GLOBAL VOLATILITY SUMMIT 2012

March 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 info@globalvolatilitysummit.com

The Third Annual Global Volatility Summit ("GVS") was a success. There were over 360 people in attendance, and we are looking forward to planning next year's event. We have asked industry experts to discuss their thoughts and opinions on the volatility universe. This past year we have seen an uptick in interest in various strategies available in the volatility space, namely in relative value and tail risk, and we are keen to ensure investors are kept abreast of the most recent developments in all relevant strategies. We believe there is a volatility strategy that can be a suitable component of every investor's portfolio. That said, a concerted effort from the volatility community is required to continue to educate investors so they are aware of the pitfalls and benefits of various strategies available to them.

We asked ***Alan Gerstein*** **from BlueMountain Capital Management to share his outlook for tail hedging in 2012.**

Cheers,
Global Volatility Summit

There were many "unpredictable" events in 2011, such as the Japanese earthquake, Arab Spring, U.S. debt ceiling standoff and downgrade, and (maybe the most predictable of the bunch) the European sovereign crisis. Not surprisingly, tail hedging was a frequent topic of conversation given these events and the ensuing gyrations in the market.

However, when volatility is high and options are expensive, investors need to be thoughtful about the tails they are trying to hedge and the costs of the protection they are buying. Otherwise, they risk paying too much or buying suboptimal positions that fail to protect their portfolio.

Take a static long volatility strategy as a simplistic example. Despite the series of global shocks and market turmoil in 2011, a long volatility position would have struggled. As demonstrated in the table below, an investor that bought one-year variance swaps in the major equity markets at the end of 2010 would have lost money on all of them. Just as going long volatility in 2011 would have been a losing trade, we believe that profiting from a directional volatility bias will continue to be difficult over time.

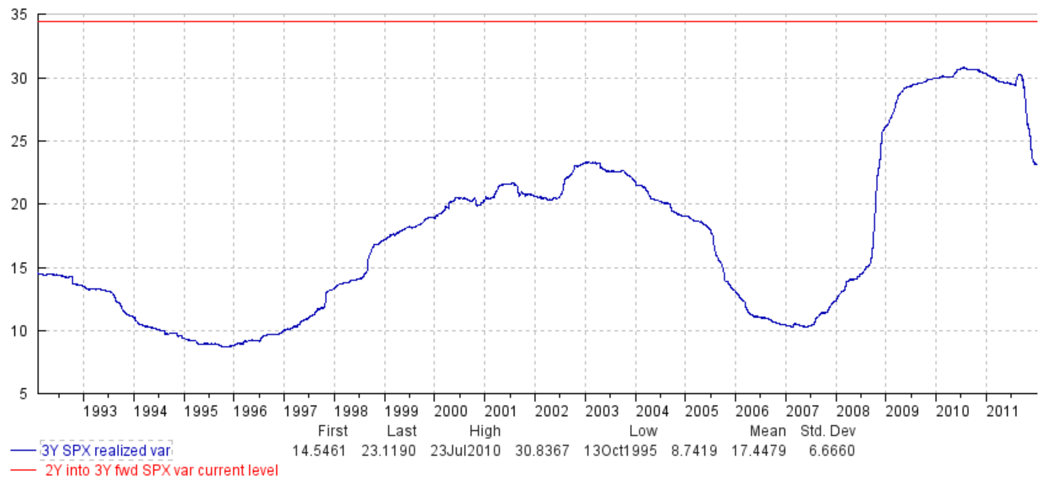
December 2010 Implied versus December 2011 Realized Volatility

	12/31/2010	12/30/2011	
Index	1-Year Implied Variance	1-Year Realized Variance	Difference
SPX	25.70%	23.30%	-2.40%
SX5E	29.50%	28.70%	-0.80%
NKY	27.30%	23.80%	-3.50%
HSI	27.30%	26.00%	-1.30%

Prospective tail hedgers often overpay for protection because the “tail” event that concerns most investors is often not an extreme event in the first place. At the start of the year, listed volatility levels implied that the market was pricing in a 2/3rd chance that the S&P 500 would end 2012 between 950 and 1550. Of course, that leaves a 1/3rd chance it finishes outside of that range, with over half of that probability weighted to the downside. Trying to hedge against an almost 20% chance of a 25% fall in the market is really not buying a “tail” hedge. Instead, it is hedging against something that, while not probable, is still quite possible.

Despite the growing demand for tail hedges, there is a lack of natural sellers of long-dated volatility. This is due to reduced bank risk taking and the limited number of option writers who are capitalized to sell longer dated options. Nevertheless, the demand side of the equation does not show signs of softening, with continued buying from insurance company and other hedgers. This ongoing demand for hedges, coupled with a lack of supply, has created mispricings in the market, making volatility trading more interesting. For example, there has been recent demand for forward starting volatility in the S&P 500, which has led to excessively high prices. The chart below shows the recent bid for 3-year variance swaps starting in two years, compared to 3-year realized volatility over the past 20 years. The position would have never lost money on a hold-to-maturity basis over that time period. But of course, too few investors live in a hold-to-maturity world anymore!

SPX Long-Dated Volatility



Sophisticated investors can capitalize on these mispricings in volatility through relative value trades across tenors, instruments, and regions. These investments require systems and expertise in both listed options and over the counter derivative products, which means there is less competition for trades in this space (relative value volatility investing) than in more traditional areas.

Going forward, as we continue to experience bouts of volatility in the market, investors will keep searching (unsuccessfully) for the “silver bullet” for hedging beta risk to the financial markets. While we do not believe there will be any incredibly cheap hedges, we do believe that those who seek them will perpetuate supply/demand imbalances in volatility and continue creating exceptional relative value opportunities.