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36 South Starts Hyperinflation Bet After Black Swan (Update1)

By Netty Ismail



June 16 (Bloomberg) -- 36 South Investment Managers Ltd., whose Black Swan Fund gained 234 percent in 2008, is raising money for a new hedge fund, betting that government efforts to pump money into economies could result in hyperinflation.

The Excelsior Fund targets returns that will be five times the average annual rate of inflation of the Group of Five economies -- France, Germany, Japan, the U.K. and the U.S. -- should the rate exceed 5 percent, **Jerry Haworth**, co-founder of the firm, said yesterday. Raising \$100 million for the fund would be a "good" amount, he said.

"There is a sharply increased risk of greater than 5 percent inflation starting from now," Haworth said in a telephone interview from London. "We are in the lag period between when the seeds of inflation are sown and when their offspring, that is higher prices, are evident for all to see."

U.S. President Barack Obama is selling record amounts of debt to try to end the steepest U.S. recession in 50 years, while Japanese Prime Minister Taro Aso has unveiled three stimulus packages worth 25 trillion yen (\$261 billion) since taking office in September. Governments around the world selling record amounts of debt may devalue currencies against assets and spark inflation.

Most investors are underestimating the risk of inflation, Haworth said. Consumer prices in the U.S., the world's largest economy, are set to rise 1.7 percent next year, following a 0.6 percent decline this year, according to the median of 70 economists surveyed by Bloomberg.

Inflation Risk

"There is certainly talk about inflation but people might think of inflation at 5 percent or 6 percent," Zimbabwean-born Haworth said. "We're talking 5, 10, 15,

20 percent or more.”

Investor **Marc Faber** said on May 27 he was “100 percent sure” that U.S. prices may increase at rates “close to” Zimbabwe’s gains, and the U.S. economy will enter “hyperinflation” because the Federal Reserve will be reluctant to raise interest rates. Zimbabwe’s inflation rate reached 231 million percent in July, the last annual rate published by the statistics office.

Universa Investments LP, the hedge-fund firm advised by “Black Swan” author **Nassim Taleb**, is also adding a strategy betting that stimulus efforts won’t prevent deflation or could result in hyperinflation.

Inflation will likely be “very low” through 2010, said **Alvin Liew**, an economist at Standard Chartered Plc in Singapore. There will only be “a risk of very high inflation” starting in 2011 if governments fail to rein in “those excesses that they did to stimulate the economy in the near future,” he said.

“For now, I will be more concerned about how sustainable the growth recovery path is,” Liew said. “When we move into the later part of 2010, investors should pay more attention to inflation.”

Options

36 South’s Excelsior Fund will buy long-dated options it considers cheap and that “stand a good chance of outperforming in an inflationary environment,” Haworth said. Options are contracts to buy or sell a security by a certain date at a specific price.

The fund will wager on an increase in commodity and equity prices, bond yields and increased currency volatility.

“It’s a very high-risk, high-return fund,” said Haworth, who has been trading derivatives for more than 20 years as the former head of equity derivatives at Johannesburg-based Investec Ltd., and co-founder of Peregrine Holdings Ltd., a South African money manager and stockbroker.

The firm will be marketing the fund in the next three months.

36 South has closed its Black Swan Fund, which bet on risk-aversion events, and returned the money to investors after profiting from last year’s global markets rout.

Returns on the inflation fund “could be even higher than the Black Swan Fund though the likelihood is smaller as options are more expensive than they were when the Black Swan positions were bought,” Haworth said.

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