A global marketplace built for today's trader.
Learn more at miaxglobal.com

EUROPE, MIDDLE EAST AND AFRICA FEATURED ARTICLES PEOPLE & FIRMS QUANTITATIVE STRATEGIES VOLATILITY

Q&A: Pierre de Saab Talks Cassiopeia Fund, Vol Markets, Investment Decisions

NOV 9, 2023

By **Georgia Reynolds**, deputy editor

The USD1.4 billion Swiss asset manager Dominicé celebrated its 20th anniversary this year. Dominicé runs alternative investments, real estate and wealth management. Within the alternative investments unit sits four funds in volatility arbitrage and quantitative equities, as well as custom solutions. EQDerivatives caught up with **Pierre de Saab**, partner at the firm, to discuss how its flagship volatility strategy Cassiopeia, which is up 10% through the end of October, has evolved and how the fund is operating within the current environment.

EQD: How would you describe Cassiopeia fund today and how has it evolved?

PS: The strategy aims to generate positive uncorrelated returns in any market environment. Investors typically consider it for three key reasons. First, it has a long and consistent track record with 17 positive years out of 19. Second, with low correlation to most asset classes and hedge fund styles, the fund brings important diversification benefits. Third, the strategy has the potential to deliver crisis alpha, as it did during the global financial crisis and Covid.

While the purpose of the fund has not changed over the years, the methods it employs have constantly evolved. The original strategy was to capture vol carry in the VIX futures market, a game we practically invented, as we were up to 60% of the VIX futures open interest back in 2005. Over the years, we have added new trade ideas and today, we run a well-diversified portfolio of strategies. Each strategy has a specific purpose, method and market. They can be discretionary, systematic, or, in most cases, a bit of both. They trade volatility from various angles: carry of course, but also pure relative value, trend and mean-reversion. To make decisions, we use quantitative metrics combined with a qualitative assessment of the market environment (flows, impact of structured products). Our goal is not to guess the direction of the markets or volatility itself, but rather to decide how the macro context may affect certain trades over the medium term and, consequently, allocate the risk budget.

EQD: How did you go from trading VIX futures to a diversified portfolio? How does your research process work?

Pierre de Saab

organizations, we don't break down research, portfolio management and execution. These three functions are covered by the investment team operating a single book. The benefit of this approach is that it makes the portfolio manager's role more interesting, allows some flexibility and crucially, it fosters innovation, as many new ideas originate from observing and trading our markets.

For this to work, we have built a team of talented individuals from diverse backgrounds. It is not mandatory to have previous experience trading volatility to join the team. For instance, the last portfolio manager we hired worked previously at a commodity trading advisor.

EQD: What other factors would you highlight as contributing to the fund's success?

PS: Besides new trade ideas, our development effort has also helped improve our technology and trading operations. We do not depend on external vendors for our core functions, which allows us to tailor the system to our needs. In the last three years, we have redesigned the architecture of our system to be centered around strategies rather than funds. As a result, instead of trading sequentially for each fund, we can trade the full amount for a given strategy at once and then allocate it to the various funds. This also gives us the flexibility to propose tailor-made solutions to investors, such as a managed account or a dedicated fund.

EQD: What is the future of Cassiopeia?

PS: Our goal is to continue to improve existing investment processes or create new ones. We are prepared to go after any opportunity in volatility markets as long as it is in line with our mandate of delivering uncorrelated and defensive alpha.

EQD: Let's talk about the current volatility environment. What has driven the performance in the last 12 months? Were there any surprises?

PS: In 2022, when inflation picked up and equity volatility moved firmly over 20, we were expecting that the fund would have many trading opportunities because this is what is supposed to happen when liquidity is tight, and investors don't have a free put from central banks. We were surprised to see that, during that time, equity vol was very efficiently priced, for instance the average VIX level and SPX realized vol were in line at 25, but we believed it would be transitory.

So far this year, implied equity vol levels have been in decline and have trailed lower realized volatility levels, except during the Silicon Valley Bank episode in March and the recent October correction. More importantly, volatility has been generally expensive, and we've found numerous opportunities so far this year. Almost all of our strategies have done well, especially those that lean short vol on SPX and VIX. On the other hand, trades designed to profit from the inefficiencies of [volatility-linked exchange traded products] market have struggled, but this was expected as this segment of the market has lost its predominance in the equity vol space.

More surprising than the performance itself was the low volatility of our profit and loss. We thought that with vol levels moving into the high 20s, the volatility of the fund would increase for a given level of vega and gamma. It turned out that individual trades were less volatile than anticipated but also that the correlation between trades stayed moderate. We have increased our overall leverage in 2023 to get closer to our long-term vol target of 8%.

EQD: Are you seeing fundamental changes in volatility markets? Does this affect your outlook?

PS: We believe this situation of declining but expensive vol levels exists because investors have not overstretched their risk budget, either by purchasing protection or by keeping leverage low.

We notice an evolution in the drivers affecting volatility markets, [such as] the impact of fundamental/macro data (CPI, jobless claims) is diminishing whereas the flow data (volume, open interest) and the market's

These changes do not affect our outlook. Despite the recent correction, we expect volatility to remain overall expensive in the coming months and we think the U.S. news flow will continue to drive markets, especially as the 2024 elections come into focus.

EQD: Over recent years Dominicé has published several research papers to help investors in their thinking about how they approach volatility investing. Can you share your latest findings?

PS: The first important takeaway that we found is that investors should consider vol investments alongside their entire portfolio, especially when looking at relative value, long, and tail vol funds, because the real value of these strategies is their ability to deliver returns when the rest of the portfolio suffers.

There is a second, less obvious takeaway, which is not only should investors diversify their bets, but they should seek to increase the number of approaches to volatility trading rather than the number of asset classes traded. In other words, it is better to pick five different managers that trade only equity vol with their own style instead of one manager that trades vol across five asset classes in a similar fashion.

EQD: Tell us more about your latest piece on quantitative investment strategies. Any surprises in your findings?

PS: The piece followed discussions we had with a few investors in Switzerland, where QIS are widely used. Because there is a systematic element in what we and other vol managers do, these investors believed that investing in a basket of volatility QIS would be similar to investing in well-established funds.

In our paper, we used machine learning to classify over 300 vol-related QIS in the three traditional groups (long, short, relative value) and compared these with the corresponding Eurekahedge benchmarks of volatility funds. Of course, many QIS have not gone through a market crisis and there is a selection bias. Nevertheless, we were surprised to see how close the characteristics of QIS [were] compared with vol funds benchmarks.

EQD: What does that tell you about the role of QIS?

PS: QIS have come of age. For investors, they can be a complement or tactical play but they cannot replace a strategic allocation in a few established funds. Managers can use them too, tactically or as a way to outsource the repetitive and low added-value part of their investment process. The progress of QIS also means that managers' true value is not anymore in their ability to manufacture a specific derivatives exposure but rather in their ability to actively manage volatility and option bets. In other words, investors don't need to hire a manager to create a static vega or gamma exposure, which they can get from a QIS. They want their manager to act when there is an inflection point, or a regime change in the market. In our research, we highlight this key feature for our fund by showing graphically that it sits between the relative value and long vol groups.