

The VSTOXX Kept Its Virtue

One of the most difficult things to do during one of the market's periodic stampedes for the exit is to remind yourself babies are being thrown out with the bathwater, the piano player is being arrested, things are being tarred with the same brush, the sun will rise tomorrow and metaphors will continue to be mixed. The opposite applies to rallies as well, although we never seem to be as concerned about those as they are presumed to be the natural course of events.

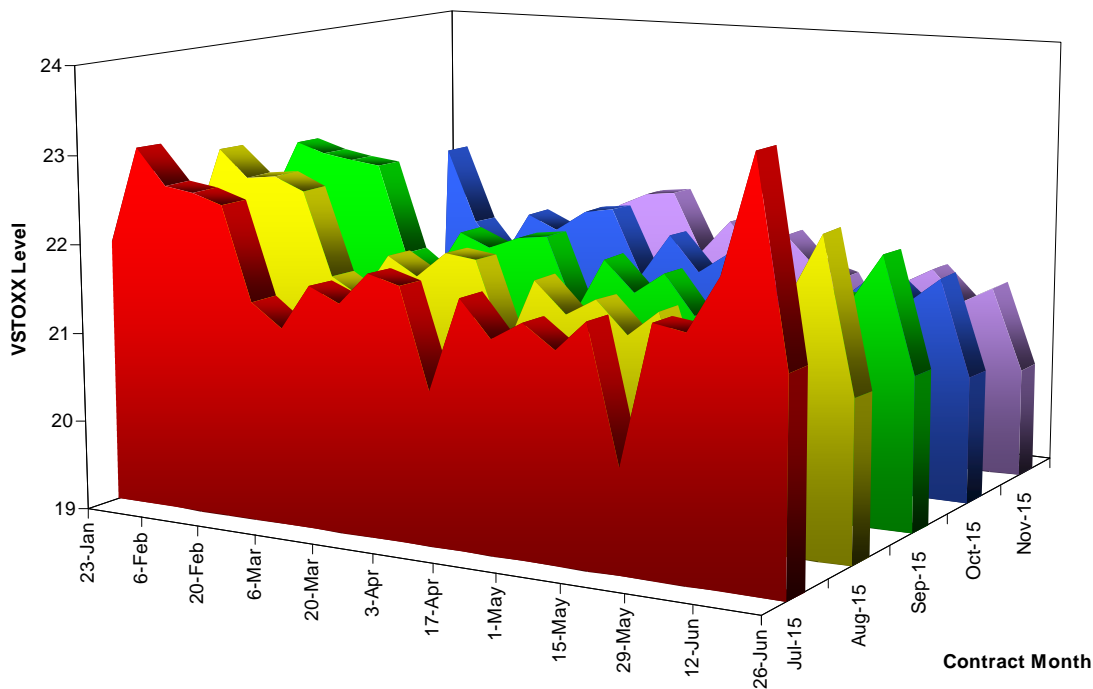
A case in point was found on Monday after something or other happened with Greece that was not as bad as some thought might happen with Greece; who knows? European stocks rallied massively on the welcome news the forces of self-delusion prevailed once again. The Euro STOXX 50, the underlying stock index for the VSTOXX volatility index, jumped by 4.06%. Predictably, the VSTOXX declined by more than 5.07 index points, from 28.6184 to 23.5436 (four decimal points for a volatility index? Dudes!) but that is not the end of the story. If it was, you would be at that little "follow me and I'll set you free" link that demarcates the actual end of this story.

Pseudo Forward Curve

VSTOXX futures, like VIX futures, trade over a number of months and therefore have what for all the world appears to be a forward curve. In reality, nothing is being carried forward and each month represents a one-month forward-start leg of fixed measure of volatility. So saying, it is very common to see an inverted structure during bearish periods as long-side speculators in volatility realize events today are far more likely to affect the front month's values far more than those for any of the back months. The opposite does not apply quite as symmetrically as good news today can push the front month values down only so far and back-month volatility sellers are not willing to accept lower prices. However, these structures generally will see a positively sloped pseudo forward curve.

What happened on Monday? The pseudo forward curve remained inverted even after the large drop in front-month July VSTOXX futures.

