Twitter Thread by Tar ■

Tar ■
@itsTarH

It's the weekend!

Grab a cup of coffee, in this thread we will explore

1. What is risk management?
2. What is position sizing?
3. How to apply both these concepts to reduce volatility and drawdowns in your portfolio?

Lets dive right in.



What does losing $20 Billion in 24 hours and A Bank being sold for less than $1, have in common?

The answer is Risk Management.

Through this thread we will explore 2 stories - Stories that will teach us the importance of risk management and position sizing in a portfolio.

These stories will show you that no matter

How Rich You Are
How Respected You Are
How Educated You Are

Improper risk management will blow up your portfolio and most likely bankrupt you.

Our first story is the story of Bill Hwang and the saga of Archegos Capital Management.

ARCHEGOS
CAPITAL MANAGEMENT

Bill Hwang was a somewhat a prodigy in finance and one of the wealthiest individual in US with a net worth of $20 Billion.



Bill Hwang had a modest upbringing, his family immigrated to the US from South Korea in 1980s. Soon after immigrating to US, his father passed away and Bill Hwang took up the night shift at a local McDonalds to help feed his family.

From these modest roots, Bill Hwang climbed up the ladder of finance and became one the most revered fund managers at Tiger Management started by the legendary hedge fund manager Julian Robertson.



Bill Hwang had to eventually shut down his hedge fund called Tiger Asia and from the proceeds of that fund he started his family office called Archegos Capital Management.



At Archegos, Bill Hwang turned $200 Million of his own money into $20 Billion in under 7 years.

Despite this wealth, Bill Hwang lived a modest living. He had a single house in suburban New Jersey and drive a Hyundai SUV.

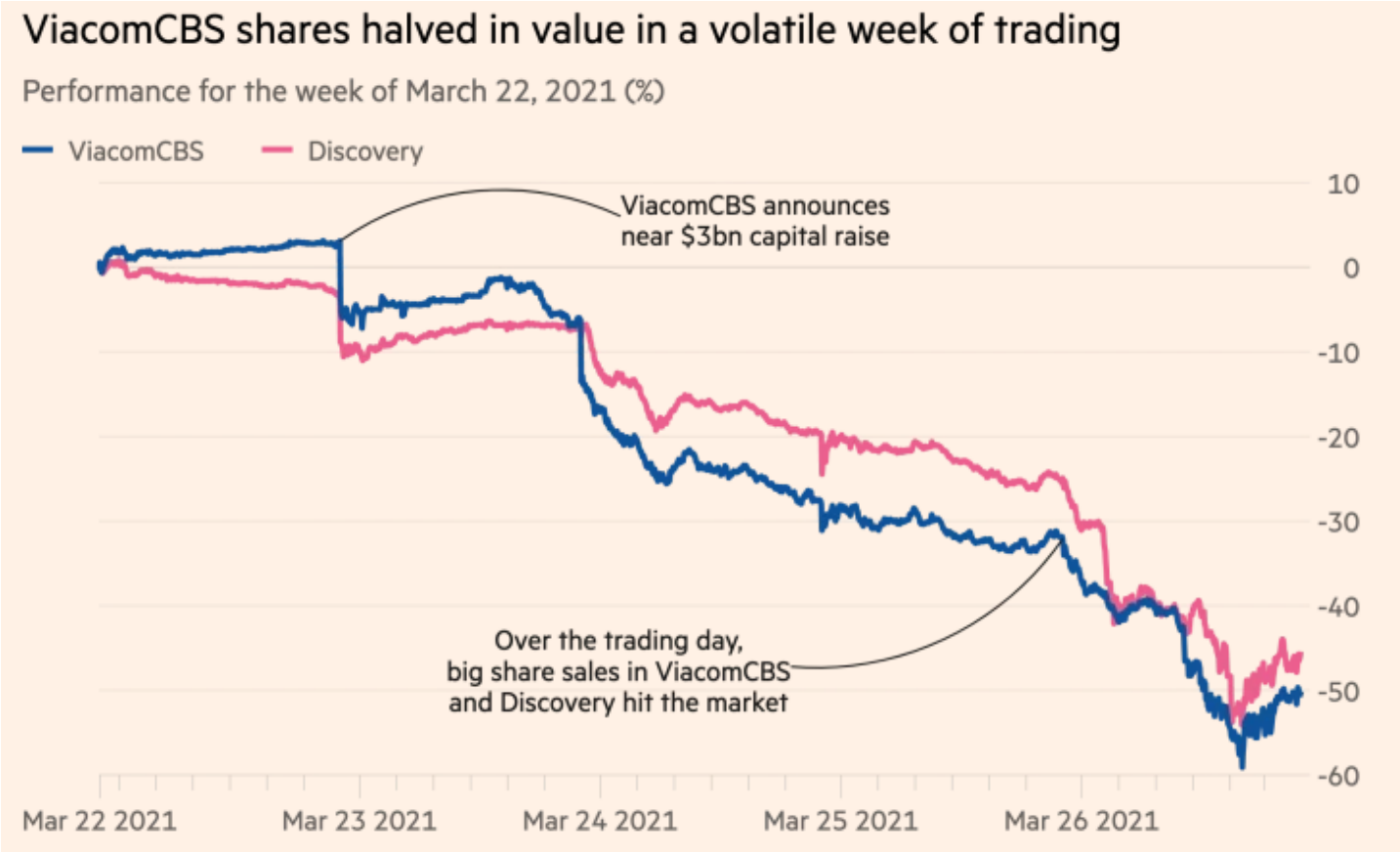
No luxury houses and cars for him.

