

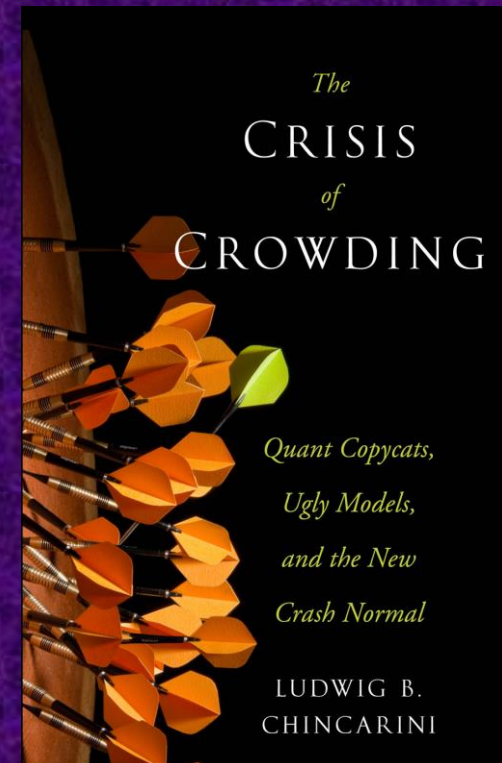
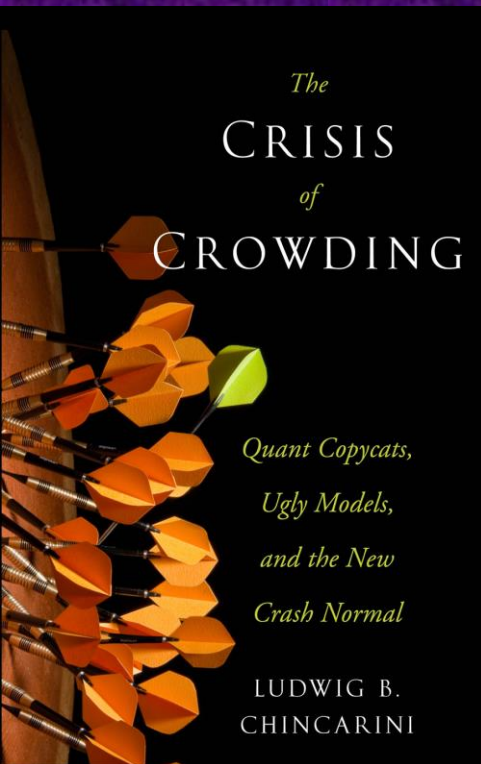
**FORBES & FINANCE in the SILICON VALLEY at the Rosewood**

# Some Stories about Financial Markets in 2014

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IndexIQ  
FutureAdvisor  
NERA

[www.ludwigbc.com](http://www.ludwigbc.com)

October 29, 2014



# A Collection of Stories

1. My Financial Predictions and Financial Markets
2. Big Picture of Financial Markets
3. Alibaba Trade
4. Crowding and Crowding Research
5. The Bull and Bear

# I. The Financial Markets

On 01/04/2014 and 03/19/2014, I made a couple of remarks:

1. Treasuries might be dangerous. Avoid them, especially 7-10 year area.

*Incorrect – has surprised many.*

	SHY	IEI	IEF	TLT
Jan - Oct 2014	0.49%	2.26%	5.89%	16.66%
March - Oct 2014	0.52%	1.73%	4.02%	11.12%

# I. The Financial Markets

2. Housing might slow down and not do well.

*Incorrect, has slowed down. Direct investments did ok, but REIT investments did well.*

	RWR	ROOF	SPCS20*	SPCS10*	Futures 10
Jan - Oct 2014	20.83%	10.51%	4.85%	4.73%	5.69%
March - Oct 2014	13.07%	5.27%	5.03%	4.79%	5.81%
* Through end of August					

# I. The Financial Markets

3. Dollar will strengthen versus Euro.

*Correct. ROW has more to do.*

	Dollar - Yen	Dollar - Euro
Jan - Oct 2014	3.16%	6.28%
March - Oct 2014	5.72%	7.93%

