Introducing Dao Capital Advisors

道(DAO)者无为而治也.

Daoism, the ancient Chinese philosophy with thousands of years of history, argues that effortless actions lead to order and harmony and any intentional or deliberate actions against the laws of nature will lead to unintended consequences. Applying this to governing countries, it argues for small government and self-management of the people. (democracy) Applying this to economics, it argues for minimal intervention and letting natural economic forces play out. (i.e. the invisible hand) Daoism emphasizes natural cycles in life, in the universe and in economic and social affairs.

We named our firm Dao Capital Advisors for a simple reason - we are firm believers in free market capitalism. By trying to manage economic affairs and cycles, governments can extend and twist them, but will suffer from unintended and often severe negative consequences, which require even more active management. Central banks and Keynesian policies can lower interest rates and apply fiscal measures to artificially extend economic expansion cycles, but by doing so, they plant seeds for the next economic crisis, which demand more drastic actions. The Federal Reserve has not been able to raise rates above previous cycle highs since Volcker, which eventually led to the ZIRP (zero-interest rate policy) today and likely NIRP (negative-interest rate policy) down the road. Once normal interest rate policies were ineffective, QE was launched to purchase financial assets: first government bonds, then corporate bonds (like in Europe) and likely eventually stocks (like in Japan). Through these economic cycles, global debts levels have been making higher highs and currently sit at the highest level in human history. What are policy responses for the next economic downturn? ZIRP/NIRP, QEs of everything, plus fiscal measures with outright monetization, aka. MMT – Modern Monetary Theory. Contrary to the common perception that the Chinese model of economic management has led to China's decades of economic prosperity, we argue that there is no Chinese model and that the only reason that the Chinese economy does not resemble North Korea today is that a market economy was introduced decades ago. The minute the government started more active management of the economic downturn in the 2007-2008 Great Recession, they planted the seeds for an unprecedented debt bubble, which will more fully manifest itself in the years and potentially decades ahead.

Being Daoists, we are detached, objective and emotionless observers of economic and geopolitical developments as well as capital markets. Others pontificate on what is right or wrong, what should have happened, what the right policies responses should have been and should be in the future, what the market responses should have been, what normal markets are and what abnormal markets are. We dislike those pontifications, and instead, accept that everything exists and occurs for a reason (Dao), and will happen in a certain way for certain reasons (Dao) regardless what we think or any other pundits think. We don't hypothesize what right policies should be, but rather we try to analyze the likely policy responses, the consequences and the likely implications for the economy and capital markets. We accept that everything that happens in the capital market is normal, and no period of time is abnormal. We accept that boom and bust cycles are not only normal but unavoidable based on economic forces, and if someone tries to eliminate "busts" and only keep "booms," we could have more volatile cycles. We don't prefer "booms" over "busts" or vice versa, but rather we embrace both whole-heartedly as both present risks and opportunities.

Being Daoists, we don't have binary views, forecasts, and predictions – but rather we make assessments of the probability distribution of different paths for the capital markets. We are humble students of the economy and capital markets. Unlike other pundits who can predict key economic data to the 2nd decimal using sophisticated econometric models, we analyze leading economic indicators, providing a mosaic picture of what economic growth momentum and inflationary pressures are likely to be. Unlike those who can precisely forecast expected long-term returns and correlations for different asset classes using all kids of sophisticated theories, our first step is to listen to the implied messages from Mr. Market, from different asset classes, and different instruments. We identify conflicting messages among them and between markets and the economy. We then assess what is likely to transpire and then make a plan to navigate the markets under the institutional constraints. It has always been curious to us that these long-term expected returns are very similar both at the peak the cycle and at the trough of the cycle and always the same regardless of market conditions. In the end, actual returns depends when you measure them (the starting point and ending point) and where you measure them (for example in the US or in Japan). There is no guarantee, or even strong theoretical backing, that "long-term expected returns" will be similar to long term historical returns. We have seen long-term institutional investors change their Strategic Asset Allocation much more often than their original intended horizon with much higher frequency, often following adverse movements in capital markets, not unlike driving by looking at the rear mirror.

Being Daoists, we do not insist on being right or wrong, being bulls or bears. We simply want to be in-sync and in harmony with the markets. Unlike other pundits who has linear and deterministic views, our assessments of the future are non-linear and path dependent, and we believe that market reactions to changing environments lead to the changes to the environment themselves, which leads to changing market reactions. We navigate the markets following paths and do not blindly believe that things will "eventually" work out just because they have in the past. We do not fight markets and insist that markets are wrong. We can be contrarian by accident - if we are contrarian it is only because we believe that we are in "harmony" with economic forces, and we want to be one step ahead.

