Ferguson and Baz: The limits of macroeconomic policy

In the opening panel discussion at Gaim International 2012, GLG Partners’ chief investment strategist Jamil Baz started off by outlining the general macroeconomic consensus. He noted that governments had thrown the kitchen sink at the problem, that Ben Bernanke deserves a big fat cigar and that at 2 per cent, GDP growth in the US isn’t actually that bad. There’s no reason why this crisis should be any different to all other historical crises, including 2008: it is, said, Baz, “just another crisis”. He then outlined his reasons for disagreeing with everything he’d just said in his opening address about consensus opinion.

“If I had to summarise why I disagree with it in one word it would be leverage,” said Baz. “In 2007, weighted average total debt to GDP in G7 countries plus the four countries under the microscope – Spain, Portugal, Ireland, Greece – was 380 per cent. Today it’s 420 per cent. A lot has changed but then absolutely nothing has changed.”

Baz then gave three predictions: firstly that the crisis has not even started and could take another 15 years to reach its zenith; secondly, the economic impact will be devastating; thirdly, risky assets will look ugly as a result.

Baz said that countries would need to deliver by about 220 per cent: that’s basically 20 years of deleveraging. The economic impact of this deleveraging will be much bigger because countries have no ability to depreciate their currencies or cut interest rates which are already at zero per cent. The impact of this deleveraging could create another Japan scenario of 10 years of zero growth, “if we’re lucky”, said Baz. On risky assets looking uglier, Baz said: “If you believe like I do that deleveraging hasn’t even started, then you’ve also got to believe that profits are only going to head one way and that’s down.”

Harvard University’s Niall Ferguson agreed with Baz that the deleveraging story had yet to start and offered some historical insights into what the deleveraging story might imply. He referred to Adam Smith’s point about economies like 18th Century China reaching a stationary state because its laws of institutions don’t allow it to grow anymore: something that western economies now face.

“The great re-convergence will continue,” said Ferguson, referring to IMF projections that within four years China would overtake the US on a purchasing power parity basis. He said the Chinese middle class would become the most important player in the market faster than people expect. The point he was making was that the non-stationary character of emerging markets will continue.

Ferguson then introduced a...
Specialists in seeding and accelerating hedge funds

www.imqubator.com

This does not constitute investment advice, nor does it constitute an offer to sell or a solicitation to invest in the fund. This information should not be used as the basis for an investment decision.
Managers should review their relationships under AIFMD

Jeff Campbell

The legislative proposal Level 2 draft of the EU-wide AIFM Directive was released at the end of May, and it looks increasingly likely that hedge funders are going to bear the financial brunt of appointing a depositary bank. Under the Directive, each AIFM will need to hold all of an AIF’s financial instruments in custody, with no exceptions made such as assets used for collateral arrangements.

Speaking to Hedgeweek at Gaim International 2012, Jeff Campbell, sales and relationship manager in the institutional investor segment at BNP Paribas Securities Services, said: "Managers should definitely be concerned as both the liabilities and direct costs at depositaries will increase as a consequence of the legislation; it's unrealistic to expect these costs to be absorbed by the depository banks.”

Rather than upping fees, BNPSS’s view is that managers and their depositaries should review their relationship on a more fundamental basis. "For example, the structure of the fund’s accounts, where and how they are maintained, the use of the depositary for OTC valuation, risk reporting and collateral management, coupled with cash and asset protection can have a material bearing on the cost of the overall control framework," said Campbell, adding that if discussions were to be elevated to a "more sophisticated level" it could mitigate the direct financial impacts of using depositaries.

Prime brokers will have to ensure that they share with the depository the total value of assets held in the AIF, cash margin positions, short sales cash proceeds, etc. Campbell thinks this might create closer partnerships between primes and depositaries “but what will be more interesting is the way in which sources of financing will diversify. We see this driven both by regulation, and banks’ ongoing deleveraging of their balance sheets.”

The time is nigh for people to adapt if they wish to continue to prosper in Campbell’s opinion. “We genuinely believe that we can design intelligent solutions that will allow funds to be able to access markets and deliver alpha to their investors. The times of either pretending that the legislation will not come into force or will be weakened are past – we must come together to work this out.”

News Editor: James Williams, james.williams@globalfundmedia.com
Special Reports Editor: Simon Gray, simon.gray@globalfundmedia.com
Sales Managers: Simon Broch, simon.broch@globalfundmedia.com; Malcolm Dunn, malcolm.dunn@globalfundmedia.com
Publisher & Editorial Director: Sunil Gopalan, sunil.gopalan@globalfundmedia.com
Graphic Design: Siobhan Brownlow, siobhan.brownlow@globalfundmedia.com
Published by: GFM Limited, 1st Floor, Liberation Station, St Helier, Jersey JE2 3AS, Channel Islands
Tel: +44 (0)1534 719780
Website: www.globalfundmedia.com

©Copyright 2012 GFM Limited. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publisher.
Concept Capital Markets, LLC offers a comprehensive suite of brokerage services that provide global investment managers with solutions that are customizable and scalable. The firm was built by former investment managers to serve traditional institutional customers, hedge funds and registered investment advisors with turn-key solutions and a full range of fund services designed to free investment managers to focus on their core competencies. Our multi-asset trading, clearing, financing and reporting capabilities combined with our dynamic, relationship driven culture differentiates us in an ever changing market. The company was established in 2010 following the spin-off of the Concept Capital division of Sanders Morris Harris Inc., whose origins date back to 1995. Concept Capital Markets, LLC is headquartered in Garden City, NY and operates branch offices in New York City, NY, Greenwich, CT, Chicago, IL, and Del Mar, CA. Concept Capital Markets, LLC is a member of FINRA and SIPC.
Lyxor and Koris offer new investment solutions

Lyxor Asset Management and Koris International are teaming up to design investment solutions for distribution across Europe based on funds available on the Lyxor Managed Account Platform (MAP).

