acuiti management intelligence

EXPANDING HORIZONS IN VOLATILITY TRADING:

How more products are bringing new opportunities to the listed volatility markets

In association with:

miax®

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Introduction

Interest in trading listed volatility products has grown significantly in recent years, as what began life as a niche asset class grows both in volume and range of products.

Volatility has been a hallmark of global markets for the past five years and companies that have developed the skills and sophistication needed to trade the asset class have profited from that investment. As firms across the global market look to diversify their strategies and increase the opportunity for alpha, trading volatility will become more mainstream and the volumes and availability of products on the market will increase.

In order to understand how approaches and attitudes to volatility trading are changing, MIAX commissioned Acuiti to conduct a study analyzing the needs of the global trading community with regards to volatility products. Acuiti has conducted this research through surveying or interviewing senior executives at 94 proprietary trading firms, hedge funds, banks and interdealer brokers.

Over half (64%) of survey respondents were currently trading volatility products or strategies, while about a quarter were not and were not planning to. The rest were either considering trading it or in one instance had traded it but stopped.

The study found that for those already trading it, volatility has largely proven a profitable strategy. Furthermore, those who participate in the asset class are keen for growth in the range of products that they use to take positions.

The key findings in this report are:

- There is significant appetite in the volatility trading community for new derivatives contracts that they can trade alongside more established products.
- Volatility trading is set for significant growth as more firms plan to adopt the asset class.
- Index methodology is very important to most market participants and will be a key component in any new contract's success.
- The rise in popularity of short-dated options trading is a trend that could have a major impact on market participants' expectations both for listed volatility products and how they are calculated.

The growing appeal of volatility trading

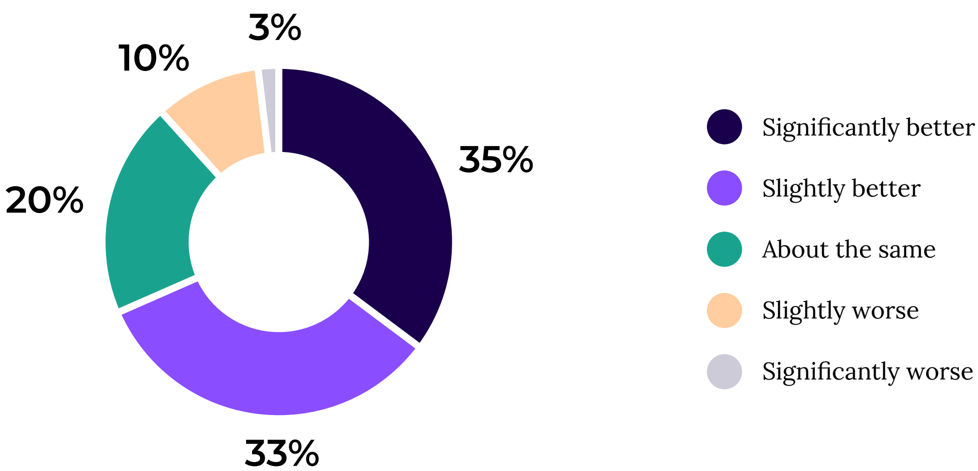
Volatility trading requires a sophisticated skillset but has the potential for huge returns for firms that can trade it effectively. Last year was another turbulent one for most asset classes and volatility traders benefitted as a result.

Over three-quarters of survey respondents that traded volatility reported that their volatility trading strategies had performed better than those in other markets in 2022.

With the right knowledge and capabilities, this is therefore an asset class that can offer considerable opportunities for alpha. That is especially relevant at a time when many of the correlations and strategies that served firms well prior to 2022 are breaking down and underperforming.

Volatility trading is moving from a niche asset class to a core strategy for many firms seeking to diversify their strategies.

In 2022, how did the performance of your volatility trading compare with other strategies?



Demand for trading volatility products is growing. Around half of the FCMs Acuiti engaged for this report said that they had seen an increase in demand for trading volatility products among their client base. In addition, a third of the firms that took part in the survey that did not currently trade volatility products said that they were planning to do so.

44% of FCMs said that they had seen increased interest among clients for trading volatility since 2020

Expanding the product suite

This study found strong demand from market participants to trade new volatility products and to expand the overall ecosystem for volatility trading.

This is evidenced by the popularity of OTC products in respondents' volatility trading strategies — a clear indication that market participants are actively looking to expand the number of new volatility products they trade and where necessary customizing alternative contracts. In Europe, OTC instruments benchmarked to volatility measures were more popular than listed alternatives.

OTC volatility trading often involves trading contracts that reference widely used and publicly published indices with a broker-dealer. This has proven an attractive way of avoiding the costs involved in trading on exchange, such as exchange and clearing fees.

