Endorsements and praise for Global Macro: Theory and Practice

Congratulations to Permal for organizing a marvelous contribution to understanding global macro investing—a must read! Often I am asked to recommend a book so that one can better understand this approach—and Permal has provided such insight with a diverse, articulate group of professionals.

– M. ELAINE CROCKER, President, Moore Capital Management, and former Executive Vice President of Trading Administration, Commodities Corporation

…a thoughtful look at one of the main investment styles in alternatives - global macro, making a strong case for its long-term investing value. I have no doubt it will help investors immensely in navigating the challenges of portfolio construction.

– ARMINIO FRAGA, Chairman and Chief Investment Officer, Gávea Investimentos, and former Governor of the Central Bank of Brazil

Global Macro Theory and Practice is an important primer for institutions seeking to understand macro from two sides of the looking glass: the view of practitioners like myself and the view of investors. The broad range of topics covered—discretionary versus systematic approaches, the role of risk management in macro, the role of policy analysis and prediction in macro, among others—will draw institutional investors into the stimulating world I have lived and breathed for three decades.

– PAUL TUDOR JONES II, Co-Chairman and Chief Investment Officer, Tudor Investment Corporation

…a compulsory read for investors who want to fully understand the different styles, strategies and challenges of macro.

– COLM O’SHEA, Founder and Chief Investment Officer, COMAC Capital LLP

A well-conceived and superbly executed volume that is a must read for anyone interested in portfolio management... The central takeaway: a properly constructed and sized allocation to global macro managers will improve the expected risk-adjusted returns of any investment portfolio.

– F. HELMUT WEYMAR, Founding Chairman and Chief Executive Officer, Commodities Corporation
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Discretionary Global Macro: a Manager’s Perspective

Kenneth G. Tropin
Chairman and Founder, Graham Capital Management, L.P.

Introduction

While global macro is one of the “original” hedge fund strategy types, it has generally evolved alongside the industry from single managers trading a portfolio to more complex multi-manager, multi-asset class portfolios. Managing a discretionary global macro fund is therefore a complex and expensive venture. Many macro funds are still dominated by a founder or key risk taker who tends to concentrate a fund’s risk profile, but the majority of today’s large macro funds have multiple portfolio managers trading a portion of the fund. The typical macro fund today trades a broad variety of asset classes, geographic regions and instrument types, therefore necessitating a robust investment platform and an equally robust operational backbone. The increasingly institutional nature of hedge fund investors also reinforces this need for robust systems, processes, and reporting, both internally and externally. Successful funds today should have a well-defined business model, top caliber trading talent, a disciplined investment process, robust risk management, and sophisticated operational infrastructure.

While there is no single methodology for successfully running a discretionary global macro fund, this chapter will focus on the various investment and operational considerations from one investment manager’s perspective. It is critical to acknowledge that the industry – including both trading and management - evolves over time, whether due to regulation, paradigm shifts in global markets, or other exogenous factors. Because of this, investment managers should evaluate their individual processes on an ongoing basis in order to remain potentially effective. Therefore, this chapter presents a current perspective with the understanding that the process for running a discretionary macro fund will undoubtedly continue to evolve over time.

Like any strategy, the starting point for a discretionary macro fund is the “raw talent.” A successful global macro fund should strive to attract and retain the most talented discretionary portfolio managers available, and build substantial infrastructure in order to adequately support these portfolio managers and minimise non-market related distractions, while also meeting the due diligence needs of the firm’s clients. Given the importance of creating a structure that identifies and fosters successful portfolio managers, much of this chapter will emphasise the portfolio management aspects of managing a discretionary macro fund in the current market environment.
Historically, one of the key attributes of global macro strategies is that they tend to display low correlations to a broad variety of traditional indices as well as to other hedge fund strategies, such as long/short equities, relative value, and credit strategies. As a result of these low correlations, global macro strategies tend to add true diversification to an investment portfolio, and tend to provide performance when broad markets or other strategies are under duress. The 2007-2009 credit crisis – when macro funds broadly outperformed other strategies – was perhaps the best recent litmus test for this assertion.

