I am evaluating two key strategies for protecting our equity-heavy portfolio during severe market stress: Taleb-style option buying and trend-following.

The first strategy involves buying deep-out-of-the-money (DOTM) put options. We can think about it like cheap insurance policies that provide a very large payout if a market crash occurs. The downside is the regular premium to pay for these options, which will affect the portfolio return in the long run if crush doesn't occur. This strategy excels in the unexpected crashes like VIX-spiking crash.

Trend-following strategy systematically checks the market direction. If a major index like the S&P 500 starts a downward trend, for example falling below its 100-day average, this strategy aims to reduce equity proportion or even go short. This can save capital in a prolonged bear market but might give false alarms in choppy and directionless markets. Trend-following is better suited for a slower decline.

The main difference is that options excel in unexpected crashes, trend-following may be a stronger hedge against long-term negative markets. To evaluate Taleb’s strategy, we can examine S&P 500 historical option data for tail hedging and VIX levels. Trend-following approach needs industry based index historical price data.

Those strategies need back-testing against historical “black swan” events like black monday in 1987, financial crisis in 2008 and covid in 2020. Example in 2008, a long volatility overlay might have yielded huge payout as the market crashed, whereas a trend-strategy also performed well by shorting equities.

It is crucial to play through different scenarios, build a statistical distribution and make a risk management. One possible way is to simulate a 100€ portfolio with a 1-2% annual premium spend on DOTM puts and compare this to a 15-25% allocation to a generic trend strategy, then compare outcomes in key crisis periods.

Taleb's strategy faces bleed and deep OTM liquidity risks in crises. Trend-following can lead to whipsaws, affecting client optics. Both carry implementation costs and need control against existing risk budgets (bleed tolerance, drawdown limits).