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The Odd Couple

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Senrigan Shines

Oxford-trained Nick Taylor shows that Asia is ripe for event-driven hedge funds

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A new generation of managers helps the hedge fund industry reclaim its greatness.

EREZ KALIR

"Anyone who tells you they can predict the future is selling you a unicorn."

CRAIG PERRY

"We want to be a throwback to the earlier era in the history of hedge funds."

BOAZ WEINSTEIN

"I named the fund in honor of my grandfather. He was very wise."

AZIZ NAHAS

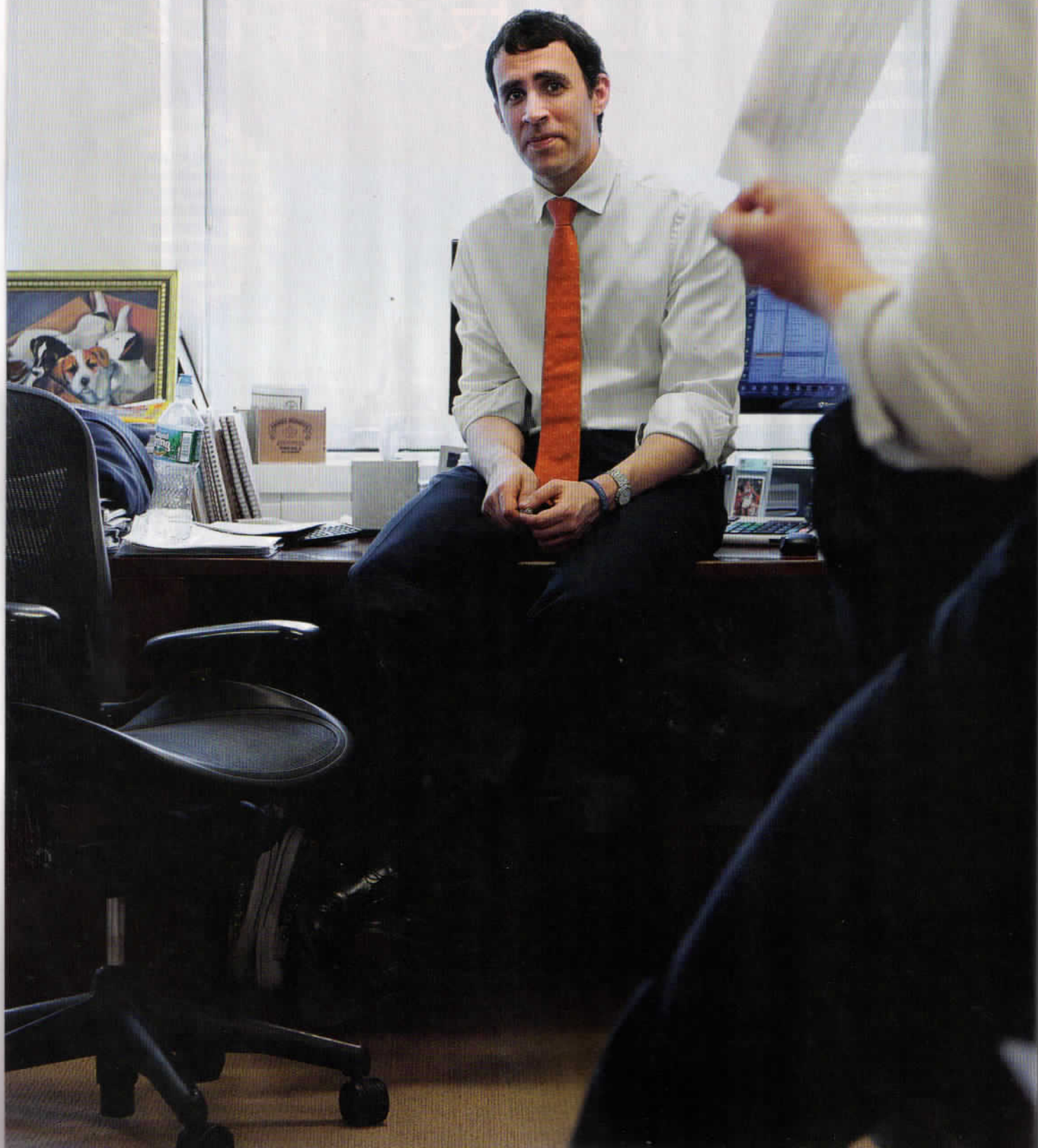
"You compete every day, and every day you need to earn the right to play."

