Billionaire Investor Runs For Cover!

SYNOPSIS

- George Soros is a legendary investor and philanthropist who made billions betting against key financial markets at just the right time.
- The financial media loves to follow Mr. Soros and his recommendations, and many bad actors repeat the same story every year.
- With all due respect to Mr. Soros, these stories should be taken with a grain of salt.

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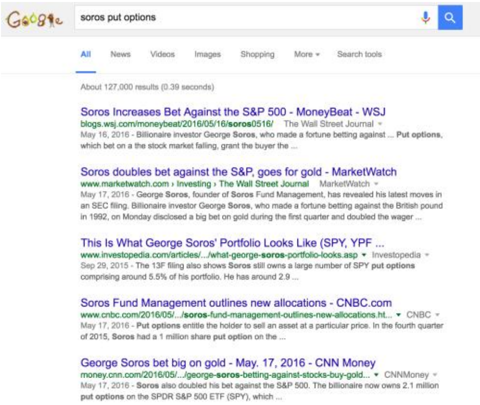
The “Soros Put”

George Soros is one of the most well-known, respected and closely followed investors of all time. Mr. Soros achieved much of his fame and notoriety by making a huge bet against the British pound over 20 years ago. He believed that the value of the currency would fall dramatically and netted over a billion dollars on that single trade.

Since then, he has amassed a fortune estimated to exceed $30 billion and now spends most of his time as a philanthropist. However, he still remains invested in markets and is frequently outspoken about his concerns in various economies.

One such story that the financial media just cannot let go is the story of Mr. Soros buying “put options” as a way to profit from an imminent fall in the U.S. stock market. This story and others that point to him being bearish have made headlines consistently over the last four years.

In fact, here’s a snapshot of the most recent wave of media coverage from nothing more than a simple Google search:



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Soros Increases Bet Against the S&P 500 - MoneyBeat - WSJ
blogs.wsj.com/moneybeat/2016/05/16/soros0516/ The Wall Street Journal
May 16, 2016 - Billionaire investor George Soros, who made a fortune betting against ... Put options, which bet on a the stock market falling, grant the buyer the ...

Soros doubles bet against the S&P, goes for gold - MarketWatch
www.marketwatch.com › Investing › The Wall Street Journal MarketWatch
May 17, 2016 - George Soros, founder of Soros Fund Management, has revealed his latest moves in an SEC filing. Billionaire investor George Soros, who made a fortune betting against the British pound in 1992, on Monday disclosed a big bet on gold during the first quarter and doubled the wager ...

This Is What George Soros' Portfolio Looks Like (SPY, YPF ...
www.investopedia.com/articles/.../what-george-soros-portfolio-looks.asp Investopedia
Sep 29, 2015 - The 13F filing also shows Soros still owns a large number of SPY put options comprising around 5.5% of his portfolio. He has around 2.9 ...

Soros Fund Management outlines new allocations - CNBC.com
www.cnbc.com/2016/05/.../soros-fund-management-outlines-new-allocations.ht... CNBC
May 17, 2016 - Put options entitle the holder to sell an asset at a particular price. In the fourth quarter of 2015, Soros had a 1 million share put option on the ...

George Soros bet big on gold - May. 17, 2016 - CNN Money
money.cnn.com/2016/05/.../george-soros-betting-against-stocks-buy-gold... CNNMoney
May 17, 2016 - Soros also doubled his bet against the S&P 500. The billionaire now owns 2.1 million put options on the SPDR S&P 500 ETF (SPY), which ...

