FUNDAMENTALLY SPEAKING

A simple explanation of the finance terms we all hear about but don't really understand

Where there's fear, there's also a chance to be greedy

ROWAN JONES

Whenever the share market experiences a bit of fear and panic a three-letter word always rears its head — the VIX.

We can often go for months or even years without hearing about it but when volatility picks up it comes out of hibernation.

The VIX is actually the stock code for the Chicago Board Options Exchange Volatility Index and it measures the US share market's expectation of volatility. It's why its unofficial nickname is the 'fear index'.

Investors and fund managers will often look to VIX values as a way to measure the levels of stress and fear in the market before they make an investment.

Because it's a forward-looking index it doesn't look at the level of past price fluctuations, it looks at the expectations of future volatility. But funnily enough the expectation of future volatility generally mirrors the level of volatility we are experiencing. This is because big price fluctuations usually lead to greater uncertainty about the future, therefore the VIX rises. But when there's no volatility the markets tend to be less anxious about what the future holds, resulting in a low reading.

As a point of reference, in early January, before the recent volatility kicked in, the VIX was trading around 16. It reached a high of more than 30 towards the end of the month. Although 30 may sound high, the VIX peaked at well over 80 during the height of the 2020 COVID panic. As a rough rule of thumb, a reading below 15 is considered low and a reading above 20 is high.

Some use the VIX as a contrarian indicator to pick when investor sentiment is at its lowest ebb and pick the time to become greedy when others are fearful.

Rowan Jones is an adviser with Entrust Wealth Management

Illustration: Don Lindsay