

## ***Archegos, Disclosure and Price Discovery***

In the aftermath of the Archegos affair, there are calls to improve regulation – and within this, expand disclosure guidelines for stock holdings via cash or swap instruments. Some countries already do this, and the reasons for doing so all sound very reasonable at first blush, including to “improve transparency” and “level the playing field”.

However, I think we should ask ourselves if Archegos *had been* disclosing the size of its swap positions, would things have turned out much differently? Is it naïve and hopeful to believe that us all knowing the size of their positions would have prevented all this?

In my view, the problem wasn't necessarily the percentage ownership that Archegos had in certain names, the problem was that they were wholly undercapitalized.

Sure, better disclosure would have meant the other prime brokers would have specifically seen that Archegos had similar positions with other banks – but believe you me the PBs *already* know that their clients have similar positions at other banks. That's the business. All large funds have multiple prime brokers. Each PB evaluates their potential clients' strategies, monitors their AUM, sees the positions they hold for them, extrapolates and estimates exposures to other PBs vs. that AUM, considers the risks, and builds it in to their appetite and spreads. That's just what PBs do.

That's what they did with Archegos too, but they were just dead wrong (or perhaps even fraudulent, I don't know).

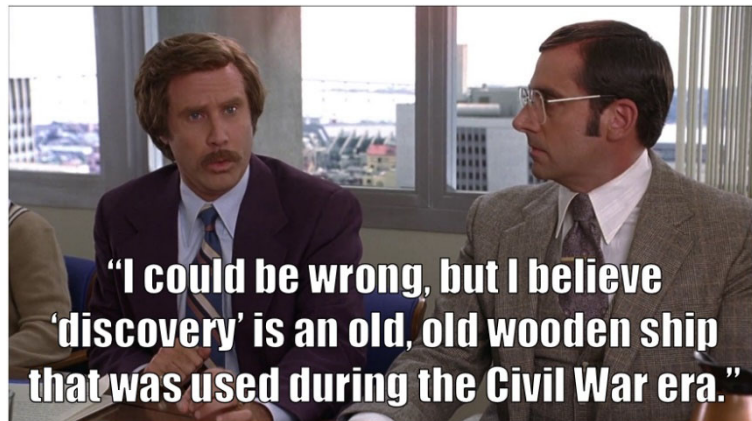
In any event, yes, the banks were absolutely too greedy financing Archegos as long as they did (or even taking that business in the first place post Tiger Asia). But let's be clear, **the primary problem here was Archegos itself**. The banks (once again) suffered from their perpetual agency problem, and put themselves in a position where they might have to sacrifice long-term value for short-term gains; but it was Archegos that couldn't meet its margin call. Archegos was the main problem here.

This had a lot to do with bad banking, but most to do with an overzealous client. Meanwhile, **it had very little to do with holdings disclosure**. Sure, our kneejerk reaction is (always) for more regulation, because we want to believe that some regulatory response will immediately solve all our future problems. But we should question this intuition.

Enron was one of the most highly regulated public companies in the world, and that didn't stop the charade.

But back to this very basic issue of reporting holdings, you and I knowing how much ViacomCBS or Tencent Archegos owned would not have prevented these shares from selling off. In fact, there is an argument that *because* we all soon learned what they owned, the price action in any Archegos-owned shares was more panicky, tempestuous, emotional, and flow-led than it might have been otherwise.

In fact, I think we should consider that forcing asset managers to disclose their holdings may actually *damage* price discovery. In many jurisdictions, I've already seen some of these reporting levels move lower and lower, and the intervals between them tighter and tighter. In my view, this – almost certainly - cannot be good for investors.



Perhaps unsurprisingly, I believe that some regulators realize this but are sometimes forced to weight short-term political pressure against the long-term implications of their actions. In quieter times, the SEC – for example – will temporarily waive the requirements for someone like Berkshire Hathaway to disclose their stakes publicly. Warren Buffett himself has intimated that public investors should not always be allowed to piggyback on investment ideas before they are finished buying.

Extending this logic, one wonders if everyone shouldn't be allowed to see you start selling before you've completed selling.

Think about a fund manager running money for you. The last thing (in most cases) she wants to do is disclose to the rest of the world in which positions her fund has economic exposures. This is especially the case in a concentrated fund, or where there is sizeable ownership in percentage terms. If you take it to the extremes, and we give everyone a list of every share of every company she owned, and did so in real time, then the entire game would be to front-run this PM. If she was getting inflows, buy those stocks before she does; if she is getting redemptions, short them before she does. Traders make money, investors lose.

Of course, this happens now already. When you see the big trading P&Ls for a lot of the investment banks over the past year, it's not because they had a crystal ball. It's because they had visibility into who owned what. If there were rumors that hedge fund XYZ was exiting a disclosed position (long or short) and an order came in to cover or sell those shares in size – guess what the bank did?

And then when the asset manager (sometimes the next morning) is compelled by her regulator to disclose those same purchases or sales, the *whole world* then knows she is exiting a position. This disclosure introduces a new mob that effectively front runs her investment until the fund is finished exiting the position, and her investors are punished in the process.

In many cases, these investors ultimately are pensioners, future retirees, charitable foundations or endowments. In other words, they are you. You are not benefitting from tighter and lower disclosure levels, you are suffering.

And there is a more sinister outcome too, that being when the disclosure triggers front running and share price volatility that forces your fund manager to sell markedly lower than she should, thus reducing future returns, and driving further redemptions in turn.

If you don't think that narrative could start feeding on itself, nor that there is potential for a self-fulfilling prophecy triggering a redemption spiral, you should. Because it can.

I saw it happen in 2008 a few times. Back then, the regulatory response to the initial volatility was to tighten the screws, increase disclosure requirements (and in some cases, ban short sales altogether). This didn't turn out well for many funds and their underlying investors.

Since then, we've all seen the research showing how these short-sale bans were actually bad for price discovery and market efficiency (and if anything removed a natural buyer from the equation); but **I believe that increased holdings disclosure requirements have a similar potential to destabilize markets and exacerbate volatility.**

Sure, there is a big post-mortem due on the whole Archegos debacle, but we should at least consider that more holdings disclosure, while an easy political target, is probably not the answer.

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*Photo Credit: Anchorman: The Legend of Ron Burgandy (2004), Dreamworks Pictures, Apatow Productions*

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