

# FINANCIAL REVIEW

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HD **US traders termed 'macro-tourists'**  
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Hedge funds Australians understand the **Chinese** better

The boss of Pacific Alternative Asset Management **Company** (PAAMCO), of one of the world's biggest hedge fund managers, thinks the industry is making a big mistake in shorting Australian assets on the assumption the local economy will come under increasing pressure from slower growth in **China**.

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"Shorting **China** is one of the most popular trades in the world at the moment and a lot of US hedge funds have been shorting the biggest Australian banks, miners, and the Aussie dollar as a proxy trade," PAAMCO co-founder and chief executive Jane Buchan says. But she dismisses these traders as "macro-tourists", saying people around Asia and in Australia have a much more sophisticated and sanguine view of what is happening in **China** than most hedge fund managers based in the United States and Europe.

"People in the northern hemisphere are so bearish on **China** due to a very simplistic view based on what has happened in other developing economies historically. The power of what a command-control government can achieve is being underestimated," she says. While Buchan agrees with the popular view that Australian bank share prices face some risk from an "overheated" local housing market, she is not tempted to short them due to her more positive view on Australian growth linked to **China**.

Nor does she think it is time to sell the local currency. "Shorting the Aussie dollar looks set to prove a 20-year widow-maker trade, much like shorting Japan **bonds** has been," she says.

PAAMCO has very little exposure to Australian assets, just "a small number of curve trades on the yield curve and a couple of **bonds** in the **oil** and gas sectors, but nothing meaningful in equities", Buchan says.

However she is keeping a close eye out on opportunities in the local merger and **acquisition** scene. "Globally there has been a big uptick in **M&A** activity over the past few months. Geographic barriers to deals are breaking down so more Australian companies are likely to find themselves targeted by international suitors."

Of particular interest to PAAMCO are mid-size companies that look attractive targets for larger, more highly rated, companies.

Both the debt and **equity** in such target companies typically re-rate higher when swallowed by a larger rival. Larger companies that are good candidates for a demerger also present good opportunities for hedge funds to profit, Buchan says.

Another favoured ploy for PAAMCO managers is investing in companies that have had their credit ratings slashed and are on the brink of collapse. Investing in distressed companies is risky, but if the hedge fund shareholders can agitate to push bankruptcy proceedings through more quickly than the market is pricing, then there is money to be made.

Founded in 2000, PAAMCO is a \$US9 billion (\$9.6 billion) fund of hedge funds. It allocates investment funds to emerging managers but does not buy them. There are currently about 40 hedge funds in the stable. The fund's niche product targets the biggest institutional investors and targets sovereign wealth funds and the 500 biggest pension funds globally.

Buchan travelled to Sydney in May spruiking for business. She met with the Future Fund and about half a dozen of the largest superannuation managers in the country. Buchan, who was appointed to the global Hedge Funds Standards Board last month, is scathing about what she sees as a proliferation of "quasi hedge funds" damaging the industry's reputation. "There is no point in institutions paying a premium for a long equity manager that takes some short positions using exchange traded fund products just to label themselves a hedge fund," she says.

Escalating unrest in Iraq and the threat of US-led military intervention over the past week will have little impact on PAAMCO's strategy because it is focused on making money out of company specific risks, Buchan says.

The fund of funds has been reducing its already limited exposure to macro-economic risks over the past six months in response to territorial disputes between Russia and Ukraine. Buchan and her team will be paying close attention to crude oil prices, which have surged in response to an escalation in the latest wave of conflict in Iraq which has the potential to disrupt global supply.

While PAAMCO has no direct exposure to the oil price, it does have significant indirect exposures through stocks and bonds issued by energy producing companies – including a few Australian producers. Regardless of what upsets occur on the global macro-economic stage, PAAMCO is unlikely to be among a throng of investors rushing into the perceived "safe haven" asset of gold.

"Gold is the drug of choice for hedge fund traders. Once they start, they never get out," Buchan says.

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