

# Global Markets Forum

An exclusive, interactive, live forum managed by experienced Reuters journalists.

**Stephen Aniston, Stephen Aniston, President & CIO at Black Peak Capital LLC**



Stephen joined us to discuss trading volatility index VIX and the shared insights on why the fear gauge is trading so low this year.

On Wednesday, August 2, Global Markets Forum welcomed Stephen Aniston Stephen Aniston, President & CIO at Black Peak Capital LLC, to chat about volatility index VIX and gave his rationale as to why the fear index is trading lower and why it would continue to remain lower for the rest of the year.

Stephen said " I think we will see 8 handle VIX this year."

## HERE'S THE TRANSCRIPT OF THE CHAT

Manoj Rawal - Starting shortly:

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Stephen Aniston, President & CIO, Black Peak Capital LLC

Volatility Index or VIX as is popularly known as, made new all time low on Wednesday, and Stephen Aniston, President & CIO, Black Peak Capital LLC, says it would remain so throughout this year. Stephen joins us on the forum to discuss trading VIX futures.

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Join us!

Alright folks let's welcome our guest for the day - Stephen Aniston

Hello Stephen, welcome to GMF

GMF Guest 3 - Hi everybody, glad to be here

Manoj Rawal - Pleasure to host you here Stephen... lets start right in - Your views on VIX and why do you think it would remain lower for longer?

Member 1 - Hi Stephen

Michael Connor - Hi Stephen. Welcome

GMF Guest 3 - The low volatility this year has been a much unexpected development since most people (especially hedge funds) thought that Trump will take down the market.

with his protectionist policies. But instead what we got was a pivot to health care and tax reform first.

Manoj Rawal - GMF, our guest for the day is Stephen Aniston, President & CIO, Black Peak Capital LLC, taking questions on VIX trading.

Member 1 - Stephen none of which has materialised though

GMF Guest 3 - When you couple that with SPX earnings growing, the market had no place to go but up.

Michael Connor - And strong S&P 500 results for two quarters?

Member 1 - So is Market running on Fumes as SF Fed governor mentioned last times

last time\*

GMF Guest 3 - SPX GAAP earnings growth has been 16.5 percent since the election. The SPX is up only 15.4 percent

So the market is actually trading at a slight Trump discount - would be trading higher if not for Trump

Manoj Rawal - Good pointer

Member 2 - Hi Stephen--so SPX should be higher?

GMF Guest 3 - I don't think the market is running on fumes - if anything it is trailing behind earnings growth

Member 1 - Thought the players were chasing yield in equity markets as there is no other alternative

GMF Guest 3 - So yes SPX should be higher

Member 2 - 10 percent higher?

GMF Guest 3 - We think that is definitely a possibility. Our price target for SPX is 2650 this year, which is about 150 points from here

2017 will be the best year for corporate earnings by far if current projections hold up

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO, Black Peak Capital LLC. Member 2



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& that target is ex tax reform?

Member 3 - Is lack of Volatility and a low VIX driving prices higher or are higher prices holding the VIX down?

Member 1 - When US 10yr moves close to 3 percent do you think equity market run can be sustainable?

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

GMF Guest 3 - At this point we believe that Tax Reform is not going to happen and we have believed that ever since Health Care reform broke down

Michael Connor - Is infrastructure toast also?

GMF Guest 3 - The VIX is down for the following reason - when managers hedge with options and the market goes up, the net effect is managers are behind the SPX

Manoj Rawal - So... if tax reform doesn't happen, isn't that a negative for stocks?

Member 1 - SPX hasn't had any draw downs worth of noting can it be sustainable?

GMF Guest 3 - When they are behind the SPX, whatever they were worried about didn't happen so now they second guess their hedging activities

If SPX never goes down (and this year -3 percent has been the biggest drawdown), options burn out

That leads to lower demand for options and ever lower VIX which measures options pricing

Member 3 - So when [or IF, if you prefer] a downturn starts there is going to be a huge rush to unwind and we may see a market portfolio [see 1987] effect? the result will be a self feeding loop?

