R I S K P A R I T Y

Risk Parity Derangement Syndrome

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You may have noticed the market turbulence lately. You may have also noticed the legion of commentators among the media, politicians, and famous investors, blaming this turbulence on “risk parity,” “trend-following strategies,” or my favorite, just “the machines.”

Poppycock. Yes, it’s come to this; they’ve driven me to swear like Mrs. Doubtfire.

To be clear, it’s not unreasonable to think that strategies that target volatility in a long-biased portfolio are likely to sell into the higher market volatility that often coincides with market losses. Nor is it unreasonable to think that strategies that explicitly follow trends are likely to sell into bear markets (that’s kind of obvious). So I guess they get the direction right. But, size matters. To make a statement about this you have to have a vague idea about how many dollars are in such strategies and what they are likely to sell in a down draft. You may notice a conspicuous lack of relevant estimates from the many “machine” haters. This isn’t surprising because the facts show “the machines” can’t possibly be the culprit.

If those blaming “the machines” (sorry, I seem to be compelled to keep using the air quotes) have different numbers and want to debate these findings, let’s do it. That’s always fair game. But if they just want to make accusations with nothing to support them, then they’re just irresponsible yentas throwing shade they can’t back up.

Okay, you may have noticed that I too have not offered anything concrete. Mea culpa. But, I got something up my sleeve: peeps. Well one peep. My partner Michael Mendelson, who, thankfully, is far less belligerent and snarky than me, has been on top of this issue for the last several years and he explains here why risk parity and trend-following strategies are not to blame — and unless someone wants to argue with his views on the actual sizes, which again we’d welcome because legit debate is always great, they should sit on it.

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