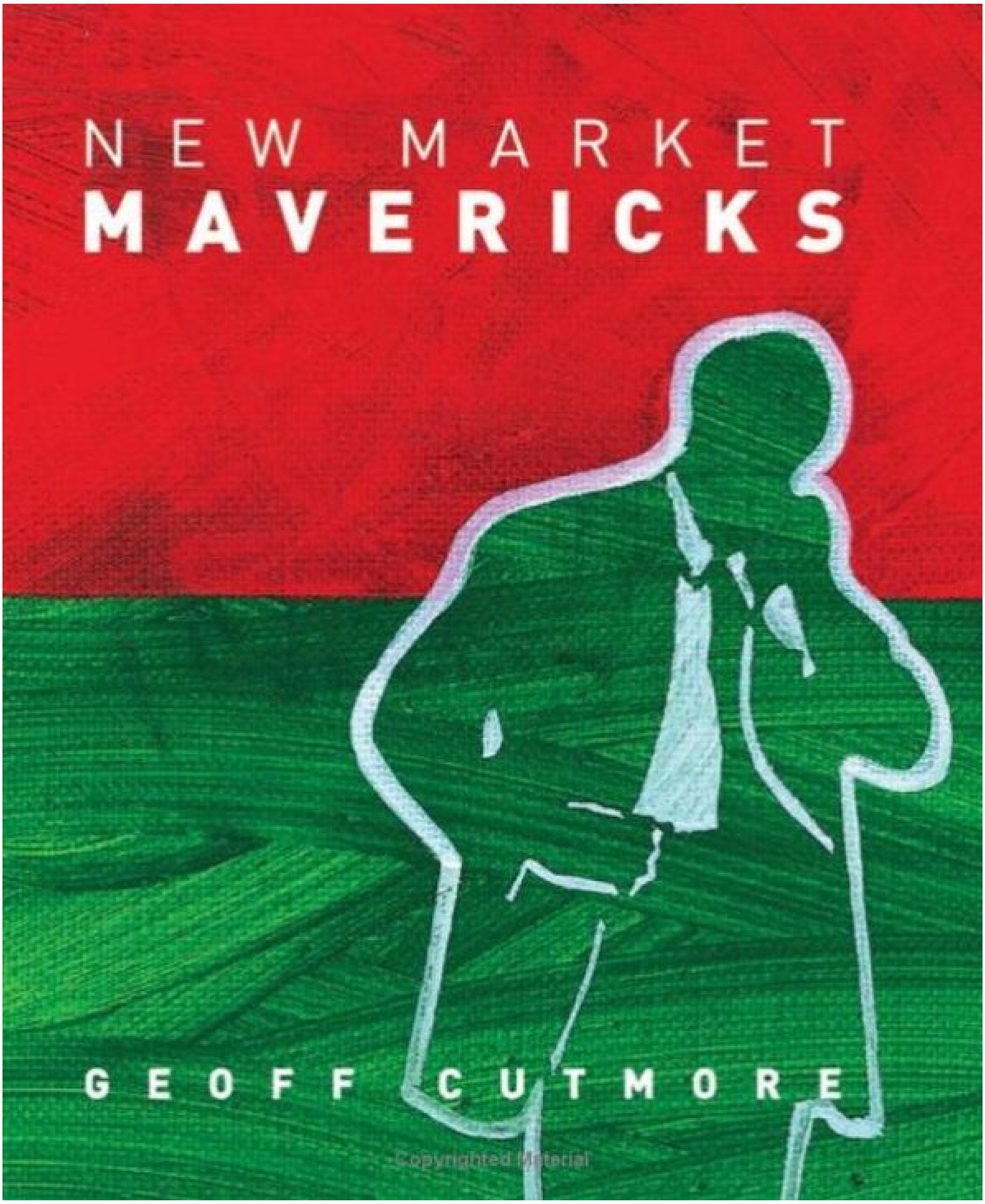
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David Murrin: Trading the Roadmap

'The genie is out of the bottle, the ongoing fight against proliferation will be a long-term process and will throw up other trading ideas.'

David Murrin's investment process is built on a model of a world that is locked in a battle to control the disbursement of nuclear technology. Potential clients at Murrin's hedge fund company Emergent Asset Management get a lesson on global power politics before they hand over their cash. Murrin is keen for all who put money into his funds to understand how they are going to profit from the West's desire to halt nuclear proliferation. The key, he says, is in finding emerging markets where that policy drives a change in sentiment and the valuation is an incentive to invest.

Geopolitical risk normally scares investors away from financial markets as they seek safety in cash. That is no problem for hedge funds like Murrin's which can buy or sell the market. How then does the fight against nuclear-proliferation create opportunities? Murrin says the war on terrorism and the US goal of gaining influence in the Middle East should be viewed in the context of the broader battle against the spread of nuclear technology.

For instance, in 2003, Murrin made money from the row over US military bases in Turkey. In March of that year, ahead of the start of the invasion of Iraq, the Turkish Parliament voted against having 62,000 extra American troops stationed in the country. The bases would have helped to provide air support to operations in the region. The Americans were offering a $30 billion aid package in return for access, but the Turkish government resisted the money. The reaction on the Istanbul Stock Exchange (ISE) knocked 10% off the market. Murrin reasoned that once US forces had secured a base in Iraq they no longer had to depend on Turkey. The disagreement over the bases looked likely to end the large lending packages Washington had delivered to support the Turkish economy.

The loss of aid was a negative for the Turks, but Murrin figured it might force the government to tackle deeper economic problems. Without that aid, but a desire to meet fiscal rules for convergence with the European Union, the government would have to take action to stimulate the economy. His hunch paid off. Under a new reform programme the government set targets to bring inflation under 20%, and for economic growth of 5% for the year. In September of 2003 official interest rates were cut aggressively, with the central bank lopping three percentage points off short-term rates.

