THE GREENWICH
Roundtable Letter

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KNOWLEDGE, VERACITY, FELLOWSHIP

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Website 1.0: The Right Stuff

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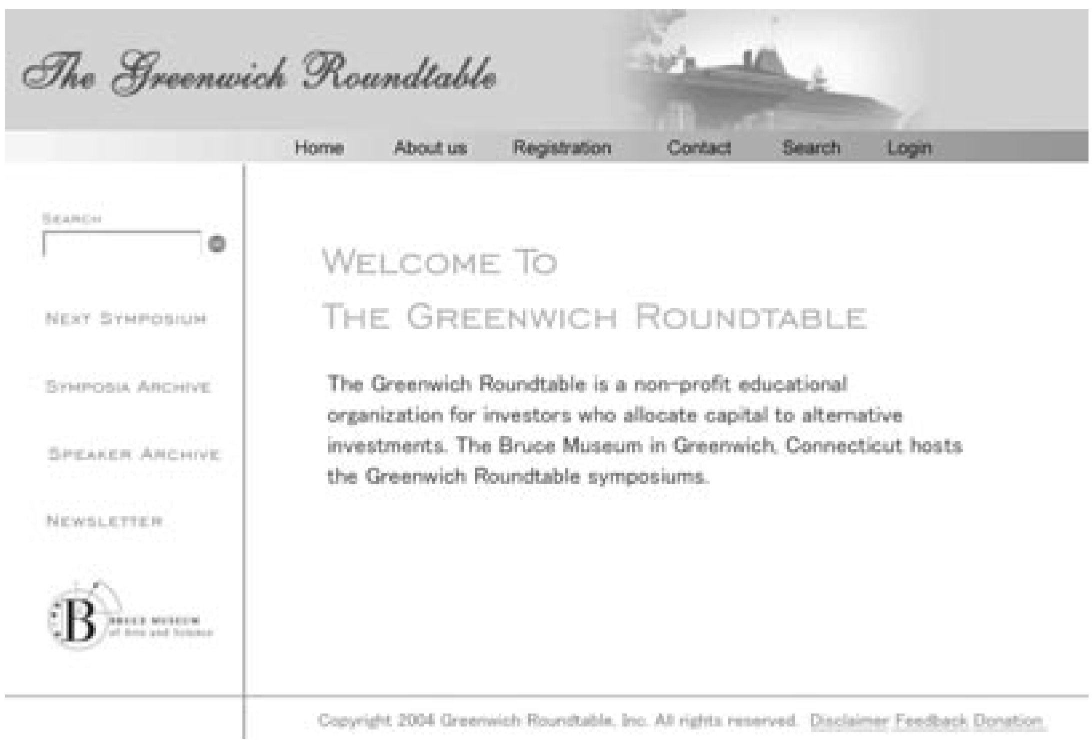

Is Associate Membership for You?

by Fred Baker

Associate Membership is essentially web-only access to the Greenwich Roundtable. According to our Membership Policy, web access provides you with digital audio access to all current and past sessions. Web access also provides admission to the vast archives of the GR. This treasure of research and education is available to all Associate Members who meet the following criteria. First, your office must be beyond a 75-mile radius of central Greenwich, Connecticut. Second, you must be a senior investor, actively allocating capital to alternative investments. Finally, you must be an investor in good standing within the alternate investment community.

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Is Associate Membership for You?

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The Board may make exceptions to these criteria from time to time. After you meet these criteria, the Greenwich Roundtable Board upon the recommendation of the Membership Committee will approve your application and you will be appointed as an Associate Member. Appointments are annual. Dues for Associate Membership depend on the nature of your investing practice. Dues for investors who are money owners, for example, family offices, foundations or endowments are $350 per year. Dues for investors who earn fees from managing other people's money, such as private banks or fund of funds investors, pay $650 a year.

Qualified purchasers may apply for associate membership via email at www.greenwichroundtable.org/registration.

An Update on the O.L.C. Risk Scoring System by Kevin Mirabile

I am pleased to report that Barclays Capital continues to build momentum in developing independent criteria for assessing the business risk of hedge funds on a basis similar to how investors look at VAR and other risk factors.

We have held several meetings over the past few months with law firms, accounting firms and a rating agency. We met to find the best way to create a common yardstick to measure the operational, liquidity and counterparty credit ("OLC") risk management skills of a hedge fund manager. Barclays is also in the midst of creating an OLC survey and subscription database for hedge fund managers to populate and for institutional investors to evaluate these risks.

The need for a better way to evaluate the business risks of a hedge fund manager was emphasized in 2003. This was discovered as a result of comments raised during the SEC Roundtable preceding its report to the US Congress, comments made in the press by Tremont Advisors, as well as an industry report issued by the Capco consulting firm. According to Tremont, a record number of hedge fund closures occurred in 2002 and 2003. Over 50 percent of the failures cited in that Capco survey were caused by weak internal infrastructure rather than poor performance. Fund failures in 1994 and 1998 were also, at least in part, caused by a meltdown in liquidity to hedge fund managers in certain sectors.

Investors often over analyze return data and volatility measures (sometimes referred to as "The Greeks") and under investigate or over compensate middlemen such as fund of funds who perform qualitative assessment of business risk factors. Our initial survey of 17 managers indicated that the average return of managers with a high Operations, Liquidity or Counterparty Credit score, those that did well, returned 2 percent more that the average of those that did poorly. Managers with high scores had higher returns.

A number of factors went into to determining the score. For example, operations risk factors included such things as relative trade volume, open swap agreements, and the ratio of IT and risk management staff to traders. Liquidity risk included measures such as the average term of liabilities, whether the fund uses leveraged sources of equity, how many Prime Brokers are employed and whether a fund marks to market its repo and securities lending deals or uses independent marks to calculate NAV's. Counterparty credit risk factors included credit ratings of the funds trade counterparts, concentration of equity at its Prime Brokers and NAV threshold amounts included in swap terms.

