Volatility and Tail Risk Hedging Conference

from 36 South Capital Advisors LLP

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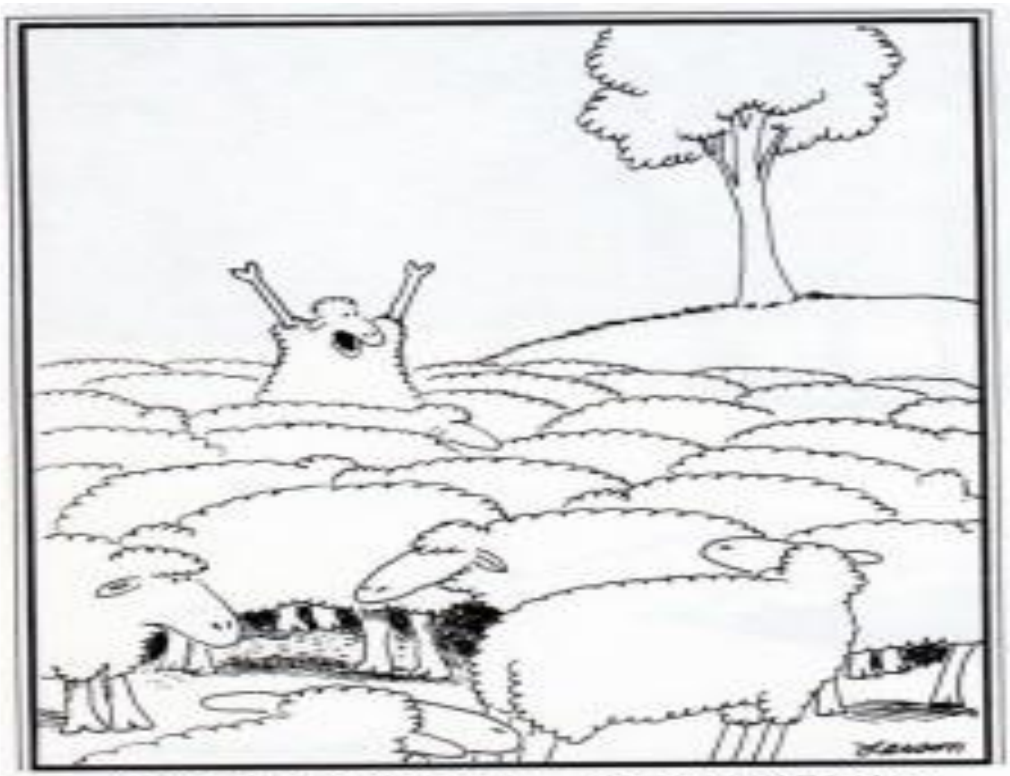
Co-founder, CIO

Welcome

So why are we here?

1) We think that the volatility asset class and tail risk hedging are important to investors.



"Wait! Wait! Listen to me! . . . We don't HAVE to be just sheep!"

Why Volatility is important?

Restate to ….

"assets which perform well in the presence or absence of volatility are important to investors"

Why are volatility assets important?

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Why?

It is a big market.

It tends to become irrationally cheap or expensive.

Thus providing a massive <u>source of alpha</u>

Potential for unique diversification

Perfect qualities for tail hedges

Volatility is the proxy for risk

- forecasting
- risk management

Why Volatility is important?

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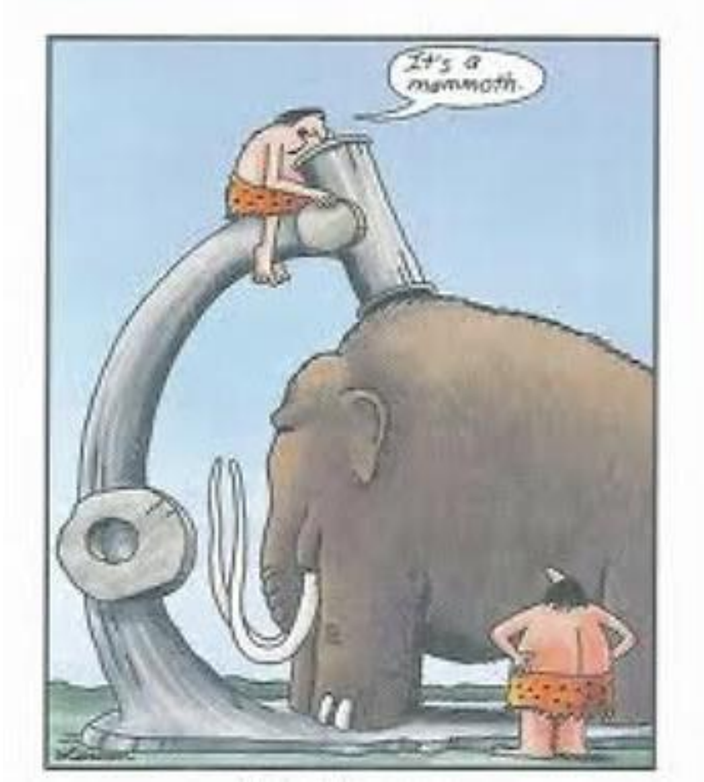
Volatility market is BIG

