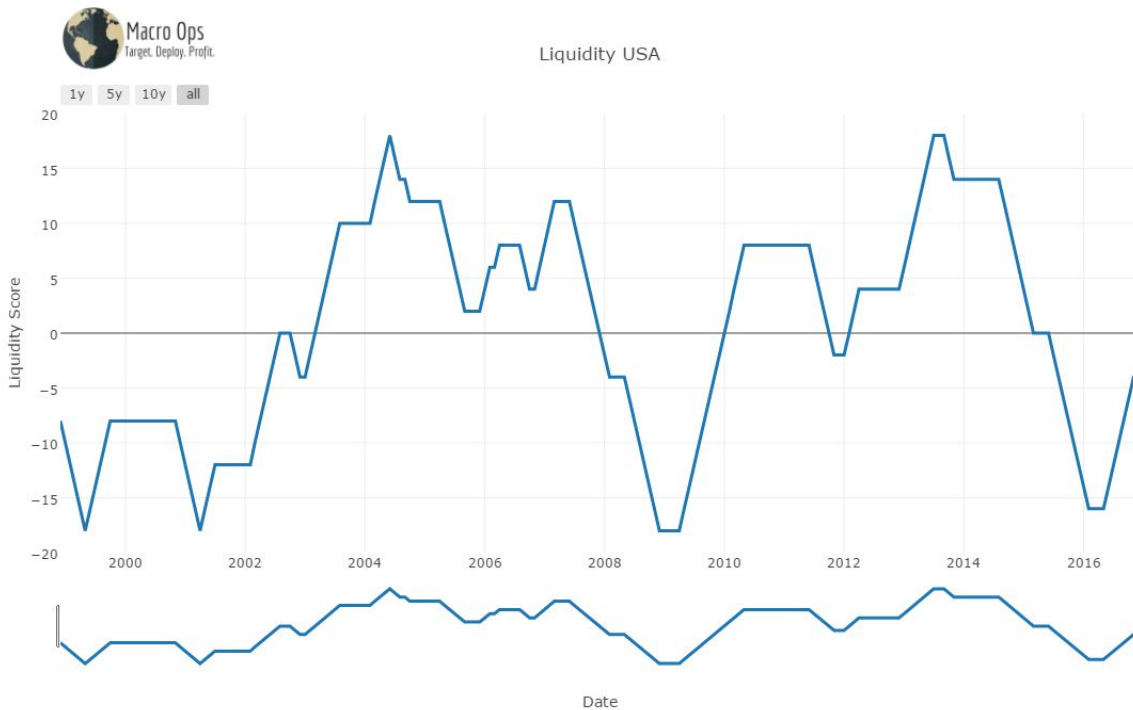


Signs Of Super Volatility

Fortunes are made and lost during super volatility. More dollars change hands in a high VIX environment than in any other environment. Luckily for us, the market usually tips its hand before a super vol event. We monitor four key indicators to keep us on the right side of a volatility firestorm.

