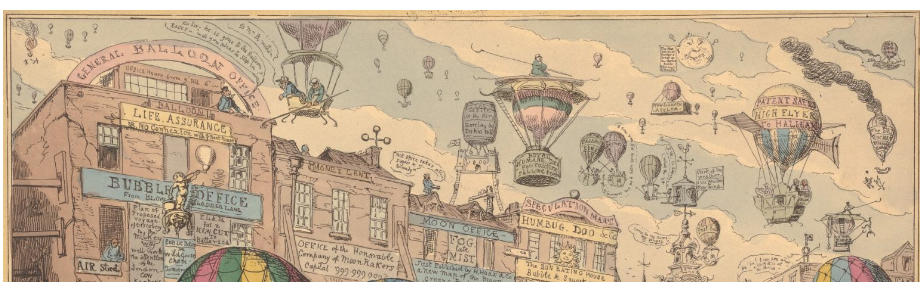
Sunday Reads

Insider Trading, Chinese Debt, Art Strategy

By Jamie Catherwood December 8, 2019



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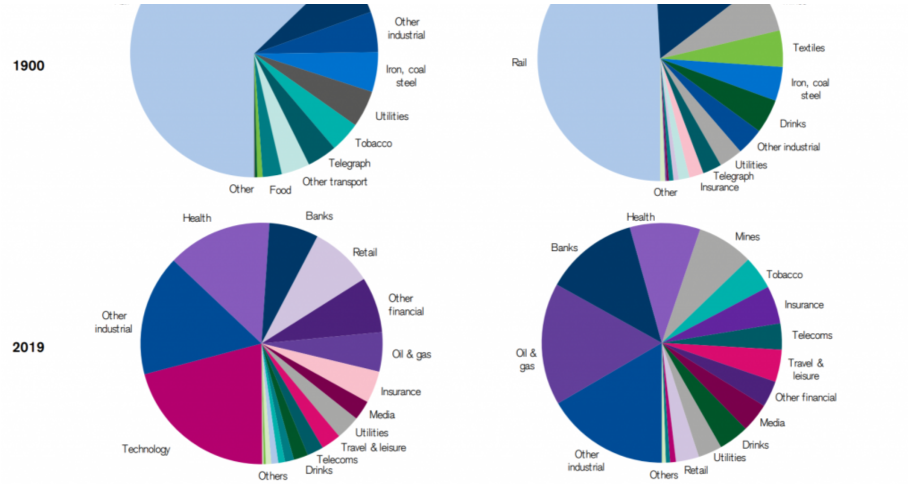

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FORMING A

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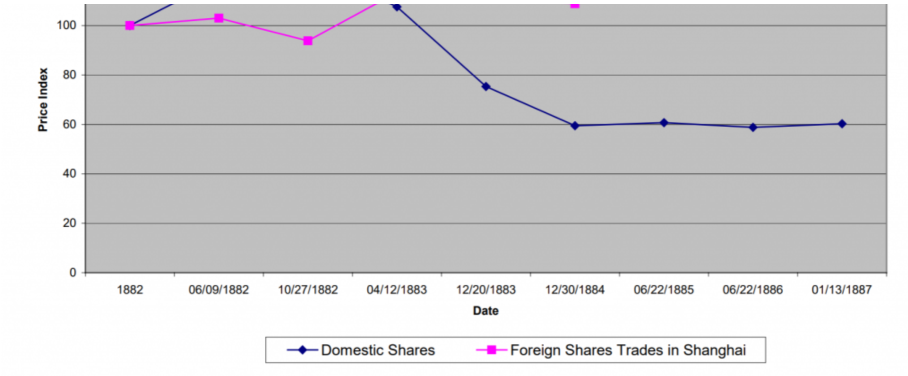
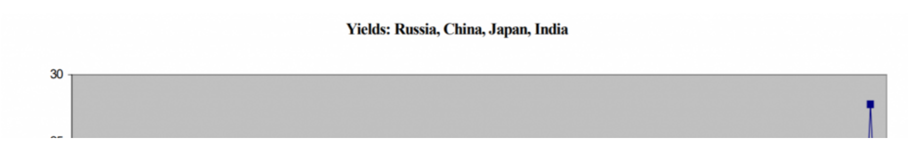


It is safe to say that China has been a heavy focus for investors, journalists, and politicians recently. As it turns out, events from over a century ago provide excellent historical context for recent developments.

> *"This paper focuses more narrowly on the process of securitization of the assets of Chinese firms and government debt that began to occur in the late 19th Century, both inside and outside of China. Over the period 1870 to 1930, the Chinese financial system underwent extraordinary change. Chinese enterprise in major port cities developed from family-based, private equity ventures and quasi-public firms, to publicly-held corporations which could tap both domestic and foreign savings through both international and domestic stock and bond markets."*

For a while, this system was great. Just take a look at how relatively stable the yields on China's debt was at the time:



> *From the Chinese perspective, however, these terms were viewed as an affront to Chinese sovereignty and an impediment to the development of a domestic corporate sector. As a consequence, the terms of Chinese external investments contributed to a backlash against foreign ownership of Chinese capital and foreign encroachment on Chinese sovereignty.*
>
> *Although a vigorous capitalist system grew in cities like Shanghai in the late 1920's and 1930's, **the seeds of resentment towards foreign capital became a popular catalyst for the Leninist revolution in 1949, an event that shifted China away from widespread economic and financial relationships with large sectors of the developed world**. Only in the last two decades has China returned to the global financial community and in the last decade China has begun to rebuild her own domestic capital market."*

