

*Barton*  
**BIGGS**

*New York Times* bestselling author

*A*

**HEDGE  
FUND TALE**

*of Reach and Grasp*

*...or what's a Heaven for?*





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*. . . With melting wax and loosened strings  
Sunk hapless Icarus on unfaithful wings;  
Headlong he rushed through the affrighted air,  
With limbs distorted and dishevelled hair;  
His scattered plumage danced upon the wave,  
And sorrowing Nereids decked his watery grave;  
O'er his pale corse their pearly sea-flowers shed,  
And strewed with crimson moss his marble bed . . .*

—Erasmus Darwin, "Icarus"





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HEDGE  
FUND TALE

*of Reach and Grasp*



# Introduction

*Ah, but a man's reach should exceed his grasp, or what's a heaven for?*  
—Robert Browning

**A** *Hedge Fund Tale* is a business and investing book masquerading as a fable. I have come to believe that professional investors, especially hedge fund types, must not only have superb analytical and judgmental skills, tremendous intensity, and a dollop of luck, but, to survive and be successful, they must also profoundly comprehend that they are going to be vulnerable to and enslaved by extreme mood swings and terribly susceptible to hubris. Both can be mortally dangerous not just to their investment health but also to the well-being of their most intimate life relationships. Too dramatic? I don't think so!

This book is about the investment management business, the rise and fall of hedge funds, and the various forms that the plagues of the



great financial panic assumed. It is in the form of a fable because I use disguises to mask identities, just as I did in my previous book, *Hedge Hogging*. However, at its core, it is a book about people—investment people—and my faint hope is that their stories will help future investors deal with the ecstasy of financial victory, the black dog of despair, and the mortal sin of hubris.

Hedge funds were the gold rush of the past 20 years and, like all bubbles and manias, ended with a bust that destroyed many of the egomaniacs and most of the latecomers, and even took out some solid citizens. The immense wealth accumulated in a few years by mostly young hedge fund managers—who haven't hesitated for a moment to spend it ostentatiously and often rudely—has generated great animosity and envy from everyone else. It's a tale worth exploring, as it is littered with compelling stories of triumph and tragedy.

Almost by definition, those who are willing to live by raw performance alone are mostly people who believe their investment life reach should exceed their grasp. Beating the stock market inflames even a normal ego. Becoming very rich very fast has swiveled many a head to the point of madness. As the ancients warned us, "Those whom the gods would destroy they first make mad," and "Pride goeth before destruction and a haughty spirit before a fall." Remember, Icarus, whose reach exceeded his grasp, sank headlong "through the affrighted air" when he went too close to the sun on "unfaithful wings."

Over the course of my 40 years in the professional investment arena, I have known many a charming, ambitious Icarus who has flown too high. The business breeds them in profusion. The protagonist of this book, Joe Hill, is an imaginary character, but his path from rags to riches to perdition personifies the arc of the lives of so many hedge fund people I have known. I have noticed no correlation between hedge fund success and being born on the right side of the proverbial social tracks or having gone to the fancy colleges and the best business schools. A glittering resume helps a lot in getting a job, but a majority of the winners I have known have undistinguished pedigrees; brains, guts, drive, and intuition put the points on the board. Performance investing is a numbers game.

That's why I spend space on Joe Hill's background. The early chapters of this book try to develop his character in terms of his will to

win, his intensity, and his toughness, and then his loneliness and love. I try to make him an appealing figure, a hero, because I want to show how even someone who is fundamentally a sound and admirable character can get sucked into the vortex and destroyed.

The business of investing is also about the interaction of social relationships within the office. As I try to describe in Chapters 3, 4, and 5, the normal stresses inherent in people working together day after day in an investment management company is intensified by the stresses of performance investing and both internal and external competition. You have got to be tough and develop a thick skin or you'll be overwhelmed.

Within a large hedge fund firm the intensity is far higher, as demonstrated in Chapters 7 and 8 and then in later chapters of the book. When the market environment gets really difficult and there are life-or-death decisions, the most intimate relationships and lives—both in and outside the office—often fracture. The environment and stress become comparable to an infantry unit in combat or life on a destroyer in the North Atlantic in World War II. The fledgling investor should know what he or she is getting into, as the only defense mechanism is a prepared mind.