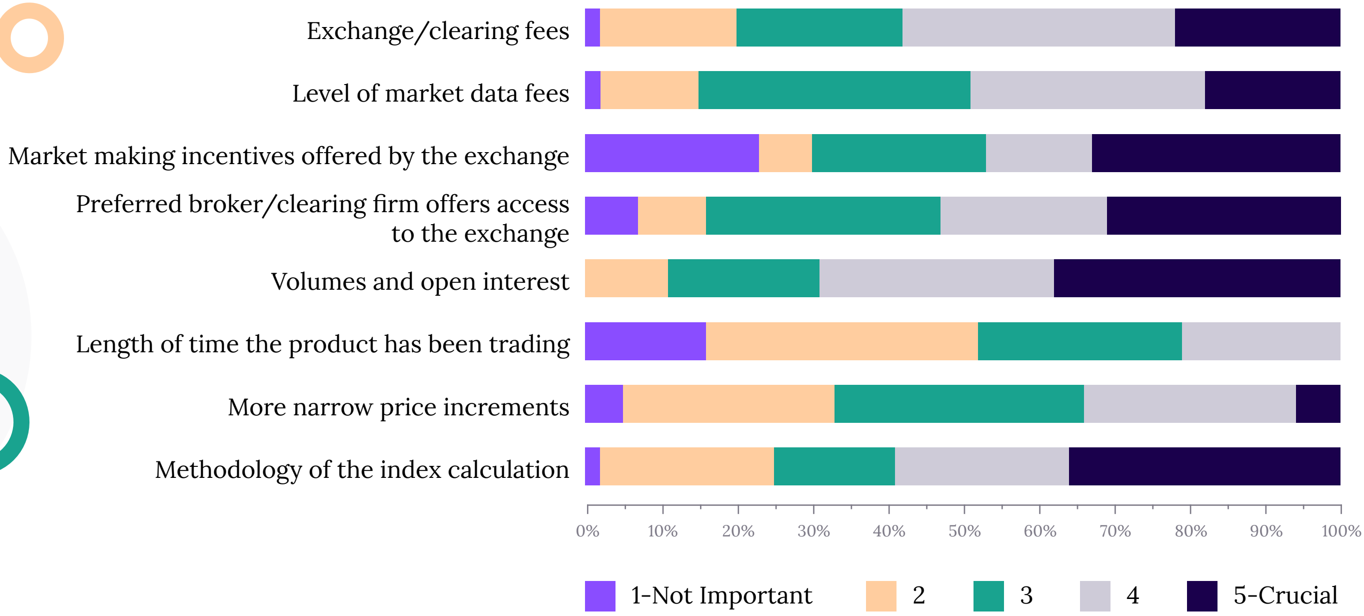
Away from exchange fees, market participants showed a common desire for new features that would reduce their trading costs and improve execution. These included smaller tick sizes for futures and options, which can reduce the multiplier effect and subsequent trading costs as well as improving the precision that traders can take in their positions.

Launched in 2019, the SPIKES Volatility Index measures the expected 30-day volatility in SPY (SPDR S&P 500 ETF)

Addressing liquidity

Liquidity is a crucial factor for any trader deciding where to allocate their capital. However, while survey respondents cited volume and open interest as their most crucial factors for determining where to trade volatility, other issues ranked very close. Two other important factors that survey respondents cited were methodology of index calculation and market making incentives offered by exchanges.

