HEDGE HOGGING

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INTRODUCTION

In the lingering hangover aftermath of the great bull market of the 1990s and the carnage of the bursting of the bubble, professional investors are viewed with disdain. They are disparaged as overpaid and motley crews who have promised much and delivered little. Hedge funds in particular are shrouded in mystery and mistrust. They are blamed for every spasm in the financial markets, and there is a perception that they often act together in vicious conspiracies to destabilize the world. Some see hedge funds as akin to financial pirates, preying on the innocents, and the people who run them are regarded as greedy and vicious hedgehogs. Recently the investment performance of hedge funds as a class has languished.

Everyone knows hedge funds have had dramatic growth. Assets have grown from $58 billion in 1991 to $972 billion at the end of last year. What is not fully understood is how volatile and market sensitive the hedge fund business really is. Morgan Stanley calculates that after eight years of growth, in 1999, the industry had earnings (incentive compensation plus fees) of $43 billon on assets of $456 billion or a return of 9.4% on assets. As stocks fell, even though hedge funds performed well, earnings shrank over the next three years to a low in 2002 of about $8 billion or a decline of 81%. Then as stocks rallied, they soared to a new high of $45 billion in 2003 before falling again in 2004.

I hope that these chapters, which are designed to be impressionistic glimpses of the investment business and its professional participants, will help others understand the intensity, stress, foibles, and insecurities of the men and women who manage other people's money. I have also tried to capture the ecstasy and elation of getting investment performance right, and to describe the agony and despair of being wrong. However, for all its frustrations, being a professional investor is still the most intriguing, challenging, and overcompensated occupation in the world.

Incidentally, professional investors, or hedgehogs, are avaricious about making money and getting compensated, but they are extraordinarily generous in giving it away for a diverse assortment of charitable and political causes. Furthermore many contribute not just money but huge hunks of time, which is an even more precious currency. In many ways they have become the new eleemosynary class.

To protect and to avoid offending or embarrassing the innocent and unwary—and to foil those who are intrigued with deducing who did what to whom—many names, places, and dates in the narrative have been altered. In this process, some of the people described have become almost composites, as characteristics of firms and individuals were mixed and blended. On the one hand, I hope my disguises are effective. On the other hand, many of the events I have written about actually happened. There is much to be said for the old adage, truth is often stranger than fiction.

Why did I write this book? Because I love the business and am fascinated by its citizens. For many years I have found that the act of writing regularly, keeping a diary so to speak, not only helps crystallize my own investment thinking but also provides a record of right and wrong calculations, which is very instructive on future review. A diary helps you to learn where your thinking about people and events was right and where it went wrong. Just as some investors shape and sort their calculus by talking, I get the same effect from writing. For me writing is a crucial investment and personal discipline.

This book is a collection of disparate reflections and anecdotes. Some are related to events and sagas that occurred during my time at Morgan Stanley. Others are of more recent vintage and related to the creation of the hedge fund of which I am a managing partner and of one of its subsequent investment misadventures. Then there are portraits of investment friends and acquaintances. There are also a few reminiscences and stray thoughts about the battle for investment survival. This book is not a how-to primer. There are no enduring answers about how to invest successfully in these pages because I have none.

One of the attractive wonders of the investment business is that it is populated with fascinating characters, and hedge funds in particular seem to attract strong, obsessive, and often eccentric personalities. Hedgehogs are intriguing animals, and hedgehogging, the never-ending search for investment acorns, often reveals the best and the worst characteristics of the species. *Hedgehogging* offers an insider's view that I hope will entertain and inform readers, regardless of their investment experience.

BARTON M. BIGGS

New York City
December 2005

CHAPTER ONE

The Triangle Investment Club Dinner

Hacking Through the Hedgehog Jungle

I went to the Triangle Investment Club dinner at the Century last night. There were about 25 guys there, about half from hedge funds and the other half very aggressive long-only managers. The age mix was about half and half, too. There were plenty of distinguished oldies with curly gray hair and husky voices who roll their words, but also a lot of sleek-looking young guys who talk very fast. Young or ancient, everyone there was a big-time investor running public, competitive money of one type or other.

