TALARIA

Thought Piece
13 February 2018

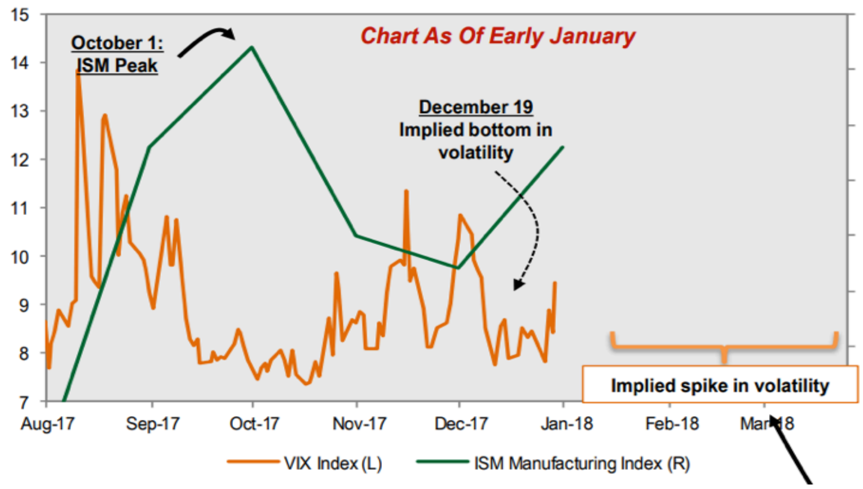
VOLATILITY - SET TO BE A TAILWIND IN 2018

Harnessing volatility is a unique feature of our process at Talaria.

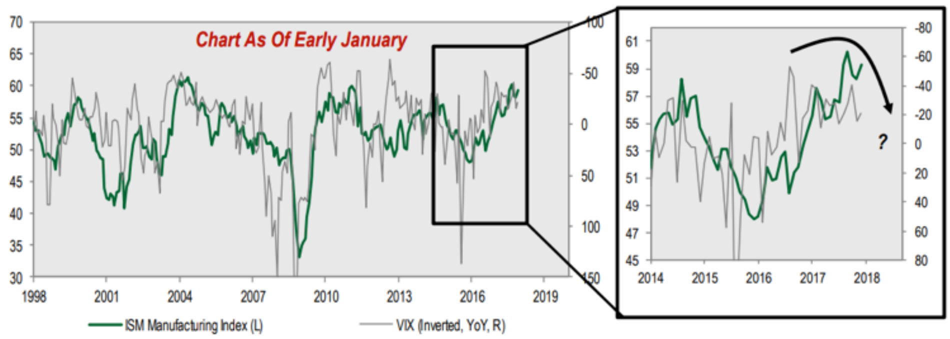
In this piece we outline our expectations for a pick-up in volatility for 2018 vs. 2017 following the bottoming of the VIX in December 2017. We also highlight how this pick-up in volatility provides a tailwind to our returns looking forward – irrespective of equity prices.

Looking at volatility of the past 30 years…the VIX has bottomed after the peak in the ISM 7 out of 8 times. The average bottom has been 79 days historically…In the current cycle the October 1st peak in the ISM implied volatility troughed on Dec 19th 2017.

On average, the VIX surges 60 days after it bottoms with a tight historical range of a month either side. This would equate to 17 Feb 2018 given the ISM peak of 1 Oct 2017. The behaviour of the VIX across history is consistent following a peak in the ISM index.



As it pertains to our income generation via selling put options – we currently have 31% of our total assets in put options earning an annual rate of return of 24% …equivalent all else equal to 7.44% income generation over the course of 12 months. So even assuming volatility stays as it is today – and equity prices decline - our strategy would still receive 7.44% income. This compares to Q4 when the annualised rate of return was 15% - which assuming the same amount of cash backing our commitment to buy specific stocks would generate 4.65% annualised income. So without doing anything different – the pick up in volatility has generated an annualised pick up in return of 2.8% on a forward 12 month basis from today.



Given Volatility follows the ebb and flow of the economy - and with Lead Indicators expected to fall from todays elevated levels given that tightening in the pipeline has been stacking up (Slowdown in money supply growth / 5 Fed rate hikes / mortgage rates +98bsp from low / oil up 55% from 2017 low etc) - we fully expect volatility to remain a tailwind for fund returns – irrespective of the direction of equity markets.