Banking by John Hoefle

Bloodbath for the hedge funds

Federal Reserve Board Chairman Alan Greenspan is feverishly trying to salvage the unsalvageable.

In a letter to shareholders dated Oct. 23, financial warfare specialist George Soros announced a restructuring of his $20 billion Soros Fund Management hedge fund empire, following $2 billion in losses, primarily on Russian investments. Soros announced that he was closing his Quantum Emerging Growth Fund, which has lost about one-third of its value this year, dropping it to $1.5 billion in assets. Soros also announced that his Quasar International Fund, down 18% for the year to $969 million in assets, would be merged into another Soros fund, the $2 billion Quantum Industrial Holdings Fund. In addition, the London-based manager of Soros's Quota Fund, Nick Roditi, is stepping down due to "illness."

Soros Fund Management also lost heavily on its U.S. stock holdings, reporting in a filing with the U.S. Securities and Exchange Commission that its U.S. stock portfolio was worth $3.9 billion on Sept. 30, 1998, a 50% decline from the $8 billion value reported the previous quarter.

Julian Robertson's Tiger Management hedge fund also suffered heavy losses in the wake of the Russian crisis. Tiger's funds lost $2.1 billion in September and $3.4 billion in October, a two-month loss of $5.5 billion, dropping the fund's assets to $17 billion. Tiger lost nearly 10% of its value on Oct. 7 alone, when the dollar fell sharply against the yen.

The third quarter was a disaster for the hedge funds, and the financial system as a whole. MAR/Hedge aptly described August as a "bloodbath" for the hedge funds as a whole, with 75% of the funds reporting losses. Most of the funds which managed to turn a profit, did so by going short, betting on falls in the markets.

Among the big funds, according to Managed Accounts Reports, Soros's Quota Fund declined 24% during the third quarter, followed by drops of 21% at his Quasar International Fund, 20% at his Quantum Dolphin Fund, 16% at his Quantum Industrial Fund, 13% at his Quantum Emerging Growth Fund, 10% at his Asian Infrastructure Development, and 5% at his Realty Trust fund; Robertson's Tiger Fund lost 7% and his Jaguar Fund lost 6%; and Leon Cooperman's Omega Overseas Partners lost 21% of its value. Quantum Fund lost 2.9%

Even harder hit were the Everest Capital funds: The Everest Capital Frontier LP and Everest Capital Frontier Ltd. funds lost 61% of their assets in the third quarter, and the Everest Capital International fund lost 42%. Other big losers among the funds with assets in the hundreds of millions of dollars, included the Oscar Investment Fund, down 54%; the Appaloosa Investment I and Palomino Funds, each down 43%; the Latinvest Fund, down 33%; the Apam High Performance Capital Fund, down 32%; and the Infinity Investors fund, down 28%.

In August, three hedge funds run by McGinnis Advisors filed for bankruptcy protection when they could not meet margin calls from their bankers. And numerous other funds were forced to liquidate significant portions of their holdings to meet similar calls.

The banks were also hit hard during the third quarter, with the market capitalization of the top 100 U.S. bank holding companies dropping $242 billion (23%) during the quarter, and the market cap of the world's top 100 financial services institutions dropping $635 billion (22%) over the same period, according to *American Banker*.

These losses, along with the Sept. 23 Fed-sponsored $3.6 billion bailout/foreclosure on Long-Term Capital Management, have once again raised the issue of increased regulation of the hedge funds and the global derivatives market.

Federal Reserve Chairman Alan Greenspan predictably defended the role of hedge funds, and the Fed's role in saving Long-Term Capital Management, in testimony before the House Banking Committee on Oct. 1. "If somehow hedge funds were barred worldwide, the American financial system would lose the benefits conveyed by their efforts. . . . The resulting loss in efficiency and contributions to financial value added and the nation's standard of living would be a high price to pay—to my mind, too high a price," Greenspan stated.

To head off a growing demand for increased regulation of the hedge funds, the Bank for International Settlements is considering, in the words of William McDonough, the chairman of the Basel Committee on Banking Supervision and the president of the New York Fed, "regulating them [the hedge funds] indirectly through a closer control of their counterparties—the securities firms, banks, insurance companies."

With three interest rate cuts in seven weeks, the Fed is desperately trying to lure the suckers back into stocks, junk bonds, emerging market paper, and asset-backed securities, and the derivatives based upon them. It won't work, and further shocks are on the way, far beyond anything experienced to date.