This hedge fund tale of Joe Hill is not an American tragedy in the sense of Theodore Dreiser's hero. This is a modern hedge fund tragedy: the story of what happens when a good man's reach exceeds his grasp. As F. Scott Fitzgerald so succinctly put it, "Show me a hero and I will write you a tragedy."





# Chapter 1

## Big Neck, Virginia

**J**oe Hill grew up in Big Neck, an old textile town of 20,000 people in the rolling flat lands and gentle blue hills of rural Piedmont Virginia. Once, maybe a century ago, the mills had offered jobs and a measure of prosperity, but Big Neck was too far from Washington, Charlottesville, and Richmond to have benefited from their fancy suburban sprawl, and the mills now struggled along with light manufacturing and electronics. The railroad still ran through the center of town, but the heavy freight trains just thundered through on their way to somewhere else. American prosperity had more or less casually, thoughtlessly passed Big Neck by, and the population was down from 35,000 a quarter of a century ago.

Big Neck was integrated, hardworking, stalled, middle America. There was nothing upwardly mobile about it, but the town functioned. The climate was mild, the schools were decent, and, all things considered, it wasn't a bad place to grow up in. Although it wasn't a small town, everybody knew a lot about you by the time you had lived there for



10 years or were 13 years old. You had a public history, which maybe was Dolores's problem.

Dolores was Joe's mother. She was white. Joe's dad, Big Joe, as he was called, was black. Their son was the result of a high school romance, conceived by accident just after graduation. The pair lived together after Joe's birth in a rented dingy row house on Elm Street, separately but amicably enough when whatever magic there once was, wore off. In the years that followed, Big Joe and Dolores were distantly friendly, held within a tenuous orbit by their mutual love for their son.

Little Joe was a big strong baby who would stand in his playpen and violently shake the railing, laughing and yelling at the same time. Big Joe's friends were impressed. "Joe, that boy is going to be a banger," they would say. "That kid is going to be all muscle and fight."

Big Joe was a foreman in the mill. He was a large, contemplative, handsome mahogany-colored man whom people looked up to and who didn't waste a lot of words on idle chatter. "The first screw to get loose in your head," Big Joe liked to say, "is the one that holds your tongue in place." A couple of years after his split with Dolores, he married a black woman and they had three girls. Joe's half sisters idolized him and frantically competed for his attention.

Despite his second family, Big Joe was involved in his son's upbringing. On his way home from work, he would drop by before dinner most evenings. Since Big Joe was a good natural athlete, he encouraged his son to play sports and, as the boy grew up, they ran pass patterns on a field down the street and played one-on-one basketball in the driveway. When the mild southern Virginia weather cooperated, they played golf. About once a week, you could find the two of them out on the scruffy municipal golf course lugging their old bags over the bedraggled, wandering links. There were pullcarts available for three dollars, but they always carried their bags.

"Makes no sense for us to pay six dollars between us when we got strong backs and like the exercise," Big Joe would tell his son. "Besides, we ain't long on money."

By the time he was 12, Joe could outdrive his father and hit a golf ball nearly 300 yards. But his favorite sport was football. Football was—and is—the big sport in the mill towns of rural Virginia, and Joe played

his way up through the Midget and Peewee leagues. His father was one of the youth league coaches, and he never missed a game or practice. Never! Yet, during these games, Big Joe discovered that within Joe's seemingly happy-go-lucky, well-adjusted personality burned a fierce competitive fire. Sometimes Big Joe worried about this intensity. The boy concealed it from others, but one day after his team lost a Peewee game, the 12-year-old boy kicked the stuffing out of the backseat of his father's aging car. Big Joe made him pay for the repairs, once again saying: "We ain't long on money, son. Best you learn now that temper tantrums are expensive."

Joe was also an obsessive perfectionist; he could not bear to lose in a one-on-one basketball game or on the golf course. A muffed golf shot would cause Joe to pound the offending club against a tree, and a lost father-son basketball game would send him sulking, silently furious, back into the house. Although Joe got mad, he worked hard at practicing so that he could do better the next time.

As for Dolores, life seemed to have passed her by. She worked long hours as a waitress. Though in the early years she dated other men, she never married. As she aged, she became thick around the waist and lost her looks. Her face became pale and pinched, her eyes dark and anxious, and her hair stringy. She didn't appear to be a happy person. There was a certain unspoken, lugubrious bitterness in her attitude as though she sensed she had been ostracized.

