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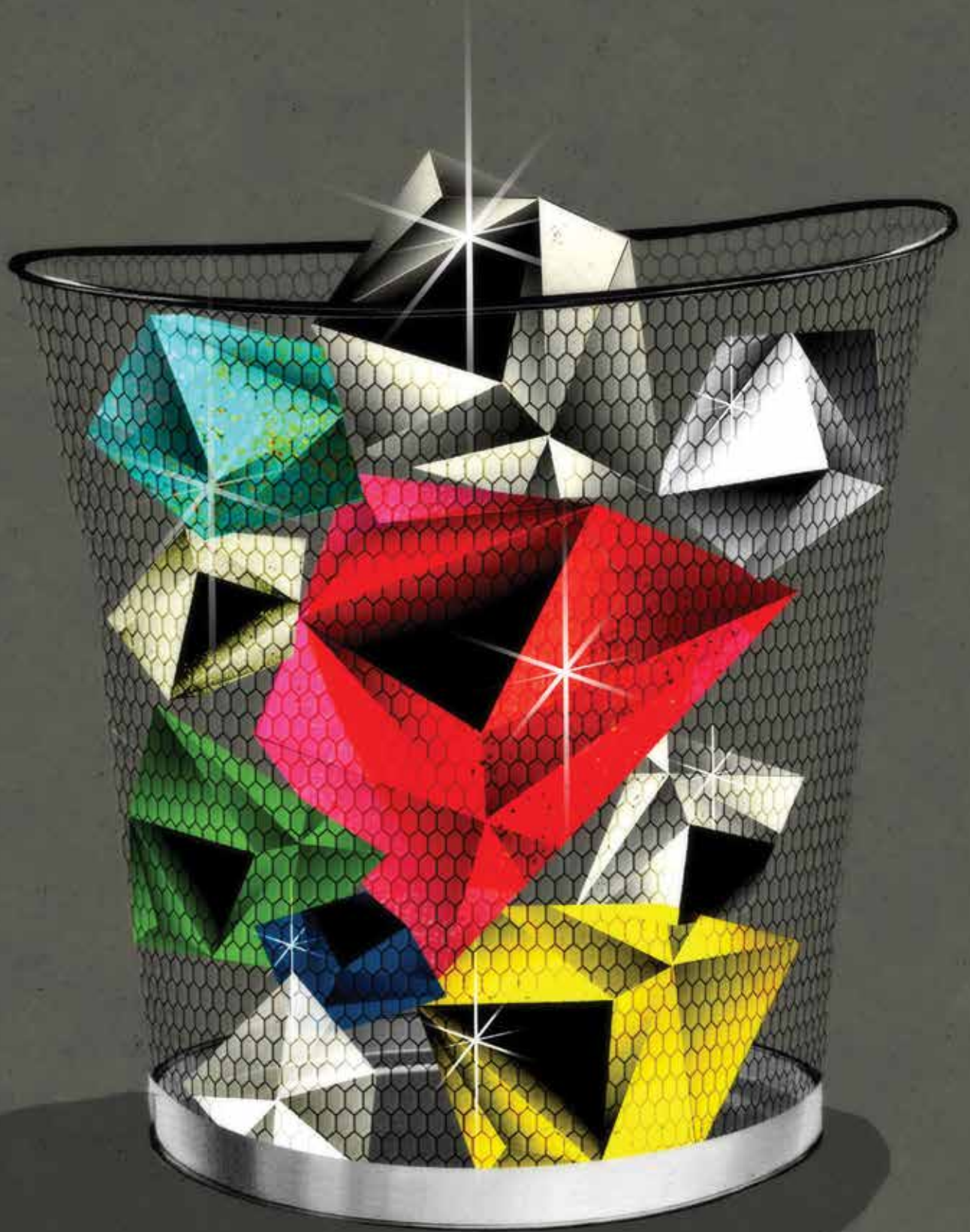
THE  
HEDGE  
FUND  
ISSUE

# GETTING FINDING MISSES

MICHAEL CRAIG-SCHECKMAN'S STS PARTNERS AND BRETT JEFFERSON'S HILDENE OPPORTUNITIES SIFTED THE DISTRESSED-DEBT WRECKAGE TO REACH THE TOP RANKS OF OUR LIST OF BEST-PERFORMING HEDGE FUNDS.