enough to warrant attention

65 Trillion notional invested in options globally according to www.bis.org.



Tend to become irrationally cheap or expensive?

Volatility is cyclical, mean reverting and counter-intuitive

A picture is worth a thousand words

Volatility investing in pictures

2002-2007

Net short strategy

Net long strategy

Volatility investing in pictures

Jun 2007 – Dec 2008

Net short strategy

Net long strategy

Volatility investing in pictures

2008

Net short strategy

Net long strategy

Volatility investing in pictures

2009 -2012

Net short strategy

Net long strategy

Tend to become irrationally cheap or expensive?

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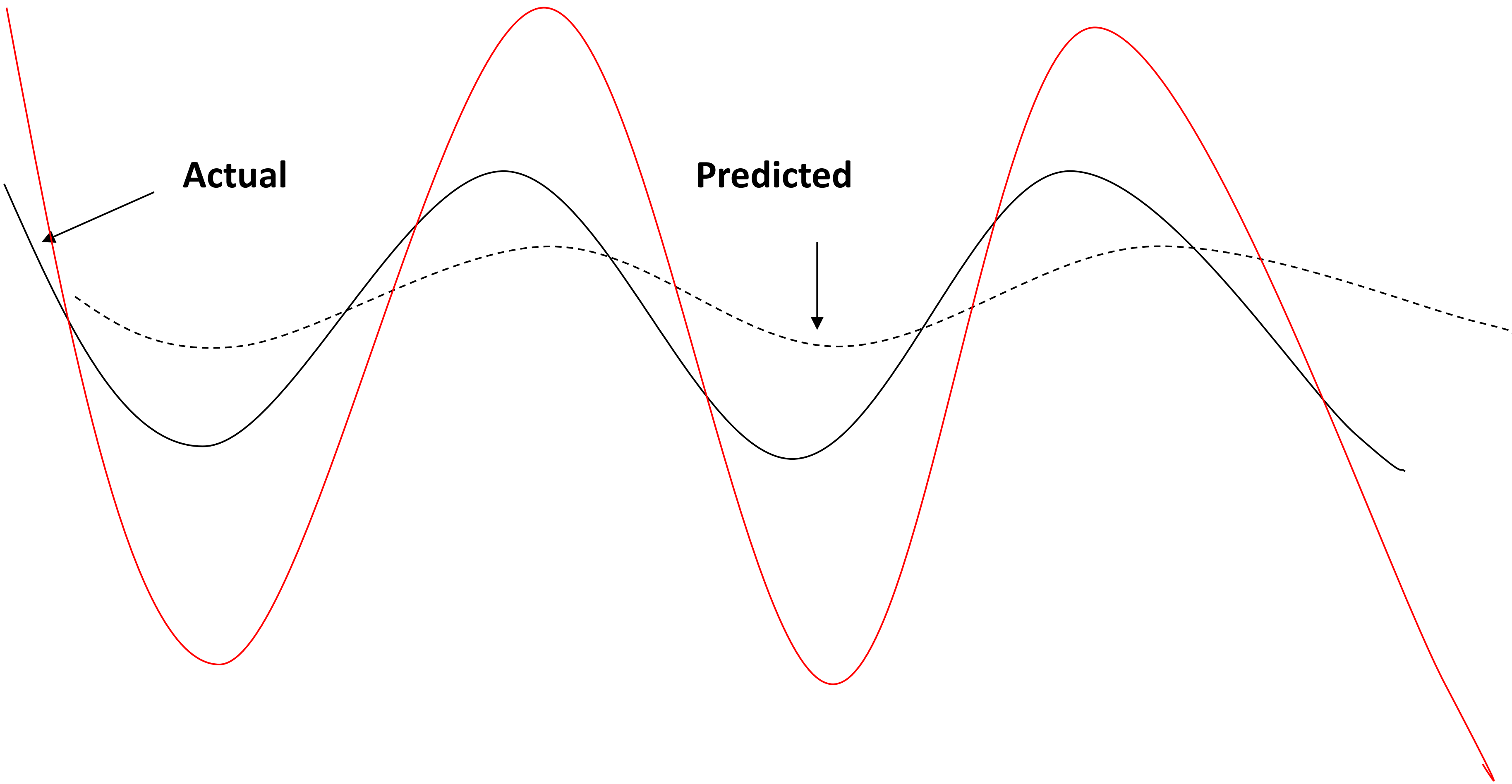
Volatility is cyclical, mean reverting and counter-intuitive



Why Volatility is important?

