



## Financial Alchemy and You

August 6th, 2013

Recently had occasion to look at Hedge Funds For Dummies by Ann C. Logue (2007). A couple of things struck me.

- Would I get more dirty looks reading a book about Hedge Funds in a public place than I would by reading the current equivalent to Playboy?
- Would I be able to read the book without getting into a series of arguments with it?

It is clear to me that the opinions that people have about Hedge Funds is not very high:

1. 50% of that may be due to ignorance.
2. 50% may be due to part the 'cutting edge jargon' that surrounds the financial industry as a whole and the hedge fund industry in a particular.
3. 50% is because of the managers.

Now I know what some of you are thinking – hey that is more than 100% - and of course you are right, but welcome to the Hedge fund world, where they do more with less (more on that in a moment) and of course the hedge fund managers needs to take their cut!

Yes, hedge funds can provide a valuable service for the economy – but the managers that manage them give them a bad rap and the regulators that 'supposedly' regulate them are clueless on how to do their job.

Aside: The regulators are fighting a losing battle as the financial industry – for better or worse – is constantly modifying, expanding and changing, so a rule based system is always fighting yesterday's wars.

So let's peel away some of the jargon and battle some of the ignorance so that you can make an informed decision as to whether hedge funds can be good (as opposed to inherently evil) and whether you can use them to help you or your family.

What is a 'hedge?' Let's start with the story of Giovanni. He grew tomatoes and other vegetables on a small garden. One day in May, Fred, a market-man (the middle man between Giovanni and the ultimate consumers) came to see Giovanni and offered to buy his tomato harvest – say 100 bushels at \$3 a bushel.

Giovanni looked at Fred with amusement, and said: "The tomatoes? They are still green or flowers. There is no hundred bushels."

Fred said: "No problem, here is \$1.00 now and the balance when you deliver...less my commission."

Giovanni thought about it, realized with the money upfront now, he could plant some extra onions, potatoes and beans – "Sure", he said, "DEAL! You want a glass of wine?"

That folks is what hedging is all about. Giovanni gets a sure sale and cash up front. The factory, in this case, that sent Fred out to Giovanni and many others, gets a sure supply of tomatoes to produce their salsa, at a set price with only a partial commitment of cash now.

So what is the problem? Well Fred retired. His kids became doctors, lawyers and teachers. So Giovanni had to do his 'transactions or trades' by telephone. The regulators brought in rules, do now Giovanni had to hire Fred's daughter the lawyer to read the contract. One year the tomatoes did not produce so well, (Giovanni almost had a heart attack and had to call Fred's son the doctor), so there were legal issues with the Factory, which was now located in a different state.

Things in our global economy seem to be getting more complicated. But as you enter the world of 'hedge funds' remember these three people:

1. Giovanni – or the maker of things
2. Consumers – the people that use things
3. Fred – the distribution networks that connect producers and consumers

Hedge fund managers are supposed to be Fred.

Instead they are often Larry – you know him, he is the sometimes funny guy, who likes to drink, tell jokes, is good at counting and ALWAYS seems to be at the casino.

Now if Larry was playing with his money he would be adorable, but when Larry plays with OPM (Other People's Money) – we are not so sure that we want him at the casino.

So let's review the comment made by Ms Logue: "Not all hedge fund managers are performing financial alchemy. Many of the techniques they use are available to any investor who wants to increase return relative to the amount of risk taken."

We agree with her so much. Many of the techniques are available to financial literate people. The 'alchemy' part throws people off. The definition of alchemy: "the pseudoscientific predecessor of chemistry that sought a method of transmuting base metals into gold."

It conjures up images of a quaint or quasi mad medieval philosopher on a fool's quest. After all who would believe?

- That you could speak to someone over hundreds of miles by using strings
- That you could heat up sand, draw pictures on it and it would allow me the power to write this article
- That you could use a 'special' card to buy your provisions for the week
- That you could use the same card to transport yourself 1200 miles in a couple of hours.

Nonsense, right?

As we have seen in this Information Age that the power of invention and discovery is still amongst us and it only seems ridiculous until you find a way to do it.

Some very smart people have devoted their lives and in some cases fortunes, to an activity that was unheard for most a hundred years ago. Financial alchemy exists. Let's follow Giovanni as he discovers how to use it for his and your advantage.

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From the desk of Andre M.

To your success!