BY ANTHONY EFFINGER AND KATHERINE BURTON

ILLUSTRATION BY BRIAN STAUFFER



**Brett Jefferson told his 5-year-old son this about Wall Street recently: “Never will you find a place where so many smart people do so many stupid things.” • And that’s a good deal for Jefferson, 49, who has been profiting from Wall Street’s blunders for more than a decade. His hedge-fund firm,**

Stamford, Connecticut-based Hildene Capital Management, vacuums up complex securities when others are shunning them as toxic junk.

So does Michael Craig-Scheckman’s Deer Park Road Corp. “We make money because people on Wall Street make mistakes,” says Craig-Scheckman, 62, whose firm is based in Steamboat Springs, Colorado.

Six years after the 2008 debt crisis exposed how clueless the smart people on Wall Street can be, both men are profiting from what could be called the schadenfreude trade—buying for pennies what big investment banks once flogged for dollars. Their bottom-fishing lifted them into the top five of *Bloomberg Markets’* annual ranking of the best-performing large hedge funds for 2014. Craig-Scheckman’s STS Partners Fund, up 23.9 percent in the 10 months ended on Oct. 31, took third place. Jefferson’s Hildene Opportunities Fund, up 23.6 percent, came in fourth.

The top spot went to activist investor Bill Ackman’s Pershing Square International, which returned 32.8 percent on investments including Allergan Inc. and Canadian Pacific Railway Ltd. (See “How Do You Like Bill Ackman Now?” on page 26.) Ackman was an outlier, though. Most managers on the list were debt traders, including a dozen funds dealing in bonds backed by mortgages and other assets, or quants—investors who use mathematical models to trade a variety of securities.

It was debt trading that powered the best quant fund on the list: Quantedge Global, which ranked No. 2, with a 32.3 percent gain. The firm is a group of hypereducated actuaries, most of them in Singapore. The 15 people on Quantedge’s investment research team hold degrees in math, economics, finance, financial engineering and physics from

Harvard University, the University of Pennsylvania’s Wharton School, the University of Oxford, the University of California at Berkeley and the Massachusetts Institute of Technology. They trade everything—stocks, bonds, currencies, commodities and insurance-linked securities such as catastrophe bonds, where their actuarial skills come in handy. Yet it was fixed income that drove gains in 2014, a Quantedge Capital spokeswoman said in an e-mailed response to questions.

TruPS CDOs are the sole investment of **Brett Jefferson’s** Hildene Opportunities.

Mortgage funds did well in 2014 in part because fewer debtors missed payments on home loans—including the subprime borrowers whose debt hedge funds love. The collateral backing mortgage bonds performed well, and the owners of the bonds did, too. At the end of the third quarter, 18.75 percent of subprime home loans were delinquent, down from 27.2 percent in March 2010, according to the Mortgage Bankers Association.

Bonds backed by home loans have rallied for five years, making analysts wonder how long the good times will last. “Everyone thought mortgages were over,” says Chris Acito, chief executive officer of Gapstow Capital Partners in New York, which has \$1.1 billion invested in hedge funds that trade credit. Yet the party goes on. “If people haven’t defaulted on these yet, they probably won’t,” Acito says.

Better yet for the sketchy-debt crowd: There aren’t enough old bonds to go around, Acito says. When prices get low enough, Wall Street’s gaffes turn into gold.



