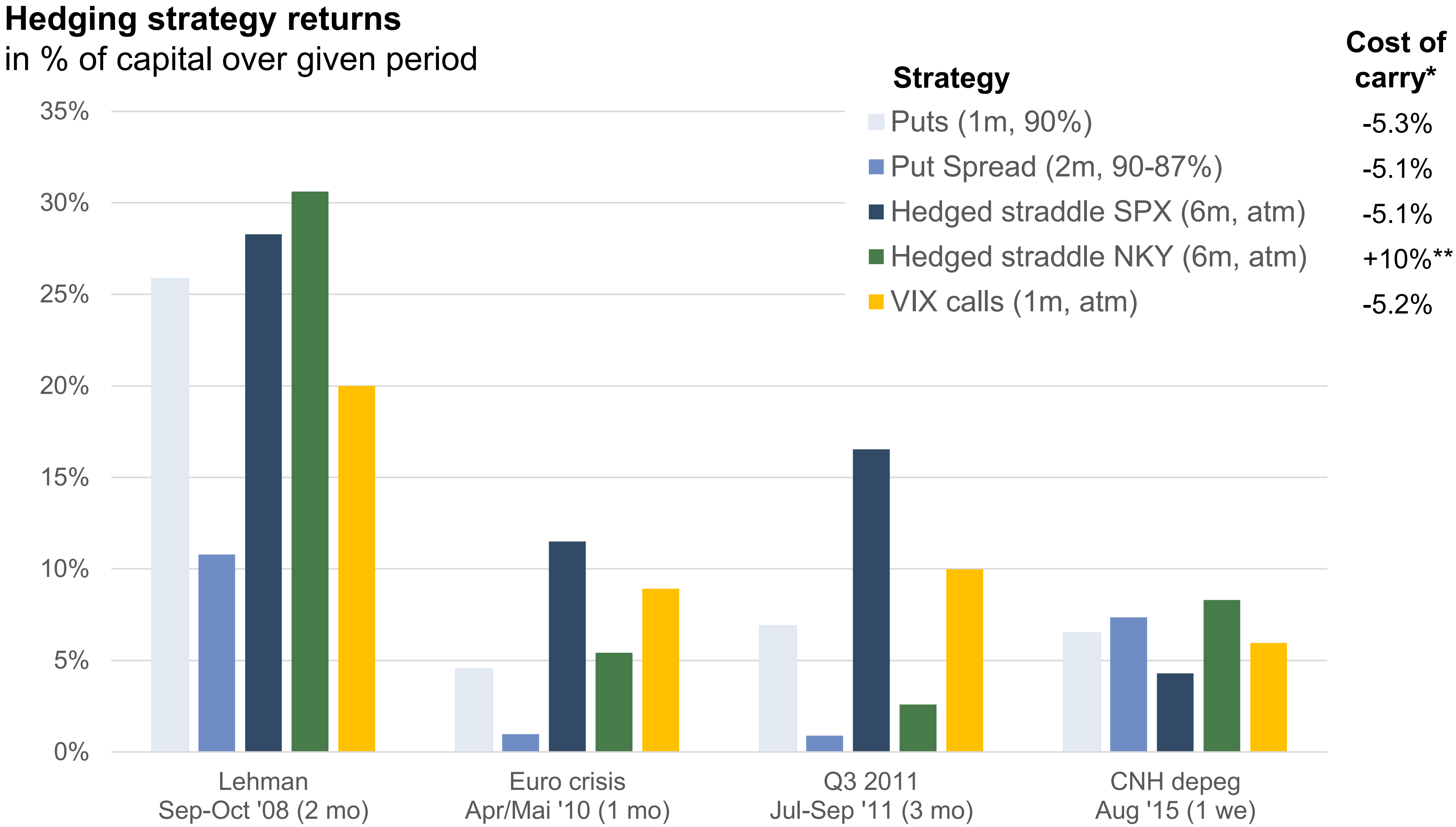
How do they perform?



SPX move	-24.5%	-10.5%	-15.5%	-11.2%
VIX move	+39.2	+28. 5	+27.1	+23.0

* Strategies sized to cost 5% of capital per year during 2013-14 period
** NKY straddles sized as SPX. Cost of carry measures in 2014 only would have been -1%

Source: Morgan Stanley IRIS, Argentière Capital analysis

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