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Volatility guru works on ways to make money from a roller-coaster market

Lisa Macnamara
Equities

FOR the man who put the VIX volatility index on the map, there is no better time to invest.

Alvin Wilkinson — a former director of the Chicago Board Option Exchange who helped establish the infamous “fear” monitor — says uncertainty over where financial markets will turn to next is expected to drag on for another couple of years.

“Volatility is going to be here for a while — at least for another two years — and when we have elevated volatility environments, that’s just enormous amounts of opportunity for us,” Mr Wilkinson said.

“We’re going to have inflationary pressures in the market: agricultural products are moving up in price, oil prices continue to rise, mixed messages from the Federal Reserve,” he said of the likely catalysts for continued skittish behaviour.

Mr Wilkinson is in Australia as part of his role with the Sydney-based fund manager Pengana Capital. He will oversee its new Global Volatility Fund, an investment vehicle he designed to scale the highs and lows of global market turmoil to reap returns from a

range of indices. “If we have a catastrophic event — ie, we drop 15 per cent in a relatively short period of time — the fund will do very well,” he said.

“Our fund is almost negatively correlated to a catastrophic market, so if we should have that catastrophic movement on the downside, we should really shine because this is what we’re designed and engineered to do.”

As a former director of the Chicago Board Options Exchange, Mr Wilkinson was the key driver in establishing the global barometer of market sentiment, the VIX volatility index in 1993.

It is considered to be one of the most reliable guides to investor intentions — namely, the level of nervousness held by investors.

“The VIX is a calculation of option pricing in the S&P 500 and it looks at the first three months’ worth of options and it weighs it heavily to a 30-day average — so it gives you a sentiment of where index pricing is in those particular options,” he said.

The huge volatility that has been unleashed by the crumbling of the US sub-prime mortgage sector and associated credit crunch has seen the VIX drastically change shape.

“A year ago that calculation on the VIX was trading at 9 when we had

dormant markets that continued to creep up and volatility was under (the level) 10,” Mr Wilkinson said.

“When we had this correction just recently that calculation in a day went over 40 — and yet the market had only dropped around 10 per cent in a day.”

The depth of recent concerns is also revealed when comparing the VIX reaction at the time of the Chinese-induced market correction back in February, when it moved to the mid-20s level. “So is there something behind all this that we’re not really aware of or has it come out? There’s a lot of fear running in the market right now,” Mr Wilkinson said.

But another explanation for the global jitters was that investors were asking questions after the huge run over the past five years in the aftermath of 9/11.

“By summer 2002, the S&P 500 traded at 770 — but the S&P 500 has now basically doubled in a five-year period on a mature market — that is a significant movement,” he said.

“And people are starting to say we’ve really had a good five to 10 years of solid gains and maybe we’re not going to be able to sustain those gains for the next few years — and we’ll come back to a normal market in a sense.”



Inflation: Alvin Wilkinson says market uncertainty is expected to drag on for another couple of years

Picture: Alan Pryke

Private equity deals forced to slim down

Michael Sainsbury

AUSTRALIA'S debt markets remain open for private equity deals of up to \$1.5 billion, but last year's media mega-deals by James Packer and Kerry Stokes dwarf anything that could now be executed in the global financial markets.

Senior players in Australia's leveraged buyout sector say they do not believe that debt markets could digest deals of that size — \$3.5 billion to \$4 billion — until 2009, and then only if there are

Debt markets can't digest mega-deals like those by Packer and Stokes last year

no more market shocks. Some 58 banks were involved in the PBL Media deal to raise \$3.6 billion in debt. Under the contract, 50 per cent of the media assets of Mr Packer's Publishing and Broadcasting were sold to CVC Asia Pacific.

Credit Suisse director Lyndon Hsu estimated that at least \$1 billion of that capacity had gone

from the market, as banks scaled down their exposure. Some, including a number of Chinese banks, had withdrawn altogether.

The world's debt market continues to suffer a heavy bout of indigestion, with about \$US350 billion (\$397 billion) of North American and €75 billion (\$120 billion) of European deals, all already struck, now awaiting syn-

dition. But Mr Hsu said there were some promising signs emerging, with \$US5 billion in debt from the \$US24 billion buyout of American financial services group First Data by Kohlberg Kravis Roberts, at a discount of 4 per cent, being oversubscribed by \$US3 billion in the past week.

Still, estimates of when the debt will be syndicated — farmed out for a margin to other lenders — now range into the second half of next year. The cost of senior and mezza-

nine debt has risen and the multiples of earnings that banks are prepared to fund have dropped from 7.5 times by about 1 point, the annual Australian Venture Capital Association (AVCAL) conference at the Gold Coast was told.