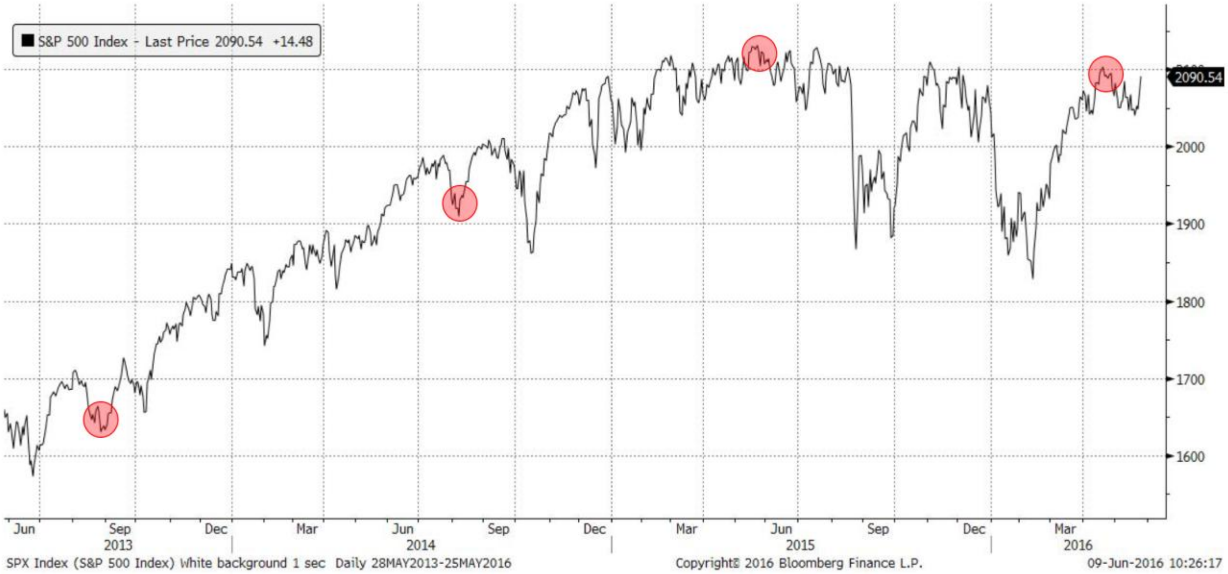
Source: https://www.google.com/search?q=soros+put+options

The mechanics of put options are complicated and can get very technical very fast. Just know that if an investor buys a put option, it is a bet that the price of an investment will fall in a specific amount of time.

For example, if I believed that Apple's stock is too expensive and expect it to fall more than 10% by the end of the year, I could buy a put option on the stock that makes money if I am right on both the amount and the timing. Options can make investors huge amounts of money, but they are also extremely risky and should only be used by experienced professionals.

Anyone who becomes a billionaire on one bearish call will most certainly create a loyal following, so when Mr. Soros buys puts, investors want to know the story. Here's where the financial media takes its cue and publishes countless articles about the "Soros Put."

I recently encountered an excellent post on a financial blog called Price Action Lab, written by Michael Harris, about this phenomenon. I recreated one of his charts below.



Source: Bloomberg, Aviance Capital analysis

This is a chart of the S&P 500 performance since early 2013, and the red circles indicate times where the Soros Put story ran wild in financial media.

The problem with this story is that it is plagued with so many fallacies and inconsistencies that it's tough to decide which of them are the most egregious. However, there are three notable issues worth further discussion.

The first issue is that none of the data can be supported from the actual filings. Large investment firms are required to disclose their holdings every quarter to the Securities and Exchange Commission (SEC), but this data is often useless due to the lag time from when the trade was executed. In many cases, data on holdings can be up to 45 days old.

It's certainly possible that Mr. Soros could have only had the position on for a few days and removed it shortly thereafter. There is just no way to know for sure when the position was held and for how long.

The second issue is that he does not have to disclose any information on why he owned put options, so we don't know how or why Mr. Soros used them. This is a really big deal.

Often times professional money managers will use put options as a form of insurance on a portfolio. To understand the concept more clearly, let's revisit our example on Apple's stock. Even if I was a believer in the company over the next several years, there may be risks that occasionally surface that warrant attention.

An example could be a competitor release of a new cell phone that poses risk to Apple's iPhone sales. If I assume the likelihood of such an outcome to be very improbable, say less than a 10% chance, I would not necessarily want to sell the stock. Instead, I may just want to look for a cheap way to protect in the event that it does take share away from Apple.

In this scenario, I could buy put options as a form of insurance. Since the value of a put option rises if the stock price falls over a specified time period, these instruments are very frequently used `by professional money managers as a tool to protect against the downside.