The Future Face of Hedge Funds

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Sabretooth Capital's Erez Kalir (this page) and Craig Perry are creating a culture of intellectual honesty and respect for investors





The **NEXT** Best Hope

Forged in the fire of financial crisis, a new generation of managers is embracing many of the original values that once made the hedge fund industry great.

By Imogen Rose-Smith

PHOTOGRAPHS BY GABRIELLE REVERE

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Aziz Nahas is a student of failure.

In 2006, following the collapse of hedge fund Amaranth Advisors, which lost an eye-popping \$6 billion in less than two weeks late that summer betting on natural gas, Nahas, who was working at a rival firm, interviewed former Amaranth employees to find out what had gone wrong. Two years later, Nahas — by then managing his own fund, 1798 Fundamental Strategies — experienced investment adversity firsthand when markets went into free fall after the September 2008 bankruptcy filing by Lehman Brothers Holdings. To Nahas's horror, his equity-focused multistrategy fund plunged in value as the global credit contagion worsened.

"I lived through 2008 as the toughest and most challenging year of my professional life," says the Moroccan-born Nahas, 39, who in his previous 14 years of trading never had a down year.

Nahas was worried that his dream of running his own hedge fund, something he had been meticulously planning for years, was in jeopardy. But what bothered him the most was that he felt he had let down the people who had trusted his ability to preserve capital.

Swiss private bank Lombard Odier Darier Hentsch & Cie. staked Nahas in 2007 to launch his hedge fund business, now part of Lombard Odier Investment Managers. Although the majority of Nahas's 60-person team is based in New York, he spends most of his time working out of the bank's staid Geneva headquarters. During the crisis he spoke daily with Hubert Keller, CEO of LOIM, whose parent firm had avoided the problems that befell many other European financial institutions at the time. The conservative Swiss bank stood by Nahas and Keller, even extending them capital to pay staff and hire more talent.

"If I had partnered with the usual European seeders, my fund would have ended in November 2008," says a grateful Nahas, who as CIO of LOIM runs the 1798 Fundamental Strategies Fund.

The fund — named after the year the original partners of Lombard Odier established the bank — might not have lived up to its manager's own high standards, but it came through 2008 remarkably well. The fund fell 15.9 percent, outperforming the typical hedge fund, which lost 19 percent that year, according to Chicago-based Hedge Fund Research, and trouncing the Standard & Poor's 500 index, which plummeted 37 percent. In addition, because the fund uses only moderate leverage and has a small and stable investor base, strong agreements with counterparties and highly liquid positions, Nahas didn't face the steep margin calls and redemption requests that led many of his competitors to anger investors by blocking redemptions or moving illiquid assets into so-called side pockets to be accounted for separately. Such foresight left him well positioned to bounce back in 2009, a year that saw his fund return 50.31 percent.

During the financial crisis, the hedge fund industry teetered on precarious ground — assets declined precipitously, funds seemed to be closing almost daily, and scandal stalked the business. Now,

two years later, the industry isn't just in good shape, it is positively booming. At the start of 2011, hedge funds were managing nearly \$2 trillion in assets. Pension funds and other institutional investors — still feeling the effects of the market meltdown and desperate for the downside protection that hedge funds can offer — have been plowing money into many of the largest managers. But in their haste, these investors may not only be missing the opportunity of a lifetime, they might be taking on unnecessary risk and forfeiting returns.

Nahas is one of a new generation of managers who represent the best hope for a healthy and profitable future hedge fund industry. They have learned not just from the economic collapse but also from the bubble that preceded it. They are younger, hungrier and, for the most part, smaller than many of their more established hedge fund peers. These emerging stars talk about the importance of financial stewardship and actually mean it. They are acutely aware of their responsibilities to their investors, as well as their obligations to build a strong, sustainable business. They want to do it the right way, focusing on counterparty relationships and risk management. They are not as much interested in the trappings of wealth — the fast cars, society functions, glamorous friends — that defined the previous generation of managers. There is a newfound seriousness that comes from having seen how easily, and quickly, success can be taken away.

Craig Perry and Erez Kalir hired a sports psychologist when they started Sabretooth Capital Management in the spring of 2009 to keep them intellectually honest — making sure they would be willing to disagree, change their minds and admit mistakes. Boaz Weinstein, one of the pioneers of the credit derivatives market, founded Saba Capital Management at around the same time. As co-head of global credit at Deutsche Bank, he managed a proprietary trading fund that had made billions of dollars for the bank before losing \$1.8 billion in the last quarter of 2008, when the credit markets seized up. Gregory Lippmann — who launched LibreMax Capital late last year — was previously head of the Deutsche's nonagency residential mortgage-backed and asset-backed securities trading and became famous by shorting the subprime mortgage market.