Murrin was already in the market. In July 2003 he bought the Turkish stock market index when it stood at 10,500 points and rode the market to his exit at

17,000 points in mid-December 2003. He says that he feels better about a trade if he is early and alone. After the row with the US and a struggling economy there was general disinterest in the country from other investors. That allowed him to buy at a price he felt undervalued the market's potential. Murrin always validates his trades with technical price analysis and, in the case of Turkey, his model suggested a low volatility entry point with plenty of risk already built into the price. Figure 3.1 shows how he traded the ISE with a stop-loss marker tight to the purchase price to limit any potential downside.

Figure 3.1 Trading with a stop-loss marker.

Murrin says success in event-driven trades is about understanding both the state of the market and its linkage to the catalyst for changing the price. In this case the market condition in Turkey was fragile and the threatened removal of US aid hurt the currency and the equity market. The art comes in thinking beyond the short term. Murrin anticipated the Turkish reaction to implement reforms, and recognised that the valuation made the market too cheap to ignore.

The Iraq invasion generated several trading ideas. Murrin also bought more direct exposure to Iraq in the form of the rights to $6 million of defaulted loans to the country's old regime. When his funds picked up the debt in early 2003 the paper was trading at around 16 cents on the dollar and had doubled from 8 cents in September 2002. Murrin reasoned that the inflow of US cash into the country should help to bolster Iraq's economic foundations. Ultimately it was a calculated gamble on the Saddam Hussein era debt being repaid close to face value. At the time of writing Murrin was still waiting for the pay off. He described the debt's performance so far as disappointing; the price had barely changed from where he bought it and he was still a holder.

How does Iraq fit into the nuclear proliferation story? Murrin feels that analysts who view the US invasion of Iraq as driven by a desire to secure oil supplies from the Middle East are missing the bigger picture. The powers that toppled Saddam Hussein's regime justified their action by pressing the cause for finding Weapons of Mass Destruction. But, he argues, the strategic purpose was much wider. Securing territory in the Middle East by force sent a message to any state in the region that was in the process of developing nuclear technology.

> ‘The US wanted to let Iran know it would take action over proliferation. With US forces in Iraq, Iran now had this western gorilla just over the border. Would Libya have been willing to do a deal on nuclear inspections with British Prime Minister Tony Blair if there had been no invasion of Iraq? Libya had centrifuges; these are a vital piece of equipment for refining Uranium.'

Murrin believes the World Trade Centre attacks in 2001 forced Washington and London to face the reality of a world where terrorists have the resources and intent to commit atrocities. The greatest fear in both governments is that the terrorists are supplied with nuclear technology. Preventing that from happening means cutting off the most likely source. These are mainly the governments of countries that have a record of aiding anti-Western terrorist cells. He says that Western efforts since September 2001 have focused on preventing proliferation from 'hostile' governments by imposing diplomatic or military pressure on countries labelled 'rogue states'. It is a story, he says, that will rumble on through the rest of the decade, and Murrin thinks it is a difficult policy to sell directly to democratic electorates. Nonetheless it is a campaign already underway with democracies forced to respond to the threat even if they don't come out and say so explicitly.

> ‘The democracies have to be pro-active without declaring it to their electorates, which is why in Britain we had an intense debate about whether we should be in Iraq. The leaders have understood the change in the paradigm but the populace has not.'

What other opportunities does Murrin see in the nuclear issue? South Korea is another market where Murrin has sought to benefit from the proliferation trade. On 10 January 2003 the North Koreans announced they would withdraw from the nuclear non-proliferation treaty. The South Korean equity market, the KOSPI, lost 8% over the next month. This time he was banking on heightened tension with North Korea dampening interest in the market. Nervous investors were already worried about a fresh campaign in Iraq, and the local accounting scandal at SK group. The KOSPI struggled through the first quarter of 2003. Murrin couldn't see anything that would change the negative sentiment and he entered trades shorting the market.

This trade was less successful, as the KOSPI benefited from the push of liquidity into global markets in the second half of the year. Murrin closed out the shorts as foreign investors poured money in the Korean market. By the end of the year foreigners owned more than 40% of the market cap, the first time that has ever happened. Despite the retreat from his short position Murrin will watch Korea for further opportunities. He believes tensions with Pyongyang will rumble on, creating opportunities to short share prices in Seoul.

Murrin says that this is a feature of the proliferation trade. The markets become sensitive at different times and investment tactics depend on reading the ebb and flow of the story. There will be periods when confidence and money push the issue out of investors' minds. But a spate of negative news flow combined with weak market sentiment will put the potential trades back on his radar screen. “The genie is out of the bottle, the ongoing fight against proliferation will be a long-term process and will throw up other trading ideas.'

At a broader level, the nuclear story is an important theme for opportunities in emerging markets because the issue frames the way the West reacts to the emerging world. Although he doesn't see too many direct trading stories in Pakistan the country remains a particular area of concern for him because the nuclear technology is aligned with an Islamic country. Murrin believes that that will keep Pakistan close to the heart of the issue for Western governments and it will remain the potential flashpoint with the greatest risk of nuclear conflagration.

THE ROADMAP

The proliferation theme is part of a larger model of the world Murrin and his team have created called the Roadmap. The Roadmap is modelled on the price of financial assets, and an understanding of economic and historical cycles. It is an educated guess at how financial markets and the world will change during this decade. It is a fluid model and is continually updated as the forecasts are compared with the unfolding reality. Assumptions are amended and modified where the two conflict. Murrin’s Roadmap is designed to have predictive value until the year 2009 and is built on several core ideas:

- 1929-2000 represents one growth cycle. The dates mark the two worst bear markets in history and periods of distress in corporate America - particularly the insurance industry. A repeat of the pattern suggests a decade where equity prices fall from January 2004 levels.

- The correction is played out in shorter time-frame moves. These are smaller versions of the longer time-frame trend. The technical term for these is *fractals* – imagine a pattern which, when subdivided, reveals identical smaller patterns. For instance, think of looking at a stock chart from some distance. The price line is downward sloping. As you move closer to the chart the line is still downward sloping but you start to notice the line zig-zags on its way down. Even closer and the bigger move becomes blurred, but you notice within the shorter time-frames that the same downward zig-zag pattern is repeated. These are fractals and Murrin considers them to be vital trading patterns.

- January 2000 to March 2003 was the first bear cycle. Until the end of 2005 the US markets will stay in a large trading range. From 2005 to 2009 expect a powerful deflationary market in US and European stocks.

