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Hedge-Fund Veteran’s Brexit Gains Crimped as Volatility Subsides

- 36 South ‘to take advantage of cheap implied volatility’
- Investors expect policy makers to stem fallout from Brexit

36 South Capital Advisors, a London-based volatility hedge fund, was surprised at how rapidly calm returned to markets after the initial Brexit shock spurred massive price swings such as the pound’s widest one-day range on record.

While the fund made money in June, it wasn’t as much as the manager had anticipated as most markets recovered from the convulsions sparked by the British vote to leave the European Union, said Richard Haworth, chief investment officer of 36 South Capital. The 57-year-old manager declined to provide details of the fund’s performance or assets under management for compliance reasons.

“This is the strangest environment I’ve seen in 30 years,” Haworth said by phone from London. “I had a sneaking suspicion that Brexit could have been the butterfly’s wing that created a hurricane down the line. But maybe, maybe not.”

A JPMorgan Chase & Co. gauge of global exchange-rate volatility has fallen to the lowest level since June 23, the day Britons cast their ballots, from an almost four-month high reached on June 27. The CBOE Volatility Index, a measure of market turbulence known as VIX, has fallen to 13.55 after rocketing up 49 percent, the most since 2011, to 25.76 on June 24.

“We’ll take advantage of cheap implied volatility again,” Haworth said.

Investors are seeking to profit from any surge in volatility after stimulus by central banks from Europe to Japan had damped price swings.

"Everybody is cannibalizing correlation, volatility, anything they can lay their hands on to get more yield," Haworth said. "None of that is really fundamentally sound reason for selling volatility and will end badly one day; but today is not the day."

Stocks globally have regained the almost $4 trillion in value that was obliterated in the days following the U.K. secession vote, as investors bet officials in the world's major economies will stem any fallout from the decision. Investors expect the Bank of England to ease policy this week, while Japanese Prime Minister Shinzo Abe said he planned to add fiscal stimulus. Traders are pricing in a less-than-even chance of the Federal Reserve raising interest rates this year.

"Volatility is not persistent anymore," Haworth said. "It's episodic, short lived, mainly due to the perception that as soon as the markets go down, the central banks will move and provide the implicit put."

Black Swan

36 South buys long-dated options it considers valuable, betting unforeseen events will generate large profits across currency, interest rates, equities and commodity markets. It prefers options with more than a year to maturity, Haworth said.

The manager has said [that one of the firm's funds had strong returns] during the global financial crisis in 2008. It closed the fund and returned money to investors the following year.

"Europe is back on the front burner," Haworth said. "And if there was another leg down on commodities, the currencies of commodity countries would come under fire. When your alternative of bonds are this low, there is a chance that the equity markets melt up."

Haworth said he'd put "105 percent of the blame" on central banks for the market distortions.

Sovereign debt in countries such as Japan and Switzerland offers negative yields across almost all maturities. Swiss government bond yields with tenor of as long as 50 years have all fallen below zero on concern Brexit will damp global economic growth.

"Because the bond prices don't reflect reality and it's such a huge asset market, it's forcing all the other markets not to respect reality,"' said Haworth, who has been trading since 1987. "Everybody has thrown their fundamental analysis out of the window and they just go for yield."