Subconsciously, Dolores worried that her son's biracial background was a disadvantage and her worry made her feel guilty. She focused on Joe, but he grew secretly ashamed of her as he grew older and she became less predictable. Once as a young boy, on a soft, golden October afternoon, Joe was gang tackled during a Peewee football game. The play ended with Joe at the bottom of a pile of aggressive boys. Suddenly, Dolores detached herself from the cluster of other parents standing on the far sideline and bolted across the field screaming, "Leave him alone," and then began pulling the other boys away.

Years later, Joe would recount that suspended moment—when he was imprisoned at the bottom of the pile under the brilliant, windless sky of early autumn—as perhaps the most mortifying moment of his life.



Yet, Dolores made some important contributions to Joe's childhood. Forced to listen to three televisions blaring endlessly in the tavern where she worked, she insisted on minimal television at home.

In fact, the only time TV was permitted was when a sporting event was on or Big Joe came to visit. Father and son would watch sports in Dolores's congested, high-ceilinged living room, which was dominated by a sagging couch on a gray carpet stained with 20 years of footprints and spilled soft drinks. Dust motes reeled in the shafts of sunlight as they watched games there, sunken into two stuffed armchairs, while Big Joe explained the complexities and nuances of football, basketball, and baseball. At these moments, Joe felt like he was part of a real family. It was as close as they ever came to a communion.

But, as soon as the game was over, Big Joe would leave and Dolores would insist that Joe turn off the television and read a book. She loved to read and she was determined that her son would be an educated man. "You gotta be somebody," she would tell him. "You gotta be smart; you gotta make money; you gotta get out of here." Listening to her, he didn't discard her exhortations. Joe understood, albeit dimly, her dissatisfaction with the monotony of her life, and early on he knew he wanted something better—a lot better. But it seemed as though the fastest, easiest way out of Big Neck and into money was through sports.

In an effort to combine Joe's love of sports with his education, Dolores gave him a card football game called *Running Back* on Christmas day. The game and its statistics became his obsession. He created a league with two divisions of four teams and stocked them with players from the actual National Football League. Then he played endless games and kept detailed statistics for each quarterback, running back, and receiver. The mathematics of quarterback ratings and yards gained after the catch were complex, and he became engrossed with the analysis of the statistics and the ebb and flow of his players' careers. *Running Back* was the beginning of his interest in numbers and the message within them.



As Joe played his way up through the age groups in the youth sport leagues in town, it became apparent that he was by far the best athlete

of his age in town. Big and strong, he was superbly coordinated and almost preternaturally fast.

By the time he entered junior high, Joe was a lean, handsome, dark-complexioned boy whose biracial background was apparent. He had learned at age nine from an older boy's snide comment that he was a mulatto, a half-breed from an unwanted pregnancy, but after he gave the boy a bloody nose, no one ever mentioned it again—at least not to his face. Nevertheless, it was always with him although he never spoke of it. Was he white, he wondered, or was he black? Which crowd should he naturally hang out with or did he have *entree* to both?

He eventually came to realize, however, that outside of Big Neck, the rest of the world viewed him as black because of his dark complexion. When he came into contact with the outside world, he couldn't go around with a sign on his back affirming that he was half-white. Nor did he want to. In fact, as time went on, if anything, he became prouder of his blackness than his whiteness. Partially, he recognized, this was because he was more comfortable with his father than with his mother.

Nevertheless, Joe was a socially, athletically, and intellectually confident boy. Schoolwork came easily to Joe, so easily that Dolores considered taking him out of the Big Neck public school system and sending him to St. David's, the Jesuit Catholic school in town, which was considerably more rigorous academically. Big Joe objected, not because of the religious conversion that a scholarship would entail, but because the athletic program at St. David's was weak.

In junior high school, Josh Gibson noticed Joe. Gibson's family had lived in Big Neck forever, and he and his older brother owned the mill where Big Joe worked. Gibson lived five miles from town on a 200-acre spread of rolling land with several hundred beef cows, and by Big Neck standards he was immensely rich. The mill was very profitable, and everyone knew he was the biggest customer of the Merrill Lynch office on Third Street. He was perhaps 40; a bald, heavysset man. His belly bulged over his belt, his neck bulged over his collar, and his eyes bulged out of an open, friendly face. He was as affable as the day was long. He was married but without children, and he genuinely cared about kids, the town, and his employees at the mill, but above all, he loved jocks and sports.



