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Hedge funds
Full of hot air

Hedge Hogs: The Cowboy Traders Behind Wall Street's Largest Hedge-Fund Disaster.

By Barbara Dreyfuss. *Random House*; 285 pages; \$28 and £19.99

THE amaranth flower is praised both in Aesop's fables and John Milton's "Paradise Lost" for its everlasting qualities. In the eyes of Nick Maounis, a bond trader, that made it a good name for the hedge fund he set up in 2000. Six years later, Amaranth Advisors looked an astonishing success, with a stellar investment record and assets under management of more than \$9 billion. But by the end of the year, the group had been consigned to the compost heap.

The story of its collapse is clearly and entertainingly told in "Hedge Hogs" by Barbara Dreyfuss, a former Wall Street analyst who is now a journalist. It is a tale of hubris and nemesis, of traders who forgot about risk in pursuit of reward. Amaranth was brought low by energy trading, and by the outsized positions in the gas market of one man in particular, Brian Hunter.

Amaranth did not actually begin trading in energy until 2002 and did not hire Mr Hunter until 2004. As late as March 2005 a San Diego pension fund that invested in Amaranth was not aware of Mr Hunter's importance to the fund. But the trader staged a spectacular coup that year when his options on the gas price shot up in value after Hurricane Katrina disrupted supplies; he rescued a difficult year for the group and received a bonus of \$113m.

Taking big bets was a mark of Mr Hunter's style. He had a tendency to increase his position when prices moved against him and was relaxed about revealing his positions to others. At his previous employer, Deutsche Bank, he had battled a superior who wanted him to reduce his risk-taking; when the bank lost \$53m in a few weeks, Mr Hunter was demoted, denied a bonus and moved off the trading desk.

At Amaranth his initial success emboldened him to take more risk; by the end of February 2006, he was trading billions of dollars' worth of gas contracts. Two months later 38% of Amaranth's total capital was being directed by Mr Hunter.

Investors were told that Amaranth carefully monitored its portfolio, with more than a dozen people devoted to risk management. However, Mr Hunter ran energy trading from an office in Calgary, Alberta, while the risk management was handled from the firm's HQ in Greenwich, Connecticut. Ms Dreyfuss says there was no computer system in Greenwich capable of viewing Mr Hunter's trades in real time.

At first, things went well; he earned the firm \$320m in February 2006 and another \$1.1 billion in April. But in May, the firm lost \$1.1 billion, even though the firm's risk calculations predicted the maximum possible loss would be \$350m. Amaranth's positions were so large that offloading them was impossible without incurring a further \$1 billion in losses. Mr Hunter was told to reduce his positions gradually.

Once again, however, he doubled up, hoping that he could shore up prices and force traders who were betting the other way to drop out of the market. By the end of May, 50% of the firm's positions were invested in energy; by late July he owned 80,000 gas contracts for January 2007, nearly as much as all American residential consumers actually used that month. It worked for a while but other market participants could sniff blood. Once prices turned against him, the end was swift; in one day at the end of August, trading counterparties demanded that Amaranth hand over a further \$1.5 billion in collateral to cover its losses and the firm's assets fell by \$6 billion in four weeks.

The author is rightly angry about the extent to which one trader can dominate a market. She shows that there was real collateral damage, in the form of losses to local gas utilities that were trying to protect themselves against rising prices. She is perhaps a little too swift to tar the entire hedge-fund industry with Amaranth's brush; there are plenty of managers who take much less risk, and who merely try to pick the best and worst shares. But her book is a salutary example of how traders who believe they are super-smart might be nothing more than lucky, and how there is nothing so intoxicating as the ability to speculate with other people's money. ■