Think about how and why drivers use car insurance. They pay an annual premium that is a fraction of the sticker price to protect them against the unlikely but possible outcome of totaling their automobile. If nothing happens to the car over the life of the insurance contract, the policyholder is only out the cost of the premium.

The same concept applies to using put options as a form of "portfolio insurance." When used properly, a put option can make an investor whole if something really bad happens to an investment.

This is a very common practice for professional investors as a way to manage risk in a portfolio. Hence, we don't know if Mr. Soros is actually bearish or just using puts as a form of insurance.

We also don't know the "deductible" on his insurance policy either. Put options have an embedded deductible in them, where they are worthless unless the price of an investment falls past a specific threshold.

Going back to Apple for a moment, if the stock is trading at $100, and I buy a $90 put option, the value of my insurance contract is worthless until after Apple's stock falls below $90. The same concept applies with car insurance. If a driver has a $5,000 deductible, then the policy does not kick in until the damages exceed $5,000.

The size of deductible says a lot about the motivations of an investor, and we just have no way of knowing whether Mr. Soros felt that a decline in the stock market was improbable or imminent.

Mr. Soros may just want to protect against a catastrophic event by using put options as a form of high deductible insurance. For example, I pay for homeowner's insurance each year to cover the value of my assets in the event of a fire, flood, asteroid, etc. It's a relatively small premium each year that covers a much larger asset base.

However, I don't buy homeowner's insurance each year because I expect bad things to happen. In fact, I am almost sure that the money I spend on homeowner's insurance will go to waste, but it's not worth the risk of being wrong and having to buy all new clothes, electronic equipment, etc. Mr. Soros could be thinking the same way, and his logic may be that paying a small premium for protection against a catastrophic event is worth the peace of mind.

NOTE*: Investors may be asking why they aren't using portfolio insurance, but keep in mind that very few people in this world share similar investment objectives of billionaires who spent decades managing huge amounts of money. These strategies don't always apply to everyone.*

The third big issue with these Soros Put stories is that they make Mr. Soros look really bad. If we were to ignore my first two grievances and assume that these articles accurately portray his bearish views on the market, then take another look at the chart of the S&P 500 above to see just how wrong he has been for four straight years. Under this pretext, he would have wasted millions of dollars betting against the stock market.

If this is the case, why would any investor follow someone who has been so wrong, so often? Why wouldn't the story be more about why Mr. Soros is "at it again" and instead attack his track record? The media loves to go after billionaire hedge fund managers who lose money, yet they seem to be giving him a hall pass, and it's safe to say that hall passes from the media are incredibly rare.

The answer lies within one of the pillars of economic theory, which states that we are all "self-interested." The fact that we tend to do what is best for us is at the heart of the incentive structure that guides our decision making.

Financial media is not in business to cure starvation, disease, or elicit any other outcome for the greater good of humanity. They are for-profit institutions that exist to make money, and they do so by charging companies to advertise on their television shows, magazines, and websites.

The more eyeballs they attract, the more money they make from advertisers. It's just that simple, and what better way to attract readers than with headlines that look like this:

> *"Billionaire hedge fund manager who's practically a household name is protecting against another 2008-style crash!!!"*

I can't say for sure if they know that the data they use to report this garbage is inaccurate, but I'm pretty sure they don't care. They are not in business to help investors make money, so the only wallet they care to see grow is their own.

Lastly, in no way am I attempting to be critical of Mr. Soros or question his investment acumen. His track record has cemented him as one of the most brilliant investors of all time, and I regard him as nothing less than a genius.

My goal is to expose the incentives behind many of the bad actors that plague financial media. Always remember to be careful what you read on the internet, and be sure to take stories like the Soros Put with a grain of salt.

NOTE*: Those interested in the story of how Mr. Soros brought the Bank of England to its knees and practically demolishing Britain's monetary system in a single day are strongly encouraged to read this well-written summary: http://priceonomics.com/the-trade-of-the-century-when-george-soros-broke/*

Sincerely,

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