Bloomberg's Tracy Alloway wrote about how *Trump's New Trade War Tool Might Just Be Antique China Debt*. In her article, she notes:

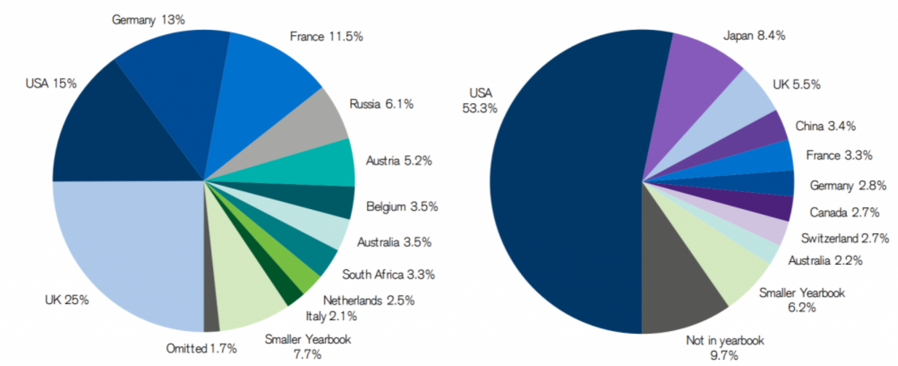
> *"The U.S. once referred to the money that flowed into China at the turn of the 20th century as "dollar diplomacy"—a way of building relations with the country (and its massive untapped market) by helping it industrialize. The Chinese have another term for it: For them it fits squarely into China's "Hundred Years of Humiliation," when the Middle Kingdom was forced to agree to unfair foreign control."*

The Lost History of Insider Trading

Can you imagine what the world of insider trading looked like before any real regulatory authority was established? Well, this article provides an excellent oversight on the 'lost history of insider trading'.

markets. If anything, this is worth checking out for the visuals.

Figure 10: Relative sizes of world stock markets, end-1899 (left) versus start-2019 (right)



There is also some interesting analysis on asset returns by geography:

Table 1: Real (inflation-adjusted) equity and bond returns in selected markets, 1900–2018

Country	Geometric mean (%)	Arithmetic mean (%)	Standard error (%)	Standard deviation (%)	Minimum return (%)	Minimum year	Maximum return (%)	Maximum year
Real equity returns								
Europe	4.2	6.0	1.8	19.8	–47.5	2008	75.2	1933
Japan	4.1	8.6	2.7	29.3	–85.5	1946	121.1	1952
Switzerland	4.4	6.2	1.8	19.4	–37.8	1974	59.4	1922
United Kingdom	5.4	7.2	1.8	19.7	–56.6	1974	99.3	1975
United States	6.4	8.3	1.8	19.9	–38.6	1931	55.8	1933
World	5.0	6.5	1.6	17.4	–41.4	2008	67.6	1933
Real bond returns								
Europe	1.2	2.4	1.5	15.8	–52.6	1919	72.2	1933
Japan	–0.8	1.7	1.8	19.4	–77.5	1946	69.8	1954
Switzerland	2.3	2.7	0.9	9.3	–21.4	1918	56.1	1922
United Kingdom	1.8	2.7	1.2	13.5	–29.9	1974	59.4	1921
United States	1.9	2.4	0.9	10.3	–18.1	1917	35.2	1982
World	1.9	2.5	1.0	11.0	–31.6	1919	46.0	1933
World ex-US	1.6	2.6	1.3	14.3	–46.1	1919	75.4	1933

Art Dealers' Strategy: The Case of Goupil, Boussod & Valadon (1860 – 1914)

> *was disposed of within a year. Returns on artworks varied hugely in function of the rapidity of the sale. For artworks sold in less than a month returns were very substantial with a daily return averaging 5.78% to be compared to an overall daily average (not including orders and unsold works) of 1.44%."*

What I found most interesting about this paper was the idea that art dealers would have artists 'in-residence', which sounds similar to the concept of VC 'incubators'.

> *"During the 19th century the practice to have artists in residence increased. Goupil managed to have several artists under contract. The analysis shows that Goupil was ready to gain a lower return on the sale of these artists' artworks. This may have been a way to support these artists by allowing a larger number of collectors to buy their work. However, requiring a lower return did not mean that Goupil was likely to sell these artworks at a loss. Goupil was thus promoting these artists while at the same time protecting the value of their works he held."*

As the author alludes to in the conclusion, the fact that these in-residence artists generally recorded lower returns on their art than non-resident artists has implications for how good the 'active management' (selection) of art dealers was.

> *"If Goupil was indeed exploiting a monopolistic position for some artists, then one would expect returns to be higher for artists in residence from whom Goupil probably got a preferential treatment. On the other hand if Goupil had made a wrong bet then he would have ended up with a large inventory of artworks from a given artist and might have agreed to sell these at a discount or even at a loss. The artist in residence dummy shows that, on average, returns from artworks made on works made by artists in residence were statistically lower than for other artists."*

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