- Japan's 1989–March 2003 corrective cycle is complete. A new bull cycle is underway. The recovery will benefit the Asian basin.

- Some Emerging markets will enjoy a primary bull trend in this environment.

Murrin's aim is to exploit these themes going both long and short equities, the flexibility of running a hedge fund means he can also trade using derivatives, bonds, gold, commodities and currencies.

Emergent, as the name implies, specialises in uncovering opportunities in the emerging markets. In Asia, where he is generally bullish on the outlook for markets he has taken on several trades in Thailand. A currency position in the second half of 2003 capitalised on the perceived economic strength of Thailand and the problems in South Korea. He opened a position long the Thai baht and short the Korean won in August. The baht was the strongest regional currency; the Korean won was the weakest with low domestic demand from the overhang of the threat from North Korea. Again Murrin looked for confirmation in the price pattern and entered the trade at 28.2 won to the baht, with a tight stop-loss at 28 (Figure 3.2)

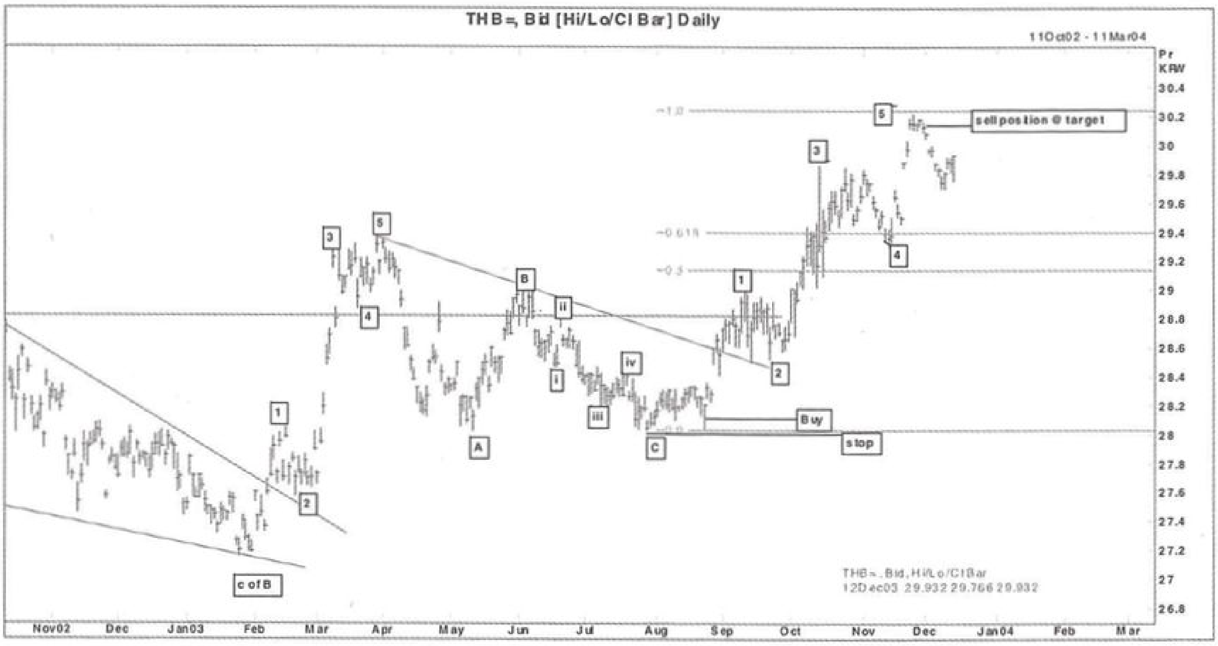

Figure 3.2 Trading the won against the baht with a stop-loss marker.

Murrin enters positions with a specified price target. By November 2003 he closed out the baht/won trade having reached the price target.

MAKING TRADES

Murrin's company, Emergent, offers three themed funds called: Ballistic, Cosmopolitan and Alternative. Their respective focus is on Emerging equity markets, developed G10 equity and fixed income markets, and Emerging debt and currencies. Two other products, Global Macro and Diversified, are blended versions of the main three themed funds. All of the products target a 20% annual return, and carry a 20% performance fee.

These are relatively early days for Murrin's hedge funds but returns already look promising and have been achieved in both bull and bear market conditions. The Alternative fund was ranked number 1 in its class by S&P Micropal in 2001. It has beaten its internal 20% target for four of the six years it has been running. In performance terms Ballistic has been the star, producing annualised returns of 30% since its inception in January 2001. In 2002, a bear year for Western equity markets, the fund made 50% and was ranked number 1 in its class by S&P Micropal. The fund benefited from long holdings in Russian and Chinese oil companies and South African gold. Murrin shorted financial stocks in Latin America and technology in Taiwan and South Korea.

Cosmopolitan was launched in March 2003 and, despite gaining 34% in nine months of pre-launch trading, struggled to find its feet in the rally and ended the full year with a modest 3% rise. The fund was up 22% from March to September 2003 but lost ground in the last three months of the year as Murrin shorted G10 equities and bonds. He was expecting the bombings in Turkey on 21 November 2003 to dampen European equity market performance towards the year end but, in the event the sell-off proved to be short lived. A correct call on the dollar mitigated some of the losses. 'We looked for a turn in equities and were negative on treasuries. Both strategies proving incorrect. The G7 gave a good launch to a $ bear move which we shorted.'

The trading process for all Emergent funds starts with the idea. That is generated by a combination of market awareness and price analysis. The awareness comes from a view on how economic and geopolitical events will affect financial markets and commodity prices. The price analysis comes from Murrin's technical work using Elliott Wave theory to detect price trends. Once the idea develops momentum, more work is done to confirm its validity. It is cross-checked with the Roadmap, and assessed historically over long and medium time-frames.

