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# A reductive macro-economic framework can manage biases

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Portfolio  
Construction  
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# A REDUCTIVE MACRO- ECONOMIC FRAMEWORK CAN MANAGE BIASES

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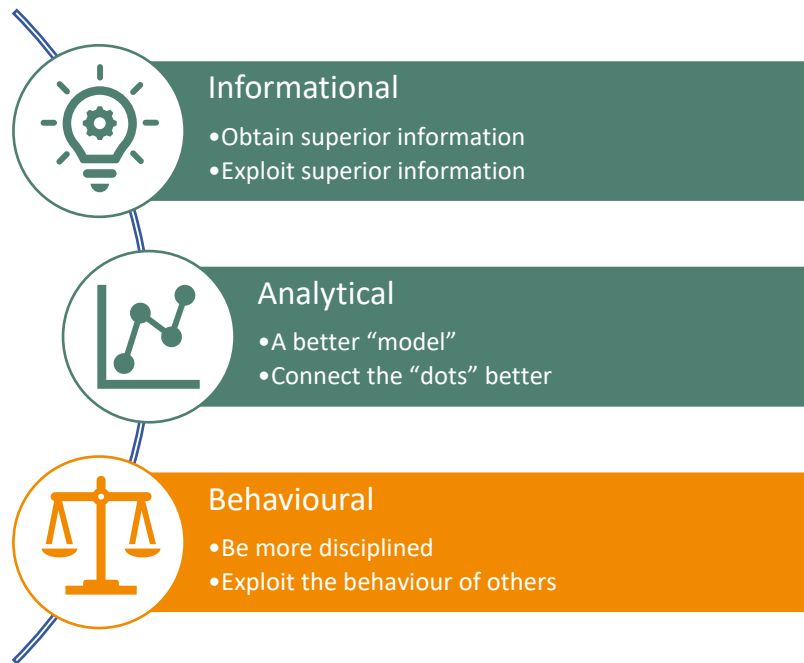
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# | THE THREE SOURCES OF ALPHA



What is the probability that an investment manager has

- Better information than everyone else?
- Uncovered a way of analysing that information that has never been done before, and is actually useful for predicting the future?

**Behavioural alpha is where the most money can be made. Acting more rationally than others can be a more consistent source of alpha.**

*“The time to buy is when there's blood in the streets.” – Baron Rothschild*

# INDIA DEMONETISATION

## ATMs, banks seen dry on 10th day after demonetisation declaration



DP CORRESPONDENT  
Ludhiana

Large numbers of ATMs were seen closed or without cash which have created problems among different sectors of society.

From past two days, banks and ATMs were seen dry though long queues were seen. However, people are now not spending even a single penny at other things. Basic necessities of people are getting fulfilled.

Different stores and shops have come up with debit card facility but this is not a full fledged solution to the prob-



Different stores and shops have come up with debit card facility but this is not a full fledged solution to the problem. People are not able to complete their basic facilities as invalid currency has posed several problems.

lem. Different sectors of business are going on down graph though people are suffering number of problems.

People are not able to complete their basic facilities as invalid currency has posed several problems.

City residents again suffered from various problems on the eighth day after the announcement of discontinuation of Rs. 500 and Rs. 100 currency by Prime Minister Narendra Modi. People have to wait long outside ATM machines here on Wednesday. People are facing many problems as they are not having the short denomination currency for buying stuff of their regular needs. However, most of the shopkeepers and offices are refusing to accept the invalid currency.