Triangle is an investment club of mostly guys who have dinner once a month to exchange ideas and take one another's temperatures. I don't go that often. You must be in the mood. You have to be capable of putting (and keeping) your game face on because, although everyone is ostensibly friendly and jovial, the members are some of the most intensely competitive people in the United States. There is definitely an edge to the interaction and conversation. It's not exactly a relaxing, friendly evening with old tried-and-true comrades in arms.

It was the usual routine. We stood around with drinks for half an hour or so and gossiped mainly about how tough it was to make money. I chatted with Jonathan, a big-time hedge fund mogul who must be worth a billion dollars and flies everywhere in his own Gulf Stream. I've known him since he was a young analyst at Tiger, Julian Robertson's legendary hedge fund. I like him. He is one of those guys who tells you exactly what's on his mind.

Tonight he is shaking his head. A week from now is his oldest daughter's tenth birthday, so last night he asked her what she would really like for her big double-digit birthday. She looks at him and says, "I can ask for anything?" He says, "Yes." She says, "You won't get mad? My wish involves an airplane." He's stunned. What has he wrought? Poor little rich girl! She wants her own plane. With trepidation he says, "Okay. What is it?" "Daddy," she says, "I'm almost 10 years old, and I've never been on a commercial airline flight. All the other girls at school have. What I really want is for you to take me to a real airport, check in, go through security, get searched, stand in line, and fly commercial to someplace. Daddy, never having done it is really embarrassing." Hedgehogging with children is not easy!

KIBITZING, GILDING, AND SANDBAGGING

Then we go in to dinner at a long table with candles and fresh flowers, and immediately Leon, who had the chair last night, gets things going and we begin to go around the table. In no more than four minutes, each guy is supposed to elucidate his favorite stock or concept and the reasons why. Everyone takes notes, and there is a lot of kibitzing. Because there are many mammoth egos present, the chair has to be ruthless about cutting speakers off or we would be there all night. There are some guys who say they get a lot of ideas out of the dinner. I don't find that I do, but you do come away from the evening with a sense of what the mood of the members is and what the hot areas are.

Last night I got a sense of confusion. The mix between longs and shorts was pretty balanced. Some of the stories boggle the imagination, with lots of aggressive supposition. With energy hot, one young guy told a fantastic tale about a Malaysian wildcat oil company that had a structure at offshore Borneo, which rivaled the North Sea. Sure! A mutual fund manager told of a new surgical process that cuts the risk of impotence from prostate surgery by 75%. Then there are the usual market-cap-toeyeballs stories about new and old Internet adventures, and wondrous tales about everything from health-food chains to nanotechnology.

It is assumed you're going to be recommending what you already have a position in. Most guys announce their positions before talking. As always, there was a lot of cynical, sardonic byplay, with certain notorious offenders being accused of gilding (as in gilding the lily) and an occasional joking cry of "Sandbagger." *Gilding* is just what it sounds like—when you dress up your story to take it to the party by exaggerating the fundamentals in your favor. In other words, if you are plugging Symantec and making the case that it's cheap because it's going to have big earnings next year, you might, in the spell of the evening, jack up your earnings estimate from $3.50 a share to $3.75, when even $3.30 would be a minor miracle. But who can forecast earnings of an exotic tech company anyway, and why not dream a little?

Gilding is a relatively minor offense because, to some extent, everybody does it all the time. The members have very sensitive built-in BS detectors, so egregious gilding backfires and tarnishes the credibility of the gilder. Also, members who know the story being presented have no compunction about rudely interrupting and correcting the gilder. This can be quite embarrassing, but it's all part of the charm of the evening. If a guy tells a good, original story and nobody interrupts, it means that the tale is at least fresh and maybe for real.