# I. The Financial Markets

4. Twitter and King Digital shorts of the year?

*Correct. Both are hugely down.*

	TWTR	KING
Jan - Oct 2014	-36.55%	
March - Oct 2014	-14.56%	-48.84%
* From March 25, 2014		

## II. Big Picture of Financial Markets

1. Interest rates are not rising
  - Fed is quiet, QE to stop
  - 85% probability that Fed won't raise rates until second half of 2015 (mode is 2Q:2015)
  - **Why?** Global glut? Inflation tame. Yellen's focus on unemployment as long as inflation is low

# II. Big Picture of Financial Markets

## 10-year US Interest Rates





# II. Big Picture of Financial Markets

## 30-year fixed rate mortgages



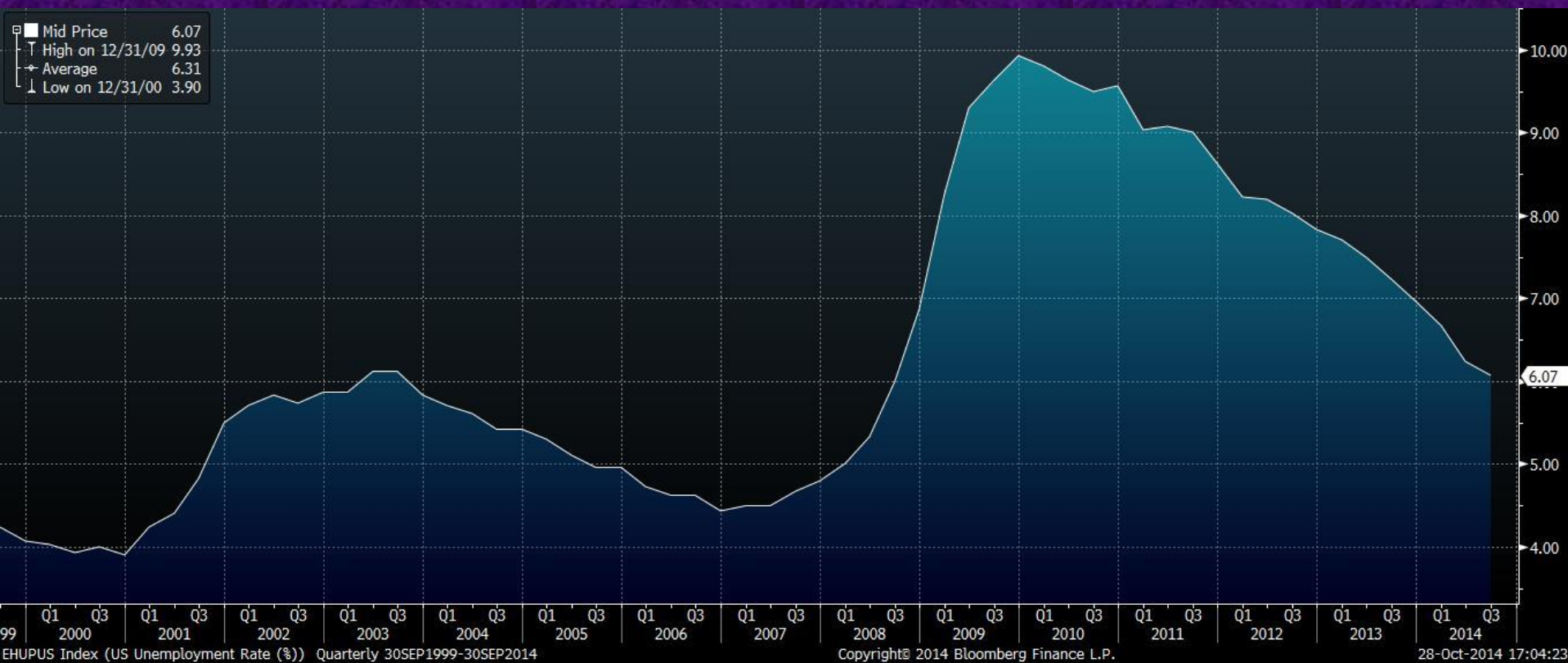