08 November, 2017  
by BW Online Bureau

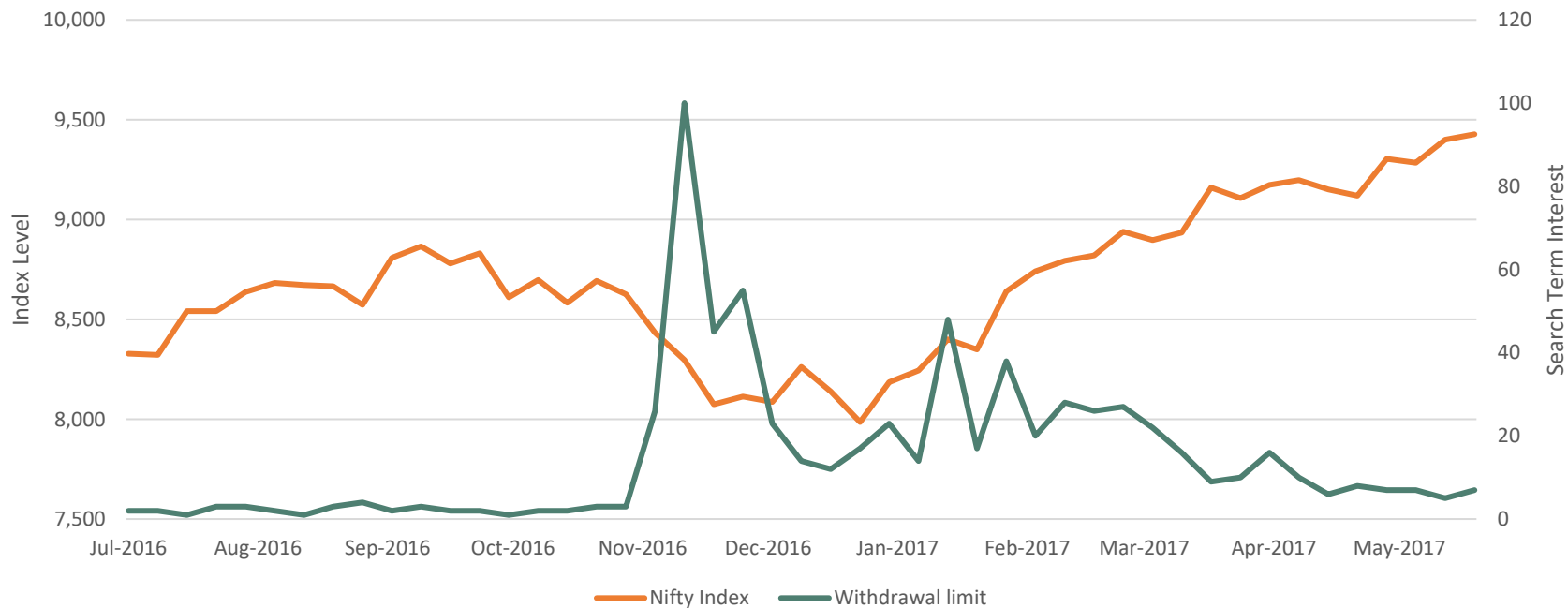
Photo Credit : PTI



Daily Post India, Nov 2017

# INDIA DEMONETISATION

NIFTY 50 Index level & Google Search Term “Withdrawal” Interest – July 2016 to May 2017



# COVID CASE-STUDY



Trump says the coronavirus is the Democrats' 'new hoax'

POLITICS

## Trump says the coronavirus is the Democrats' 'new hoax'

PUBLISHED FRI, FEB 28 2020 7:32 PM EST | UPDATED SAT, FEB 29 2020 3:14 PM EST



Thomas Franck  
@TOMWFRANCK

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The Washington Post  
Democracy Dies in Darkness

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Health

Get a gripe, America. The flu is a much bigger threat than coronavirus, for now.



Certified medical assistant Wendy Kerley gives Ethan Getman, 15, a shot of the flu vaccine in Memphis. (Jim Weber/Daily Memphian/AP)

By Lenny Bernstein

February 1, 2020



The Washington Post  
Democracy Dies in Darkness

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## Past epidemics prove fighting coronavirus with travel bans is a mistake

Even if it were feasible to contain it, these measures could make us less safe in other ways



Delta planes sit on the tarmac at John F. Kennedy Airport on Friday in New York City. (Spencer Platt/AFP/Getty Images)



By Jennifer B. Nuzzo

Jennifer B. Nuzzo is a senior fellow for global health at the Council on Foreign Relations and an associate professor at the Johns Hopkins Bloomberg School of Public Health.

February 2, 2020



# | COVID CASE-STUDY

FINANCE

## Jamie Dimon warns: We're getting a 'bad recession' plus 'financial stress' like the 2008 crisis

PUBLISHED MON, APR 6 2020•6:51 AM EDT | UPDATED MON, APR 6 2020•1:38 PM EDT



Hugh Son  
@HUGH\_SON

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## Coronavirus savages U.S. economy in first quarter; bigger hit still to come

By Lucia Mutikani

7 MIN READ



Coronavirus

### Don't bet on vaccine to protect us from Covid-19, says world health expert

Professor of global health at Imperial College, London warns we 'may have to adapt' to virus

- [Coronavirus - latest updates](#)
- [See all our coronavirus coverage](#)

