

Inside The House of Money – Top Hedge Fund Traders on Profiting in the Global Markets

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Steven Drobny's new book, Inside the House of Money is a series of interviews with hedge fund managers and institutional traders who pursue "Global Macro" trading as their primary investment strategy. For those unfamiliar with the inner workings of an institutional proprietary trading desk, the book is a great "behind the scenes look" at the thought processes and strategies employed by proprietary traders to generate profits from perceived imbalances in the global economy. Given that so much attention has been lavished upon hedge funds in recent years by the media, and with little corresponding discussion of how these organizations approach the markets, it is a worthwhile book to read. Inside the House of Money is a starting point for those who want to understand the way "Global Macro" hedge fund traders view the world, and how they implement their insights through trading in financial markets.

Generally speaking, "Global Macro" is used to describe trading strategies which seek to profit from imbalances in the global economy. For example, if currencies are misaligned so that a basket of basic goods in Japan costs 50% less (in U.S. Dollars) than the same basket of goods in the U.S. (in U.S. Dollars), it would suggest that U.S. Dollars are more valuable than Japanese Yen. As a result, a U.S.-based global macro trader might buy Japanese Treasury Bills, with the expectation that the Yen would appreciate as U.S. investors flock to buy Japanese assets and products to take advantage of their cheap price. In order to buy Japanese goods, you need to buy their currency. And if enough demand for Yen is created, the price of the Yen could be driven higher. This would translate into the value of the U.S.-based investor's Japanese Treasury Bills rising, when priced in U.S. Dollars.

Inside the House of Money is full of anecdotes of both successful and unsuccessful trades. Christian Siva-Jothy, former head of proprietary trading at Goldman Sachs and a Principal at Semper Macro in London, describes to Drobny one of his favorite trades: a bet on monetary union in Europe. The interest rate spread between German Bunds and Italian Government Bonds was 500 basis points or 5 percent. He believed that monetary union would happen, and as a result, spreads would narrow. Indeed monetary union did happen and the spread narrowed to 50 basis points or ½ of a percent, at which point they closed out the trade. Needless to say, the trade was very profitable.

Usually these Global Macro trades are implemented in such a way as to provide leveraged profits if the trade is successful. Some of the most interesting discussions in the book relate to strategies used to leverage success and limit losses. While financial leverage is a common tool used by "Prop Traders" to leverage gains, other strategies are also used including the extensive use of options. One of the most thought-provoking ideas in the book is volatility and its role in option pricing, and as a result, how powerful options can be as a hedging tool during difficult markets.

Another interesting observation is the trading advantage which arises simply by having a longer time horizon than other traders. Most hedge fund members have quarterly rights to draw down capital, which can limit traders' strategies. Hedge fund managers need to have adequate liquidity if there is a quarterly call on capital. Inadequate liquidity can lead to a hedge fund facility being forced to close if capital calls can't be met. Having a longer time horizon can eliminate competition for a trade, and as a result, improve its potential profitability. This is a valuable insight for long-term stock investors looking for a competitive advantage against quarterly-performance-driven institutional money managers.

Through "conversations" with various "Global Macro" traders, the reader gains insights usually limited to those sitting at a proprietary trading desk at a major investment bank or hedge

fund. While the particular strategies described may not be applicable to most investors, Inside the House of Money is worth reading. Anybody involved in the financial markets who is trying to understand how to profit from macro and micro-economic trends, and steer clear of volatile institutional money flows, will find the book instructive.