Our goal is to complete our work by year-end and get a meaningful survey size of greater than 100 fund managers. We intend to publish our first report ahead of the launch of a commercial OLC information service.

We are delighted to work with the GR and its members. I encourage you to contact me. We will be underwriting the third evening session in the autumn on managing and developing an OLC risk framework. This is an important area of original research that Barclays and I feel will assist investors in their understanding of the business risks associated with hedge fund investing. Again, please do not hesitate to contact me with your interest, suggestions or comments on the OLC information service. Kevin.mirabile@barcap.com.

Members

Founding Members

Global Macro Trading Strategies

Global Macro Trading Strategies was held as we began our first in-depth examination of a strategy that is known for its flexibility. It is has also been referred to as the agnostic school of investing. The mood in the room was curious. First time buyers tried to understand how to make an allocation and seasoned buyers were looking for nuance. Everybody got what he or she was looking for. The speakers engaged in passionate disagreement with each other. Their contrasting approach to the same strategy was evident. Ray Dalio runs one of the largest global macro hedge funds in the business. Dan Tapiero offered a buyer's guide based on his tenure at several legendary global macro firms. Rene Haugerud before starting her own macro fund was a proprietary trader for Cargill. Bill Brown of UBS O'Connor moderated and selected our speakers with an eye on the diversity of their approach.

Ray Dalio
Bridgewater Associates

Unlike most global macro funds, we don't make big leveraged bets or big concentrated bets. We create diversity by combining many different return streams. The key to successful investing is finding 15 good, uncorrelated return streams. Diverse return streams reduce your risk by 80%. Diversity increases the consistency of your returns. Institutional investors are also looking for these streams by trying to diversify themselves out of equities. They are also trying to find 5 good uncorrelated return streams. Good hedge funds are really a batch of portable alphas. Historically, global macro managers were cowboys who made a few big levered bets on market dislocations. All value added is a zero sum game. A manager must take alpha away from someone else to take it for himself. The smart manager will take money away from the dumb. Focus is needed. We focus on the currency and fixed income markets and take a lot (150+) of smaller uncorrelated bets. With over 150 decision rules and the accompanying data, a systemized process is essential. A group of hedge funds has their own inherent beta. Most practitioners of a given strategy tend to track each other based on the opportunities available to all. If an idea is predictable, like an announced merger, then it's a problem. Look for managers with unique insights. There are too many systematic biases because most strategies do not separate alpha from beta. From an engineering perspective, alpha must be separated from beta. China is a deflationary force. The US needs to reflate by 2005 to compete with China.

Ray Dalio

Dan Tapiero
DTAP Advisors

How do you buy a global macro manager? Everything begins with the anomalous viewpoint. Can the manager find an idea that is not commonly known? What does he know that the market has not already discounted. Steinhardt called this the "variant perception". Original ideas come from unusual places. They tend to last for 3-6 months. Be careful with global macro managers who only talk about ideas….the pontificators. They are more concerned with the idea rather than the return on capital. Ideas, while seductive, are only tools to extract profits. They are seductive because they tend to be universal and can lead a manager to hold a position through treacherous volatility. The idea needs a catalyst that will force the market to see it in the next 1-2 months. A year is too long to wait. If your macro manager has an idea but no near term catalyst he is not on top of his game. So the macro manager needs an idea, a catalyst, a time horizon and an expected payoff. All is irrelevant unless the manager employs a well-defined risk management process with specific risk parameters and performance expectations. A consistent approach and method is crucial. It is also important to have the flexibility to trade against his core position. Getting in the habit of seeing the opposite viewpoint makes it easier for the manager to exit his position when the appropriate time comes. Having a predetermined exit point allows the manager to leave the party while the music is still playing. The good global manager is sensitive to daily nuance, has a medium term view and can trade both with equal skill. He has a breadth and depth of knowledge of many different markets around the world. This reduces his risk by selecting the best bets in many different, uncorrelated markets. Those who are too concentrated are not global macro managers but rather market-specific managers. Some managers may have an insider's view but there is little magic in predicting the actions of governmental policy makers. Here are the risks of the global macro strategy: the manager's ideas may be bad, the manager may be too large which limits her flexibility, the manager may not be competent in different markets or different cycles. The investor base has changed. In the old days, family offices were the biggest investors and simply wanted to make as much money as possible. Today the fund of funds investor rules and wants less volatility and therefore less profit.

Dan Tapiero

Rene Haugerud
Galtere International

Galtere is a global macro and commodity hybrid fund that capitalizes on consumptive and macroeconomic dislocations. Why global macro? Global macro is a thought process. In today's world of increasing globalization and synchronicity, all asset classes are interrelated. The global macro manager must interpret the impact on many different markets. Why commodities? Early in 2002, commodities emerged from a 20-year bear market. Supply shortages are increasing due to surging demand and unforeseen events. The explosive Chinese economy is upsetting the balance of supply and demand. Our methodology is to think in the generalities and live in the details. We start at the top and work down. We develop 3-5 themes and look for 15 return streams. Some current themes include 'Inverse Stagflation', Commodities, Precious Metals, Free Trade Areas of the Americas and Economic Convergence. Some special events include trading around our core positions, trading against our long-term views, and taking shorter term trades against our long term positions. Once our themes have been identified, we create a technical value zone in each market for entry and exit. In 2004, we think global macro still has the wind to its back. Equities are over valued and will not repeat their out performance. Investors should diversify across asset classes not across equities. Commodities represent the best opportunity for capturing value. We are entering an inflationary period. But we don't see the FED raising rates soon. The yield curve will become more V shaped with mid-curve rates falling below the inflation rates. My father was the local sheriff. He wrote a short story whose moral told us two things "things are not what they seem and if only I had known beforehand".