Other areas of this book delve into the portfolio benefits of macro strategies, so this will not be a specific area of focus for this chapter. However, it is worth noting some of the attributes of macro strategies that historically have led to their low correlation as it provides context for managing a macro fund. These differentiating factors include the emphasis in macro strategies on liquid markets, which makes it more likely a manager will actually be able to sell when markets are under duress, as well as the ability of macro practitioners to trade multiple market sectors, rather than being constrained to any one market or asset class. Additionally, the lack of an embedded long or “value” bias relative to other strategies enables macro funds to have positive or negative beta depending on the market opportunity set. Further, macro strategies tend to capture divergence, or directional breakouts in markets, rather than focusing on mean reverting or convergence type strategies, which can suffer significant losses if markets move far from a historic mean during periods of duress.

Finally, it is worth noting that the term “global macro” often encompasses a broad umbrella of strategies, and there are many subsets of macro investing. The most basic dichotomy is between discretionary macro trading and systematic macro trading. In discretionary macro, portfolio managers trade global markets based on a view of fundamental macro drivers across economies. In systematic macro (also referred to as “managed futures” or “CTAs”), trading algorithms implement positions based on market trends or price dynamics and in some cases on other factors such as fundamental macroeconomic data. Both of these strategies tend to trade liquid global stock, bond, currency and commodity markets. CTAs traditionally trade listed futures and foreign exchange, whereas discretionary macro funds typically trade futures and foreign exchange as well as cash and derivative markets. While the author’s firm has a significant presence in both discretionary and systematic macro trading, the primary focus of this chapter is on the issues and considerations related to managing a discretionary macro business.

**Establishing a Well-Defined Business Model**

As mentioned in the introduction, two major styles of global macro strategies have emerged over time. In systematic macro trading, an individual or quantitative research team develops a computerised algorithm to identify market and price movements and the algorithm (or “model”) then makes the decisions as to when to buy or sell based on a variety of proprietary indicators that generate trading signals.
Success is determined by the robustness of the concept and the research process behind the trading model, and the establishment of an equally robust technology and trading infrastructure to execute a model’s trading signals. Risk management is integrated into the model, and there is little or no discretionary intervention once the model has been developed – hence the term, “systematic.”

In discretionary global macro trading, a portfolio manager (or managers) determines when to buy and sell various instruments based on a range of fundamental and technical inputs. While there are many styles of discretionary macro trading, the starting point for trading tends to be the establishment of a framework or “themes” based on a portfolio manager’s analysis of key macroeconomic factors. This analysis often spans a range of global economies and asset classes, and may include a high level analysis of key macroeconomic indicators such as growth rates, inflation rates, and monetary policy in key economies, or may be more micro in nature and include an analysis of how specific legislation or policy action will impact segments of the yield curve or other asset markets.

As themes are developed, they act as a road map or compass for the portfolio manager as to the presumed directionality of asset markets; if market prices deviate from the portfolio manager’s compass, this may provide the opportunity to implement a trade. Portfolio managers may establish a forward looking view for the general directionality of markets, and implement a trade expecting the market to “catch up” with this view over time. For instance, a portfolio manager may believe that an economy is beginning to display signs of a “virtuous cycle” as low interest rates feed into consumer and business demand driving employment and spending higher and thereby leading to further growth, and in such a world equity and commodity prices should drift higher while yield curves should be steep as today’s low interest rates and growth environment may feed into inflation or higher rates down the road. Or, portfolio managers may look for opportunities “after the fact” where they believe markets are mispricing currently available macroeconomic data. For instance, a key piece of data may be released which drives market prices, but the portfolio manager may believe that the data point has been misinterpreted, asset prices have moved too far as a result, and a portfolio manager may look to “fade” or trade against that move.