COURTESY OF BRETT JEFFERSON

# 100

## TOP-PERFORMING

# LARGE HEDGE FUNDS

	Fund, Manager(s)	Management Firm, Location	Strategy	ASSETS, IN BILLIONS	2014 RETURN*	2013 RETURN
1	<b>Pershing Square International</b> , <i>Bill Ackman</i>	Pershing Square Capital Mgmt., U.S.	Activist	\$6.1	32.8%	9.3%
2	<b>Quantedge Global</b> , <i>Team managed</i>	Quantedge Capital, Singapore	Quantitative	1.0	32.3	9.2
3	<b>STS Partners</b> , <i>Michael Craig-Scheckman, Scott Burg</i>	Deer Park Road, U.S.	Asset backed	1.3	23.9	25.6
4	<b>Hildene Opportunities</b> , <i>Brett Jefferson</i>	Hildene Capital Mgmt., U.S.	Structured credit	1.3	23.6	35.3
5	<b>AHL Diversified</b> , <i>Tim Wang, Matthew Sargaison</i>	AHL Partners, U.K.	Managed futures	4.4	21.1	-3.1
6	<b>MBS Agency</b> , <i>William Mok</i>	Structured Portfolio Mgmt., U.S.	Mortgage-backed arbitrage	1.0	20.6	-9.1
7	<b>Citadel Tactical Trading</b> , <i>Team managed</i>	Citadel Advisors, U.S.	Multistrategy	2.3	19.7	12.0
8	<b>Stratus</b> , <i>Team managed</i>	Capital Fund Mgmt., France	Multistrategy	3.8	17.7	2.5
9	<b>Citadel Global Equities</b> , <i>Team managed</i>	Citadel Advisors, U.S.	Market neutral	4.4	17.3	12.2
10	<b>Dymon Asia Macro</b> , <i>Danny Yong</i>	Dymon Asia Capital, Singapore	Macro	3.5	17.0	5.2
11	<b>Glenview Capital Opportunity</b> , <i>Larry Robbins</i>	Glenview Capital Mgmt., U.S.	Long/short	2.8	16.9	101.7
12	<b>Tiger Global</b> , <i>Feroz Dewan</i>	Tiger Global Mgmt., U.S.	Long/short	7.0	16.2	14.3
13	<b>BZC Investment Partners</b> , <i>Denys Grossmann</i>	BlueZone Capital Mgmt., Bahamas	Multistrategy	5.9	15.9	21.9
14	<b>Two Sigma Compass Cayman</b> , <i>Team managed</i>	Two Sigma Investments, U.S.	Managed futures	2.1	15.7	14.1
15	<b>AHL Evolution</b> , <i>Tim Wang, Matthew Sargaison</i>	AHL Partners, U.K.	Managed futures	4.0	15.6	16.9
16	<b>Citadel Wellington</b> , <i>Team managed</i>	Citadel Advisors, U.S.	Multistrategy	11.6	15.1	19.4
17	<b>Mudrick Distressed Opportunity</b> , <i>Jason Mudrick</i>	Mudrick Capital Mgmt., U.S.	Event driven	1.0	14.7	7.8
18	<b>Golden China</b> , <i>George Jiang</i>	Greenwoods Asset Mgmt., Hong Kong	Long/short	1.2	14.5	17.5
19	<b>AHL Alpha</b> , <i>Tim Wang, Matthew Sargaison</i>	AHL Partners, U.K.	Managed futures	2.8	14.2	-1.5
-	<b>Lynx (Bermuda)</b> , <i>Jonas Bengtsson, Svante Bergstrom</i>	Lynx Asset Mgmt., Sweden	Managed futures	2.2	14.2	11.1
-	<b>Tilden Park Investment</b> , <i>Josh Birnbaum</i>	Tilden Park Capital Mgmt., U.S.	Credit	2.6	14.2	20.5
22	<b>PanAgora Diversified Risk Multi Asset</b> , <i>Team managed</i>	PanAgora Asset Mgmt., U.S.	Macro	1.4	13.9	3.0
23	<b>SPM Core</b> , <i>William Mok</i>	Structured Portfolio Mgmt., U.S.	Mortgage backed	1.3	13.0	-2.6
24	<b>DoubleLine Opportunistic Income</b> , <i>Jeffrey Gundlach, Philip Barach</i>	DoubleLine Capital, U.S.	Fixed income	1.8	12.8	2.2
25	<b>AHL Dimension</b> , <i>Tim Wang, Nick Granger</i>	AHL Partners, U.K.	Quantitative	1.6	12.0	3.0
26	<b>Viking Global Equities</b> , <i>Team managed</i>	Viking Global Investors, U.S.	Long/short	21.5	11.9	22.7
27	<b>Kayne Anderson MLP</b> , <i>J.C. Frey</i>	Kayne Anderson Capital Advisors, U.S.	Long/short	1.9	11.8	25.7
28	<b>Autonomy Capital Global Macro</b> , <i>Robert Gibbins</i>	Autonomy Capital Group, U.S.	Macro	3.0	11.7	2.5
-	<b>CCP Quantitative-Aristarchus</b> , <i>Ewan Kirk, Erich Schlaikjer</i>	Cantab Capital Partners, U.K.	Systematic	1.7	11.7	-27.7

