2006 Job Forecast Reality Check

By Kathleen A. Graham, Principal, HQ Search, Inc.

Every year a multitude of forecasts on a variety of different subjects are issued. For the last four years, I have joined the throngs by giving an annual financial services job forecast at the December meeting of the Chicago chapter of QWAFAFEW (an informal organization of quantitatively oriented professionals in various aspects of financial services). What is different about my forecast is that it begins with a review of predictions versus the reality of that year. Thankfully, for the first three years these annual job forecasts have been 100% accurate. This article's focus will be to review that forecast's opines for the hedge fund industry and compare those estimates with first quarter 2006 reality.

2006	JOB FORECAST SUMMARY
SECTOR	**FORECAST**
Hedge Funds	Growth Areas: • Accounting/Compliance • Risk Management • Commodities • Almost all financial positions
	Non-Growth Areas: • All positions at firms whose assumptions differ from real world. Source: 2006 Job Forecast; available at *www.hqsearch.com*

Two forecasts were made for the hedge fund industry based upon an analysis of the 2005 leading economic indicators for financial services positions. These indicators are fiscal and industry statistics; status of retained search recruiters; personal perceptions of people in the different sectors (or what I call "the word on the street"); and senior financial management's outlook.

Based upon the above input, the conclusion was that overall 2006 job growth in hedge funds will be good for almost all financial positions, and especially in the accounting/compliance, risk management and commodities sectors. The second prediction was that there would be enough hedge funds going "belly up" or "in the red" that individuals considering positions in this field really need to do their due diligence on the firm, especially their strategy, before accepting an offer.

This caution is issued because of three concerns – the issues of "group think/action;" the "double whammy" effect; and the "new markets" impact. Commanding a majority of the funds invested in the hedge fund sector, large multi-billion dollar hedge funds can own sizeable portions in whatever market "view" they've taken. The concern arises when a majority of these super-sized firms own the same perspective; i.e., are participating in a "group think/action." Even more of a concern is when this majority's viewpoint is the same as what the investment banking community's majority outlook is. Last year's GM situation remains a good example of what happens when both the investment banks and the hedge funds hold the same view: the concern becomes if everyone is selling/buying the same asset, whom do they sell to and at what type of discount?

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This year's "group think/action" could occur in many different ways; however, volatility was cited as one likely candidate in the 2006 Job Forecast. Many think that volatility is going to be low in 2006 while a few think it will be increasing significantly. When there's minimal diversity of opinion among investors in a field, the concern becomes how will liquidity be impacted if an event contrary to the held opinion occurs?

Do you remember when Enron, WorldCom, and a few other firms were "sliding south" fast? Some major banks with significant asset management practices received a "double whammy" from these events because the clients that they were lending to were the same ones that were in their investment portfolios, which led to a default loss on the loans and a capital markets loss on the major downgrading of these equities. This example highlights the "double whammy" concern that the 2006 Job Forecast names as the second reason for some hedge funds perhaps finding themselves on the wrong side of the market this year.

Overall 2006 job growth in hedge funds will be good for almost all financial positions, and especially in the accounting/compliance, risk management and commodities sectors.

One asset class that could be a cause of the "double whammy" effect is the derivatives area. Because the value of many synthetically created derivatives and CDOs designed to hedge risk actually far outweigh the total value of their underlying assets, there appears to be a number of portfolios containing this type of asset that investors aren't aware they're in. If a large adverse event occurs, a possible "double whammy" (i.e., you think that you've hedged your risk but instead your actions actually increased your risk again without protecting you against the event you wanted to hedge) could occur for a number of firms and hedge funds.

The last concern is with the "new markets" impact. Because so much liquidity was created in 2005 from low interest rates, financial innovations, global diversity, leverage, and corporations with free cash flow/net cash from recovering markets, cost-cutting and outsourcing; monies flowed heavily into hedge funds. However, many hedge funds were generating fairly low returns, especially given their fee structure, primarily because of low volatility. As a result, hedge funds trying to capture higher returns ventured/are venturing into
a wide range of other products, including insurance/re-insurance, middle market lending, motion pictures, private equity, rare coins, real estate, trade finance, and water.

These new forays are posited to be favorable in increasing market efficiency, such as the impact hedge funds are having on European corporations when they challenge entrenched management. However, the risk is that when companies expand into areas that aren't their core businesses, mistakes regarding risk and profit levels can be easily made. The two most common errors in the "new markets" impact are the "switching factor" and the "ignorance factor."

For instance, the time frame and objective for private equity (time frame: 3-5 years, objective: profit on sale) is different than for hedge funds historically (time frame: less than one year, objective: absolute return). It is not easy for many individuals to make the mental switches necessary to be successful under these different outlooks.

Added to this potential switching factor error is the "ignorance" factor, which is basically not knowing that you didn't know something of critical importance in the new field because it's of no impact in your current expertise area. With hedge funds investing in such a diverse product scope, the ignorance factor could become great enough even on its own to negatively impact some hedge funds. So although most hedge funds are predicted to offer good job growth potential, candidates with offers from hedge funds are encouraged to conduct extra due diligence so that they can hopefully avoid those firms who may be negatively influenced by the "new markets" impact.

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Comparing the 2006 Job Forecast predictions to reality, a review of news articles shows that indeed almost all financial positions with most hedge funds have been job growth areas as forecasted. Furthermore, because of the increasing regulation/scrutiny and reliance on institutional funds that usually demand more information, the largest job expansions have remained in the accounting/compliance and risk management sectors. As for the anticipated increase in commodities-related positions, that area too has continued to grow in the first quarter of 2006.

The only 2006 Job Forecast statement yet to be proven correct is its downside prediction for some hedge funds whose assumptions turned out to be different than real world scenarios. Although there are rumors of hedge funds taking sizeable hits on some of their views, at the writing of this article no trend has yet to emerge. Quite frankly, if the 2006 Job Forecast is not 100% accurate, it would be welcomed by all if this portion of the prediction were incorrect. ■

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