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Panic sweeps financial markets smashing records of 1929 crash

BY GAIL LEM
The Globe and Mail

Share prices crumbled on stock exchanges around the world yesterday as a classic financial panic swept the equity markets.

The decline was of epic proportions. Fortunes were lost in a matter of hours as the New York Stock Exchange suffered a gut-wrenching collapse — far worse than that recorded during the massive stock market crash of 1929 that ushered in the Great Depression.

The Dow Jones industrial average, the most widely watched measure of share values on Wall Street, buckled by 508.32 points or 22.62 per cent. It closed at 1,738.41. The devastation erased $503-billion off the value of U.S. stocks.

The trauma continued overseas after the U.S. exchanges closed for the night, with prices plunging in early trading in Japan, Australia and New Zealand. On the Tokyo Stock Exchange, the Nikkei stock average dropped 972 points to 24,775 in early trading.

"It's just incredibly hectic here," one broker said. "Everybody wants to sell but there are practically no buyers."

And the Hong Kong stock market suspended trading for the rest of the week after its Hang Seng index fell 11 per cent yesterday, a re-

The plunge at a glance

Other aspects of yesterday's stock market plunge:

- Crowd psychology in stock markets concerned with the economy and the threat of war created a crisis of confidence — and a crash. B1
- Bad news for equities investors wasn't shared in other markets, where the dollar was strong and short term rates eased. B1
- New York Stock Exchange chairman John Phelan is glad the "finan-

The 4 fallacies about hedging

By Kambiz Kazemi Linked in profile ***September 10th, 2018***

"I sometimes curse the day I got into derivatives" told me an old friend as we were talking. For a moment, I definitely could sympathize with him. After nearly two decades being involved with all things derivatives, I can attest that too often, discussions involving options/derivatives with investors and sometimes investment managers remain as much a non-starter today as back when I started.

I often wondered why that is the case? To me the natural answer was: this is a niche area on which many do not focus naturally or spend time, so education is key. So, I spent a great deal of time and effort throughout the years in interreacting with colleagues and investors alike doing my best to show that these instruments are like any other investment instrument – from small cap equities to private debt, etc. – they can be used to both make money and avoid or diversify risk, not just a source of loss and concern.

Lately, in an effort to showcase our advisory services, I have spent a lot of time discussing hedging and risk management with a variety of people. And through it all, it finally dawned on me: the challenge with derivatives and hedging is not about education, but an urgent need to "de-educate"!

For nearly 40 years the main message, discourse and headline in both main and specialized financial media about derivatives have contributed to create the wrong "first impression" and driving investors away. The news' focus has been two-fold: a) hedging against the coming disaster, which rarely comes! (often at high cost and with mixed if not inefficient outcomes), b) unsavory characters using complex instruments to disguise risk, causing fund implosions and havoc leaving investors distraught.

We were all told and explained amply how derivatives were the root cause of the subprime crisis and the LTCM (1998) implosion, but how often were we told that the best performing funds in those periods relied on option strategies? How about the fact that most executives in the corporate world have amassed their wealth thanks to stock options? (yes, they are derivatives!). Right here in Canada, many pensioners owe the fact that their pension funds are fully funded to the existence of these products and the great expertise of the investment managers specializing in them at institutions such as OTPP, HOOPP, etc.

So, I am out to start a "de-education" effort, and as a first step let's do away with some major fallacies considered now as "established facts" and "common wisdom" about hedging.

1. Hedging is like insurance

This is by far the most misleading of all fallacies on hedging. The recurrent use of terms such as "portfolio insurance" and "option premium" and "put buying" by pundits, suggest there is a similarity between hedging and insurance. Far from it, why?

"Hedging is like insurance, to protect against a disaster". Not really. Insurance is a protection against an extreme scenario of which one usually can not recover without having been insured. Hedging is actually about controlling risk and reducing the jumps both up or down (i.e. volatility) in an investment or a portfolio.

Hedging is not just about "market crash" insurance

Simply put, hedging is about making sure there is less uncertainty going forward. A practical example: for many companies hedging is about having some degree of certainty and visibility about their future cash flows, costs, etc.

2. Hedging is a costly proposition

"Hedging is like insurance, you need to spend money". Wrong.

Hedging, does not need to or always involve buying an option (an upfront payment)

One can hedge by investing in any security that has a movement contrary (especially in adverse scenarios) to what is being hedged. For instance, if you think NAFTA is falling apart and it will really hurt the Canadian economy, buying US dollar can be a hedge.

The expertise (or art) of hedging is to find the right instrument and use it in the right amount. Like anything else hedging needs to be done the right way.

3. If you hedge you will miss out on gains

The point usually put forward is that by hedging one forgoes some gains, either because one is explicitly paying for a hedge product or because the hedge makes money when the rest loses money.

What one must remember is that: yes, you will miss on some gains at some point in time BUT you will also avoid some losses at other times.

All in all, "proper" hedging means in the long run you aim to achieve a similar performance to the one if you were unhedged BUT with less up and downs – and hopefully sleep better at night

Extra bonus, should the rare scenario of the "end of the world" happen, you have that one covered too (at least in part).

We must remember, that a hedge does not necessarily loose money when the rest of your investments gain. Back to our example, the US dollar can stay stable while Canadians stocks rally on the back of a new and improved NAFTA (or may be GAFTA): your gains would be barely eroded.

The fallacy is that hedging too often has been presented as the "avoidance of losses at a cost" instead of the "avoidance of a volatile path – potentially ruinous in rare cases - to achieve similar returns".

4. Hedging passively (buy and hold) can work

Unfortunately not. The thought that one can find a set of investments that can be added to a portfolio as a buy and hold hedge gained some traction a little while back, especially with the advent of new products such as volatility Exchange Traded products (ETPs). This has left many less than satisfied, as they have incurred losses or underperformance by using them. If like me you do not subscribe to the school of thought that favors passive investing in general, I do not need to convince you of the importance of active hedging. But if you are a believer in passive investing, then think of passive hedging as having inverse results of investing passively in equities. Passive investors consider that buying and holding an equity index is the way to go because in the long run the economy grows on aggregate. Conversely, in the long run and on aggregate, less risks materializes than what we would expect, so a pure passive investment in a risk control instrument is likely to lose value.

So, in my view (and experience) there is no real case for a passive hedge strategy.

Conclusion

I hope by now I have made up for some of that wrong "first impressions" that have built up about hedging. Hedging (and derivatives) are not just meant to avoid losses but to achieve better risk-adjusted returns (i.e. a steadier and more reliable stream of returns). Hedging needs not be costly, but to do it right, one needs to avoid passive and off-the shelf hedging schemes. Like most things in life it is a good idea to rely on expert analysis, advice and implementation!