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Niederhoffer eyes new risks in 2021 - “There’s no vaccine for a debased currency”

Bailey McCann, Opalesque New York:

2021 could be the year where investors remember why they keep uncorrelated strategies in the portfolio, according to hedge fund manager Roy Niederhoffer founder of New York-based R.G. Niederhoffer Capital Management. 2020’s rebound in stocks could be giving investors a false sense of security given the potential for inflation as well as continued macro uncertainty.

“It’s really critical for investors to remember that stocks and bonds can go down together,” Niederhoffer tells Opalesque. “A mix of stocks and bonds is not always enough diversification to preserve capital when they are going down together.” Stocks and bonds did in fact go down together during the March crash last year. An event that’s likely in the rearview for many investors given the scale of the rebound.

Niederhoffer is talking his book here a little bit. His quantitative systematic strategies made it through the correction up more than 20%, at a time when other managers were caught out.

Niederhoffer’s approach is designed to look for situations where behavioral bias is likely to work against investors and capture the opportunity embedded in their miscalculations. The strategies often do particularly well during crisis situations, but can be effective anytime there is a mismatch between investor expectations and reality. Algorithms support the investment team’s identification of these opportunities. The firm has worked to refine its models since its founding in 1993, to keep pace with shifts in the market and advancements in technology.

Markets have been riding high on vaccine news and other nascent indicators of recovery so far this year, but Niederhoffer says we are far from being in a risk-off environment. Inflation could pick up this year which will limit the performance of some investment strategies. In an edge case, interest rates could rise - a potentiality few investors are anticipating.

“Central bank balance sheets are growing faster than ever before. Trillions of dollars are being printed every year around the world,” Niederhoffer says. “Eventually, this will filter into financial markets and it will create pressure. The most likely outcome is that rates rise.”

Against this backdrop, Niederhoffer argues that investors need to consider adding diversifiers to the portfolio beyond stocks and bonds. That could mean adding systematic strategies like his or VIX futures. He’s also bullish on bitcoin as a potential alternative. The cryptocurrency has hit new highs in recent weeks but remains extremely volatile. Each of these approaches has a higher risk than stocks and bonds but could pay off if realized volatility remains higher than it was pre-pandemic. “There’s no vaccine for a debased currency,” he says.

As ever, Niederhoffer is looking for dislocations. “The stock market is hitting new highs but VIX is telling us that it’s twice as risky compared with pre-covid highs. Meanwhile, realized volatility in fixed income and FX are near all-time lows. That’s where I think the action could be.”