July 2012 Newsletter

2013 Event Details

Date. TBD

Details. A one day summit to educate investors on the universe of volatility funds and tail hedging managers and discuss the market environment.

Please continue to check the website for updates on the 2013 Global Volatility Summit
www.globalvolatilitysummit.com

2012 Event Recap

Keynote speakers. General Stanley McChrystal gave an insightful presentation on volatility in the Middle East, and The Honorable Rahm Emanuel (Mayor of Chicago) was interviewed by Charlie Rose and discussed the current volatility seen in politics.

Managers. The following managers participated at the event:

36 South Capital Advisors
Acorn Derivatives Management Corp.
Alphabet Management
Amundi Asset Management
ArrowGrass Capital Partners
BlueMountain Capital
Capstone Investment Advisors
Fortress Investment Group
III Associates
Ionic Capital Management
JD Capital Management
Man Group
Parallax Fund
Pine River Capital Management
Vulpes Investment Management

Questions? Please contact
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The Global Volatility Summit remains dedicated to educating investors on the space and providing you with thoughtful and timely updates from Volatility and Tail Hedging managers. Summer is heating up and in June the markets followed suit. On the whole, June was a strong month for trading strategies. Uncertainties surrounding the global policy environment caused significant market moves, which created opportunities in the volatility space. This could continue to be a driver of volatility in the market throughout the summer. We are working towards setting a date for the Fourth Annual Global Volatility Summit in March 2013; please continue to check the website for additional newsletters and further details on the event.

We asked *Dean Curnutt*, CEO of Macro Risk Advisors to share his thoughts on the volatility market in 2012.

Cheers,
Global Volatility Summit

Equity Volatility … Micro, Macro, Systemic and Now Political

The causes of market uncertainty and volatility are complex and always evolving. Common causes of equity volatility, such as an earnings surprise, remain important. Yet, the onset of the 2008 credit crisis has exposed and created cracks in the financial system's plumbing that lead to new sources of broader, more macro volatility. Today's investors must grapple with the reality that the financial system is itself now an important part of the market risk dynamic. Adding complexity to the risks embodied in this more fragile financial architecture, are financial policymakers who can create substantial bursts of volatility when choosing to intervene in markets. In the paragraphs that follow, we explore these concepts and provide a roadmap to help investors understand modern day volatility.

On the most basic level, an earnings announcement is a source of volatility in a single stock. When a company make it results public, its share price may move sharply higher or lower. Of course, idiosyncratic risk is not limited to earnings. Stock prices may rise or fall for a myriad of reasons including a change in company leadership, a new product cycle, a competitor's announcement, a patent expiration, a litigation outcome, an accounting change, a spin-off or a debt or equity issuance. These company specific factors have been and will continue to underpin changes in stock prices.

More broadly, stock prices fluctuate as investors process information on not just individual companies, but on business conditions and the macro economy. Unforeseen events such as a natural disaster, an act of war, or a substantial change to the price of oil have all proven to have wide scale impact on equity prices and be sources of volatility. The constant stream of economic data reports, too, provides an updated reading on the pace of overall business activity that may create volatility in stock prices. Lastly, changes in Central Bank policy, especially if not properly anticipated by investors, can drive stock prices higher or lower.

All of this is not new. Investors have always needed to determine the implications of idiosyncratic and broader risk factors on share prices. In a post credit crash world, however, investors must also understand systemic risk, which has become a critical driver of global market volatility. Systemic risk results from the degree to which large financial intermediaries are exposed to one another in the process of credit creation, borrowing, and lending. As the financial system seeks to regain stability post 2008, the inter-dependencies of banks (and now sovereigns) leave the counterparty network vulnerable to the potential that the failure of one intermediary is transmitted in contagion-like fashion to the system at large. The occurrence of a financial "accident" (Lehman, Greece) can set in motion a rush to unwind risk exposures that can lead to extreme levels of market volatility. In the worst-case scenario, the deleveraging assumes a self-reinforcing quality, causing a market crash.

Fears of this domino effect have inspired policy intervention on a scale never seen before in modern day finance. In 2008, the US Treasury, FDIC and Federal Reserve launched a series of initiatives aimed at backstopping the financial system. Today, Europe is plagued by an unfortunate intertwinement of exposure between banks and sovereigns. In Spain, for example, the yields on sovereign bonds recently widened dramatically as the country appeared to take on debt to shoulder the burden of recapitalizing its banks ailing from a property crash. Knowing that contagion can be quickly transmitted through multiple channels, investors are fearful of committing risk capital to weaker areas of the Eurozone. At the same time, policymakers are tasked with the challenge of delivering near term palliatives that reduce financing spreads for peripheral countries and reverse the capital flight from peripheral banks. This fragile backdrop and the high level of ongoing policy intervention in markets is one that many investors have deemed untradeable. When policymakers become the most significant determinants of market outcomes, investors often stay home.

Where does this leave us with respect to understanding equity volatility? Company specific fundamentals still matter, but they are often overwhelmed by the systemic factors at work. Investors must now understand the complex fragility of the counterparty network where a failure of one intermediary can have far reaching implications for the entire system. In addition, the interaction between governments and the markets has rarely been so important. The current low level of volume likely amounts to a waiting game among investors seeking clarity as to whether policymakers have both the political will and financial resources to sufficiently arrest the deflationary forces at work. If markets deem policy remedies insufficient to quell the high and rising spreads in peripheral Europe, risk assets will suffer. Conversely, the extent of intervention since the crisis began carries the risk that easy monetary policy and fiscal stimulus put forth will overshoot, resulting in the left tail of inflation. This wide range of outcomes lends importance to the use of derivatives as risk management tools.

Dean Curnutt is CEO of Macro Risk Advisors, a firm that advises institutional investors on global market risk.