The investment process for identifying and placing trades can be broken down into three-stages. Murrin uses Figure 3.3 to describe the process to client

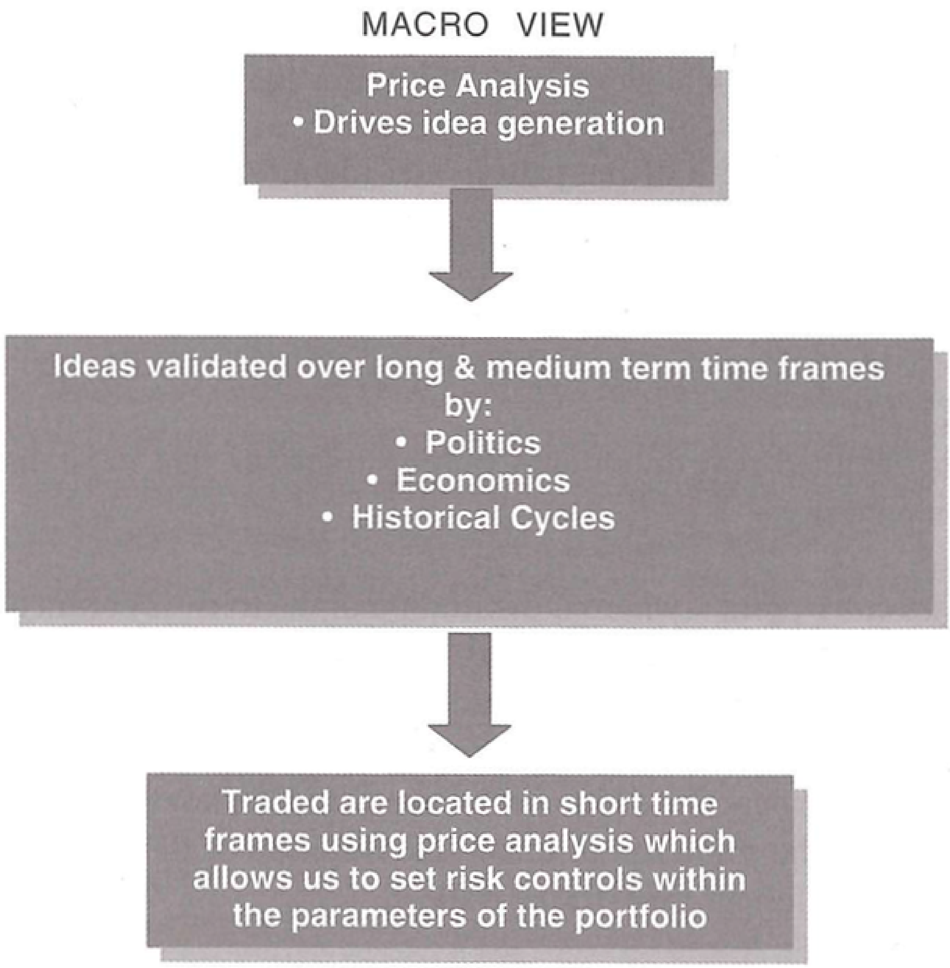

Figure 3.3 Trade idea generation.

Murrin's approach to any asset is to seek out Elliott Wave price patterns and, as accurately as possible, identify the correct wave count. As a discipline, Elliott Wave has a loyal following among some technical analysts. For readers unfamiliar with the theory, in the 1920s Ralph Elliott studied decades of US market price charts and concluded there were patterns that repeated. He identified sets of eight waves – five trend waves and three subsequent corrective waves. Remember the fractals? This is an important point for trading; the Elliott Wave pattern is repeated within junior patterns.

Murrin stresses that the pattern reflects the state of mind in the market. Each rising wave is a reflection of buyers in control until the risk in the price is greater than the momentum to take it higher. The discomfort for buyers' increases as the price rises, until some buyers become sellers. When the sellers outnumber the buyers the price drops, forming the down wave. Murrin's own research sums up the emotional element.

'For the purposes of market analysis, we may conclude that the market has a collective consciousness that processes information and then responds predominantly on an emotional basis, reflecting fear and greed. For the individual this equates to the fear of losing money, employment and self-respect, and the greed associated with a higher standard of living, freedom of action and increased self-esteem.'

After a series of rises (higher highs), buyers become more cautious. The Elliott Wave pattern shows the subsequent falling price as a 3-wave corrective cycle. Murrin says that corrective patterns are vital for identifying trading opportunities on the short side of the market, but are harder to get right because the pattern loses some resolution.

“The psychology becomes more mixed as investors lose conviction after a correctional move. The degree of fear and greed falls and so the quality of the pattern falls and the certainty of the pattern becomes lower.’

Recognising the strength of the pattern and identifying its relative magnitude are the tools Murrin uses to confirm an investment idea. In over two decades of using the same methods he says he has never seen a period when at least somewhere in the world the analysis couldn't be applied. It then comes down to the experience of the manager in deciding when the signals are strong enough in a particular asset or market to warrant a trade.

Murrin has defined two directional trading methods that capitalise on the price development patterns:

- Contra entry point - where the initiation of the trade is contra to the prevailing trend, which, if correctly located, is also at the end of the trend. From this entry point the duration of the trade can be varied across all time-frames.

- Trend trading - where the initiation of the trade only occurs a considerable time after the new trend has commenced. To take advantage of such trades the duration of the trade has to match the duration of the trend. This style tends to be that of longer time-frame traders.

Murrin combines the trading technique with a close attention to risk control. He runs stop-loss positions close to entry points to protect the downside. If a trade works and the trend is still intact he may have several attempts at exploiting the same theme. If the analysis is wrong he takes the loss quickly and re-examines the strategy.

An old Chicago pit trader once made a great impression on Murrin by relating a story about how, over 40 years in the pit, the traders alongside him came and went. Their styles were fixed and as the markets changed they weren't able to adjust and went out of business. Murrin has tried to integrate the lesson into his trading, and that means recognising when the ideas aren't working. You need to build an adaptive system for changing with the market environment.'

This chart of the Dow Jones Index (Figure 3.4) encapsulates all of these elements at work. In June of 2002 Murrin was bullish on equities and expecting a rally before a significant bear move towards the end of August. He made two attempts to buy the Dow for the rally but was stopped out on both occasions at critical levels.