Rene Haugerud

Please join me in expressing our gratitude to Donlad Putnam of Punam Lovell NBF. Once again, Putnam Lovell has not only provided the generous grant that made our symposium possible but they also share our values as they conduct their business by putting the investor first.

February 12, 2004

UNDERWRITTEN BY –

Barclays Capital

Fixed Income: Is the Party Over?

Fixed Income: Is the Party Over? was held in response to what seems like a bond market at its peak. Fixed income strategies have enjoyed healthy returns and a fair measure of predictability. Our speakers came prepared to debate whether those returns will persist and if they don't, where can we make money instead. Cliff Viner is the erudite hedge fund manager who revealed the hardships ahead from a tactician's point of view. He was original and highly sophisticated. Michael Strauss is the uncannily accurate chief economist for the Commonfund who offered a strategic prediction on the road ahead. Kevin Mirabile skillfully moderated this important topic armed with insights that only a bulge bracket lender can provide.

Michael Strauss
Commonfund Asset Management

The party ended in June 2003 for US Treasuries. Ten-year notes at 4 percent are unsustainable. Historically ten-year notes have yielded 250 bps above inflation. Inflation will rise as the economy expands. Rising industrial commodity prices will also add an upward bias on inflation over the next 2 years. Corporate credit spreads have narrowed. Government stimulus and an economic recovery sparked a recovery in corporate earnings. High yield spreads have shrunk from 1100 bps to 400 bps over triple A credits. These spreads do not offer much risk premium either. The easy money in the junk credits has already been made. Global credits offer some good opportunities. The US dollar may fall another 5 percent so don't bet on a bid drop there to help boost global bond returns. Opportunity exists with many developed nations that have yields higher than the US ten-year note. The US economy is the "real McCoy". Greenspan is the most optimistic we've ever seen him. The Fed targeted 4 percent growth. The risk to that forecast is on the upside. Expect it to be stronger. But why aren't the employment statistics more positive…because the government

Micahel Strauss

can't count. Their counting mechanism lags the actual rate of job creation. If employment growth is understated then personal income, the saving rate, and the wealth effect is understated too. The economy is in the third year of its recovery. The Fed will not stay on the sidelines for long. The deflation scare is over. Inflation will not tick downwards again. Corporations will begin removing their discounts as they move to expand their margins. Inflation may move to 2 percent. The real return for ten-year notes has vanished. Japan and China have pushed US Treasury Bill prices artificially high to support their currencies. The "Patience at the Fed" quote was overemphasized. The major point was really "The real Fed Funds rate will need to rise to a neutral level". Greenspan recognizes that excess liquidity needs to be removed from the system. With 2 percent inflation, a "neutral level" translates into a Fed Funds rate of 3-4 percent in 2-3 years. The Fed will tighten again. Opportunity exists in global credits, in credits that are improving, in a flattening yield curve, and in taking long-short positions. Middle market distressed debt offers opportunity too. Corporate credits bought ahead of expectations of an upgrade may yield 4-6 percent. The triple C credits have rallied the most. Focus on higher grade junks or those that will improve their creditworthiness. Depending on currency movements, global bonds can fetch 4-8 percent. In Europe, interest rates are converging. The European Union needs to lower interest rates… because they can. Short rates are too high in relation to US rates. Be prepared, in March, for foreign central bank buying on the front part of the curve. Treasuries and their falling prices will not earn their coupon. US budget deficits are a concern. They are not shrinking. Focus on yield curve flattening strategies. Focus on trades that benefit from rising yields.

Cliff Viner
III Offshore Advisors

Fixed-income alternative managers are in a massive transition phase. Fixed income has enjoyed a classic and vigorous bull market for 3 years. Going forward, many alternative strategies will not work as well, or not work at all. This depends on whether the rally continues, stalls or whether it bearishly corrects. Many strategies have been bullish and achieved their goals. Many just made macro bets. Many just purchased calls. This will be difficult going forward. First, volatility remains high. Second, with yields lower and short-term rates pegged, the at-the-money strikes are no longer above spot levels. The entire premium will be lost. Rising rates will wipe out any premium. Third, the "bull carry" strategy will suffer from the same conditions and there will be less room to be wrong. Many bullish call spread strategies benefited from the high prices for out-of-the-money volatility, which was created by the mortgage market. As the mortgage market stabilizes, demand for out-of-the money volatility cools. Fifth, many bullish managers used "yield curve steepeners" to express their views. The risk-reward of these strategies has greatly diminished as entry price points rose. In a bullish or stable market, there is the risk of "bull flattening". As short rates approach zero and stop falling, long rates continue falling and the curve flattens. Even if rates rise, the curve can still flatten. Sixth, many bullish strategies used "conditional steepeners" where the manager buys and sells calls. This is a pure yield curve steepener trade, which is fine for a pure bull market. Going forward, this structure not only has bull-flattening risk but it also has the added risk of an increased "break-even strike spread". Seventh, bullish managers may have pursued "curvature strategies". Similar to steepener strategies, they benefit from the front part of the curve, twos-tens, getting steeper against the back part of the curve, tens-thirties. But new entry levels are far above previous levels and the unusual prevailing volatility advantage has greatly diminished. Credit spreads have narrowed dramatically. This created profit windfalls in many sectors. Managers in asset-backed, junk bond, corporate bond, and emerging market strategies all saw hundreds of basis points of relative yield declines in their sector. With narrow spreads, these parties will be impossible to repeat. The party in convertible bonds has benefited from sharply declining interest rates, a renewed equity bull market, and significantly lower corporate credit spreads. The party in inflation-linked securities has performed well despite significant declines in inflation. These were designed to float, to appreciate, in tempo with inflation. Take your time in selecting your managers and your strategies. A shakeout may be underway. The enormous flow of funds into alternatives and into fixed-income strategies is a problem. Too much capital is chasing fewer bonds. I am concerned about the amount of leverage that is being layered into these strategies. It's 1997 all over again. Hundreds of new entrants emerged. Margins got compressed. Trades got crowded. Returns were diminished and a shakeout winnowed the herd. Today increased competition is compressing margins. The Fed only controls the overnight rate. Tax cuts and interest rate cuts have sustained the economy. The US needs bigger budget deficits to stimulate demand and to return the economy to its former health. The US, as a fiat currency, does not borrow. Europe has a different dynamic than the US. Europe has turned itself into a series of municipalities. They are fiscally constrained from running the necessary deficits to stimulate demand. The chance of an accident in Europe is significant.