# II. Big Picture of Financial Markets

## CPI Inflation



# II. Big Picture of Financial Markets

## Unemployment



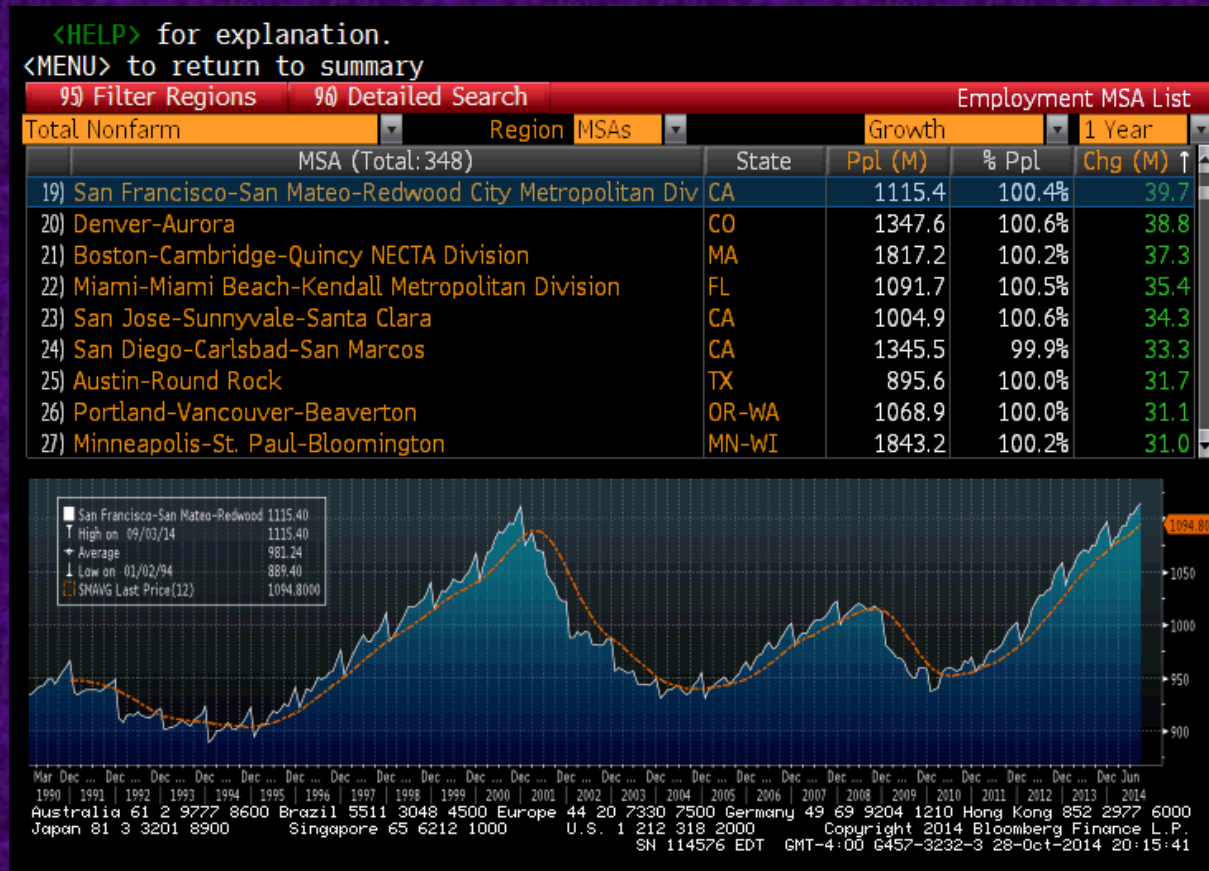
EHUPUS Index (US Unemployment Rate (%)) Quarterly 30SEP1999-30SEP2014

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# II. Big Picture of Financial Markets

## San Francisco too



# II. Big Picture of Financial Markets

## Participation Rate Declining still



PRUSTOT Index (US Labor Force Participation Rate Total SA) Monthly 30SEP2008-30

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# II. Big Picture of Financial Markets

2. Low rates are driving equities up

- Does QE create inflation or bubbles?