Then there are the quants, managers who use mathematical and scientific techniques to build computer models to exploit price anomalies in liquid markets. Last November, Mark Carhart, a former co-head of Goldman Sachs Asset Management's quantitative investments, began trading partners' money for his new hedge fund, New York-based Kepos Capital. A few blocks north of Kepos's Midtown headquarters, Peter Muller is working out of Morgan Stanley's offices to start his own firm. Muller, the longtime head of Morgan Stanley's Process Driven Trading quantitative group, and his 60-person team are part of the exodus of investment talent from Wall Street in the wake of regulatory reform.

The Volcker rule, named after former Federal Reserve Board chairman Paul Volcker, prohibits U.S. banks from engaging in proprietary trading. As a result, banks have to either spin out or dissolve internal trading units, like PDT, which have often been an incredible source of profits. Outside investors will now have to provide the capital for these former bank traders, a development that is making J. Tomilson Hill very happy.

"Hedge funds have been significant beneficiaries of the Volcker rule," says Hill, CEO of alternative-investment firm Blackstone Group's \$36 billion hedge fund business. "The brain drain from the

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banks has accelerated dramatically.” In 2007, Hill’s group launched the \$1.1 billion Blackstone Strategic Alliance Fund to partner with new managers, injecting \$100 million to \$150 million for a minority stake in their businesses. The fund has seeded eight managers, including George (Beau) Taylor, former head of commodities trading at Credit Suisse Group, and Nick Taylor, who had been running an Asian event-driven fund for Citadel (see “Philosophical Difference,” page 54). Blackstone recently raised \$2.4 billion for a second Strategic Alliance Fund.

It wasn’t long ago that market pundits were predicting the demise of hedge funds. Some of the industry’s biggest criticism came from within. In November 2008, George Soros, arguably one of the greatest managers of all time, testified before the House of Representatives as part of a hearing on financial markets and regulation. “It has to be recognized that hedge funds were also an integral part of the bubble,” the billionaire Holocaust refugee told Congress. “But the bubble has now burst, and hedge funds will be decimated. I would guess that the amount of money they manage will shrink by between 50 and 75 percent.”

Soros’ prediction turned out to be too dire. Although hedge fund assets fell by nearly a third from their second-quarter 2008 peak of \$1.93 trillion, by the end of last year, they were back up to \$1.917 trillion, according to HFR. Still, Alex Ehrlich, head of Morgan Stanley’s prime brokerage unit, which provides financing and other services for hedge funds, says that it is harder for small firms and start-ups to raise money in today’s market than before the crisis. The main sources of capital—larger pension funds, foundations, endowments and insurance companies in need of both diversification and better investment results—are plowing their cash into the biggest players.

“The largest funds are getting larger,” says Citi managing director Alan Pace, regional head of the bank’s prime finance business for the Americas. Institutional investors favor managers like New York-based Paulson & Co., whose founder, John Paulson, personally made an estimated \$3.7 billion in 2007 shorting the subprime market. His firm’s assets have grown from \$6.4 billion at the end of 2006 to \$32 billion when this year began.

“[W]e are not concerned about our size,” Paulson told investors recently. “Scores of smaller funds have failed or delivered subpar performance.”

But recent research by the New York-based investment management firm Spring Mountain Capital, an early Paulson investor, suggests that size matters an awful lot. “Size has a very significant impact on performance,” says Jason Orchard, a principal with the firm. “Smaller funds have historically produced higher absolute returns and greater alpha than larger funds.” Contrary to what many investors think, he adds, “larger funds are not in fact safer than smaller funds.” When capital raising stops, and when redemptions start, the negative pressure on an investment portfolio can be even greater at larger funds, producing a more rapid downward spiral.

“As an investor, it is just much easier to go from \$50 million to \$500 million than it is to go from \$8 billion to \$20 billion,” argues Julian Robertson Jr., founder of legendary hedge fund firm Tiger Management Corp. in New York. Robertson knows of what

he speaks. In the late 1990s, competing with Soros Fund Management for the title of largest hedge fund firm, Tiger grew too large. After sustaining significant losses, Robertson decided to shut Tiger to outside capital and return investors’ money.

