Title:
Market Risk – Not To Be Ignored or Overlooked

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673

Summary:
Understanding Market Risk and the solutions available to mitigate or eliminate financial loss

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Article Body:
The first of a two part article….
Fund managers, whether they be equity or bond traders, know all too well that returns are not simply a result of their asset selection prowess. Many external factors come into play. But what are the issues facing the professional money manager.

Commodity Trading Advisor, Genuine Trading Solutions of Toronto, find not all fund managers analyze their market risk. The company explains this is often due to a lack of education and a failure to understand the mitigating solutions for off-setting risk.

Genuine Trading Solutions President, Dwayne Strocen explains market risk as “the unexpected financial loss following a market decline due to events out of your control.” He goes on to explain that stock or bond market volatility or market reversals can be the result of global events happening in far flung corners of the globe. Top analysts and fund managers simply do not have the resources to crystal ball gaze and predict those events.

Examples of several major unexpected events that sent shock waves throughout the financial community have been:

- 1982 Mexican Peso devaluation;
- 1987 stock market crash knows as “Black Monday”;
- 1989 USA Savings and Loan Crisis;

- 1998 Russian Ruble devaluation;
- 1998 $125 billion collapse of Hedge Fund Long Term Capital Management;
- 2006 collapse of Hedge Fund Amaranth with losses of $5.85 billion.

In 1994 Bank J.P. Morgan developed a risk metrics model known as Value-At-Risk or VaR. While VaR is considered the industry standard of risk measurement, it has its drawbacks. VaR can measure total dollar value of a funds risk exposure within a certain level of confidence, usually 95% or 99%. What it cannot do, is predict when a triggering event will occur or the magnitude of the subsequent fallout. For some company's and funds, a steep decline or protracted recession can be devastating. Even forcing some un-hedged firms into bankruptcy. A triggering event can have a ripple effect forcing people out of work and economies into recession effectively putting more people out of work. No person and no economy is immune.

If you own a mutual fund, chances are your fund is un-hedged. Until recently, mutual fund legislation prevented mutual funds from hedging. Many jurisdictions have repealed this rule however mutual fund managers have been slow or decided to continue with 'business as usual". The reason is that most investors of mutual funds are unsophisticated and do not understand the hedging process and may re-deem their money from an investment strategy they do not understand.

Hedge funds on the other hand do not have these restraints. Investors are more sophisticated and are more open to the nature of hedge fund strategies. Some of which are not disclosed due to a fear of piracy by competing hedge fund managers.

Risk reduction solutions are not complicated but do require the services of a professional who understands the process. This is the role of Commodity Trading Advisor firms such as Genuine Trading Solutions, also known as a CTA. President, Dwayne Strocen states that while most CTA's are hedge fund managers, few specialize in risk management analytics. Our focus is on the analysis of solutions to reduce or eliminate market and / or operational risk. No matter the role, all Commodity Trading Advisors are specialists in the derivatives market.

The first step is the value at risk calculation to determine a funds risk liability. A risk mitigation strategy known as a hedge is then implemented. After all, identification of one's risk is only beneficial if a solution to off-set that risk is put into place. Hedging requires the use of derivatives, either exchange traded or over-the-counter. They can take many forms. The most commonly used hedging instruments are index futures, interest rate futures, foreign exchange, exchange traded commodities such as Crude Oil, options and

SWAPS.

A more detailed explanation of derivatives and hedging will be discussed in our next article. Now that we've identified an easy solution for your market risk worries, the implementation of the right strategy can be as easy as a call to a qualified and registered Commodity Trading Advisor.