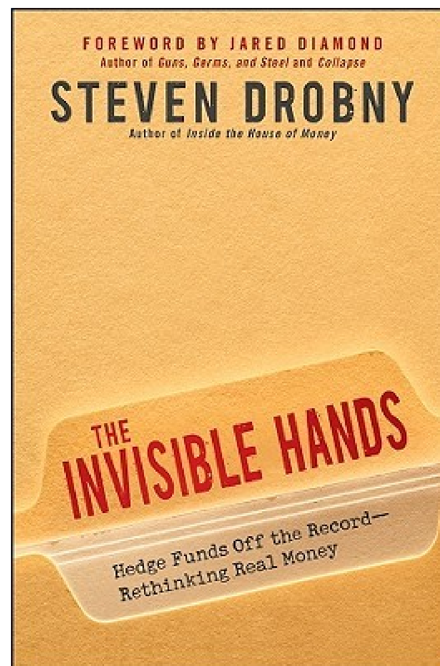

The Invisible Hands: Hedge Funds Off the Record - Rethinking Real Money

Steven Drobny , Jared Diamond (Foreword)

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Timely investment advice from the investors who survived--and thrived--during the economic crisis In light of the colossal losses and ongoing difficulties caused by the financial crisis, it's obvious that the time has come to rethink money management in the broadest of terms. Drastic changes are clearly in order, but no new model has yet been implemented. Steven Drobny explores a new model from a simple starting point--by consulting the traders and managers who actually made money during this profoundly difficult period. In *The Invisible Hands*, top global macro managers reveal their own (clearly successful) approaches to markets and risk, suggesting important tenets for money management in a future, precarious world.

Providing money managers and investors with the proven expertise of the best and most successful players in money management and detailing many specific elements of their risk management processes, *The Invisible Hands*

Outlines investment strategies for the rocky road ahead Provides guidance on how real money managers can implement certain elements of macro hedge fund strategies, developing a new paradigm of portfolio construction anchored in superior risk management Reveals intimate aspects of the investment processes of some of today's top hedge fund managers The book highlights the similarities among successful traders, showing that the investment process should be anchored in understanding the true risk-adjusted returns in your portfolio.

The Invisible Hands: Hedge Funds Off the Record - Rethinking Real Money Details

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From Reader Review The Invisible Hands: Hedge Funds Off the Record - Rethinking Real Money for online ebook

Zak says

In this book, Steven Drobny interviews primarily macro hedge fund managers who actually finished the year up during the Great Financial Crisis of 2008 (two of them were marginally down), while 'real money' managers like pension funds, endowments, insurance companies, etc. suffered huge losses. The interesting angle is that he selected those who didn't make spectacular gains by making specific one-off bets on the subprime bust, like John Paulson who reportedly made $4 billion from the crisis and the various other personalities covered in 'The Big Short' by Michael Lewis. In other words, Drobny wanted to identify those managers who were just going about their ordinary business, while making sure they were adequately hedged against tail risks and to see if their strategies could be applied to 'real money' portfolios.

This was an interesting read, although a bit esoteric at times, with the central theme being an almost religious focus on managing risk and asset correlations (even at the cost of extra return). The magic of compounding works but only if one avoids huge drawdowns, even if they only occur very rarely. The asymmetric relationship between gains vs losses can really do significant damage to years of compounded gains.

Terry Koressel says

The Invisible Hands attempts to critique and improve the long-term investment performance of real money managers (pension funds; endowments; etc) by studying the techniques of top hedge fund managers, primarily those engaged in macro investing. The book is a long set of interviews with these top fund managers. You'll learn from this book. It is more theoretical and general; it is not intended to leave the reader with a specific investment plan(s). However, it does offer excellent, valuable perspectives from some of the world's best investors. The downsides: (1) the book was a little long; (2) the interview style lent itself to shallow, uninteresting and unchallenged answers at times; and (3) the book was repetitive in parts where managers shared the same investing style and investing philosophies. I recommend the read for individual investors only if you are super-serious about your investing. Otherwise, I am afraid you'll find it unhelpful and uninteresting.

Alex Mcloughlin says

Very good read with great insights from many different traders from global macro to commodity traders. The key message throughout the book is capital preservation and the avoidance of large drawdowns that can kill long term performance. Being fully invested all of the time is not a necessity, knowing when to sit back and watch the market is as important as knowing when to go all in. Good insights and food for thought throughout

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Alex says

Good if you want to read detailed accounts of macro investors' strategies. Not worth it otherwise.

Carl Yang says

I was excited to purchase this book following Inside the House of Money, but found it noticeably weaker. My main complaint would be that Drobny focused very narrowly on real money and should have just renamed the title "The Smoke and Mirrors in Pension Funds." Traders or other fund managers might develop a negative view of real money after reading this.