“As for the idea that bigger is better, I would have thought the Madoff thing would have squelched that right away,” Robertson adds, referring to longtime Wall Street power broker Bernard Madoff’s \$65 billion Ponzi scheme. Although Bernard L. Madoff Investment Securities was not a hedge fund, many funds of hedge funds were investors in it.

The Madoff scandal was a symptom of a malaise that crept into the hedge fund industry as the business grew from \$38.9 billion in assets in 1990 to close to \$2 trillion by 2008. As money flooded in, returns became harder to come by, creating a temptation to reach for yield—be that through the use of excessive leverage, colluding with other fund managers or, in the most egregious instances, falsifying returns or participating in insider trading.

The best of the new generation of hedge fund managers know the cost of placing personal gain above integrity. They want to get back to some of the old-fashioned values hedge funds used to have.

THE SMILODON, OR SABER-TOOTHED TIGER, ROAMED Europe and North America during the Pleistocene era, becoming extinct about 10,000 years ago. Naming a firm after a vanished species might seem like a bad idea, but Erez Kalir and Craig Perry don’t see it that way. They chose the name Sabretooth Capital Management because they wanted to emulate the “dinosaurs” of the hedge fund industry—people like Robertson, Soros and Michael Steinhart, who built their reputations during the 1970s, ’80s and ’90s, delivering net annualized returns of 24 percent or more. (Incredibly, \$1,000 invested in Soros’ flagship Quantum Fund in 1969 would have grown to \$4 million by 2000.)

But it isn’t just the dinosaurs’ numbers that appeal to Perry and Kalir. It is also their versatility. These managers hunted among different securities and styles looking for investment opportunities. To Kalir and Perry’s way of thinking, it is not that the dinosaurs themselves became extinct, but that the influx of institutional money into hedge funds during the past decade made their way of doing things obsolete. And that, Sabretooth’s founders believe, is a bad thing. “We want to be a throwback to the earlier era in the history of hedge funds,” Perry, 31, says.

Perry didn’t originally intend to go into finance. After graduating from Princeton University in 2002 with a BA in economics, he enrolled at the University of Pennsylvania School of Medicine. After one semester he realized he didn’t want to be a doctor, so he dropped out and got a job as a distressed-debt analyst at New York-based hedge fund King Street Capital Management. Although he enjoyed the work, he was soon hungering for more autonomy and responsibility. He found the freedom he was looking for when he joined Credit Suisse in 2005 to work in its credit proprietary trading group.

As Perry was beginning his career in banking, a whole generation of senior traders was leaving banks to start hedge funds. Among the highest-profile was

“**Smaller funds have historically produced higher absolute returns and greater alpha than larger funds.**”

— Jason Orchard
Spring Mountain Capital

Eric Mindich, who in 1994, at the age of 27, ran the risk arbitrage desk at Goldman, Sachs & Co. and became the youngest partner in the firm's history. When Mindich left to launch Eton Park Capital Management a decade later, he raised a then-record \$3 billion, which he would use to hire a large team and put in place significant infrastructure out of the gate to try to recreate his success at Goldman.

Kalir, 39, was an unusual hire for Eton Park. He didn't come from Goldman or have a background on Wall Street. With a BA degree in literature from Stanford University, an MSc in biology from the University of Oxford and a law degree from Yale University, he was in Washington working for John Kerry's presidential campaign when a partner at Eton Park decided to take a chance on him, hiring him as an analyst for the event-oriented special situations group.

In March 2008, Kalir left Eton Park to join a long-short equity fund seeded by Tiger's Robertson. The economy was a few months into what would be the worst recession since the 1930s. That same month, JPMorgan Chase & Co. bought troubled investment bank Bear Stearns Cos. in a government-brokered shotgun marriage.

Around this time, Kalir was introduced through a mutual friend to Perry, who had left Credit Suisse in the summer of 2007 to co-launch a proprietary distressed-debt-trading business for reinsurer Swiss Re. The two found they had similar views on investing and business. They believed the evolution of the hedge fund industry had created false dichotomies—debt versus equity, fundamentals versus macro. Instead, they thought that a manager should look across the whole board of investment options.

Perry's decision to join Swiss Re proved ill timed. The reinsurer was neck deep in subprime mortgages—precisely the type of securities that Perry and other traders wanted to short—and as the mortgage market continued to weaken, its available balance sheet for distressed-debt trading shrank. Throughout the 2008 summer the markets worsened, and Perry found himself out of a job.

