Hedged Ambition
by C-Lab

Until recently, alternative asset management (hedge fund and private equity investing) was a relatively unknown phenomenon. Even now that it is being discussed its presence in the city is barely felt. In New York, the world headquarters of hedge funding, the conspicuous consumption that characterized earlier booms is hardly to be found.
If the city was once a place where the visibility of money spent was proportional to the money made, then today this is less the case. The lesson of this period of accumulation is that to have real ambition requires keeping success under wraps. Hedging attention to reduce exposure to scrutiny has resulted in a city within the city, separating the experience of the haves from the have a lots. C-Lab investigates the urbanism of private wealth management and the world of takeovers and protectionism.
The field of alternative asset management developed in the middle of the twentieth century as pools of capital raised from small groups of wealthy individuals. These pools came to be called ‘hedge funds’ for their strategy of ‘hedging’—short-selling some stocks while maintaining long positions in others. The low profile and small number of big investors allowed hedge funds to avoid government oversight, provided that they agreed to never publicly solicit potential investors or otherwise advertise their product. By forsaking their public image, hedge funds were permitted to operate without regulations or transparency.

In the last two decades, the total assets invested in hedge funds have experienced rapid growth, from less than $30 billion in 1990 to $1.4 trillion as of 2007. This expansion was driven by deregulation, emerging economies in the developing world, and technological advances that have synchronized world financial markets. Hedge funds became a popular mechanism for profiting in a down market, an important advantage in the bursting bubbles of the last two decades. Hedge funds were a boomer economy that no one noticed.

In fact, it went so unnoticed that as of 2007 most Americans felt the economy was in a slump. According to a Gallop Poll taken on June 19 (prior to the subprime mortgage crisis), 7 in 10 Americans believe the economy is getting worse, the most negative reading in nearly six years. Hedge funds have been an invisible boom, generating incredible capital, but for very few players.
Comparing Three Booms:
The leading figures of the hedge fund economy receive far greater compensation than the moguls of previous generations.

- 80s: Michael Milken, Drexel Burnham
- 90s: Stephen Case, AOL
- Today: James Simons, Renaissance Technologies

The combined incomes of the top seven hedge fund managers is greater than that of the top 500 companies' CEOs.
What's the 'Alternative'?

Speculation
The alternative asset manager pursues speculation rather than nurturing the development of a company beyond what is necessary to ensure a quick profit. Such an approach reflects a return to the dispassionate quantitative mindset of the mergers and acquisitions era of the 1980s and counters the more well-rounded approach to corporate development and identity popularized during the late 90s. Any benefits to the company or to shareholders become byproducts of the process, though they are more likely to occur with longer-term private equity strategies. Activist shareholder strategies have become a popular method of corporate manipulation in the pursuit of short-term gains.

Qualitative Outlets
The fund manager is torn between the role of a cutthroat outsider and the guise of a benevolent citizen of the community. Such figures are often the leaders in charitable donations and political fundraising. On top of such philanthropy, leading fund managers also support art museums with generous loans from their carefully assembled collections of modern art. While such moves benefit the public, the involvement with museums reciprocally serves to validate the sophistication (and monetary worth) of the managers' private collections and further increase their status within the exclusive realm of the alternative asset world. Despite the desire to elude public scrutiny, there is an intense and often eccentric competition among peers for the material and social symbols of status.

Quantitative Zealotry
Armed with hair-trigger instincts and supported by quantitative research, the fund manager can move rapidly to exploit market inefficiencies in ways that more regulated pools of assets like mutual funds cannot. Fund managers combine this asymmetric information advantage and tactical agility with the clandestine nature of their industry in order to leverage their image and exponentially exaggerate the threat posed by their activist tactics, which, for unprepared targets, can become a self-fulfilling prophecy. With the use of an elaborate technical infrastructure, even small hedge funds are able to maximize their impact with a minimal physical footprint, often by using algorithmic trading strategies.

Mythical Identities
Even for the quantitative zealot, a compelling mythos is indispensable.
Anatomy of an Activist Letter
13D notices are filed with the Securities and Exchange Commission when an entity attains a 5% or more position in a public company. Beginning in 1997, activist investors have used such forms as a way to publically terrorize the management of the companies they choose to attack. These opening salvos are used to artificially amplify the profile of the writers in order to garner support from fellow shareholders in attempts to provoke corporate shake-ups from which fund managers are able to realize quick profits.