<HELP> for explanation.  
90<Go> to Save Current Settings as Default View

99 News 95 Settings World Equity Indices

Standard Movers Volatility Ratios Futures AVAT vs 10d % Ytd USD

	2day	Value	Net Chg	% Chg	Δ AVAT	Time	P/E	Dvd Yld	% YtdCur
1) Americas									
11) DOW JONES		16996.85	-8.90	-0.05%	-32.72%	12:10	15.31	2.23	+2.53%
12) S&P 500		1985.49 d	+44	+0.02%	-17.87%	11:55	17.67	1.95	+7.42%
13) NASDAQ		4541.29	-23.01	-0.50%	+10.49%	12:10	68.55	1.28	+8.73%
14) TSX		14568.68 d	-55.57	-0.38%	-11.92%	11:50	18.50	2.85	+2.03%
15) MEX IPC		44218.12 d	+178.48	+0.41%	-47.94%	11:50	25.27	1.72	+0.64%
16) IBOVESPA		51988.26	-341.77	-0.65%	-29.72%	12:10	15.37	4.71	-2.16%
2) EMEA									
21) Euro Stoxx		3032.98 d	-3.17	-0.10%	-28.71%	11:55	21.57	3.77	-9.42%
22) FTSE 100		6457.85 d	+55.68	+0.87%	-25.68%	11:55	16.36	4.84	-6.66%
23) CAC 40		4124.93 d	+12.26	+0.30%	-38.13%	11:55	25.30	3.40	-10.84%
24) DAX		9115.80 d	+47.61	+0.53%	-25.30%	11:55	16.62	2.94	-11.39%
25) IBEX 35		10257.00 d	-137.80	-1.33%	-20.78%	11:55	21.01	4.82	-3.96%
26) FTSE MIB		19271.48 d	-205.14	-1.05%	-17.58%	11:55	173.37	2.96	-5.66%
27) AEX		402.06 d	+8.0	+0.20%	-18.69%	11:55	20.42	3.02	-7.08%
28) OMX STKH30		1389.03	+8.20	+0.59%	-21.68%	12:10	15.47	3.72	-8.15%
29) SWISS MKT		8663.95 d	+33.54	+0.39%	-27.03%	11:55	19.54	3.13	-0.31%
3) Asia/Pacific									
31) NIKKEI		15553.91 d	+224.00	+1.46%	+2.15%	02:28 c	20.04	1.58	-7.00%
32) HANG SENG		23819.87 d	+299.51	+1.27%	+42.76%	04:01 c	10.34	3.78	+2.19%
33) ASX 200		5447.68	-4.92	-0.09%	-6.31%	01:46 c	18.87	4.44	+1.58%

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Currency Losses too

# II. Big Picture of Financial Markets

2. Low rates are driving equities up

- Does QE create inflation or bubbles?

<HELP> for explanation.

94 News		95 Settings		World Equity Indices					
Standard	Movers	Volatility	Ratios	Futures	AVAT vs	10d	% Ytd	USD	
1) Americas		2day	Value	Net Chg	% Chg	Δ AVAT	Time	% Ytd	% YtdCur
11)	DOW JONES		16970.07	-35.68	-0.21%	-26.67%	14:29	+2.37%	+2.37%
12)	S&P 500		1977.74	-7.31	-0.37%	-15.21%	14:29	+7.00%	+7.00%
13)	NASDAQ		4537.89	-26.41	-0.58%	+7.38%	14:29	+8.65%	+8.65%
14)	TSX		14504.59 d	-119.66	-0.82%	-6.14%	14:09	+6.48%	+0.90%
15)	MEX IPC		44074.93 d	+35.29	+0.08%	-33.98%	14:09	+3.15%	-0.29%
16)	IBOVESPA		51492.68	-837.35	-1.60%	-19.98%	14:29	-0.03%	-4.28%
2) EMEA									
21)	Euro Stoxx		3022.42 d	-13.73	-0.45%	-27.48%	12:50 c	-2.78%	-10.54%
22)	FTSE 100		6453.87 d	+51.70	+0.81%	-24.88%	12:35 c	-4.37%	-7.47%
23)	CAC 40		4110.64	-2.03	-0.05%	-36.67%	13:05 c	-4.31%	-11.95%
24)	DAX		9082.81	+14.62	+0.16%	-23.59%	13:30 c	-4.91%	-12.50%
25)	IBEX 35		10247.80 d	-147.00	-1.41%	-23.27%	12:38 c	+3.34%	-4.91%
26)	FTSE MIB		19157.41 d	-319.21	-1.64%	-14.35%	12:30 c	+1.00%	-7.06%
27)	AEX		401.10	-.16	-0.04%	-18.97%	13:05 c	-0.17%	-8.14%
28)	OMX STKH30		1389.95	+9.12	+0.66%	-12.24%	13:40 c	+4.28%	-8.79%
29)	SWISS MKT		8654.47 d	+24.06	+0.28%	-27.42%	12:31 c	+5.50%	-1.29%
3) Asia/Pacific									
31)	NIKKEI		15553.91 d	+224.00	+1.46%	+2.15%	02:28 c	-4.53%	-7.55%
32)	HANG SENG		23819.87 d	+299.51	+1.27%	+42.76%	04:01 c	+2.20%	+2.20%
33)	ASX 200		5447.68	-4.92	-0.09%	-6.31%	01:46 c	+1.78%	+0.35%

