

# Increasing performance through portfolio hedging



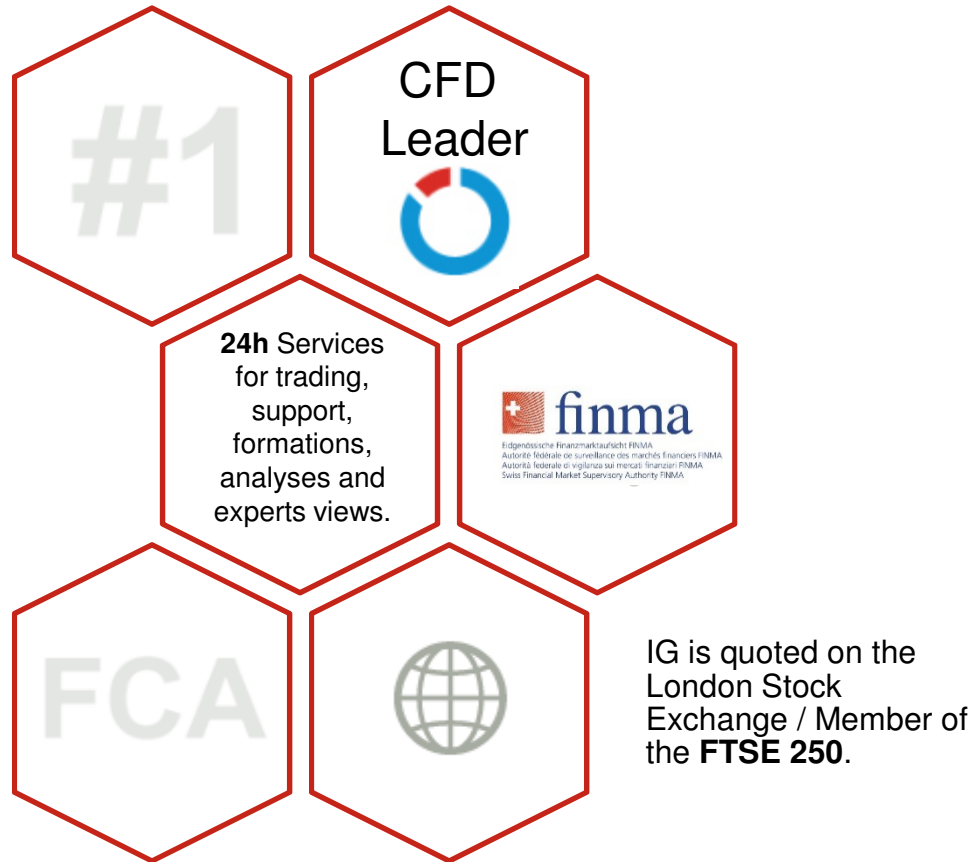
**Geneva, 26 January 2017**

Andreas Ruhlmann – Market Analyst

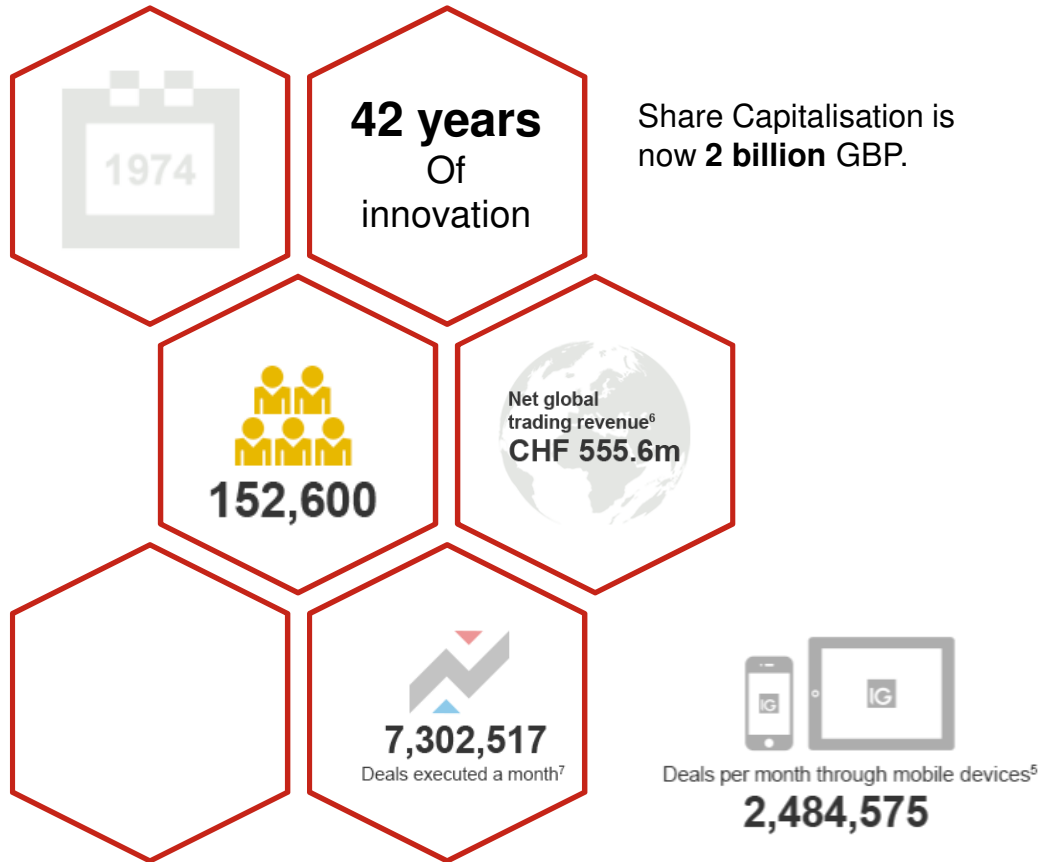


Planet of finance

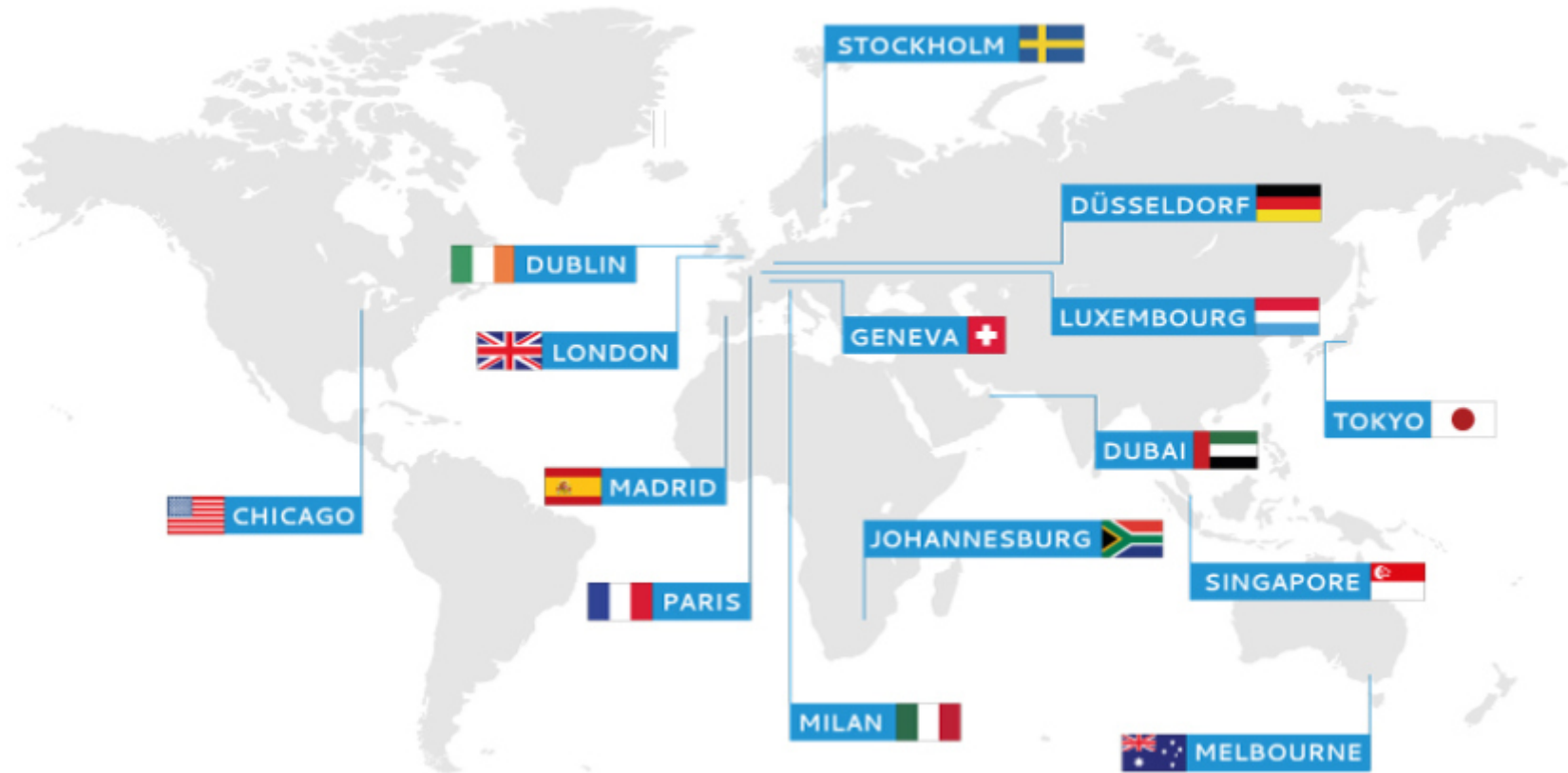
# IG GROUP : KEY POINTS



# IG GROUP : KEY FIGURES



# IG on 5 continents and 15 countries





# SEMINAR OBJECTIVES

- Should you be hedging your portfolio in 2017?
- Various hedging methods: Pros & Cons
- Practical examples