March 22, 2021

Viacom CBS announces a stock and convertible bond sale after market closes for that day.

Viacom wanted to raise money and for what so ever reason, market didn't like this new stock and bond sale from Viacom.

That week, Viacom CBS shares would lose 60% of its value.

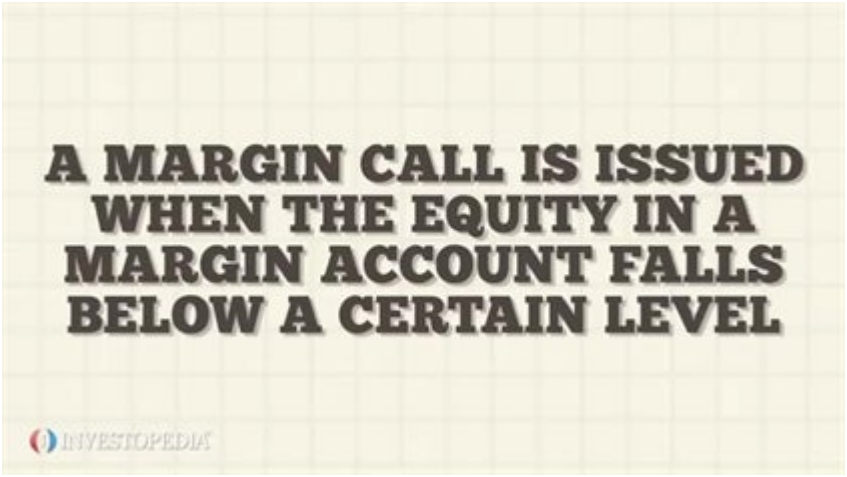


And Bill Hwang would lose $20 Billion.

Why did Bill Hwang lose all his wealth with the drop of a single stock?