But last week's deal by Pacific Equity Partners to buy Hoyts for \$440 million was a sign that mid-market deals in Australia can be funded, even if offshore debt markets remain closed.

AVCAL chairman David Jones estimated that local banks could

fund deals worth up to \$1.5 billion. BOS Capital chief Michael Johnston said there were still plenty of deals possible in the mid-market — the \$250 million-\$400 million range.

PEP managing director Rob Koczar said one of the biggest changes to emerge was that no single bank would now underwrite a deal.

"It's not just about the size — no-one wants to go out on their own," he said. Mr Hsu said: "Our approach

would be to underwrite with at least one other bank."

One session at the conference — spurred by failures such as the Qantas sale — dealt with the sector's poor image as an asset-stripping, cost-cutting, financial-engineering investor class, admitting it had failed to communicate its strategies and the benefits to target companies and the broader community.

"Get some of the people who have been involved in restructuring enterprises to tell the story from the inside," Mr Jones said.

MacBank in \$167m Canadian purchase

Katherine Jimenez Banking

MACQUARIE Group is to buy boutique North American investment bank Orion Financial for \$167 million, saying the deal will cement its position in Canada.

Orion is an independent Canadian dealer focused primarily on the resources sector. "Our objectives in acquiring Orion are, firstly, to round out our global resources investment banking business and, secondly, to extract maximum advantage from combining their successful Canadian operations in equity underwriting, sales, trading and research with the scale and global reach of Macquarie Securities," Macquarie global investment banking head Nicholas Moore said.

News of the deal saw Macquarie's share price surge 4.4 per cent or \$3.53 to \$83.80.

Orion will be merged with Macquarie's investment banking services. Macquarie said this "will create a leading investment banking and securities franchise in Canada".

Orion's primary activity is in merger and acquisitions advisory, equity underwriting and research, sales and training. It had a pre-tax income of \$C41 million (\$46.5 million) in the year to March 31, 2007.

Over time, Mr Moore said, the enlarged Macquarie Capital Markets Canada "will expand its product offering to complement our existing activities in infrastructure, utilities and resources".

Under the agreement, Macquarie will issue 1.6595 million exchangeable shares to Orion, with those shares to be held in escrow and released over five years. Upon release they will be exchangeable on a one-for-one basis with MBL shares at any time up to 10 years, subject to certain conditions.

A cash payment of \$C30 million will be made upon completion of the deal — expected to be by the end of 2007.

Macquarie's investment banking executive director in Australia, Peter Donnelly, will move to Toronto to head the enlarged business.

Orion's senior management team will remain with the business and key Orion employees

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Picture: Alan Pryke

Agencies under scrutiny

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The agencies came under fire from senior politicians, including Senator Jim Bunning, a Republican from Kentucky, who described the ratings process as "like a movie studio paying a critic to review a movie and then using a quote from his review in the commercials".

Moody's and S&P strenuously defended their actions. Vickie Tillman, executive vice-president of credit market services at S&P, said: "There is no evidence, none at all, to support Mr Bunning's contention."

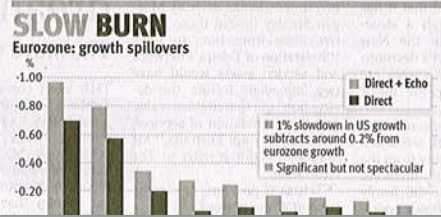
Ms Tillman defended the practice of working with companies when rating their securities, even in

Share investors 'yet to feel pain'

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"It's much more disintermediated. You could lean on the banks in 1987 to lend to the brokers. That world is gone ... it's much more international and if the markets decide to have a strike, you can't stop them."

"If the banks in 1987 decided to have a strike and not supply credit you could go to them and say 'we want you to do it, whatever you want, we can do it



Basis Capital's Aust-Rim fund loses half its value

From Page 23

The Basis Yield fund sought bankruptcy protection last month when it could not prevent creditor banks from selling assets at fire sale prices.

But when asked if there was a fundamental flaw in CDOs, a charge levelled by some because of their opacity and the difficulty of assessing the risks involved, Mr Howell said: "You can't

credit markets came in late June, when two hedge funds managed by US bank Bear Stearns collapsed.

Mr Fowler said they were conscious of the pain investors in Basis were suffering, noting that they and their staff also had money in the funds. "It's just been very tough," Mr Fowler said. "Our duty right now is to our investors, which is first and foremost in our minds."

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