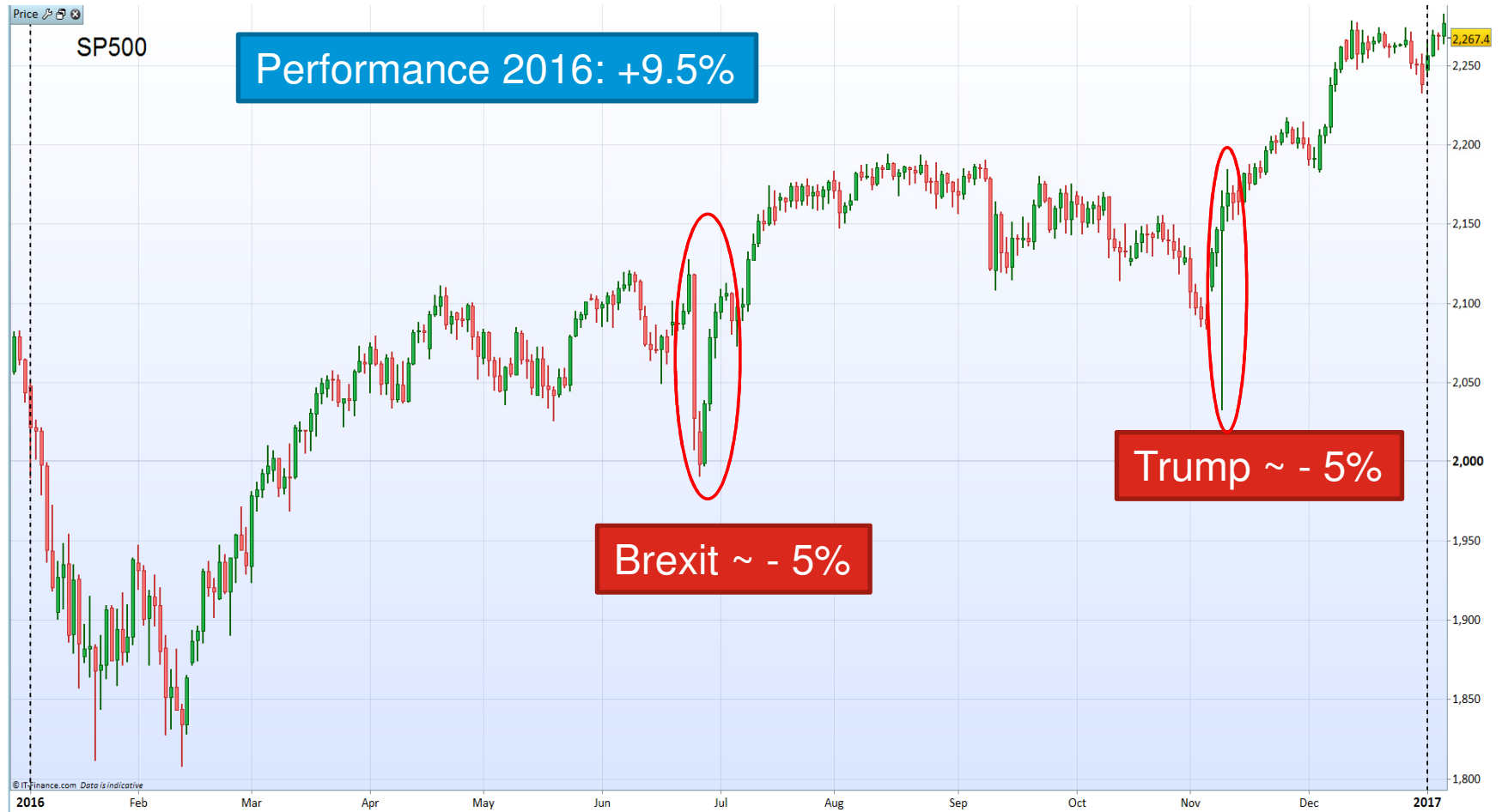


# WHY HEDGE?

- Hedging is the protection of a portfolio against unwanted volatility
- The end goal of hedging is to increase the portfolio performance



# 2016 RETROSPECTIVE - SP500



# SMI



# POLITICAL UNCERTAINTY IN 2017

2017	Country	Event
Jan 20th	US	Beginning of Trump's term. (1st six months are critical) (??? Trade policy, tax reforms timing and size)
Mar 15	Netherland	General Election
March	UK/EU	Article 50 for EU exit
April 23 / May 7th	France	President election 1st/2 <sup>nd</sup> round
September	Germany	General election

Fed tightening: expect volatility around FOMC meetings



# THE CALM BEFORE THE STORM?

	Jan 19th	52 wk low	52 wk high	10Y average
VIX	12.44	10.93	32.09	20.7
VDAX	14.72	14.49	39.23	24
VSTOXX	15.11	14.39	42.27	25.4

