Lupus alpha

Press Release

8 December 2021

Volatility asset class passes its biggest stress test to date
Premiums currently more than twice the long-term average

Lupus alpha's volatility strategies withstood their biggest stress test to date during the coronavirus crisis. Seventeen months after the slump in the global financial markets reached its nadir, these strategies have completely recovered the losses they suffered. While extremely high-risk volatility strategies offered by other providers disappeared from the market, Lupus alpha Volatility Invest generated a return of over 7.0 percent, with Lupus alpha Volatility Risk-Premium generating 10.4 percent (as of 30 November). Forward-looking risk management helped the funds to limit their losses during the crash before successfully recovering.
They are benefiting from the fact that the volatility risk premium from which they generate their returns is currently more than twice the long-term average. It is likely to take several years for this risk premium to normalise.

Investors who invest in volatility capitalise on the difference between the implied volatility expected by investors and the realised volatility actually observed in the market. The higher this difference is, the higher the **volatility risk premium** they can receive. During the coronavirus crash in March 2020, both realised and implied volatility reached historic highs. Volatility on the US equity market briefly reached 96%, the third-highest ever observed after 1929 and 1987. While implied volatilities also reflected these extreme variations, realised fluctuations have since returned to pre-coronavirus levels and are now around 12 percent on the S&P 500.

By contrast, the **volatility anticipated by market players is currently at 30 percent, still around twice as high** as it was before the crisis. The more uncertain market participants are about future developments on the equity markets, the higher implied volatility climbs. "Market players are still sceptical and their desire to hedge against extreme volatility remains high," said **Alexander Raviol, Partner and CIO Alternative Solutions at Lupus alpha**. "This persistently strong demand is reflected in high implied volatilities and thus in the historically extremely high volatility risk premium," Raviol added.

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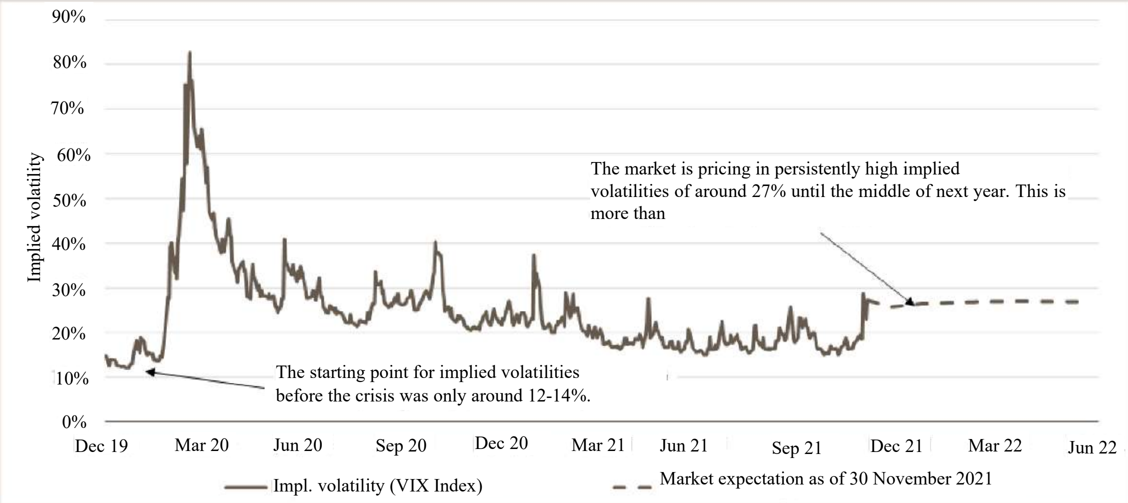
Desire for hedging twice as high as before the crisis

Implied volatility of S&P 500 before and after the coronavirus crisis (VIX Index)