Cyclical, counterintuitive characteristics combined with the fact that volatility assets easy to price, difficult to value.

Result: massive potential for alpha.

Example: Google call option 5 year strike 1800

Current price 900

Lo IV	15%
Hi	100%

What is the price of a Google 5 year call option, strike \$1800 when the current price is \$900?

0

1. \$0 - \$4
2. \$5 - \$10
3. \$11 - \$40
4. \$41 - \$100
5. \$101 - \$400

What is the price of a Google 5 year call option, strike $1800 when the current price is $900?

1. $0 - $4	0%
2. $5 - $10	0%
3. $11 - $40	0%
4. $41 - $100	0%
5. $101 - $400	0%

Why Volatility is important?

Potential for unique diversification

The "volatility" assets have unique qualities which should be highly desired by portfolio managers.

Can generate returns in volatile markets?

Long volatility strategies...

In becalmed markets?

Short volatility strategies ...

In idiosyncratic markets

Long / short volatility strategies

Why Volatility is important?

Potential for unique diversification

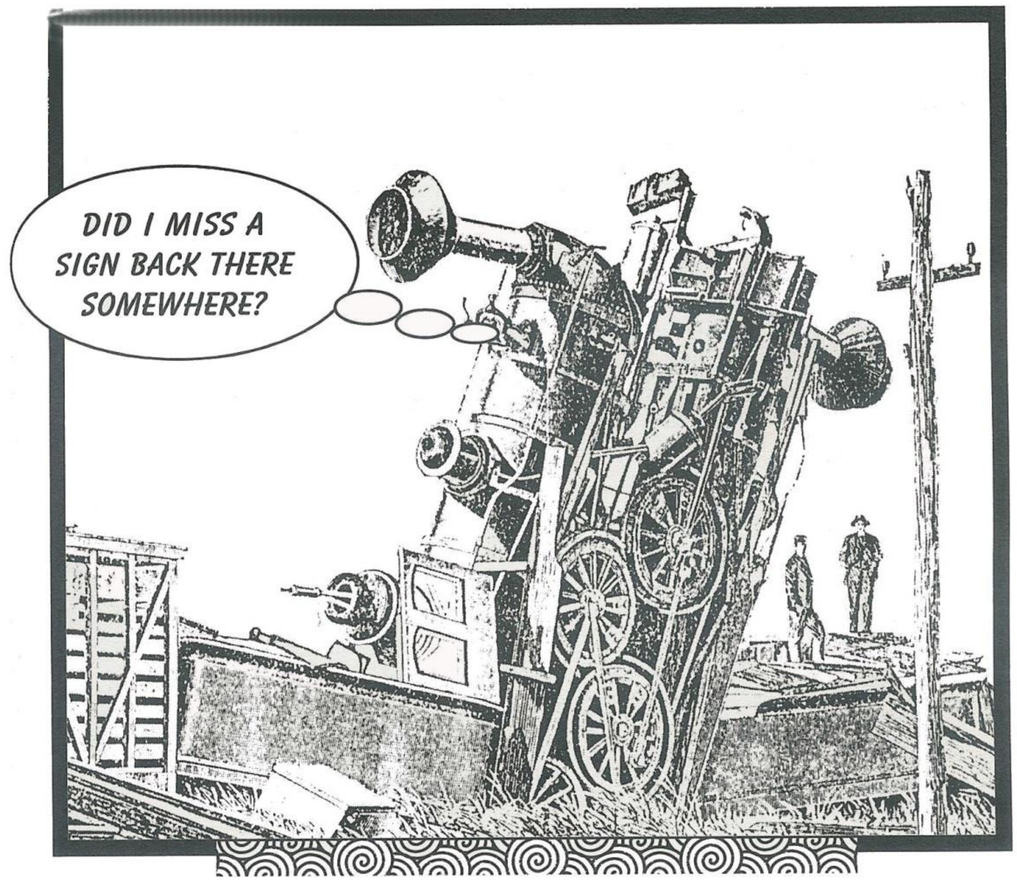
Long volatility strategies…

2008 … the year that changed everything.

