

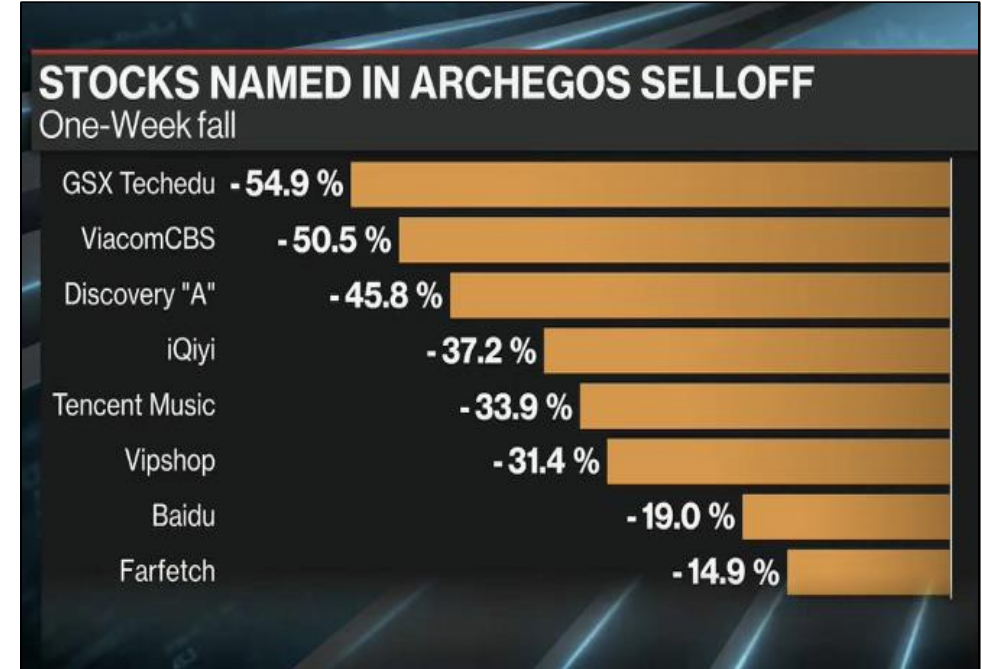
“To make money they didn’t have and didn’t need, they risked what they did have and did need. And that is just plain foolish” – Warren Buffett on LTCM

While most of us were still making jokes about the container ship stuck in the Suez Canal, a wave of unusually large block sell orders circulated the market on Friday causing large price drops for the stocks of a handful of well-known U.S. companies and U.S. listed Chinese companies. Viacom, Discovery, Baidu, and Tencent were among them (see chart, top right). The culprit is supposedly Archegos Capital, a ~\$10 billion family office run by Bill Hwang. If the firm goes completely under, it will likely go down as the largest fund blow up since Long Term Capital Management (LTCM) in 1998. The likelihood that contagion meaningfully spills into other areas of the market like LTCM are small, but it’s worth understanding the situation and what the effects could be.