Gibson had always liked Big Joe, and he began to hear chatter on the mill floor that Big Joe had a kid who was some kind of a super athlete. In the fall of 1983, Gibson had gone to one of his Peewee League football games, and as he got to know the boy he came to like him more and more. He recognized Joe's intelligence, and he was particularly intrigued with Joe's statistical bent with numbers and with *Running Back*. As Gibson listened to Joe talk about *Running Back*, the boy's natural reserve evaporated. Gibson and Joe shared a love of numbers.

But Gibson also cared about the land, his land. He was easily moved to quote Robert Frost's lines "the land was ours before we were the land's" which meant, he explained to Joe, that a man had to physically work his land to have the land accept him. There was a tract of 50 acres that had once been part of his farm with an old mill that lay between his place and the river. "My place is lopsided without it," he would tell Joe. He yearned for it. "The corn in that bottom is doing right well. That was always good ground for corn. No better on the river."

Joe was with him the afternoon the owner of the parcel sent word he would sell. He would experience the elation on Gibson's face, and that evening observe how Gibson went into the twilight to gaze down at the fields, the dark green mass by the river, that was now his land. They later would walk through the grove of cedars to the disintegrating structure of the old mill; the stone dam hung with moss. At night, the motionless water above the mill looked like slick, black metal.

Joe fell in love with that piece of land. From the river, it swept away to the hills and the sky. It was thick and green and beautiful. During summers he worked for Gibson one summer clearing brush and another rebuilding the stonework on the dam. It was hard, manual labor and he relished it. At noon he would eat his sandwiches up on the meadow and then roll over on his stomach and inhale the land. He loved the rich, fragrant odor of the black earth and the grass. Years later, when the financial plague came, the feel of the land, the work, and the smell of the soil saved his sanity and maybe his life.

Gibson also harbored a secret fascination with the stock market. Like Joe, he loved to pore over statistics and valuations. As the year passed, and they became almost kindred spirits, Gibson began to jabber

at Joe about his stock ideas. His mill was a supplier to Wal-Mart and he was intrigued with the company and its lean modus operandi. He bought the stock in early 1982 and hung on to it.

On a Saturday in May of 1984 Gibson took both Joes out to lunch at McDonald's. When they had settled into a booth, Gibson said, "Look, son, I know you're a good athlete, but even more important, I think you're a smart young guy with a fascination and gift for numbers. The stock market is numbers and brains and intuitions. I want to get you interested in it, so you know what? I'm going to give you 15 shares of Wal-Mart. The stock closed at \$31.40 yesterday so that's like \$470, but I want you to promise me you won't sell it for two years. After that you can do what you want with it and the money. Is it a deal?"

Big Joe looked puzzled and Little Joe looked stunned.

"That's real generous of you, Mr. G," Big Joe said. "But tell me again why you're doing this."

"Plain and simple. I want to get this man-boy of yours interested in the stock market, and not just football, and I think Wal-Mart is going up and that'll get his attention."

"Mr. G, you know I want to play in the NFL someday," Joe said.

"Yeah, I know that and I'm rootin' for you. But I want you to use those big muscles in your head and not just the ones in your legs and arms. Will you agree to the deal?"

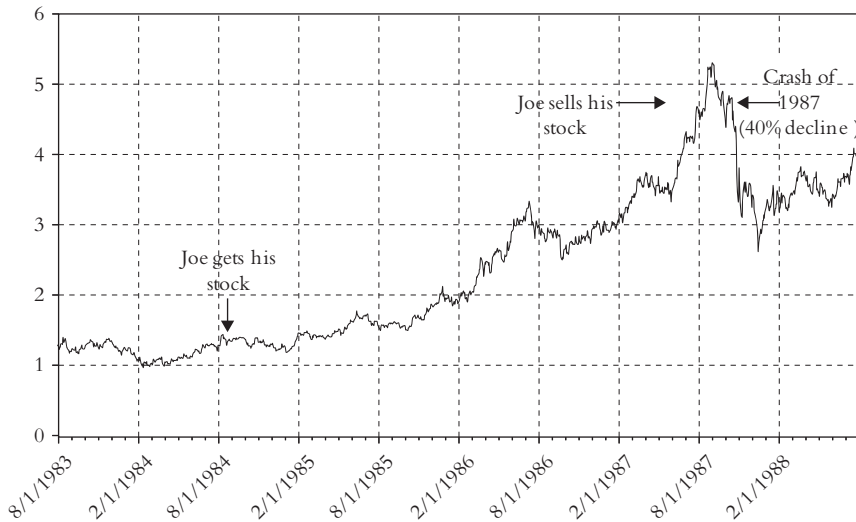
Joe looked at his father, who nodded. Then he replied: "Yeah, of course I will. It's the first money I've ever had, and you're right, I'll watch it real close. You've showed me how to look up stock prices before. Guess I'll have to ask Mom to bring home her restaurant's copy of the *Richmond Post Reporter*."

