

October 2008



Global markets “tumble” - The month of shotgun marriages, bailouts, and bankruptcy

Following the government seizure of Fannie Mae and Freddie Mac in early September, Lehman Brothers, the fourth largest U.S. investment bank, filed the largest bankruptcy in history. On the same day, Merrill sold its operations to Bank of America. The following day, AIG ceded 79% control of its operations to the U.S. government in exchange for a US\$85 billion bailout package. Washington Mutual, the biggest mortgage lender in the U.S. was taken over by the FDIC, and later sold to JPMorgan Chase. The month of September ended with the worst one-day point drop the Dow Jones Index has ever had after Citigroup bought Wachovia, and Congress rejected a contentious US\$700 billion bailout package.

SEC bans short selling – hedge funds “wrongly” labeled as the scapegoats!

In its on-going assault on hedge funds, the SEC has temporarily banned short selling on 799 financial stocks following similar moves by the UK's Financial Services Authority, the Russian government, and many other exchanges globally. In the past, both the SEC and the Financial Services Authority have endorsed short selling. The Alternative Investment Management Association (AIMR) has condemned the move, noting the following:

- Short selling is not limited to hedge funds;
- Banning short selling will complicate legitimate trades where the short position is just one leg of the trade;
- A ban on short sales would hamper the price discovery process, which is inherent in every market and;
- Short selling is necessary to provide liquid

efficient markets

Following the ban on short selling, we witnessed the collapse of more banks such as England based bank, Bradford & Bingley. Andrew Baker, Deputy Chief Executive of AIMA mentioned that short selling was not the cause of Bingley's share price decline as regulators had incorrectly stipulated. An autopsy of Bingley, shows that they succumbed to growing bad debts, and panic selling by investors.

Cash is king for hedge funds - Hedgeweek

According to a Citigroup research paper, hedge fund cash holdings are now at their highest-ever average level, or approaching record levels. Hedge funds are increasing their allocation to cash. Citi estimates that currently, hedge funds are holding US\$600 billion in cash, which is approximately 30% of hedge fund assets.

Hedge funds bearish on equities – Merrill Lynch Fund Manager Survey

According to the Merrill Lynch Fund Manager Survey of 186 fund managers managing US\$641 billion, 61% of hedge fund managers believe that a global recession looms. The survey indicates that risk-aversion has risen to its highest level in over a decade, and has heightened expectations of a recession within the next 12 months. Underscoring increased risk aversion is the fact that respondents to the survey are overweight bonds for the first time in a decade. Investors are most skeptical about the Euro zone economy, with 50% of respondents underweighting Europe. According to the survey one in four managers are net short (28%) compared to 6% in August, and investors are underweighting emerging market equities the most since 2001.