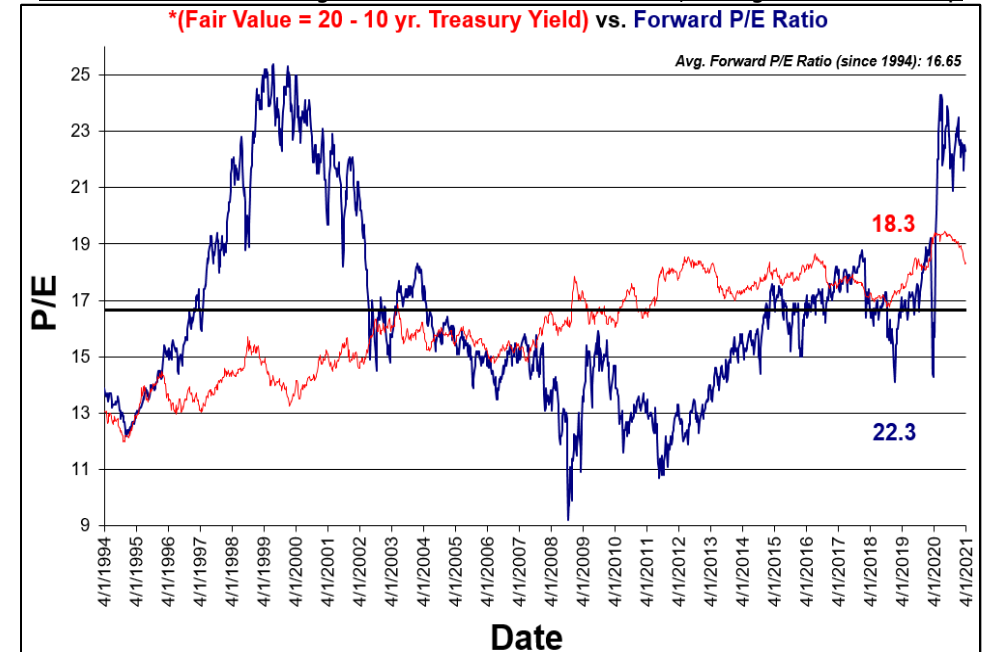
Most of the companies involved in Hwang’s trades were heavily shorted stocks. The future of ViacomCBS and Discovery are in doubt in the digital streaming age, and many U.S. listed Chinese stocks have fears surrounding potential de-listing on U.S. exchanges. That has caused many hedge fund investors to bet that these stock prices will fall. Hwang’s firm took the “long” side of some of these, betting that those stock prices would go up. He then leveraged those trades 5-to-1 magnifying the firm’s trading capital to ~\$50 billion. Since Archegos was structured as a family office managing Hwang’s own money (and that of family/friends), Hwang avoided much of the usually required regulations/disclosures. Some of the banks that structured these trades and provided the leverage were Goldman Sachs, Morgan Stanley, Deutch, Credit Suisse, and UBS. The recent downward price pressure forced these banks to issue a margin call requiring Archegos to provide more capital, and Archegos could not meet it. The banks then forced liquidation of around \$30 billion of Archegos’ leveraged holdings. You don’t usually see these levels of trade sizes and leverage ratios for a family office. It begs the question of how Hwang was able to convince the banks to support these trades? If you guessed that profits might have played a role, then you’re probably right. Hwang’s management style is one of opaque, concentrated large bets and leverage. A profitable client for investment banks who facilitate hedge fund trades.

Hwang is no stranger to Wall Street (or controversy). He is an alum of Tiger Global, a pioneering hedge fund company run by Julian Robertson that is famous for former employees striking out on their own as “Tiger Cubs”. In 2012, Hwang agreed to pay \$44 million to settle with the Securities and Exchange Commission (SEC) over insider trading allegations with Chinese bank stocks. In 2014, Hong Kong fined him \$5.3 million and banned him from trading for four years. Safe to say there will likely be some layoffs in the “Know Your Customer” compliance groups at these banks. The Archegos losses are likely to be humiliating, but don’t likely pose systemic risks. There is some risk that a debacle of this magnitude will cause the investment banking industry to scale back how much they lend hedge fund clients, sparking a broader hedge fund deleveraging. Similar to the GameStop saga, the culprit here is not Wall Street broadly but rather incredibly poor risk management. This is exactly why we keep harping on how important it is to know who is managing your money, what strategy/process they are utilizing, and how that process evolves over time. Good investing ideas are nothing without good execution. That includes risk management. The reward for using leverage is often a tempting siren that can cause managers to ignore the massive inherent risks.

Margin Call Forced Large Block Trades; Led to Selloff in Notable US & Chinese Stocks



S&P 500 Price-to-Earnings Valuation Remains Stretched; Rising Rates Don't Help



Sources: Top – Bloomberg LP; Bottom – Refinitiv, BCA Research, Bloomberg LP, Yardeni Economics

Market Rates & Returns

All returns are total returns and are annualized past 1-year. All rates are snapshots, as of the date noted. Source: Bloomberg LP