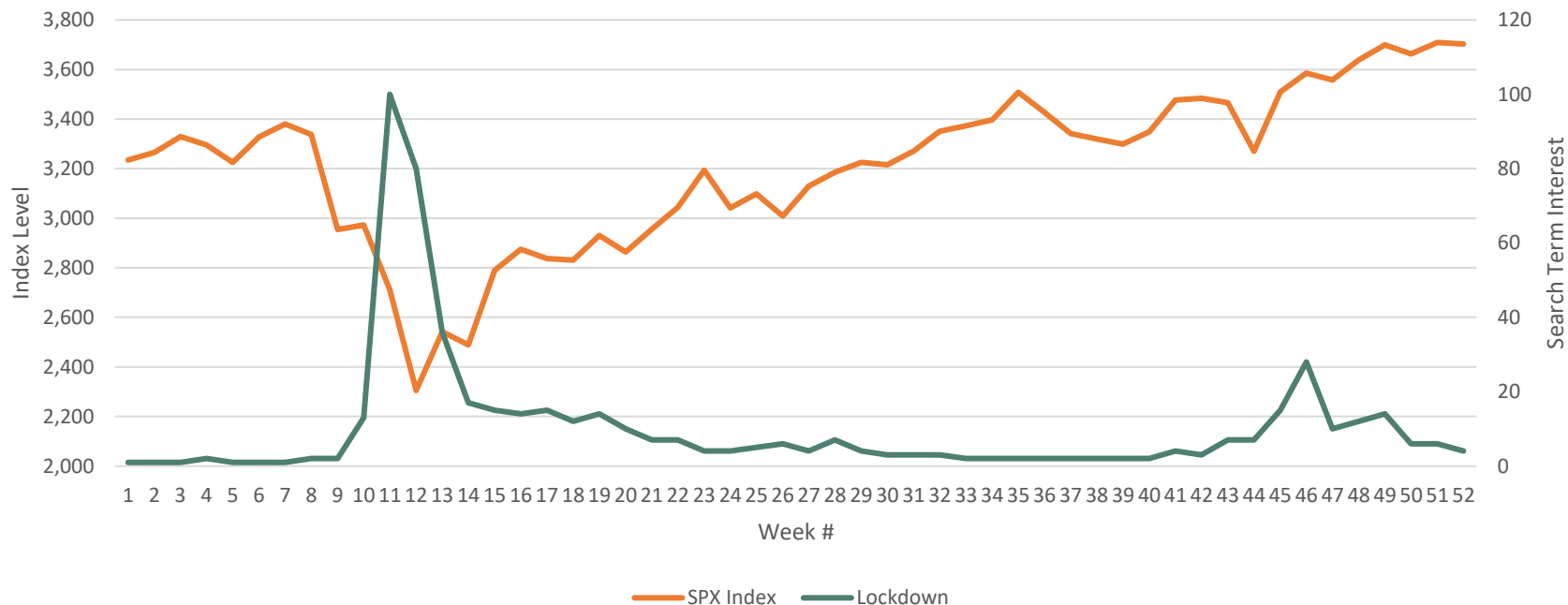
Robin McKie, Toby Helm and Michael Savage

06:23 Sunday, 19 April 2020



# | COVID CASE-STUDY

S&P500 Index level & Google Search Term “Lockdown” Interest – by week starting 5 Jan 2020



