Q&A

Ryan O'Grady, ROW Asset Management

Ryan O'Grady is co-founder and ceo at recently formed **ROW Asset Management**, an investment management firm which takes a systematic approach to currency positions, which are set up via forwards and non-deliverable forwards. He is the ex-head of investment research at **FX Concepts**, one of the largest foreign exchange hedge funds with over USD8 billion in assets under management. He founded ROW in November with **Jeffrey Weiser**, an ex-portfolio manager of FX Concepts' Global Currency Program. O'Grady spoke to Reporter **Mike Kentz** about the firm, current trends in the fx market and the impact of forthcoming regulation.

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DW: What have been some notable trades that your fund has put on since its launch?

RO: Our system is meant to be very diversifying, so it analyzes a lot of different relationships and puts on a lot of different inter-regional trades. Carry is an important input to our process. A consistent trade we've had on has been short U.S. dollar and long a basket of Latin American currencies. The reason that's interesting is because it has good yield differential, the trend is in favor of that trade and it's sort of isolated from the euro/USD back and forth that's been going on. What is interesting is that carry and trend favor Brazil far and away, but we have relative value models that favor some of the other countries, like Mexico, and that helps to shift some of the focus away from Brazil, which is pretty unique.

DW: What's the benefit of systematic as opposed to discretionary?

RO: Systematic is able to analyze more relationships. If you talk to a discretionary manager they'll usually tell you three or four dominant themes or trades that they have on. Whereas we analyze thousands of different relationships, trading 32 different currencies,

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so we're not married to any specific trade or cross. On top of that, systematic is testable. So if you have an idea, you can look at how it has outperformed, with also a lot of our ideas coming from intuition. Jeff and I were both traders and are familiar with discretionary trading. Having that background is really useful for putting models together and understanding interactions.

My guess is if you called 100 systematic managers and you ask, with hindsight, do they wish they had intervened more or less with their model, their answer is almost always less. So from our POV, we do use some discretion as a point of disaster avoidance but we're really a systematic shop.

DW: How often do you update your models?

RO: We probably roll a new model out every three to six months and update existing ones every two to three months. We're pretty much always generating new ideas, though. We've got a laundry list of new ideas about a mile long, and it's not that models stop working; it's that once the market catches onto it, the efficacy will drop. So it's more about keeping your models and process ahead of everyone else as much as it is staying ahead of changing market conditions. And that's a big part of our process is maintaining a credible pipeline. Investors come to evaluate your research process and you need to be able to explain how you come up with new ideas and where those ideas are currently.

DW: What kind of trends are your models identifying right now?

RO: Our approach is a balance of carry, trend and relative value. Right now we're pretty balanced among all of them with a slight bias towards carry. If there were a dominant theme in our current portfolio it would be that the models are positioned for a flow of funds out of near zero interest rate countries and into countries that are commodities exporters or high interest rate countries. Plenty of people are probably long Australian dollar or South African rand against U.S. dollar on the back of this type of view, but what's unique about us is the variety of different positions we keep on in Asia, Latin America and even Europe that I think most others probably don't.

DW: Is your strategy an outright directional view or a hedge against something else?

RO: Ours is an absolute return strategy. We're standalone.

DW: Why don't you use options at this point? Could you see yourself using them in the future?

RO: We don't use options because they are heavily dependent on expectations. If you look at fx, current spot is a fairly good predictor of future spot, so if you have an accurate forecasting model that says EUR/USD is going to go up, then you are able to make money on those kinds of views if the pair does appreciate.

But if you think volatility of EUR/USD is going up, and the market agrees with you, then vol's are already priced to take that into that account. There's sort of a second level when you're talking about a systematic approach to options in that you have to predict not only what vol is going to do but also what the market

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thinks vol is going to do. Quite often you find yourself "short the tape", so if your short options it means you're model thinks they are overvalued and they are overvalued because the market is anticipating something your model can't see. For example a systematic model can't take into account that the G7 is meeting over the weekend, which would be one reason why an option would appear to a model be overvalued. So that's the downside to trading options systematically.

Options will be more useful for us in structuring better returns. For example, the distribution of our trades tends to be the bell curve; we're long/short the plain vanillas, linear payoffs, with symmetric payoff structures. So we'd use options to change that structure. For example a carry trade you'd make small amounts, so we'd look to give away a little bit of upside to get more of an advantage if the cross trades in a range. Outright bets using options are probably unlikely but in structuring payoffs as an overlay we'll likely use them.

DW: Are your models based on fundamentals or technicals? What kind of size do you trade?

RO: Almost all technicals. The only fundamental input we use is in relative value by using inflation data. Trading size tends to be between 2-10% of assets under management, and we turn our portfolio over about 60 times a year, so about USD1 billion in turnover a year.

DW: What are the average maturities?

RO: Two to three months, six months at the most. It's a tradeoff between how often do you need to roll a portfolio versus synchronizing your trades. Our hold time is anywhere from two weeks to two months depending on the strategy, so for that anywhere from two to six months is a good maturity.

DW: Why was May such a difficult month for most currency managers? How did your fund perform in May?

RO: May was a good month for us to demonstrate what we do. It was a difficult month because EUR/USD had a nasty whipsaw experience where it shot up to 1.49, collapsed to 1.40, and then recovered to 1.44. So if you were doing a trend following or carry strategy on major currencies it would have been difficult for you to have a good month. We outperformed many other FX managers, though, because we're not dollar-centric. On top of that, people talk about carry and trend being uniform factors, but they're not. Carry and trend trades can be working in some regions of the world and not others, so you've got to identify the successful models and pairs under either strategy. In May if people were limited in the selection universe with respect to carry and trend strategies they would have had_a tough time having a good month.

DW: What major trends are your models identifying now, outside of the USD/LatAm one?

RO: Another one outside of USD/LatAm is going long Indonesia and India and short Philippines and Taiwan. It hasn't worked great yet but it's pretty interesting. It's driven primarily by carry and trend at this point.

DW: What are some opportunities in FX markets going forward?

RO: We don't really take long-term views, but over the short-term there are two things creating opportunities: central bank activism in both developed and emerging currencies; and this overall growth in moderation seems to be over, where countries are decoupling and there's strong growth in some regions and weak growth in others, which contributes to sustained cross-border flows and allows people like us to identify opportunities and make money.

DW: What about regulatory challenges to FX?

RO: The greatest regulatory challenge is that the Dodd-Frank Act proposed to require currency swaps to be subject to exchange margin and clearing unless the Secretary of the Treasury determines otherwise. Recently, the Secretary of the Treasury announced that it would act to exempt currency forwards from the Dodd-Act's margining and clearing requirements although it has not, to date, taken any formal action. This change, if it moves forward, would without question add complexity to our industry.

One other regulatory initiative is the **Commodity Futures Trading Commission** proposal to require certain pool operators to look through to their underlying investors (who must be eligible contract participants in order for the commodity pool to be considered an eligible contract participant). Most commodity pools do not have this information about the underlying investors. Therefore, if this moves forward, there is going to be a lot of work that will need to be done by managers.