COLUMBIA THREADNEEDLE INVESTMENTS

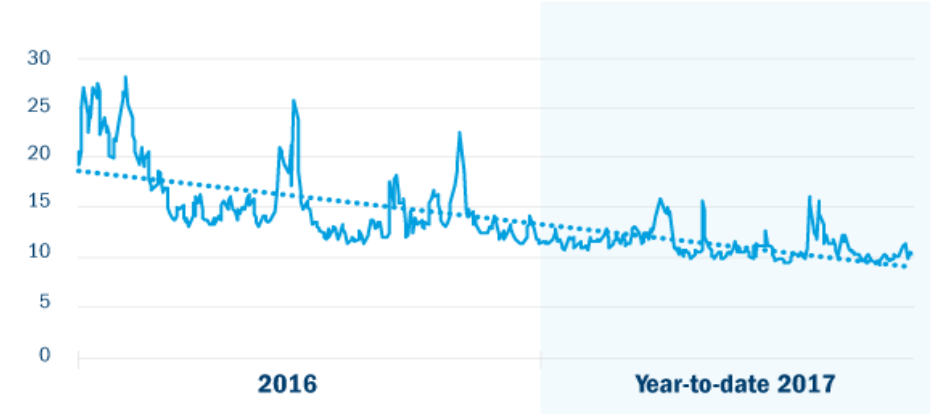
Fear and risk: Does the VIX measure up?

November 10, 2017

The Chicago Board Options Exchange Volatility Index (VIX) is the market's most widely followed measure of fear and risk. But is this a good measure?

Global Chief Investment Officer Colin Moore recently highlighted the lack of volatility in the markets and asked our investment leaders to join the low volatility and valuation debate. But we also wanted to take a closer look at the way many investors measure volatility — by monitoring the VIX — and hear from two senior members of our global asset allocation team to get their interpretations. Is it flawed?

A look at the VIX: Market volatility has been much lower in 2017
VIX Daily Close 01/04/16–10/31/17



Source: Columbia Threadneedle Investments, 2017

Josh Kutin, Senior Portfolio Manager, Global Asset Allocation team: It's not that the VIX is a bad indicator of fear and risk, it's just that there are forces that are dragging it down. There is a lot of trading activity that is keeping the VIX low — I am mainly referring to trades where market participants are betting on the

direction of volatility and shorting the VIX. When the market inevitably goes into distress, we'll see the VIX go higher after the fact. **The VIX may be the right indicator of current fear but it is not predictive of future fear levels.**

Maya Bhandari, Senior Portfolio Manager, Global Asset Allocation team: A chief "flaw" of the VIX is that it captures implied volatility in **U.S. equities only**, which makes it tricky to interpret for global investors. I look at two deeper measures of risk aversion that include more asset classes — one for developed markets and the other for emerging markets. Both use equally weighted indices that reflect sovereign spreads, credit spreads, TED spreads and implied volatility in currencies, equities and swaps. I tend to pay more attention to these broader indicators and surveys that rate consumer and business confidence than I do to the VIX when gauging fear and risk.

Bottom line

The VIX may be a good indicator for some aspects of market volatility, but it's not future-proof, and it doesn't provide a reliable global interpretation. To get a more accurate understanding of fear and risk — especially in today's eerily quiet market environment — look to broader measures of volatility and investor sentiment.

Chicago Board Options Exchange Volatility Index (VIX) reflects a market estimate of future volatility, based on the weighted average of the implied volatilities of S&P 500 Index options.

TED spread is the difference between the 3-month London Interbank Offered Rate or LIBOR (the interest rate on interbank loans) and the 3-month U.S. Treasury bill.

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