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LASTING LEGACY

THE SEVEN NEWEST MEMBERS OF THE HEDGE FUND HALL OF FAME HAVE HAD A PROFOUND IMPACT ON THE INDUSTRY AND THEIR INVESTORS

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"Constant skepticism and an existential sort of humility are very useful in risk control."

PAUL SINGER

No hedge fund manager has proved the power of compounding more than Paul Singer, founder of New York–based Elliott Management Corp. His firm's flagship Elliott Associates partnership has delivered a 14 percent net annualized return since 1977, beating the S&P 500 index by 300 basis points a year with just one third of the volatility. Singer, 69, was born in Miami Beach; grew up in the New York City suburb of Teaneck, New Jersey; and started investing in the late 1960s while attending Harvard Law School. After graduation he worked as a corporate lawyer but continued to trade stocks for his family, suffering huge losses in the 1973–'74 bear market. Determined to never lose money again, Singer in January 1977 quit his job in the real estate group at investment bank Donaldson, Lufkin & Jenrette to start Elliott with $1.3 million from family and friends. A pioneer in convertible arbitrage, a low-risk strategy that involves buying a company's convertible bonds while shorting its common stock, Singer is best known for investing in distressed securities. He especially likes complicated and opaque situations in which he can control risk by controlling the outcome. Elliott was an active investor in the bankruptcy of Lehman Brothers Holdings, buying securities on the cheap, then fighting to get on the Official Committee of Unsecured Creditors. Elliott has also been a high-profile investor in the debt of emerging-markets countries, including Peru and Argentina. Even as he has grown his firm to $22 billion in assets, Singer has continued to focus on the twin goals of preserving capital and managing risk.

Alpha: How did you become interested in investing?

Singer: My dad convinced me that investing was a good thing to do. When I was in law school, in the years '66 through '69, he and I traded stocks long and short, with very, very tiny amounts of money. A lot of people back then enjoyed participating in the capitalist system, even if they only had $1,000 or $2,000 to be trading. And basically I think I found every possible way to lose money in the stock market.

So you and your father didn't do particularly well?

We did terribly. Our trading results were adversely affected by a combination of whipsaw markets, what in retrospect was superficial research and then sort of the coup de grâce, the 1974 bear market. By that time I was managing a tiny little family partnership and lost almost all the money in it. So my introduction to risk and risk management — the difficulty of deciding when any asset is so cheap that it can't get cheaper or so expensive that it can't get more expensive — my introduction to those lessons was personal and visceral, not academic.

Why did you decide to leave your job as a lawyer at DLJ to manage money? That would seem a fairly risky move at the time.

You know, sometimes when you're on a diving board, somebody comes back and gives you a little boot in the rear end. And the boot in the rear end in 1976 was that the two guys running DLJ real estate, as I recall, were fired, and the thing basically was in

Photographed by Ethan Hill on August 12, 2013, in New York, NY disbanding mode. I said to my wife at the time: "Gee, I really enjoy this other stuff, and actually I can make fees roughly comparable to my job as a staff lawyer. I'd like to do this." And she said: "Sure. Why not?" We didn't have an extravagant lifestyle at all. We lived in a rental apartment.

So if you were going to take a chance, that would probably have been a good time to do it?

I don't want to exaggerate the taking a chance part. It was something I was really interested in doing. I was determined to try to make back my parents' money that I had lost in '74. And convertible hedging really was a very solid, consistent strategy. I had never worked as an investment professional on Wall Street, so I didn't have any grandiose notion of myself as a master trader. But this convertible hedging was very solid.

What attracted you to the strategy?

My style in convertible arbitrage was low leverage and being very reliably hedged, meaning I rarely shaded the hedge ratios, rarely went just long or short convertibles. One of the lessons of my pre-Elliott life is that it's difficult — and, I later came to conclude, impossible — to determine turning points. So I felt — and it was part of my strategy then, and it's part of my strategy now — that being risk managed at all times and hedged at all times is the only way to actually control risk.

When did you stop doing convertible arbitrage?

We had been making money, good money, in the 1980s in convertibles. So when the 1987 crash happened — the timing of which was a surprise to me, as it always has been in crises — the portfolio volatility really was dampened by the combination of the convertibles and the hedges. We still lost 3.5 percent in the crash quarter, but we made money for the year as a whole. The crash experience was pretty searing because despite being hedged and not losing too much money, I saw the way convertibles traded: They became extremely illiquid during the crash and for a few weeks afterward. What happened after the crash, in a gradual process, was boosting the proportion of capital devoted to some other strategies that I had undertaken during the 1980s. Distressed became the largest area of capital deployment, but I also built fixed-income arbitrage and event arbitrage.

What attracted you to distressed investing?

Our first distressed trade was Western Union in the mid-1980s. What we came to like very much about distressed investing is the opportunity to control one's destiny and to make money in a different way than just buying a security that had its value priced by other market participants. We are willing to trade, wherever possible, complexity and manual effort for risk and to sign on for opacity when we think that we can join a process, control a process, make something happen through our manual efforts and our analysis of complexity rather than just identifying an undervalued stock or an undervalued security that's related to the value of businesses.

PAUL SINGER
ELLIOTT ASSOCIATES
FOUNDED IN 1977
$118.1 MILLION
(what $1 million invested on day one would be worth now)

If you read any of the stuff that I write to my investors, you see that I'm very interested in trying to understand what's actually happening in the American and the global economy and financial markets and the financial system. Yet I do not make large, directional, do-or-die bets based on these predictions. I'm almost always assuming or forcing myself to assume that the world is managed poorly and that the experts — including the experts that I hire that give me advice — don't really know what's going on and I have to take all of their advice with grains and grains of salt. That's a very useful set of mind because constant skepticism and an existential sort of humility are very useful in risk control.

Do you consider yourself an activist investor?

Yes. But there are different flavors of activism, and we have our own particular style, of course. I think we try to be active in every situation in which we can utilize that path to try to control our own destiny. In event arbitrage we sometimes are just passive arbitrageurs, but whenever possible if there's an angle we can use to create a better result or a different result or to control risk by being active, we seek it out. We like having more than one level or layer of protection against risk, and manual efforts help us to dig out from mistakes or possibly to create extra value from any situation.

Some critics have called Elliott amoral for purchasing the distressed debt of emerging-markets countries and demanding to be repaid in full. What do you think of that criticism?

Our investments in sovereign debt, just like our investments in distressed corporate debt, our activist equity positions and many other types of trades in our portfolio, have to be viewed in the context of our overall approach to investment. As I've told you, we prefer situations, all else being equal, that are dependent in large part on our individual efforts, as opposed to those that are dependent solely upon market forces.

We've never been in a fight with any sovereign that couldn't pay its debts, and we've made the point over and over again that sovereigns that could pay their debts and choose not to may be attempting to save some money but are harming their people and their economies by making investing in their countries more risky and more problematic and by discouraging foreign investment.

What are a couple of the most important lessons you have learned as a money manager over Elliott's nearly 37-year history?

You have to be in risk management mode all the time, not just when you might be particularly nervous, because it is impossible to time the transitions of markets to crisis conditions. And as your firm grows and you and your organization go through changes in your life circumstances, you need to keep constant the energy, humility and intelligence that built your track record. Coasting in money management does not turn out well.

— Interview by Michael Peltz