

MONEY & INVESTING

Market troubles snag Meriwether, again

LTCM founder has tough time stemming losses, investor exits

By JENNY STRASBURG

A decade after overseeing a hedge-fund collapse that buckled the world's financial markets, John Meriwether again is scrambling to stem losses and keep investors from jumping ship.

Mr. Meriwether is best known as a founder of Long-Term Capital Management, which in 1998 lost \$4 billion. That helped foster a global financial crisis and triggered both a Wall Street-led bailout and congressional hearings on the dangers of hedge funds, the free-wheeling pools for wealthy investors and institutions that often trade heavily and rely on borrowed money to boost returns.

Now, Mr. Meriwether's biggest fund, a bond portfolio, has plunged 28% this year; another, broader market fund is down 6%. Both had sub-par performances last year. Some investors in the funds are seeking to get their money out. Mr. Meriwether and his colleagues at JWM Partners LLC—which he launched in 1999 with LTCM alumni—are trying to reassure investors in the two funds that they have slashed risk and will use their experience to survive this market crisis, preserving some \$1.4 billion in assets.

The struggles represent a warning signal to investors that the perils of the current crisis aren't over, despite lower market values and government efforts to calm the financial system. Mr. Meriwether, a 60-year-old former vice chairman of Salomon Brothers, has seen three decades of market zigzags, recessions and credit contractions. Yet he can't corral the risks of today's markets and is trying to play it safe, even though he believes he should be buying securities.

"We have sharply reduced the risk and balance sheet of the portfolio," Mr. Meriwether told clients in his bond fund, the Relative Value Opportunity Fund, in a March 18 letter. "While the opportunities are among the best we recall, we continue to balance our need to control risk while attempting to capture the opportunities we feel are available."

Mr. Meriwether, through a principal at the firm, declined comment.

His funds' losing positions have included mortgage securities backed by Fannie Mae and Freddie Mac, trades tied to municipal bonds and triple-A-rated commercial-mortgage-backed securities, according to the letter. Those bets have eaten into his returns this year, particularly as hedge fund Peloton Partners LLP and Carlyle Capital Corp. unloaded many of the same securities as they spiraled toward demise.

One of Wall Street's best-known traders, Mr. Meriwether was featured prominently in the book "Liar's Poker." He was considered a master of liar's poker, a complex game of bluffing involving large bets, popular with high-rolling bond traders at Salomon, a firm that now is part of Citigroup Inc.

His LTCM hedge fund, located in Greenwich, Connecticut, included Nobel Prize winners and math whizzes, but it was undone in 1998 by massive "leverage," or borrow-

ing—up to \$50 for every dollar invested—which amplified losses when the markets turned on him.

Mr. Meriwether's recent troubles also partly stem from borrowing. His bond fund had \$14.90 in borrowed money for every \$1 in equity at the end of February, according to the March 18 letter. Though far lower than at LTCM, the fund's risk level, which includes leverage, still was too much for this year's volatile environment, he and his fund managers have acknowledged in conversations with investors.

Mr. Meriwether marketed his bond fund as a lower-risk version of LTCM's core strategy, of identifying the next financial crisis and profiting from it by buying securities its managers consider underpriced. Investors were told that the firm would aim to keep borrowings below 15-to-1 even during less-volatile times. Mr. Meriwether and his colleagues promised to behave more conservatively, rebuilding their reputations with consistent returns. His bond fund hasn't had a money-losing year.

Unlike in 1998, Mr. Meriwether isn't a central player in the current crisis. His firm has about 70 employees, most working in LTCM's former offices in Greenwich, and some in London. Some LTCM investors invested in JWM when Mr. Meriwether started the new firm.

But his funds' recent performance comes amid comparisons of the collapse of LTCM and last week's implosion of securities firm Bear Stearns Cos.—as well as the market fallout, the government's response and the investment opportunities created by events. In 1998, as markets around the world seized, the concern was to contain losses with LTCM's trading partners, which included most of the U.S.'s major securities firms and commercial banks.

The U.S. Federal Reserve orchestrated a controversial \$3.625 billion rescue plan funded by a consortium of 14 Wall Street banks. Global markets were roiled for weeks, but the Fed pared interest rates and pumped liquidity into the system. The markets zoomed upward in 1999, leading to a tech-driven market bubble that popped in 2000.

The current crisis is far broader and deeper. Despite numerous efforts to rein in systemic risks, the Fed hasn't been able to stem investor panic and market volatility. More investments than ever are unregulated with opaque pricing, and there remains the risk that trading partners won't make good on their trades. Financial firms have written down \$150 billion, and more losses are expected. Several hedge funds have collapsed.

When Bear Stearns teetered, the Fed did more than simply orchestrate a bailout. It guaranteed \$29 billion of the firm's losses, and paved the way for J.P. Morgan Chase & Co. to buy Bear at a rock-bottom price—moves far more controversial than in 1998. Investors trying to pick a market bottom have gotten burned.

JWM's Relative Value bond fund, launched in December 1999, has lost 28% this year through last week after notching a 5.6% return in 2007, according to people familiar with the fund. The recent losses further weigh on the fund's average annualized return since inception of about 7% through February 2008. The Lehman Brothers U.S. Aggregate Index, a measure of investment-grade bond performance, has returned an

annualized 6.5% during that period.

JWM's bond fund, which seeks to profit from price discrepancies among stocks, bonds and other securities, trails the 9% average annualized gain of hedge funds world-wide during that period, according to Hedge Fund Research, a Chicago research firm.

Moreover, Mr. Meriwether's five-year-old macro fund, JWM Global Macro, which invests in broad trends through currencies, commodities, stocks and bonds, was down 6% through February after falling 5.6% in 2007. The fund has gained about 5.7% per year, on average, since it began trading in 2003. That record means the macro fund, too, trails its peers, which have gained twice as much a year, on average, during the same period.

JWM's losses this year have pared the bond fund's assets to less than \$1 billion from its peak of more

than \$1.3 billion, according to people familiar with the situation. The macro fund has shrunk by at least half, to about \$350 million. JWM managed about \$2.3 billion in total assets at the start of 2008.

Amid the price drops and borrowing, Mr. Meriwether's firm, like others, has been at risk of receiving margin calls, or demands for additional collateral, from lenders. JWM has remained in compliance with its lenders, according to a person familiar with the fund.

Of course, the credit crunch and market volatility have roughed up other multibillion-dollar hedge funds, which on average have lost about 3.35% this year, according to Hedge Fund Research's daily global performance index.

Mr. Meriwether, in phone calls and letters to clients, has been spreading the message that he learned his lesson in years past and has been playing it safe this year since his funds started losing

money, according to people who have spoken with him.

His funds' investors have until Monday to request withdrawals that would happen at the end of June. Hedge-fund managers have varying rules about such investor redemptions. In Mr. Meriwether's case, the three-month lag could buy him some time, in addition to the funds' restrictions allowing clients to withdraw just one-eighth of their capital during any given quarter.

Not surprisingly, Mr. Meriwether and other JWM executives, including LTCM veterans Richard Leahy and Lawrence Hilibrand, prefer to talk about their funds' low volatility relative to stock-market indexes, rather than leverage.

Meanwhile, there is a big disadvantage to reducing how much money they borrow. Lower leverage cuts into the fund's chances of climbing back from losses. And it is a steep climb before JWM can start collecting its 20% performance fee again, in addition to the 2% of assets that the managers collect. Such performance fees are the key to hedge-fund-manager riches.



John Meriwether