Manoj Rawal - circular!

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

GMF Guest 3 - The other factor at play here is lower expected returns - because interest rates are low and stock valuations are high, expected returns for stocks are low

if expected returns are low, then portfolio managers can't afford much for protection - so they are very quick to dump hedges

Member 1 - That's what I said earlier markets are up pure because there is no other alternative

All yield chasers

GMF Guest 3 - We think infrastructure is more feasible because that will get Democrat support and Schumer has talked about this as area for cooperation

Michael Connor - Trump should have done that first. It is low hanging fruit.

GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

Member 1 - Michael not easy

GMF Guest 3 - Yes, the SPX has had 4 years in the past with biggest drawdown of about -4 percent. So yes it is possible. Interesting to note, the last time of no drawdown year was 1964 - also tax reform year

Member 2 - How will they pay for infra?

Member 1 - How would find money to fund it??

Exactly Member 2

Tax has to go before infra

Tax fails Infra falls flat on its face

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

GMF Guest 3 - Before we go down the DC rabbit hole, of the entire economic indicator I have matched the VIX up against (GDP growth, employment, etc), low VIX has greatest correlation with earnings growth

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Member 1 - Coming back to VIX. Do you look at European volatility indexes as well like V2TX?

GMF Guest 3 - If earnings are growing 10 percent, the VIX is on the way down or low. In years, when SPX earnings grow 10 percent, the 50 percent of the time the VIX is between 11 and 15 with 11-12 being the highest modality (most often seen numbers)!

Member 1 - But don't forget earnings forecasts have been lowered for 7 straight quarters since 2015

Saqib Ahmed thomsonreuters.com - Hi Stephen. I had a question about the VIX. I have seen a few notes in the recent days where analysts at big banks JPM, MS have warned that positioning in VIX Exchange Trade Products is a big risk to the whole market if stocks experience a big -3 percent -4 percent one-day pull-back. I wanted to know if you keep an eye on positioning in the various LONG, short VIX ETPs

Member 1 - So current earning beating forecasts is not that great

GMF Guest 3 - So if nothing happens in DC, you are still looking at strong earnings growth in the SPX (mostly because of world GDP growth). 50 percent of SPX revenues come from outside the US

Michael Connor - Welcome Saqib great question

Saqib Ahmed thomsonreuters.com - Thanks Michael.

Manoj Rawal - welcome Saqib

GMF Guest 3 - I don't follow European volatility markets that closely, other than I know they are beating the US markets big this year

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

Member 1 - Yes they are more active than VIX

Member 2 - will that 50 percent not increase due to weak \$--if \$stays weak?

GMF Guest 3 - Saqib, yes I keep an eye on positions. The ETF markets (where most of the directional action is) are still long volatility - about 1 billion long volatility.

1 billion net long volatility. At the election, the number 3.5 billion net long. But we are still net long unlike mid 2014 when we were net short

So we are still a long way from an imbalance in the volatility markets

To address the fears of a sharp VIX spike - there is no historical precedent of a big VIX spike off single digit VIX

Manoj Rawal - Interesting point

Saqib Ahmed thomsonreuters.com - True. pretty uncharted waters

GMF Guest 3 - That has happened twice in 1993 and in 2006. In 1993, it took 2 months to hit 14, another month to hit 16 and another month to hit 18. In 2006, it took 3 months to hit 14

Saqib Ahmed thomsonreuters.com - In other words, given positioning is still net- long fair to say people ARE prepared for a volatility spike?

GMF Guest 3 - Big VIX spikes are more likely in weak markets when the VIX is already high than in strong markets when VIX is low. Simply there is money waiting to buy the dip aggressively when markets are strong.

Cash levels today are still above average meaning that there is plenty of money to buy dips

Member 1 - What do you think of this mis-pricing.