Sandbagging is a much more serious crime. You can even get kicked out of the club if you're caught red-handed, *en flagrante* so to speak. Sandbagging is when you tell a story and egregiously gild it, hoping to attract buyers at the same time you are actually secretly selling the stock. It's one thing to promote the story of what you own or are short, and as noted, most members make it clear that they have a position one way or the other in the merchandise they are talking about. It's quite another to sandbag. Sandbagging is dishonest, cheating, a violation of the rules of the money game.

JUST BECAUSE YOU'RE A SNAKE DOESN'T MEAN YOU'RE NOT A MONEYMAKER

One guy who used to be a member, Richard, was always suspected of being a sandbagger, but it's a capital offense and very hard to prove, and as long as nobody got hurt, it was overlooked. Richard, incidentally, is one of those guys who insists on being called Richard and not Dick.

Now there are some slick, slimy guys in the big-time hedge fund business who traffic in stories and even in forms of inside information. Richard is as slick and slimy as they come, although he has a smooth, cultured, Harvard veneer, wears fancy suits, and talks with a hint of a Boston accent. But just because you're a snake doesn't mean that you are not a moneymaker. Richard has been around for a long time, and one of the other members was even in business with him for a while. That ended in a nasty lawsuit. Richard once arrogantly described himself as a self-made man, and his former partner interjected, "and you worship your creator." Richard is very smart, very obnoxious, and has made a lot of money, mostly for himself. He tells a stock story with great certainty and precision, and so I guess that's why we all put up with him for so long.

Years ago, Richard and I played singles tennis four or five times. It was a horrendous, mind-twisting experience, even though I knew I was better than Richard. If a shot I hit was in but close to the line, he would often, but not always, call it out. If he hit a ball that was clearly out but only by a couple of inches, he would walk up toward the net and stare at the spot. To a certain extent, it was intimidating, and you found yourself hesitating on out calls if they were close. When I got a run of points going, Richard would insist on sitting down and retying his shoes for five minutes. Sometimes, he would miscall the score, always in his favor.

I talked to other guys about it, and they had the same problem. One guy told me that Richard once wanted to start a set over when his opponent was ahead three–love. The problem with confronting Richard was, were you going to make a huge scene and accuse him of cheating? No, it would be too ugly, with people on adjacent courts listening in and thinking that you are both total jerks. So you end up playing carefully and not hitting balls close to the lines. Each time I played him, I resolved it would be the last, but he would press me to play again. As I said, I definitely knew I should beat Richard, but the cheating and the byplay were so unnerving, and my mind was so bent that the fourth time we played, he won, which further enraged me, especially since he immediately told the other guys about it as if it were the usual thing.

Richard finally went a shenanigan too far with the Triangle group. One night a couple of years ago, he told an intriguing story about a company that had secretly developed a weight-loss drug with no side effects that really worked. He rattled off the names of compounds nobody had ever heard of. You took a pill twice a day, and presto, in a month you had lost 10 pounds! Obviously, such a drug would be an absolute blockbuster with obese Americans! He told us he had seen the results of the blind tests, and he cited data from the Stanford Research Group and the AMA. Food and Drug Administration (FDA) approval was imminent. A number of the guys knew of the company, which was a legitimate biotech with some real scientists but a flabby balance sheet. It had announced it was working on a weight-loss drug that was promising, but the biotech analysts, of course, were skeptical.

Guys were intrigued by the story. When they work, biotech stocks can be moon shots. Richard was asked a lot of tough questions, and he handled them well. I told you he was a smart, savvy guy. "Look," he said, "the former chairman of Pfizer is a director of Stanford, and I've known him for years. We all know nothing is a sure thing in genome land, but he tells me extensive tests show the pill works wonderfully with rats, and best of all, they haven't found any side effects to speak of. The rats pee a lot more than normal, but their dispositions don't change. Do what you want. I've got a big position, and I'm adding to it."

The next day, some of the guys put in buy orders and were a little surprised when they got filled quickly and in size. Surprise wasn't their emotion two weeks later, when the company suddenly announced one morning it was withdrawing the FDA application. Apparently, the drug did cause rats to lose weight, but it also gave them inoperable, incurable stomach cancer, resulting in death. The stock price instantly collapsed. I was at the next meeting, which Richard did not attend. At dinner, one of the guys, John, told how he had been suspicious when his order got filled in a flash, so he had checked who the big seller was. It was the broker Richard always used!

