

Ineichen, Alexander M. – Asymmetric Returns*Wiley Finance, 2007, [Finance] Grade* ★★ ★

The author's thesis is that what he calls active asset management will become the norm in the asset management industry instead of today's long only, buy and hold paradigm. Ineichen who, before he started up his own consultancy business had a long career as the head of Alternative Investments at UBS Asset Management, is of the opinion that interim volatility matters more than most investors realize as the outperformance of riskier assets in "long run" can be longer than they think and meanwhile volatility will negatively affect the compounding of the capital.

So what is "active asset management"? It is to have a strategy that seeks asymmetric returns. The investor should employ an absolute return approach with an investment process for the upside seeking returns and a risk management process for the downside and so protecting already generated returns. What Ineichen is after is "equity like returns with bond like downside", a call-option like structure. Investors have difficulties in managing the returns but they can choose to manage risk, which leads the author to state that "alpha is an option". In this respect the long-only industry have opted out as they, irrespective of whether they are active or passive with regards to generating returns, are always passive and unprotected when it comes to managing risk.

Ineichen is clearly not defining alpha as the text book would. Instead he defines alpha as something along the lines of "an ability to create a positive and asymmetric risk/return profile in a sustainable and entrepreneurial fashion". The word entrepreneurial is not as farfetched as it might seem. It refers to the fact that market opportunities change as the old ones get competed away and a part of the skillset is to understand when this change from one opportunity to another occurs.

The problem with this book is that it's too much talk and too little action. The author repeats time after time that asymmetric returns are good but he says nothing about how they are created. The

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whole book becomes a teaser. It feels like you have read a long introduction. It is also a bit too much of a debate paper on why hedge funds are better than long-onlies. It makes the author look somewhat Don Quixote-ish, as in 2007 when the book was published hedge funds and private equity owned the world.

In his eagerness to convince, Ineichen brings forward his favorite topics three or four times at various places in the book. They could for example be that Grinold and Kahn's "Law of Active Management" states that value added is a function of a manager's skill and the number of uncorrelated situations he can apply those skills on. If that's so, then constraining the manager to a smaller area than his skill must be counterproductive and is only done because it makes a product more transparent and marketable. Another is that it is unfair to compare kurtosis for hedge funds with equity portfolios because kurtosis is put in relation to the standard deviation of the return of the asset. If an asset has a high standard deviation then even large drawdowns are normal, but if it's low then relatively small drawdowns add to kurtosis. Instead one should look at the absolute size of the drawdowns. There's nothing wrong with the arguments but the repetition of them makes the book unstructured and rambling.

The tools to manage risk are derivatives, flexibility to use cash and lever the portfolio and the ability to sell assets short. However, the crisis of 2008 turned out to be a liquidity driven one that in many ways (temporarily?) changed the conditions for these tools. Since 2007 the traditional alpha of hedge funds (ex. a few alternative betas) has been zero. I agree with the premise of the author but it might not be as simple as just to opt to have alpha.

I agree with many of the author's opinions. I like Ineichen's focus on downside management and on the current opportunity set, seeking returns where they are most likely for the moment. However, I don't like the book as much.