"Okay," said Gibson. "I'll open an account for you at Merrill Lynch on Monday morning. I'm going to tell them to send you the same research they send me. And I'm going to tell my guy there to keep his mouth shut about this."

"Should be interesting," said Big Joe. "Only stock I ever owned is Virginia Electric & Power and it's been a dog."

"Well, Wal-Mart ain't no dog," said Gibson with a big grin. "It's a hungry tiger."

And that's how it began. Joe followed the stock's progress. As Figure 1.1 shows, Wal-Mart's shares soared and by July of 1987, the



**Figure 1.1** Up, Up, and Away—Wal-Mart: 1983–1988

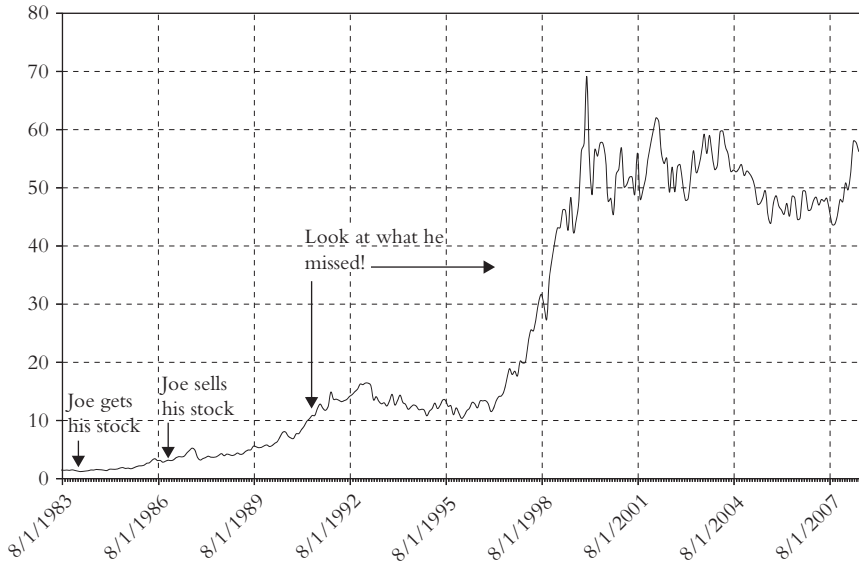
stock was selling in the \$90s. (Note, price data have been adjusted for subsequent stock splits.)

Gibson had never had such a winner, and at that price he sold out his position. Joe followed him; after all, he said to himself, “What do I know?” But the money certainly got his attention. When Gibson told him about the capital gains tax, he was appalled at the Internal Revenue Service’s share of the profits. Nevertheless, it felt marvelous to have \$1,350 in the bank, and he began to think about finding another stock. Maybe, he thought, I have a magic touch.

His elation faded as the stock kept climbing throughout the summer of 1987, touching 106. Then, to his astonishment, came The Crash of 1987, and at one point Wal-Mart hit 56. In the long run, though, the Crash of 1987 was barely a blip on the radar screen (see Figure 1.2).

Over the next 12 years, Joe watched in awe as Wal-Mart soared to an adjusted price of 1,380 on the last day of 1999, a peak it has not yet reached again. Once, much later, he calculated that the \$471 worth of stock that Gibson had given him over a cheeseburger on that May afternoon would have been worth \$20,700 in 1999. Watching





**Figure 1.2** Patience Is a Virtue—Wal-Mart Long-Term History

the stock market as a teenager, Joe learned that a great stock is the most fabulous wealth creation vehicle imaginable, but that the markets require a stout heart and patience. He was hooked.