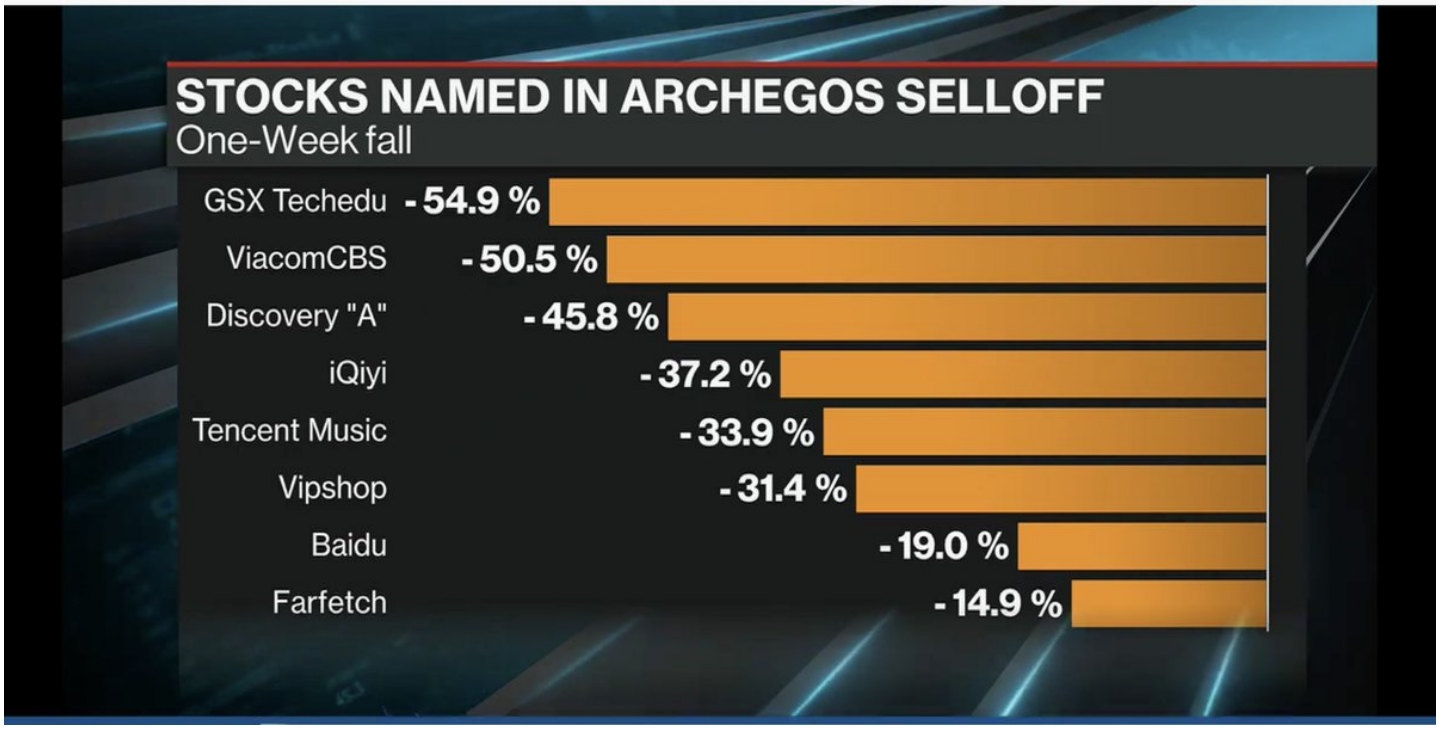
Cause, Bill Hwang was levered massively. He used a financial instrument called a total return swap (which is a type of OTC derivative) to leverage all his positions.

A simple 10% fall in any of his stocks was enough to trigger a margin call.



A margin call on one or two of his positions would have been fine, Bill would simply sell some of his other holdings to pay for the margin.

But, see as soon as the street realized that Archegos wasn't immediately able to pay for the margin call on Viacom shares, his other positions started to tank as well.



Bill had bought these Total Return Swaps with almost all the banks on Wall Street, if Bill wasn't able to fund his margin calls, these banks would be forced to liquidate his holdings and incur losses.



As these holdings were very large, the first bank to liquidate would be hurt the least.

