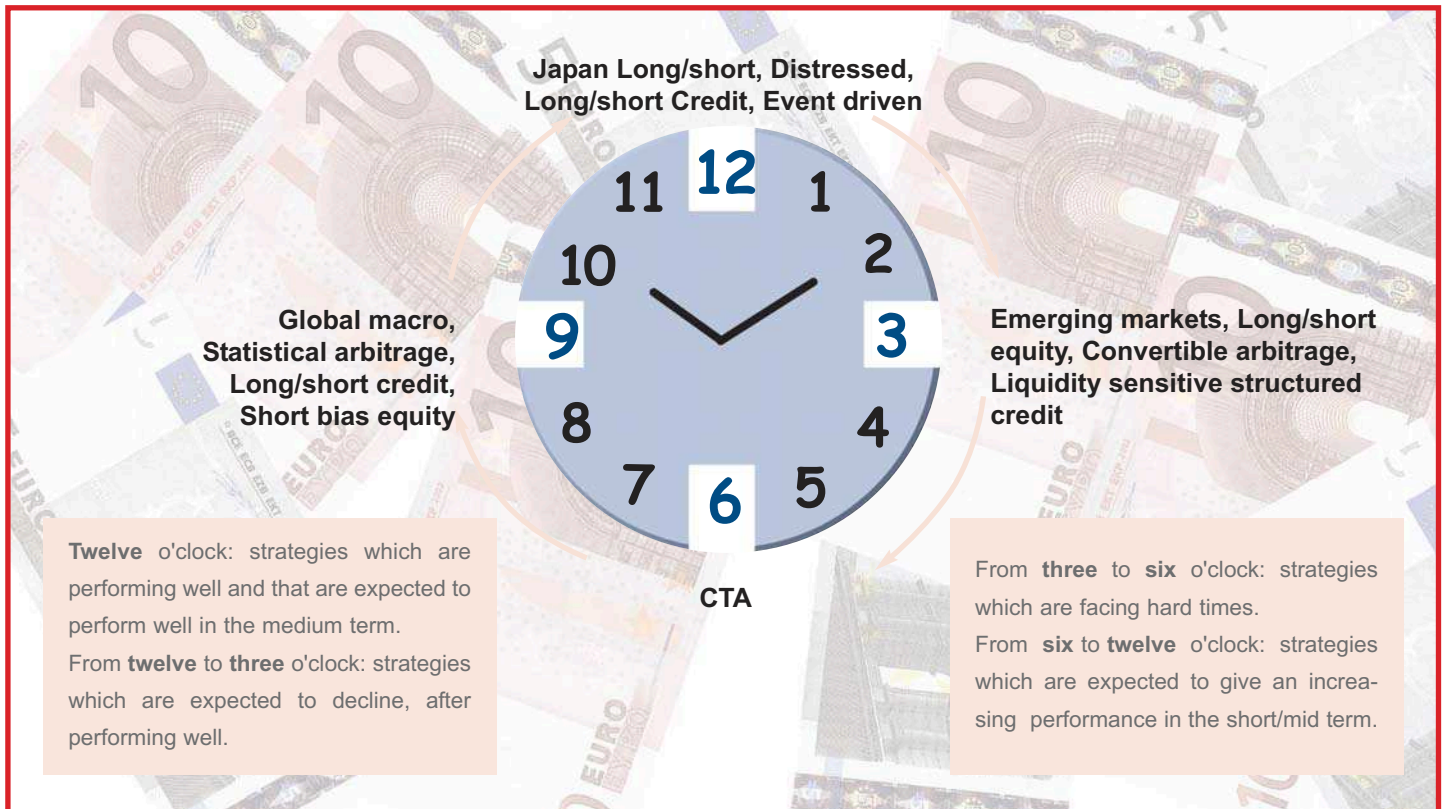


Every month the clock shows the mid/long term outlook of main hedge fund strategies.

Timing the risk trades

by Fabrizio Ladi Bucciolini*



The bull market of 2009 pushed valuations of many risky assets to very rich levels. As we all know the drivers of such an epic move were a combination of government interventions, stimulus packages and a return of investors from the abyss of depression into the "more normal" framework of a recession. As we move into the new year and the effect of these forces abates, capital markets may destabilise further as they wait for more tangible indications of what the future has on hold for the economy and as investor's debate between inflationary or deflationary scenarios.

As we prepare to sail these uncertain waters a new paradigm, at least in my investment career, has materialized as a consequence of the financial crisis of the last two years. The high correlation that all asset classes experienced has de facto left investors with a binary investment choice; you are either long risk or flat risk. Little sophistication is needed to observe that when markets move

up everything is bid up, even assets that manifested historical inverse correlations, and that when the same markets move down everything goes down in unison. To be fair Treasuries provided some shelter, and so did certain currency pairs. However given the colossal transfer of private problems to public balance sheets, the safe haven status of these sovereign issues may soon be challenged.

In this scenario, investors are left with the most challenging of tasks; timing their entry and exit from the risk trade to generate returns. We all know what the average success at timing the markets has been over the last centuries.

Investors that will be unable to adapt to this new market structure, be it because of their mandate or because of their philosophy, will be forced to pay rich premiums for liquidity and will have to avoid any form of complexity. As a direct consequence this same environment will represent a green and fertile pasture for nimble and expert money managers,

which will gladly stand on the other side of the same trades. I believe that in the coming months attractive hedge fund returns will come from less directional strategies, that they will be the result of well identified divergences from intrinsic value, idiosyncrasies, inefficiencies, from single company events, and that they will necessarily be the fruitful result of thorough fundamental research and astute risk management.

In considering strategies for the coming months, it should be noted that the short side of the book is once again gaining prominence, as is sector and industry rotation. On the short side there has been opportunity for several months across the corporate capital structure, but until very recently most managers have been averse to establishing contrarian positions, both to avoid fighting a strong trend and because of the lack of a strong catalyst; Greece may have involuntarily changed this. ■

*Head of alternative investments at Reyl Asset Management