Section 3: Blog

VTS Community,

As I continue to analyze this very odd market crash, I think it might be useful to keep a little database of the relevant articles for future reference. We'll keep a list people can easily click on and revisit later on down the road.

4 types of VTS drawdowns and why this one in 2022 is strange

Volatility metrics have been very slow to respond to this crash

There may not be any safety assets left anymore

I'm 46 years old, which means I have at least 30 years of investing timeline ahead of me. When things go badly and I suffer a drawdown larger than I'm comfortable with, I simply have no choice but to learn from it and figure out what went wrong and why the volatility metrics were so slow to respond.

We've crossed the 10th anniversary of the launch of VTS in January 2012 and I've had many drawdowns in that period. For the leveraged portfolio, there's been 5 in the double digits. However, it's pretty clear this month is going to be the worst yet. Based on long-term averages, the drawdown is going to be about 4% larger than it should have been, and for the leveraged portfolio that will mean about 6% or so.

I sincerely apologize to everyone, this was quite unexpected. 100% of my net worth is in my own strategies so I'm feeling the pain of this market crash as well. It can and will be recovered, but there's only two things I can do:

- First, figure out why the volatility market was slow to respond which allowed our strategies to run about 5% too far before getting to safety.

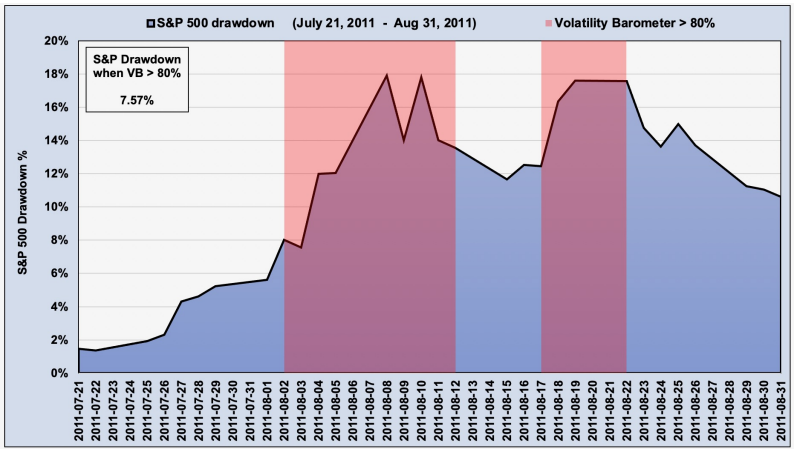
- Second, find a solution to make sure it doesn't happen again.

The VTS Volatility Barometer hasn't yet crossed 80%

I've gone through the 7 largest drawdowns for the S&P 500 in the last 10 years and marked the point where the VTS Volatility Barometer first crossed over the 80% level. We need to determine the average and whether this latest crash is an outlier or not. It certainly feels like one right? I would have expected to be into long volatility VIXM several days ago. What gives?

** All of these charts are showing the S&P 500 drawdown level, so the higher the line goes the larger the S&P 500 drawdown is. The red periods are an overlay of when the VTS Volatility Barometer was over 80% so we can see what level it was happening at.*

August 2011 crash:



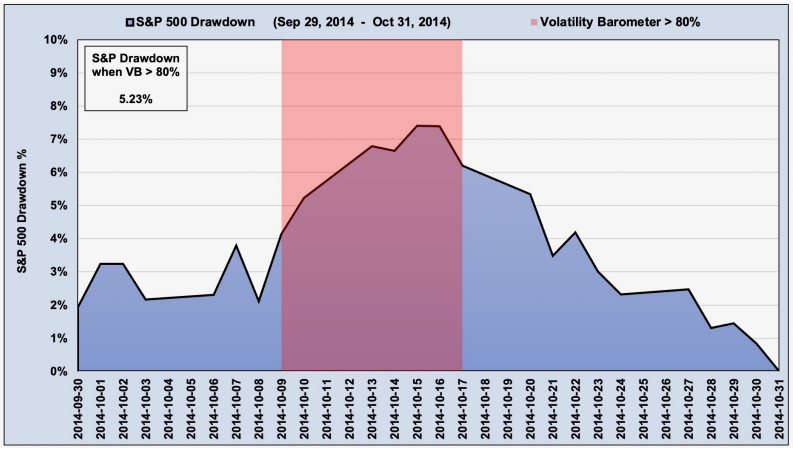
The Volatility Barometer crossed over 80% when the S&P 500 was dipping below a 7.57% drawdown. It's a little slow which meant there was an uncomfortable drawdown, but in that case there was some reward with a few extra days of crash to recover some of the initial pain.

This is the ideal situation when the barometer crosses over 80%. **If it's going to go, it's best to go big!** Remember, the VTS Portfolios do have tail risk protection. The initial drawdown can be painful, but if there is follow through and a legit crash, that's when we can start to benefit from the carnage.

