Macro Outlook Summary

March 2025

In the past three months volatility has staged something of a comeback. Not just in equities but everywhere. Commodities, currencies and even bonds. The long only equity propaganda machine broadcasts the same message every time - that volatility is inevitable, inescapable and you just have to grin and bear it because in the long run it doesn't do you any harm…..

More sophisticated investors adjust their risk downwards when volatility is high and up when it is low to adapt to longer term changes in volatility. This is something they typically have to do because they are using leverage which involves changes in the lender's margining. Other investors, including us, view volatility as an asset which can be bought or sold. Investors can go long volatility and make money when it rises or short volatility to make money when it falls.

Quite a number of sophisticated investor instruments and structured products are sold by banks to their clients with opaque embedded volatility tilts, either long or short. Typically they are short vol, the most dangerous tilt by a very long margin. But often, the way in which a product has embedded short vol is hard for investors to understand and see. Short vol products tend to deliver attractive streams of small returns to investors when markets are quiet and then suddenly they don't.

In 2018 there was a Credit Suisse product which systematically sold volatility by being short the VIX index, an index of volatility. Cleverly, Credit Suisse called it the XIV ETN. Incredibly, investors put in several billion dollars probably in some cases not really understanding what they were doing. In early Feb'18 US equities dropped sharply, the VIX index spiked 115% and the product cratered. Investors lost everything and then possibly learnt that being short vol is highly dangerous.

Our Fund is never short vol but rather is long vol through several managers and we vary this exposure over time depending on market conditions. This is an attractive way of making money and goes well beyond what conventional investors are able to do or understand. On a broader point it has also become clear in recent months that there are numerous hedge fund strategies beyond the most common 'equity long-short' strategy which thrive in this sort of volatile climate and provide reliable stabilising portfolio returns in a way that bonds have not recently done.