# CHINA EVERGRANDE

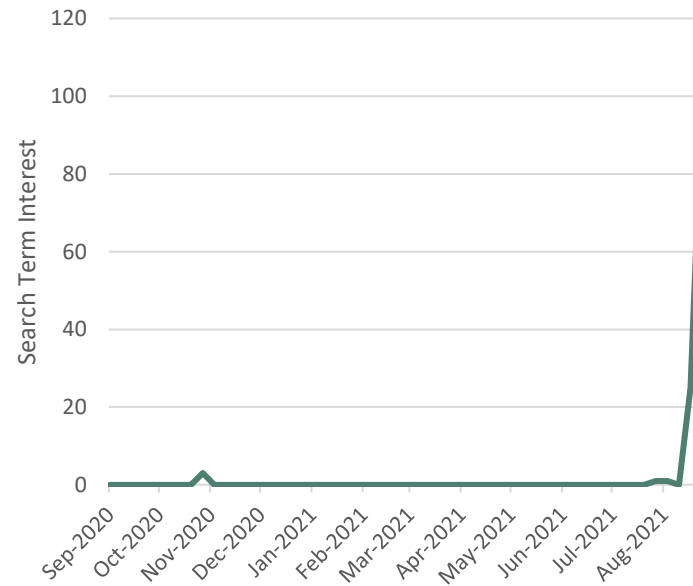
**Evergrande Real Estate Group**

## Evergrande fallout could be worse than Lehman for China, warns Jim Chanos

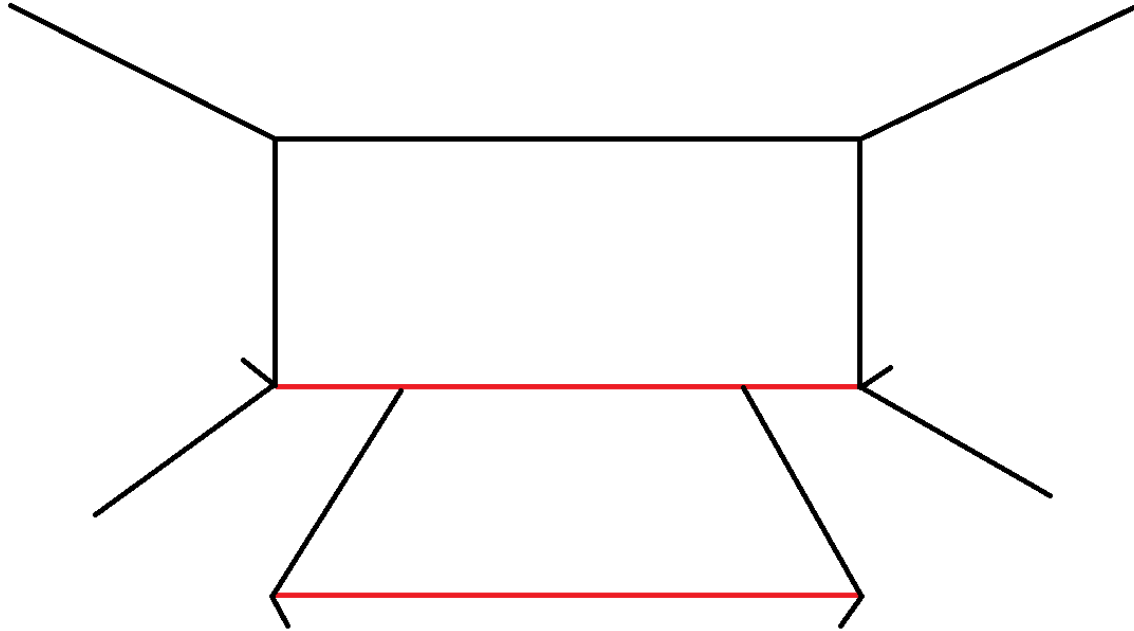
## Crisis at property developer 'symptomatic' of broader woes in world's biggest emerging market, says short seller

By **Harriet Agnew**, Asset Management Editor SEPTEMBER 22 2021

### Google Search Term “Evergrande” Interest in the United States



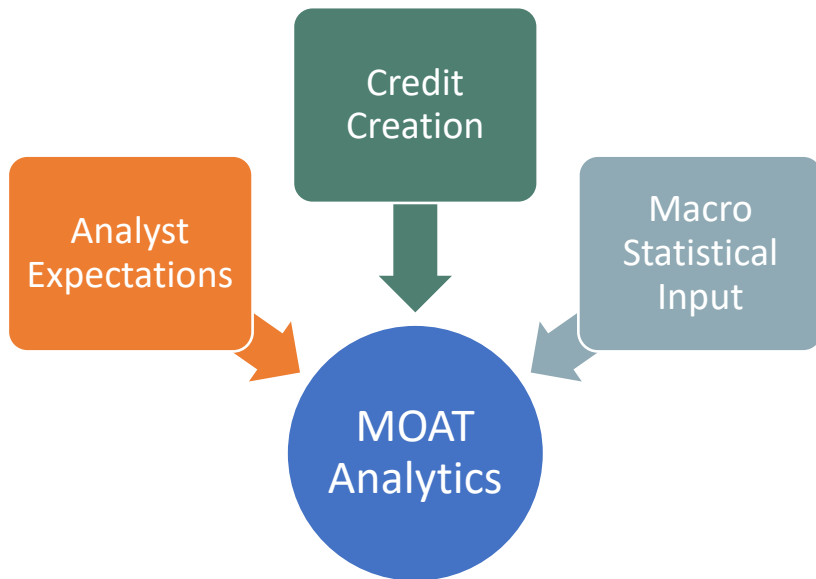
# | WHICH LOOKS LONGER?