Kalir, meanwhile, was unhappy at his new firm. To him it seemed unprepared for the bad economic environment. In early September he fired off an impassioned e-mail to the fund's managing partner outlining where he thought the global economy was headed—down—and how the portfolio should be positioned. Sent just days before the collapse of Lehman Brothers, Kalir's prescient e-mail found its way into the hands of Robertson, and the Tiger founder liked what he read. By this time, Kalir and Perry were talking about setting up a firm together. They met with Robertson to see if he would back them.

Since Robertson closed Tiger Management to outside investors,



Saba Capital Management founder Boaz Weinstein has yet to have a down month

he has operated as a seeder firm, using his own money to stake an army of new managers. The vast majority of Tiger seeds are fundamentally focused long-short equity managers. Blending strategies and styles, with an eye to the credit markets as well as equities, Kalir and Perry were something new. Robertson was impressed by the duo and staked Sabretooth with \$65 million in March 2009.

"I like that they are so completely different from the other people we have," he says. "Every organization needs people who think differently."

One of the first things that Kalir and Perry did was put together a business plan that included a statement of principles—pledging to do things differently and avoid the common errors that hedge funds often make. Their goal: to create a culture based on intellectual integrity and respect for investors. "To keep us honest," as Kalir puts it, and true to its principles, Sabretooth hired a coach, sports psychologist Graham Jones.

Jones, a Brit, was helping to coach the 1996 U.K. Olympic swimming team when he met 1988 gold medalist Adrian Moorhouse. The two decided to start a firm, Lane4, to apply the techniques used in training successful swimmers to other sports and areas, including business. The Sabretooth founders read an article Jones had written in the *Harvard Business Review* on how winners keep succeeding,

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continued from page 39 and Perry, who had been an All-Ivy League rower at Princeton, contacted him.

Jones had never worked with hedge fund managers before, and he says he was skeptical of anyone in an industry with a reputation for big egos and questionable behavior. But it didn't take long for Kalir and Perry's enthusiasm, commitment and desire to forge their own path to win him over. "They believe in their own fallibility," says Jones, who has started a new firm, Top Performance Consulting. "The last thing they want to do is get complacent."

All three men speak on a regular conference call once a month. By asking Kalir and Perry tough questions, Jones says, "I help keep them on the straight and narrow."

"What is great about these two is they are not satisfied with the tangibles, the financial rewards," he continues. "They are more interested in the process, in running an organization to be proud of. It is about sustainability."

Now with \$600 million in assets, Sabretooth's founders are humble in their attitude toward the markets. Perry sees every day as a battle to make money. "We don't try to predict the future," adds Kalir. "Anyone who tells you they can predict the future is selling you a unicorn, something that doesn't exist. We attempt to construct a portfolio that has a quality of resilience. We look for asymmetries."

By asymmetries, Kalir is referring to trades that have identifiable limited potential downside with a larger potential upside. Sabretooth's six-person investment team starts by identifying macro trends, which they distill down to investable themes, such as going long U.S. regulated utilities or shorting the Australian housing market. They then employ bottom-up fundamental security analysis to capitalize on those themes, searching out opportunities across asset classes, geographies and industries. Unlike

most multistrategy firms, Sabretooth doesn't assign its traders and analysts to specific asset classes. Kalir and Perry want them to remain flexible. In addition, Sabretooth uses little to no leverage; to its founders' minds, making returns from borrowed money is cheating.

Unlike most Tiger seeds, which operate out of Tiger Management's longtime Park Avenue offices, Kalir and Perry have chosen to maintain their independence and work a few blocks away, on the 50th floor of the Chrysler Building. "They prefer to live apart from us," Robertson says. "I think it is a mistake on their part; but I admire their willingness to differ."

Their formula seems to be working. For the ten months Sabretooth was up and running in 2009, the fund returned 26.5 percent; for 2010 it was up 14.1 percent.

A MATH WHIZ AND PRODUCT OF MANHATTAN'S acclaimed Stuyvesant High School, Boaz Weinstein began his Wall Street career at 15, interning for a mother-and-daughter advisory team at Merrill Lynch & Co. After graduating with a BA in philosophy from the University of Michigan in 1995, he entered a training program at Merrill, where he ended up on the corporate bond desk. A few months later he decamped to investment bank Donaldson, Lufkin & Jenrette, where he quickly became a trader, but he rejoined the team he had worked with at Merrill when it moved to Deutsche Bank. Arriving in January 1998, he was put on the credit derivatives desk to trade a relatively new product—credit default swaps.