In discretionary trading, the breadth of instruments traded is generally very wide, and risk management is implemented by the portfolio manager during trade construction and typically via a risk management team that carefully monitors the portfolio’s exposure after a trade has been established. Again, there are many styles of discretionary macro trading, but in its purest form, discretionary macro managers tend to focus on the most liquid global markets and instruments. Managers may trade listed global futures and foreign exchange, as well as cash and derivative markets. While some macro funds may trade structured products and less liquid markets, these positions tend to be a small part of a macro manager’s portfolio, albeit with the caveat that liquidity in any market is a constantly moving target.
For any investment manager and their clients it is important to establish a clearly defined business model when structuring a macro business. A typical distinction between discretionary macro funds is whether they are single manager funds or multi-manager funds. Single manager discretionary portfolios tend to emphasise the expertise and trading of one individual risk-taker, typically the founder or CIO. Today, many single manager funds actually employ multiple portfolio managers, but nonetheless, the founder or CIO plays a central role as the largest risk taker, and may also “size up” or concentrate the positions of other portfolio managers if there is a theme the principal would like to emphasise in the portfolio. At the very least, the founder or CIO often brings moral suasion to bear, and other portfolio managers tend to know the key thoughts or positions of the principal, making it somewhat difficult to establish opposing views. This style of trading is well-established in the macro community, and many of the largest funds in the space have been founded and continue to be run by a central risk taker.

At the other end of the spectrum, discretionary macro funds may employ a true multi-manager style of trading. In this framework, multiple portfolio managers trade a specific allocation of capital. Each portfolio manager is provided with trading rules and risk factors (described further below) to which they agree to adhere, and formulates positions based on the portfolio manager’s independent market views. Ideally, the component strategies would utilise a variety of discretionary trading methodologies and disciplines and participate in a wide breadth of global markets, thereby fostering low correlations among the portfolio management teams. When these function as planned, the benefit to the manager and to investors is a diversified portfolio comprised of a broad array of markets and trading methodologies, and a portfolio which can potentially capitalise on a variety of market environments.

There is no one “right” way to trade a discretionary macro portfolio. The author’s own firm currently employs a multi-manager macro portfolio, and historically has developed a portfolio of truly low or non-correlated macro strategies where at any one time a specific strategy or asset class may have driven returns, but where over time returns have been derived from multiple alpha streams. But regardless of the business model chosen, it is important that a manager establish a clearly defined strategy where portfolio managers – and investors – understand how capital is allocated in the portfolio, the instrument types and style in which that capital can be traded, and the risk constraints that exist at the individual portfolio manager and aggregate portfolio level. Portfolio construction and risk management are discussed later in this chapter, but the key takeaway should be that a clearly defined business model and trading and risk parameters are key inputs for the potential success of a macro platform.

**Identifying, Attracting, and Retaining Trading Talent**

A central ingredient in running a successful discretionary global macro fund is finding, attracting and retaining the most talented portfolio managers in the industry. Hedge funds must constantly compete for standout talent in order to build the
strongest team possible and to have the highest probability of success. Due to the competitive landscape, recruiting has become increasingly expensive over time as funds compete for individual talent by providing attractive payouts and substantial initial capital for portfolio managers to trade.

In assessing potential recruits, an investment manager should consider multiple factors, including:

- Does a portfolio manager have a substantial track record, both in terms of longevity and the quality of returns? This track record should be based on a consistent and replicable strategy that has demonstrated an edge over time, and any signs of style drift should be minimal or at least the result of gradual style evolution over time.
- Does a portfolio manager have appropriate professional credentials, and does the portfolio manager display a history of moving from firm to firm? Clearly a portfolio manager should have the requisite professional credentials, and any history of excessive job switching may indicate management and/or profitability concerns.
- Is the portfolio manager’s edge derived from a robust, well-defined and well-articulated trading methodology? The portfolio manager should be able to explain in detail the way in which he or she develops themes, establishes trades, determines instrument selection, implements trading stops and takes profits.
- Does a portfolio manager have a detailed and well-constructed view of current market dynamics, and are these macro views represented in trading positions that reflect these views? Experienced portfolio managers have a 1:1 mapping of views and positions; less experienced managers tend to have more superficial market views and less coherent and more difficult to defend positions.
- Do a portfolio manager’s returns display beta to various market indices or instruments? While macro managers will at times have high beta to markets, this beta should be episodic and not a consistent presence over time.
- Has a portfolio manager traded substantial capital? A 1.2 Sharpe ratio on $5 million in capital is very different from a 1.2 Sharpe on $200 million.
- Has the portfolio manager navigated a variety of market cycles? Seasoned portfolio managers may come from other hedge funds, their own hedge fund, or proprietary trading desks at banks. Depending on the background of the individual, it may not be possible to furnish a complete track record for analysis, but a history of weathering a variety of market environments should be established.
- Is a portfolio manager’s trading style and instruments traded consistent with or adaptable to a firm’s risk culture, volatility tolerance, liquidity constraints, and operational and trade processing infrastructure? A portfolio manager should typically be a “fit” for a firm’s trading style, and the firm should of
course have the ability to trade, process, and clear the types of instruments traded.