Includes only funds with \$1 billion or more in assets. \*As of Oct. 31. Sources: Bloomberg, hedge-fund databases, investors

	Fund, Manager(s)	Management Firm, Location	Strategy	ASSETS, IN BILLIONS	2014 RETURN*	2013 RETURN
30	<b>Graham Tactical Trend</b> , Ken Trapin	Graham Capital Mgmt., U.S.	Systematic	\$1.2	11.4%	8.7%
31	<b>Graham K4D-15V</b> , Ken Trapin	Graham Capital Mgmt., U.S.	Systematic	2.3	11.3	15.5
32	<b>PFM Healthcare</b> , Brian Grossman	Partner Fund Mgmt., U.S.	Long/short	1.2	11.2	28.7
33	<b>D. E. Shaw Composite</b> , Team managed	D. E. Shaw Group, U.S.	Multistrategy	10.0	11.1	13.2
34	<b>Solus-Sola</b> , Chris Pucilla, Scott Martin, C.J. Lanktree	Solus Alternative Asset Mgmt., U.S.	Distressed	2.8	10.7	34.7
35	<b>Glenview Capital Partners</b> , Larry Robbins	Glenview Capital Mgmt., U.S.	Long/short	6.7	10.6	44.3
36	<b>Two Sigma Spectrum Cayman</b> , Team managed	Two Sigma Investments, U.S.	Market neutral	5.1	10.4	11.5
37	<b>Atlas Enhanced</b> , Dmitry Balyasny	Balyasny Asset Mgmt., U.S.	Multistrategy	2.0	10.0	21.1
38	<b>Axonix Credit Opportunities</b> , Clayton DeGiacinto	Axonix Capital, U.S.	Mortgage backed	2.0	9.9	12.1
–	<b>LibreMax Capital Partners</b> , Greg Lippmann	LibreMax Capital, U.S.	Credit	3.1	9.9	12.9
40	<b>Goldman Sachs Invnt. Partners Offshore</b> , Raanan Agus, Kenneth Eberts	Goldman Sachs Asset Mgmt., U.S.	Multistrategy	5.7	9.7	14.2
–	<b>Metacapital Mortgage Opportunities</b> , Deepak Narula	Metacapital Mgmt., U.S.	Mortgage backed	1.2	9.7	0.5
–	<b>Waterfall Eden</b> , Tom Capasse, Jack Ross	Waterfall Asset Mgmt., U.S.	Asset backed	1.1	9.7	12.4
43	<b>Highline Capital Partners</b> , Jacob Doft	Highline Capital Mgmt., U.S.	Long/short	2.4	9.5	27.7
–	<b>Kepos Alpha</b> , Mark Carhart	Kepos Capital, U.S.	Quantitative	1.7	9.5	–3.5
45	<b>Credit Suisse Securitized Product</b> , Albert Sohn	Credit Suisse Asset Mgmt., U.S.	Asset backed	2.2	9.4	18.0
–	<b>Renaissance Institutional Equities</b> , Peter Brown, Robert Mercer	Renaissance Technologies, U.S.	Quantitative	9.2	9.4	17.6