Credit default swaps, or CDSs, are bilateral contracts that act like insurance. The buyer of the CDS pays the seller a quarterly fee for protection on a bond, typically issued by a company or a country. If the bond defaults, the buyer receives full value.

The then-\$300 billion CDS market was a backwater when Weinstein joined Deutsche. But that started to change following Russia's decision in August 1998 to default on its debt, which had investors running for cover as the contagion quickly spread. Over the next few years, demand for CDSs grew as volatility became the norm thanks to events such as the 9/11 terrorist attacks and the bankruptcies of companies like Enron Corp. and WorldCom. By 2002 the market had grown to \$2 trillion, as more and more investors were using CDSs to place bets rather than to hedge bonds.

Weinstein was instrumental in educating many of the top hedge fund firms on how they could best use the new instrument, in part because that's what he was doing for Deutsche. Starting in 1999, Weinstein began running Deutsche's in-house relative value credit proprietary trading fund. In 2001 the bank let him trade equities as well as credit—enabling him to exploit the relationships between the two markets. Deutsche also promoted Weinstein, then 27, making him the bank's youngest-ever managing director.

In 2006, Weinstein struck an agreement with Anshu Jain, Deutsche's head of investment banking, that would enable him to lift out his proprietary trading operation in 2009. In preparation, Weinstein named the group Saba, the Hebrew word for "grandfather," so he could start branding it outside the bank. "I named it in honor of my *saba*, who saved my mother's life and several other people during the Holocaust," Weinstein says. "He was very wise."

As Deutsche Bank's co-head of credit, Weinstein had a front-row seat going into the financial crisis. The weekend before Lehman filed for bankruptcy in September 2008, Weinstein was among a group of bankers who met with then-Federal Reserve Bank of New York head Timothy Geithner to discuss how to deal with counterparty risk in the event of a default. "That was an incredible weekend," says Weinstein, now 37, who was widely recognized as one of the leading experts on the then-\$57.4 trillion CDS market. "I got to represent Deutsche at the Fed."

Following Lehman's bankruptcy filing, counterparty relationships throughout the capital markets became fraught as the stability of more and more financial services companies came into question. In particular, investors began doubting the ability of the bank underwriters of CDS insurance to make good on those contracts. CDS values went up when the associated bonds and loans were plummeting in value, but they didn't rise enough to offset the massive losses. The problem was exacerbated by the fact that many of the traders had built their positions with borrowed money; as they got margin calls, they had to unwind trades, creating more downward pressure.

Although Saba, which by then had grown to about \$10 billion, didn't use leverage, it had a large portfolio of synthetic CDSs it was using to hedge equity and credit posi-

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tions in companies like carmakers General Motors Co. and Ford Motor Co. Between its CDS, equity and credit positions, Saba lost \$1.8 billion in the last four months of 2008, ending the year down 18 percent. That, combined with a further \$3.2 billion in losses Deutsche sustained in other areas, was enough to create unflattering headlines for the bank — and for Weinstein.

In that climate of crisis, with Deutsche dialing back on risk, Weinstein decided to go ahead with the previously agreed-upon lift-out of Saba. He took the majority of his team, including the most-senior members — Paul Andiorio, Jeremy Benkiewicz and George Pan, who became portfolio managers and partners at the new firm, Saba Capital Management. Weinstein was also able to take all of the intellectual property, including trading systems and analytics, that he and his team had created at Deutsche.

“Having the ability to take the trading infrastructure with us was a huge advantage,” says Pan, who has worked with Weinstein since 2002 and is regarded as the quantitative brains at Saba. “We didn’t have to build it from scratch.”

Weinstein and his partners started managing their own money in April 2009, but they were already thinking big. “People give

a successful proprietary business outside of a bank with a large capital base of institutional investors — looks and feels more like Mindich’s Eton Park than like Sabretooth. Saba is more credit-focused and quantitative than Sabretooth. But both firms rely on fundamentals, look at equity and credit markets, practice capital structure arbitrage and use a relative value approach. In fact, Weinstein sounds a lot like Sabretooth’s Kalir when he describes his investment approach: “I look for asymmetry.”

Weinstein has a salesman’s eloquence for breaking down complex trading ideas into simple, logical strategies — and a trader’s instinct for the killer deal. “The competency Boaz has, his ability to structure trades, is really a very unique and valuable commodity,” says Thomas Macina, president of Mesirow Advanced Strategies, the \$13.6 billion fund-of-hedge-funds business of Chicago-based financial services firm Mesirow Financial. “We were an investor with Saba early on and have been very pleased.”