2008 – the Year that Changed everything

- How?
- Global financial crisis
- Characterized by…
- Contagion
- Rapidly falling prices
- Extreme Volatility
- Correlations on all assets except

  bonds tending to 1



Why Volatility is important?

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Long volatility strategies display…

- Convexity – ability to snowball returns positively
- Unique Correlation footprint – tendency for long vol assets to correlate towards -1 in a crisis.

This…

- Helps a traditional portfolio stay diversified and smooths out extreme losses.

When the assumptions of mean variance fail…..

Why Volatility is important?

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Potential for unique diversification

Short volatility strategies…

Why Volatility is important?

Potential for unique diversification

Long/Short volatility strategies…

Inter market product

Inter product

US vs Europe
Europe vs Asia
Stock vs Bonds

Front month vs back month
OTM vs ATM
ETF vs OTCs

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Long volatility strategies…

In becalmed markets?

Short volatility strategies …

In idiosyncratic markets

Long / short volatility strategies

Summary – volatility is important…

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Why?

It is a big market.

Tends to become irrationally cheap or expensive.

Thus providing a massive <u>source of alpha</u>

Potential for unique diversification

Perfect qualities for tail hedges

Volatility is the proxy for risk

- forecasting
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Reality check

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Volatility managers have been found wanting in their ability to generate returns even when there is a "tailwind" for their style.

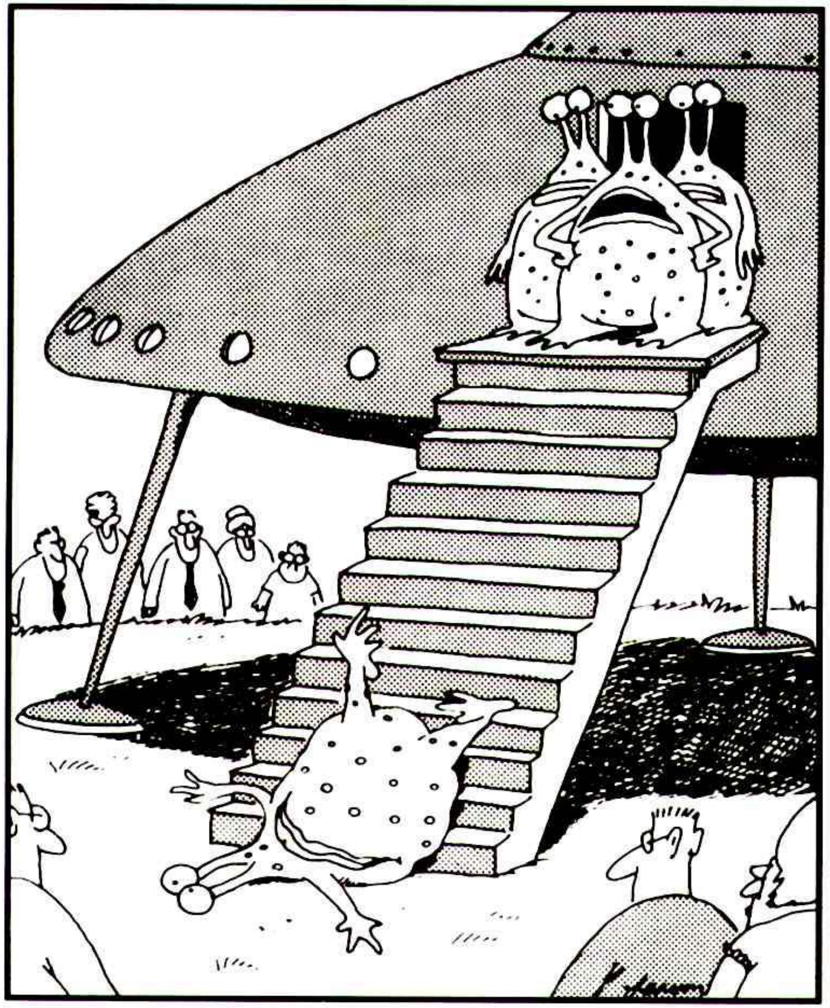
Why?

So have investors been found wanting.

Why?

Client pull in a counter-intuitive space.

Way forward?



"Wonderful! Just wonderful! ... So much for instilling them with a sense of awe."

Summary

I will now hand you over the various speakers who will spell out exactly how to "tame" or "time" the volatility assets.

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