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The VIX is an index created by the Chicago Board Options Exchange (CBOE), used as a thermometer of market sentiment and volatility. The more intense is perceived volatility, the greater the VIX – or "fear". (UBS)

What is the VIX? – When volatility spikes think quality bonds

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Over time, the VIX has earned the moniker of "fear index". In this note we provide a brief explainer on the VIX, discuss some of the recent market volatility, and highlight the importance of quality bonds in times of turmoil.

What is the VIX exactly? – how to read it?

As per CBOE, it is "a financial benchmark designed to be an up-to-minute market estimate of the expected volatility in the S&P 500 Index, and is calculated by using the midpoint of real time S&P 500 option bid/ask quotes."

More specifically, the VIX Index is a calculation designed to produce a measure of constant, 30-day expected volatility of the US stock market. The headline VIX figure is derived from prices of S&P 500 call and put options. When there is rising demand for call and put options – which partly serve to hedge risks – the price of options increase, and thus the VIX rises. When the urge to hedge risks is low, there's no out-of-the-ordinary pressure in option prices, and hence VIX levels are rather contained.

In sum, the more intense the perceived volatility, the greater the VIX – or "fear". As per several research papers, the seeming conclusion is that VIX levels under 15-20 points suggest a somewhat standard volatility; in turn, when then the index surpasses 25-30 points – volatility is seen as high.

For instance, back in March 2020 – when the COVID-19 pandemic triggered market selloffs – the VIX reached levels of up to 80 points. Meanwhile, between 2015 and 2019 (a pre-pandemic benchmark), the VIX averaged about 15 points.

How has the VIX been doing as of late?
The VIX has averaged ~14 points year-to-date, with volatility spiking beyond the 20 point level during mid-April. This was a time in which weaker-than-expected GDP data, along with upside inflation surprises, worsened investment sentiment and fueled (unwarranted) discussions about stagflation. So far this month, the VIX has been at 'normal' levels; unsurprisingly, in line with a positive performance in equity markets.

Just like in life, a sudden spike in "fear" should not trigger you – cool heads generally prevail
As UBS CIO Investment Strategist Justin Waring recently highlighted, "viewing markets through the lens of short-term returns can skew your perception of risk and reward, and make you more susceptible to emotional decision-making."

"Focusing on long-term returns can improve the investment experience, and embracing a longer investment time horizon can help you unlock greater growth potential," Waring stated.

There's nothing wrong with keeping an eye on the market's movements, which can be sudden and surprising. Yet, for the most part, your investment objectives should be based on long-term targets, which have much to do with fundamental analysis and personal goals, and rather little with short-term asset volatility.

A note to the wise: A level of fear will always be there and at some point will spike. Thus, remember, it's important to keep your cool, even when that seems a hard thing to do.

Yet, in "fearful" times – high-quality bonds generally perform
Moments of market distress tend to result in "flight-to-quality" moves. Investors in their attempt to cap losses tend to sell risky positions and allocate funds to safe-haven assets such as US Treasuries, high-quality corporate credit, and gold.

In fact, one of our current Messages in Focus at the Chief Investment Office is **Buy high-quality bonds**. Our macro base case accounts for lower interest rates and yields in the year ahead. In the most plausible scenarios, we think high-quality debt can outperform cash over the next 12 months, so locking in today's high yields may maximize returns.

As a reference, the 10-year US Treasury yield has risen from 3.8% in late December to ~4.5% today. As such, this appears as a good opportunity to lock in yields; we expect 10Y US Treasury yields to close the year at 3.85%.

For further information, please see our notes:
Quality bonds – your soft landing gear, published on 6 May, 2024
Macro and market outlook: April showers followed by May flowers, published on 5 May, 2024
Fear is the path to underperformance, published on 1 May, 2024
Messages in Focus: Buy quality bonds, published on 26 April, 2024.

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