By freshman year, Joe stood several inches over six feet, weighed almost 200 pounds, and had the broad shoulders, thick hands and powerful legs of his father. He could effortlessly flick a football 40 yards on a line, and outspurt any wide receiver or running back on the Big Neck High team by several yards. His energy was boundless.

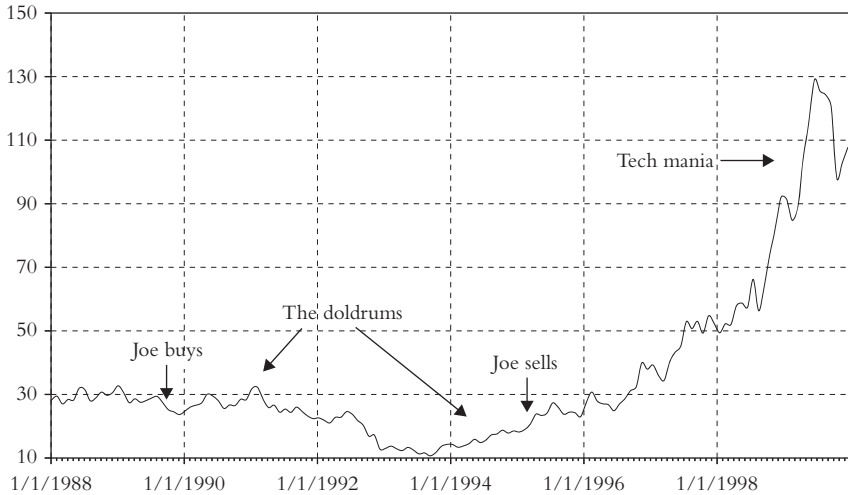
Joe was supremely confident in his natural athletic skills and his ability to perform under pressure, and he used those assets to make some pocket change. Frequently, he would challenge his friends to foul shooting, golf putting, or football throwing contests so he could win some money. As his prowess (and his winnings) increased, his friends either wouldn't play or would demand substantial advantages. Joe loved the pressure—and the money.

However, Joe was invariably friendly and inclusive. He would not tolerate bullying, and any boy who bullied was ostracized from his presence. As one of his best friends said, “I could be a real nice dude too if I had all his natural assets in my back pocket.” The anointed star and captain of every team he was on, he played high school varsity basketball and baseball but his first love remained football.

In rural, small-town America, everyone in town goes to high school sports events—particularly football. Parents, old men with cheap cigars, and kids with big, idolatrous eyes flock to the fields, sit in the high, wooden bleachers, and carefully watch the game that everyone cares about so desperately. Most high school football games in Virginia are played on Friday nights in almost a carnival atmosphere. Big Neck High had played in the Southern Virginia, eight-team high school league for years with only moderate success, but Joe’s class had a number of large athletic boys who could play very well. Joe was the big star, scoring almost as many touchdowns running with the ball as he did passing. When at the beginning of each game the starting lineups were announced, and the public address system echoed across the field: “At quarterback for Big Neck High, number twelve, Joe Hill,” a huge roar would rise from the crowd. The team lost one game during his junior year and the next year Big Neck was undefeated. Both years Joe was voted first team All-State. Suddenly, everyone in town knew Joe. He was an all-star; a town hero.

With his fame and athletic achievements, the girls came easy. Except for the physical part, no girl really attracted him or was his close friend and confidante. He had no idea of the concept of finding intimacy with a girl. But there was plenty of sex available, and Joe lost his virginity at age 16 to the blandishments of an 18-year-old—a fox, with incredible legs and a bulging bosom. He realized afterward that he was just a trophy for her. The realization turned him off; he felt demeaned by what should have been a transforming experience. It instead made him feel cheap and used.

It was only the first of a number of fast, secretive spasms with different and diverse girls. He had decided that sex for him was going to be careful. No romances, no unwanted pregnancies. Perhaps because of this scruple and the covert nature of the act, affection and



**Figure 1.3** Patience Is a Virtue II: IBM 1988–1999

intimacy did not play a part in these relationships. After he had sex, there was always an empty, hollow feeling as though he had somehow missed the essence of the experience, and he invariably wanted to be away and gone from the girl. In fact, he always wanted to take a shower, and wash the dirt off, so to speak. Girls, as far as he was concerned, were boring chatterboxes, hard to talk with, and generally to be avoided.

