



HowToTrade

VIX TRADING STRATEGIES [PDF]

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Table of Contents

- **What is the CBOE Volatility Index (VIX)?**
- **How Does the VIX Work?**
- **How Does the VIX Trading Strategy Work?**
- **What Are the Best VIX Trading Strategies?**
- **What Are the Benefits and Limitations of Trading the VIX?**
- **How Can You Trade the VIX?**

VIX Trading Strategy

The CBOE Volatility Index (VIX) is a tool used to gauge market sentiment and the degree of fear in the market. It has an uncanny correlation with the market, and many traders and investors rely on it to plan and manage their risks, as well as to predict future price movements. While you cannot buy the instrument like you would buy a stock, a bond, or a currency pair, there are ways to trade it.

What is the CBOE Volatility Index (VIX)?

The CBOE Volatility Index measures how much the US stock market is expected to fluctuate in the next 30 days. Simply put, it measures the implied volatility of the stock market within the next 30 days.



The use of the VIX measures how much market participants expect the stock market to fluctuate in the future. Armed with this information, participants have an idea of what to expect from the market within the next 30 days in the market. The VIX is essentially a gauge of investor sentiment and fear in the market. That's why it is often called the "fear index." The logic is very simple – when the VIX is low, then the market is in risk-on mode, meaning stock markets are rising, and the economy is usually booming. On the other hand, when the VIX is rising, stock indices are falling, and investors may consider a risk-off mode.

When the VIX index was created, it was only used on the S&P 500. Even in its calculation, as you'll soon see, the VIX only considers the S&P 500. But over time, investors have come to rely on it to gauge the overall stock market fluctuation. And seeing that the S&P 500 itself is only an index that tracks over 500 U.S. stocks, the relationship makes sense.

How Does the VIX Work?

Technically, the VIX index tracks the options market's strike prices of SPX (S&P 500 options contracts) over a specific time range.

A high VIX figure indicates that the S&P 500 and the general U.S. stock market will likely become more volatile within a month. It also indicates that the markets are likely to drop since investors' fear is rising. A low VIX figure signals a potential low volatility in the S&P 500 within the next 30 days. Generally, it is said that the market is at increasing risk when the VIX rises above 30. On the other hand, when VIX is trading below 20, investors interpret it as a low-risk market condition.

Evidently, as of the end of February 2024, VIX is standing at 13.65. Unsurprisingly, all leading US stock indices are trading at all-time levels.

How Does the VIX Trading Strategy Work?

The VIX trading strategy is based on one single rule: The stock market is inversely correlated with the VIX. So, when the VIX is low, stock market prices often rise. But when the VIX is high, stock market prices usually fall.

The SPX chart below is a perfect example of this correlation. The VIX is the line graph below it.



This correlation can be somewhat explained this way:

- When the VIX is low, the market becomes complacent and “fearless.” This encourages traders and investors to throw their capital at the stock market, causing prices to rise.

- When the VIX is high, investors are more “fearful” and cautiously approach the market. Some take their capital off the market, while others steer clear altogether. Then, prices drop.

Every VIX trading strategy is based on that foundation. But, of course, the VIX is not 100% accurate. No tool is. So, you should always cautiously approach the market regardless of a high or low VIX number.

What Are the Best VIX Trading Strategies?

Here are some of the best and most straightforward VIX trading strategies:

1. Trade the VIX Index with the 20 EMA Indicator

Of course, the first VIX trading strategy is to trade the tool as its instrument. This means you are trading the VIX index.

Note, however, that because the VIX is simply a measuring tool, you can’t buy or sell it like you would a stock or bond. But there are CFDs, options and futures contracts, and Exchange Traded Products (ETPs) based on the VIX. You can trade the VIX through any of these methods.

And a simple strategy to trade the VIX is to place the moving average on it. For the sake of our example, we’re using the [20-EMA trading strategy](#).

Step 1: Place Trades

With this strategy, whenever the 20-EMA crosses the VIX to the upside, we sell. And we buy whenever the 20 EMA crosses the VIX to the downside.



Step 2: Manage Risk

Place stop losses below the most recent swing low in a bullish trade and above the most recent swing high in a bearish trade. But if your VIX is very choppy and the potential stop loss level is too far away, get creative and use other risk management strategies.

And for profit-taking, you can set a standard 1:2 risk-to-reward ratio. This means you take your profits off the trade when you've made two times the amount you're risking.

Another way to get out of the trade when in profit is to monitor when the EMA gives an opposing signal to the one you've entered. If the EMA signals a sell when you are in a bullish trade, exit your position. And if you were in a bearish trade when the EMA signals a buy, exit your position. Use the chart below to see what we mean.



2. Trade VIX Alongside the S&P 500

The second method is to utilize [the asset correlation trading strategy](#) by trading the VIX alongside the S&P500. Investors and traders can use the uncanny correlation between the VIX and S&P 500 to their advantage using the following steps:

Step 1: Place the Moving Average on the VIX Chart

Once you have the S&P 500 and the VIX charts on your screen, place the 20-EMA on the VIX chart. In the chart below, the candlestick chart on the upper half of the image is the S&P 500. The orange line on the lower half of the image is the VIX. We changed it from a candlestick chart to get a clean look. Finally, the blue line crisscrossing the VIX is the 20-EMA.



If you're using [multiple trading monitors](#), you don't need to complicate things. Just make sure your 20-EMA is on the VIX. Your S&P 500 can be on another screen.