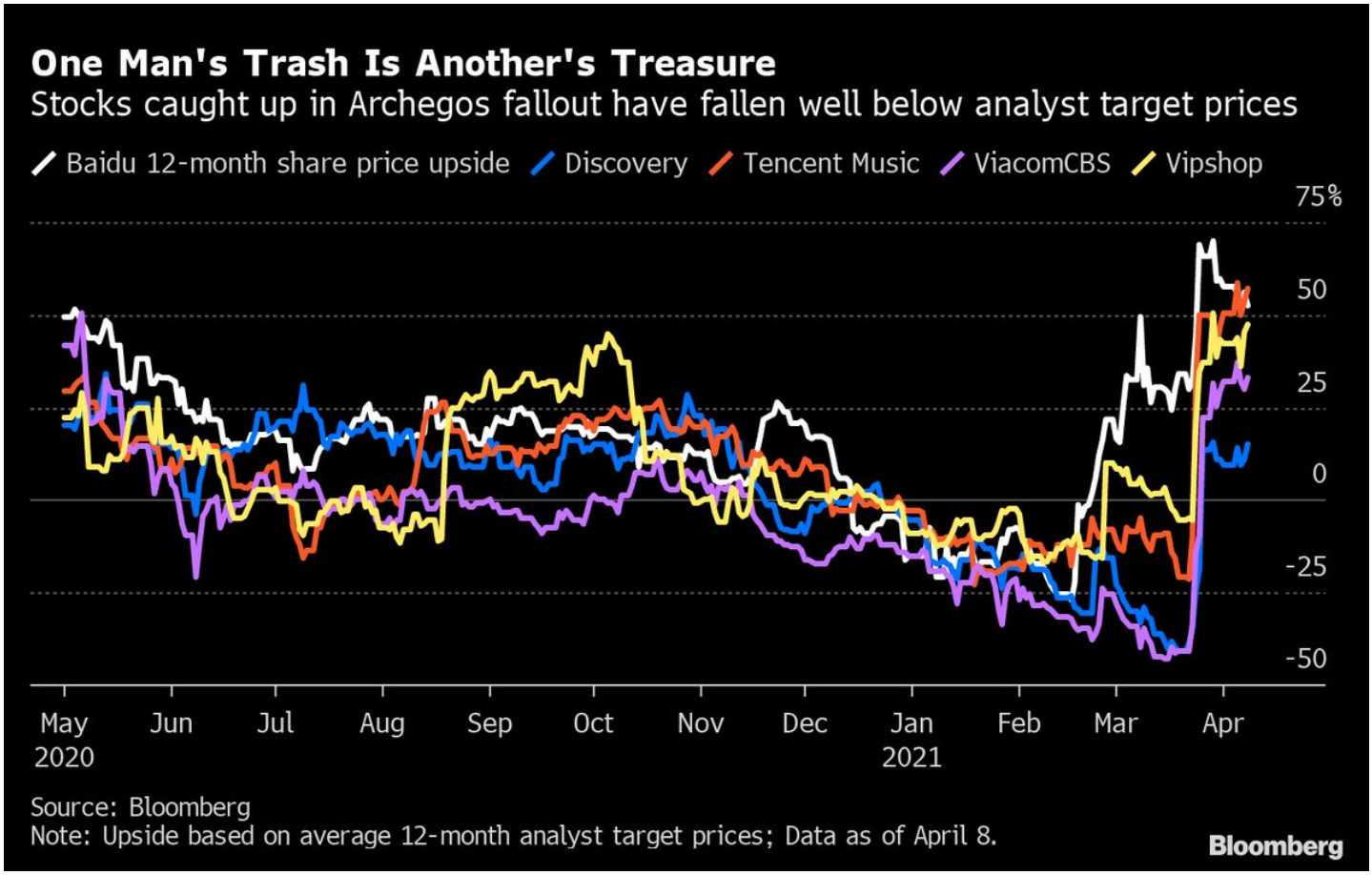
Goldman Sachs was the first one to dump these holdings, Credit Suisse was the last.

Goldman escaped unscathed by this entire mess while Credit Suisse took one the biggest losses in their entire history.

As for Bill Hwang he lost it all, in matter of 24 hours.

$20 Billion, his life's earnings, all gone, poof, zero, zlich, nada!

The sad part is, all of Bill's stock holdings recovered most of their losses the next week, but because Bill was levered his portfolio didn't survive to see that day.