Murrin then reversed his view on the market. He says the WorldCom default coupled with some financial market instability in Brazil over the possible election of the leader of the left-wing Workers Party, Luiz Inacio “Lula da Silva, as President had accelerated the time-frame for the bear market. From late July into mid-August Murrin initiated three new profitable bear trades. The chart shows:

1. risk control when the ideas are wrong;
2. bull to bear changes in strategy;
3. several bites at the same trade where the idea can be exploited.

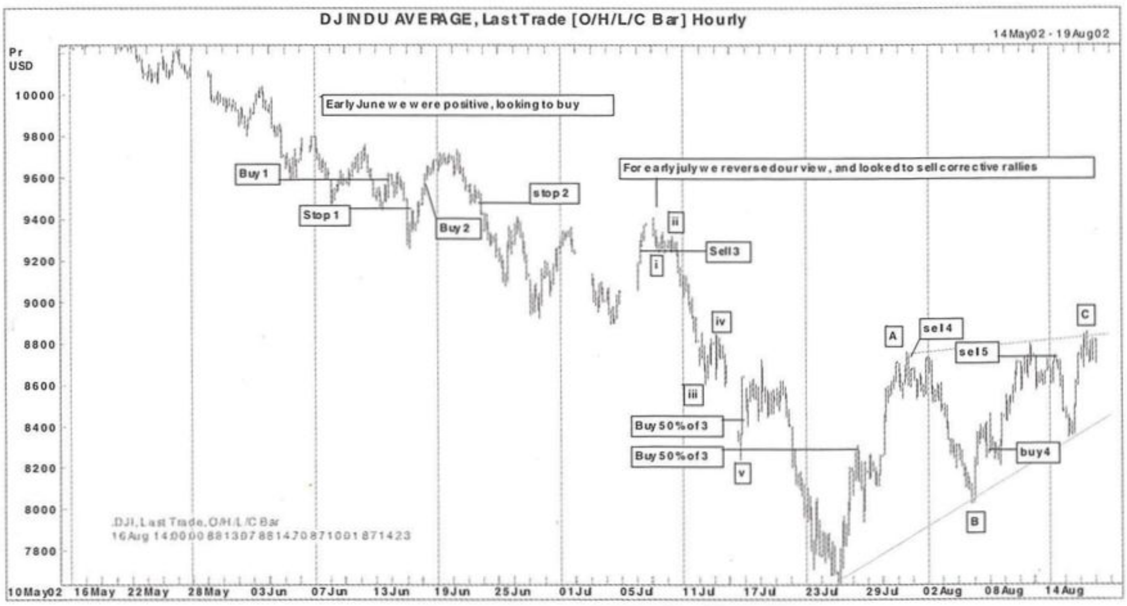

Figure 3.4 The Dow Jones Index

RUSSIA

The Russian debt crisis in 1998 almost sank Murrin's business. Emergent's funds have been open to all investors since 2001, but the company has invested in Emerging markets since its inception in 1996. At that time any investment fund worth the name was active in Russia in the mid-1990s. In the post-Soviet experiment of shock capitalism Russia was pumped full of foreign cash that inflated the price of financial assets. When the party stopped, the foreign investors were trapped by an overnight devaluation and a government debt default. Murrin’s funds suffered an option default that would end up costing a quarter of the portfolio. It was a defining moment in the business. We could have closed but we decided to stay with it and we slowly recovered. That is where we learnt that even though we were directional traders once in a thousand years credit is a diabolical situation.'

The experience brought a dramatic change in Murrin's attitude to risk. Having once nearly lost the business on a concentrated trade, there are now strict limits on how much is ventured and how much can be safely lost. In the emerging equity fund, Ballistic, a very strong idea might see at most 25% of the portfolio spread over 7–8 stocks. Elsewhere, on a single trade Murrin says the maximum bet might be 0.5% of Net Asset Value. He prefers not to think of diversification as protection, but instead chooses to concentrate on good ideas. Where he doesn't see opportunities there is no requirement to stay invested, which is the main advantage of being a hedge fund. The biggest discipline is not to be overactive and waste money before something really good comes up. We think that through understanding long-term pictures, transcended into short-term movements, we can choose timing.'

Murrin was actively trading in Asian markets before the region's currency crises in 1997. He considers that, unlike Russia, the Asian problems were easier to identify. He liquidated all positions in Asia before the crisis took hold. The chart patterns were showing that the Asian bull had run its course; he had seen signs of completion of the market rally. The forecast allowed him to sidestep a business offer that probably would have finished the company.

‘Before the crisis a Korean bank came and offered to invest $200 million with us, but we would have gone from $17 million to $217 million and then back to nothing. They couldn't understand why we refused. We said there are problems coming and you are going to be in trouble.’

THE MINDSET OF MARKETS

Murrin's commitment to charts and price patterns evolved from an event that left a profound impression on his life 20 years ago. He is a physicist by training and his approach to markets reflects a scientific mind searching for rational explanation in all things. Watch, learn, observe and make your own decisions is Murrin's credo. If it is possible to see what happens, why it happens, what effect it creates and whether the outcome perpetuates the cause - that's halfway towards predicting the future. Where a stock chart is in its simplest form a reflection of investor behaviour, understanding the motivation and cause of that behaviour ought to have some predictive value.

This is the guiding principle in Murrin's investment process. Improbable as it may sound, it was a frightening showdown with natives in the jungles of Papua New Guinea that set him on this course. He graduated from university as a physicist specialising in geophysics. In his first job after university he joined an oil exploration company. His first task in the field saw him transported thousands of miles to the Papuan jungles, where within hours he was set to work managing a crew of 60 Papuans cutting a swathe through the undergrowth. After a cold and wet first night, Murrin awoke to a terrific rain beating on the tent canvas, and was presented with his first problem of how to motivate the disconsolate native workforce.

With a lack of diplomacy Murrin explains away as the arrogance of youth, he told the reluctant workers he understood they didn't want to work in the wet conditions, but in his country even women and babies worked in the rain. The translated slur upset the son of the local chief and the anger spread quickly through the assembled Papuans. As the worker's anger escalated they became more hostile towards Murrin until fearing for his life he retreated to his tent. As calmly as he could he began writing out a letter to his mother explaining why her son had died at the hands of enraged Papuans.

