No Such Thing as a Free Lunch

Efficient markets and zero-sum game are outdated notions which lead to the mistaken belief that one cannot lower both risks and costs or, said another way, gains are not possible without risks.

We can categorically state that opportunities to profit while mitigating risk do exist, arbitrages are available even in efficient markets, and participating in financial markets is NOT necessarily a zero-sum game.

Not a zero-sum game:

> Both buyer and seller of an option can make a profit from the transaction, as long as each hedges their respective risk differently. For example, buyer hedges while seller does not.
>
> Option ends out-of-money at maturity:
>
> > Seller keeps premium – profit
> >
> > Buyer hedging activity (iteratively selling and buying underlying during option life) result may exceed premium – profit

Arbitrage in efficient markets:

> For example, US Treasury bonds and future markets. Insurance companies needed immediate liquidity to shore up short-term investment portfolios and replaced their Treasury bonds (sold) with futures (bought), releasing capital while maintaining their exposure to treasuries. Their actions created a supply/demand mismatch between bonds and futures which allowed cash-rich entities with low cost of funds, few regulatory constraints, and proper infrastructure to take advantage of, i.e. arbitrage.

Once acknowledging arbitrages are available, the next step is identifying them. The above US Bond market arbitrage is temporal and available to properly positioned entities constantly monitoring markets, not to everyone. For Corporations to participate, an available arbitrage needs to fit their mandate and capabilities, i.e. frequently occurring and lasting, structural. Given the size and breadth of multi-national's balance sheets, there are at least several opportunities.

For example, corporations have structural advantages in FX markets and can obtain "free lunches" by opportunistically exploiting their strengths (no return on capital thresholds, long time horizons and wider risk tolerance relative to other market participants) to systematically garner excess gains on their currency management.

Similar types of structural advantages may be identified in commodity, interest-rate, and credit risk exposures. Requires corporations to make a small initial investment of time to revisit and dig a little deeper into their balance sheets and understand market structure.

Conclusion:

With a small investment in time and energy corporations have the potential to unlock significant and systematic gains from their structural advantages within markets.

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