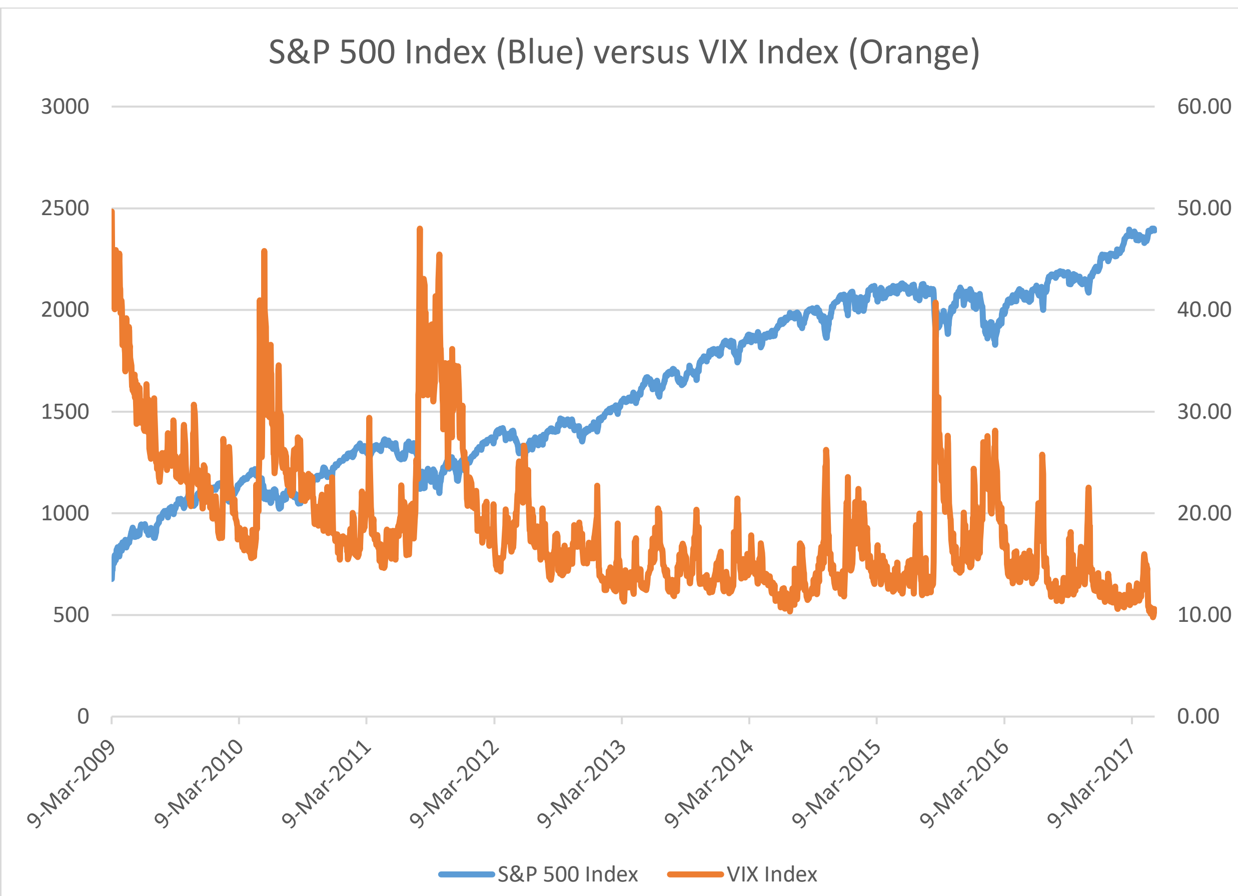
What's the VIX and Why Does It Matter to You?

Recently, the VIX has been in the news. The VIX is the ticker symbol for the Chicago Board Options Exchange Volatility Index. This index shows the market expectations of near-term volatility conveyed by S&P 500 stock index option prices. The VIX index will also be referred to as the volatility index and sometimes the fear index. The reason that the VIX index is referred to as the fear index is that a higher number means the market is expecting a higher annualized volatility going forward.

The reason the VIX is in the news is that it is at very low levels. The month of May saw the VIX under 11. To put that low number in perspective, on March 9th, 2009 the VIX index was 49.68 and the S&P 500 Index was at 676.53. The trend over the last eight years has been an increasing stock market paired with a decreasing volatility index as seen in the graph below.



Despite the surprise events in 2016 of Brexit and the Trump presidency the VIX index continues its move lower. In fact, as of May 11th, 2017 the realized one month volatility of the S&P 500 index was 6.92. With the VIX Index at 11 it means the options market is pricing over a 50% increase of volatility over the next 30 days. This 50% increase means investors who are using options to hedge their portfolios are willing to pay a premium versus the recent volatility.

A result of this hefty premium is that some investors are selling volatility products. These investors will have profits if the realized volatility continues to be lower than 11. However, the average level of the VIX index is 19.67. A return to the average level would create large losses for current volatility sellers. These losses could be accelerated if everyone must sell at the same time. For some market historians, it reminds them of 1987 and the selling of portfolio insurance. Some people have blamed the forced computerized selling tied to portfolio insurance for the 20% drop of the market on October 19th, 1987. That day the Volatility Index increased from 36.37 to 150.19. Virtue Asset Management believes some investors are too complacent and we expect volatility to eventually move higher. We believe the selling of volatility products has created the possibility of a coiled spring waiting to be sprung.

At Virtue Asset Management, we believe our streamlined structure that focuses on a smaller client base allows us to react quickly if the compressed spring of volatility uncoils. Our streamlined structure allows us to quickly adjust asset allocations for our clients. Contact us for an investment review of your current portfolio.

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