Cliff Viner

March 18, 2004

UNDERWRITTEN BY –

DPM

The Outlook on Investing in Hard Assets

The Outlook on Investing in Hard Assets was held in response to what seems like the end of a 20-year bear market in commodities. This session is also a continuation of our reexamination of an asset class that we first believed was rallying as a result of the war on terror. Dwight Anderson who once ran commodities research at Tiger and Tudor, now invests in commodities and basic industry companies in his own hedge fund. Peter Palmedo is considered to be one of the most knowledgeable hedge fund managers who specialize in gold. John Hill runs a highly respected private equity fund that focuses on energy, the mother of all commodities. Hunt Taylor moderated this important topic with insights of a seasoned commodities trader.

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John Hill, Peter Palmedo, Dwight Anderson

Dwight Anderson
Ospraie Partners

Finally, someone is interested in hard assets. Even my mother was worried about my career choice. We invest in hard assets and commodity-related companies around the world. We are concentrated and directional. We invest on a long and a short basis. Active or discretionary managers, such as Ospraie, tend to focus on intrinsic values, long horizons and the underlying businesses. We are micro economists. We focus on inelastic commodities, their supply-demand characteristics, their costs and the balance sheets. Other vehicles in this sector vary dramatically in their duration and their methodology. The CTAs are focused on the futures. They are the most visible and the most active traders. Most are purely technical who focus on prices rather than fundamentals. The macro traders could be characterized as the 'have a hunch, bet a bunch' group. Commodities are only more volatile than stocks because of the leverage being applied. Both CTAs and commodity index funds are now experiencing massive inflows. This is due to increased volatility, to low interest rates, lower opportunity costs and the view that China is putting heavy pressure on demand. It's also due to the perception of an energy bull market, of lower returns in equities, the acceptance of hedge funds, and the need to hedge the dollar. Liquidity in the long duration commodity markets has deteriorated after Enron collapsed. Overall, there is less corporate hedging and greater short term technical trading, which creates greater short-term volatility. Commodity markets are breaking open interest records. When this is combined with inelastic demand, low inventories and supply disruptions these markets experience explosive volatility. Supply disruptions due to transportation and logistics bottlenecks should get worked out in the next 2-3 years. We are not bullish on all commodities. Some are dramatically overvalued and some markets are vulnerable to collapse. Grain prices may go lower as normal weather, substitution and more supply comes online. Base metals are rising now but there may be a supply response in two years. Energy is being supported by long term demand for crude, its decline rate and the dollar. Crude prices may not stay high in the short term. Going forward, buy an index for general commodity exposure. Buy a CTA on weakness. Buy a discretionary manager after you understand their biases, their leverage, their diversity and their ability to stay disciplined. Commodity markets are relatively illiquid. This limits our capacity.

Peter Palmedo
Sun Valley Gold LLC

Gold has been dismissed as an asset class due to the belief that it is driven on perceptions and fear. But, empirically, it has been dependable. If oil is the mother of all commodities, gold is the father. It has a rich history that has taught us many lessons about commodities. Gold is differentiated from other commodities by its durable nature. Only 144 thousand tons have been mined in the world, which represents $1.85 trillion in value. For the past 300 years, annual production is 2.5 thousand tons, only a drop in the bucket. Supply demand characteristics are different from others. Fundamentals such as the fabrication of jewelry account for 50% of supply. The official sector such central banks respond to political or policy events, not fundamental events, and account for 30%. The investment sector, bars and coin, accounts for 18% and is equivalent to the value of a large cap stock. Overall, scarcity is the defining factor. The supply of gold is inelastic. Fabrication factors are fairly consistent and driven by the market. The official sector is neutral. The Washington Accord was recently renewed. It has further defined and constrained demand. Investment demand is driving the price of gold at the margin. A one tenth of one percent shift of demand will overwhelm supply. This is the factor to watch. Why invest in gold? Gold is a store of value. It has a dependable record as a unit of measure. This is driving the interest in the market today. The 2002 Bernanke speech on deflation spooked the market and further sparked more interest. The opportunities in gold are due to global, post bubble, free floating exchange rates. We have no history in this kind of environment. We have never been here before. Thus, precious metals will become increasingly important. With floating exchange rates, determining real value will become more complex. Gold does not usually rise when stocks and bonds rise like 2003. The falling dollar was the factor. We've got to watch whether gold becomes the fifth currency or a unit of real value. The risk in gold is that everything goes right. Gold does well in bad times. The other risk is that everything goes wrong. In a deflationary environment, the nominal price of gold declines while its real value rises. Our field is small. Finding young geologists who want to explore is hard. Thus our capacity is limited.

