Risk management

Great words are subject to wear and tear or inflate over time, as observers of life know. Overuse occasionally dilutes them beyond recognition. The words 'love', 'friendship', 'responsibility', 'sustainability', 'social' and most recently 'justice' are examples of such developments.

In business life, and especially in financial markets, the term 'risk management' belongs to the category of euphonious but largely gutted language bubbles. No financial services company is known that does not have a so-called 'risk management system'. The entire industry is required by law to have such systems in place. It is certainly true for the big houses of the capital market such as Goldman Sachs, Morgan Stanley, Deutsche Bank, UBS, Credit Suisse, Nomura Holdings, and so on. This is why the attentive contemporary might be surprised about the recent Archegos fiasco.

A former hedge fund manager and speculator convicted of insider trading had built up a huge portfolio of equity derivatives with mostly borrowed money. The good reputation of his former employer (Tiger Asset Management) helped him to gain access and trust with the lending investment banks. He is rumored to have had $60 billion in deposits with nearly eight times the loan-to-value ratio.

When equity positions, which Archegos had bought to lofty heights and which served as collateral for the high loans, began to fall and thus slipped into deficit, the first lenders required additional contributions, which Archegos was unable to make. Then certain lenders decided to sell the shares they had held as collateral to salvage what could still be salvaged from the loans. A chain reaction started and those institutions that sold last, namely Credit Suisse and Nomura Holdings, had the biggest financial loss. In total, the damage to the shareholders of the financial institutions involved is more than ten billion US dollars.

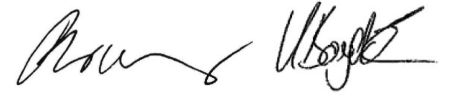
As the case shows, risk management in financial market practice often consists of limiting losses as soon as they occur. If the amount of damage is too high, the state is called in to rescue system-relevant banks and insurers with tax or central bank money. At least, that was the picture during the great financial crisis, and the impression remains that only a few things have changed in high finance when it comes to dealing with risks. Unfortunately, the Archegos case shows once again that the supervisory authorities do not play a proactive role, but rather only wake up after the horse has bolted. It would therefore be advisable for regulators to direct their focus primarily on

debt exposures, derivatives (especially over-the-counter), and high financial leverage to prevent credit-financed speculative excesses à la Archegos but also à la LTCM in the future.

In essence, risk management should consist of a 'prae meditatio malorum', which Zenon of Kition, the founder of the Stoa, already contemplated 300 years before the birth of Christ. It would involve the proactive avoidance of excessive risks, as has been common practice in LOYS AG's equity fund management since 2005. Of course, investors can help avoid risks by not chasing every spectacular short-term performance, as was once the case with LTCM, subprime bonds, Wirecard, and currently cryptocurrencies. Excessively high valuations, as can be diagnosed in some segments of stock markets today, represent a significant risk. You don't have to dance at every party. It is wiser to choose good parties and stay there as long as possible.

Sincerely yours,

Fund managers and co-investors



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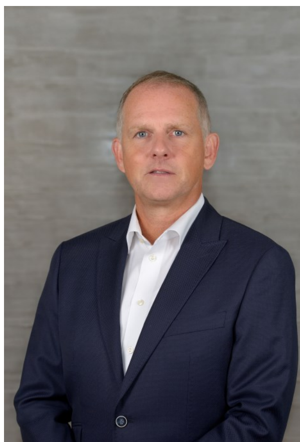

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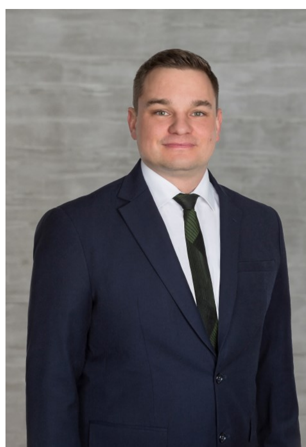

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