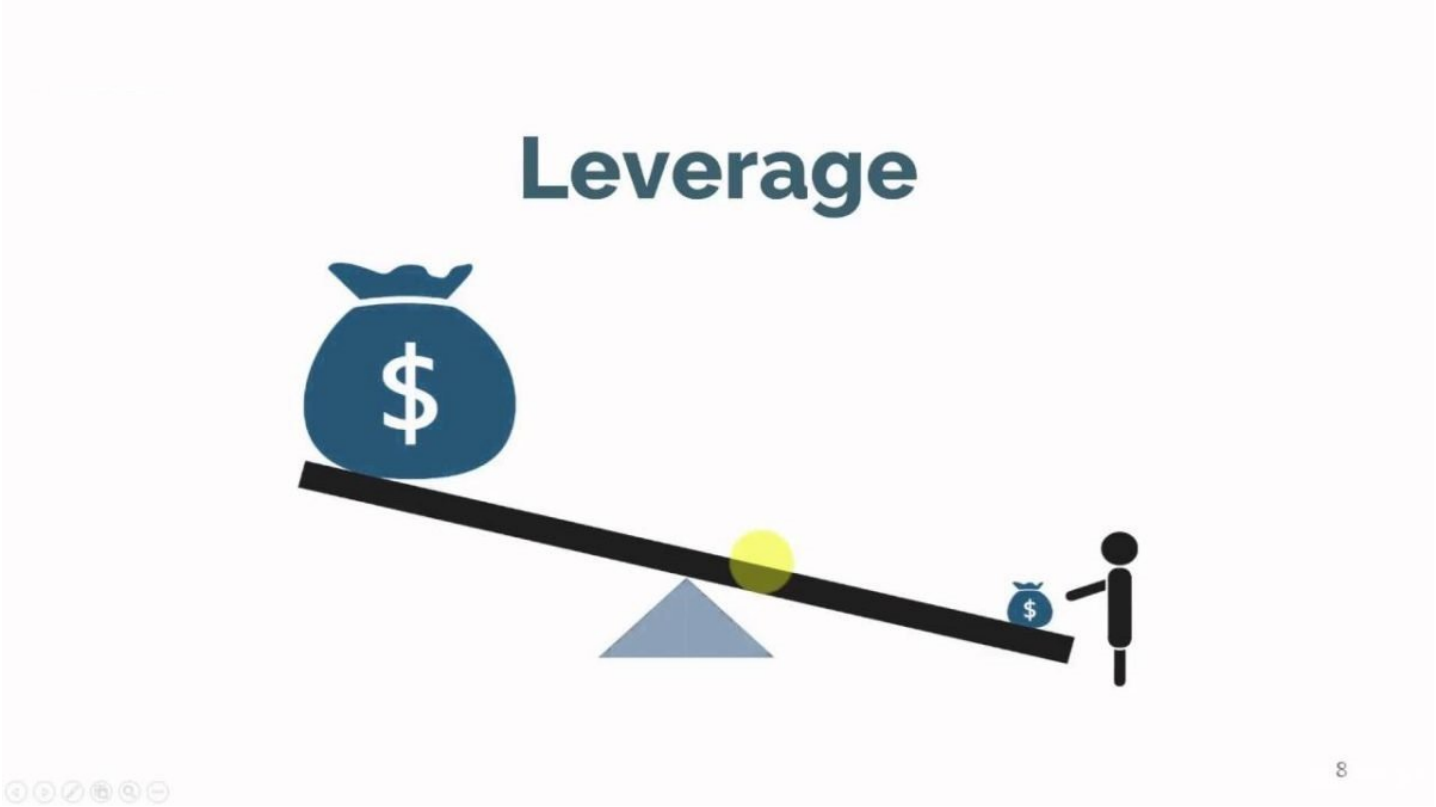


Lesson #1

Never take on leverage and never invest with borrowed money

Borrowed money is like the grim reaper that is waiting to kill your portfolio at the first instance

If a prodigy like Bill Hwang wasn't able to survive with leverage, why would you?



Had Bill hadn't leveraged himself, he would have survived and recovered most of his losses.