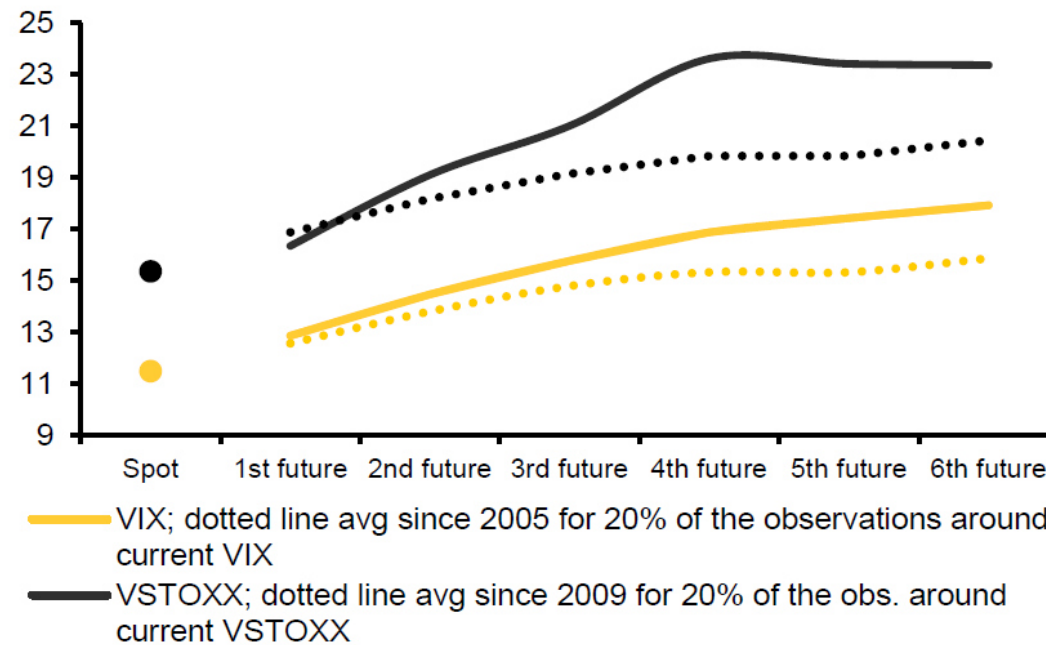
*Reuters, IG Bank*



# VIX & VSTOXX FUTURES CURVE

- The Curve of the VIX and VSTOXX future are both steeper than average, suggesting investors expect volatility to increase over the coming months

