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Ex-Citi Analyst Who Called Out Broken Libor Sees a 6% Rate Shock

- **Scott Peng of Advocate Capital expects tough inflation battle**
- **His RRH fund is one of the best-performing rising-rate ETFs**

By Sam Potter and William Shaw

(Bloomberg) -- Before the Federal Reserve kicked off its most aggressive policy-tightening campaign in decades, Scott Peng warned that a "tsunami" of rate hikes was set to thrash Wall Street.

Now Peng is riding the fallout, as the founder of a top-performing ETF that's up 39% in an otherwise awful year for US investors. And the Advocate Capital Management LLC executive says the monetary mayhem is far from over -- with interest rates set to jump to disruptive highs of as much as 6% thanks to endless inflation.

The former analyst at Citigroup Inc. is a small-time player in the $6.1 trillion US exchange-traded fund industry. But Peng's pronouncements command attention in key corners of the Street given his colorful past, helping to expose the biggest scandal in modern banking with a damning 2008 report on the Libor benchmark.

These days the veteran has his sights on the benchmark rates set by central banks -- and the ensuing challenges for unhedged investors.

"The current bout of inflation is much more difficult for the Fed or other central banks to get on top of," said the New York-based founder of Advocate. "Supply shock-driven inflation is much, much harder for central banks to manage because they can only address it indirectly by dampening demand."


Scott Peng

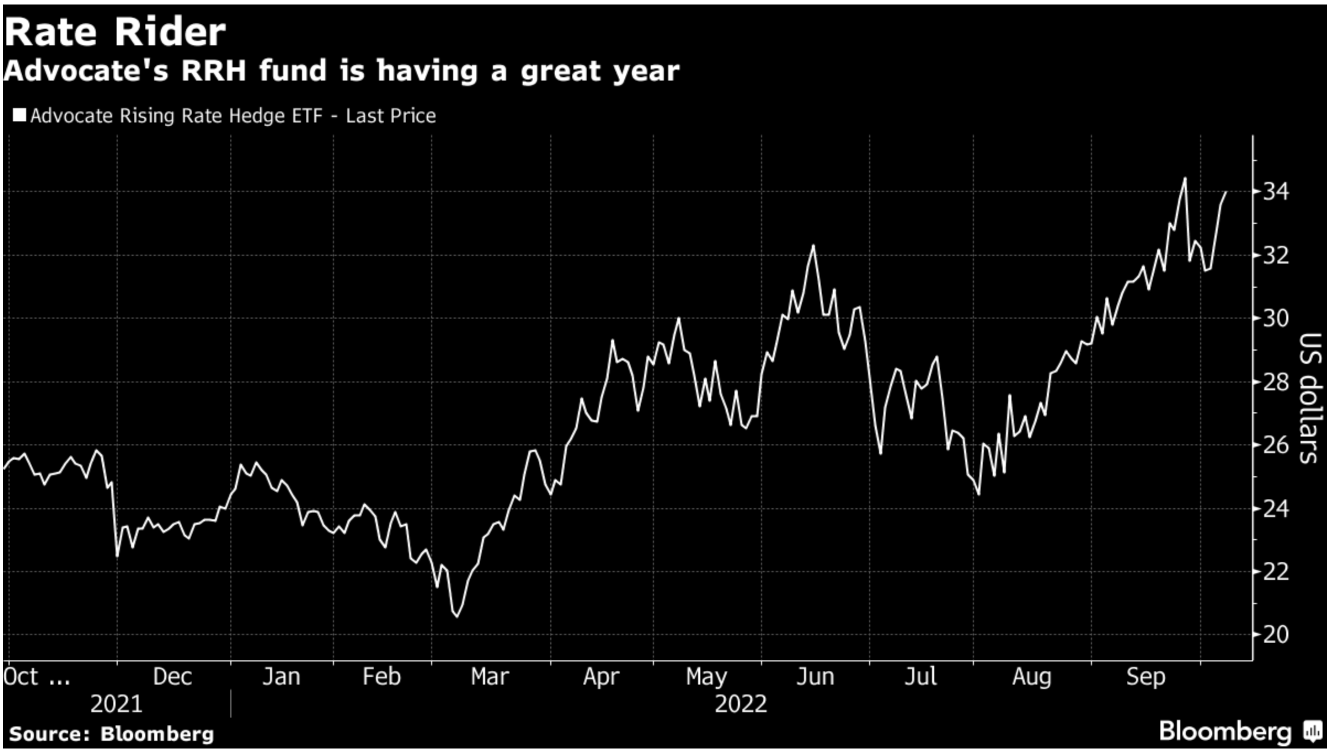
The Federal Reserve is leading policy makers globally in the quest to tame rapid price growth at decade highs, with talk of a dovish monetary shift summarily dismissed this week by a succession of officials.

The latest was Fed Bank of New York President John Williams, who on Friday said interest rates need to rise to around 4.5% over time. Combined with strong jobs data, it reinforces the notion that talk of a dovish monetary pivot is a fantasy with inflation continuing to rage. Stocks slumped while yields jumped anew.

Peng offers a defensive buffer in the Advocate Rising Rate Hedge ETF (ticker RRH), which launched a year ago. The actively managed product trades Treasuries and derivatives across bonds, equity indexes, currencies and commodities to generate returns when long-term US interest rates rise. It has outperformed all-but-one ETF of its kind this year and was up 1.1% as of 1:15 p.m. in New York, headed for its fourth straight day of gains.

Yet its surge has been overshadowed by the Simplify Interest Rate Hedge ETF (PFIX), which debuted a few months earlier. PFIX is up about 80% this year, becoming one of the five best-performing non-leveraged ETFs in the US across asset classes.

Despite being among only a handful of rising-rate ETFs posting gains this year, RRH has struggled to consistently attract cash. The fund had assets of about $41 million as of the Thursday close, versus $350 million for PFIX.



As head of US rate strategy at Citi, Peng famously co–authored the report “Is Libor Broken?”, which helped spark investigations that led to banks paying billions of dollars of fines.

His call for US yields to hit as high as 6% is well above consensus, with market pricing currently indicating a peak interest rate of around 4.65% for this cycle. But in his view, the Fed will have to take the benchmark rate “well above” its preferred inflation reading, known as the core personal–consumption expenditure.

While the central bank may well pause hikes in the first quarter next year, it will be forced to resume tightening when inflation remains elevated, the former managing director at Credit Suisse Group AG reckons.

In this regime, Peng said Advocate has benefitted from shorting the yen –– though it has since closed that position –– and favors value over growth investments. The equity allocation of RRH is to energy and healthcare funds, according to data compiled by Bloomberg.

With rates set to soar higher than expectations, investors should “throw away the post–2000 playbook” as once–dependable trading patterns break down, according to Peng.

“There may be no hiding place if most traditional asset classes drop in sync,” he said.

Related tickers:
1737816D US (Advocate Capital Management LLC)
RRH US (Advocate Rising Rate Hedge ETF)

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