The partnership combines Lyxor’s MAP, which applies liquidity and systematic risk control to alternative strategies, with Koris International’s quantitative asset allocation technologies, and will last for at least two years.

The investment solutions resulting from the partnership will be tailored to small institutions, family offices and private banks seeking asymmetry in the risk-return profiles of their investments, as well as access to the wide range of alternative investment strategies available on the Lyxor Managed Account Platform. Lyxor will manage the portfolios while Koris will act as an independent advisor. The two firms will jointly market the investment solutions to European investors and money managers.

Christophe Baurand (pictured), managing director and global head of business development at Lyxor, says: “We are delighted to step up a long-term business relationship with Koris International, a recognised player in the European industry. This new partnership highlights the leadership of Lyxor’s Managed Account Platform, which provides a comprehensive framework for hedge fund investing. Lyxor’s platform is amongst the largest in the industry in terms of assets under management as well as number and variety of managers and strategies available.”

Manager skill continues to take centre stage in these volatile times according to GAIM conference director Victoria Chatterton. With that in mind, this year’s event focuses on four big picture themes:

- Evolving investor opinions on manager selection and asset allocation
- Making money in volatile times
- Business strategies for a low return & high regulation era
- Hedge fund regulation & the way forward for hedge fund distribution

“Risk management is now so much more integral to the hedge fund and the investment process. As a result we have extended our thinking on this and have included two new panels – one on due diligence and one on risk,” says Chatterton. She adds that for the first time this year’s event also features a regulatory clinic to give attendees the chance to question the experts on pending changes.

There are a number of big draw tickets for GAIM 2012: “We’ve got Professor Niall Ferguson of Harvard University and Jamil Baz, the Chief Investment Strategist at GLG Partners offering a historical and financial perspective on the limits of macroeconomic policy. Secondly, we have a special entrepreneurial address from Peter Thiel, the founder of Paypal. Thirdly, we have Nassim Nicholas Taleb, Principal of Universal Investments and renowned author of ‘The Black Swan’.

“I am very excited by the speaker line up this year. I enjoy seeing how much business is done at the conference – it is mind-boggling to think about how many business cards are exchanged!”

GAIM 2012 – plenty of business cards required!
Selected as Top Third Party Marketer of the Year
Things that gain from disorder

Nassim Nicholas Taleb, principal of Universa Investments and famed author of “The Black Swan”, delivered a keynote speech on some useful properties of barbells at Gaim International 2012. Noting that the opposite of fragile is “antifragile”, Taleb explained that barbells - a type of investment strategy that sits on both ends of the yield curve for example in bonds - possess this antifragile characteristic, enabling them to benefit from crises.

Barbells, then, have the capacity to turn something that’s robust into something antifragile.

If you have a lot of upside and a lot of downside in a portfolio (left tail distribution) it’s still fragile said Taleb, noting that antifragility has a big right tail distribution with big upside and little downside. Constructing a barbell, said Taleb, involves “clipping the left tail”.

In terms of strategy, said Taleb, instead of investing in medium-risk securities you invest 80 per cent of money in zero risk securities (left side of the barbell) and 20 per cent in maximum risk securities (right side of the barbell). “The linear correlation is vastly superior to medium-risk securities,” said Taleb. “Barbells put you in a situation where error and uncertainty help.”

The reason barbells are important is because today we’re building systems that are vulnerable to model errors. After all, small changes in the standard deviation of tails can blow things up. You want to be protected from any concentration of risk in the left tail and replace that with barbells said Taleb.

“Anything that has a right tail increases with variance and these portfolios gain from variance: we call that the barbell theory,” said Taleb. He said that uncertainty should be welcomed because that’s what nature itself is built on. Evolution is based on things failing and being replaced by stronger equivalents.

Running to stand still

Gavyn Davies, chairman of Fulcrum Asset Management, chaired a panel discussion on how Greek elections and eurozone political upheavals are shaping the markets. Part of the discussion was to establish the extent of bullish/bearish sentiment of Gaim International 2012’s audience. Karlheinz Muhr, CEO of QFS Asset Management and Mark Poole, CIO, BlueBay Asset Management, were the other two panellists.

Noting that there was an important meeting on 22nd June between Merkel and Hollande, Poole believed it would give some indication as to how much ground Germany is likely to give and said the Greek situation was an inflection point. He said he didn’t believe the markets would continue to fund Spain anymore. “The whole debate has moved towards whether Germany will do something. We’re expecting to see some sort of road map coming out on the 28th June going forward. It’s very difficult at this point to see Merkel having the necessary domestic constituency to make the changes that markets will be expecting on the 28th,” said Poole.

On Spain, Muhr said the solution was merely patching things up and was continuing to erode the euro.

Davies then asked the audience a series of questions. When asked when Greece would exit the euro, 40 per cent responded “later or never”. Davies then made things interesting by asking “When will Spain exit the euro”? A more bullish response resulted, with 82 per cent answering “later or never”. As for how German 10-year bunds will be impacted over the next 12 months, 50 per cent of the audience voted that it would trade within the 1.5 to 2.5 per cent range.

“I think this will be the more likely trading range as inflationary pressures take hold over the next 12 months,” said Muhr.