# | WHICH LOOKS LONGER?

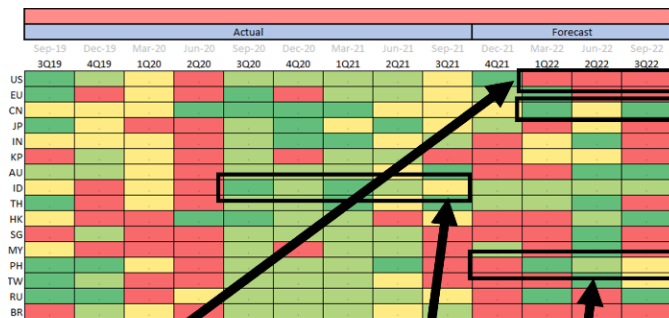


# | A REDUCTIVE MACRO FRAMEWORK IN PRACTICE



- Use a model that systematically tracks what you think are the most salient indicators of macroeconomic dynamics.
- A model must:
  - have **breadth**
  - have **depth**
  - be **timely**
  - guide **sector allocation decisions**

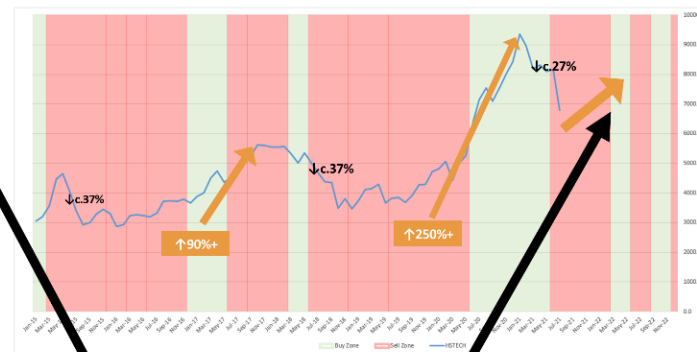
# MANAGING BIAS THROUGH THE MACRO



■ **US:** Economic condition is plateauing and it is time to be cautious.

■ **Indonesia:** Has been green, the Jakarta index has done well

■ **The Philippines:** Red in Q3 and Q4 2021 because of COVID. It is set to improve in 2022 as vaccination rate goes up.



■ **China:** Left the green zone 2Q21, the HK Tech index has been hit hard. Set to turn green in 2022. An opportunity to start positioning.

# | COMMON COGNITIVE INVESTING HEURISTICS



# | CONCLUSION

- A Reductive Quantitative Macroeconomic Framework can help to identify cognitive biases in investing.
- Biases are often the intense at turning points in markets, it is dangerous to go where cognitive biases leads you.
- Tools that can tease out the biases from objective reality can capitalise on others' heuristics and improve investment returns.
- The right quantitative tools can enable us to leave the comfort of the CONSENSUS and take a differentiated view. This can make a real difference to return for you and your client.



# | HOMEWORK

1. The Cboe Volatility Index (VIX) is a real-time index that is derived from the prices of S&P index options with near-term expiration dates. It generates a 30-day forward projection of volatility. It is a way to quantify the intensity of fear in the markets. Search for a long term (20yr) chart of the VIX on the internet and see if you can identify what market events those spikes coincided with? See if the peak of the VIX correspond to the bottom of markets?
2. Certain EM stock markets are more prone to US monetary tightening. For example, the Indonesia JSX. Go to Google Trends and search for the key words “Fed tapering” in the last decade, and see whether peak of search trends coincides with Indonesia JSX bottoms?
3. “The Linda problem” Kahneman and Tversky, 1982. Linda is 31 years old, single, outspoken, and very bright. She majored in philosophy. As a student, she was deeply concerned with issues of discrimination and social justice, and also participated in anti-nuclear demonstrations. Which is more probable?
  - a) Linda is a bank teller.
  - b) Linda is a bank teller and is active in the feminist movement

The correct is a), as b) is a subset of a) hence more probable.

Having the right quant framework to work out the likely “expected value” can help overcome fallacies
4. Mindware: Tools for Smart Thinking Kindle Edition - by Richard E. Nisbett - tips to be more aware and deal with biases



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