John Hill
First Reserve Corporation

Energy prices are not high today in relation to the $40 crude price of the 1980s. But the public market prices of equities in the E&P and oil services sectors suggest that the owners of these assets do not believe these prices are sustainable. They are discounting lower prices in the next 9-12 months. Globally, oil supplies are tight. Not enough capacity is available in the near term to effect prices. Even Iraq's supply will not have an impact. Most OPEC countries are running flat out. Fundamentals, not cartels, are driving prices. Even in the 1970's, world demand was outstripping supply. The embargo had little impact. Natural gas is a North American commodity and it has not kept up with demand. Nevertheless, the outlook depends on world economic activity. If demand from China stays strong, prices will stay high. First Reserve invests in the exploration and production, oil field service and the infrastructure sectors. In the E&P or resource sector, our preference is for natural gas due to declining reserves and its clean nature, and for coal due to its declining excess capacity and its growing demand from electric utilities. Coal is attractive and misunderstood. It can be burned cleanly and quickly. Oil is a difficult sector for our firm. Most oil opportunities are in high-risk places like Russia, Brazil and Libya. This is the domain of the major oil companies, which have the political, financial and geological capacity to take on these risks. Service companies have benefited from higher oil prices due to greater capital spending. These have been plays on operating leverage, margin improvement and consolidation. But that strategy hasn't worked due to capacity issues that may work out in the next 18 months. We tend to invest in middle market, operating companies that are not dependent on forecasting oil prices. We focus on building value in the company. We have always been cautious on leverage. Excessive debt caused a lot of damage in the 1980's. We remind ourselves that this is still a commodity industry and keep our debt to equity ratio at 40 percent. This is low by buyout industry standards. Investments in Saudi Arabia have high social and political risks. China has enormous energy needs and will keep supply tight. The energy complex is constantly reshuffling its assets and the need for capital in the resource sector is vast.

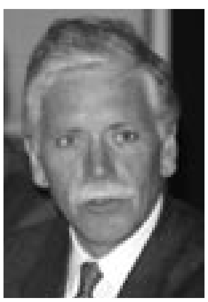
April 15, 2004

UNDERWRITTEN BY –

Putnam Lovell NBF

What's Up with the Stock Market

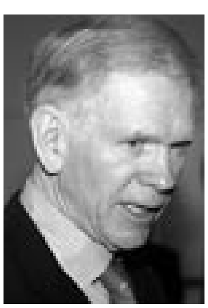
What's Up with the Stock Market was held as our first examination of the public equity markets in over 5 years. Since the bubble burst we have explored private equity or defensive, non-equity strategies. Our speakers were very different from each other. Yet both agreed that stocks should be bought for longer terms. Jeremy Grantham is the co-founder of two highly respected quantitative money management firms, Batterymarch and GMO. His high altitude and bearish insights provoked a cautionary response. David Einhorn is one of the brightest lights in the long-short hedge fund community who revealed some structural anomalies that produce mispriced companies. Don Putnam skillfully moderated this session with his usual panache.



Donald Putnam

Jeremy Grantham
Grantham, Mayo, Van Otterloo

Last night we concluded that the stock market could be condensed to four things. First is mean reversion. Everything goes back to trend. Second is uncertain timing. We don't really know when it goes back to trend. Third is career risk. Nothing is arbitrage-able if you have uncertain timing. At that point your job is at risk. Fourth is that size matters. Do well with $5 million and they'll give you $500 million. Do well with that and they'll give you enough money to make sure that whatever value you could add is gone. The 100-year PE trend on the stock market is 16. The normalized return on sales is 6%. Multiply 16 by 6, which gives you a trend line of 720 on the S&P 500. The stock market will go back to 720. If it does not it will be the first time in history. There have been 27 market bubbles (a 2 standard deviation event that occurs every 40 years) in the last century. All 27 reverted to the mean. There have been no paradigm shifts in the last century in any market. Never has been "different this time" but, hey, hope springs eternal. The ugly thing about reverting trends is that they over correct. They spend a lot of time below the line. It took over 30 years to recover from the 1929 bubble. Japan has still not recovered from its bubble. We are likely to go below 720 and stay there for a while. Be prepared for a correction. Any expectation contrary to this trend will be in complete defiance to a huge breadth of historical evidence over a vast number of economies and asset classes. Recently we've been trying to get a better fix on timing. We've observed that politics have an important role. For one-year horizons, the presidential election and Federal Reserve cycle is better than value in predicting the economy. But value or mean reversion is excellent in predicting over 7 years and weak over 1 year. The last two years of a cycle the president engineers a stimulus, a strong economy and rising employment to get votes. In the first two years, they tighten the controls to create room in order to expand in years 3 & 4. In years 3 & 4, speculate. Buy growth stocks. In years 1 & 2, duck! Buy value stocks. Since 1932, the politicians have engineered this to work like clockwork. Our economy is skating on thin ice with record deficits and debt. The ice will hold until after the election. Assets are as overpriced as I've ever seen them. Next year will be the black hole of moral hazard. Timber has higher returns than stocks because it is illiquid and misunderstood. It has beaten the S&P over the last century and has been uncorrelated. All bubbles break. We are still 1.5 standard deviations above the mean. Bear markets don't end with growth and technology stock rallies. They end with talk about fiduciary responsibility, protection of assets, bonds and an obsession with risk. Too much optimism still exists. And career risk is rising. The clients don't want to hear "duck". My personal portfolio in 2005 would short the S&P and junky stocks and go long international blue chips, timber and some REITs.