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 SN 146715 EDT GMT-4:00 H443-3457-1 29-Oct-2014 14:29:21

## II. Big Picture of Financial Markets

3. Global growth sagging
  - China and Germany not leading
  - Oil prices taking the hit



# II. Big Picture of Financial Markets

## 3. Global growth sagging (China)

<HELP> for explanation.  
 #<Go> for Details

96) Chart      97) Set as Default View      Economic Forecasts

Country/Region/World      Contributor Contributor Composite       Yearly  Quarterly

China       Private  Official

Actual / Forecasts

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<b>Economic Activity</b>										
1) Real GDP (YoY%)	14.20	9.60	9.20	10.40	9.30	7.70	7.70	7.40	7.00	7.00
2) CPI (YoY%)	4.77	5.90	-0.68	3.33	5.42	2.65	2.63	2.20	2.60	2.80
3) Unemployment (%)	4.00	4.20	4.30	4.10	4.10	4.10	4.05	4.10	4.15	4.10
<b>External Balance</b>										
4) Curr. Acct. (% of GDP)	9.70	9.14	4.87	3.90	1.81	2.59	1.95	2.40	2.30	2.20
<b>Fiscal Balance</b>										
5) Budget (% of GDP)	0.58	-0.40	-2.28	-1.69	-1.14	-1.67	-1.86	-2.10	-2.10	-2.00
<b>Interest Rates</b>										
6) Central Bank Rate (%)	7.47	5.31	5.31	5.81	6.56	6.00	6.00	6.00	5.95	-
7) 3-Month Rate (%)	3.60	1.00	1.45	2.80	2.65	2.86	5.00	-	-	-
8) 2-Year Note (%)	3.98	1.27	1.65	3.40	2.86	3.10	4.38	3.50	3.48	-
50) News Headlines										
51) Bloomberg Consensus Forecasts Summary as of Oct. 29 (Table)										BN 04:35
52) SURVEY: China Economy to Expand 7.3% in 4Q14; Prior +7.3%										BFW 10/28
53) China Economic Forecasts: Bloomberg Monthly Survey (Table)										<b>B</b> BN 10/28
54) China Recession Probability: Bloomberg Monthly Survey (Table)										BN 10/28
55) China QOQ% GDP Forecasts: Bloomberg Monthly Survey (Table)										BN 10/28

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# II. Big Picture of Financial Markets

## 3. Global growth sagging (Europe)



# II. Big Picture of Financial Markets

## 3. Global growth sagging (Commodity Prices dropping)

<HELP> for explanation, <MENU> for similar functions.

