UPROOTING THE HEDGE

Hedges are complicated, they're dangerous and the only people who really want them are investment banks and their rocket scientist clients

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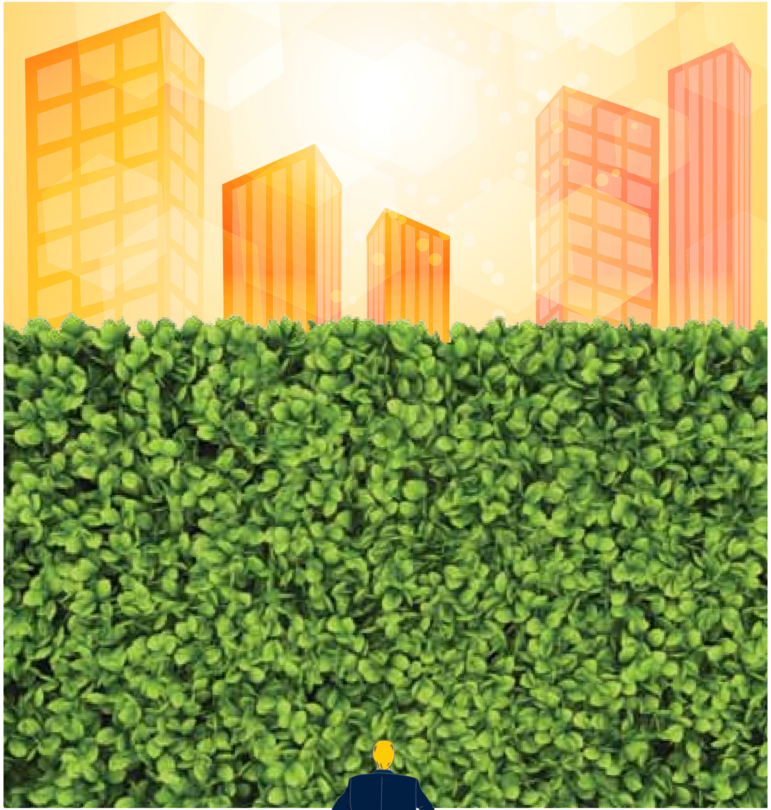
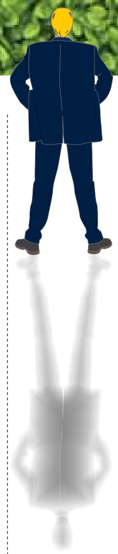




OK, that's it. It's time to forget about hedging. Borrow money, buy things, make things, sell things. Collect the cash, bring it home, give some of it to shareholders, pay back debt. Repeat. All the rest of it you can keep. All that hedging and financial engineering and trying to put it in the accounts without getting in trouble with the auditors and without having the private investors whinge at the AGM about it being indecipherable gobbledegook – it's all, frankly, now getting to be just a distraction from the main event: buy things, make things, sell things, collect the cash.

I first started to worry about hedging years ago, when I heard Sir David Tweedie, who was then the head honcho at the International Accounting Standards Board, say that if you export to Germany and then lock in the revenue with a forward euro hedge, then that's actually two transactions: an order to sell your stuff to a customer and a punt that the euro isn't going to strengthen against the pound. A *punt*? It was supposed to be a bit of insurance. We're not off to the bookies, you know.

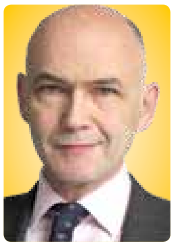
I worried more when I heard about an airline going bust a few years ago. It had fully hedged its aviation fuel requirements months ahead – at $140 a barrel. Fail. Pity. Would have looked damn clever if Brent crude had gone to $200 and not $100.

Hedge funds? They're as out of control as leylandii. Excuse me while I get my chainsaw...

The financial crisis really put me off the idea of hedging. It's bad enough that a bank might go down with a few hundred thousand of the company's cash flowing through the payments system. (Please, God, don't let a transaction bank fail on payday.) But now there's the risk that when a bank goes down, it will stuff up a swap arrangement at the wrong moment, with the humble treasurer left to explain to the finance director why a safe-as-houses defensive mechanism just blew up in everyone's faces.

Now it turns out that banks have been putting the lie into Libor, shaving basis points off derivatives contracts like medieval coin-clippers. Figuring out who's been diddled out of what is going to be a game no corporate can win; time to stop playing. Libor is going to stand for 'Lawyers In Bed Of Roses', I'll tell you that much. It's just not worth whatever we thought could be gained from these ruddy, discordant financial instruments.

I remember the days when the City beasts were called 'merchant banks', not 'investment banks'. And quite right, too. They toiled away, working in the best interests of the honest merchant and the industrious manufacturer – not Ferrari-driving rocket scientists who run what are ironically called hedge funds, and foist their financial weapons of maths destruction on simple folk in the corporate world. Hedge funds? They're as out of control as leylandii. Excuse me while I get my chainsaw...



Andrew Sawers is a freelance business and financial journalist. He is the former editor of ***Financial Director*** and has worked on ***Accountancy Age***, ***Business Age*** and ***Commercial Lawyer***

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