Jeremy Grantham

David Einhorn

David Einhorn
Greenlight Capital

My job is to pick stocks from the bottom-up. I don't have any top-down thoughts. But there are some large structural inefficiencies baked in the capital markets. The largest one is that the big money in professional management is playing a relative value game against a benchmark. They ask, "Will this security outperform this benchmark?" Whereas I ask, "will the reward outweigh the risk?" This is a fundamentally different question. If you care about a benchmark, you'll pat yourself on the back if you lose less money than the benchmark. The exciting thing is that I'm still in the minority. I don't have to be that smart. I just need to ask the better question about risk and reward. The second big inefficiency is that the majorities of professional investors are lazy in their analytical rigor or are incapable. A recent study revealed that most professional investors use the PEG ratio to gauge a stock's attractiveness. The ratio of Price Earnings to Growth rates is the most widely used metric on Wall Street for its simplicity. But the proper relationship between the PE and growth is not linear. So these professionals are trying to fit a flat line across a sharply increasing curve. It intersects in only 2 points. It's nonsensical. The third big inefficiency is leverage. Analysts don't correct for leverage when they evaluate PE multiples. Levered earnings are more risky than unlevered earnings. They don't seem to understand that it is less risky and cheaper to buy the unlevered company. The last major inefficiency is the investment horizon. Most investors won't buy and hold over 6 months. Equities are long duration assets. Predicting their outcome over 6 months is difficult. The career risk of owning dead money beyond 6 months is high. That's exciting. Investors who won't invest because the stock won't perform in 6 months create opportunity for me. The long-term investor's biggest challenge is to avoid making mistakes. In the long run, absolute return investing should be offered to more people. Big money investors should abandon their benchmarks.

Arild Johansen and Margaret Towle

Please join me in expressing our gratitude to Donald Putnam of Putnam Lovell NBF. Once again, Putnam Lovell has not only provided the generous grant that made our symposium possible but they also share our values as they conduct their business by putting the investor first. Donald and Putnam Lovell continue to perform original research into the operational, liquidity and counterparty risk.

May 20, 2004
UNDERWRITTEN BY –
Barclays Capital

Deficits, Inflation or Deflation: Probabilities and Implications?

Greetings from the Greenwich Roundtable. Our session titled Deficits, Inflation or Deflation: Probabilities and Implications? was held as the continuation of the session we never had. The new Fed Governor, Ben Bernanke, was slated to speak last year but suddenly cancelled. While we were left to guess what he would have said. Today our speakers, with the benefit of hindsight and a ton of insight, revealed much more. Peter Fisher, fresh out of the Treasury, eloquently braced us for the unwinding of leverage. Larry Kantor, the prophetic and plain speaking strategist, offered some practical insights. Ed Mule', a savvy credit-oriented hedge fund manager, translated the predictions into moneymaking opportunities. Kevin Mirabile skillfully moderated this session armed with insights of a large lender.

Peter Fisher
BlackRock Inc.

Will our deficits cause a replay of the unexpectedly rapid interest rate rises of 1994? The short answer is probably not. The current account deficit will not destabilize rates because we have more investment opportunities in the US than we have savings. However, this will be a persistent negative for the dollar. Our long-term fiscal position is dismal. But this will not effect the term structure of rates in the next few years. Rather, the expected path of the funds rate is the single most important determinant of the term structure. Expected deficits have an important influence too. If the market expects the deficit to widen, it will price that into the yield curve. Current account deficits have no impact on the term structure. Today, the market has accepted the Bush Administration's prediction that deficits will narrow over 5 years. It's accepted because the economy is picking up steam and the duration of the marginal Treasury buyer is less than 5 years. Our fiscal problems loom large in 7-10 years, which is hard to price. Will inflation be like 1994? Yes. We should be so lucky. I suggest we get over it. We know the impact that higher rates of discount have on the present value of future cash flows. We will see a flatter yield curve, gradually. We will see a steeper credit curve, quickly. And these will not be parallel shifts. Following the equity market declines of 2001 and 2002, the Fed gave us the opportunity to rebuild our balance sheets by lowering the funds rate to 1%. This helped institutions as it generally reduced liability costs and increased assets values. However, this will reverse itself in the future as rates rise. Already companies are adjusting based on the rumor of higher rates. Those people that hope for an easy adjustment to higher rates misunderstand the role of monetary policy. It plays the role of a shock absorber in both directions. Lowering rates is a sugar high and a shock to the body. Raising rates withdraws the sugar high and is also a shock to the body. In 1994 we were all surprised how quickly all G10 markets were correlated. Risk appetites contracted quickly as losses were suffered. Risk management systems were working. In the case of Orange County, Kidder Peabody and the Mexican Peso crises, they did not adjust their risk quickly and did not understand their risks. They miscalculated and waited. Accidents like this will happen again. Those who are disciplined and react quickly will be fortunate. Others will miscalculate, wait too long and crash. Will we experience the soft landing of 1994? We should be so lucky! For the only time in its history, the Fed engineered a rate increase that avoided a recession and dampened inflation. That was unique. Today the Fed is not so lucky. In contrast to 1994, prices and employment growth are rising together. In summary, the Fed will be measured as they raise rates but they've got a lot more to go. The yield curve will be flat and the credit curve will be steep. The yield curve will move a little bit but the credit curve will move a lot. A lot of debt will be unwound. Going forward, the volatility of our financial markets will be determined how banks, brokers, hedge funds and corporations have anticipated the impact of higher short term rates and whether they have the discipline to respond promptly as they learn the path of the economy and inflation.

