

Hedge Funds: Excellent Scapegoats, an example of what could have happened

Hedge funds are secretive, or private businesses who shun the limelight. Their success and sometimes spectacular implosions make them excellent news material and often a target for sensationalists. They are also excellent scapegoats. Here is an example of how this can be done:

Assume now that you are the ruler of a small emerging market economy. In South East Asia, say. The year is 1997 and things are getting a bit rough in the financial markets in the region. Your currency is trading at 3.20 to the USD. You see weakness in the currency of your neighbours to the north and further south. You read and hear daily about the turmoil that traders and hedge funds are causing with their speculative attacks on South East Asian currencies. Your currency, thankfully, has been spared. You decide to take preemptive action to head off any speculative attack.

You call your central bank governor to take action. In a matter of days your currency is at 3.50. The newspapers report of speculative attacks on your currency. You are annoyed. You call your central bank governor again demanding more action. One week later the currency is at 3.80. Interest rates are put up to deal with the run on the currency. The stock market begins to react, badly. More news about a general speculative strike against the financial markets of your country.

Night meetings over the local equivalent of pizza with the finance minister, the central bank governor, powerful local bankers and businessmen. The currency slips towards 4.20 to the USD. The equity market is falling. Some of your local corporates have been borrowing in USD and DM. Not a good move

after all. Nobody can identify the source of speculative selling.

At last it dawns on someone in your crisis committee. Your currency is quoted in number of local units per USD. Someone subtly hints it to you. Realization. At 3.50 there was little interest in your currency or stock market. Your directive to the central bank for preemptive action led them somehow to take the currency to 3.80. You are furious. Embarrassed. You need a scapegoat. Hedge funds! Who is the biggest. Soros! Perfect. The personal profile is perfect. George Soros did it.