Volatility as investment - crash protection with calendar spreads of variance swaps

Nowadays, volatility is not only a risk measure but can be also considered an individual asset class. Variance swaps, one of the main investment vehicles, can obtain pure exposure on realized volatility. In normal market phases, implied volatility is often higher than the realized volatility will turn out to be. We present a volatility investment strategy that can benefit from both negative risk premium and correlation of variance swaps to the underlying stock index. The empirical evidence demonstrates a significant diversification effect during the financial crisis by adding this strategy to an existing portfolio consisting of 70% stocks and 30% bonds. The back-testing analysis includes the last ten years of history of the S&P500 and the EUROSTOXX50.