The Classical Warriors
Hedge funds and private equity often look to antiquity for inspiration, rarely to the founders of rationality and democracy, but to mythic heroes, warriors, and monsters.

The Fortress
Castles figure prominently in hedge fund mythology as an image of stability and defense against the threat of market uncertainty.

The High Seas
Nautical imagery promotes not only the industry’s supposed ability to stay afloat during periods of market volatility, but also evokes the glorious risk-defying brashness of the solitary marauder.
The Lean, Mean Hedging Machine

Hedge funds manage large amounts of capital while maintaining a small operational footprint. Their logistical lean-ness is in part an effect of their sophisticated quantitative trading strategies, which gather vast amounts of information and execute quick decisions, effectively bypassing traditional business practices based on human relationships. Their efficiency allows them to retain a low public profile and concentrate the wealth in a limited geographical area and in the hands of very few employees.

While their assets are dwarfed by those of investment banks, the hedge fund model has been effective in operating at a small scale with proportionately high returns. Compared with investment banks, hedge funds require far less office space and far fewer employees per dollar of assets under management.

Forty-four of the top one hundred hedge funds are based in Manhattan. Almost all of them are located in an area of a few blocks in midtown Manhattan. This hedge fund district manages $436 billion in assets, 32% of the world’s hedge fund assets. The logistical efficiency and stealth tactic of hedge funds allow this heavy concentration of capital to remain largely invisible.
In Manhattan, hedge funds have proliferated in the Class-A office buildings of midtown such as Lever House and 9 West 57th Street. Lever House has earned the nickname ‘Leverage House’ for being the home of several funds.

Hedge funds can accommodate all of their operations within the space of a single suite of an office building, often occupying only a few thousand square feet. While a traditional investment bank typically requires an entire tower for its thousands of employees, a hedge fund can leverage quantitative strategies and technical sophistication to function effectively with a small staff and limited office space.

If the ambition of the skyscraper is to extract as much capital as possible from a small footprint of land, then the hedge fund is the immaterial equivalent of a skyscraper, generating an extraordinary return from a minimum area.
The accumulation of wealth from the hedge fund boom is invisible in the city but is easy to see in the rest of the world. At the international scale, hedge funds have shifted the balance of economic power even more decisively toward the United States. The rest of the world has recently begun to respond to this vast asymmetry in ways that have thrown the alternative asset management into a deepening crisis.

International distribution of the top one hundred hedge funds, totaling $1 trillion in assets under management, or 68% of the total assets of hedge funds around the world.

America accounts for 65% of all the world's hedge fund assets.
What, Me Worry?
In recent months, hedge funds have dramatically entered the public consciousness, following a series of widely reported shocks to the industry. Hedge funds are most visible at the moment of their implosion, when the accumulated risks of their strategies—market volatility, governmental inquiries, investor panics, and the competition of a crowded field—sharply coincide in a catastrophic collapse, a scenario that is playing out with increasing frequency. Hedge funds have been intimately connected with several recent financial debacles, such as the subprime loan crisis and the shake-up of national banks like the Netherlands’ ABN AMRO. All of the attention is leading to greater public scrutiny and government oversight that may limit the unregulated tactics that hedge funds historically have employed. The industry will have to transform itself in order to survive.