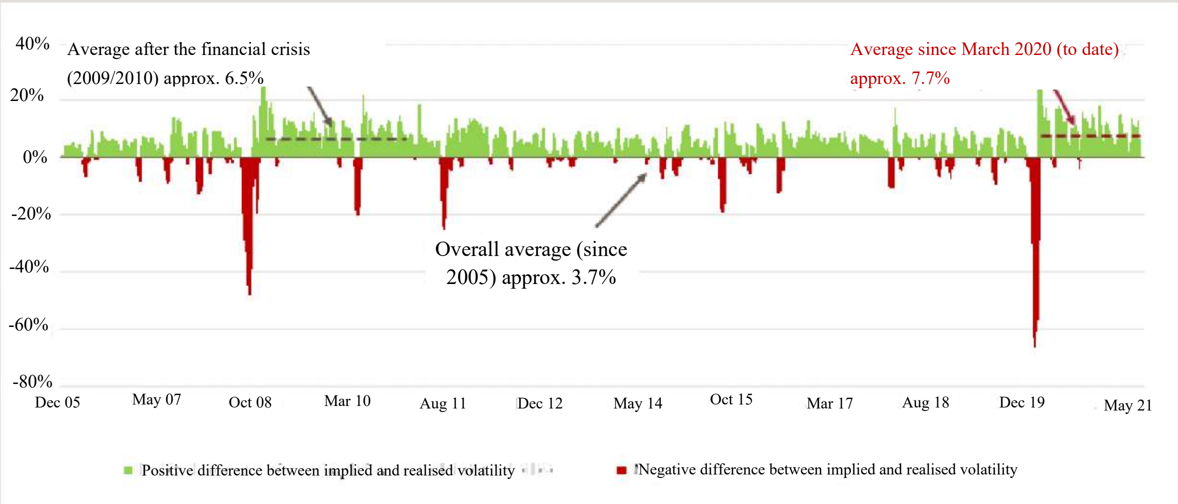


Source: Bloomberg, own calculations

Since March 2020, the risk premium **of 7.7 percent has been twice as high** as the long-term, 15-year average of 3.7 percent. Even when compared to figures measured after the financial crisis in 2009 and 2010, the remaining volatility strategies on the market are currently receiving a higher volatility risk premium.

Average volatility risk premium reaches historic highs after coronavirus crash

(S&P 500 and Euro Stoxx 50 average)



Development of volatility: S&P 500 and Euro Stoxx 50M average
Source: Bloomberg, own calculations; observation period: Dec 2005 - Nov 2021

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At the same time, **the supply of hedging products on the capital markets has fallen**: During the sometimes heavy losses in March 2020, a succession of volatility sellers exited the market. A double-digit number of volatility funds closed in Germany alone. This scarcity of supply of hedging products was further exacerbated by reductions in volume by other sellers of corresponding products such as investment banks. There has been consistently high demand for this reduced supply of hedging products since the crisis. The combination of both these effects resulted in the exceptionally high volatility risk premium.

Alexander Raviol: "After the financial crisis in 2008/2009, it took several years for a renewed increase in the supply of hedging products to normalise risk premiums. Even now, we expect this process to continue for quite some time yet. This is apparent from the exceptionally high returns being generated by the short volatility strategies still remaining in the market after the coronavirus crisis."

Analysis
"Volatility as an asset class - Taking stock after the coronavirus crisis - Catch-up potential remains intact": This **downloadable** analysis contains further charts, data and facts, including the role currently played by the hedging of extreme events (tail hedges) and increased retail investor activity.

Lupus alpha Volatility Invest C | ISIN: DE000A0HHGG2 | More
Lupus alpha Volatility Risk-Premium C | ISIN: DE000A1J9DU7 | More

About Lupus alpha
As an independent, owner-operated asset management company, Lupus alpha has been synonymous with innovative, specialised investment solutions for over 20 years. As one of Germany's European small and mid-cap pioneers, Lupus alpha is one of the leading providers of volatility strategies as well as collateralised loan obligations (CLOs). Global convertible bond strategies complete its specialised product range. The Company manages a volume of more than EUR 15.0 billion for institutional and wholesale investors. For further information, visit www.lupusalpha.de.

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