Slowly their anger dissipated and some hours later they were once again behaving in a friendly fashion to the young English geophysicist. In Murrin's mind the experience was an early primer on understanding financial market psychology. The lessons were essentially two-fold: firstly, crowds run on emotion and that the group will at times behave together, either desiring or rejecting the object of their attention; secondly, those who are able to exercise personal self-control can ignore or move in opposition to the crowd if their will is strong enough. This is an approach to markets that any contrarian investor would understand.

Murrin later put the jungle experience into the context of financial markets on the trading floor at JP Morgan. Joining up the dots as a 23-year-old new boy at the American investment bank's operations in London, Murrin watched the way the best traders made money. It didn't appear to correlate with academic qualifications or even fundamental knowledge; instead the best traders understood the emotional state of the market. Within the first 10 days on the trading floor at JP Morgan Murrin had determined that the correct approach to markets was directional trading, basically taking on long or short positions by analysing the price and predicting its movement.

‘So there it was, investment is an emotional process and the emotion is linked to price. From that it was clear, price is the only quantifiable variable and it is tied to emotions that create eclectic behaviour patterns.'

Early on, Murrin posed himself the question whether price patterns are fundamental in nature or self-fulfilling. Intuitively he felt there were two elements, an underlying fundamental shape and a feedback loop where investors have some awareness of the pattern and, in their behaviour, force the pattern to sub-evolve into a slightly different shape. Emerging markets provided a promising testing ground because the relatively lower number of market participants and the smaller size of the markets would give the fundamental pattern clearer definition.

'It proved to me once and for all that there is a basic embedded pattern, but that as you go up the financial food chain towards bonds where there are more and more people involved in trading them and there is more awareness of the patterns, the patterns inevitably become more complicated.’

JP Morgan gave Murrin his first job in the financial industry. His career as a geophysicist was memorable but brief. After some months being helicoptered from one inhospitable landscape to the next to take mineral samples, he quit. Instead he decided to seek out an industry that was both better compensated and recognised advancement on the basis of ability. It was at JP Morgan where he discovered charts and directional trading and finally found his way onto the Prop desk in the treasury. This is the operation where the bank does some trading on the markets for its own account, and is in nature very similar to the operations of a hedge fund. Prop traders move between asset classes; they can use leverage and are able to short the market. The Prop traders are considered to be the trading superstars in the institution and are entrusted with the firm's own cash.

Later Murrin was plucked from his trading tasks to work as a strategic adviser to the Head of Trading. He says there weren't many people in the bank in London at the time who shared his view of the world. The position put him at the top table when bank strategy was discussed. Murrin stayed at JP Morgan for seven years, he left in 1993 at the age of 30 to start his own trading consultancy, Apollo.

He continued to provide directional trading advice to JP Morgan and any other investment bank willing to pay. The consultancy business still exists alongside Emergent and the work it does ties-in directly with the original research on price patterns Murrin generates for the hedge funds. Emergent was founded in 1996 and is currently based in Surrey in the UK.

LOCATION, LOCATION, LOCATION

Murrin's office comes directly from a scene in a James Bond movie. After some time on quiet country roads a turn-off down a barely made track ends in a tarmac turning area. There are two houses, both many hundreds of years old, built on the side of a valley giving unspoilt views across the lush Surrey countryside. Murrin and his family live in the main house; the other is Emergent's headquarters. Beyond an unusually high number of cars for two residential properties there is little to give away the location of the team inside electronically monitoring the world's financial markets for trading opportunities.

Pop the latch and step through the old-fashioned wooden door and the countryside gives way to a snug L-shaped room humming with computing power. There are several large flat screen televisions fixed to the walls. The televisions are permanently tuned into 24-hour business and news channels. Desks are covered with computer monitors and trading research. The screens show fund positions and a range of bond and stock prices. The small team of managers that work alongside Murrin are constantly making calls and checking prices. There is the atmosphere of tidy efficiency, of people getting on with the business of trying to stay one step ahead of the competition.

Apart from being conveniently situated a 10-second walk from his own front door, Murrin makes a virtue of his managers' distance from the City of London. The old joke about hedge funds described them in the early days as akin to two guys in a log cabin in Montana. This is as close to the European equivalent as it is possible to find. Murrin says the out-of-town location keeps costs down, and limits the influence of peer and other environmental pressures on his team's market analysis.

LEFT-EYE DOMINANT

Murrin is tall, of slim build and, when working, is most likely to be found in a pullover or turtle neck top. In conversation there are traces of the scientist; the approach is direct and the answer considered. His manner is intense, and he relates his investment process with deep conviction.

He describes his early teens in an English state school as tough and not much fun. Murrin grappled with slight dyslexia, which wasn't recognised at the time. With a strong internal desire to learn and take head-on life's challenges, Murrin stuck with the school when a private alternative was offered. He says he later only took a physics degree because it seemed a difficult subject to master. Sport proved a useful diversion, and when he began to excel, other areas of school life settled into a more comfortable routine.

Much later in life Murrin identified himself as left-eye dominant, a characteristic that appears to be more common to left-handed people (although the evidence seems inconclusive). This is now widely recognised as being related to creativity and a non linear outlook on the world. The hard wiring of the brain brings the right hemisphere to prominence. Murrin contends that left-eye dominant people take a different approach to problem-solving from the majority of the population. It is thought that around 70% of the population is right-eye dominant.

In trading terms he thinks left-eye dominant people make better wave counters. They are superior at pattern recognition because they have strong visual perception skills. Right-eye dominant traders should show a more linear thought process that is better suited to systematic trend trading. A simple test for eye dominance is to hold at arm's length a piece of A4 paper with a small hole in the centre. Look through the hole and focus with both eyes open on an object in the distance. Close the right eye. If the object is no longer visible through the hole you are right-eye dominant.

Murrin has extended his work on eye dominance into other areas of brain activity. He is intrigued by the idea of honing the mind, like an athlete's body, to a peak of performance. The research continues in that field: 'I'm looking at this a lot, if you can train your body, why not your mind.'