Data As Of: 3/26/2021

Asset Class	Sub-Asset Class	Index	YTD	1-Year	3-Year	5-Year	10-Year	2020
Equity	U.S. Large Cap Equities	S&P 500	6.19%	53.71%	16.51%	16.56%	14.04%	18.39%
Equity	U.S. Mid Cap Equities	S&P 400	14.17%	81.18%	13.62%	14.95%	12.23%	13.65%
Equity	U.S. Small Cap Equities	Russell 2000	12.70%	90.46%	14.39%	17.08%	11.97%	19.93%
Equity	Developed ex. U.S. Equities	MSCI ACWI ex U.S.	3.49%	50.08%	7.22%	10.74%	5.62%	11.23%
Equity	Emerging Markets Equities	MSCI Emerging Mkts	1.50%	57.34%	6.27%	13.00%	4.24%	18.79%
Fixed Income	Broad Aggregate	BB Aggregate	-3.28%	1.72%	4.88%	3.23%	3.45%	7.51%
Fixed Income	U.S. Treasury	BB U.S. Treasury	-3.96%	-3.68%	4.38%	2.39%	2.94%	8.00%
Fixed Income	U.S. Treasury Inflation Prot.	BB U.S. Inflation Linked	-1.42%	6.44%	6.14%	4.32%	3.61%	11.54%
Fixed Income	U.S. Investment Grade	BB U.S. Invest. Grade	-4.81%	11.24%	6.41%	5.00%	5.02%	9.89%
Fixed Income	U.S. High Yield	BB U.S. High Yield	0.58%	27.22%	6.78%	8.10%	6.46%	7.11%
Fixed Income	U.S. Leveraged Loans	CS Leveraged Loan	1.98%	24.28%	4.13%	5.36%	4.43%	2.78%
Fixed Income	U.S. Municipals	BB Municipal Bond	-0.35%	5.70%	4.99%	3.57%	4.49%	5.21%
Fixed Income	Non-U.S. Gov't Bond	FTSE Non-U.S. WGBI	-5.64%	6.69%	0.86%	2.45%	1.14%	10.78%
Fixed Income	Emerging Markets Debt	JPMorgan EMBI	-4.44%	13.51%	4.25%	4.96%	5.39%	5.88%
Real Assets	Real Estate	FTSE NAREIT	10.38%	39.78%	11.02%	6.17%	9.01%	-8.00%
Real Assets	Master Limited Partnerships	Alerian MLP	23.12%	103.83%	-2.73%	-0.27%	-0.76%	-28.84%
Real Assets	Broad Commodities	Bloomberg Commodity	7.79%	32.86%	-1.21%	1.14%	-6.60%	-3.50%
Real Assets	Oil	WTI Crude	25.66%	169.78%	-2.39%	9.09%	-5.33%	-20.54%
Real Assets	Gold	Gold COMEX	-8.59%	4.91%	8.53%	7.24%	1.96%	24.42%

Key Market Interest Rates	Current Rate	1 Month Ago	2 Months Ago	3 Months Ago	4 Months Ago	6 Months Ago	1 Year Ago
Federal Funds Rate	0.07%	0.07%	0.08%	0.09%	0.08%	0.09%	0.10%
Secured Overnight Fin. Rate (SOFR)	0.01%	0.02%	0.06%	0.08%	0.08%	0.07%	0.01%
90-Day Treasury Rate	0.01%	0.02%	0.07%	0.08%	0.07%	0.08%	-0.10%
2-Year Treasury Rate	0.14%	0.12%	0.11%	0.12%	0.16%	0.13%	0.29%
5-Year Treasury Rate	0.87%	0.60%	0.40%	0.36%	0.39%	0.28%	0.53%
10-Year Treasury Rate	1.68%	1.38%	1.03%	0.92%	0.88%	0.67%	0.84%
30-Year Treasury Rate	2.38%	2.23%	1.79%	1.66%	1.62%	1.41%	1.43%
3-Mon/10-Yr Treasury Spread	1.67%	1.35%	0.96%	0.85%	0.81%	0.59%	0.94%
2-Yr /10-Yr Treasury Spread	1.54%	1.25%	0.91%	0.80%	0.72%	0.53%	0.55%
6-Month CD Rate	0.18%	0.20%	0.19%	0.27%	0.28%	0.31%	0.51%
1-Year CD Rate	0.33%	0.34%	0.34%	0.40%	0.41%	0.44%	0.70%
2-Year CD Rate	0.37%	0.38%	0.39%	0.44%	0.45%	0.47%	0.76%

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