1. Widening Credit Spreads

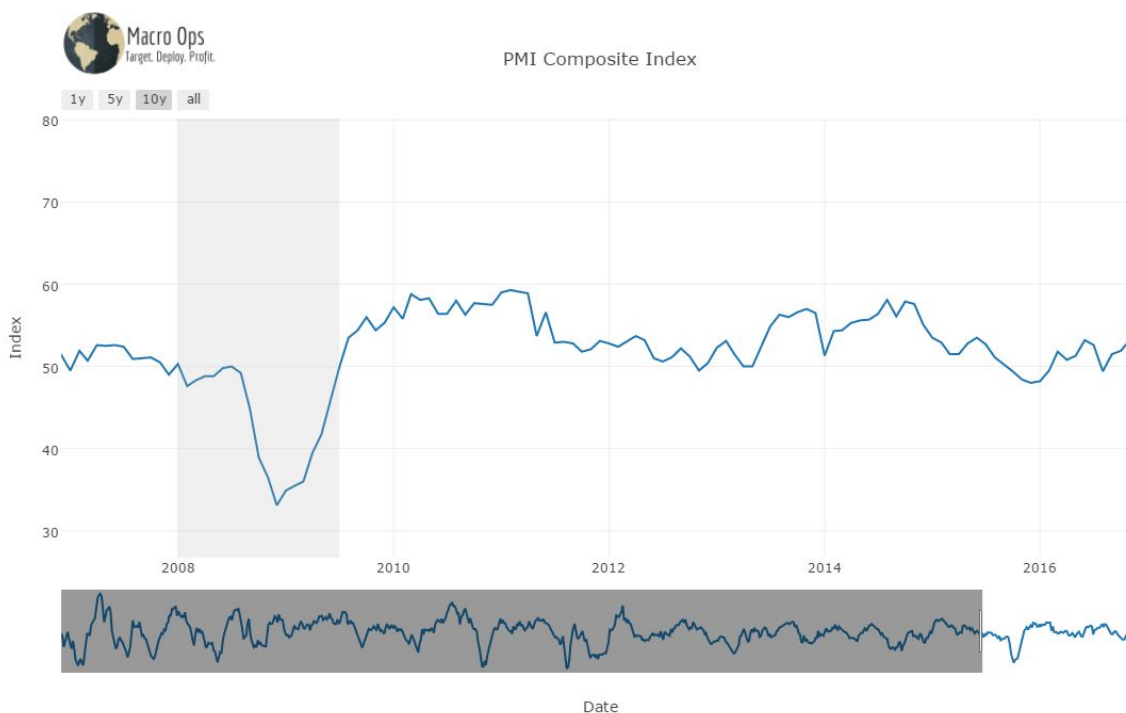
First off, we watch the trend in credit spreads as measured by our liquidity indicator. Widening spreads make it harder for companies to service their debt and increases the likelihood of a default contagion in the system. When the graph below is in a downtrend, it means credit spreads are widening and we have the potential for a volatility fire storm to break out. If the line is uptrending, then credit spreads are tightening and the probability of a super vol event is tiny.



You can see during the 2008 crash the liquidity indicator was in a steady downtrend. Credit spreads were widening sending a shockwave of defaults across the financial system.

2. A Downtrend In PMI

On top of monitoring credit spreads it's a good idea to keep track of the PMI number. Super vol occurs when the PMI is in an established downtrend. You can see the PMI index downtrended into the VIX spikes of 2008, 2011, and 2015.



3. SPX Trading Below The 200 DMA

Another good thing to keep track of is SPX price action. Almost all volatility super spikes occur when the SPX is trading below its 200-day moving average. It's not a perfect indicator (it didn't catch the flash crash in 2010) but it alerts us to the majority of important vol events — the ones where VIX spikes really hard.

The August 2015 spike in VIX and the elevated vol in the beginning of 2016 both occurred while SPX was trading below its 200-day moving average.



Here's the 2011 sell off during the European debt crisis. Once again price is below the 200-day MA as VIX spiked.



Next is the 2008 crash where we saw VIX all the way up in the 90s at one point. The whole event took place with the SPX below the 200 day.