Equity implied vol curves suggest no complacency by investors



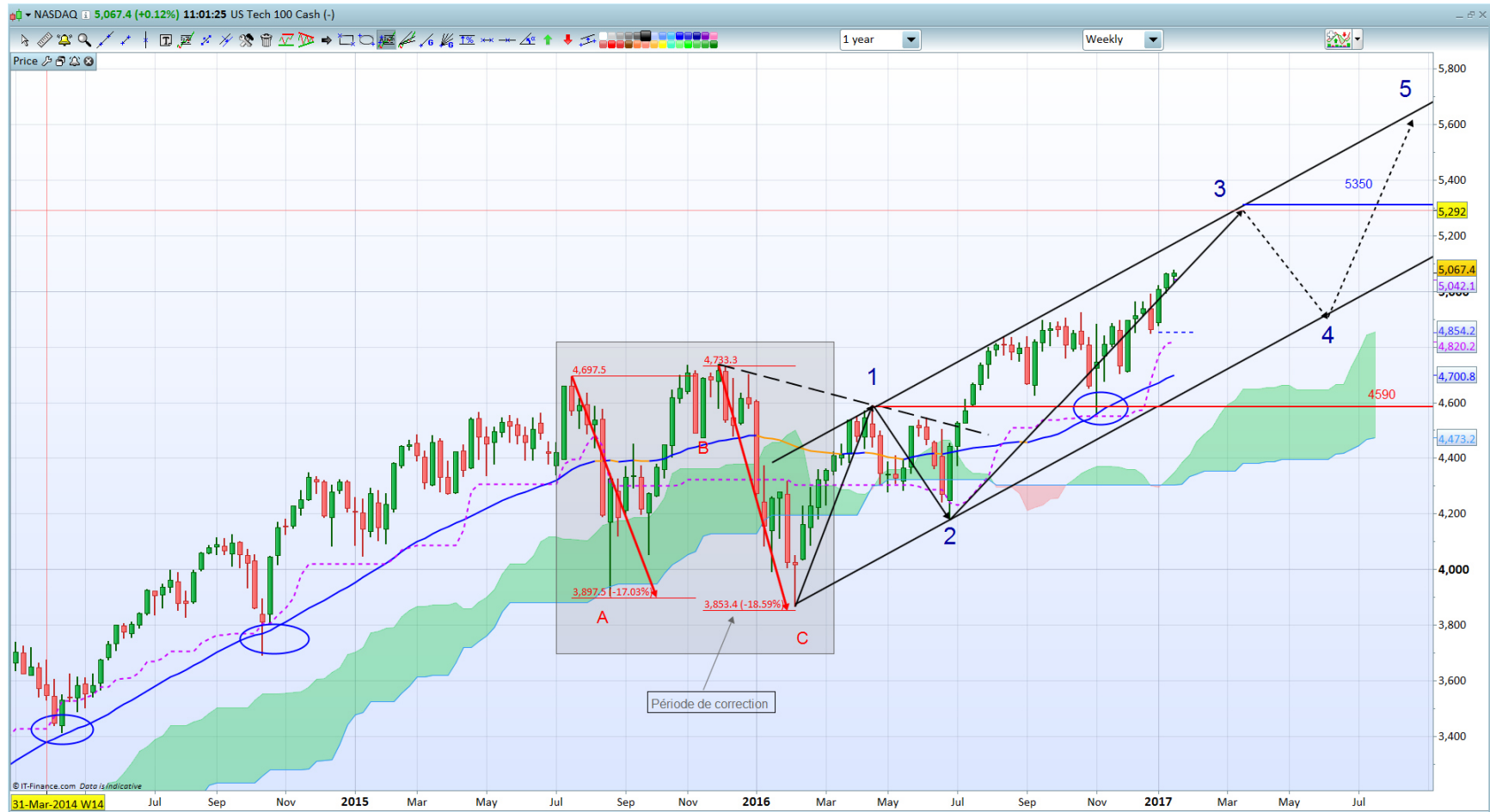
Source: Bloomberg, Commerzbank Research

# SP500 – PRIMARY TREND REMAIN BULLISH





# NASDAQ 100



# DAX



# EURO STOXX 50



# SMI



# MARKET DISPERSION



Source UBS

# EXTREME OPTIMISM

Chart 7.) S&P-500 with NAAIM Exposure Index



Source UBS

# US 10 YEAR NOTE



# BUND





# DJ-UBS COMMOMDITY INDEX



# WHY REFLATION HAS ROOM TO RUN

- Tight job market in the US = rising wages
- Oil stabilized above \$50, and bottoming commodity prices
- Central bank tapering? Low rates vs healthier banks and money availability
- Trump fiscal Push?



# OUR CONCLUSION FOR 2017

- Equity markets remain strongly bullish
  - Reflation: Stocks > bonds
  - Volatility to pick up: Historic high, Extreme bullishness, Market Divergence
  - Expect more volatility spike around political events
- **It will probably pay off to be long equities, but the road will be bumpy and hedging will play an important part in order to boost performance**



# REDUCE MARKET BETA

## Portfolio rotation

- Méga-cap ex: Nestlé, Coca-Cola, Johnson & Johnson
- Value stocks vs Growth stocks
- Defensive sectors – Food & Beverage, Health, Infrastructure, Telecom
- Hold a larger portion of treasury or cash

(-)

- Portfolio rotation is expensive. Some private banks still charge 2% round-term
- Reflation? Negative for cash and fixed income (except inflation-indexed bonds)
- Defensive dividend stocks were the biggest winner during the low-rate environment. New era?

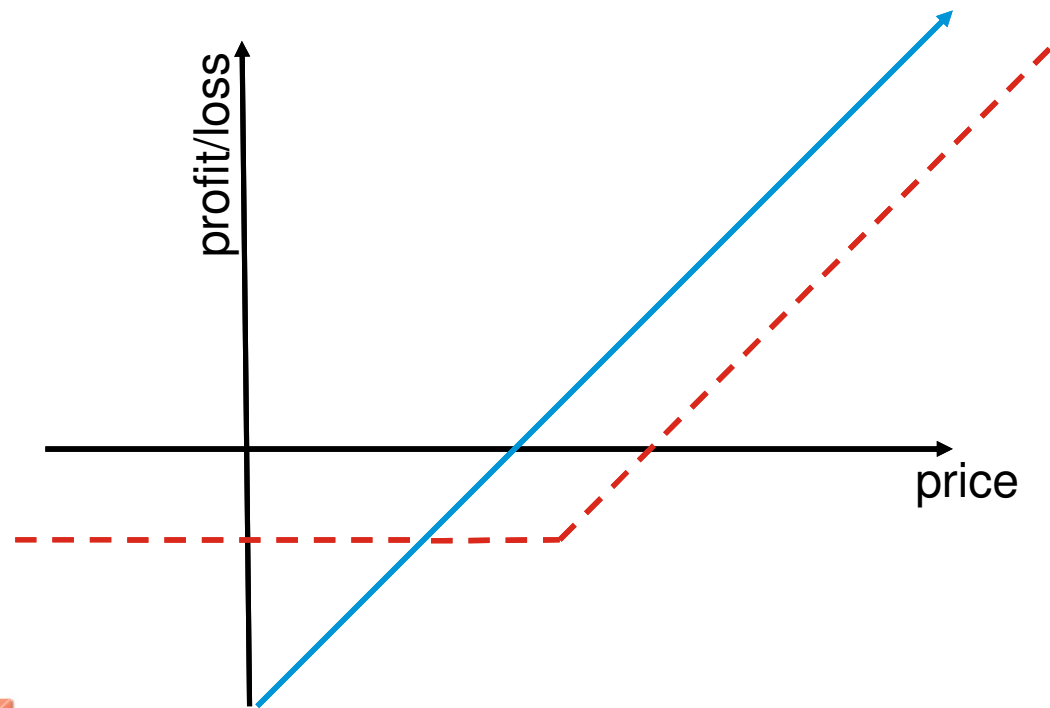


# DIVERSIFY INTO PRECIOUS METALS



# PROTECTIVE PUT OPTIONS

- Protective Put: the right to sell at a pre-defined price
- Pay a premium for an insurance



