

Drobny, Steven - Inside the House of Money

John Wiley & Sons, 2009, [Finance] Grade ★★★★★

This is very much a book in the Market Wizard-tradition - a knowledgeable person interviews prominent macro hedge fund managers on how they work and what investments they have done. As the author knows many of the interviewees personally the conversation becomes open and relaxed. Steven Drobny is the co-founder of DGA, a macro research firm selling to many of the macro hedge funds he first got to know as a member of Deutsche Bank's Hedge Fund Group.

Macro hedge funds take long and short leveraged positions in almost any asset class around the world through any liquid vehicle. The investment style is sometimes relative value but more commonly directional, i.e. trend following. Some funds are rules based and quantitative, so called systematic, but the really cool guys work for discretionary funds. Giants and geniuses like George Soros, Louis Bacon and Paul Tudor Jones with the flexibility to do whatever they want!

After three chapters where the author sets the stage by defining macro hedge funds and discussing their history and future, the interview section starts off with a superstar - Jim Leitner of Falcon Group. Among several good interviews this first one stands out as exceptionally interesting. Leitner is an astute analyst of markets but also of psychology and investment processes and his sometimes philosophical thoughts covers areas you wouldn't normally expect, such as the optimal size of an investment team (8 to 9 persons) and the way to write monthly reports making sure it's a learning experience also for the portfolio manager. Under the label "Aikido Spirit" the sympatric Leitner fosters a responsive approach to the markets and a humble probability driven view of losses and gains. Building a case for a position, numbers trumps stories. Leitner searches for imbalances and values but does not act before a trigger has created momentum around the idea.

Even if most investors interviewed are trading oriented, a presentation of thirteen PM's will

inevitably display a lot of differences. If something unites the many PM's then I would say that it's their innovation, flexibility and imagination – an ability to think of the next step. As such they are tactically good strategists. With an alert outsider mentality they gain a valuable broad view of the states of the world and they understand not to optimize the given environment but to look for signs that the environment will change.

The first edition was published in 2006 so the interviews were done during the goldilocks economy. The updated second edition from 2009 came out when macro hedge funds were scolding hot. Not only did they do superbly in the boom, they also did much better than most other hedge funds and long onlies in the subsequent downturn. Top-down investing was the name of the game. Bottom-up was knocked out. In a broader portfolio the utility an allocation to macro hedge funds brings is that they often have their best relative performance during periods when the stock market is weak. The reason is that they are trend following and bear markets bring powerful trends to follow for those who have a flexible choice. In the last few years the glory of macro hedge funds has become a bit tarnished by uncompetitive returns. I'm not entirely sure of the reasons but explanations could include that they – like all trend followers – have been whipsawed by the risk-on-risk-of character of the market, that they have focused too much on more catastrophic scenarios than those that turned out to be the case (so far) and perhaps more importantly that the space has become more crowded. Trend following strategies are today sold as mainstream beta products to institutional investors.

Imitation of the successful is an excellent way to boost performance. However, to succeed there has to be an in depth understanding of the person's accomplishments, as pure imitation without adjustments to the person or the times is a recipe for disaster. This book will bring the reader plenty of deep understanding.

Mats Larsson, December 26, 2013