The members looked at each other the way I suppose the apocryphal Western posse looked at each other when they finally figured out who was the cattle thief. John is a large, serious man with big hands, and during cocktails at the following month's dinner, he and a couple of other guys confronted Richard. Richard squirmed and said he had sold only a little stock to lighten his position. "Get out of here, you piece of crap," said John quietly, and Richard did. He doesn't come to the dinners anymore, and I heard he had moved to Los Angeles.

IT'S A JUNGLE OUT THERE, AND THE HEDGEHOGS ARE KILLING THEIR GOLDEN GOOSE

Anyway, after dinner last night, some of us sat around and gossiped about hedge funds. The members of the Triangle, opinionated veterans of the investment wars, are not shy about expressing their opinions, and we all have known each other for years. The insults flew like shrapnel on a bad day in Baghdad. It began when someone remarked that there are now 8,000 hedge funds in the United States, and that hedge fund capital has exploded from $36 billion as recently as 1990 to probably around a trillion dollars today. A long-only manager sourly said something along the lines of the following: "The golden age for hedge funds is about over, and it will end with a bang, not a whimper. The larger capital and the bigger talent pool now being deployed by hedge funds mean that the pricing of everything from asset classes to individual securities is under intense scrutiny by manic investors, who stare at screens all day, have massive databases, and swing large amounts of money with lightning speed. This has the effect of bidding up the prices and reducing the returns of all mispriced investments. Obvious anomalies now disappear, almost instantly. In effect, the alpha available for capture by hedge funds has to be spread over more funds with bigger money, resulting in lower returns on invested capital for hedge funds as an asset class. Risks will also rise as hedge funds have to take larger, more concentrated positions. You greedy hogs are in the process of killing your own golden goose. It's not only endangered, it is about to die. "

"Don't you wish," one of the hedge-fund guys replied from the bottom of his brandy glass. "The golden goose was plumper and sturdier than you think."

"Global macro is headed for a bust," another guy said, looking at me. "Too much rookie money. You had better make it quick." I just stared at him.

"It's a jungle out there in macro now," he went on. "There are so many macro players and momentum investors, they're bumping into each other. There must be a couple of hundred new macro hedge funds formed in the last six months by guys who think they are the next Stan Druckenmiller or Lewis Bacon. Some of these guys are so green, they can confuse you with their stupidity, and they are big and clumsy, so they can hurt you if you bump into them. And then, stumbling around are the proprietary trading desks of all the big investment banks, plus various rogue central banks like Bank Negara and the Nigerians. Last week, I got crunched between an Asian central bank and some rookie hedge fund guy who panicked on his first macro trip. It's all very disorienting!" The guy, despite his alleged bruises, looked tanned and rested, so I ignored him.

"It's like the money game; our nice old game is being played at faster and faster speeds by bigger and rougher guys, so it's getting tougher and more dangerous all the time," another hedge-fund guy said glumly. "Everybody is on steroids. The violence level is soaring. It's like the NFL."

"As more and more funds are unable to earn sufficient excess returns to justify their fees," another guy said, "the love affair with hedge funds is bound to cool. But not before all that excess capital takes its toll on the performance record and exalted reputations of the big stars. The alpha pool of the whole hedge fund industry is not growing, but the number of guys trying to drink from it is. Ask not for whom the bell tolls; it tolls for thee."

"I'm not so sure the alpha pool isn't growing," I argued. "As all these new, naive, trigger-happy crazies, long on aspiration and short on experience, enter the business, a lot of them will get creamed. Then their losses will expand the alpha pool for the rest of us." I noticed one of the veterans was looking at me kind of funny, as though he was thinking, "Who are you, punk, to go talking about naive talent?"