Blackstone, Fortress Tax Structure Targeted by Senate (Bloomberg.com 15 June 2007)
Where’s Steve? Schwarzman Lies Low for Blackstone IPO (NYPost 22 June 2007)
Anchors Away! Fund Boss’ Yacht on Block (NYPost 30 July 2007)
Investor Sues Bear Stearns Over Fallen Funds (NYTimes Dealbook 8 August 2007)
U.K.’s Subprime Crisis May Be Worse Than U.S.’s (Bloomberg 8 Aug 2007)
August Heat Burns More Hedge Funds (NYTimes Dealbook 9 Aug 2007)
Investment Banks Pull Deal-Financing Offers (WSJ 10 Aug 2007)
Hedge Funds Get Bitten by Pack Mentality (NYTimes Dealbook 13 Aug 2007)
KKR Sees Challenges if Downturn Continues (NYTimes Dealbook 13 August 2007)
Blackstone Warns of Buy-Out Slowdowns (The Financial Times 13 August 2007)
Goldman ‘Quant’ Fund Reduces Fees to Woo Investors After 28 Percent Drop (Bloomberg.com 15 Aug 2007)
France’s Sarkozy Attacks Hedge Funds as ‘Speculative Capital’ (NYTimes Dealbook 2 April 2007)
Sentinel Sued by SEC, Accused of Defrauding Clients (Bloomberg.com 20 Aug 2007)
How to Get Out of Hedge Funds (WSJ 15 Aug 2007)

The Beginning of the Backlash: Schwarzman’s Birthday
With a cost estimated as high as $5 million, Stephen Schwarzman’s high-profile February 2007 celebration was an exercise in extravagance. But it may end up costing Schwarzman billions more. Subsequent Congressional inquiries into the alternative asset management industry have pointed to Schwarzman’s party to justify tax increases on the sector, with one proposed tax-hike even being casually referred to as the ‘birthday bill.’

Gimme Shelter
The ‘Stop Tax Haven Abuse Act’, a bill recently proposed in the U.S. Congress, would increase governmental scrutiny of the financial dealings of companies operating in the Cayman Islands. This includes the 3,000 hedge funds that have located themselves (or rather their mailboxes) in Ugland House, a small building in the Caymans that provides a tax shelter for 14,000 transnational companies.
All Quiet on the Western Front

Hedge funds have been making a lot of noise lately with takeover attempts and strategic disruptions of Western European targets. But an even more powerful financial juggernaut is rising in the East. Sovereign wealth funds are entities that manage and invest the accumulated capital of a nation, acting like giant hedge funds but serving the economic interests of their respective countries. Many sovereign funds were started with profits from oil or cheap labor, and they allow countries whose national stock markets lack transparency to invest globally. Sovereign funds extract profit directly from their foreign investments, and also help their nations to acquire the technical and organizational knowledge necessary to modernize their domestic industries and financial markets. As one commentator put it, the last time we saw nationalization on this scale, it was called socialism. While hedge funds are encountering resistance internationally, sovereign funds are quickly remapping the terrain of economic power.
June 2007, The U.S. SEC settles its lawsuit with London-based hedge fund GLG Partners over the fund's illegal short selling tactics involving 14 IPOs.

June 2007, Europe's third-largest hedge fund, GLG Partners, announces that it is pursuing a reverse merger with Freedom Acquisition Holdings Inc. in order to go public in the U.S.

June 2007, A U.S. hedge fund, Third Point, announces the launch of an IPO of its Cayman-domiciled Third Point Offshore Investors on the London Stock Exchange.

June 2007, Lehman Brothers announce plans to raise money for a private equity investment fund by floating an IPO in Amsterdam.

June 2007, The Carlyle Group launches an IPO offering of a mortgage-backed fund by 25% to $300 million after subprime mortgages and 2 funds at Bear Stearns collapse.

June 2007, Germany explores creating an agency to evaluate Sovereign Wealth Fund activity with the aim of preventing foreign nations from taking control of vital sectors of the German economy.

June 2007, Sir Andrew Large, former deputy governor of the Bank of England, heads a working group of European hedge funds that will consider an ethical standard for the industry.

June 2007, The U.S. housing market decline and the weakness of bonds linked to subprime mortgages causes the collapse of 3 hedge funds managed by Bear Stearns.


June-July 2007, UK Parliament hearings on tax policies regarding private equity firms as well as concerns over the amount of leverage debt used in their takeover bids.

July 2007, U.S. private-equity firm The Carlyle Group enters into talks with the Abu Dhabi Investment Authority regarding the possible sale of a 10% stake in the private equity firm worth nearly $1.5 billion.

September 2007, China set to launch a $200 billion Sovereign Wealth Fund for investment activities abroad including direct investment in foreign companies.

June 2007, German chancellor Angela Merkel makes an unsuccessful attempt to impose compulsory disclosure standards on European hedge funds at the G8 Conference.

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