OPALESQUE
17 YEARS
Tuesday, September 15, 2020

DIVERSIFICATION MATTERS
Report 9

A multi-strategy approach to volatility trading drives Deep Field Capital's year to date outperformance

2020 has been the year of the long volatility trade. After years of investors being paid handsomely to short volatility, the first quarter of this year reminded investors what realized volatility looks like. For Swiss firm Deep Field Capital, 2020 has been an ideal year to explain why volatility strategies should ultimately have multiple pathways to generate alpha beyond a basic long/short binary.

"We think we're in a heightened volatility environment for the foreseeable future," said Bastian Bolesta, CEO of Deep Field Capital, in a recent interview. "How does that play out for VIX? Hard to say, but we believe having multiple path dependencies is important."

Deep Field Capital trades a quartet of stand-alone volatility strategies that each have different investment goals. The first of the four is the Liquid Equity Alpha (LEA) program. LEA is a quantitative intraday mean-reversion strategy applied to a universe of approximately 2000 stocks and ETFs with the goal of generating crisis alpha as well as a positive absolute return. In simplified terms, LEA is a long-only strategy that looks for quick intraday price rebounds on stocks that trend down on news or investor overreaction. It's essentially a long volatility equities strategy.

LEA returned 35.89% in March (up 43.29% in Q1) as markets flipped on pandemic news. The strategy's intraday time horizon has been beneficial in the months since March, as volatility has become a feature of the trading day. The strategy is up 79.72% year to date through August 31 and up 102.22% net as of

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September 14.

Crisis alpha

Deep Field's remaining three programs fall under the umbrella of volatility strategies. The Systematic Volatility Arbitrage (VOLARB) program highlights the firm's work in pioneering volatility arbitrage as a trading strategy. The systematic program uses a handful of sub-strategies designed to work in concert and generate steady returns.

The sub-strategies include: market-neutral calendar spreads in VIX futures; VIX Index futures versus S&P 500 Index futures to arbitrage the equity market volatility risk premium; directional intraday momentum trades in equity index futures, and VIX index futures. Taken together, the sub-strategies are designed to react dynamically to changes in the volatility regime of the market. As markets change during the day certain sub-strategies may outperform.

Because two of the four sub-strategies trade intraday only, the fund avoids some of the inherent problems of buying and holding VIX futures - namely the cost. Holding VIX futures overnight comes with significant margin requirements and holding VIX futures over several days or weeks can become expensive because of time decay. VIX futures decay quickly, costing money as they do, which can create a significant drag on portfolios over the medium to long term. Deep Field argues intraday trading limits both margin and decay costs. In addition, the short time horizon allows the strategy to capitalize on volatility opportunities as they happen, rather than trying to wait for price trends that support buy and hold directional bets.

VOLARB was up 1.04% in August and is up 25.52% % year to date through August 31. In the turbulent Q1 this year, VOLARB was up 11.20%

Along similar lines, Deep Field's Intraday Crisis Alpha fund (ICA) looks to capitalize on volatility in a single session by focusing on large tail events in global equity indices and aiming to stay away from the average daily trading ranges that tend to be mean-reverting. The program was initially developed for S&P500 futures but has evolved into a global intraday program that closes out all positions at the end of the day. The strategy is up 21.01% year to date through August 31. ICA has been able to capitalize market moves in equities ranging from single day selloffs to intraday selloffs that end in a rebound before the close.

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Classic VIX

Although Deep Field focuses heavily on volatility arbitrage, the firm has also developed an intraday long/short VIX futures program with a twist. The firm's Intraday Convexity Capture (ICC) strategy takes directional long/short VIX positions over the course of a single day and has been built on the team's experience developing and trading the Intraday Crisis Alpha (ICA) Program The program is up 1.42% year to date through August 31.

For Bolesta, the key to volatility trading is not just guessing the direction of the VIX and being right. Instead, it's about using volatility to capture opportunities each day that cumulatively smooth out performance and provide diversification within a portfolio.

Bolesta will explain this multiple-pathways approach to trading volatility in an upcoming Opalesque Webinar - "Diversification Matters: Outperforming Strategies" on September 22. Registration is free and available here.

Upcoming Webinar:

DIVERSIFICATION MATTERS - More outperforming strategies
Time: Tuesday, Sep. 22nd 10 am EST
Details and free registration here: www.opalesque.com/webinar/

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