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VIX at Biggest Discount to Europe’s VStoxx Since 2008: Options
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By Cecile Vannucci and Jeff Kearns

Sept. 13 (Bloomberg) -- Implied volatility for European equities has climbed to the highest level since 2008 compared with the Standard & Poor’s 500 Index, as traders hedge against a potential default by Greece.

The VStoxx Index, which measures the cost of options protecting against Euro Stoxx 50 Index losses, surged 7.5 percent to a 32-month high of 53.55 yesterday. The Chicago Board Options Exchange Volatility Index closed 14.96 points below the gauge, the widest gap since October 2008, when Lehman Brothers Holdings Inc.’s collapse drove both to record highs.

Concern Greece will default on its loans and spur a banking crisis is driving up the price of options relative to contracts in the U.S., where equities are beating their euro-zone counterparts by the widest year-to-date margin since 1987, according to data compiled by Bloomberg. The Euro Stoxx 50 Index has plunged 29 percent in 2011, compared with a 7.6 percent decline for the S&P 500.

“Volatility markets are definitely implying that the U.S. is a safe haven relative to Europe,” Nelson Saiers, chief investment officer of Alphabet Management LLC, said in a phone interview yesterday. The New York-based volatility hedge fund manages about $635 million. “People are much more focused on Greece and the potential impact on European banks rather than the U.S., particularly the effects on the French banks.”

U.S. stocks surged in the final hour of trading yesterday, avoiding losses posted earlier in Europe and Asia. The S&P 500 ended with a 0.7 percent gain, while the Euro Stoxx 50 Index completed a two-day drop of 7.8 percent.

50 Biggest Companies

The European measure, which tracks 50 of the biggest companies in the 17 nations using the shared currency, has trimmed its gain since the bull market began in March 2009 to 10 percent from 70 percent in February. The S&P 500’s advance has shrunk to 72 percent from 102 percent.

The VIX, a gauge of S&P 500 options, rose 0.2 percent to 38.59 yesterday, pulling back after reaching 43.18 about two hours before trading ended for the day. Markets changed course after the Financial Times reported that Italy is trying to convince China to purchase bonds, citing Italian officials the newspaper didn’t identify.

Lower U.S. options prices are no guarantee American stocks will avoid losses should investors turn more pessimistic about the economy, said Stephen Wood, who helps oversee about $163 billion as the New York-based chief market strategist for Russell Investments.

‘Flagship Risk Asset’

“When markets get nervous you see investors jettison risk of all stripes, and stocks are a flagship risk asset,” Wood said in a telephone interview yesterday. “Stocks are going to be affected by a risk-off environment. U.S. equities are the cleanest dirty shirt right now. Nothing looks great, so they’re the least bad.”

American lenders faced almost $700 billion in exposure to Greece, Italy, Ireland, Portugal and Spain at the end of the first quarter, according to data published in July by the Basel, Switzerland-based Bank for International Settlements.

European volatility is increasing as officials in German Chancellor Angela Merkel’s government debate how to protect the nation’s banks if Greece defaults, three coalition officials said Sept. 9. Juergen Stark’s Sept. 9 resignation from the European Central Bank’s executive board spurred concern that the region’s leaders disagree on how to contain the crisis.

Europe’s benchmark volatility gauge may keep increasing, said Barclays Plc’s Maneesh Deshpande, who leads the top-ranked equity-linked strategies team in Institutional Investor magazine’s 2010 survey.

‘Blowing Out’

“The spread should be blowing out,” the New York-based strategist said yesterday in a telephone interview. “If you look at the spread between S&P and Euro Stoxx volatility, it’s a lot higher, but that doesn’t mean it’s at an extreme. If anything it should be higher than that because all of the catalysts are in Europe, and European equities are near the March 2009 lows.”

The last time the difference between the VIX, as the CBOE measure is known, and the VStoxx was this wide was Oct. 16, 2008, when European equities plunged and U.S. stocks posted an advance after the Dow Jones Industrial Average swung more than 700 points for the sixth straight day.

A gauge of European banks fell to its lowest level since March 2009 yesterday, led by a 12 percent drop in Paris-based BNP Paribas SA, France’s biggest bank. The company fell to 26.12 euros, a 30-month low. Societe Generale SA of Paris sank 11 percent to 15.57 euros, the lowest level since 1992, while Montrouge, France-based Credit Agricole SA tumbled 11 percent to a record low of 4.83 euros.

Record CDS

Credit-default swaps on the three lenders surged to all- time highs after two people with knowledge of the matter said the companies may have their credit ratings cut as early as this week. France’s lenders top the list of Greek creditors with $56.7 billion in overall exposure to private and public debt, according to a June report by the Bank for International Settlements.

“There’s a lot more uncertainty with the situation in Europe, and in some way people seem more comfortable about the outlook for the U.S. market,” said Daniel Hawkins, director and founder of Mariana Capital Markets Ltd., a London-based brokerage firm specializing in equity derivatives. He spoke in a telephone interview yesterday. “People are indirectly viewing the outlook for the U.S. market as being more stable.”

Relative Value

Price-earnings ratios show investors have more confidence in the outlook for U.S. corporations. The S&P 500 trades for 12.7 times reported income, up from the 2 1/2-year low of 12.2 reached on Aug. 8, according to data compiled by Bloomberg. For the Euro Stoxx 50, the multiple sank to 8.4 yesterday, the lowest level since December 2008.

Investors are more concerned about a Greek default than they are about the U.S. entering a recession, said Larry Hatheway, UBS AG's chief strategist and economist. He recommended buying VIX futures to hedge stocks in a report on July 22, when the S&P 500 began a 17 percent drop as global stocks lost $8.1 trillion, data compiled by Bloomberg show.

"People are starting to look for pockets of value and there's an argument that it's to be found in the U.S.," the London-based strategist said in a telephone interview yesterday. "The U.S. is seen as relatively safer."

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