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Monday, October 20, 2014 – A Near Buy Trigger For XIV And SVXY

Oct. 20, 2014 6:16 PM ET6 comments | Includes: SVXY, ...

F1 (18.50) -F2 (18.30) VIX futures ended their trading still in backwardation today, October 20. By the model, the event did not trigger a buy signal.

However, the action leading up to 3 pm gave a strong, but faulty, indication that the F1-F2 futures would close in contango. This adds a bit of complexity to trading the model's buy signal. Free quotes of VIX futures are delayed by 15 minutes, and the equity market closes 15 minutes before futures trading closes. In other words, the trigger signal / buy timing is anachronistic. There are at least three options for dealing with the time delay, none of which are perfect.

Option 1. If, within 15 minutes of equity market close, it appears nearly certain that the futures will end in contango, an investor can make a best-guess and can commit the trade that same day. *That is exactly what I did today.* As it turned out, the F1-F2 futures returned to a mild state of backwardation before the futures closed today.

Option 2. The investor can wait until the closing futures data are posted, confirm the buy signal, and then try to obtain the best entry price (after hours) via a limit buy.

Option 3. The investor can wait as in (2), but postpone entry until the next market day. This is my least favorite of the three options, because opening prices often differ, sometimes significantly, from the previous closing prices.

The long-position entry requires a decision. My personal decision today was to go with option (1). As a result, I committed myself to entering the long XIV

position before the official buy signal occurred, as defined by the strategy.

General comment: Tomorrow, Oct 21, is the last day of trading for October futures. Beyond then, the current F2-F3 prices becomes F1-F2 prices. As of 4:45 pm Oct 20, these were in contango, but not by much.

Best of luck to all.

Disclosure: The author is long XIV.

Comments (6)

ianxponent

I think these are the times when you might want to look at external conditions for guidance although that's not part of your strategy. With the good news today regarding folks being released from Ebola quarantine, I think that's enough to give an edge to triggering the entry into short volatility vehicles. Me, I jumped the gun and bought svxy last week. Time will tell as to whether this was a good trigger point or not.

21 Oct 2014, 12:23 AM

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tmdoherty

I think the market is getting ready for the next leg down. SPX is very close to a test of overhead chart resistance at around 1910, and another one not far above that at 1946. A failure at one of these levels followed by a lower low (i.e., a close below 1846) is very likely in my view.

Also, there is evidence of technical deterioration and bearish divergence (e.g., slow stochastics).

If we set a lower low, then the likelihood is high that we will see a 15% to 20%

pullback, perhaps even more.

As I write this, the futures are down about 0.5%, but perhaps more importantly, the VIX futures have slipped further into backwardation (F1, F2 and F3), and the F1 has risen significantly above the closing reading on the VIX. If that situation holds, that suggests to me that we will see a gap up in the VIX at the open, which will put added downward pressure on equities.

So I am in "wait and see" mode, with sharply reduced equity exposure but a supplemented defensive hedge, and in no rush to enter any position at all in the volatility trade.

Just my opinion.

21 Oct 2014, 02:42 AM

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ganswijkw

ianxponent,

you bought at an intraday rsi-level of 20. probably also I nice entrypoint

21 Oct 2014, 09:32 AM

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ianxponent

Well into contango at this point (around noon). It was risky to buy the svxy last Thursday but it had bounced of sub-50 lows and I felt confident that the Ebola scare was close to subsiding. Why? My main focus since the start was on what would happen to the family members who had been in the apartment with the patient. By last Thursday, they were within three days of being released from quarantine and the two nurses who were showing symptoms and were hospitalized had been exposed more recently than the family members. That told me two

things: first, the family members were unlikely to have caught the disease and second, assuming they didn't have the disease, it meant it was not that easy to catch and so the general public here would most likely be spared an outbreak.

21 Oct 2014, 12:30 PM

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David Easter, Contributor

[Author's reply »](#) ianxponent,

Nicely played. The model's trigger points are best viewed as guideposts to "good" entry and exit points. I agree with your thesis: an astute trader can often improve outcomes based on how well they read the market. Kudos to you.

21 Oct 2014, 01:17 PM

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David Easter, Contributor

[Author's reply »](#) This comment was also posted in the article.

Tue, October 21, 2014.

VIX futures closed trading in contango, signaling the strategy's buy signal.

Closing prices for XIV and SVXY were 32.74 and 64.23 respectively.

21 Oct 2014, 05:23 PM

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