With respect to a multi-manager macro portfolio, a final consideration is whether a potential portfolio manager’s trading style and return history is correlated to other existing managers in the fund. As noted earlier in this chapter, a key benefit of a well-constructed multi-manager fund is the presence of a truly diversified portfolio with unique and disparate potential return streams. While two or more managers may focus on the same markets, it is helpful if they have different styles or time-frames for expressing their trade ideas. Or at the very least, if two or more portfolio managers are correlated, this should be factored in to capital allocation decisions.

Once an appropriate candidate has been identified, the campaign then begins first to recruit the portfolio manager to the firm, and then to retain the most successful talent over time. Just as a firm has multiple criteria for identifying talent, portfolio managers decide to join a particular firm based on a variety of factors. Many of these factors are obvious, and include the size of the capital to be allocated to the portfolio manager and the payout on that capital. Other factors relate to the firm’s franchise, culture or manner of operation, and may include factors such as:

- Does the firm have a successful track record, and correspondingly, a stable and ideally growing client base, so capital allocations are consistent and have the scope to grow over time?
- Does the firm have significant proprietary capital, providing an even more stable capital base?
- Is a portfolio manager’s payout impacted by the performance of other managers; i.e., if an individual portfolio manager is profitable but the fund is not, will that portfolio manager be paid?
- Is the firm well-managed and capable of providing the infrastructure, counterparty relationships, technology and operational resources so that the portfolio manager can focus on trading, without unnecessary distractions?
- Does the firm provide a culture of open information and interaction, and will the portfolio manager be surrounded by other bright and talented managers from whom they can glean market insights and unique perspectives?
- Is the firm reasonably committed to a portfolio manager’s strategy and does it have an adequate degree of patience, providing the portfolio manager the “runway” to become successful?

Beyond these factors, experience shows that a final element in recruitment and retention is providing portfolio managers with a clearly defined mandate and risk framework to trade within, thereby lending clarity into how allocation and risk decisions are made that will impact their trading. Portfolio managers do not want to be de-risked or de-allocated for opaque or inconsistent reasons, and need a coherent framework in which they can work and be successful. Some firms believe in ultimate
clarity in these factors and include risk limits and performance and volatility targets in the portfolio manager’s employment contract. This management style assures that there is no confusion as to what is expected of the individual trader. On the other end of the spectrum, some hedge fund managers approach boundaries in a less defined manner, which generally leads to more interference over time from management as the “rules of the game” change. This interference can cause potential frustration for experienced portfolio managers who prefer distinct boundaries within which they can freely express their market views. Potential frustration like this can cause turnover among portfolio managers as a result of dissatisfaction with the firm’s culture.

Hand-in-hand with a clear framework, portfolio managers must often decide whether they prefer the single manager or multi-manager model described earlier in this chapter. At times, portfolio managers may feel they can “learn” under the auspices of a legendary macro trader, but the trade-off may be that they have less autonomy than they would otherwise. Although the author has a vested interest in the multi-manager model, he has found that experienced portfolio managers often like the rules-based and transparent nature of a multi-manager platform. Regardless, whether in a single manager or multi-manager framework, providing portfolio managers with freedom of thought and intellectual space tends to foster lower correlation between individual portfolio managers and ideally more consistent returns over time for clients.

All of the above factors and considerations should permeate a firm’s culture to ensure the success of portfolio managers – and all employees – throughout the firm. The firm’s culture is not accidental, and most often is defined at the ownership or leadership level. The founder and senior management create a style, work environment, and a philosophy upon which the firm is built. For portfolio managers and employees more broadly, a key differentiating feature of culture that varies between hedge fund managers is to what degree is freedom of thought encouraged?