THE DESIRE TO SUCCEED

I asked him whether his trading system could be taught to any investor. It is based on clear rules and uses a traditional Elliott Wave charting process. Murrin agreed that the mechanical side could probably be passed on but he insists its success, or indeed the success of any trading system, lies with the individual rather than the system.

“Think about it,' says Murrin, 'by far the most important part of any trading process is the trader. If the trader is not open-minded, unstressed and self-aware the best trading programme on the planet is not going to make them a success.' Self-awareness comes up continually during our interviews. Murrin describes it as the ability to stand back a little from yourself to observe and understand why you are making certain decisions and how you, in turn, are being affected by events and the decisions made. When I suggested the sporting analogy of being in the "zone', Murrin agreed that it must feel as though all senses are geared to the one goal of beating the market. He has a deep interest in martial arts and Eastern religions as routes to a greater awareness. He is fascinated with spirituality, and the idea that it can bring clarity of thought and process. He is a great believer in rhythms and cycles in all things, and that extends to his managers' feel for the markets on any given day. "You have a rhythm, the universe has a rhythm; when the two of you are synchronised that is when the opportunity will appear. So you can't try to force it, but recognise the rhythm instead.

Murrin sees no division between working life and private life – in fact he thinks making such a distinction is a barrier to success. Investors who view the process of buying assets as work will probably not succeed. He believes in the philosophy that the working life and the non-working life should be extensions of one another. 'You see self-sabotage in the fund management business all the time. What it comes down to is the conflict between what people say they want, and what they really want inside.'

Murrin says he can tell which managers are going to make money from their mental attitude. The starting point is to open the mind of any prejudices before coming to the market. He says managers are successful when they are not trying to project their own desires and needs into the trade. Murrin's method over two decades boils down into three components:

1. Build a risk management structure or system that is designed for the person using it, implicit in this is the understanding that the risk system will be different for each person according to their personality.

2. Take a model of the world that you think is successful and adaptable. Any model will contain many assumptions about future and current events. Where it is predictive, assign values of probability to those outcomes. It should be a model that is applicable in both bear and bull market environments. It should also work across different time-frames – in essence it should be linear.

3. Finally, understand that the first two principles will only continue to work if you recognise that your abilities are the key to their success. The third principle then requires a constant questioning of your own capabilities to act and react appropriately to circumstance.

WHEN IT GETS HARD - STOP

Murrin says when it is no longer easy to make money stop trading. It is an unwritten rule in the Emergent office. When it starts to get difficult to find ideas that generate good profits it is probably a good time to take a break from trading. Murrin describes it as being out of phase with the market, and sometimes no amount of cool detachment or self-awareness makes it any easier. Recognising it when it happens could be one of the best investment decisions any trader makes. ‘You go through periods when it is just like pulling your own teeth without anaesthetic, then it is just a question of managing your risk.'

Murrin says it is usually ‘easy' when all elements of the trade come together:

- There is a long-term pattern - which manifests itself in a shorter time-frame. There is very strong clarity in the price pattern.

- That corresponds to corroboration of political, economic and all other price related variables.

- You are alone in the trade - are you seeing it differently from other people? The risk reward is well covered in the price, and there is time to run the trade several times if the idea is confirmed.

BUY AND HOLD THE DECADE?

If I were to buy a portfolio in 2004 based on the Roadmap and then hold it for the decade, what should that portfolio contain? After making it clear that no one should ever just buy and hold because it's a recipe for losing money, Murrin was willing to play along with the scenario as an intellectual exercise.

‘Coming to the end of 2004 and then into 2005 there may be a lift for US equities, this would coincide with the Presidential elections. But I would reduce positions in equities in Europe and the US coming to the end of 2005. If you need to be long equities stay in Asian markets there will also be the benefit of currency appreciation. If that down cycle for European and US equities is correct, buying bonds in ’04 and ’05 might be the right decision.'

Murrin thinks investors need to make diversification a high priority through the decade and must not limit their trading or investing to a single asset class. That also applies to the geographical breakdown of holdings. He stresses that there will be emerging markets, and developed and emerging markets, that trade in opposing directions. ‘The last 10 years has seen a cementing together of asset classes – equities and bonds in developed markets became highly correlated. That relationship will break down.'

He says that sharp-eyed investors will be able to find pricing anomalies and make money. There is a simple example from Emergent’s holdings in 2000 where the group bought Colombian government debt. It carried the same internationally recognised debt rating as the government paper issued by Argentina but was cheaper. It ought to have traded at the about the same price as it carried the same likelihood of default. At some point that gap would be noticed and start to close, giving Murrin's team a profit.

WHAT CURRENCY?

Murrin's current preference in the foreign exchange markets is for Asian currencies because he cannot see the justification for the appreciation in the euro. The dollars decline will be tempered in his view by problems in Europe, because 'Europe is structurally much weaker than the United States'. He says people who took their money out of the dollar and put it in the euro were just responding to a desire to get out of the dollar. When they sit down and examine the situation they will realise the last currency they want to be in is the euro.

Murrin does see the dollar regaining some strength around the end of 2004 but the move will be temporary. His confidence in the Japanese recovery means that the yen will remain favoured among the major currencies. He believes that the start of a new bull cycle will support the yen, pushing it to 80 to the dollar by the end of 2004.

GOLD

Murrin actively traded the rise in gold in 2002, but he thinks the precious metal has further room to appreciate. He started buying at $316 in December 2002 and sold at $355 as the volatility increased. He intends to trade in and out of gold believing it will reach $800 by the end of the cycle. The $800 level is modelled in the Roadmap. He dismisses those who still don't view gold as a significant store of value. Murrin says there will be a time when investors will want to have about half a percent of their worth in gold. ‘At the moment there is a rough balance between supply and demand, when you get new people wanting it then you will see the price move up. When the price fell below $300 many marginal mines closed. It will be difficult to get supply up; you can't just restart mines. There will be a time lag.'