Step 2: Place Trades

Upon using this strategy, you should enter a bearish trade on the S&P 500 whenever the 20 EMA crosses the VIX to the downside. Conversely, enter a bullish trade on the S&P 500 whenever the 20 EMA crosses the VIX to the upside (as presented in the chart below).



Step 3: Manage Your Risk

Your stop loss on the S&P 500 can be below the most recent swing low in a bullish trade and just above the most recent swing high in a bearish trade.

Step 4: Backtest Your Strategy

We chose the 20-EMA as the signal indicator because the moving average is straightforward to use and portrays the strategy without so much fuss. But, like many other indicators, it can be prone to many false signals, as you saw in the chart above. So, to find the most accurate trading combination, you must try other moving average periods, other [indicators](#), or other [trading strategies](#) altogether. Whatever you do, just ensure you backtest it extensively on a demo account and [build consistency](#) before you employ the strategy in a live account.

3. Evaluating VIX Long/Short Positions

This is another VIX trading strategy that many investors use, especially those who engage in [swing](#) and [position trading](#). And because it isn't technical, many traders sleep on it.

Here's how to trade the VIX Long/Short Positions trading strategy.

Step 1: Check the Latest CFTC COT Report for VIX Futures

The Commodity Futures Trading Commission (CFTC) releases the Commitment of Traders (COT) report every week. You can get the report for the VIX futures from the [CFTC website](#).

Step 2: Observe the Disparity Between Commercial and Non-Commercial Net Positions

Sometimes, the disparity in the net long and short positions of the commercial traders can give you an insight into what's happening. See the [report](#) from the 20th of February, for instance.

VIX FUTURES - CBOE FUTURES EXCHANGE Code-1170E1
 Commitments of Traders - Futures Only, February 20, 2024

	Total	Reportable Positions						Nonreportable Positions		
		Non-Commercial		Commercial		Total		Long	Short	
	Open	Long	Short	Spreading	Long	Short	Long	Short	Long	Short
		(\$1000 X INDEX)								
All :	341,280:	74,671	113,742	88,392	152,747	109,259	315,810	311,393:	25,470	29,887
Old :	341,280:	74,671	113,742	88,392	152,747	109,259	315,810	311,393:	25,470	29,887
Other :	0:	0	0	0	0	0	0	0:	0	0
		Changes in Commitments from: February 13, 2024								
All :	-21,190:	-1,835	-13,730	-3,883	-14,634	-3,451	-20,352	-21,064:	-838	-126
		Percent of Open Interest Represented by Each Category of Trader								
All :	100.0:	21.9	33.3	25.9	44.8	32.0	92.5	91.2:	7.5	8.8
Old :	100.0:	21.9	33.3	25.9	44.8	32.0	92.5	91.2:	7.5	8.8
Other :	100.0:	0.0	0.0	0.0	0.0	0.0	0.0	0.0:	0.0	0.0
		# Traders								
All :	205:	64	75	93	53	45	175	163:		
Old :	205:	64	75	93	53	45	175	163:		
Other :	0:	0	0	0	0	0	0	0:		
		Percent of Open Interest Held by the Indicated Number of the Largest Traders								
		By Gross Position			By Net Position					
		4 or Less Traders		8 or Less Traders	4 or Less Traders		8 or Less Traders			
		Long:	Short:	Long	Short:	Long	Short	Long	Short	
All :		26.6	19.7	36.0	29.5	22.6	14.0	30.1	21.7	
Old :		26.6	19.7	36.0	29.5	22.6	14.0	30.1	21.7	
Other :		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	

Notice that the non-commercials are mostly going short while the commercials are mostly going long. This may mean the big guys know something you don't know, and it may be worth digging into.

This strategy doesn't offer you trade entry signals but gives you useful insights into the market that you may not find anywhere else.

What Are the Benefits and Limitations of Trading the VIX?

One of its most significant benefits is that it helps to measure market sentiment. When there's a concern in the markets among economists and investors, the VIX is the first financial instrument to show that. As a result, traders can employ a [systematic approach to trading](#), being fully cognizant of how much volatility to expect in the coming days.

Additionally, the VIX can be used as a hedging tool against market volatility and unexpected events.

Conversely, trading the VIX is not the ideal way to trade the markets. Normally, getting access to VIX as a tradable product can be quite a hassle. It's not very likely to be part of a traditional trading account, which means you need to make an effort to be able to trade it.

Another drawdown is the Contango risk, which may bite into the investor's profits. Either way, Black Swan events like natural disasters and unexpected political developments can cause the VIX to spike sporadically. So, if you're trading VIX in any form, put proper risk management in place.

How Can You Trade the VIX?

So, how can you trade the Volatility Index?

- The primary method for doing that is to open a Futures trading account and trade VIX futures contracts or options directly on the CBOE. This is the most conventional way to get access to VIX trading; however, it also requires you to make a fairly high initial deposit and go through a long and complicated registration process.
- The second method is to trade VIX via ETFs (Exchange Traded Funds) or ETNs (Exchange Traded Notes). Once again, for that matter, you typically need to invest a large sum to be able to make substantial profits as a trader.

Lastly, another option to trade VIX is through CFDs (Contract for Difference). Those are derivative contracts offered by CFD brokers. Bear in mind, however, that not all brokers offer VIX CFD contracts. If you wish to take this route, you can [visit our top brokers' page](#) to find the one that allows you to trade the Volatility Index as a CFD contract.