Trend-Following: What's Vol Got To Do With It?

It is well documented that trend-following has generally performed well during crisis periods for equities. And since volatility tends to spike during equity crisis periods, many investors are tempted to characterize trend-following as a long volatility strategy. Contrary to such an interpretation, trend-following can perform well in both high and low volatility environments. It is the existence of sustained market trends rather than high volatility that preconditions good trend-following performance. Using the VIX Index as a measure of market volatility, trend-following performance can be observed to perform well in both high and low volatility regimes.

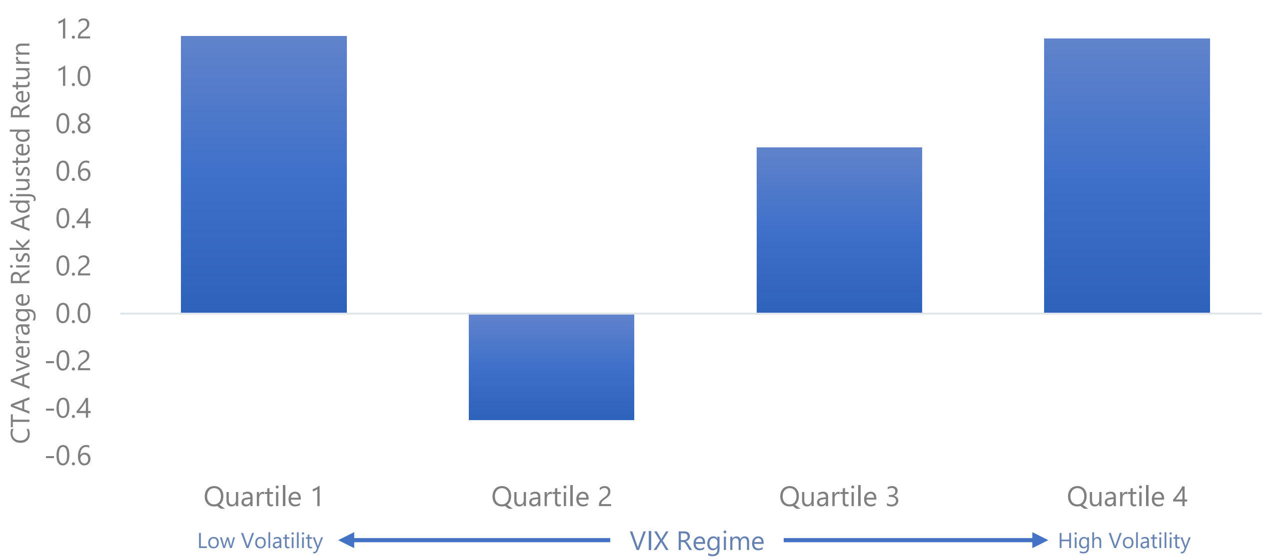
Hypothetical Example: Low Volatility Asset

Consider a hypothetical asset that goes down 1% every day. Any reasonable implementation of trend-following would short this asset and thereby make a certain gain on an asset that itself has no volatility. Having zero-volatility is not in itself a reason for poor trend-following performance.

Hypothetical Example: High Volatility Asset

Consider a hypothetical asset whose daily returns are consistently +5% followed by -5%. This asset is all volatility. Yet, trend-following on this asset would almost certainly yield terrible performance, suggesting that it is not volatility per se that matters to trend-following.

CTA RISK-ADJUSTED RETURNS ACROSS VOLATILITY REGIMES



Four volatility regimes are derived from the four quartiles of VIX Index levels based on data from January 1990 to June 2017 and the average risk-adjusted return for the Barclay CTA Index performances in these four VIX quartiles are computed. The highest and lowest quartiles show better performance than the middle quartiles.

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Access the full Research Note here:
[Trend Following and Volatility Regimes]

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