Headline: A column on 'The India VIX'	
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All you wanted to know about...

AARATI KRISHNAN

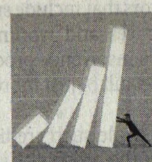
SLATE

As the Nifty sailed past 10,000 points last week, the stock market promptly divided into two warring camps. One argued stocks were too hot to handle and the other asserted they still had steam left. At such times, if you're a follower of behavioural finance, you'd look at the extent of greed and fear among market players to gauge the market mood. One widely used fear gauge is the India VIX. The India VIX at the time of writing this was hovering at 11.98. The number indicates that market participants are not exactly quaking in fear, worrying about uncertainties ahead.

What is it?

India VIX is the pet name for the India Volatility Index, an index disseminated by the NSE. It measures the degree of volatility or fluctuation that active traders expect in the Nifty50 over the next 30 days. It was the Chicago Board Options Exchange which originally came up with the term VIX in 1993 and the NSE, with the CBOE's permission, kicked off the India VIX a few years ago.

The VIX calculation is based on the Black Scholes Model which is used to price options contracts. The Black Scholes model uses five key variables to arrive at the 'fair price' of an options contract: the strike price of the contract, the market price of the stock, the time to expiry, the risk-free rate and volatility. The VIX arrives at the volatility expected by the traders in the market by back-working from buy-sell prices of Nifty options contracts.



While all this may thrill maths nerds, the thing you need to know as an investor is how to interpret the VIX and the level of fear or complacency it indicates.

Why is it important?

Ever experienced that nasty jolt at the beginning of a roller-coaster ride? Well, big market moves are usually flagged off by a similar bout of stomach-churning volatility. The India VIX is a good indicator of whether participants in stocks are feeling fearful or complacent about the near future.

One way to understand the VIX is that it represents the expected annualised change in the Nifty50 over the next 30 days. To simplify, a VIX of 11.98 means that, for the next one month, market participants expect the Nifty to move by an annualised rate of 11.98 per cent in either direction. A 12 per cent move in one year, as you can well gauge, is not a high number.

The other way to read the VIX is to compare its current value to its high and low points during the last 52 weeks or even its entire life-time. Historical data from 2009 tells us that the high points for the VIX were reached at 55-57 levels in April-May 2009. Its life low was made quite recently, in June 2017 at 8.75. In the last 52 weeks, the VIX has stayed in a band between 8.75 and 23.09.

The current VIX of 11.98 is clearly much closer to the lower end of that range. That indicates that the fear factor in the markets now is at a low ebb.

Why should I care?

If a good chunk of your portfolio is in equities, bravado among market players is a bad sign. It shows market players, even as they're arguing hard about valuations, aren't really all that afraid that a big market move is imminent. Therefore, the relatively benign VIX is just another indicator that should have you treading cautiously at this point in time.

However, as the mood of the markets can change in the blink of an eye, it wouldn't take much for complacency to give way to fear. So, whether you're already heavily invested in equities or sitting on the fence, keeping a hawk eye on the VIX would be good idea as it would provide indications of choppy markets ahead.

The bottomline

Vexed about the markets? Watch the VIX.

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