

## [2007-12-28] The Hedge Fund Misnomer or 'What have they done to our 'hedge'?'

The small Jewish metalocrat sat across the table looking out over the panorama of the Mont Blanc range of mountains from his eyrie in Crans Montana and turned to my father and said 'So, I have copper cathode coming out of Zambia. How will you hedge it for me?'

The year was 1967, and the interviewer was Mr Henry J. Leir, a man who had written his 'Mein Kampf' of the metal trade about a decade after Adolf scribbled his – and later put his plan into action with something of the same unbending purpose. His company was Continental Ore, then a mighty name only to be rivaled amongst trading houses forty years ago by the name of Philipp Brothers.

This was the period of the Vietnam War, a time when metal people spoke of Nickel in awed tones as a metal of the future. It was also about to be the nemesis of both its main producer, International Nickel Company (Inco) and one of its leading consumers, Rolls Royce aero engines. The latter finding itself vulnerable to a lack of Nickel caused by the force majeure of the former.

There was nowhere to hedge of course, as there was no LME Nickel contract. The producer had maintained its producer price and an arrogant disregard of the free market while Rolls-Royce was content to believe its only hedge was the signing of a purchase order. In fact it was Inco's failure to deliver, which led directly to the inception of the LME contract 12 years later.

So, as Mr Leir swiveled in his chair and gazed across at the silhouette of snow-capped peaks that looked rather like the graph of his incredible wealth, my father considered his reply.

'With respect, Mr Leir,' he said, 'I would not hedge copper cathodes on a wirebar contract'.

A fine point, you might say, but in those days only wirebars (copper suitable for drawing wire) and not cathodes were the LME deliverable standard. The issue, my father argued, was all about the definition of a hedge. To him, the LME provided a forward market for a product that was the very same as your physical. The nature of the off-set or 'hedge' was price and time, it was not energy costs, currency or some other hedge-fund fantasy. The flaw my father was pointing to, was the fact that it was entirely conceivable that the wirebar/cathode spread could easily move in opposite directions. Today, this would be regarded as hair-splitting and yet upon such pedantry the London Metal Exchange was, dare I say it, responsibly run - a financial instrument to reduce risk not a vehicle with which to expand it.

My father got the job and ran the LME section of Continental Ore from Grafton Street in Mayfair for a number of years. I believe he would never have understood what non-metal people appear to regard as a hedge today. Indeed, perhaps some of those hedge-fund managers, whose glister has been somewhat tarnished in recent days, could do worse than attend an LME trading course on what metal people regard as 'hedging' before getting trapped in the web of their misnomer.' I wish they would just give us our word back!