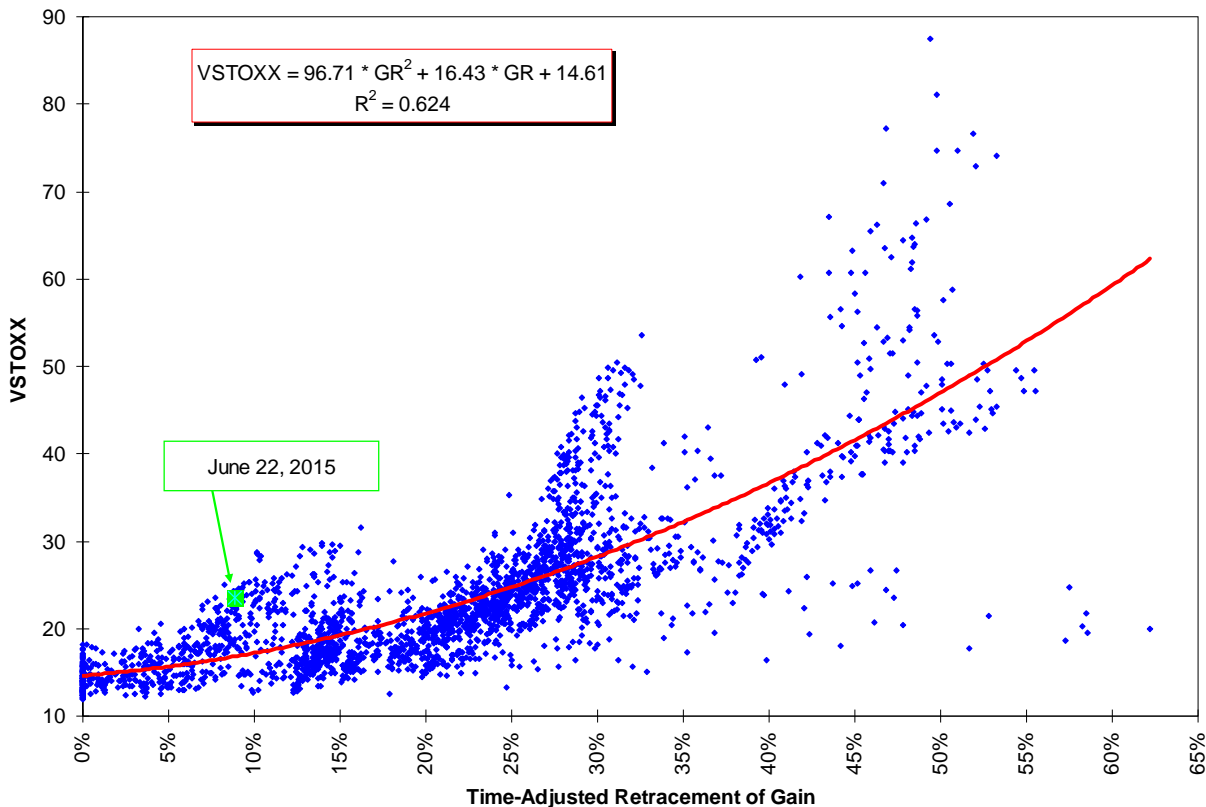
Forward-Start VSTOXX Retains Skeptical Stance



Another way of noting how the VSTOXX itself managed to retain a measure of skepticism about Monday's large short-covering rally in the Euro STOXX 50 (I just love these double-X's, don't you?) is to map its value against a

time-adjusted measure of retracement of gain for the Euro STOXX 50. A small disclaimer is in order here: The Euro STOXX 50 has not made a new high in price since July 2007, just before the financial crisis began. This makes it substantially different from most other major indices that have been making new highs with regularity since 2013.

Volatility And Retracement of Gain April 2005 - June 2015



The 23.54 value on June 22, 2015 was 40% above the model's fit of 16.82, which lies along the red trendline. What can we take away from the VSTOXX pseudo forward curve remaining inverted and its value remaining above its modeled fit? A strong recognition Eurozone equities as measured by the Euro STOXX 50 index remain in an unsettled state. We might note, tongue-in-cheek Rome was not built in a day and Greece will not be solved in a day, either.