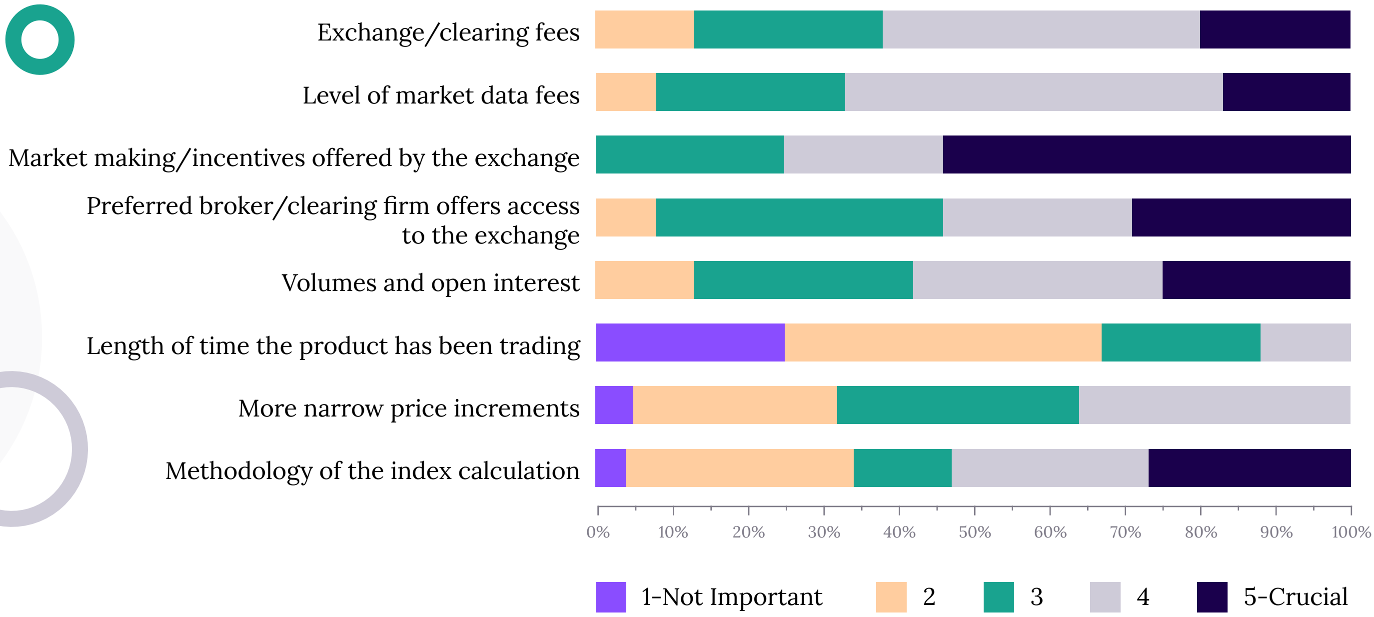
How important are the following in your decision on where to trade volatility



Transaction costs and fees are key concerns once traders are able to source liquidity

Incentives offered by exchanges was a crucial factor for over half of proprietary trading firms when trading a new contract. This contrasted to hedge funds, which overwhelmingly favored volume and open interest and methodology of index calculation as selecting factors. This was a similar trend among banks and interdealer brokers. Exchange and clearing fees were also cited as an important factor by a majority of respondents. Market data fees were also highlighted and were a particular concern for trading firms in Europe.

How important are the following in your decision on where to trade volatility (proprietary trading firms only)



The SPIKES Volatility Index (SPIKE), which updates every 100 milliseconds for improved accuracy, is built using the variance swap methodology, using live SPY options prices to calculate volatility. It is available via OPRA and the MIAX Product Feed (MPF)

The importance of index methodology

A key conclusion from the volatility community was the importance of innovation in order for a new product to break into the market.

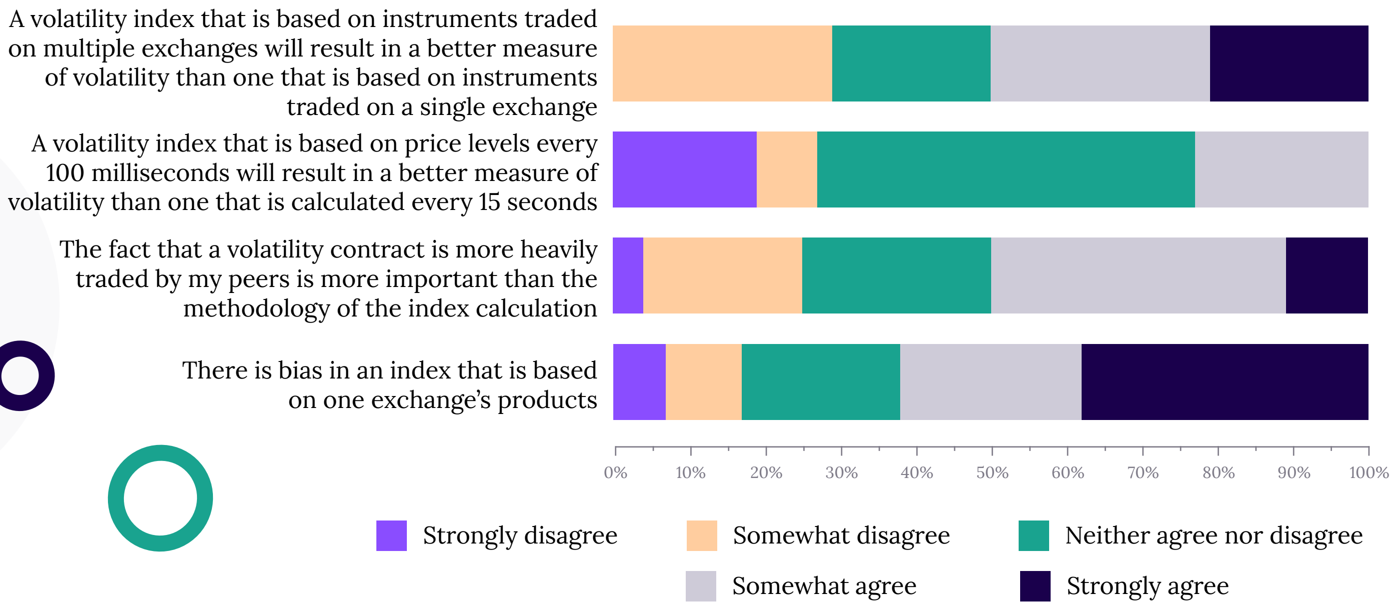
Methodology is one area in which exchanges are innovating to bring new products and alternatives to the market. MIAX has sought to innovate in this area in terms of how it calculates SPIKES. Cboe calculates the VIX index as a measure of 30-day volatility by using S&P 500 options traded exclusively on its exchange.

