GLOBAL VOLATILITY SUMMIT 2012

June 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

On the heels of the Third Annual Global Volatility Summit in March, the most well attended event thus far, we look forward to continuing our correspondence throughout the summer months. We remain dedicated to educating investors on the space and providing you with thoughtful and timely updates from Volatility and Tail Hedging managers. In 2012, we have seen high levels of uncertainty across the global markets, fueled by political and economic fears, and we have seen the VIX fluctuate between 25 and 14 this year as a result. Volatility and Tail Hedging strategies are incredibly topical at the moment because of the violent swings in the market and the elevated levels of "volatility of volatility". Please continue to check the website for additional newsletters and further details on the 2013 Global Volatility Summit.

We asked ***Josh Thimons*****, Portfolio Manager of PIMCO's Multi-Asset Volatility Fund to share his thoughts on the volatility market in 2012.**

Cheers,
Global Volatility Summit

The Intersection of Monetary Policy and Volatility Markets

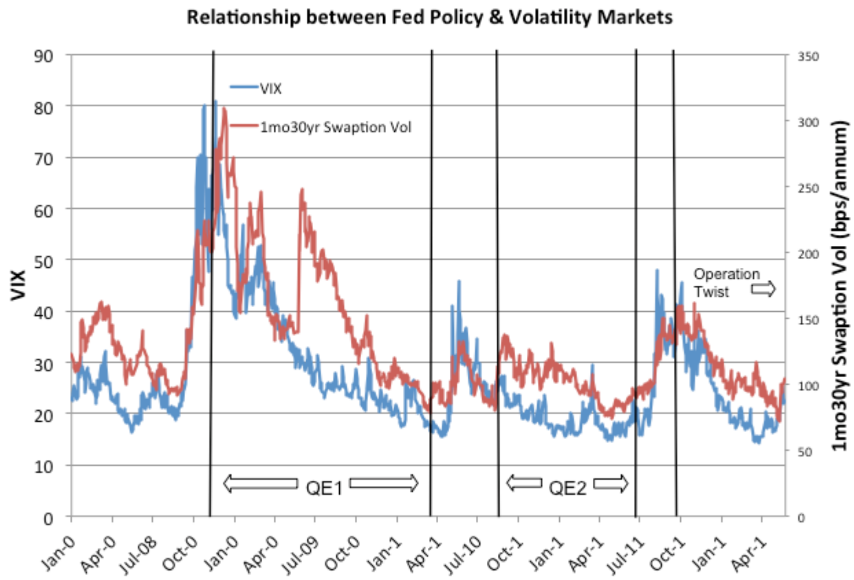
By Josh Thimons

In the press conference following the most recent Federal Open Market Committee meeting, Chairman Ben Bernanke was asked how he would assess the success of recent communication changes. Chairman Bernanke replied, "I think we're making progress." He cited one financial market as evidence of that progress, and that market may come as a surprise to most Fed watchers. Chairman Bernanke's evidence of success was "less volatility in interest rates related to greater certainty about what the Fed is likely to do." The Fed has had a great deal of success influencing many financial markets – admittedly a second best objective in lieu of success in influencing actual economic growth and employment outcomes. Nonetheless, equity valuations, real interest rates, break-even inflation expectations, the dollar, secondary mortgage rates and LIBOR/Fed Funds spreads have all responded quite favorably to Fed policy changes in recent years. While each of those market's relationships to Fed policy has been well documented, the relationship of volatility markets to Fed policy is little studied but ripe for analysis.

The volatility trader is not often considered to be the one on the trading floor with the policy insight – the Fed watcher, the fiscal policy expert, the ECB prognosticator. That's the purview of the currency trader or the Treasury trader or the global macro expert. The volatility trader wears a propeller hat, not a cowboy hat, and talks about things like "kurtosis" and "covariance" and "path dependence" – the kind of things that make one largely unapproachable at a cocktail party. The volatility trader needn't bother with policy, as numbers, not words, are the key to profitability.

Until now.

The intersection of policy and volatility markets has always been an underexplored opportunity set, but never more so than in the current environment. The chart below demonstrates the relationship between recent Fed policy measures and the volatility markets.



Source: PIMCO

During periods of Fed balance sheet expansion, both interest rate and equity implied volatility experienced significant declines. And during periods of Fed inactivity, volatility in both markets increased drastically. One may suggest that the relationship between Fed policy and volatility markets is an indirect and secondary relationship.

That is misguided. The Fed is directly targeting interest rate volatility markets, as evidenced by Chairman Bernanke's quote. When the Fed exhausted the power of its traditional monetary policy tools by lowering Federal Funds to the zero bound, it turned to increasingly creative and innovative policy measures. These have included outright balance sheet expansion and new communication approaches. Paramount to the new communication measures is a desire by the Fed to reduce term premium in interest rate markets, risk premium in asset markets, and the general level of uncertainty regarding future Fed policy action.

In other words, the Fed is attempting to engineer lower volatility. By assuring market participants that the Federal Funds rate will be extraordinary low for an extended period of time, interest rate volatility is suppressed, and risk-taking is promoted, because investors are less concerned with an unexpected change in Fed policy to hike interest rates. By assuring market participants that any meaningful deterioration in the economic outlook will be met with additional Fed balance sheet expansions, equity market volatility is suppressed, and risk-taking on behalf of investors is promoted as the "left tail" is truncated.

The opportunities presented by the intersection of monetary policy and volatility markets are often compelling, because most options market participants are not looking at the world through a policy lens. These opportunities are perhaps most compelling in interest rate volatility because the distribution of future outcomes is truncated by a zero bound to the left and a steadfast Federal Reserve to the right. Policy also creates cross-asset volatility opportunities. While broad markets are all influenced by the same macroeconomic factors and Fed policy responses, often short-term price action in response to changing policy expectations is disparate across markets, creating relative value opportunities to act on. Finally, while the tried and tested "Don't Fight the Fed" mantra clearly argues for a short volatility position in both equities and fixed income, the common-sense "Don't Trust that the Fed's Extraordinary Policy Experiments Will End Smoothly" mantra creates interesting long volatility positions to prepare portfolios in the event that the Fed loses its tenuous control over markets.

In the current environment, we should consider telling the volatility trader to turn in his propeller hat and grab the Fed binoculars, because it is policy more than any mathematical model parameter that will be the primary driver of volatility performance in the months ahead.