VIX fair value model.PNG

GMF Guest 3 - That is correct, not as much as during the US election and Brexit when people were "over prepared" for a volatility spike. In my view that is why the Brexit drop was brief. People had hedge on, hedges made money; they cashed the hedges and redeployed them at lower levels.

Saqib Ahmed thomsonreuters.com - I see. Yes and the kind of scenario that the analysts at JPM, MS were painting would need the VIX to about double overnight. I guess at that stage the market would be in turmoil in any case, right?

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GMF Guest 3 - I understand what they fear, but for that I first need to see a net short volatility position by about 1 billion dollars - we are far away from that.

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

GMF Guest 3 - But mostly big VIX spikes tend to have fundamental economic driver (like 2015 devaluation). Now there is certainly risk of that. But the initial reaction will be to buy the dip which will soften a VIX spike

Saqib Ahmed thomsonreuters.com - I see.

Member 2 - Are clients using other hedges bar the VIX? they can see earnings progression/option hedges keep losing money--move away from VIX to something else?

Saqib Ahmed thomsonreuters.com - That 1 billion net long volatility figure... is that a dollar figure? asking because I see people generally expressing it in terms of Vega...

GMF Guest 3 - I don't think people are particularly interested in hedging these days (as low VIX can attest). For the most part, it is a game of who can make more money this year

Most foreign markets are above 15 percent

Member 2 - Agree

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

Member 2 - Weak dollar -- What impact will it have on revenues?

GMF Guest 3 - EEM is +25 percent! Europe is +20 percent, India is +33 percent

Manoj Rawal - Stephen, there were some questions above you may have missed, one is from Member 3: So when [or IF, if you prefer] a downturn starts there is going to be a huge rush to unwind and we may see a market portfolio [see 1987] effect? The result will be a self feeding loop?

Bryan Guguen - Hi folks, Bryan here, good to see some genuine interest in VIX as well as Stephen's perspectives

Manoj Rawal (Y) Bryan

GMF Guest 3 - We think that weak dollar is good for the SPX. Obviously the same revenues are worth more and make it easier for companies to beat estimates.

The weak dollar is another big factor in the low volatility environment. Most expected it to go higher and to create problems, but instead it is lower (mostly because Trump agenda is dead)

Member 1 - Just out of curiosity when you say Europe is over 20 percent this year, what exactly do you mean by that????

GMF Guest 3 - To answer the 1987 question - in our view the SPX drives the VIX, not the other way around. So a big VIX spike comes only because of a big SPX drop. A VIX spike can't create an SPX drop. The volatility markets are very small compared to the SPX markets

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

GMF Guest 3 - FEZ ETF (Euro Stoxx) - which is the Dow Jones of Europe

Bryan Guguen Also I'm guessing that VIX is actually calculated from S&P to begin with so it's not VIX driving SPX

GMF Guest 3 - To give you an idea of the size of the markets - SPX futures market is 150 billion traded per day. SPX options is 170 billion

Saqib Ahmed thomsonreuters.com - true. SPX options

GMF Guest 3 - VIX is calculated out of the SPX options market (170B)

Member 1 - Eurostoxx 50 is only up 7 percent YTD

GMF Guest 3 - VIX futures market is 4 billion per day, VIX options about 1.5 billion per day

We don't think that a 4 billion per day market is capable of crashing a 170 billion market.

Saqib Ahmed thomsonreuters.com - My best understanding is that at worst it can end up aggravating a volatility

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spike, not causing one.

Manoj Rawal – GMF, any last questions for Stephen please?

Saqib Ahmed thomsonreuters.com - That 1 billion net long volatility figure... is that a dollar figure? asking because I see people generally expressing it in terms of Vega...

GMF Guest 3 - One more tidbit for bankruptcy crash in the VIX

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

Member 2 - What about 2018 earnings--do we see close to 10 percent?

