WRITING BOND OPTIONS

Firm:
Blackheath

AUM:
$5.5 million

Portfolio Manager:
Levente Mady

Strategy:
Fixed Income/ options

Location:
Vancouver, Canada

Most Canadians prefer playing their sports on water that is frozen, but Levente Mady, a former member of the Canadian Olympic swim team and water polo coach doesn't mind swimming against the tide.

Case in point, Mady operates an option writing strategy, but instead of focusing on equity options—as the vast majority of option sellers do—Mady writes options on 30-year U.S. Treasury bond futures.

It was only natural as Mady has worked in the Treasury space for more than 25 years in various roles, including as a fixed income trader for major investment dealers CIBC Wood Gundy and Deutsche Bank Canada, as well as managing multi-million dollar bond portfolios.

Mady is portfolio manager for the Blackheath Tactical Fixed Income Strategy. Why bond options? "First and foremost that is where my expertise is," acknowledges Mady, who adds that the bond market is very much event driven.

"The various economic numbers, unemployment in particular, drive the bonds market," he says. "Knowing what to look for and understanding the influences and how things impact the market; all of that gives me a good [framework] to rely on in terms of [knowing] why the market is doing what it is doing."


Photo: Courtesy of Levente Mady

Mady has spent a career analyzing these figures and seeing how the market responds.

"I still think that the most important number out there is the payrolls number itself," he says. "I look at the actual [unemployment] rate, I look at the household survey, I look at the average work week and the inflationary aspect of the hourly [earnings]."

Understanding how the market reacts to those reports are important for Mady because his program is short-term, writing options five to 15 days before expiration.

"My objective is to sell volatility out-of-the-money. Depending on the technical picture I will be anywhere from half a point to 2-3 points out-of-the-money depending what is going on in the market," he says.

He calls his approached targeted delta. "I start with the fundamental picture: What do I think of the economy? What do I think of the Fed? Where are we going in terms of inflation? Then we look at the technical picture. What is the seasonality? What events are coming?"

"After doing all of that analysis I come up with a general bias on the market: Do I like it, do I dislike it, am I neutral on the market? If [so] I ask where is the range and try to sell calls at the top of the range and sell puts at the bottom of the range and be as close to delta neutral as possible."

It has worked as Mady's program has produced a compound annual return of 25.58% since its October 2011 inception, and is up 13.30% year-to-date through September despite a difficult environment.

"Rather than be mediocre in 10 different things, I try to focus on one or two things, like the long bond and the volatility aspect of the bond market," he says. "I try and be more specialized, grind out the returns and generate positive alpha on an ongoing basis rather than flip-flop and be distracted.

When pressed on the dangers of options writing, Mady likens it to riding a motorcycle, another one of his passions. "If you are careful, conservative and aware of your surroundings—you don't ride a motorcycle when there is a blizzard— it is a safe and environmentally friendly method of transportation. It is easier to park and it is a good way to get around (when you are stuck in traffic you've got more [maneuverability])," Mady says. "The worst thing about motorcycle riding is the people that ride motorcycles are [often] crazy. If you ride 100-miles per hour in a 30-MPH zone you've got trouble. It is the same thing with option writing."

Every option writer is only as good as his performance in difficult environments and the bonds have gone through a couple of shocks of late.

"During four years there has been two flash crash scenarios where there was a chance of getting seriously hurt," Mady says. "The last one was October and we skated through that with a positive month."

The Blackheath program struggled with the 2013 "Taper Tantrum" but managed to finish the year with double-digit profits.

Certainly we had instances of difficult markets with higher than normal volatility," Mady says. "More often than not the nature of trading volatility is whenever you get these spikes you better take your opportunities because that is where you get some juicy [premiums]. When volatility double or triples I definitely want to be selling it. If I don't have a conviction on one side of the market I will be on both sides to collect premium." Δ

Daniel P. Collins