Bill was actually given the option by his banks to liquidate half his holdings and pay for the margin call. ~$10 Billion

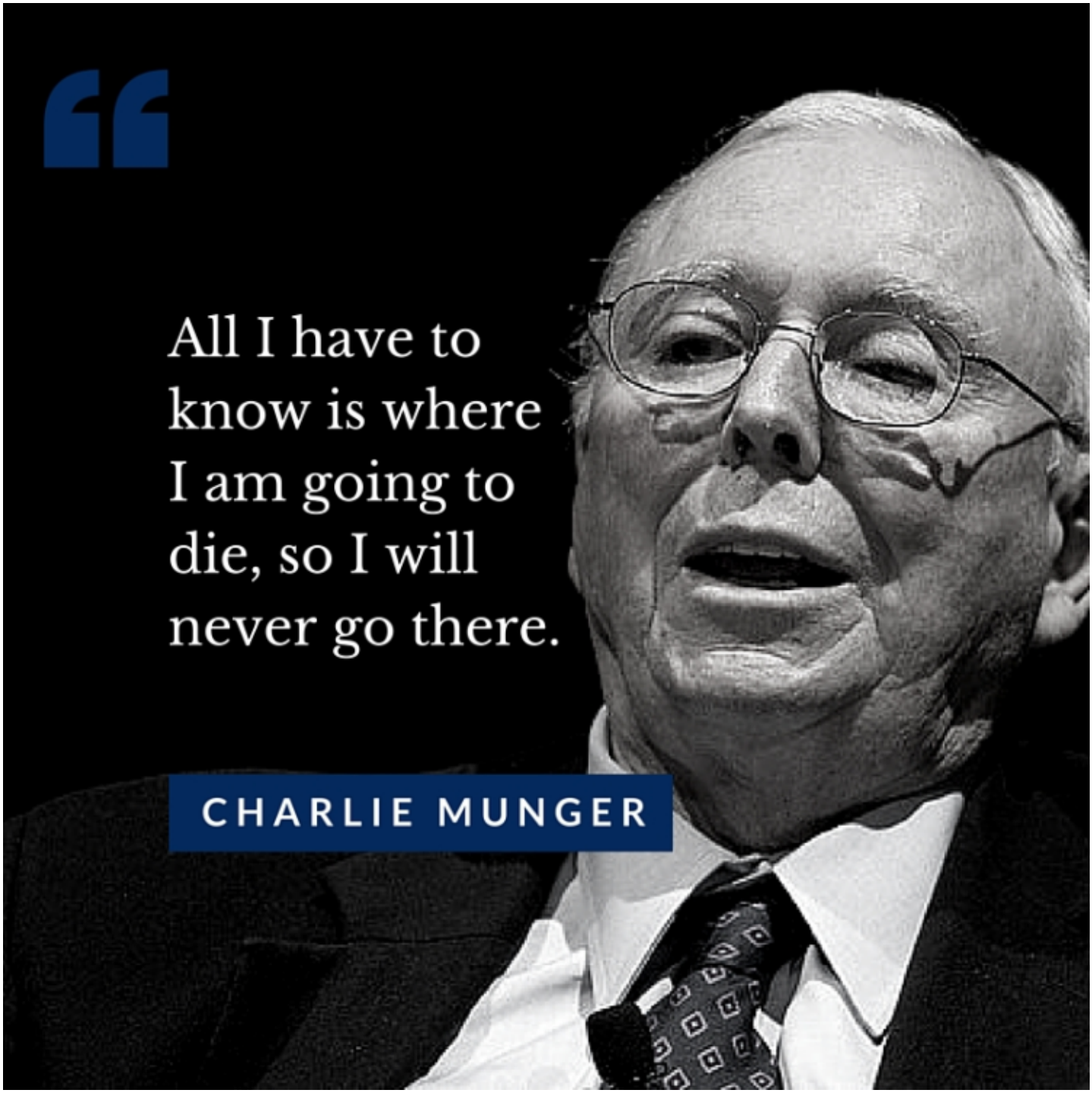
After paying for the call, he would still be left with ~$10 Billion and live to survive another day.

Bill Hwang didn't agree to that.

Lesson #2

Be willing to take a loss.

No investment is without risk and knowing the risks in an investment will help you minimize losses if things go south.



