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Day Trading in Wall Street's Complex 'Fear Gauge' Proliferates

By Landon Thomas Jr.

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Each morning, at the market's open, Seth M. Golden, a former logistics manager at a Target store, fires up the computer in his home office in northern Florida and does what he has done for years: Put on bets that Wall Street's index of volatility, the VIX, will keep falling.

It has been a lucrative strategy as the so-called fear gauge has been, outside of the occasional spike, largely fearless — confounding experts by sloping persistently downward and in the process making Mr. Golden a multimillionaire.

"There has been a lot of white noise," said Mr. Golden last Tuesday on a day that the VIX plummeted more than 10 percent, allowing him to lock in profits from short trades. "You had North Korea, Afghanistan, Trump people resigning. But I was never nervous — so today I just sat back, ate some popcorn and cashed in my profits."

On Monday, the index ticked up, after falling 8 percent on Friday, as investors took the view that the Fed would not be raising interest rates soon after a speech by Janet L. Yellen, the chairwoman of the Federal Reserve.

Twenty years ago, when the shares of dot-com and tech companies soared and swooned, investors loading up on hot tech stocks would define the speculative fever of that era. Across the country, people quit their day jobs to trade the likes of Webvan and eToys from their living rooms or glittery new E-Trade outlets.

Now, a new generation of day traders, deploying an expanding array of opaque, high-risk, high-return trading vehicles concocted by Wall Street, are pouring into one of the market's most arcane corners, making bets on whether the VIX — otherwise known as the Chicago Board Options Exchange Volatility Index — will rise or fall.

Wagering on the fear gauge, a measure of how volatile investors expect stock markets to be in the month ahead, has traditionally been the province of highly specialized investors with the cash and financial relationships to purchase the derivatives that facilitate these trades.

In the years after the financial crisis, however, investment banks like Barclays and Credit Suisse came out with VIX-linked investments that investors could purchase on the stock exchange, just as if they were buying shares of IBM or Microsoft.

Called exchange traded notes, they were a racier version of the exchange traded funds, or E.T.F.s, that track every variety of index and investment strategy and now have more than $4 trillion in investor assets.

Led by Barclays iPath S&P 500 Short Term Futures ETN (VXX), these investments have attracted over $14 billion in investor flows since 2012, according to FactSet, a data-gathering firm.

There are now more than 30 different VIX-themed investment choices (including some that use leverage, amplifying gains and losses) that investors can snap up on a public exchange.

Because they are so easy to trade and because the question driving the trade — Will the markets succumb to fear or won't they? — borders on the existential, a new wave of millennial day traders has been at the forefront of this trade.

And many are using Stock Twits, the social media investing website embraced by stay-at-home investors, as well as Twitter and Facebook to passionately promote their strategies.

“You could describe it as a cult — it is about how you define and measure fear and can you trade it,” said David Moadel, an independent trader who uses social media to identify and interview emerging investors.

But this explosion in interest is prompting concerns that investors may not be truly aware of what they are getting into.

Today, VIX-themed entities are among the most actively traded securities on the public stock markets. The Barclays iPath note, Ultra VIX Short Term Futures (UVXY) by Pro Shares, and Daily 2X VIX ETN (TVIX) and Daily Inverse VIX ETN (XIV), both by Velocity Shares, are frequently among the most widely traded stocks of the day.

In theory, the murky nomenclature of these investments ought to be warning enough for amateur investors to tread with caution. And it is also true that the fund prospectuses warn bluntly that investors can lose large sums of money if they buy and hold these investments.

Robert E. Whaley, a financial professor at Vanderbilt University, who is known in volatility circles as the “father of the VIX,” for the work he did in helping the Chicago Board Options Exchange develop the index, says he has told the Securities and Exchange Commission that these securities are too risky for many nonprofessional investors.

“These are incredibly complex products when you consider their price dynamics,” Mr. Whaley said. “The volume in these things is huge, and my concern is that investors don’t understand what they are and how their prices behave.”

The S.E.C. has in the past publicly warned investors about the risky nature of these types of investments.

Indeed, the most popular of the funds, the Barclays iPath fund, known broadly by its ticker symbol VXX, has since its inception averaged a yearly return of negative 58 percent, according to FactSet.

Or look at it this way: If an investor bought VXX when it came to market in 2009 and held onto it until now, that investor would have lost 99 percent of his investment.

While many professionals will purchase these securities to hedge their exposure to the stock market, analysts say that day traders are now using them to gamble on a sharp spike in the VIX.

"You have seen this infusion of millennials coming in and buying VXX and UVXY," Mr. Moadel said, referring to the main VIX product and its leveraged cousin. "But most of the time they just get killed."

Doing the killing, so to speak, have been investors like Mr. Golden, who consistently shorts VXX and UVXY whenever they spike upward.

His bet is founded on two principles: one being that VXX and UVXY, because they track a basket of VIX futures, not the index itself, will decline in value over time as the contracts expire.

He describes it as a heavy anvil weighing down on the value of each security.

Mr. Golden also believes that in the decades since the VIX was introduced in 1993, its long-term trend has been to push consistently downward. Yes, there will be spikes as during major cataclysms (9/11, the 2008 financial crisis) and other less tumultuous events (a devaluation in China, a North Korea crisis or even a presidential tweet).

But after every spike of fear must follow a longer period of calm, Mr. Golden contends, which, he argues, is a perfect scenario if your bias is to always bet against fear.

"The nature of volatility is that it desensitizes over time," he said. "Which is why the index has been tracking down for so long."

Just as the frenetic buying of tech stocks by day traders in 1999 and 2000 came to be seen as a major factor behind the boom and bust, market experts say that traders like Mr. Golden who persistently short the VIX have distorted the market.

"The VIX spikes have become more extreme — on the upside and the downside," said Salil Aggarwal, a derivatives strategist at Deutsche Bank.

Mr. Golden, who is 40, lives in a suburb of Ocala, Fla. Since he has been shorting VIX, he says his net worth has gone to $12 million from $500,000 in about five years.

When it comes to his craft, he is more the pedant than boastful trader, carefully posting snapshots of his trades on his Twitter feed and churning out dense treatises and videos laying out his methods. The best part of his day, he says, is picking up his toddler daughter from day care.

But, as with any trader on a roll, he likes to keep score, and he is quick to spar on Twitter with the traders who appear on CNBC's "Fast Money" program.

Now, he is starting a hedge fund dedicated to wagering against the VIX. Investors, he says, have been pounding on his door to get in early, offering him $100 million for starters.

That is a lot of money for a onetime Target manager.

"Yes, it is a crowded trade," Mr. Golden acknowledged. "But I don't worry about crowds — I just worry what the next existential shock might be."

Corrected on Aug. 28, 2017: An earlier version of this article misstated where Salil Aggarwal, a derivatives strategist, works. It is Deutsche Bank, not Barclays.

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