MIAX SPIKES is a measure of 30-day expected volatility based on options on the SPDR S&P 500 ETF, the largest exchange traded fund in the world. The VIX updates prices every 15 seconds, while SPIKES does so every 100 milliseconds providing a closer track of price movements. Both indexes benefit from familiarity among volatility traders, an important factor when selecting which contracts to allocate to.

Indeed, after low open interest and volume, survey respondents cited uncertainty about methodology as the most likely reason for not trading a volatility product. Uncertainty can lead to susceptibility to manipulation, a concern that was repeated multiple times during interviews for this study.

Survey data also shows that market participants think an index calculated from trading data from multiple exchanges rather than one is a better reflection of volatility. These views were particularly prominent among hedge funds.

Do you agree or disagree with the following statements

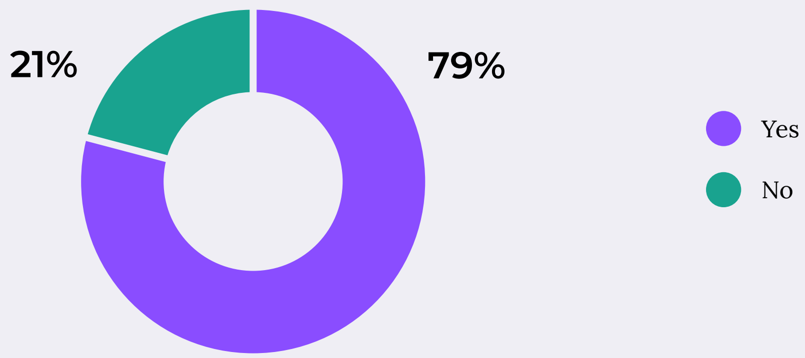


Conclusion:

Expanding adoption of multiple volatility products

Volatility traders' desire to expand the number of new volatility products that they trade was a key finding in this report. Overall, 79% of respondents were open to trading SPIKES alongside established volatility products. Clearly, the market is ready to expand. New product suites not only increase the range of strategies that firms can trade, but also bring improvements through competition and innovation, which has already been seen in areas such as tick size and structuring products for regulatory simplicity.

Would you consider a strategy trading SPIKES alongside other volatility products?



Another example of the volatility market's desire for new features came through in the desire for products that allow them to better capitalise on the surge in short-dated options. Demand for these contracts has been driven by retail and institutional investors, with participants such as insurance companies valuing the efficiency that shorter maturities can provide.

Using more weekly and even daily contracts, both in index calculation and in volatility contracts were seen as an area that exchanges should explore in greater depth.

Volatility is a nascent asset class and in the early days of its growth and innovation. While it is among the most complex asset classes to trade, firms that invest in the skills and expertise to do so reap the rewards.

As the asset class matures, demand is growing for products that offer alternative methodologies and performance to incumbent products.

Increasingly, investors will seek to enhance their trading strategies, trading across multiple indices in order to optimize performance and maximise their trading strategies.

Different products with different methodologies will enable firms to trade across different measures of volatility expanding the strategies used and creating basis and arbitrage trading opportunities. In addition, different types of market participant will find different use cases for the various methodologies, growing the overall ecosystem for volatility trading.

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About MIAX

MIAX's parent holding company, Miami International Holdings, Inc., owns Miami International Securities Exchange, LLC (MIAX®), MIAX PEARL, LLC (MIAX Pearl®), MIAX Emerald, LLC (MIAX Emerald®), Minneapolis Grain Exchange, LLC (MGEX™), LedgerX LLC, The Bermuda Stock Exchange and Dorman Trading, LLC. MIAX, MIAX Pearl and MIAX Emerald are national securities exchanges registered with the Securities and Exchange Commission that are enabled by MIAX's in-house built, proprietary technology. The MIAX trading platform was built to meet the high-performance quoting demands of the U.S. options trading industry and is differentiated by throughput, latency, reliability and wire-order determinism. MIAX also serves as the exclusive exchange venue for cash-settled options on the SPIKES® Volatility Index (Ticker: SPIKE), a measure of the expected 30-day volatility in the SPDR® S&P 500® ETF (SPY).

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