Saqib Ahmed thomsonreuters.com - Final question: Why is there more of an extreme position in VIX options than there is in say SPX or SPY options. VIX calls outnumber puts about 4-to-1. SPY & SPX put-to-call ratio is high but not as extreme as that seen in the VIX.

I saw someone suggest that this means people are more prepared for a big, violent pullback, rather than a regular every-day kind of pull back. Does that make sense?

GMF Guest 3 - The only event that could've crashed the VIX ETFs is 1987 Black Monday. Then the VIX equivalent would have gone from 22 to 140 in one day. Most of that is because computers were in their infancy then. Such an event with all the kill switches is very hard to replicate today.

You can't even find 9/11 on the list of biggest VIX spikes because the markets were closed for 5 days until normalcy returns. So catastrophic SPX crash would lead to the government getting involved as they did on 9/11.

Saqib Ahmed thomsonreuters.com - Right

GMF Guest 3 - The other thing to remember is that VIX instruments don't track the VIX - the beta is less than 50 percent so it takes a 200 percent VIX spike to get near that and outside of Black Monday the biggest VIX spike is in the 50-60 percent area. In the modern are we haven't come close to the crashes described by JPM.

Saqib Ahmed thomsonreuters.com - yes.

Manoj Rawal - Stephen, before we end the session, would you please take those two questions from Member 2 and Saqib above please?

GMF Guest 3 - I think any VIX call activity is mostly hedging. VIX calls are very cheap these days and it doesn't cost much to take a flyer. I would not consider the current positioning there to be reflective of strong opinion on the markets.

Michael Connor - GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

Saqib Ahmed thomsonreuters.com - ok

Member 1 - One last from my what's the risk of going long VIX and holding it for your grandkids?

my side\*

GMF Guest 3 - I think 2018 earnings estimates are a bit too optimistic. But if world GDP continues to grow, there will still be earnings growth in 2018 - perhaps more around 5-7 percent rather than 10-15 percent like this year.

GMF Guest 3 - Member 1, better buy bitcoin :)

Saqib Ahmed thomsonreuters.com - :-)

Member 2 - maybe the banks are trying to engineer some more trading activity!

Saqib Ahmed thomsonreuters.com - Member 1 I have some VIX calls to sell you.

Member 4 - Isn't Bitcoin going to 500.000? ;)

Member 1 - Bitcoin I can lose my shirt. VIX can't get any lower can it?

GMF Guest 3 - I think we will see 8 handle VIX this year

Manoj Rawal - wow!

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Member 1 - Alright thanks Stephen

Michael Connor - Thank you, Stephen. very fine segment

GMF, our guest is Stephen Aniston, President & CIO at Black Peak Capital LLC.

Member 4 - but that's like 10 percent lower... or 15... however, upside potential a bit higher, no? given the timeframe of like 20 years

GMF Guest 3 - I hope I answered everybody's questions

Manoj Rawal - Before we let you go Stephen, any parting thoughts for us please?

Member 4 - thanks Stephen, it was very interesting

Manoj Rawal - You were lightening fast Stephen!

Member 2 - Thanks Stephen--very instructive

GMF Guest 3 - Member 4, you can't really buy the VIX. You buy VIX futures which are at higher levels. Essentially, you can only rent the VIX and there is a cost to holding it. So long volatility doesn't quite work the way you think. There is no free money.

Member 4 - Sure... or some other derivative, ETF or so... but yeah, i get your point.

GMF Guest 3 - Final words, be very careful when trading long volatility because low volatility can last a long time. We are only about 9 months and the longest low volatility runs have been almost 2 years in length. So this low VIX environment could potentially last another year.

Manoj Rawal - Interesting thought to close the session on

Manoj Rawal - Thanks much Stephen for this enlightening session.

Hope to see you again soon, have a great day

GMF Guest 3 - Thank you Manoj and thank you everybody for the great questions.

Saqib Ahmed thomsonreuters.com - Thanks Stephen. Good chat.

Member 3 - thanks Stephen

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