I always say I'm not rooting for a market crash because I know that nearly all investors out there will get decimated. I'd much prefer to make my profit with a consistently rising stock market, it's best for everyone involved. However, just purely based on my own portfolio performance:

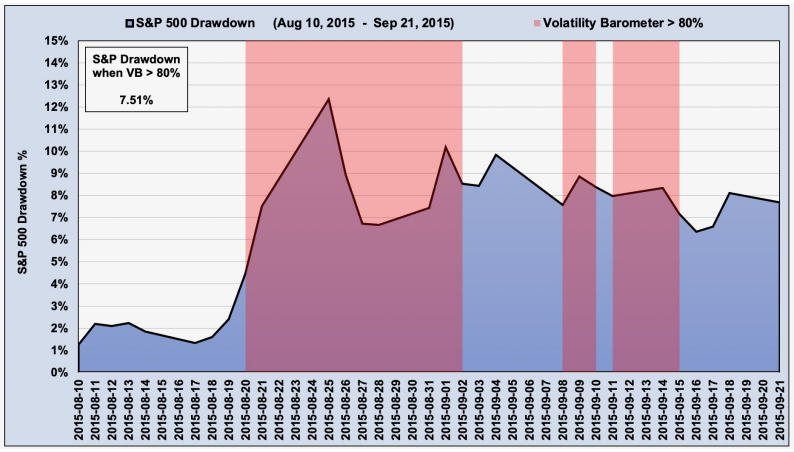
The more violent the crash, the higher my profit will be

September 2014 crash:



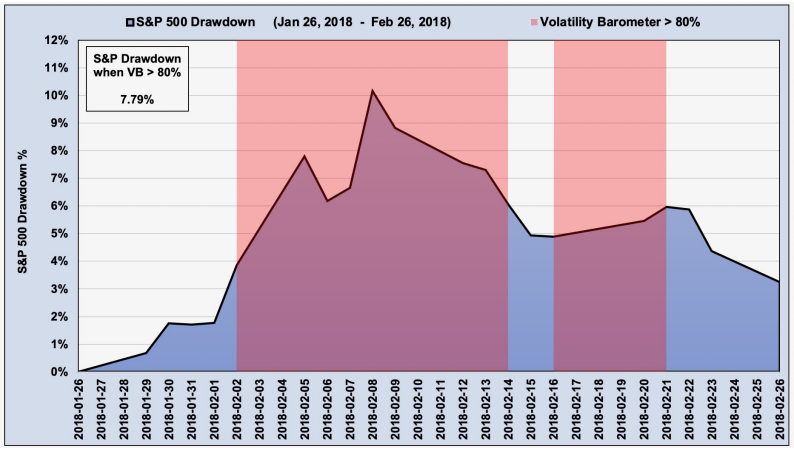
The S&P needed to drop 5.23% before we got the long vol signal, which is actually a little faster than the 6.3% long term average. This would be the perfect situation where the portfolios only need to drawdown about 5-10% before exiting.

August 2015 crash:



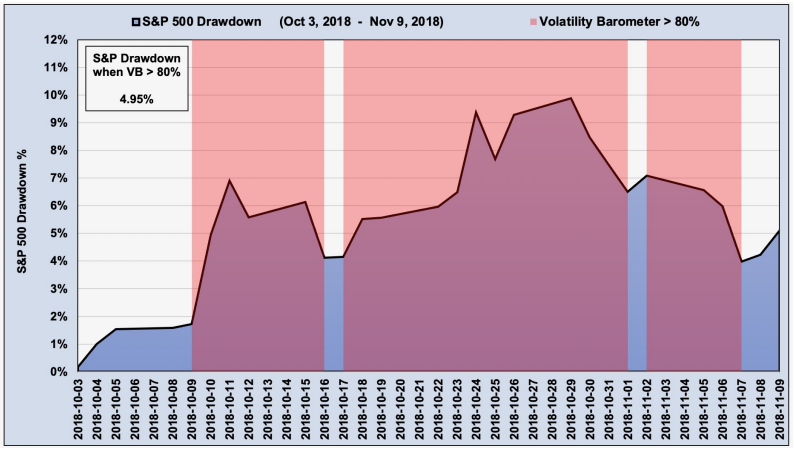
The August 2015 crash was actually one for the record books because on the Friday the VIX spiked about 45%, and then the following Monday it spiked another 45%. It was one of those rare back to back crashes that really pose problems for contrarian Short Vol traders. Far too many people rush into short vol trades at the first sign of trouble, and August 2015 was a reminder why that's a terrible idea. This is why I always wait for confirmation of signals before getting back into the market. Sometimes you feel like you're too slow to get back in, but it does reduce the potential of getting whipsawed.

