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Zeroing In on Investments

Nasdaq, VIX Creator Plan Indexes to Place Bets That Ignore Market Conditions

By Brendan Conway

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NEW YORK—Nasdaq OMX Group Inc. on Monday will introduce new indexes from the creator of the VIX "fear gauge" that will track popular stocks' performance against the broader market.

The stock exchange tapped a duo that includes Robert Whaley, who developed the CBOE Market Volatility Index, to design the new "Alpha Indexes." With regulators' approval, Nasdaq will offer derivatives to bet on or guard against moves in the new measures—something Mr. Whaley envisions letting investors screen out even a stock-market crash from the returns of popular holdings like Apple Inc. or Citigroup Inc.

Apple's Alpha

Nasdaq's Alpha Index aims to capture the outperformance shown below by the spread between performances of Apple's stock and the S&P-500 ETF.



Source: WSJ Market Data Group

"The idea is to isolate what I'm focused on and get rid of the market bet," said Mr. Whaley, who is a professor at Vanderbilt University's Owen Graduate School of Management. The indexes, which Mr. Whaley co-developed with university colleague Jacob Sagi, are to be presented this week at the Futures Industry Association's Futures & Options Expo in Chicago. Nasdaq hopes to launch the derivatives built around the indexes early next year.

With the severe stock-market gyrations of the financial crisis and this year's "flash crash," interest in vehicles to track volatility and "trade" it with complex derivatives have soared. Stock-market correlation also has shot up, pushing investments often used to hedge or diversify into lock-step with major markets.

The new Nasdaq products are built for investors seeking to combat those problems by isolating the pure "alpha" of a stock, said Eric Noll, Nasdaq OMX Group's executive vice president of transaction services. Alpha is a stock's outperformance relative to a benchmark.

The Chicago Board Options Exchange's VIX volatility index is the most closely watched market-volatility measure. The Chicago exchange is part of CBOE Holdings Inc. Volume in its options to bet on stock-market swings more than doubled in the second quarter. The Alpha Indexes appear to be Nasdaq's answer to that growing franchise.

The starting measures compare Apple, the SPDR Gold Trust, the iShares MSCI Emerging Markets Index Fund and the iShares Barclays 20+ Year Treasury Bond Fund to the SPDR S&P 500 exchange-traded fund. Also in the first group is an index that compares Citigroup Inc. versus the Financial Select Sector SPDR Fund.

Mr. Whaley envisions a less expensive way for investors to bet for or against a company or stock in ways that make profits even in a bear market, blocking out correlation.

"In stock options, you're actually making two bets. You're betting that Apple will rise relative to the market and also that the market will go up," Mr. Whaley said. "With these, you're getting a more precise investment in something you have some knowledge about."

Two weeks into the year, the iPhone maker's shares trailed the S&P 500-stock index modestly. Nasdaq's figures show that the Apple alpha index would have been slightly lower. At a time when Apple's stock was down about 2.3% and the S&P 500 ETF was up 2%, the measure would have fallen roughly 4.2%.

By mid-June, Apple had jumped, but the broader market suffered events including the previous month's "flash crash." A "call" option bought during January would have yielded gains on Apple's roughly 31% advance above the market.

Nasdaq didn't disclose pricing of the contracts, which need Securities and Exchange Commission approval before their launch. If approved, they are expected to begin trading early next year on the company's Nasdaq OMX PHLX exchange in Philadelphia.

Institutional investors, particularly those active in "pair trading," are a key initial audience, Nasdaq's Mr. Noll said. A pairs trade is a market-neutral strategy that bets on or against correlation in a set of securities. The company eventually hopes to attract retail investors seeking to invest without making a market bet, Noll said.

The Apple index's listing symbol is AVSPY, with GVSPY for gold, TVSPY for the bond fund, EVSPY for emerging markets and CVXLF for Citigroup.

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