# OPTIONS

## Pros:

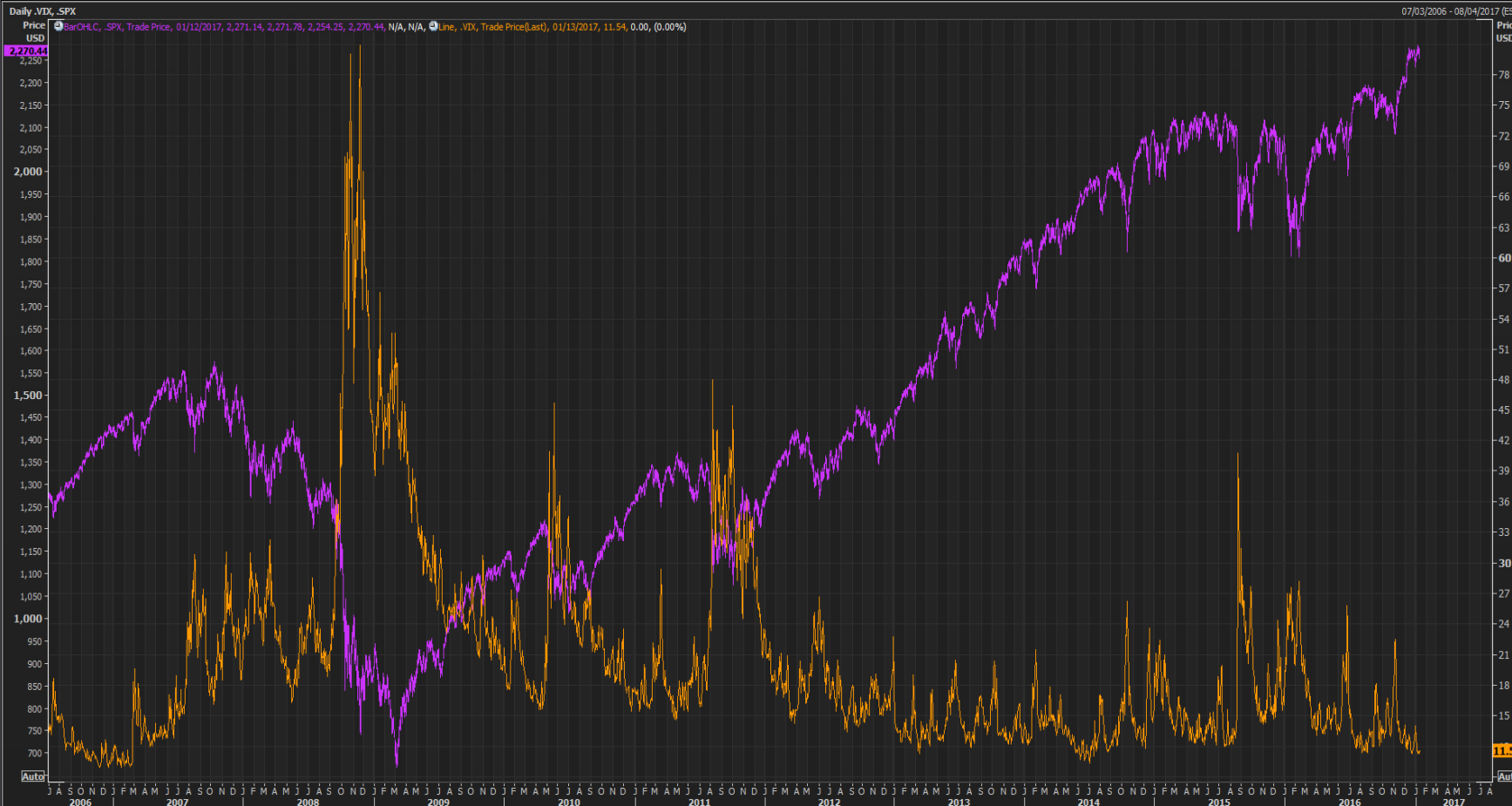
- Cost of the hedge is fixed and known in advance
- Protected against the downside, but still participate in case of upside

## Cons:

- Options factors event risks in the price (more expensive since brexit and Trump surprise)
- Expire – need to choose the right expiry date
- Standard size: 1 lot = 100 stocks
- Empirical studies show options reduce performance over the long run.



