
IN SEARCH OF THE NEXT PERFECT TRADE

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04/19/2017

One of our guests on the podcast last week, Alex Gurevich, is the author of the book *The Next Perfect Trade* and founder of HonTe Investments, an extension of his own personal family business. HonTe Investments is run with a very simple goal: make money over the long run. Gurevich attempts to make money with a benchmark agnostic view of the world, very different from most institutional investors.

Many traders look at short-term market trends, where perhaps their odds of trading individual positions are 52% likely to come out in their favor. Gurevich, by contrast, tries to identify longer-term market forces for which the odds of success might be as high as 90% winning positions over five-year outlooks. Gurevich says he talks to other traders who say, “Of course over five to 10 years this will go up, but I am staying out of it because of short-run [volatility](#) and uncertainty.” This is Gurevich’s prime focus and where he wants to get in.

A Case to Be Long Bonds

Gurevich’s main position today is being [long bonds](#). He has traded around the position at various times—such as after the [Brexit](#) vote, when rates spiked down and bond prices up—but he has been in this for a number of years and expects it to continue. As long as we have upward-sloping [yield curves](#), he sees this trade paying off. He does not see any other trade in the history of wealth creation that offers the same dynamic—a negative [beta](#) asset that pays you money while also protecting your wealth. He does not see this scenario going away anytime soon.

The Carry Factor: Why the Euro Is Not as Cheap as Spot Rates Suggest

One of Gurevich’s reasons for being long bonds is the carry he earns from these positions. This also factors into his positions in the currency markets. He says many people just look at the spot exchange of the euro-dollar cross to say the euro looks cheap—and, yes, the average level for the euro over the last 16 to 17 years has been approximately 1.24 while current levels are 1.06. If you were to buy the euro on a 10-year forward basis, given the [interest rate differentials](#) with the European Central Bank at negative rates and the [Federal Reserve \(Fed\)](#) hiking, the [10-year forward rate](#) on the euro is actually 1.29, which still looks expensive when the average is 1.24.

Equities: Getting More Suspicious of U.S. Equities

One of Gurevich’s models for equities tracks interest rate momentum—he sees this as being a key variable that influences equity market direction. When the trend in interest rates is lower, Gurevich’s modeling suggests being bullish on equities. The general rise

in interest rates we've seen recently, while not having any further directional suggestions for the future path of interest rates, Gurevich sees as being a big headwind for equity markets. Right now, the move in interest rates and the strong dollar—both associated with the [tightening](#) of financial conditions—has Gurevich the most suspicious of U.S. equities he has been since 2008. Because of inflation trends, Gurevich points to the 2000 cycle, when the Fed was hiking as the market was starting to roll over. The same for 2006. Today's strong [inflationary](#) data is thus ominous to Gurevich.

[Bullish](#) on [Nikkei](#) over the Longer-Term

The one equity market Gurevich was long last year after its initial sell-off was the Nikkei and Japan. While Gurevich says it will be hard to avoid contagion from a U.S. equity market sell-off globally, he believes that if one holds Japan long enough, this trade has more positive developments going for it. A few points in favor of Japan from Gurevich: Japan is getting control of its core [inflation](#), declining [commodities](#) prices have been a net benefit to Japan as a big importer of commodities, Japan is well positioned to be a leader in robotics and automation of its workforce and, finally, remilitarization and military tensions in Asia are likely to be a positive catalyst for spending in Japan.

Second Guest: John Martin of Martin Consulting and Advisory Services

While this write-up focuses on some of the market opportunities discussed with Gurevich, we also had a great discussion with John Martin, of Martin Consulting and Advisory Services. John has formed his own business consulting for various investment advisors on portfolio design, manager selection and being an outsourced committee member. Here are some of the topics we discussed with John:

- Why the institutional investment consulting market is too institutionalized
- Why John thinks one can do better than investing in broad indexes of hedge funds like the HFRI composite index and how he sees this changing
- Why equity long/[short](#) hedge funds are likely to become lower-weight in the [HFRI index](#)

John also wanted to jump into the bet we discussed last week with Nir Kaissar and Ben Carlson. John agrees with Nir regarding hedge funds, but he wants to make the evaluation of the winner contingent not just on raw performance but based on two of three criteria: absolute return, alpha measured versus a global benchmark because hedge funds do not just invest in U.S. equities and, third, [Sharpe ratios](#) or [risk-adjusted returns](#). He thinks the hedge funds will win two of three criteria. This changes the goalposts of the bet, but it's also interesting in thinking about where hedge fund strategies fit in.

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DEFINITIONS

Volatility: A measure of the dispersion of actual returns around a particular average level. nbsp;

Long (or Long Position): The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).

Brexit: an abbreviation of “British exit” that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Union.

Yield curve: Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

Beta: A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

Interest Rate Differentials: The Difference between the 2 Year interest rate swaps of the United Kingdom vs. the United States.

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

Forward contracts: Agreements to buy or sell a specific currency at a future date at an agreed upon rate.

Tighten: a decline in the amount of compensation bond holders require to lend to risky borrowers. When spreads tighten, the market is implying that borrowers pose less risk to lenders.

Inflation: Characterized by rising price levels.

Bullish: a position that benefits when asset prices rise.

Commodity: A raw material or primary agricultural product that can be bought and sold.

Short (or Short Position): The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

HFRI index: Captures the breadth of hedge fund performance trends across various strategies and region.

Sharpe ratio: Measure of risk-adjusted return. Higher values indicate greater return per unit of risk, specifically standard deviation, which is viewed as being desirable.

Risk-adjusted returns: Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.