Global Macro in 2009. Think again.

In the recent investor surveys a number of hedge fund strategies stand out as strategies which investors expect will do well going forward and which they intend to increase their exposure to. Among these are distressed credit, global macro and CTAs. Of the three, distressed debt hedge funds had a poor 2008 whereas macro and CTAs did well. The naïve reasons for favoring distressed debt are that the world is in recession, default rates are expected to surge. Quite what condition the companies are in when they do file is another matter. I have no comment about CTA's.

Investor expectations about macro are interesting. They expect macro to perform well in 2009 and beyond. Given the nature of macro investing, this implies that investors have some sort of macro view, at least loosely. If it is volatility in markets in general, then the probability of loss is enhanced as much as the probability of gain. Manager selection is of course paramount and what allows investors to generate more gains than losses out of volatile markets. Risk management at some level requires the investor or their manager to scale leverage to take into account underlying market volatility in the first place. These are more technical matters.

It seems that there is a tendency for investors to chase returns, to prefer strategies or managers which have been doing well recently. We can critique this approach in general or we can look specifically at the preference for macro in 2009. The clear macro trends that macro managers capitalized upon in 2008 were:

- Short rates would fall, long rates would rise. (Clear)
- Rates would reflect public balance sheets. (could take some time to manifest)
- Exchange rates would reflect risk aversion, thus strong JPY, strong USD. (not so clear)
- Credit spreads would widen precipitously. (Clear)
- Equity markets would fall. (Clear)
- Volatility would rise (Clear)

- Long rates would eventually fall as deflation risk set in. (not so clear)

Whether these were clear before the fact we cannot tell. Maybe macro managers were smart enough maybe they were lucky. We hear about the successful ones. Many of the trades were event driven, signaled by the collapse of one financial institution or the rescue of another or some narrow escape.

In 2009 what are the macro trends that managers could capitalize on?

- Short rates go to zero and stay there. (Clear)
- Long rates fall further. (not so clear)
- Weak USD (not so clear)
- Equities will fall (could take some time to manifest)
- Credit spreads recover (not so clear)
- Volatility will remain high (not so clear)

Where are the catalysts and events? There are the various rescue plans but these are for the moment limited to the housing, banking and asset backed markets in the US. Default rates will most certainly rise. But these are events more traditionally traded by ABS specialists and distressed credit investors. Where are the big macro events? One could argue that all the big macro events are behind us and that the path of the economy now follows the excruciating process of deleveraging, consolidation and repair, and releveraging. If so, where are the easy pickings for macro? Investors are likely exhibiting serially correlated expectations based on the recent performance of the strategy class and will likely end up disappointed.

Macro managers work by forming a view of the macroeconomic conditions that will unfold and then take bets to reflect those views. Whether they be in relative value or directional macro trades, whether they are long and short different parameters of the same market, most macro trades are expressed in the levels. For example, a curve steepener long 2s and short 10s, is betting on the levels of the 2 yr rates and the levels of the 10 year rates. Fewer managers trade the gamma of these markets as part of a macro strategy, an approach that adds a dimension which may be useful in a year when the traditional macro pickings are less obvious.