One worry for prospective investors is that Saba, following its experience in 2008, might be too cautious. Weinstein and his team insist that is not the case. “Strategically, we want to focus on producing uncorrelated returns with low volatility,” says Benkiewicz. “If we

45, told *Institutional Investor* last year before launching Kepos Capital. In 2007, GSAM’s onetime \$12 billion Global Alpha fund fell more than 14 percent the week of August 7 and 28.5 percent for the month. “It was unexpected given both what had happened in the markets before and our limited knowledge, at that point, of how much money was really out there,” he added.

The August 2007 quant meltdown was purely an equity event. Carhart thinks that many of the problems were caused by too many managers having similar trades. At his new firm, investors say that Carhart has gone out of his way to make sure the research Kepos uses to generate ideas and the systems it uses to put on positions are unique. He also wants his new firm to be small and nimble enough to quickly and dramatically adjust risk.

Kepos began trading partners’ money in November as a way to build a track record to attract investor capital. “Not only did we learn a lot from 2007, but we have really tried to apply those lessons,” Carhart told *II*.

As for Muller, 47, who is in the process of launching his firm, likely to be called PDT Advisors, he thinks that the big issue in August 2007 had more to do with leverage and capital flows than it had to do with the quants being in the same crowded trades.

“We are trying to build a business that will be successful out of the gate, but one that also has longevity.”

—Gregory Lippmann, LibreMax Capital

us a lot of credit for having built out the operations early,” says Andiorio. In addition to its extensive trading and settlement systems, Saba had a CFO, chief operating officer and a chief accounting officer from the outset.

Weinstein sees little difference between how Saba operates today and how it did when it was part of Deutsche. Saba launched its flagship Capital Master Fund in August 2009 with \$140 million. Its three main strategies are long-short credit, capital structure arbitrage and credit relative value.

Saba’s offices are located in the Chrysler Building, eight floors above Sabretooth Capital. The differences and similarities between the two firms are striking. Given the background of Weinstein, it is little surprise that his vision for a hedge fund — re-creating

just do our job well, the rest should follow.”

Saba returned 10.84 percent in 2010, its first full year of trading, and as of February had yet to have a down month. Today, Saba has close to \$2.65 billion in assets under management and is in the process of launching a so-called fat-tail strategy, designed to profit in times of extreme market dislocation.

Quantitative hedge fund firms lived through the ultimate fat-tail event in August 2007. That month many of the leading quant shops, including AQR Capital Management, Goldman Sachs Asset Management, Renaissance Technologies Corp. and D.E. Shaw Group, experienced huge losses after a large multistrategy fund liquidated its portfolio.

“It was a very traumatic experience,” former GSAM quant group co-head Carhart,

SUCCESS BRINGS ITS OWN UNIQUE SET

of challenges. Just ask Greg Lippmann. At Deutsche Bank, Lippmann was early to spot the subprime crisis. Starting in early 2006, he pitched the bank and its clients, including a list that would grow to more than 50 hedge funds, on the merits of shorting the subprime mortgage market. When the subprime market started to crumble in 2007, Lippmann’s star shone — he features prominently in at least two books on the financial crisis — resulting in billions of dollars in gains for the bank as well as some very grateful clients.

Lippmann left Deutsche in May 2010 to start a hedge fund, LibreMax Capital, named after its four founding partners. (The Libre comes from the “Li” of Lippmann and “Bre” of Fred Brettschneider; the “Max” is meant to represent Jordan Milman and Eugene Xu.) Like Weinstein, Lippmann took much of his old band with him. LibreMax president Brettschneider was the former head of global markets for the Americas at Deutsche. Xu, the chief risk officer, was head of investing technology for Lippmann’s

team at the German bank. Milman, who heads up trading at LibreMax, ran subprime and nonagency trading.

For his part, Lippmann has to prove he isn't a one-hit wonder, showing that not only is he capable of investing but that he can do so without the resources and advantages of a big bank. To that end, LibreMax hired back-office and operational staff—including a CFO, COO and CAO—with extensive hedge fund experience.

"We know what we know, and we know what we don't know," says Lippmann, who talks about the need to create a strong, stable, partner-oriented firm. "We are trying to build a business that will be successful out of the gate, but one that also has longevity."