Our second story highlights this lesson.

Barings Bank was one of the oldest bank in UK. At its prime, the Queen of England had an account there.

It was founded in 1762 and almost 233 years later in 1995, the Bank would be bought by ING for less than $1.

BARINGS

Barings hired a trader called Nick Leeson and Lesson single handedly bought the entire institution down.



FINANCIAL

MONDAY FEBRUARY 27 1995

Bank of England set to provide liquidity to system ■ Singapore trader

Barings forced to cease trading

Countdown to collapse

- **Early February:** Barings derivatives trader in Singapore takes a huge gamble in futures contracts on movements in the Nikkei 225 index.
- **Mid-February:** Trader agrees further derivative contracts to provide cash for losses he is sustaining as index falls.
- **Thursday, Feb 23.** Barings fails to roll over derivative contracts in Asia. Bank's senior executives in London are told that the contracts expose it to catastrophic losses.
- **Friday, Feb 24:** Barings advises Bank of England of its plight.
- **Saturday and Sunday, Feb 25 and 26.** Bank of England meets executives of leading UK clearing and merchant banks to agree a rescue package before Asia- Pacific markets open today.

By John Gapper and James Blitz

Barings, the UK's oldest merchant banking group, was last night placed in administration owing more than £500m on financial derivatives contracts after the Bank of England failed to organise a rescue by other banks. Mr Kenneth Clarke, the chancellor, is to make a statement in the House of Commons today on what is the most serious crisis to face the London markets since the rescue of Johnson Matthey Bankers a decade ago.

The decision to allow Barings to stop trading came after Mr Eddie George, the Bank of England's governor, spent the weekend in talks with senior executives from UK and foreign banks to find a buyer for the bank, which employs 4,000 peo-

Bank of England governor Eddie George (front) and Rupert Pennant-Rea, deputy governor, leave talks at Barings yeste

Nick Leeson took on speculative trades in Japan's Nikkei's index during the Japanese market boom.

Leeson used to bet if the index would go up or down and if it moved in the direction he was betting he would make money.



Initially this worked and Leeson made a lot of money for the bank. The bank in return gave him a free leash and he was allowed to take as many trades irrespective of how speculative they were.

Just like with any bet that has 50:50 odds, these bets soon turned sour and Nick had to book losses.

Instead of stopping there Nick tried to recover these losses by hiding them from the Banks books and taking even larger bets in hopes that they would recover all the losses.

Nick would have maybe succeed too, had it not been for an earthquake in Japan that cause Nikkei to report one of the biggest single day falls.

Kobe Earthquake of 1995 was one of the most intense in Japan. While building his positions Leeson would have never imagined that an earthquake could occur and wipe his entire position and bring down his employer.



Los Angeles Times

WEDNESDAY, JANUARY 18, 1995

Kobe Paralyzed; Toll Hits 2,014

120,000 Seek Refuge, 1,058 Missing in Quake

Citron Says He Did Not Calculate Risks

■ **Orange County:** Apologizing for crisis, he tells Senate panel he relied too much on professional advice. But Merrill broker says ex-treasurer called the shots.

By ERIC BAILEY, MARK PLATTE and JODI WILGOREN, TIMES STAFF WRITERS

SACRAMENTO—Portraying himself as an unsophisticated financial neophyte who relied too heavily on the advice of others, former Orange County Treasurer Robert L. Citron offered a public apology Tuesday before a special state Senate committee, declaring that the county's financial crisis is a burden he will carry "the rest of my life."

Citron—at times appearing nervous and hesitant but defending his performance over 24 years in office—said he had no contingency plan to handle the sort of investment meltdown that prompted the county to file for bankruptcy protection last month. Indeed, Citron asserted that he never had analyzed what would happen if interest rates rose or investors pulled their money out of the county's investment fund.

"I was so sure of what I was doing based upon the many years of success," Citron, 68, told the members of the Senate's Special Committee on Local Government Investments. "In retrospect, I find that I was not the sophisticated treasurer I thought I was."