In general, Joe had difficulty maintaining intimate relationships with his peers. The only person he confided in was Josh Gibson. Gibson never missed an athletic event Joe was involved in, but it was hard for Joe to pay much attention to him in the post-game turmoil. Instead, they would have lunch on Saturdays and talk about sports, the market, and stocks. Gibson traded a lot, and a couple of times he brought along his broker from Merrill Lynch. Joe was not impressed with the man.

Occasionally an analyst from New York would visit the Merrill Lynch office, and Gibson always would urge Joe to attend the presentations with him. Joe liked these sessions, and he scanned the reports he was sent. He felt he was learning more and more about the way the

market worked. He particularly responded to the apparent precision of the valuation numbers in comparing the attractiveness of stocks. It was like analyzing the player statistics in his boyhood board games. In 1989, after listening to a presentation from Merrill's computer analyst, he put the proceeds of his Wal-Mart sale into IBM at 27. The analyst was personable and passionate, and his description of the new products IBM was creating was inspiring.

Although Joe didn't know this at the time, this stock pick was to be his first financial debacle and the beginning of his endless discontentment with the technology sector. Although the price of IBM shares drifted over the next few years, it collapsed to 10 in 1992 and 1993. Joe initially refused to take the hit, held on, but then, feeling bored and lonely at college, sold his shares at 24 in 1995, absorbing a small loss. Then he watched with dismay as IBM soared fivefold in the tech mania of the late 1990s (see Figure 1.3). Again, Joe learned that patience is a virtue and that technology analysts are glib and sound good but can be very wrong.

## Chapter 2

# Arizona Union

**I**n the fall of his senior year, the college scouts from Virginia Tech and Penn State came to check Joe out. Although they praised his athletic ability, they said he lacked the really great arm of a big-time Division I quarterback. Maybe he could be converted to a wide receiver, they thought, or a defensive back. He was definitely a talent they wanted to recruit. But, Joe was disappointed that he wasn't getting more attention from the famous Division I football schools. He dreamed of going to bowl games and playing for a national championship team.

Joe also wanted to get out of Big Neck and make a lot of money. He was tired of skimping. The Wal-Mart experience had whetted his appetite, but nothing like it had happened to him in the stock market since. He had continued to follow the market and read the material Josh Gibson gave him but neither of them had found any great stocks in a difficult market environment. Joe determined that the only way to make money was to play in the NFL.

One December afternoon Joe got a call from Josh Gibson, who wanted to talk about Joe's post-graduation plans. They met in Gibson's

simple, workman-like office. When Joe entered the room, Gibson didn't get up and continued to sit at his big wooden desk

"Pardon me for not getting up," Gibson grinned. "I didn't ask you here to shoot the breeze. This is serious; I think you're making a mistake. Your SAT scores are good enough to apply to an Ivy League university or another first-rate college, and those schools give academic, not athletic, scholarships to kids who have excelled in a sport. There are some wonderful colleges where you could be a scholar-athlete and get a fine free education that will be worth something."

"I don't want to play amateur, Division II or III football at those schools," Joe told him. "I think I can make it big in Division I, and then I really want to play in the pros where the big money is. And, let's face it, I'll never make the pros from Division II."

"The Ivy League has twenty players active in the NFL right now. Their alumni care about football, too; they just aren't insane. It's not professional football like the NCAA Division I. Furthermore, the Ivy League alumni are far more influential and better placed to help you with a real job after you graduate," Gibson said.

Joe would have none of it. "I'm going to play Division I football. The scouts that have seen me play say I have NFL potential. Just wait and see."

"Do you realize that only one out of every thousand college football players makes it to the pros? Suppose you get hurt? Suppose you don't make it in Division I. Then your scholarship is gone and you got nothing. Besides, the big money is in business and the stock market, not in smash mouth football."

"Maybe," said Joe. "I appreciate your interest. I really do, but I have to make this decision for myself."

"Okay, go get 'em," said Gibson with a large but flat smile.

Later, Joe would admit that that foolish decision cost him six years and that he blew a huge opportunity. "I was a just a dumb kid," he would say.



That winter, Virginia Tech, a Division I national powerhouse, wooed Joe hard, and he went to a three-day recruiting weekend there with