47	<b>AG Mortgage Value Partners</b> , Jonathan Lieberman	Angelo Gordon & Co., U.S.	Mortgage backed	1.2	9.2	13.0
–	<b>Eminence</b> , Ricky Sandler	Eminence Capital, U.S.	Long/short	4.2	9.2	14.6
–	<b>Macquarie-Winton Global Alpha</b> , David Harding	Macquarie Investment Mgmt., U.K.	Quantitative	1.0	9.2	11.3
50	<b>Steadfast International</b> , Robert Pitts Jr.	Steadfast Capital Mgmt., U.S.	Long/short	3.2	9.0	11.8
51	<b>Hutchin Hill</b> , Neil Chriss	Hutchin Hill Capital, U.S.	Multistrategy	2.9	8.9	19.4
–	<b>Marathon Securitized Credit</b> , Stuart Goldberg, Andy Springer	Marathon Asset Mgmt., U.S.	Structured credit	1.7	8.9	13.3
–	<b>One William Street Capital Partners</b> , David Sherr	One William Street Capital Mgmt., U.S.	Asset backed	1.0	8.9	5.8
–	<b>The Children's Investment</b> , Christopher Hahn	The Children's Investment Fund Mgmt., U.K.	Activist	8.8	8.9	47.2
55	<b>Securis I</b> , Robert Procter, Espen Nordhus	Securis Investment Partners, U.K.	Multistrategy	1.4	8.8	8.8
56	<b>Campbell Mgmt. Futures Program</b> , Team managed	Campbell & Co., U.S.	Managed futures	3.4	8.7	12.6
57	<b>Danske Invest Hedge Fixed Income Strategies</b> , Michael Petry	Danske Bank, Denmark	Fixed-income arbitrage	1.4	8.5	18.4
–	<b>GSA QMS Fund</b> , Jonathan Hiscock	GSA Capital Partners, U.K.	Quantitative	2.1	8.5	29.5
–	<b>Guggenheim Ptnrs. Opportunistic Invnt. Grade Securities</b> , James Michal	Guggenheim Partners Investment Mgmt., U.S.	Fixed income	2.6	8.5	9.0
–	<b>KLS Diversified</b> , Jeffrey Kranthal, Harry Lengsfeld, John Steinhardt	KLS Diversified Asset Mgmt., U.S.	Fixed income	2.6	8.5	1.6
61	<b>Drawbridge Special Opportunities</b> , Peter Briger, Constantine Dakolias	Fortress Investment Group, U.S.	Credit	5.5	8.4	18.4
62	<b>BlueTrend</b> , Leda Braga	BlueCrest Capital Mgmt., Guernsey	Quantitative	5.6	8.3	–11.5
63	<b>GSA International Fund</b> , David Khabie-Zeitoune	GSA Capital Partners, U.K.	Quantitative	1.3	8.1	13.3
–	<b>Scopia PX</b> , Matt Sravich, Jeremy Mindich	Scopia Capital Mgmt., U.S.	Long/short	4.8	8.1	11.1
65	<b>Catella-Hedgefond</b> , Ulf Strömsten	Catella Fondförvaltning, Sweden	Multistrategy	1.0	8.0	7.5