"Leverage, leverage, leverage—that's what is going to wreck you guys eventually," said the long-only guy. "Actually, since LTCM with its huge balance sheet and various forms of tail optionality (whatever that means) blew up, hedge funds have been reducing leverage. Instead of them, it's their investors, both individuals and the fund of funds, who are putting on the leverage. The clients of the fund of funds are unhappy with the meager returns they are getting, so the fund of funds goes to the bank and borrows. And the banks, particularly the European ones, are falling all over themselves to offer credit to their wealthy individual clients to leverage up their hedge-fund holdings. Theoretically, it makes sense. A basket of diversified hedge funds has lower volatility than one fund, so why not leverage it up to magnify the returns?"

"Yeah," said somebody else. "It makes sense until a bolt from the blue, a tsunami wave, a two- or even three-standard-deviation event happens, and then the you-know-what hits the fan. The hedge fund basket has a 10% drawdown not in a year but in a month, and a big leveraged fund of funds could be down 15% in a flash. What happens to the whole hedge-fund universe then? I'll tell you what. The frightened fund of funds clients redeem, the fund of funds in return have to redeem from their hedge funds, and the whole asset class does an extreme shrink. Furthermore, there are no safe havens. The long–short market-neutral funds get killed, too, because when they have forced liquidations, their longs go down and their shorts go up."

"Meltdown," said the long-only guy, "not just for you perps but for everyone else and me too." The evening was over.

CHAPTER TWO

The New Hedgehogs May Have Been Golden Boys, but They Still Bleed Red

As I mentioned before, for every hedge fund rags-to-riches story, there are at least two to three rags-to-rags or rags-to-riches-to-rags tales. In 2004, an estimated 1,000 funds went out of business. Despite media sensationalism, there are very few spectacular blowups, in which a fund goes down in flames like LTCM or Bayou, but there are a lot of slow, lingering deaths. A couple of guys start a hedge fund and raise $10 million or even $50 or $100 million. Their fee is 1.5% fixed on assets and 20% of the profits, but they can't survive on the fixed fee. They have a lot of overhead in space, accounting, computers, back office, and technology. Then they have three analysts and a trader to pay salaries to, plus hard dollars to fork out for Bloomberg terminals and research services. The fixed fee doesn't even cover the overhead, so there is no money left for the partners. Unless the partners have some money to begin with, they have nothing to live on.

Their future then depends completely on the fund's performance over the first couple of years. If the fund does well, the partners earn the 20%, get more money, and wear smiles to bed. If they really blow it in the first year, everybody redeems their money, and they're gone with barely a ripple. But if they just dog along for a couple of years with mediocre performance, then no new money comes in, and it's tough at the office and austere at home: 20% of nothing is nothing. The New York research firm of Bernstein estimates that the 200 biggest hedge funds have 80% of the total industry's assets. The rest of the horde are just dreaming of a hot streak that makes them viable.

I personally know of a dozen funds that were started in the past few years by very successful analysts or savvy institutional salespeople. They were the golden children of the great bull market, and they made a lot of commission money in the late 1990s, which they spent with luxurious abandon. They are attractive guys and gals (not many gals, as a matter of fact), but to some extent, they confused charm, a low handicap, and a bull market with investment brains. Flushed with success, they embraced a voluptuous lifestyle that included everything from wine cellars to jet time-shares. They all seemed to have windblown blond wives, multiple children, starter castles with eight bedrooms and four-car garages, ski houses out West (Vermont is *déclassé*), and a brace of Scottish nannies. Add in private school tuition at $20,000 a crack for even nursery school, annual dues at four or five famous golf clubs, and lots of help, and you get some serious embedded overhead.

THREE GUYS FROM GOLDMAN SACHS

Take the case of three successful guys from private wealth management at Goldman Sachs, who a couple of years ago formed a market-neutral long–short equities fund. They had been big winners at Goldman. One had a real nose for tech stocks, another was particularly good at trading IPOs. But being successful brokers, which is what private-wealth-management people really are, and making a lot of money wasn't sufficient. Brokers are a little grubby. Wives aren't elated to tell another wife that her husband is a broker. So these guys aspired to run a market-neutral hedge fund and be stock pickers. Were they investors or asset gatherers at Goldman Sachs? Mostly the latter, I suspect. *Market neutral* means that a fund's net exposure ranges from maybe 30% net long to 10% net short, volatility adjusted. Market neutral is fashionable because the good practitioners produce consistent, low-risk annual returns in the 7% to 12% range.