LibreMax had 15 people when it began trading in October and has quickly grown to \$500 million in assets. The fund invests in many of the same kind of asset-backed and other securitized products that Lippmann and his team made markets in when they were at Deutsche. There they saw the trouble that many investors got into in early 2008 by taking overleveraged bets on mortgage securities. "I didn't just see one hedge fund—I watched 15 to 20 hedge funds deal with margin calls," Lippmann says. As a result, like many other new funds today, LibreMax, which through February was up approximately 8 percent since inception, uses only moderate leverage and spends a lot of time on risk management.

LOIM's Aziz Nahas is also interested in building a fund with staying power. The son of an airline pilot and a graduate of France's prestigious ESCP business school, Nahas throughout his career has sought out opportunities that would help him reach that goal. Nahas began in 1994 trading convertible bonds and asset swaps with Banque Paribas, first in Paris and then in London. Two years later he jumped to Credit Suisse First Boston in London, where he eventually became head of equity derivatives in Europe.

Nahas moved from the sell to the buy side in 2005, joining JPMorgan in New York as global head of equity in its proprietary trading and principal investments business. His expectation was that the bank would spin out the unit as a hedge fund, but in the end it was too lucrative for JPMorgan to want to share. So Nahas decamped in 2006 as global head of equities and convertibles for Dillon Read Capital Management, a New York-based

multistrategy hedge fund firm staked with \$3.5 billion from Swiss Bank UBS.

Late that summer, of course, Greenwich, Connecticut-based Amaranth announced it was shutting down after sustaining the largest loss in hedge fund history. Nahas, who happened to be hiring at the time, took the opportunity to interview as many soon-to-be-ex-Amaranth employees as he could to figure out exactly what went wrong with the fund and learn from those mistakes. His conclusion: Amaranth was taking on too much risk and trading in markets its CIO did not know well.

"As a CIO, I decided I would only oversee businesses that I had intimate knowledge about," Nahas says. "Don't oversee some-

"The trajectory is very strong for the next five to ten years—not just in terms of the talent, but also the professionalism."

—J. Tomilson Hill, Blackstone Group

thing where you don't understand what the portfolio manager is doing."

Nahas never got a chance to apply those lessons at Dillon Read. In May 2007, UBS decided to pull its capital, effectively shutting down the firm, which had raised little additional money. To Nahas, that experience underlined the importance of choosing the right partners and striking the right deals—hence his decision to team up with a conservative Swiss private bank when he started his own hedge fund.

Nahas views the makeup of his fund's investor base as a critical part of risk management. "I don't understand investors who give people a lot of money on day one," he says. Nahas sees a correlation between the amount of due diligence an investor does and the speed with which money leaves a fund. Not surprisingly, he wants his investors to conduct substantial due diligence.

He launched the 1798 Fundamental Strategies Fund in November 2007 with \$300 million, restricting the first round of fundraising to friends, family and a handful of high-quality investors that had relationships with Lombard Odier. He waited until 2009 to hire a marketer and then began to cautiously target larger asset allocators.

"We have a very deep sense of our fiduciary responsibility," Nahas says. "Our clients are extremely important to us."

During the difficult months of October and November 2008, when 1798 was losing money, Nahas personally called every one of the fund's major clients and offered to return their money. Despite the challenging environment, most investors stood by him. LOIM has about \$2 billion in hedge fund assets today. In addition to its flagship multistrategy fund, the firm launched a European loan fund in June 2009, an energy multistrategy fund in January 2010 and a special situations fund in May 2010.

LOIM's growth is just one example of the resurgence of the hedge fund industry. Blackstone's Hill sees good times ahead.

"There is this runway, and the trajectory is very strong for the next five to ten years," he says. "Not just in terms of the talent we see, but also the professionalism with which hedge funds are managing money."

Tiger Management's Robertson feels the same way. He thinks the pendulum is swinging back toward the way the industry used to be, making now a great time for his seeding business, which is raising capital from outside investors for the first time.

Nahas, who does math puzzles to unwind, intends to take complete advantage of the opportunity that he has been afforded at Lombard Odier. "There is no room in my life right now for any time-consuming hobbies," he says. "I work, I spend time with my family, and I exercise. That's it."

He continues: "This is an immensely competitive business. You compete every day, and every day you need to earn the right to play. I'm not looking at this as a way of making my lifestyle so that I can sit in a boat in Monaco. Maybe one day that is what I will do, but I am going to be 40 this year. I have almost 20 years to make clients happy."

For Nahas, like many of the new generation of hedge fund managers, now is the time to be serious. ●●

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