



GLOBAL VOLATILITY SUMMIT 2012

February 2012 Newsletter

Event Details

Date. March 6, 2012

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

Location. Skylight Studio in Soho in New York City.

Event Update

Keynote speakers. We are excited to report that General Stanley McChrystal and The Honorable Rahm Emanuel (Mayor of Chicago) will be speaking at the event.

Managers. The following managers will be speaking at the event.

36 South Capital Advisors
Acorn Derivatives Management Corp.
Alphabet Management
Amundi Asset Management
ArrowGrass Capital Partners
Blue Mountain 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

Registration. Space is limited, please visit the website to sign up as soon as possible.

Agenda and speakers. Please continue to check the website for event details and tentative agenda.

Questions? Please contact
info@globalvolatilitysummit.com

The goal of the Global Volatility Summit ("GVS") is to educate investors about investing in volatility. With the approach of the third annual GVS, we felt it was appropriate to launch a newsletter continuing this mission. Leading up to GVS, 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 *Sandy Rattray and Campbell R. Harvey* from Man Group to share their outlook for tail hedging in 2012.

Cheers,
Global Volatility Summit

Tail risk hedging, anyone?

At the beginning of last summer, a number of high profile voices were warning against hedging tail risks. Some argued that these strategies only benefit the sellers. Long-term institutional investors were advised to avoid purchasing tail protection. One widely quoted investment manager asserted last June that tail protection is an "investment fad du jour".

What a difference a few months makes.

The period since 2008 has been marked by unusually frequent episodes of market instability. Many investors are not well positioned to handle these negative surprises. They can make decisions during these periods that they subsequently regret. And doing nothing about the tail risks in a portfolio is a decision in itself.

Why hedge? We believe investors' collective ability to forecast large negative events has been very limited, with policymakers and regulators doing no better. After each event, there are inevitably a small number of winners - but they appear to be different each time. Notably, some winners of the 2008 crisis appear to have had a very poor 2011.

Since January 2009, the S&P 500 has experienced four months of worse than -6.8% returns (a two standard deviation event using long run volatility); many risk models would suggest only about one should take place over that period.

In our view, relying on an ability to forecast tail events is highly risky. But the need to have a strategy to address tail events has risen. Holding large investments in cash rather than risk assets has worked well in flat or falling markets, but it can become very costly in rising markets.



The detractors are correct to point out that excessive costs are likely to be the downfall of hedging strategies. They are wrong to choose possibly the worst example of uncontrolled costs (the VXX ETF) and presume that all other strategies are equally poor.

We have found that the more directly connected an investor is to the long term consequences of their investment (in other words, a foundation, endowment or family office), the more likely they are to hedge.

Other investor types (for example insurance companies and pension funds) often argue that performance is measured in the long run, and so short run hedging is not useful to them. However, even long-term investors face short term pressures such as deciding whether to rebalance to target weights or adjusting total portfolio risk.

During 2008, many of these long-run investors became short-run investors, but without the necessary preparation. They suspended rebalancing programmes, sold risk assets and tried to exit illiquid positions in periods of severe market distress. The assertion that long run investors are immune to the short term is clearly contradicted by observing their behavior.

The left tail of returns has stung many asset classes and investment strategies. Investors do need to have a strategy to deal with this, and there are many choices available. It can be done internally or externally, using options or through controlling asset allocation. However, we believe that relying on forecasting skill to determine when the next bad market event will take place has been, and remains, an extremely unreliable way of protecting against these events.

Campbell R. Harvey is Professor of Finance at Duke University and Investment Strategy Advisor to Man Investments in London.

Sandy Ratray is CIO of Man Systematic Strategies in London.

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