Being Daoists, we take effortless action. Unlike hedge funds with pressure to constantly deliver so-called "Alpha" and long-only managers with needs to outperform their respective benchmarks "consistently", we don't constantly chase investment ideas, but rather patiently wait for opportunities of risk/reward asymmetry to come to us (either to hedge risks, to capitalize on opportunities or to make capital allocation decisions) and we then patiently wait for our thesis to materialize. Unlike most institutional investors, who get paid by taking little action and making little impact, we recommend concrete action at the right moment. We don't engage in academic or philosophical debate on whether the market is "efficient", "semi-efficient" or "inefficient", as that should be exclusively reserved for PhDs in finance, but rather, we try to understand why the asymmetry of risk/reward exists, and what factors would lead to a change over the investment horizon. By doing so, we can pinpoint certain points in time when decisions on capital allocation and portfolio hedging can have asymmetrically positive outcomes for overall portfolios. We don't think statistically rare events are "unusual" events with fancy nicknames like "black swan." We believe that based on our cause and effect framework, seemingly unusual events are actually inevitable, and we need to know the approximate time horizon they will occur. We constantly look for what is priced as "100% certainty" or "impossible", and then identify key factors that could lead to different outcomes.

Being Daoists, we accept that there are reasons why institutional investors faithfully follow pre-determined strategic asset allocation regardless of market conditions, valuation and economic developments though we think even a layman can understand that it is not right thing to do. We don't debate whether it is right, good or bad; we accept that it exists. If we can influence the changes, we will; if not, we operate under the institutional constraints and deliver results.

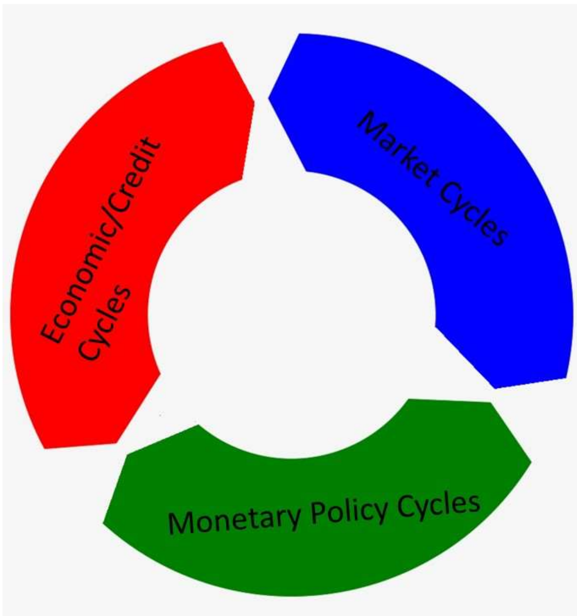
Prior to founding Dao Capital Advisors, we directed and managed billions in assets in pension fund, family office and hedge fund frameworks, and successfully navigated many different and changing market environments. But we have also been humbled by the markets and have perfected our methods based on our lessons. We hope to bring our methods and decades of lessons to help enterprising CIOs navigate the coming changing environments, delivering real impacts.

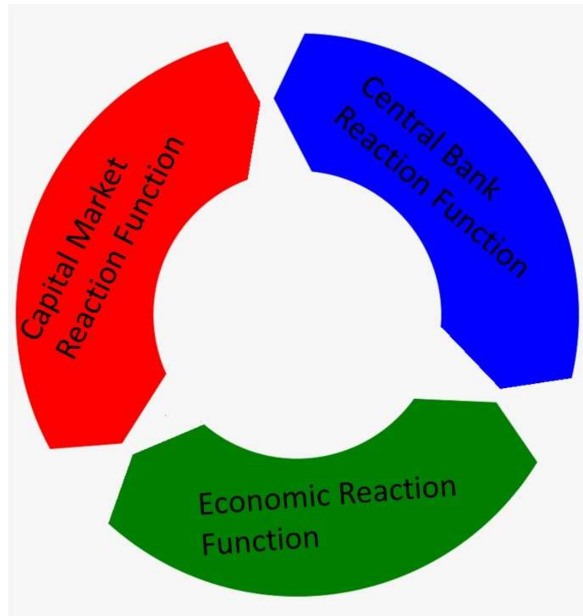
Being Daoists for personal life, we have learned that money and fame do not keep people happy. What brought us together is our passion for capital markets. We simply love trading and investing as a hobby. As long as we enjoy what we do, we will let the monetary rewards take care of themselves. It is simply exhilarating and a rewarding experience when we successfully handicap the markets and help others deliver concrete investment results. We contend that it is a lonely experience if you are managing a pool of capital. That is why we started out advising only a few of the most sophisticated institutions, each managing billions of dollars of assets.

Being Daoists, we don't push for business. Our first step is to publish our research, process, ideas and just-in-time recommendations. If you like them, you can subscribe to them. If you need more specific ideas and strategies that are customized to your portfolio, we provide consulting services. If you would like us to do it all for you, we can implement a discretionary macro overlay program. We don't want to push, and only desire partnerships that are mutually beneficial.

Being unconventional, we do not expect our process to be accepted by conventional institutional frameworks. As traditionally educated CFAs in finance, it has been a long and painful journey for us to unlearn the conventional wisdom that stands in the way of investment success. After all, conventional wisdom can only lead to conventional results. By definition, we can only work with the few aspiring CIOs and key decision makers that seek to truly fulfill their fiduciary duties to their constituents to maximize results. We do not expect to work with investors who rigidly stick to strategic asset allocation to minimize career risks, while blaming markets for "temporary" drawdowns, quoting "long term", "patient" and countless historical market statistics to “educate” the committee that everything will work out eventually, and if necessary using traditional consultants as legitimate cover. Our edge exists because so many investors operate that way, and as long as they do, market opportunities will exist.

But that is our Dao (way). What is your Dao (way)?





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