95 Save Defaults		96 News		Global Commodity Prices					
Movers	Units	AVAT vs	100d	Chg NY 14:30	Cal Sprds	Avg	Perf	%YTD	USD
1) Energy	2Day	Price	Net Chg	%Chg	Δ AVAT	Time	%YTD	%YTDCur	
10) NYMEX WTI Crude	d	82.65	+1.23	+1.51%	-13.55%	12:31	-16.02%	-16.02%	
11) ICE Brent Crude	d	87.56	+1.53	+1.78%	-12.34%	12:31	-20.97%	-20.97%	
12) NYMEX Gasoline	d	223.39	+3.78	+1.72%	-1.54%	12:31	-19.81%	-19.81%	
13) NYMEX Heat Oil	d	254.91	+5.60	+2.25%	+78.28%	12:29	-17.16%	-17.16%	
14) ICE Gasoil	d	757.50	+16.00	+2.16%	+12.47%	12:31	-19.88%	-19.88%	
15) NYMEX Nat Gas	d	3.743	+0.094	+2.58%	+23.96%	12:31	-11.51%	-11.51%	
2) Metals									
20) Spot Gold		1222.95	-5.57	-0.45%	--	12:41	+1.77%	+1.77%	
21) Spot Silver		17.23	+0.02	+0.09%	--	12:41	-11.52%	-11.52%	
22) Spot Platinum		1268.50	+1.75	+0.14%	--	12:40	-7.48%	-7.48%	
23) Spot Palladium		798.00	+4.75	+0.60%	--	12:41	+11.39%	+11.39%	
24) LME 3mth Aluminium	d	1996.00y	+13.00	+0.66%	--	10/28	+10.87%	+10.87%	
25) LME 3mth Copper	d	6795.00y	+65.00	+0.97%	--	10/28	-7.68%	-7.68%	
3) Agriculture									
30) CBOT Corn	d	368.00	+3.50	+0.96%	+28.82%	12:31	-12.80%	-12.80%	
31) CBOT Wheat	d	534.00	+3.25	+0.61%	-28.48%	12:31	-11.77%	-11.77%	
32) CBOT Soybeans	d	1036.75	+21.75	+2.14%	+100.02%	12:31	-21.52%	-21.52%	
33) ICE Coffee	d	190.15	-2.20	-1.14%	-19.36%	12:31	+71.77%	+71.77%	
34) ICE Sugar	d	16.32	+0.19	+1.18%	-52.66%	12:31	-0.55%	-0.55%	
35) ICE Cotton	d	65.45	+0.98	+1.52%	+99.55%	12:30	-22.67%	-22.67%	

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# III. Thoughts about Alibaba

1. Alibaba was a hot IPO – how could you take part in it?
  - You can't buy at the IPO date
  - Some people thought as early as May 2014 it would be hotter than expected.

**Solution:** Buy YHOO.

<http://ludwigbc.com/the-alibaba-trade/>

# III. Thoughts about Alibaba

1. Alibaba was a hot IPO – how could you take part in it?

**Fact 1:** Yahoo (YHOO) owns 22.6% of Alibaba. That means, Yahoo is worth  $\text{Yahoo} + 0.226 * \text{Alibaba Market Value}$ .

**Fact 2:** YHOO must sell 40% of its stake in the IPO. Thus, after the IPO, when Alibaba moves to the secondary market, the value of YHOO will be:  $\text{Yahoo} + 0.40 * \text{IPO Market Value} + 0.60 * \text{Secondary Market Value}$ .

**Trade 1:** Thus, prior to the IPO, one might wish to take an outright long position in YHOO. If the analyst projection is correct and the offering price is similar to what Alibaba believes, the return over the next month would be: 7%. Of course, this is a risky strategy (assumes a 62% jump over the offering price), but still may be worth doing.

Since I wrote this memo to my friends, the YHOO trade has done quite well (May 9, 2014 to September 16, 2014). **A strategy of long-short with the S&P 500 would have made a very pretty return of 18.97%.** A straight long position in YHOO would have made 26%.

