36 South Views

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Another snag

I think there is another "snag" – a piece of information that catches you and anecdotally points to a state or existence of something – which should be included when considering the volatility outlook.

I am finding it harder and harder to commentate on the state of the volatility space. The harder I find it is to write this monthly report, the closer I suspect we are to a high volatility regime.

Right now, I would rather put Tabasco in my eyes than try to explain:

- why, at decade-long volatility lows, it makes exceptional sense to buy into, or add convexity to a portfolio.
- that the recent success of short volatility strategies is attracting capital which in turn will accentuate instability when it returns.
- that negative carry does not mean negative expected return.
- that pension funds who say they can't afford hedges in a low interest rate environment, cannot afford NOT to have hedges given their general funding status. Uncorrelated investments like long volatility collapse risk at portfolio level allowing them to increase their investments levels whilst lowering their risk.

Or explain using metaphor why a forest fire is imminent despite the existence of a pedantic, over-controlling fire department that has not let a fire burn for decades. In the meantime, the brush has grown thick and trees have grown closer together, dramatically increasing the risk of a massive fire should the little fire get out of control.

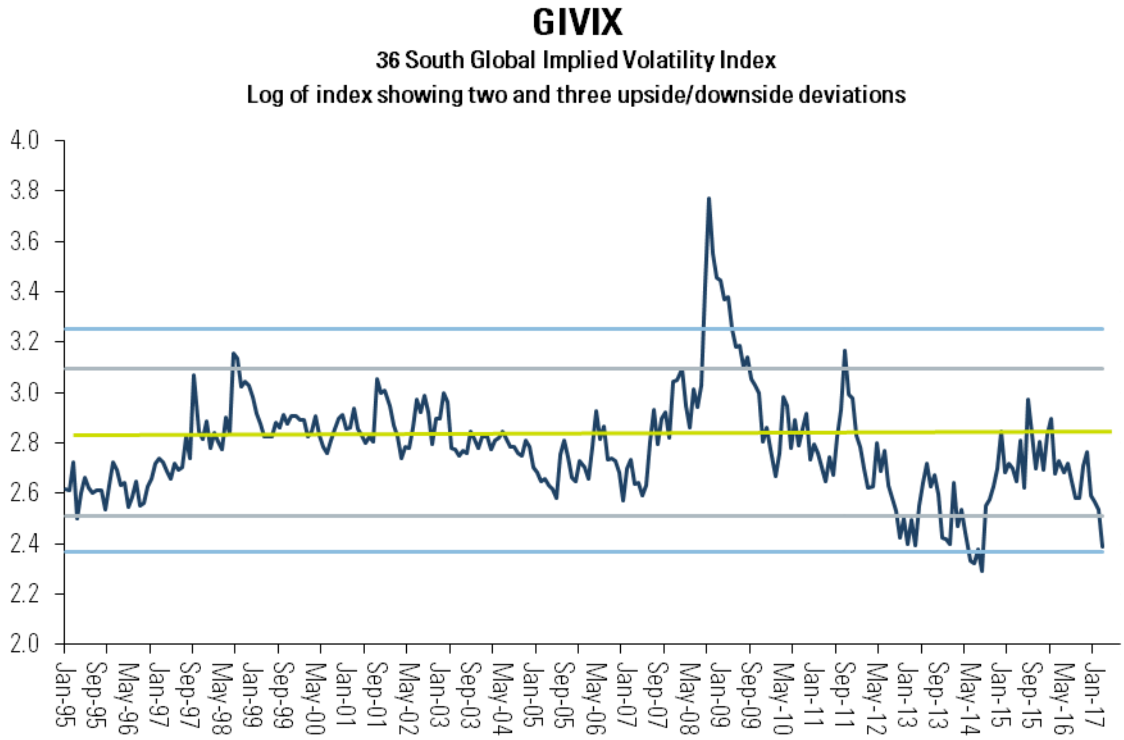
Or how the complex machinery of the world's financial affairs is held together with duct tape and super glue.

Or that the overall strategy of the world's most powerful leader is based on competition not cooperation. This should lead to extreme volatility as he transitions our societal DNA from the latter to the former. Hint: most tin pot dictators base their strategies on competition too.

Or that QE is directly responsible for the inequality of wealth and thus the rise of populism.

Nah… it's all good.

But just for old time's sake let's look at this graph of long term volatility (based on the GIVIX, a series of proprietary volatility indices combining data analysis across markets, spanning 64 indices and four asset classes – equities, commodities, currencies and bonds):



Source: 36 South Capital Advisors as at 31 March 2017

A picture really does paint a thousand words.

It does not matter at these levels whether an investor thinks volatility is imminent or not, in fact it is so counterintuitive that it DOES MATTER when investors believe, especially with some degree of conviction, that it is NOT imminent.

But maybe this time is different?

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