# VIX vs SP500



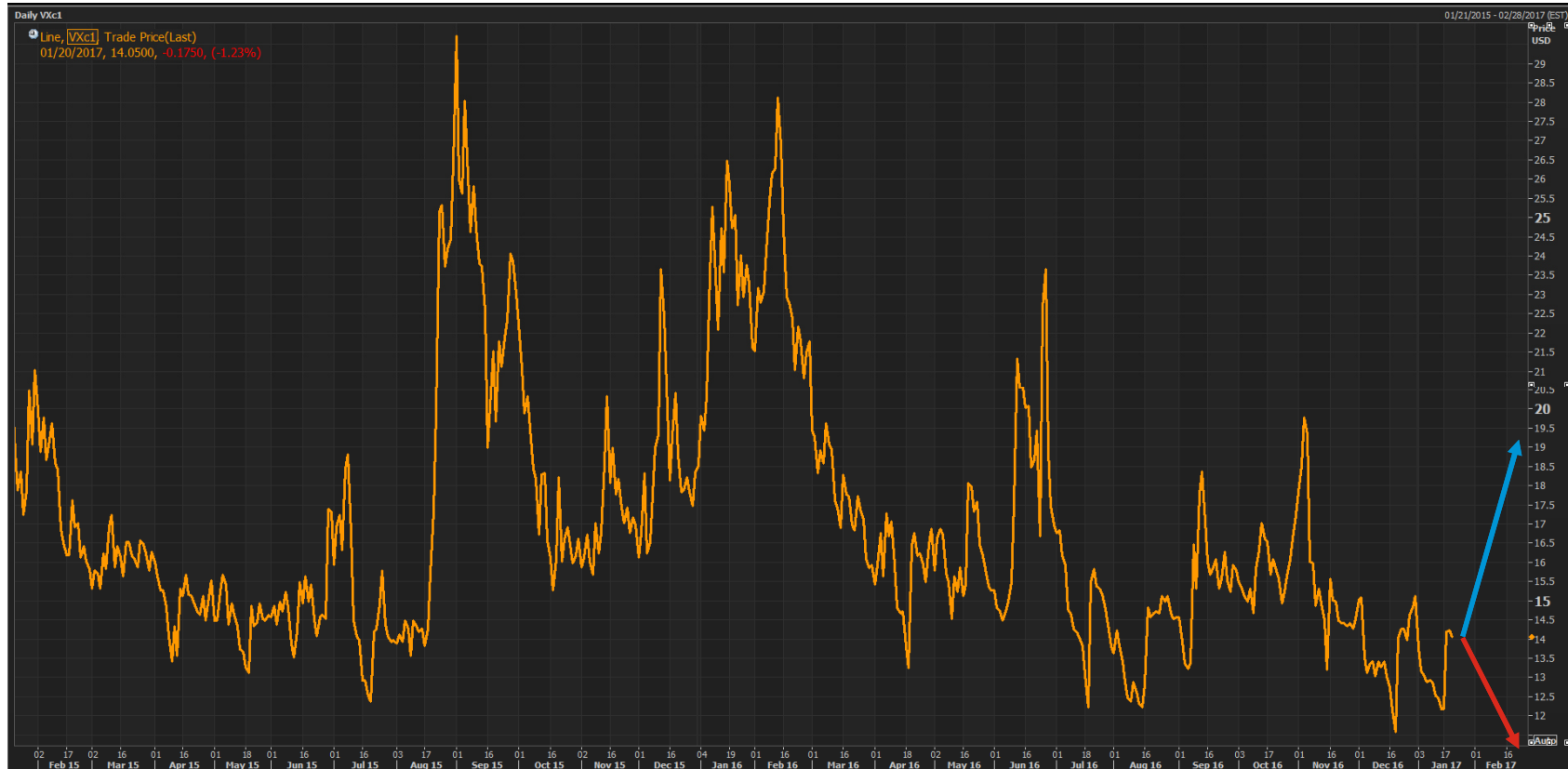


# VOLATILITY FUTURES

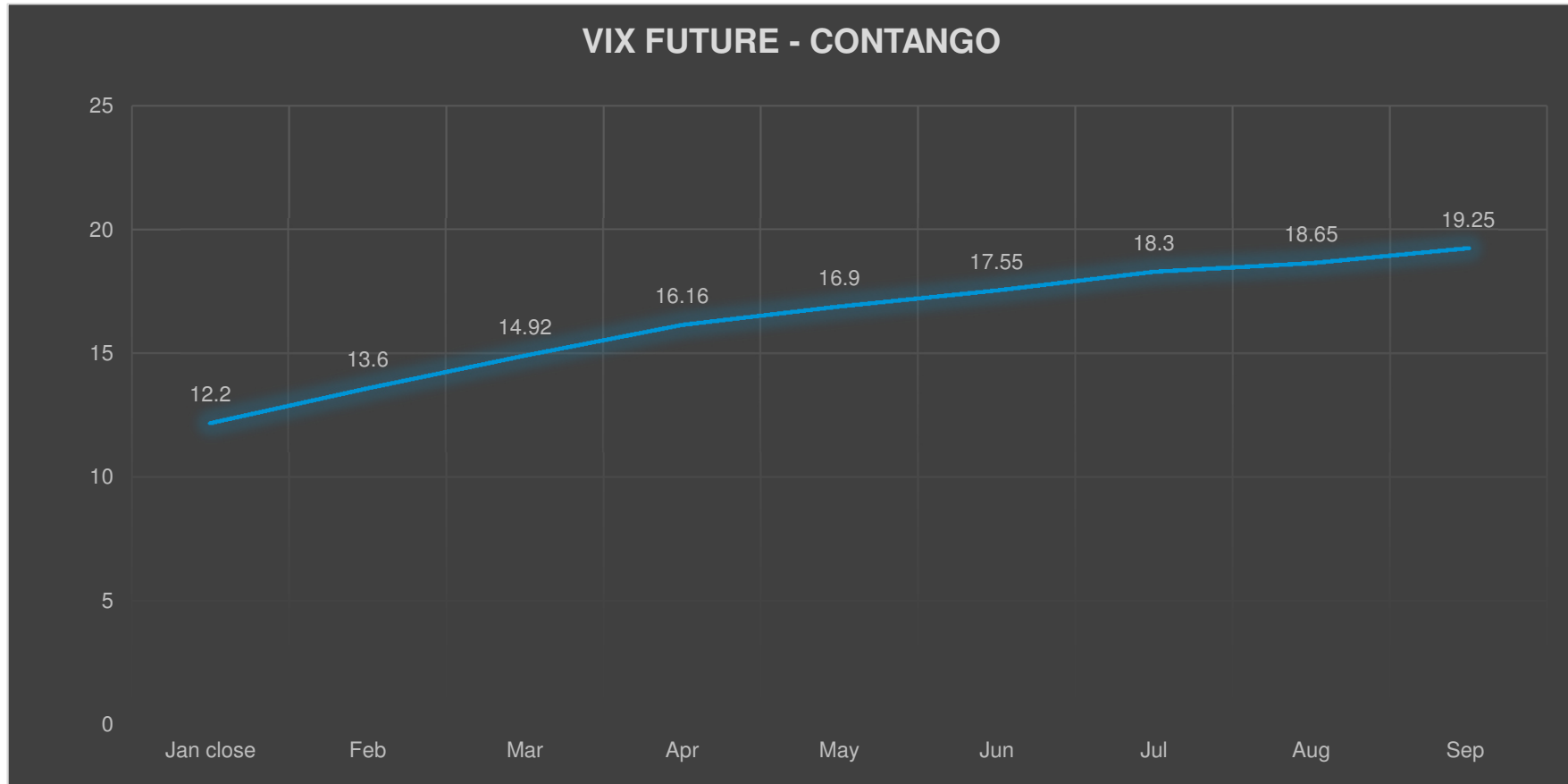
- VIX = volatility index on the SP500 shares
- VSTOXX = volatility on the Euro Stoxx 50 shares
- Expire on the 3rd Friday of each month
- Contract size: \$1000 per point



# VIX FUTURE CONTINUOUS CHART



# VIX FUTURE - CONTANGO



Note: most funds make money being **short vol** not long vol

# HEDGING WITH CFDs

## What is a CFD?

- A CFD is a contract for difference where you win or lose the difference b/w your entry and exit point
- The value of a CFD is based on an underlying asset: **Stocks, Indices, Currencies, commodities etc...**
- Margin products: leverage & no currency exposure
- **Long / Short**: short selling/ hedging
- No expiry (except for CFDs on futures)
- CFDs on shares avoid the Stamp duty



# HEDGING EXAMPLE

	Stocks operations	CFD operations
Jan 4 (start year)	Buy 10'000 ABB shares @ 17.66 CHF	
Jun 23 (Brexit D-1)		Sell short 10'000 CFDs on ABB @ 20.60 (0.1% fees: 203 Fr)
Jun 24 Brexit		close my short at mkt open @ 19.23 (fees = 192 Fr)
	Proceeds from hedge: $10000 \times (20.60 - 19.23) - \text{fees} = 13305 \text{ CHF}$	
Nov 8 (election D-1)		Short 10'000 ABB at 20.37
Nov 9		Close short at 19.75
	Proceeds from hedge (Net): 5800 CHF	
Dec 30	Sell my ABB shares @ 21.65	close short at 19.75
Yearly Profit	39'900 CHF (brut)	19'105 CHF (net)
Profit in %	22.6%	10.8%



# CFDs – PROS & CONS

## ➤ Pros

- Margin – little extra liquidity needed
- Protection 1 for 1
- No expiry
- Divisible i.e: trade 1 UBS share, 1.5 x the SMI index
- Low commission, no stamp duty, (receive interest on short positions)

## ➤ Cons

- Give up some gains in case markets do not fall
- Useful for known events such as earnings release, political events etc...but less for unexpected volatility



# **HEDGE EXAMPLE ON THE TRADING PLATFORM**



# Questions





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