Other key elements of firm culture are more environmental. Is the work atmosphere casual or formal? What is the dynamic on the trading floor? Does the firm tolerate abrasive behavior by profitable portfolio managers on the trading floor, or is a more collaborative environment established? Some firms may encourage open dialogue between traders, while other firms may isolate different trading teams and discourage the sharing of information between managers. These details contribute to the daily atmosphere of the firm, and the firm has to take responsibility for finding managers who fit into its individual culture. Different portfolio managers prefer different environments, and it is mutually important during the recruiting process for a portfolio manager to understand the firm’s culture prior to committing to the firm, otherwise it is unlikely that the portfolio manager will remain at the firm over the long term.

Discretionary trading is very difficult, challenging, and stressful. This fact cannot be underestimated by the management team of any firm that is going to run a successful discretionary macro fund. Trading is an exceptionally challenging endeavour over the long term, which is why profitable portfolio managers are compensated generously.
for their abilities. Global markets evolve over time, and traders need to capitalise on these changes and maintain their edge. There is a tremendous amount of pressure on portfolio managers due to the responsibility they carry – they manage large sums of capital for clients, themselves and usually for their senior management team. How a management team supports their traders is an integral part of the firm’s overall culture. It is important to utilise an individualised approach when coaching and supporting traders. Some portfolio managers do not need much attention, while others need to build confidence and require frequent guidance or reinforcement. Despite which coaching style works for an individual portfolio manager, it is important that the trader can identify with the management team and feels that the management team is committed to their success.

The Asset Allocation Process

For multi-manager macro platforms in particular, it is important that the firm be committed to a disciplined and repeatable investment process for both trading and allocating capital. Generally, this investment process is managed by the Investment Committee (or a similar senior management group) that oversees portfolio managers and manages matters relating to portfolio construction, asset allocation, and the selection of new strategies. In a multi-manager portfolio, one of the greatest challenges is how to allocate capital over time to individual strategies.

There are two basic models in asset allocation. First, an Investment Committee may allocate capital based heavily on a discretionary view of market opportunities and an assessment of the likely success of individual portfolio managers to capitalise on the forecasted environment. For instance, an Investment Committee may believe that commodity trading will provide the most fertile opportunities over the short- to medium-term, and therefore may emphasise allocations in this space. While this might be possible in a fund comprised of only a few underlying strategies, it becomes tedious and less realistic once there are many underlying strategies. Additionally, this method obviously relies on human judgment, which may ultimately lead to biased decision making or inopportune market timing.

The alternative method is a quantitatively-based portfolio construction process, which systematically guides allocation decisions within multi-manager portfolios. A portfolio allocation model may seek to optimise portfolio construction based upon a multitude of quantitative parameters, including returns, volatility and downside volatility, drawdowns, strategy cross-correlations, and portfolio manager tenure. This methodology provides decision-makers with data and tools to guide their allocation changes based on quantifiable statistics as opposed to subjective market views.

Some macro firms may employ one or both of these methodologies in determining allocations. At the author’s firm, a quantitative approach is currently emphasised, with the Investment Committee utilising a quantitative model overlaid with qualitative judgment to steer allocation decisions. Once again, there is no one correct
methodology and market circumstances may warrant more or less discretion at any given time, but the use of a quantitative model confines risk taking to the portfolio managers’ trading books, and taking a market view in asset allocation may add an additional layer of risk taking to a portfolio.

Risk Management Considerations

Risk management and capital preservation should be the cornerstone of every hedge fund’s business – whether discretionary macro, systematic macro, or any other style.

The preservation of investment capital during periods of adverse market behaviour is imperative to long-term trading success, as risk is inherent in all investment strategies which have the ability to offer returns in excess of risk-free rates. While even the most robust risk management process may be susceptible to unforeseen “black swan” events, a steadfast commitment to a rigorous and comprehensive risk management process is a necessary precondition to strategically managing risk during both favourable and unfavourable market environments.

The first step in risk management relies on the portfolio managers themselves. Each portfolio manager should have established risk measures and parameters. These generally include measures of first order sensitivities to the most relevant risk factors for a given book (for example, dollar value of a basis point in the case of interest rate products), measurement of stress loss in extreme market events, and the use of explicit stop loss points. Beyond this first step, however, risk management must be monitored by the firm, which requires an experienced and knowledgeable risk management team as well as sophisticated technological capabilities.