Peter Fisher

Larry Kantor
Barclays Capital

Recently, markets focused on the sustainability of demand and economic recovery. Markets were worried about jobs and confidence. Those worries are over. Households are spending and not constrained by job growth. GDP growth is the strongest in 20 years. Real GDP will be 5% and nominal growth will be 7%. Personal income accelerated for six consecutive quarters. Household sectors are not dependent on 1% Fed funds rate anymore. The purpose of lowering rates was to jump start consumption and that's not important anymore. Rising rates will not crush the household sector. No one is focusing on capacity, the supply side, yet. Bernanke says we have ample capacity. But the CPI is up to 4%. Rail companies are turning business away. Steel and cement shortages are erupting. Today there is an early cycle rise in inflation. Asian demand is booming. But has the US lost a significant amount of capacity to produce goods? Are we returning to 1-2% inflation or are we in the midst of a greater acceleration? Either way, the Fed funds rate must rise beyond its historical 3-5% range. Financial institutions will absorb the shock to the system. It's hard to predict who or where the accidents will occur. The Fed has been telegraphing its intentions to help institutions ease the transition and unwind their carry trades. With stocks, the best climate for growth is behind us. The dollar will have problems because of our current account deficits. Trade deficits will grow too.

Larry Kantor

Edward Mulé
Silver Point Capital

What are the implications of inflation on credit opportunities? Our hedge fund's strategy is to focus on credit opportunities within the capital structure of the corporate sector. We tend to be in niches and less competitively priced sectors. We also tend to be activist or catalyst focused. The bull market in Treasury bonds is over. I'm not worried about deflation. My concerns about inflation are focused on the enormous monetary and fiscal stimulus and the oil price correction. Oil has been too cheap. The CPI may be understated as well. Interest rates are going up. Rising rates will cause credit spreads to widen. Our method is to overlay these environmental conditions onto companies and determine whether it's been priced into them. Companies with long-term fixed rate liabilities, who have locked in low rates, and have increased demand and limited capacity will benefit. Companies that need constant access to capital markets will suffer because their cost of borrowing will rise. Companies such as long distance telecomms who are experiencing price deflation will suffer. Also companies exposed to interest rate volatility, such as utilities and financial firms, who are not managing their interest rate risks, may suffer. Accidents happen to companies when the Fed hikes rates. Volatility associated with instability creates opportunity. Nervous bondholders sell innocent companies when there's an accident. Thus trading opportunity erupts. Liquidity providers can often be paid a premium when capital markets are closed and a company needs financing. Invest in floating rate instruments such as bank debt. Stay at the high end of the capital structure.

Edward Mulé

Please join me in expressing our gratitude to Kevin Mirabile of Barclays Capital. Once again, Barclays has not only provided the generous grant that made our symposium possible but they also shares our values as they conduct their business by putting the investor first. Kevin and Barclays continue to perform original research into the operational, liquidity and counterparty risk.

June 17, 2004

UNDERWRITTEN BY –

Putnam Lovell NBF

Russia Now: El Dorado or Fool's Gold?

Greetings from the Greenwich Roundtable. Our session titled Russia Now: El Dorado or Fool's Gold? was held as we reexamined this exiting and dangerous market six years after our first session on the subject. Oil and inefficient businesses seemed to be the opportunity. Volatility and property rights are the risks. And establishing the rule of law is the challenge facing the reformers. George Siguler is the pioneering private equity manager who has experienced windfall profits and sudden collapses. Marshall Goldman is the skeptical advisor to governments and corporations who continues to be wary. Frank Mosier is the nimble hedge fund manager who uses short term trading tactics to control risk. Rian Dartnell thoughtfully guided the panel in his second of five sessions on the emerging markets.

George Siguler
Siguler Guff & Company

Thirty years ago our foreign policy with Russia was based on mutual assured destruction. Twenty years later, I foolishly spoke in Volgagrad to a group of Red directors of our intention to invest in their businesses. They had no clue what revenue and profit meant. Today we are the largest private equity manager in Russia. We've had our share of failures and successes. On balance, we've had a positive experience and look forward to more investments for fundamental reasons. If Russia works, it will become five Canadas, exporting energy, agriculture and minerals. After that, the service and consumer sectors will catch up with pent up demand. Today Moscow is a vibrant European capital. My partner was an advisor to Boris Yeltsin. The first investor in our fund was the Russian Government. Then the Overseas Private Investment Corporation (OPIC) guaranteed $155 million. At worst, our investors would get their money back. At best, they would get private equity returns. 1998 cost us a few companies. The fund is returning 3X, in the mid twenties now. We bought a pulp mill for $75 million, streamlined operations, pared employees, grew EBITDA from $15 to 120 million, hired Morgan Stanley to create an auction and sold it for $400 million. It was very close to a Western transaction. Our most enjoyable investment was founding MTV in Russia with its fixed priced content. It is the fastest growing most profitable MTV franchise in the world where Viacom will be our trade buyer and our exit. Ten years ago the opportunities were privatizations and deeply discounted capital-intensive businesses. Today there are scores of middle market business without access to growth capital. Today we are rolling up radio stations at 3 times cash flow to create the Clear Channel of Russia. We don't pay bribes, we comply with the law and so far we have not had our assets seized. Our capital is seen as being value added with access to Western exits. Our capital brings Western accounting standards and political cover. Russia will always be capital starved but a viable stock market is coming. Russia has its problems but it's still wide open. georges@sigulerguff.com