February 2018 crash:



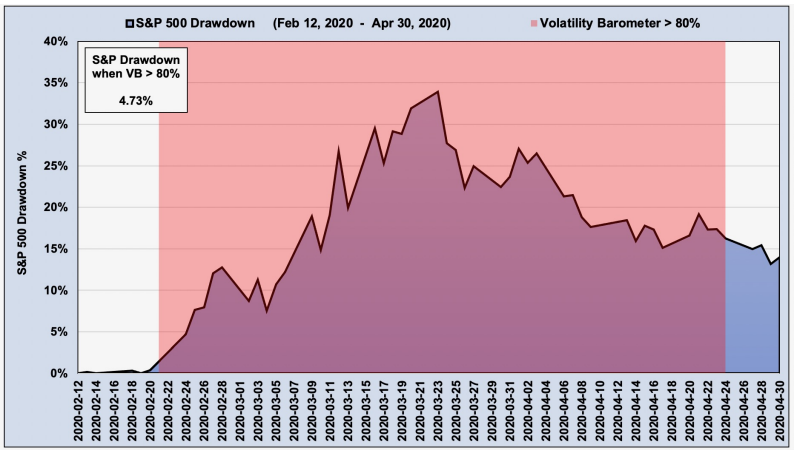
Volpocalypse will always be one of the more memorable crashes as it lead to the single day termination of our old favourite volatility ETP the XIV. Fortunately the volatility metrics signalled trouble well ahead of time and we were comfortably in safety a week in advance.

October 2018 crash:



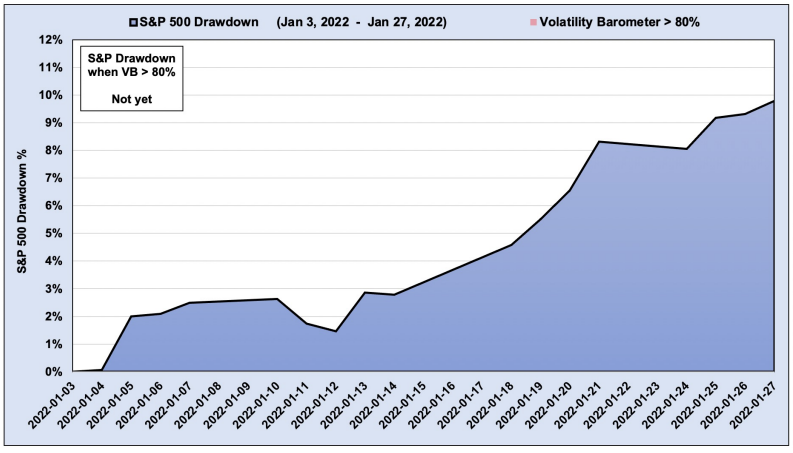
The selling in Q4 2018 was relentless, and part of me wonders if this latest crash in 2022 will look something like that one. At every step of the way, just when it felt like the market was bound to recover we had another leg down. The Volatility Barometer picked up on the signals early and it was actually a very stress free period for me and we actually turned a profit.

February 2020 crash:



For astute volatility traders, the global pandemic was telegraphed quite early on and shouldn't have posed much of a problem for those that are willing to rotate into safety when trouble arises. Now there were plenty of people fighting against it so it turned out to be devastating for most investors, but the Volatility Barometer was not fooled.

January 2022 crash:



However, so far in January 2022 the Volatility Barometer has been fooled. Notice the complete lack of a red overlay in this chart? The Volatility Barometer is certainly elevated in the high 70's which is why we are in partial safety, but shockingly it has not gone over 80%. The S&P 500 is at about a 10% drawdown which means this is the record for the slowest reaction compared to the 6 previous drawdowns. Here are the levels at which the Volatility Barometer went over 80% in the previous market crashes:

Aug 2011 at 7.57%
Oct 2014 at 5.23%
Aug 2015 at 7.51%
Feb 2018 at 7.79%
Oct 2018 at 4.95%
Feb 2020 at 4.73%

Average: 6.30%

This is what I mean when I said we're about 4% too slow to respond this time around, and for the leveraged strategies it's about 6% beyond expectations.

So duh, just adjust the Volatility Barometer right?

Now I think the obvious knee jerk reaction would be, well why don't you just make the Volatility Barometer more sensitive? Why not just adjust the thresholds so it signals trouble earlier on and we can avoid these painful drawdowns. Yes my friend, that does "seem" like the obvious solution. However, perhaps a little food for thought for the weekend.

Is adjusting the thresholds to be more sensitive without risk? Surely it would reduce the potential drawdown during bad times if we just move to safety sooner right? But on the flip side, might it possibly also reduce the potential return during good times? Sometimes allowing for a few extra trades is what is responsible for some extra profit. We wouldn't want to cut those tops off would we? I will dive into this topic for a future blog as it's quite an interesting investing dilemma.

It's been brutal folks, but **try** to have a great weekend!