Every portfolio manager should have clear drawdown limits that are monitored and enforced by the Risk Department or Risk Committee. These drawdown limits are likely to vary across hedge funds given that every firm has different return and volatility targets. Drawdown limits should be directly related to the intended volatility of each strategy and the overall portfolio. In addition, portfolio managers and the firm should monitor the liquidity of market positions on a regular basis, to ensure that a manager may be able to liquidate positions with little slippage from prior position valuation. This involves a regular review of positions and the expected cost to trade out of these positions in a normal and a stressed market environment. Any liquidity cost assessments are inherently assumptions, and should be reviewed on a regular basis.

Risk monitoring for most discretionary strategies requires the use of both internal and industry-recognised standards to ensure compliance with risk policies and limits established at the portfolio level. These processes require state-of-the-art technology that is constantly evolving. Value-at-risk analysis (or “VaR”) often provides a useful measure for the risk in directional trading strategies, but one must understand its limitations. For instance, VaR tends to break down for non-linear instruments such as
options or for relative value trading where the relationship between two instruments can diverge much further than expected. In such cases, stress test scenarios may provide a better measure of the potential loss from a position. Further, VaR is unlikely to capture unforeseen or extreme market moves, where losses may be much greater than anticipated. Clearly, it is important to establish the appropriate risk measures for each strategy and instrument type, and to apply a holistic approach to risk monitoring combining both quantitative and qualitative considerations.

A discretionary macro fund also has to carefully manage counterparty risk. Counterparties should be chosen from a group of companies renowned for their expertise in the particular market for which they provide a service. Due diligence should be performed on counterparties prior to commencing a relationship, and – as an ongoing process – the exposures and market conditions surrounding current or potential counterparties should be reviewed on a regular basis. The firm should handle counterparty risk in a manner that allows it to react to adverse situations with reasonably little disruption to its business. Typically, this means having back-up counterparties when available or possible for various product types. Once again, however, in extreme, adverse market conditions, a planned back-up counterparty may fail to materialise.

Over time, clients have demanded an increasingly high level of transparency in terms of risk exposure. Investors should gain a fundamental understanding of the strategy as well as the opportunities and risks inherent in it. Most firms provide regular risk reporting, but it varies tremendously from firm to firm. Standards are constantly evolving, but in the current environment many funds provide frequent risk reporting to clients, including exposure data, VaR, stress test scenarios, performance attribution, counterparty exposure, and potentially, lagged position data. Regulatory scrutiny regarding selective disclosure is a concern for many hedge fund managers, so it is important to provide adequate and consistent reporting to all clients.

At the author’s firm, a key aspect of risk management currently includes a Risk Committee which is comprised of senior members of the firm’s management, risk, trading and operations teams. The Committee meets daily to review position-level information and related risks for each of the firm’s strategies within the context of prevailing market conditions. The Committee also discusses how market conditions may be impacting trading counterparties, to guard against a surprise collapse of counterparties who may hold fund collateral. This process is designed to inform members of the firm’s senior management team of the various risks to which the firm is exposed and, if appropriate, the Risk Committee will effect a reduction in risk within a particular strategy, or across a specific portfolio of strategies. While this approach has proven effective historically, any firm should evaluate their process on an ongoing basis and evolve over time as needed or as market conditions dictate.

In the event that a fund must reduce risk to a given market exposure, some funds may run a separate hedging book to attempt to hedge out this risk. Other funds may simply ask a portfolio manager to cut a position to a lower level or to eliminate the
position entirely. The author’s firm has historically employed the latter approach, and the firm’s Risk Committee has the authority to instruct portfolio managers to cut positions. Philosophically, this approach is based on the belief that the most efficient way to reduce a risk is to eliminate entirely or reduce a position. A hedging book may not effectively eliminate a risk if markets behave differently than expected (so called “basis risk”). Another issue is that a hedging book is akin to a separate trading portfolio, but without a clear “owner” responsible for its profit and loss. On the other hand, it would be difficult to constantly tell portfolio managers to cut positions if their individual position is adequately sized, but the aggregate fund risk is too high. Portfolio managers do not want to be told to cut a position if they think it will be profitable. Thus, having a low-correlated multi-manager portfolio becomes important once again, because the low correlation tends to lessen somewhat the risk or frequency of position concentration at the fund level.

