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Hedge Fund Confidential. When the most secretive traders gather, the cocktail talk could be worth billions

BY JOHN BONACCOLTA/LAS VEGAS

WHO ARE THESE PEOPLE? THE ART- AND YACHT-BUYING escapades of hedge fund operators such as Kenneth Griffin of Citadel and Eddie Lampert of ESL Investments grab the headlines. Yet there are more than 9,500 funds managing upwards of $1.74 trillion in assets, according to Chicago-based Hedge Fund Research, Inc. Many of those funds individually run a mere billion or three. This group of hedgies tend to be secretive loners, not prone to trading recipes.

A rare exception is the semiannual ritual staged by Drobny Global Advisors, a boutique research firm based in Manhattan Beach, Calif., run by two guys named Drobny—Andres and Steven—who are related only by the business they are in. The Drobnys' most recent conference attracted more than 100 macro hedge fund managers—people who bet on megatrends. They descended on the Wynn Las Vegas resort for three days of hard trading talk and, of course, a bit of hard playing.

The Drobny conference is a sort of hedgie brainfest. Members are required to contribute articles and make presentations, thereby subjecting themselves to the scrutiny of their peers. "The conference is always a great time to strengthen your thinking—being up in front of that crowd, you have no choice but to have a bulletproof trade, or you'll be eaten alive," says Renee Haugerud, CIO and managing principal of Galtere Ltd., which manages a $1 billion, New York City–based global macro hedge fund that focuses on the commodity markets.

I'm speaking with Haugerud at Tryst, the sprawling nightclub at the Wynn Las Vegas, where champagne is flowing freely and folks are beginning to loosen up after a cerebral day of presentations. Can this be the same person whose talk on buying farmland in Argentina, Brazil and the Midwest was intimidating in its attention to detail? In one breath she's discussing how the price per acre for Iowa farmland is not far from its nominal highs

Marko Dimitrijevic

- Everest Capital
- Trading focus: emerging markets
- Strategy: broad portfolio that seeks diversification across markets and instruments

reached in 1973; in another she's recounting her early professional life in Geneva and how much fun she had. She seems almost normal.

We chat some more about the Wynn, about travel, about trivial things. Then somehow I bring up cocoa and the impact of financialization on some of the soft-commodity markets, and she straightens up and squints down at me, launching into some quick attributes of cocoa to test my knowledge. Cocoa production is down because of drought in West Africa, and there is fear of renewed fighting in Ivory Coast, the world's largest producer. Meanwhile, Haugerud says, "demand continues to be strong across the board, along with new demand for dark chocolate because of the health benefits of flavanols. Dark-chocolate sales in Britain alone are up 25% this year."

This command of detail differentiates hedge fund traders from civilians. Macro trading is not only about prices on screens. To be sure, the name of the game is money—but the hedge fund managers are keenly aware of the imbalances growing around the world, and they are attuned to any factors that could potentially destabilize the markets.

In fact, it was over a cocktail discussion about urban crime that I met Marko Dimitrijevic, founder of Everest Capital, a Miami-based hedge fund firm with more than $2 billion invested through various strategies, although emerging markets are his specialty. Dimitrijevic was curious to hear about crime and its economic effects, which is not unusual for a man who invests in hot spots around the world.

Dimitrijevic is multilingual and grew up in Switzerland in what he terms a Yugoslav family, a claim that offers some insight into emerging-market investing: it's always changing and evolving. In his presentation, Dimitrijevic proposes that emerging markets offer the best opportunities, even though markets such as India, China and Malaysia have had bubble-like runs. "Don't be fooled by sticker shock given their huge outperformance in recent years," he says. "We are witnessing a trend change in the fundamentals right now." And such fundamental changes are what macro traders love most.

In fact, Dimitrijevic thinks emerging-market equities may eventually trade at a premium to developed-market equities. His biggest trade, however, is to buy the Taiwan equity index and pay Taiwan interest-rate swaps to finance it. The audience pounces: Why would an emerging-market specialist rate Taiwan, a market no longer "emerging"? Relative value is the answer. "Against the broader world backdrop, Taiwan is cheap," Dimitrijevic contends, "and financing in Taiwan is ridiculously cheap." Taiwan doesn't share the deflationary problems of neighboring Japan, so long-term interest rates of just over 2% seem crazy, he explains.

The propensity to challenge convention is one of the things that differentiates a hedgie, and it's something that humans are not necessarily wired to do, says Jim Leitner, manager of the Falcon Family Fund. Leitner spoke of this phenomenon at the conference and in *Inside the House of Money*, Steven Drobny's collection of interviews with macro hedgies. "Humans in general are biased to look for confirmatory evidence," Leitner asserts in the book. "When someone is bullish on oil, they tend to pick out the pro-oil arguments in whatever they read. Very few people train themselves to look for disconfirming evidence."

Leitner wowed the crowd by presenting his overall portfolio approach, which although systematic and rigorous rules out nothing. He has been known to take positions in Turkish glassmaking stocks, Serbian construction stocks and inflation-index-linked housing bonds in Iceland. Today he says he has no dominant positions and cites certain themes such as insurance providers in emerging markets and food. In the latter, he likes beneficiaries of cheap agriculture and protein, noting opportunities in Argentina GDP warrants, Brazil broadly and fertilizer companies in Taiwan. In equities he likes Serbia, Macedonia, Malaysia and the GCC (Gulf Cooperation Council) countries, and he is looking to other frontier markets, including Kazakhstan and Georgia. Pushed to home in on one idea, Leitner says his favorite trade is buying a short-dated Swedish krona call option against the euro. It's a way of playing the next Swedish central bank meeting, he explains. Got it?

How does a mind like that operate? Where many top money managers are content parachuting into a country and meeting with government officials and ministers, Leitner prefers to trawl around places such as Kenya, Zambia and Malawi, noting that "you never know what you will find off the beaten track." He's estimated to have amassed gains just shy of 30% annually for the past decade. Quite a find.

One of the meeting's real surprises was to hear so much talk about global equities, given their strong run, and the last presentation was no exception. Geoffrey Symonds of GLS Capital spoke about the possibilities in the GCC countries. "The macro story here is excellent, and the region looks a lot like Russia nine or 10 years ago," Symonds said.

Symonds cited the Western-educated, highly professional management at most companies he visited in the region and noted opportunities particularly in investment management and construction. On the former, Symonds believes that last year's gulf states market crash was overdone, and on the latter, that despite talk of a property bubble, real estate is still extremely cheap by world standards. A penthouse apartment sells for about $350 per sq. ft. (about $3,750 per sq m). Comparable properties in New York City and London sell for about five times that price.

As usual, pointed challenges arose. One questioner noted that the construction boom depended largely on cheap labor from the Indian subcontinent, labor that will grow more expensive as these workers are integrated into society down the road. Another questioner expressed skepticism about occupancy rates. This kind of push and pull is what makes markets, of course. The difference is that for hedge funds, trades gone wrong can be disastrous.

This being Vegas, the meeting is concluded with some gambling, in the form of Hedge Against Poverty, a charity poker tournament. It's a benefit for the creation of a Millennium Village in Haiti, an extension of the self-sufficient economic units that economist Jeffrey Sachs first devised for poor African communities.

Millionaire hedgies playing high-stakes poker in an over-the-top Las Vegas hotel to improve a Third World country. The contradictions abound, but these are people who don't mind being unconventional. By the same token, they don't consider themselves gamblers. That's the greater irony. Las Vegas was built on wild, exposed, highly leveraged directional bets. I'm not sure many of the hedgies would have been comfortable with such risky trades. ■