

Differing developments in volatilities on the interest rate market: an opportunity

The current market environment

The escalating US trade war has dominated the headlines in recent weeks. This is also overshadowing what is actually a healthy economic situation in most countries. Protectionism threatens economic growth.

Central banks are now also taking a critical view and are increasingly deviating from their course of scaling back expansionary monetary policy, as the latest statements by Powell and Draghi show.

America versus Europe

In recent years, volatilities driven by central banks' fiscal policies have been fairly low in absolute terms and also largely in sync globally. In recent days, however, an interesting development has emerged: In contrast to German Bunds, the implied volatilities of US Treasuries have risen significantly.

This is shown in the chart below. There is great uncertainty about the Fed's future course. More and more

market participants now expect an interest rate cut. However, the Fed is not yet entirely convinced that it will deviate from its chosen course due to Trump's policies. This interesting market environment opens up a good opportunity for returns.

Implications for the 7orca Vega Return Strategy

In the short term, this development has cost performance in the Treasury Future. In addition to mark-to-market losses in the course of valuation due to increased implied volatilities, calls have run into the money. For new option contracts, there is the possibility that 7orca can use the increased volatility level for attractive premium income. This is also reflected in the dynamic exposure management.

The exposure is currently at a maximum for Treasury options and remains low for Bund options. The portfolio management is therefore taking advantage of the opportunity offered by the recent interest rate development.

Fig. 1: Implied Volatility (1 month, at-the-money, US Treasury Future vs. Bund Future)



Source: 7orca Asset Management AG, Bloomberg (01.01.2014 -06.06.2019)



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