



MONEY MAVERICKS

**CONFESSIONS OF A
HEDGE FUND MANAGER**

LARS KROIJER

Money Mavericks

The stress surrounding our launch was made far worse by my lack of perspective. Businesses fail to get off the ground every day and often the entrepreneurs are stronger for having tried. I still had a lovely fiancée, a great group of family and friends, my health, and a strong résumé in the bag to get my career back on track, yet I had fallen into a mindset in which failure was the end of the world, and nothing else mattered. It had certainly been a soul-destroying eight months, and my ego was badly bruised, but on 1 November 2002 we arrived at the starting line and launched Holte Capital.

PART TWO

Becoming the real deal

Mickey Mouse fund

Starting out

Holte Capital opened for business on 1 November 2002. We arrived at the office drained from the drama of the previous week's fund-raising. At the 8am opening bell Brian sent me an email: 'Houston, we have lift-off', which led to more self-deprecating banter about what a big bad hedge fund we were, now that we had \$3.5 million to throw around. 'Corporate Europe, be afraid – Holte Capital is ready to make you dance', 'The evil empire is ready to strike', etc. Then it was back to work.

In the run-up to launch we had put together a 'paper portfolio' of securities we planned to invest in once we were in business. The only thing we needed to do was to scale the size of each security for the total assets of the fund. Had we launched with \$50 million, a 1 per cent position would equal a \$500,000 investment and, assuming a \$100 share price, that would mean we had to buy 5,000 shares. As things were, we would only have to buy 350 shares.

Within a couple of hours on our first day we were ready to make our first trade. The \$50,000 buy order would be placed through Richard at JP Morgan, a broker I had talked to since my first days at HBK. After the usual banter about how honoured he would be to execute our first trade, I explained that we would like to buy 620 shares in the Belgian company GBL, working max. 20 per cent of volume at a max. price of €85 per share. Massimo and Brian were listening in.

'Hang on,' said Richard, before asking, after a pause: 'You do know this is only about a 50 grand order, right?'

‘Yeah, I know. Starting small,’ I said.

There was another pause. Then Richard asked: ‘Lars – how did fund-raising go?’

‘It was pretty tough going to be honest. We launched with a little under \$5 million.’

‘That is tough,’ he said, ‘but I gotta tell you that if this is going to be your typical order size, you might want to take your trades elsewhere. I don’t mind helping you at all, but if the higher-ups see these sizes consistently from Holte they might ask me to cut you off from research and stuff.’

‘That’s cool,’ I said. ‘Thanks for letting me know.’ But he had certainly taken the wind out of my sails. Richard was doing us a favour by keeping us in the loop for research and market information, but the truth stung. The small size of our fund would be obvious with the small orders and since the promise of future brokerage commissions gave clients access to research, conference, management meetings, etc. we might be cut off. Then it might be better not to give orders and let Richard service us on the promise of us being a larger client in the future.

Although we were a lot smaller than we had hoped, it felt great to be in business. Lots of people have endless cocktail-party conversations about how they plan to start a hedge fund, but we had actually *done* it. This was our baby and we were going to try our hardest to make it work. After months of talking about what we planned to do once the fund launched, we were now doing it – analysing companies and industries and coming up with clever hedging strategies that could

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express the nugget of value we thought we had found in each trade.

This was what running a hedge fund was meant to be like, and it felt great. Of course, it would have felt better with more money in the bank, but once we were fully absorbed in

the analysis, our dire financial state seemed to matter less. The first week was spent putting together the portfolio we had planned before launch. After that first reality check with Richard, we began to do a lot of the trades using the cheap and electronic direct market-access platforms with which Morgan Stanley had provided us. That way, we avoided humiliating reminders from brokers about how small our orders were.

But our first few days were rough. By the end of the first week we had lost money every single day. By the end of our second week we had lost money in nine out of our first ten trading days. I left the office that Friday evening in a state of puzzled dismay. What was going on? Was there something systematic in the portfolio that meant that we were somehow destined to lose money all the time? I spent the weekend poring over the trades and thinking about what might be behind the string of losses, but failed to come up with anything. After this rough beginning, things somehow stabilised. My heart rate came down a bit and results began to improve. By the end of our first month we had recovered sufficiently to end with a small positive return. Or ‘up small’ as we would tell our small group of investors.

I was writing our inaugural monthly investor letter when Brian came to me with the final net returns for the first month of business. They were quite a bit lower than I had imagined.

‘It’s the expenses that are killing us,’ he said after I queried the figures. ‘The monthly expenses for everything are about 17 grand and on top of that you have the performance and management fees.’ We had talked about the effects of fees and charges on our returns but we hadn’t worried about them because we hadn’t thought we would be starting with so little capital. Now we had reason to worry, and the table below shows why.

Monthly return

Gross return	0.71% (after trading costs)
Expenses	0.48% (17K over \$3.55 million in assets)
Management fee	0.13% (1.5% over 12 months)
Incentive fee	0.02% (20% of remaining profit)
Net return	0.08%

The expense structure for a hedge fund hit a small fund like ours disproportionately. Since many of the charges such as legal set-up, listing fees, administrative fees, clearing fees, etc. are fairly fixed, the investors in a small fund take a larger part of the financial burden than if they had been invested in a large fund. Some charges, such as stock-loan fees, funding charges etc. go up with the size of the fund, but those were not what concerned us. If an investor lost 3–4 per cent per