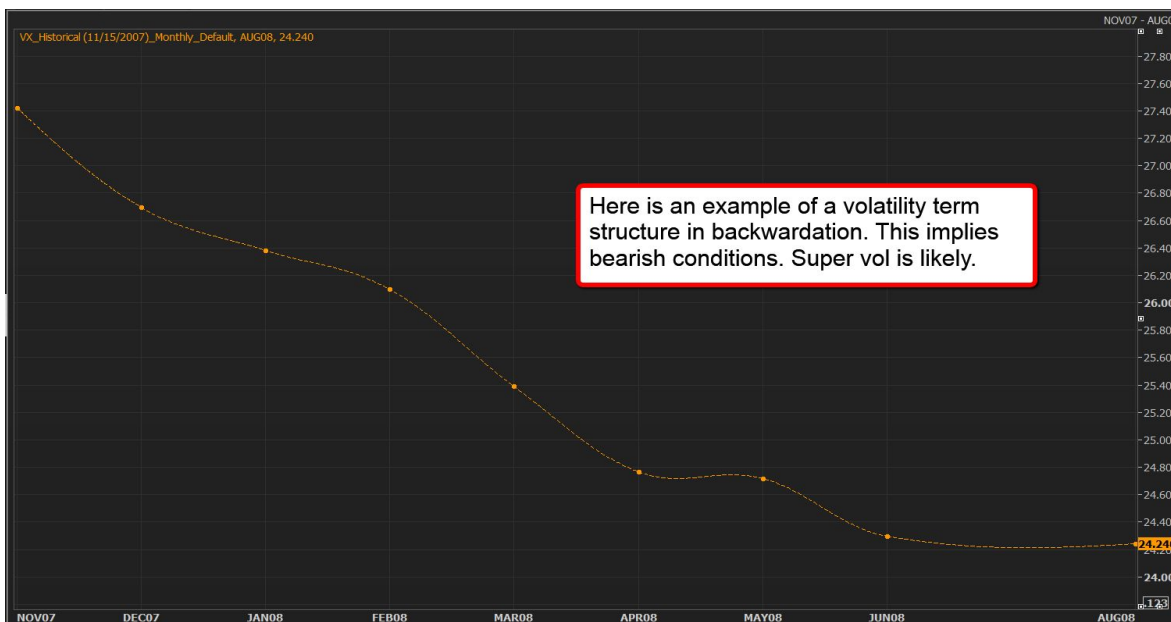


And finally we have the famous 200 day cross that PTJ caught right before the horrific 1987 crash where the VIX (calculated differently at the time) exceeded 100.

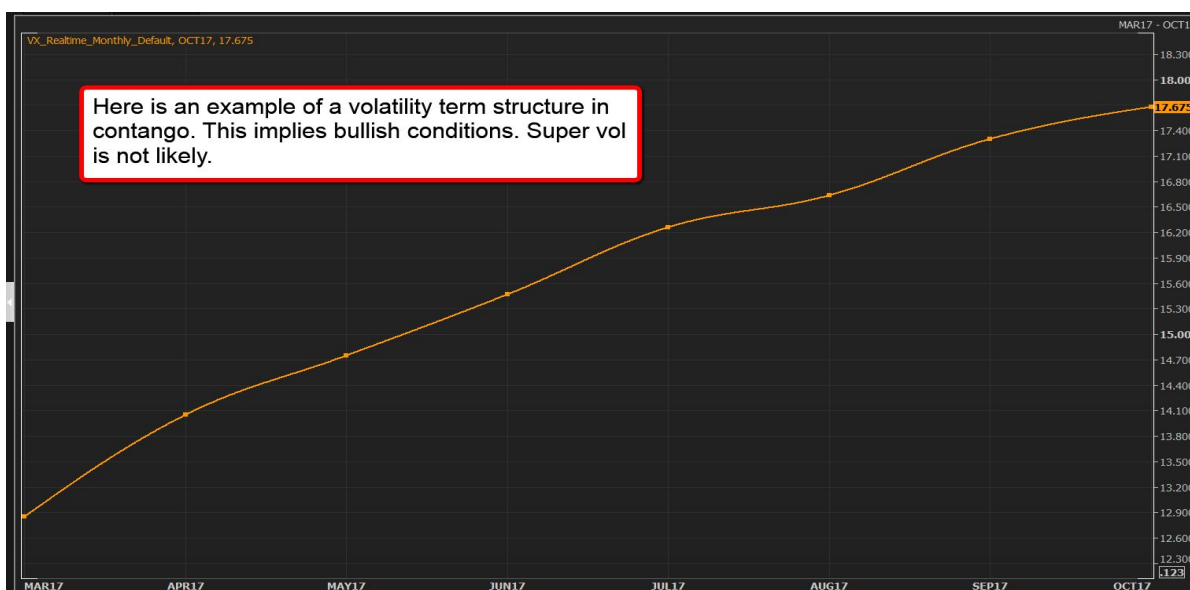


4. Backwardated Term Structure

Timing super volatility also requires us to monitor the term structure of volatility. Super vol usually occurs when the curve is in backwardation meaning the futures closer to expiry are trading for a higher price than the ones with a lot of time left. The following graph shows an example of backwardation.



And this next graph is an example of contango.



Keep track of these 4 indicators and you won't find yourself on the wrong side of a skyrocketing VIX.