The FOMC Trade

Each year the most anticipated trading days are always FOMC days. On each FOMC day, the Fed announces their current monetary policy and thoughts on the market around 2 PM EST. After the press release, markets typically go crazy, especially if there is a surprise change in policy.

But what's interesting is that following the FOMC release the VIX typically falls for an hour or so. Take a look at the chart below that shows the intraday returns of VIX on announcement days (grey line) versus non-announcement days (black line). The period studied is from January 1996 - December 2013.
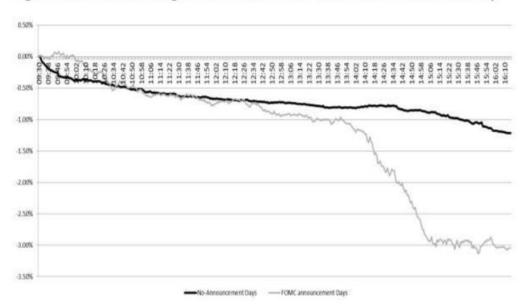

Figure 2. Cumulative Change in the VIX on FOMC versus Non-Announcement Days

Note: This figure plots the evolution at a one-minute frequency of the VIX during non-announcement days (black line) and announcement days (grey line).

You can see there is a clear rapid fall that occurs later in the day during FOMC announcements. This effect is not seen on non-announcement days. Remember VIX is not tradeable outright. It used to be hard to capture moves in the VIX. You had to buy and sell options to take a position on implied volatility. But now we have VIX futures as well as VIX ETPs that make profiting from this effect pretty simple.

Does the effect still play out in the tradeable derivatives? Yup.

Here's a graph showing the effect in VIX futures. The period studied is from March of 2004 to December 2013.
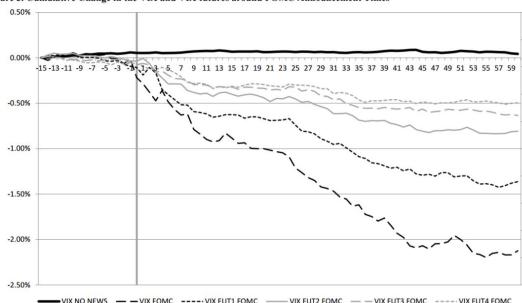
Figure 3. Cumulative Change in the VIX and VIX futures around FOMC Announcement Times

Note: This figure plots the evolution at a one-minute frequency of the VIX on announcement and non-announcement days and the VIX futures on announcement days over the interval from 15 minutes before the FOMC announcement to 60 minutes after the FOMC announcement.

You can see that all VIX futures on the curve fall for about an hour after the announcement. The most pronounced falls occurs in the front month future.

So how do you go about executing this?

Here's what you do:

Step 1: Find your favorite vol product, VXX, UVXY, VIX futures, it doesn't matter.

Step 2: Establish a short position 2 hours before the FOMC announcement. The announcements are released at 2:00 PM EST so you want to put on the trade around 12 noon EST.

Step 3: Cover the short 60 minutes after the announcement is released. This is right around 3:00 PM EST.

Step 4: Count your newly minted currency like Scrooge!

You can see the record for 2015 and 2016 below. We used VXX and a dollar notional size of 100% in this backtest.

2016 Announcements	VXX Before Announcement	VXX 60 Min After Announcement	Percent Return	Account	Account Start	$100,000.00
Jan 27	$99.00	$102.48	-3.40%	$96,604.22		
Mar 16	$82.40	$81.20	1.48%	$98,031.86		
April 27	$63.40	$62.28	1.80%	$99,794.80		
June 15	$62.72	$61.92	1.29%	$101,084.14		
July 27	$44.20	$43.36	1.94%	$103,042.41		
Sep 21	$37.20	$35.29	5.41%	$108,619.37		
Nov 2	$35.74	$35.57	0.48%	$109,138.50		
Dec 14	$25.91	$26.01	-0.38%	$108,718.90	Account End	$108,718.90
					2016 Return	8.72%

2015 Announcements	VXX Before Announcement	VXX 60 Min After Announcement	Percent Return	Account	Account Start	$100,000.00
Jan 28	$126.88	$130.60	-2.85%	$97,151.61		
Mar 18	$110.24	$105.00	4.99%	$101,999.94		
April 29	$85.24	$84.60	0.76%	$102,771.57		
June 17	$75.16	$73.96	1.62%	$104,439.03		
July 29	$64.58	$64.32	0.40%	$104,861.21		
Sep 17	$87.92	$81.44	7.96%	$113,204.78		
Oct 28	$74.24	$75.72	-1.95%	$110,992.11		
Dec 16	$81.24	$76.00	6.89%	$118,644.73	Account End	$118,644.73
					2015 Return	18.64%

Pretty incredible right? In 2016 the trade returned 8.72% and in 2015 it returned 18.64%. And you're only exposed to the market for 8 days a year!

This trade takes advantage of money managers having to unwind FOMC hedges after the announcement. So intuitively the trade makes sense. It's not just a data mined phenomenon.

We send an email alert out each morning to Hub members before the FOMC announces and then recap the results with another email alert at the end of the day. We'll also have a thread in the Comm Center for further discussion.