Requisite Firm Infrastructure

Infrastructure is a key factor in the management of any hedge fund, including discretionary macro funds. The infrastructure necessary to successfully run any type of hedge fund is significant. It is possible to write several chapters on the requisite operational, accounting, legal, compliance and investor relations infrastructure required to run a modern hedge fund, but in the interest of space this section will be brief.

Discretionary macro portfolio managers vary tremendously in terms of style and instruments traded, but maintain one commonality: they need robust support at the firm level so that any distractions from the markets and trading are minimised to the fullest extent possible. This support is created through overall firm infrastructure.

The investment management industry has witnessed unprecedented change throughout the last decade as seemingly endless advances in technology have altered the speed with which information is disseminated, the means by which such information is processed and the manner in which markets are traded. Hedge fund managers should embrace these developments. State-of-the-art technology and systems are of critical importance to the development of innovative alternative investment strategies. The effective use of technology materially enhances a firm’s trading and risk monitoring abilities while also creating operational and reporting capabilities that enable the firm to provide increased transparency and improved communication internally and with clients. Portfolio managers need market data, hardware, efficient trading platforms, and overall technical support. State-of-the-art technology is a moving target, and hedge fund managers should stay on top of the latest, leading technology infrastructure to support discretionary portfolio managers in order to maximise their potential to make money and successfully execute trading ideas.
The variety of global markets traded by many discretionary portfolio managers requires extensive support by the back office of a hedge fund. The middle office, meanwhile, often must be equipped to handle trading volume 24 hours per day. Sophisticated accounting teams are also necessary in order to accurately price the book. It is essential to have deep infrastructure built around the valuation process, with multiple layers of redundancy such as pricing by a third party administrator with regular reconciliation of all positions.

In order for a portfolio manager to focus solely on developing their trading ideas and executing them in the marketplace, it is imperative that a portfolio manager has as few distractions as possible. With respect to the marketing efforts of the fund, management must strike a healthy balance between servicing clients and providing adequate transparency while allowing portfolio managers to do what they do best: trade. It is therefore important that hedge funds maintain a strong marketing and investor relations team that is knowledgeable about the individual discretionary strategies. Additionally, members of senior management should be available to investors to discuss individual strategies and market views. This provides investors with confidence that the firm is being transparent but also allows portfolio managers to focus on trading. This member of senior management might vary depending on the structure of the firm, but is likely to comprise some combination of the Chief Investment Officer, Chief Operating Officer and Chief Risk Officer.

Overall, a firm needs to build a platform where the traders can focus on the markets, and non-market infrastructure is managed for them. Infrastructure is not to be minimised in importance, but should be handled by respective members of management rather than by the portfolio manager.

**Conclusion**

As noted at the start of this chapter, macro strategies have demonstrated unique portfolio benefits due to their history of robust absolute returns and low correlation to both traditional and other alternative investments. Of course, realising these benefits ultimately comes down to selecting the right managers – i.e., those managers who successfully manage risk and generate positive returns over time. All investors should recognise that generating alpha from macro trading is a demanding and challenging endeavour. Accordingly, in selecting a fund, investors should pay careful attention to the clarity of the investment manager’s business model, investment process, and operational infrastructure.

While it is likely that other investment managers might have different perspectives and methods, this chapter has delineated some of the key ingredients – gleaned through one investment manager’s experience – in running a successful discretionary global macro fund. An investment firm today is a complex organisation that will continue to evolve over time. Having an exceptionally talented team of discretionary portfolio managers is of significant importance, but the hedge fund manager should
also construct a robust business infrastructure around these portfolio managers to help enable their success. A business model that sets clear parameters for trading, risk control, and capital allocation provides a coherent framework for portfolio managers. Establishing an appropriate culture and operational infrastructure for the portfolio managers further solidifies their ability to succeed. Ultimately, trading comes down to percentages – the percentage of successful trades determines the number of profitable trading days, weeks, months and years. A small shift in the percent of winning trades can have an exponential impact on returns. While a discretionary macro manager cannot control global markets, anticipate “black swan” events or make an unprofitable trader into a profitable one, the manager can create an environment and support structure that provide the potential for success.