Sorry, but I think market neutral is a tough racket, particularly quantitative market neutral. There are too many people doing the same thing. In the 1980s, Morgan Stanley had a series of market-neutral funds that were run off different fundamental and quantitative models. All had boy geniuses at the controls who had made big money on the trading desk or had built a model that worked great on paper when they were dummy back-tested. In live action, none ever produced with real money. One allegedly used a computer to take stock selection to the third derivative and fifth dimension in color. There was color all right. The color of the P&L was a deep shade of red.

Anyway, this attractive trio from Goldman opened on January 1, 2001, with $100 million and lost only 10% over the next two years, which wasn't bad considering the bear market. Then in 2003, they were too cautious and bearish, and the fund went up only 5%. So for the first three years, they had no profits to take 20% of, no draw to live on, and families that were still living high on the suburban-New York hog, so the personal overhead was eating them alive.

Then one of the three partners, the one with the big house in Rye and all the nannies, quit and went back to Goldman in private wealth management. The trouble was all his accounts had been reassigned and he had to start all over again. The other two hunkered down. They let go of their two analysts, pared back on overhead, and transitioned their children to the Greenwich public school system. But as their investors heard about the departures and confidence that the firm was holding together began to dwindle, they were slowly but steadily bleeding assets. The point is that this firm's portfolio hadn't done badly at all; nevertheless, it was about to become history.

SUPERSTAR IAN SLEEPS WITH HIS PORTFOLIO—AND GRINDS HIS TEETH

Another somewhat similar case was Ian. I wrote this six months ago, so bear that in mind as you read this little essay and the addendum. For two years, my two partners and I shared office space with Ian, a brave companion from our Morgan Stanley days. Ian is in his late 30s and is a lean, ascetic-looking guy with a shaved head. He is very bright and analytical. He talks fast and passionately, and all four of us have been good friends for a long time. I think I know Ian well. He is the quintessential, hard-core, investment true believer. He is the hedge-fund version of Howard Rourke in Ayn Rand's great novel *The Fountainhead*. A man searching at all costs for *the truth* of his profession.

Ian went to Berkeley and then, like my partner Cyril, was hired by Bankers Trust for its analysts' program. He was there five years, until my other partner Madhav lured him away to join Morgan Stanley's emerging markets investment team. Ian put together a fabulous record in emerging markets. By the late 1990s, he was a managing director and running the entire investment side of Morgan Stanley's large and very profitable emerging markets business, reporting to me. We regarded him as a young superstar, and as 2000 drew to a close, I pressed very hard to get him paid big money because he was crucial for the business, because he had so much potential, and because I knew he was restless. At the end of 2000, for the first time, Ian received a huge bonus, part in cash and part in deferred compensation.

The day after he got paid in January 2001, he came to see me and, sheepishly but very sweetly, told me he was going to resign to start his own global hedge fund. I was disappointed, a little hurt, and very surprised. I felt manipulated, but on the other hand, that's the way the compensation game is played. I tried hard to talk him out of it. I told him he had a great job. Why in the world would he leave now? I knew Ian had a wife and three little children, that he had bought a small house in the Hamptons and an apartment in New York, and that he didn't have any real capital of his own to launch a hedge fund. I also argued that he didn't have the credibility to raise money for a global hedge fund. Why didn't it make sense to stay at Morgan Stanley for a few more years, make and save more money, and build up his knowledge base on global markets, so that he could raise some serious capital if a hedge fund was what his heart was set on? Of course, I hoped that over time, he would come to his senses and stay put.

