

Opportunities amid volatility

Hedge fund managers believe the volatility of this year will continue next, with tapering talks to impact emerging markets. But they are looking for progress on China reforms and raise the prospect of some upside surprise there in 2014.

As told to Yvonne Chan

TUNING INTO TAPERING: TOBIAS HEKSTER, TRUE PARTNER FUND Global volatility arbitrage



If I were to summarise, the key market event of 2013 was the phenomena, or discussions, around tapering in the US. As soon as there was a threat of [US Federal Reserve chairman Ben] Bernanke taking the punchbowl away from the party, so to speak, the markets started tanking.

Even though it is a US-based event, the repercussions were most widely felt in the emerging markets and Asia. There was a sustained market reaction to the tapering that enabled our computer model to identify periods in which one would want to own Asian volatility, and short US volatility. It turned out to be beneficial to our portfolio.

Another event this year, even though it was a relatively short-term opportunity, was the fat finger trade in China. (China Everbright Securities' mistakenly placed buy orders worth Rmb23.4 billion (\$3.8 billion) on a single day in August.) Although we can't trade CSI300 futures, we're able to look at various products in Hong Kong that proxy China. There was a diffuse market movement in the China space around the fat-finger incident that was beneficial for us.

Overall this year, the China market lagged. But in 2014, it could have some

upside surprises on a par with what we've seen in the US and Europe this year. European markets went up quite a bit and the S&P500 went up phenomenally.

At the same time, the European and US markets have not had significant movements on a daily basis. It's been more of a steady trend of crunching upwards, with volatility only hitting when tapering discussions come up.

I believe a reinstatement of the tapering discussions next year will impact emerging markets again. I would expect that towards mid-year there will start to be some tapering. It's the reason why for us, as a volatility fund, the majority of opportunities are expected to continue to originate from Asia.

MORE VOLATILITY TO COME; CHRIS CHOY, QUAM CHINA FOCUS FUND Greater China-focused long/short equity



We initially expected the macro environment to be better this year and didn't expect the market to trade at the low levels it did. There was volatility, especially in emerging markets and the US due to the QE (quantitative easing) tapering announcements, as well as concerns about slowing growth in China.

However, we found quite a number of good opportunities this year for the

long book. In the first quarter, we continued to hold onto high-yield bonds due to their capital gains, but we closed out our positions in the second quarter.

We have exposure to the health-care sector and in mid-2013 added to our TMT (telecommunications, media and technology) book. We additionally picked several stocks of companies in line for catalyst-driven corporate actions such as M&A, spin-offs and asset disposals. Sometimes it takes only two or three months for the event to crystallise before we close out our position.

Next year the markets could be even more volatile than 2013. The US will need to come to a decision on how to exit its QE programme by the end of this year. The problem is that the US economy is not on a clear path to recovery, but the Fed knows that if it keeps interest rates sealed for an extended period, the market will lose momentum.

For China, we take the view it is still struggling with internal problems, including a property bubble, bank debts and the transformation of its economic structure from a manufacturing-based economy to one that is consumption-based. The government is taking steps to remedy matters and by next year should be making progress on its promised reforms.

Going forward, we will remain invested in catalyst-driven companies and also TMT stocks, especially those in the mobile internet sector which

increase China's web traffic and the scale of the economy. For example, Ctrip, the largest online travel agent in China, has recently reached daily transaction value of Rmb100 million through its mobile channels. It represents a huge opportunity in the mobile internet sector.

MORE MARKET UPSIDE IN JAPAN; HISASHI OSEZAWA, SIMPLEX J FLAG FUND Japan-focused long/short equity



In the first half of 2013 the market was reinvigorated after a long period of sluggish stock prices, resulting in stock prices increasing across the board. Market participants have been seeking growth-related stocks, pushing up the overall market as a result.

Up until November 2012, the biggest contributor to our returns was stocks that were expected to grow in an environment of deflation and a strong yen. Since then, we have shifted our focus to companies that would benefit from Abenomics.

In May, when the Japanese markets plummeted, we reduced our long exposure from 80% to 35%, and held that position until July. Afterwards, we gradually increased our long exposure as the market stabilised.

Although most major indices have not exceeded the highs that were reached in

May, and there has since been no clear indication of future market direction, the portfolio has performed very well as a result of our stock selection process and positioning.

I expect continued market growth in 2014 and, as a result, have been increasing the fund's net exposure since September. Although I anticipate that a high level of market volatility will continue for a while, I believe that it will not be a significant factor that will impact investment opportunities. The fund will continue to look into small- to mid-size emerging companies that are generally not covered by most investors.

In January, the government is scheduled to launch the Nippon Individual Savings Account (Nisa) scheme, which will let individuals open tax-free accounts for investments. This will have a positive impact on the equity market. However, the sales tax is in line for an increase from 5-8% starting from April next year, which could adversely affect corporate profits.

EMERGING MARKETS TO EMERGE; EDDIE TAM, CENTRAL ASSET INVESTMENTS Multi-strategy



Starting from the end of 2012 we had no idea when, or even if, the Fed would taper. We decided that even having a shadow of a threat of tapering is no good for bonds, so we exited most of our credit strategies. We are now very much in equities.

Some of our best drivers of returns this year have been Asian stocks listed

in the US. Those have done much better than Asian stocks listed in Asia. In sectors such as the internet or alternative energy, the best Chinese companies are not listed domestically, or even in Hong Kong. They tend to be listed in the US.

If the Fed does taper, it will cause enormous pain to some emerging countries that are running significant account deficits, namely India and possibly even Indonesia. But North Asia, including China, should be fine because they are running current account surpluses and don't have significant budget deficits.

The main trend is that although emerging economies have lower rates of growth, they are still growing at a faster pace than developed countries. The real economies in the US and Europe continue to grow quite anaemically. It may be due to the fact that developed economies have matured and therefore cannot keep growing at the same rate as they used to, or it may be to do with the rise of China and other emerging markets, with which they are competing in many key industries.

We may very well be in an era of relatively stagnant growth for developed countries, lasting for an extended period of time. It may not be dissimilar to what Japan has been going through for the last 20 years. Because of that, QE may be the norm within a decade, while stopping or slowing down QE will be an exceptional event.

Emerging markets have been lagging developed economies for the past five years. Next year there's a chance, in my opinion, that it may turn around. While the Western markets won't experience a crash, they might not perform as well as they have this year, whereas Chinese markets may outperform. ■