First off, the managers and interviews in this book are much more academic and less practical than normal fund managers. Generally, Inside the House of Money or even Market Wizards featured interviewees who were articulate and could justify their thesis: i.e. "trade X works because of factors A and B, but you must consider that you are at risk of C". Few of the managers in this book were too theoretical, and too much "hocus-pocus" with no substance I found; in other words, expect a lot of big words and useless highly technical finance jargon backing up trade ideas and theories. Frankly, if one cannot explain to their grandmother an idea, it is usually likely he/she doesn't understand their own idea. For example, an excerpt talks about one managers approach to testing attractiveness of trades: "This approach is anchored by Bayesian methods.. we shrink my expected returns towards zero rather than towards some equilibrium model forecast, the latter of which is more appropriate given our macro focus, We then input that adjusted expected return into the Titanic funnel, which assesses how much it will lose in a variety of cataclysms, giving me the recommended position." Give me a break, this person should be teaching statistics somewhere, not managing a large pension. Is he really providing some edge or alpha to his investors? By the way, Taleb gives a great counter to Bayesian Methods in his book Black Swan using a Thanksgiving turkey as an example. Does Bayes method give you any information fundamental on what your buying? (sometimes even pork bellies can be made to look attractive if you overfit the data enough)

Also, it seemed that there was some implied praise for the Endowment Model by Swensen (Yale) throughout the book, almost as if the book itself was an advocate for it. Problem is, the whole Endowment model revolves improving returns by selling risk premia and buying illiquid assets. Ok I agree it's a good point of real money investors who are un-levered and can withstand mark to markets. Retail investors certainly can learn this and consider the effect of "time arbitrage." But it seems these guys forget that the quality of the asset and the price you pay determine the return, and they in fact simply target illiquid assets regardless of these other important factors. Besides, this concept is not new, probably as old as the history of trading, and for sure practiced by Meriwether / Long Term Capital.

On the bright side, there was a chapter by Jim Leitner which did give some great insights. For instance, he suggested that you could get exposure to hyperinflation via equity derivatives, specifically long upside out of the money calls or even long EuroSTOXX dividend swaps, pointing out correctly that EuroSTOXX dividends are priced at a discount further into the longer dated curve. As a follow up, a few other hedge funds have also suggested buying extremely out of the money calls (say 10'000 strike calls on SPX), so that trade has been repriced.

John says

like drobny's first book, "inside the house money," there are some nuggets of insight into global macro

trading here. also some analysis and critique of the "yale" or "endowment" investment modeling that failed spectacularly in 2008. the interviews are (as another reviewer noted) most relevant for those with an interest in the inner workings of the strategies of successful macro traders. however the sections detailing the shortcomings and risks of the endowment model, which is the asset allocation approach used by most state pension funds, is relevant for all taxpayers. we are ultimately on the hook for the future liabilities of these "real money" investors, so we have a civic duty to press the managers of these funds to do so in an intelligent way.

Asif says

Found it a bit boring.

Matthew says

Excellent and deep. Nothing you can take away and immediately implement, but tons to chew over about how these top money managers (across different asset classes -- bonds, equities, commodities, multi strat) approach the markets, think about and dig deep into what they do. Definitely something to reread and I will get for my shelf when the paperback comes out.

One thing I do take-away, which I have suspected for a while, is that top money managers with large portfolios all use deep fundamental research. Many do use technical analysis and price action to enter/exit trades, but their positions seem to almost invariably hang on a fundamental view. Several managers also make interesting distinctions between portfolio management (even that at a hedge fund), proprietary trading, and real money management (pension funds, endowments, etc).

InvestingByTheBooks.com says

The hedge fund advisor Steven Drobny had a huge international success with the book Inside the House of Money where he in a very easy going way interviews a number of high profile macro hedge fund managers on topics such as how they got into the business, their processes and beliefs. Perhaps because I am not as into macro trading I was not as thrilled as many others. This new book takes on a very serious topic: what will come after the 60/40- and the Yale-models? That is, how should the investment models of the likes of pension funds develop?

The concept is the same as in the last book. Drobny interviews a new round of managers of smart money, but this time on how managers of real money should run their business. Not surprisingly given that some of these people have egos larger than the empire state building the short answer is that they should be like macro hedge fund managers or at least give their money to them. Most agree on the problem description and I also think that it’s spot on: low understanding of illiquidity risk and overlooking the opportunity cost of not holding cash to be able to reinvest in bad times, underestimation of tail end risks, not understanding the time varying nature of expected returns, being too complacent around the variations in asset correlations and around the fact that diversification into overvalued and overcrowded assets gives no diversification.

Furthermore the obsession with relative return gives a short term focus which prevents paying small fees for insurance in good times to be able to soften the drawdowns later.

As the interviewees are a diverse bunch the remedies proposed are quite diverse. Some would hardly work on a larger scale and most would at least not work if they actually became the new model and the whole long only crowd would move in the same direction even if they could be good investment cases for the individual fund. The broad conclusions that Drobny draws from are three pieces of advice; 1) replace return targets with risk adjusted return targets, 2) look forward, not backwards and 3) rethink liquidity. I would say that another general advice in the book is to broaden the search for risk premium to invest into. The Bridgewater "all weather model" gets its fair share of votes also. The second piece of advice above points to the need to replace allocations based on return expectations build from averages over 50 years and instead adjusts these averages to what is reasonable for the next five to ten years when taking the starting valuation, overcrowding and the economic picture into account.

This is not light reading for the layman but the idea behind the book is till great. Input to an important topic from a knowledgeable but unrelated source. My main objection is that this is only about 1/3 of the text. The rest is basically "House of money II" where the hedge fund managers' discus their best trades etc. I'm also not really sure if the hedge fund managers' focus on avoiding drawdowns is always suitable for someone who truly has a very long time horizon. With a true long horizon it only becomes relevant to avoid drawdowns to the extent that they impair the returns compounding more than the potentially higher return from the volatile asset will give? The usefulness of a model focused on avoiding drawdowns as opposite to "seeing over the dips" depends very much on the type of environment one is in. When we eventually enter the next structural bull market the 60/40- model might not be so bad.

Drobny makes you feel like you're sitting in on a number of conversations between friends so even if the topic of pension fund revamping is perhaps not the sexiest in town it's a fairly pleasurable reed. I'm not sure the book goes all the way with the proposed topic though.

Tahir Haneef says

brilliant