It was all to no avail. He was adamant, determined no matter what the cost to become a true, practicing global investor. As it turned out, the costs were very high. By leaving, he forfeited well over $1 million of incentive compensation. In the months that followed, he found that raising money was almost impossible unless he gave up equity, and even then it was tough. In order to have some capital to invest, the maniac sold his apartment and house in the Hamptons and moved his family into a grubby rental. God only knows what austerities he imposed on them. He opened his fund in March 2002 with a pittance of $8 million.

Ian's style evolved into a combination of global macro and global stock picking. He will own or short bonds, currencies, commodities, equity indexes, or individual stocks. Since he began, his performance has been up and down. In the years since he started, he is slightly ahead after fees of the MSCI World Equity index and is doing even better versus the S&P 500. However, the monthly numbers have been erratic. He will have a month when he is up 10% and then three or four months back-to-back when he's down 3% or 4%. In November 2004, he jumped 17%. His capital now is up to $25 million, but he hasn't attracted any substantial money, I guess because of his volatility. In addition, as a purist, he is unwilling to make a deal with any of the money raisers who would require giving away part of the ownership of his fund.

I love Ian's intensity. He sleeps with his portfolio, and his wife says there are nights when he grinds his teeth in his sleep. His is the only other hedge fund to which I have given family money. I gave him money because I am so impressed with not only his head and his heart, but also his discipline and intellectual purity. Ian has come to the conclusion that at Morgan Stanley, he was letting external sources dominate his time rather than controlling it himself.

"Here I was," he says, "taking phone calls, listening to analysts chatter, going to lunches, dinners, meeting with strategists who were talking at me. They controlled the agenda. I'm basically a pretty nice Western guy, and being rude, cutting people off once they get into their babble doesn't come naturally. But I want facts, not opinions. I came to the conclusion that I was much better off not seeing anyone, and that the best use of my time was to read newspapers, trade magazines, factual stuff, and some research. To really focus, I needed isolation reading and solitary studying, with the freedom to discard immediately what is junk or irrelevant to my investment thesis."

That's what he does. He reads and probes all day long. Ian never gets on an elevator without a stack of research in his hands. In the office, he is like a hermit monk alone in his cell, searching for truth. Does this mean Ian is going to be a big winner? Not necessarily, but it is the right way *for him* to give himself the chance to be a big winner, and I'm willing to bet some of my own money that he will succeed.

Postscript: April 2005. Ian came to me today and told me that he has, after much agonizing, decided to give his investors their money back; in other words, to close down his fund. I was utterly shocked. I knew he had been struggling the past few months. In early March, he thought equity markets were breaking out, and he covered his shorts the day before the market rolled over and declined for 11 straight days. I knew he was now down 16.5% for the first four months of 2005, but he had come back from big downs before. After all, he had been up 22% gross in 2004, after being down more than 10% at one point during the year. Since inception and after all fees, his investors are still up 10%, while the S&P 500 has returned 12.65% over the same period. Not a brilliant performance, but hardly a disaster.

Ian is discouraged with the volatility of his performance. It has made it virtually impossible for him to attract assets. But, he tells me, this is not what is driving his decision to pack it in. It's because the pressure of living so intimately, so intensely with his portfolio (and dying a little on the bad days) has become intolerable. He has so much at stake that every wiggle wrenches his insides. He is a solitary investor, working alone, in isolation—but at this point, he doesn't have the emotional and financial stability to deal with the stress. Maybe, if he had had an investment partner to share the burden with, it would be different.

Winston Churchill, whose career had its up and downs and also was plagued with bouts of depression, spoke of the huge, foul-smelling black dog with breath like the sewer, which appeared uninvited and sat heavily on his chest, pinning him down. There is an investment black dog, and when you are doing badly, it comes and sits on your chest in the middle of the night, and on Saturday mornings, and on sunny spring afternoons in the office. It's almost impossible to banish the black dog when he gets on you. He plagues your life. We all have visits from the black dog from time to time, but Ian has seen a lot of him in the past three years. In his final letter to his investors, he wrote:

> *On a more personal/psychological note, it is painfully obvious that I never recovered from the fund's devastating first seven months. Getting caught on the wrong side of the worst seven-month period in equity market history in 30 years was not a great way to start a hedge fund. And while we soldiered on and caught a decent portion of the bounce, I remained somewhat scarred from the experience, and at the sight of my*

own shadow as ready to throw on shorts or sell my longs. . . . So to compound the negatives, I have also been running a business whose medium- and long-term prospects were challenging at best. And this intrinsic business fragility can often leak into the psychology of investing. It makes you feel as if you are perennially one bad quarter away from having to pack it in, which is hardly the solid foundation upon which to make medium-term investment decisions.