George Siguler

Marshall Goldman
Harvard University

I have been called the Doctor Kevorkian of Russian studies. Russia may be a land of great opportunity but there are still great risks. Enormous fortunes have been made, lost and made again. Some investors have lost their life. The securities markets have enormous volatility. A basket of energy stocks bought in 1996 at 100 dropped to 39 two months later, rose to 750 and is now valued at 535. The crux is in the timing. Today, the stock market is not trusted and susceptible to panic. The banking system is bad, rife with money laundering. Today central bank reserves are pretty good but the system's foundation is vulnerable to collapse. The oligarchs allowed corrupt officials to use their banks as personal ATM machines. Privatization auctions were rigged. Oligarchs grabbed choice state-owned businesses for pennies. Thirty-six billionaires were created overnight when they seized state assets. But it backfired. Today, Putin is obsessed with the rule of law. An angry public wants it cleaned up. Disorganized law is the rule of the day. Ill-defined property rights prevent trust and capital inflows. The assets of Yukos were seized and redistributed to its competitors. Exxon Mobil had its license in Sakhalin Island revoked. Subway Sandwich was thrown out of Moscow when they discovered its partner was a local Mafioso. Russians have a knack for rescuing defeat from success. I was wrong about buying Russian bonds in 1998. If you ignored my advice you tripled your money. There are enormous natural resource and human capital opportunities but timing is everything and you've got to trust your partners. goldman3@fas.harvard.edu

Marshall Goldman

Frank Mosier
Kazimir Partners

Putin's effort to enforce the rule of law is good in the long run. But his enforcement may be very disruptive to the markets. In 1992 we did the first cross border M&A deals. I bought the first privatization vouchers with suitcases of cash, bundled them with sliced condoms and put them in an undisclosed safe place. In 1993 the capital markets began. Three years later, Vimpelcom went public in New York. Russia can surprise you. Today we are a long-short Russian equity hedge fund with an eye on managing the volatility of that market. Russia is at an inflection point. Converging Russian asset prices with other OECD prices represents a significant opportunity. Historically, markets on the cusp of political and economic change have been among the most profitable investments in the world. Russia has lot of very competent, reform-minded Reganites (how ironic) advising the current government. It has a 13% flat tax, a federal budget surplus, a current account surplus and a 5-7% GDP growth. The volatility of stocks is breathtaking. It is the most significant risk. Since 1994, the annual return is 62% and the volatility is 77%. Size can turn you into an index fund. Liquidity is a problem. That is not a good trade. Our strategy is designed to deliver mid 30% returns with 20% volatility. We reduce volatility by getting good analytical information at the company level, the governmental and macro level. We also have an aggressive trading strategy occasionally characterized by heavy turnover, shorting techniques and large cash positions. Going forward, the Yukos situation will deteriorate which will cause some Western capital to leave. Its resolution will lead to other policy changes and actions against other oligarchs. The perception of political stability will improve. That will be the next entry point. fmosier@kzmr.com

Frank Mosier

Please join me in expressing our gratitude to Dan Kochav of Putnam Lovell NBF. Putnam Lovell has not only provided the generous grant for a session that had little commercial benefit to their franchise but they also continue to educate investors on the risks and opportunities in the emerging markets. Dan and Putnam Lovell continue to perform original research and provide us with insights on the trends within the money management industry. dkochav@putnamlovellnbf.com

Content is King: The Greenwich Roundtable Archives by Steve McMenamin

For most investors, traveling to Greenwich Connecticut at 8 in the morning was never very easy. We first started recording these sessions on cassette tapes in 1996 because there was always someone who could not attend. At first we were sending these tapes to investors at the college and university endowments. They were keen on hearing new managers and their ideas. They told us they were listening to the tapes in their cars. Then they asked us for transcripts. So we shipped our tapes off for transcription. Every month we made a recording and transcribed the proceedings. Before long, we had a collection. And what a collection it's become. Because we were fortunate enough to get the "best athletes" in their respective disciplines, the collection contains some the most enlightened investment discussions of the past decade.

Listening to the early sessions is incredible. It's a wonderful education into non-traditional investing styles. The discussions are focused on the discovery of inefficiencies and an elaboration of the risks. It's been a front row seat to the entire movement into alternatives. Some of the transcripts are timeless. Some are priceless. All of them are a learning experience.

Today, to experience the Roundtable, traveling to Greenwich is optional, not a requirement. Each new symposium is posted on the website one week after the event. In fact the digital recordings allow the listener the ability to pick and choose subjects, speakers and sections as they please. Moreover, if you click-on and minimize the digital transcript, the media player provides you with the ability to listen while you do other things. I invite our members to "browse the stacks". For instance, check out Jim Simons talk where this quiet hedge fund superstar attributes his incredible track record to good luck. Or hear Nobel Prize winner Gary Becker describe the mispricings of human assets on corporate balance sheets. And hear Fred Green tell us in 1996 that risk arbitrage was becoming a mainstream strategy and less attractive. New members and industry newcomers will find the Roundtable archives to be one of the most complete curriculums available. Anywhere!

For the past 3 years, we have been digitizing the recordings and editing the transcripts for readability. It hasn't been easy. Sakae Takushima and her brother, Shige, have performed the Herculean task of building our website. With their single-minded pursuit of excellence and their keen attention to detail, the Takushimas have designed one of the richest collections of its kind. We are also grateful to Chris Hackett who built our first prototype with a clean, Zen-like functionality.

Search the site for all of your questions. Make us your first stop on the web. Most of our content is not on Google. Above all, this is a continual work in progress. Don't be shy. As you surf the site, tell us what you think. Give us your comments and suggestions. It will make the archives more useful for us all. webmaster@greenwichroundtable.org

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Paul Aaronson
Eric Bam
Spencer Boggess
Steve Bondi
Bill Brown
Michael Castine
Douglas Cliggott
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Summer-Fall Symposia

VERY IMPORTANT! Sessions are typically held on the third Thursday of each month, but last minute changes do occur. Consequently, our schedule can change at a moments notice. Here is a tentative list of dates. Do **not** plan on being at the Museum without first receiving an invitation and a confirmation. **RSVP@GreenwichRoundtable.org**

August 19, 2004

September 16, 2004

October 21, 2004

November 18, 2004

December 16, 2004

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The Greenwich Roundtable

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