Murrin has also been trading the gold stocks. Typically the stocks are an early warning system for the bullion price. He bought the South African mine Gold Fields in February 2002 as a precursor to buying the metal in December of that year. He paid $7.50 per share for his stake and later sold the shares at around $12. Murrin says the trend for gold miners to abandon forward selling is another strong positive for the bullion price. The slide in the dollar has left the miners preoccupied with another problem, the currencies: “In South Africa in particular, the rising Rand has the miners more concerned about hedging their currency risks than anything else.

The gold bugs that fear central bank selling will suppress the price. They worry about manipulation of the market and point to the world's central banks as the most likely source of new supply. Back in September 1999, the major European central banks signed the Washington Agreement restraining their selling of gold and restating that 'gold will remain an important element of monetary reserves'. The day after the agreement the US and Japan both said they would pursue similar restraint. At the time of the Washington Agreement the participating banks reportedly held just under 16,000 tonnes or 50% of the world's official gold holdings. With the Washington agreement on central bank selling of gold due for renewal in 2004, does Murrin fear that the bullion price over the rest of the decade could be brought down by a flood of supply from central bank sales?

Murrin suggests that the conspiracy theorists make a mental adjustment and recognise the central banks as but one more player in the market. Their activities in the gold market should be viewed in that light. 'I think they have sold a lot already and I think many of them will realise they have been selling at the wrong price. They may have extra knowledge, but they are still just a bigger market participant, they’re part of the collective psychology of the market.’

WESTERN EQUITY MARKETS

If Murrin sees dark days ahead for Western equity markets, when will Western investors feel comfortable again buying their own equity markets? The short answer, says Murrin, is probably not for some years. His expectation is that 2008–2009 will mark a low for these markets. He says that a process of reassessment is still taking place about the role of equity in financing the future. It may not be grabbing headlines but it is changing long-term investment decisions.

‘The man on the street was led to believe if he worked hard and saved and worked to 65 his pension would be assured. That would be a fairly unique situation in history but that is what he was told and it all looked good until the year 2000. Everyone was so invested in this rally that governments and insurance companies perpetuated this belief that you got security through equity. Then we woke up and realised these shares are just like anything else, they can go up and they can go down. That is why you now see all this questioning. Take any business that had massive increases in the value of its equity during that period, it is likely that if you looked harder there would be some problems – it spilled over into everything, corporate governance, equity research and so on.'

Murrin believes that there will be significant changes in the way businesses and the markets operate in the West over the coming decade. Part of that long-term story will be about regaining investor trust. The comparison is Japan where it has taken more than a decade to wring out much of the excess of the boom times of the mid-1980s. Local investors are only slowly returning to the equity market after the banking and property scandals that marked the collapse in values. Ironically, in Japan it is the locals that are slow to follow the foreigners back into their own market. That will be a feature of Western markets when the coming bear market has done its work. 'By the time the lows are in place in 2008–2009, most people will have their money out of traditional long-only pension funds. They will be in absolute return funds or alternative structures. That is probably the time when you will want to do the opposite.'

Murrin says investors who are complacent about the coming bear phase for Western markets are mistaking the US authority's fiscal and monetary stimulus as a new bull cycle. The markets' rallies since March 2003 are part of an unfolding process that takes markets lower. He feels that 2003 was about being in a holding pattern after the band-aid had been applied. The Federal Reserve had watched and learned from the failure of the Bank of Japan and Ministry of Finance to sufficiently ease monetary policy in the early years of that country's deflationary cycle. If his timing is correct the US markets will follow the same pattern as Japan. After an initial fall, the Nikkei saw two years of sideways trading, from mid-1990 to 1992, before heading lower again. When that next major leg-down in US markets starts, Murrin thinks the US authorities will have a sense of helplessness at how to respond.

WHERE DO BONDS FIT?

Where the environment is negative for Western equity markets, will bonds be the beneficiary? Murrin is looking for money to find its way back into government bonds as the equity market picture deteriorates. The Emergent group made money from selling bonds in 2003 as the market experienced a sharp fall in value. He says that the US bond cycle is indicating that a 6–8 year correction is due, although this time the sell-off was delayed two and a half years because of declining interest rates.

Murrin is forecasting the S&P 500 to peak at around 1200 by the end of 2005. There will then be a major deflationary decline into 2009, and in deflation one of the safest places to be is in government bonds. The US government makes a fixed coupon payment on Treasuries every year and that will become worth more as prices in the economy fall. Murrin anticipates a rally in bond prices, underpinned by central bank policy to keep interest rates low. That will find support from money managers who are under-invested in treasuries because they were convinced an economic recovery was underway.

Emerging market corporate debt may also perform in this environment as these economies see a pick-up in growth under Murrin's Roadmap. A word of warning, however, on Western corporate debt. In deflation, debt payments become a heavier burden, and in an environment where companies could go bankrupt the risk of default is likely to rise.

END OF EMPIRE

If Murrin's deflationary decade comes to pass he thinks the Dow will be closer to 4,000 by 2009 than it is to 11,000. Murrin says investors wedded to the '90s idea that the US can continue to be the world's engine of growth, need to think again. His most pessimistic scenario envisages this decade as marking not just a 70-year peak for the US, but the peak for the English language empire and its influence on the world. That will hasten the trend of America becoming isolationist.

Murrin believes that we are at a critical transition point in the relationships between Asia, Europe and the United States. The clincher is whether China is on a sustainable growth path. He believes economic growth will bring with it a new self-confidence on the world stage. 'China is evolving finally as a real economic powerhouse, and the history of nations indicates that new-found economic confidence will bring with it a desire to play a greater role in world affairs.' A resurgent Japan will provide Asia with two systems that will increasingly compete for pre-eminence. Murrin expects that competition will find expression in the traditional manner, an escalation of meaningful military competition or, in other words, an arms race. For the best guess of the consequences of that for the world, Murrin says we should think about Britain's waning ability to control events outside its borders as the British Empire gave way to the ascendancy of the American system.

Murrin thinks the battle to control the distribution of nuclear technology will be costly and only hasten a decline in the US's dominance of world events. Increasingly, the West's relationships with emerging nations will be framed by the issue of proliferation. The dilemma is how to respond to potential aggression where the risks of getting it wrong are huge. For investors, that offers opportunities in the emerging world, against the backdrop of struggling Western financial markets.