I'm convinced Ian is a winner. At this moment, he is totally burnt out. He has taken one day off in the past three years, but now he plans to take time out to reassess what he is going to do with the rest of his life. For the past three years, he has spent a large part of his day staring at Bloomberg screens. The trouble is that there are another 1,000 smart, obsessive people staring at the same screens. It has become a grossly overpopulated loser's game, and Ian told me that he doesn't want to spend the rest of his life this way.

Ian is going to be okay. He is going to beat the black dog. Ian is happily married with three little boys, but he told me his family relationships have suffered. Screen staring, the loneliness of his style of running money, plus a tough market environment have just plain worn him out. But honestly, do I feel somewhat betrayed for the second time? Yeah, I do.

GRINNING GILBERT LOSES HIS GRIN

Of course, as you would expect after a bubble like the one that happened in the Internet and tech space, there also have been hedge funds that went out of business with a bang, and a few that have disappeared with a whimper. Then there were some that burst with a bust in the pocketbook for the investors and with a whimper for the manager. In some cases, the whimpers are sad. There was a guy who was known as Grinning Gilbert because he was always grinning when he talked to you. He could be telling you that his best analyst had just quit or that his biggest long had missed on earnings, and he would be saying it with a huge, beaming smile. It was a friendly, sincere grin, and Gilbert was a very sociable guy. Everybody liked him.

Anyway, that's neither here nor there. In 1996, Grinning Gilbert was maybe in his early forties and was laboring as a portfolio manager at Lord Abbett when he quit to form his own hedge fund. Grinning Gilbert didn't have any money to speak of, and he only raised a pittance initially, but he hired three young analysts and opened his own shop. Grinning Gilbert was a story stock, momentum investor, and he alone made all the investment decisions. In the hot markets of the late 1990s, he increasingly concentrated on tech and Internet stocks. Performance was volatile, but 1997 was huge, and 1998 was OK, and the fund grew. By 1999, Grinning Gilbert was running around $500 million and making some serious money, which he plowed back into his capital account in the fund. That summer, he moved his offices to Greenwich and paid something like $10 million for a big old stone mansion on Round Hill Road, which is about as fancy an address as you can get. It was, to say the least, an aggressive move because $10 million was probably half of his net worth at the time.

Now, Grinning Gilbert's wife Sharon is an aggressive, ambitious personality. She performed a full cannonball into the Greenwich social pool, which is not so easy since there are numerous other families that also desire maximum splashes. Sharon signed up for all the requisite charities and expensive nursery schools, and she instinctively discerned the Greenwich lifestyle. She insisted on a real Scottish nanny and a personal trainer, and that they buy a share in Net Jets. But most of all, she began to pour money into their new property. The interior of the old house was gutted and was rebuilt, complete with every modern architectural flourish, including a two-story-high screening salon and a family room with a massive fireplace and a cathedral ceiling. Her architect designed a wine cellar for the remodeled basement that could stock 5,000 bottles, surrounding an ornate dining room with an antique table that could seat 12. An electronic dumbwaiter connected it to the kitchen. Why she ever thought she would want to have a dinner party in the basement was beyond me, but she did. In any case, it took a year for the rebuild, and the combination of the purchase and the construction put another substantial dent in Grinning Gilbert's still immature net worth.

The family finally moved in on July 1, 2000. Grinning Gilbert was a little nervous about all the new overhead he was acquiring, but as long as the fund kept cranking, he figured he would be okay. Besides, the