Citron joined a parade of elected leaders, investors, auditors and brokers in the witness chair—almost all of whom sought to shift

Robert L. Citron during hearing

■ LAYOFFS HALTED
Judge temporarily bans layoffs of government workers. A15

Rams Score Big

■ **Japan:** Aftershocks and fires continue in port city where roads, rail lines and utilities are ruptured. Assurances about safety of modern construction technology are shattered.

By SAM JAMESON, TIMES STAFF WRITER

TOKYO—The western port city of Kobe remained virtually paralyzed today in the wake of the 7.2-magnitude earthquake that killed more than 2,000 people, sent as many as 120,000 seeking refuge and laid waste to assurances that modern construction technology protects city dwellers in Japan from major seismic damage.

In what Prime Minister Tomiichi Murayama called Japan's most devastating tremor since the Great Tokyo Earthquake of 1923, police today put the death toll at 2,014, with 1,058 missing and 11,377 injured. Most of the dead perished in their homes as the quake struck shortly before dawn Tuesday.

Hundreds of aftershocks continued all day Tuesday and into the morning. Injuries were reported in 13 prefectures, or states.

Railway, water, gas, telephone and electricity lines were ruptured. Damaged tollways were also closed, and roads leading into the disaster area were clogged with

■ RELATED STORIES
A8, B1, D1, D4

traffic or closed off by police. More than 120,000 people sought shelter overnight in taxis, parks, public buildings and unheated school gymnasiums as the temperature dropped below freezing.

Early today, authorities drove

Lesson #3

You don't know, what you don't know.

If you're working with leverage and borrowed ideas then anything can wipe you out.

Your task as an investor is to be fully aware of every risk that the investment has.

The probability of some risks maybe higher than others but there is no investment with zero risk.

In each of these stories, the protagonist had made some common errors.

- They used excessive leverage
- They didn't know how to take a loss
- They threw risk management out the door
- Their positions didn't reflect the proper risk return ratio

Other than not taking any leverage, position sizing is extremely important in managing risk within a portfolio.

Here is an example of how I size my positions.

The three factors that I consider are

1. Margin of Safety
2. Depth of Research
3. Longevity of Earnings

Position Sizing

Valuation or Margin of Safety	Conviction or Depth of Research	Longevity or Runway for Growth	Allocation or Position Size
High	High	High	High
High	High	Medium	Medium
Low	High	Low	No Allocation

Only when an opportunity checks of all three boxes is when I try to take a position in.

If my depth of research and longevity of earnings in a position is high then I will start with a small allocation and allocate big if margin of safety increases.

Risk comes from not knowing what you own and not from concentrating into positions you own.

Diversifying into 50 stocks will not eliminate the risk from your portfolio.

Knowing majority of risks of all 10 stocks you own will certainly help you manage it.

Look at the positions you own, determine their margin of safety, be honest with yourself about your depth of research and determine the longevity of earnings for these businesses.

You will get your answer on how much to allocate.

With this, we come to an end of this thread.
I hope this helped you understand what not to do and how to size positions in your portfolio.

If you find this thread useful then follow me
@itsTarH

I write a new thread every weekend.

All my previous work, can be found here.
https://t.co/az1Rsw05TO

> All my Threads so far \U0001f9f5 \U0001f447\U0001f3fc
>
> — Tar \u26a1 (@itsTarH) June 5, 2021

I also teach a class on Personal Finance, if you're interested.

Sign up using the link below to get free 30 days access to it.

https://t.co/NWZOPx8dvW

https://t.co/r7uNYuqjsn

Also, write and publish long from articles on my substack (https://t.co/pOJSMEyzOn)

Subscribe for free, if you're interested.

Thank you to the 2000+ of you who already have!

Here is a recent deep dive I wrote on PolicyBazaar.
https://t.co/w14k2xE0fQ

If you want to know more about Archegos and Barnings Bank, here are two great videos that will help you learn.

Archegos Capital Management
https://t.co/XwPpgIV60D

Barings Bank
https://t.co/rSkzSCNvJj

Thank you for reading, please retweet the first tweet in this thread for a broader reach.

See you all next weekend!