# III. Thoughts about *Alibaba*

2. A Peter Drucker business model reemphasized.

Priorities:

1. Customers
2. Employees
3. Shareholders

# IV. Crowding is Alive and Well

What you should do:

## 1. Buy *The Crisis of Crowding*

([http://www.amazon.com/The-Crisis-Crowding-Copycats-Bloomberg/dp/1118250028/ref=sr\\_1\\_1?ie=UTF8&qid=1339689840&sr=8-1&keywords=the+crisis+of+crowding](http://www.amazon.com/The-Crisis-Crowding-Copycats-Bloomberg/dp/1118250028/ref=sr_1_1?ie=UTF8&qid=1339689840&sr=8-1&keywords=the+crisis+of+crowding))



***"One of the lessons from the crisis, rarely discussed, are the problems caused by a crowded trading place. Chincarini takes the reader down a path not looked at by many analysts. An excellent read."***

**—JIMMY CAYNE, former CEO and Chairman of the Board of Bear Stearns**

## 2. New Research that is fascinating

- look out for my 2 papers to be on web in next month or so OR [drop your business card off](#) and I will send them to you when complete

# V. The Bull and Bear

1. Leveraged Indices – what they are and background
2. Lawsuits
3. A better formula
  - a. Monthly rebalancing
  - b. Equal-weights
  - c. Quant tilting



# V. The Bull and Bear

## EXHIBIT 5

Impact of Switching Exposure Duration, April 2002 Through April 2013

	S&P 500	Effect of Changing Rebalance Frequency from Daily to Monthly						Effect of Changing Weighting from Capitalization to Equal		Effect of Tactical Weighting based on Model			
		S&P 500 (2X, Monthly)	S&P 500 (2X, Daily)	Excess (1)	S&P 500 (-1X, Monthly)	S&P 500 (-1X, Daily)	Excess (2)	S&P 500 (2X, Monthly, EW)	Excess (3)	Alternatively Weighted U.S. Bull Model	Excess (4)	Alternatively Weighted U.S. Bear Model	Excess (5)
2013*	12.74%	26.55%	26.55%	0.01%	-11.71%	-11.68%	-0.03%	28.01%	1.45%	28.33%	0.32%	-11.53%	0.18%
Avg Annual Return	7.37%	16.00%	14.44%	1.56%	-5.68%	-8.05%	2.37%	18.90%	2.90%	20.13%	1.24%	-4.22%	1.46%
Annualized Avg Return	5.75%	9.02%	6.88%	2.14%	-7.69%	-9.61%	1.92%	12.23%	3.21%	13.95%	1.72%	-6.42%	1.27%
Annl Std Dev	18.28%	34.97%	35.31%	1.34%	20.46%	16.67%	4.42%	34.65%	4.28%	34.28%	2.82%	22.35%	2.17%

# Thank you

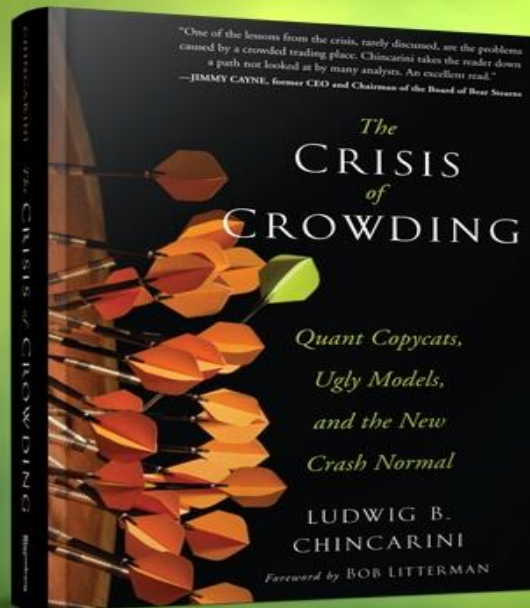
- Dr. Ludwig Chincarini
- University of San Francisco

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[chincarini@hotmail.com](mailto:chincarini@hotmail.com)

## A RARE, IN-DEPTH ANALYSIS OF THE 2008 FINANCIAL CRISIS

“An excellent read.” —JIMMY CAYNE



A unique blend of storytelling and sound quantitative analysis, *The Crisis of Crowding* explores the circle of greed from homeowners to real estate agents to politicians to Wall Street.

Linking the 2008 financial crisis back to the 1998 crisis of LTCM, *The Crisis of Crowding* shows how banks, hedge funds, and other market participants repeated the sins of the past and how the collapse of Lehman Brothers led to market insanity thanks to the irrational behaviors of buyers and sellers in the crowded space.

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