

NIGHTMARE ON HEDGE FUND STREET

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Things are starting to get very scary in the world of hedge funds. We have reported on many of the more spectacular blowups and rip-offs over the past few years, now as we predicted the larger "more credible" funds are starting to show some serious foundation cracks.

Currently, a large number of hedge funds are choking on some ill-timed bond trades involving General Motors. Hedge funds made some risky wagers on some of the more complicated relationships between stock and debt financial instruments. Hedge funds are trying to recoup small gains when neither of the two instruments become too expensive or too cheap. When these strategies work, the results have much lower volatility and predictable returns. Another ill-fated strategy has been huge bets being placed on convertible bonds. Too many hedge funds utilized the exact same strategy and now they are all stuck being unable to find an exit strategy without screwing up the entire market. Hedge funds also use an incredible amount of leverage (think margin). When money is borrowed both gains and, in this case, losses are augmented.

Too many hedge funds have been caught using the exact same strategies and now unfortunately for investors these ill-timed bets placed have gone brutally sour causing some serious losses. One of the more swanky hedge funds Bailey Coates Asset Management LLP has gone from \$1.3 billion in assets to \$600 million. (*Ouch! Judge Smalls, Dr. Beeper and the rest of the gang from The Bushwick Country Club are going to be ticked.*)

Money is flowing out of hedge funds for other practical reasons as well. Investors we have spoken to are tired of the high fees and commissions coupled with overall returns that are lackluster. Paying 2.5% management fee plus 20% of any profit takes a 4% return to practically zero. What is even more frightening for hedge fund investors is that institutions are starting to get cold feet and pull their support as well. We recently discovered that Bank of America has yanked \$1.8 billion in capital from 15 different hedge funds. Oddly enough, Bank of America had just made the investment over the past 18 months. The bottom line is that large banks and investment firms have much greater insight and knowledge of what is really going on behind the scenes at these hedge funds. We all know that the only time they take a hit on anything is when they are paying a fine for ripping someone off. If they are pulling out, don't you think that it might be a good idea to follow suit?