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Volatility Index Jumps to Record 79.13 as Global Stocks Tumble

By Jeff Kearns

Oct. 24 (Bloomberg) -- The benchmark index for U.S. stock options soared to the highest close in its 18-year history as stocks tumbled around the world on concern that the global economy is in recession.

The VIX, as the Chicago Board Options Exchange Volatility Index is known, jumped 17 percent to 79.13 after earlier rising to an intraday record of 89.53. The index measures the cost of using options as insurance against declines in the Standard & Poor's 500 Index, which slid 3.5 percent to 876.77.

"This is worse than we've ever seen," said Diane Garnick, who helps oversee $500 billion as an investment strategist at Invesco Ltd. in New York. "It's not only telling us that people are scared, but also that people don't trust the market. My fear is people will leave the equity market and not rejoin it in the medium term."

The VIX has averaged 27 this year compared with 17.54 last year. The volatility benchmark didn't close above 50 before Oct. 6 and hasn't closed below that level since then. The closing record, reached on Oct. 17, is 70.33.

The Dow Jones Industrial Average has swung by an average of 545 points over the last 30 days, including a record 1,018-point swing on Oct. 10, as the index slid 22 percent from a month ago.

"The moves are vicious and you can get killed in a matter of seconds," said **Joseph Saluzzi, a trader at Themis Trading LLC** in Chatham, New Jersey. "It's not trading, it's gambling."

November VIX futures jumped 12 percent to 55.91. January futures added 6.8 percent to 40.69. Before September, this year's highest close for the VIX was on March 17, when the gauge jumped to a five-year high of 32.24 a day after the Federal Reserve-led rescue of Bear Stearns Cos.

March VIX Options

More than 15,000 March 40 calls were purchased in the two days before today, according to Jeremy Wien, a VIX options trader at Societe Generale SA in New York. Those contracts closed yesterday at $4, up from 75 cents when they first traded on Oct. 6. They didn't trade today.

"People are buying these calls thinking that 50 or 60 is not unheard of in the next few months," Wien said. "People expect the mid 30s or even 40s is reasonable in the next few months."

The VIX fell for four straight years through 2006 and slid to a 14-year low of 9.89 in January 2007, a month before the first reports of subprime losses. The index rose the most ever on Feb. 27, 2007, when it climbed 64 percent to 18.31, as the U.S. equity market had its worst rout in four years.

The CBOE, which is the only U.S. options exchange that trades VIX options, has listed November 110, 120 and 130 contracts.

Market 'Uncertainty'

"There are unprecedented levels of uncertainty in the market," said Neil Davies, a volatility trader and head of structured equity products at SunTrust Robinson Humphrey Capital Markets in Atlanta. "There's so much uncertainty about global recession and that it'll take time for the government bailouts to work their way through."

Volatility contracts with maturities of two, five and 10 years rose to the highest on record, Davies said. Those contracts are used by institutional investors to hedge against declines in stock benchmarks over a number of years.

"These are the highest levels of implied volatility we've ever seen," Davies said.

Volatility derivatives called “variance swaps” that expire in 24 months rose 9.7 percent to 40.30, according to Bloomberg data. The 12-month swaps rose 11 percent to 44.99.

‘Old VIX’

The VXO Volatility Index, a predecessor to the VIX that reflects the price of options on the S&P 100, climbed as much as 26 percent to 86.15, the highest on a closing basis since October 1987. It jumped to 103.41 on Oct. 10. The “old VIX” set an intraday record of 172.79 a day after the October 1987 stock-market crash.

Today’s most-active S&P 500 options were November 700 puts, which added 73 percent and accounted for almost 6 percent of the 402,090 puts traded on the index today.

“It’s clear that emotion is driving this trading,” said Tim Feeney, an S&P 500 options trader on the CBOE floor and managing partner at Greycliff LLC in Chicago. “Everyone is positioning themselves to profit from a downside move.”

Investors use options to guard against fluctuations in the price of securities they own, speculate on share-price changes, and bet that volatility, or stock swings, will increase or decrease.

Europe

In Europe, the benchmark for European options rose to its highest in a week as stock markets plummeted after U.K. government figures showed the continent’s second biggest economy is edging closer to recession.

The VStoxx Index rose 16 percent to 74.74, the steepest advance since Oct. 16. The index measures the cost of using options as insurance against drops in the Dow Jones Euro Stoxx 50 Index, which fell 4.7 percent after losing as much as 9.6 percent earlier.

The VStoxx Index soared last week to 87.88, the highest since the index was created in January 1999, on concern share- price swings may become more pronounced.

“We have lots and lots of uncertainty, whether it’s the housing market, the credit markets, concerns about S&P earnings next year or unemployment,” Fred Froewiss, vice president of institutional sales at RF Lafferty & Co. in New York, said in a Bloomberg Radio interview. “It’s a very unsettled situation and that leads to volatility.”

--With reporting by Gareth Gore in Madrid and Sal Giangrasso and John Lamb in New York.
Editors: Chris Nagi, Allen Wan

To contact the reporter on this story:
Jeff Kearns in New York at +1-212-617-8138 or jkearns3@bloomberg.net.