THE WALL STREET JOURNAL. ONLINE

May 31, 2008

Banks Fumble At Operating Hedge Funds

Eager Foray Turns Into Billions Lost, Marred Client Ties

By GREGORY ZUCKERMAN and JENNY STRASBURG
May 31, 2008; Page B1

Getting into the hedge-fund business seemed like a no-brainer for big banks just a few years ago. Clients were hankering to invest in such funds, most banks had deep experience lending and trading with them, money was pouring into the industry and growth seemed assured.

But on the heels of a run of recent embarrassments for banks that operate their own hedge funds, or buy stakes in funds, the foray is raising questions.

Disappointing the Bank Clients

Some recent letdowns at bank-owned hedge funds

Firm (period)	Fund	Investment type	Estimated decline*
Goldman Sachs (2007)	Global Alpha	Quantitative macroeconomic bets	$4 billion
Bear Stearns (2007)	High Grade Structured Credit Strategies	Mortgage-backed securities	$2 billion
Citigroup (2007-'08)	Falcon Strategies	Fixed income	$1.9 billion
J.P. Morgan Chase (2007)	Highbridge Statistical Opportunities	Equities	$240 million

*Declines include estimated losses to retail and institutional clients
Sources: fund investors; the banks

Citigroup Inc., Bear Stearns (absorbed into **J.P. Morgan Chase** & Co.), **Goldman Sachs Group** Inc. and **UBS** AG have seen hedge funds that they started or invested in run into problems amid the credit crunch. That has led to billions of dollars of losses for the banks' clients or for the banks themselves.

Now, some are asking whether top-performing hedge funds, which often have an entrepreneurial streak, can succeed within a huge financial institution. At the same time, lawsuits leveled against banks such as Citigroup after sudden hedge-fund losses raise the question about whether the downside to getting into the hedge-fund game is worth any potential gains.

"Hedge funds require an enormous amount of independent thinking and flexibility in order to avoid making mistakes," said Daniel Alpert, managing director of Westwood Capital LLC, a New York investment bank. "They really need to turn on a dime."

When hedge funds collapse, their investors grumble, but there usually isn't much they can do about it.

But banks have much deeper pockets and are more likely to be the targets of messy lawsuits from investors -- legal action that can cost them money and hurt their reputations.

"These funds are a huge cash machine when they are working right," said Scott Baker, a principal at Cook Pine Capital, a Greenwich, Conn., firm that oversees about $200 million in customized hedge-fund portfolios for its clients. "When they aren't, they can jeopardize relationships that have been around for years between clients and their financial advisers."

Not all of the experiences in the hedge-fund world have been losers. **Morgan Stanley**'s investments in

firms such as Frontpoint Partners and Avenue Capital Group seem to have paid off. Since Morgan Stanley acquired Frontpont in December, 2006, the firm has expanded its assets 70%.

Gentle Giants?

And some argue that as investors seek comfort in large organizations, on the heels of the credit-market fallout, banks with hedge-fund ties could be in a position to capture more money.

"After the scares of the last year, people like the belts and suspenders that go around the process at a bank," said Tanya Beder, chairman of SBCC Group, who advises hedge funds and once ran Tribeca, Citigroup's multistrategy fund.

Still, the track record so far isn't promising: Bear's mortgage funds lost almost $2 billion last year; Goldman Sachs's huge Global Alpha fund lost almost $4 billion in 2007; and UBS's high profile Dillon Reed fund was closed after losses in the summer. More recently, Citigroup's Falcon funds ran into losses of almost $2 billion.

Highbridge Capital Management, the hedge-fund affiliate of J.P. Morgan Chase, has produced lackluster returns in several of its funds in the past couple of years, including its flagship multistrategy fund. Also, Highbridge investors pulled more than $8 billion from two so-called statistical-arbitrage mutual funds that were heavily marketed to wealthy J.P. Morgan clients. That helped those mutual funds amass more than $12 billion at one point, but the funds disappointed in 2007, finishing about break-even for the year.

To be sure, Highbridge's purchase by J.P. Morgan in 2004 helped increase Highbridge's assets to more than $30 billion last year from $7 billion, resulting in a flood of management and performance fees for the bank.

Highbridge's funds and Goldman's Global Alpha have improved returns this year and are making money. Goldman and J.P. Morgan say their hedge-fund experiences have been profitable; both have started additional funds.

"We work hard to please our clients, and any disappointment is of deep concern to us," a Goldman spokeswoman said.

"There's a luxury that exists for the funds to take concentrated risk because they don't usually have the same capital at stake as someone who starts a hedge fund," SBCC Group's Ms. Beder said.

Personnel Fallout

Hedge-fund implosions can take a toll beyond banks' -- and investors' -- bottom lines.

In the wake of Falcon's collapse, for instance, a handful of top brokers at Citigroup's Smith Barney brokerage unit left the company. The latest: a seven-person team led by Richard Zinman, who is considered Smith Barney's top-ranked retail broker, with more than $6.5 billion in assets. Mr. Zinman said Friday that he is joining Credit Suisse Group.

A Citigroup spokeswoman confirmed the move. She also said the company recently hired a number of well-regarded brokers from other firms.

--David Enrich contributed to this article.

Write to Gregory Zuckerman at gregory.zuckerman@wsj.com[1] and Jenny Strasburg at jenny.strasburg@wsj.com[2]

URL for this article:
http://online.wsj.com/article/SB121219666370234667.html

Hyperlinks in this Article:
(1) mailto:gregory.zuckerman@wsj.com
(2) mailto:jenny.strasburg@wsj.com

Copyright 2008 Dow Jones & Company, Inc. All Rights Reserved
This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.