Fund, Manager(s)	Management Firm, Location	Strategy	ASSETS, IN BILLIONS	2014 RETURN*	2013 RETURN
– <b>FQ Essential Beta</b> , <i>Team managed</i>	First Quadrant, U.S.	Macro	\$2.2	8.0%	–1.71%
– <b>Macquarie Asian Alpha</b> , <i>Nick Bird</i>	Macquarie Invnt. Mgmt./Australia, Hong Kong	Long/short	1.8	8.0	9.0
– <b>Seminole Offshore</b> , <i>Michael Messner, Paul Shiverick</i>	Seminole Mgmt., U.S.	Long/short	1.4	8.0	23.2
69 <b>BlueMatrix</b> , <i>Michael Platt</i>	BlueCrest Capital Mgmt., Guernsey	Market neutral	2.4	7.9	12.6
– <b>Pimco Distressed Senior Credit Opps. II</b> , <i>Daniel Ivascyn, Joshua Anderson</i>	Pacific Invnt. Mgmt., U.S.	Fixed income	2.8	7.9	12.4
71 <b>CQS ABS</b> , <i>Simon Finch</i>	CQS, U.K.	Asset backed	2.1	7.8	9.7
72 <b>Pharo Macro</b> , <i>Team managed</i>	Pharo Global Advisors, U.K.	Macro	4.0	7.7	18.5
– <b>Renaissance Inst'l Diversified Alpha</b> , <i>Peter Brown, Robert Mercer</i>	Renaissance Technologies, U.S.	Quantitative	4.8	7.7	7.1
74 <b>Greywolf Event Driven Master</b> , <i>Jon Savitz, Jim Gillespie</i>	Greywolf Capital, U.S.	Event driven	1.0	7.6	15.7
75 <b>Candlewood Special Situations</b> , <i>Michael Lau, David Koenig, Jon Weiss</i>	Candlewood Invnt. Group, U.S.	Event driven	1.2	7.4	12.3
– <b>Citadel Global Fixed Income</b> , <i>Team managed</i>	Citadel Advisors, U.S.	Macro	4.4	7.4	19.8
– <b>Millennium International</b> , <i>Israel Englander</i>	Millennium Mgmt., U.S.	Multistrategy	24.1	7.4	13.5
– <b>Structured Servicing Holdings</b> , <i>William Mok</i>	Structured Portfolio Mgmt., U.S.	Mortgage-backed arbitrage	1.5	7.4	3.2
79 <b>Prosisr Global Opportunities Master</b> , <i>Reza Ali</i>	Prosisr Capital Mgmt., U.S.	Credit	1.2	7.3	16.3
– <b>York Global Credit Income</b> , <i>William Vrattos, Jeanne Manischewitz</i>	York Capital Mgmt., U.S.	Event driven	1.2	7.3	14.9
81 <b>Triam Partners</b> , <i>Nelson Peltz, Peter May, Ed Garden</i>	Triam Fund Mgmt., U.S.	Activist	9.8	7.2	40.1
– <b>Tyrus Capital Opportunities</b> , <i>Tony Chedraoui</i>	Tyrus Capital, Monaco	Event driven	1.1	7.2	14.7
83 <b>Elliott Associates</b> , <i>Paul Singer, Jon Pollock</i>	Elliott Mgmt., U.S.	Multistrategy	8.8	7.1	12.6
– <b>Ivory Optimal Master</b> , <i>Curtis Macnguyen</i>	Ivory Investment Mgmt., U.S.	Long/short	1.5	7.1	28.3
85 <b>York European Opportunities</b> , <i>Christophe Aurand, Christian Reyntjens</i>	York Capital Mgmt., U.K.	Event driven	3.3	6.9	12.6
86 <b>Crabel Multi-Product</b> , <i>Toby Crabel</i>	Crabel Capital Mgmt., U.S.	Quantitative	1.6	6.8	2.1
– <b>Two Sigma Absolute Return Cayman</b> , <i>Team managed</i>	Two Sigma Investments, U.S.	Managed futures	4.6	6.8	11.2
– <b>Tyrus Capital Event</b> , <i>Tony Chedraoui</i>	Tyrus Capital, Monaco	Event driven	1.4	6.8	15.8
89 <b>Renaissance Inst'l Futures</b> , <i>Peter Brown, Robert Mercer</i>	Renaissance Technologies, U.S.	Quantitative	1.5	6.7	2.1
90 <b>BlueCrest Emerging Markets</b> , <i>Nick Riley</i>	BlueCrest Capital Mgmt., Guernsey	Macro	1.2	6.6	4.8
91 <b>Alphadyne Intl. Master</b> , <i>Bart Broadman, Philippe Khuong-Huu</i>	Alphadyne Asset Mgmt., U.S, Singapore	Macro	2.7	6.5	5.2
– <b>NZC Guggenheim</b> , <i>Michael Damaso</i>	Guggenheim Ptnrs. Investment Mgmt., U.S.	Fixed Income	1.5	6.5	13.1
93 <b>Winton Futures</b> , <i>David Harding</i>	Winton Capital Mgmt., U.K.	Systematic	10.7	6.4	9.4
94 <b>Black River Fixed Income Relative Value Oppty.</b> , <i>Jeff Drobny, Tim Magnusson</i>	Black River Asset Mgmt., U.S.	Fixed-income arbitrage	1.6	6.3	5.1
95 <b>EJF Debt Opportunities</b> , <i>Emanuel Friedman, Jeffrey Hinkle</i>	EJF Capital, U.S.	Event driven	2.5	6.2	18.5
96 <b>AQR Style Premia</b> , <i>Team managed</i>	AQR, U.S.	Multistrategy	4.4	6.1	27.9
– <b>Palmetto Catastrophe</b> , <i>Team managed</i>	Nephila Capital, Bermuda	Event driven	1.5	6.1	6.8
98 <b>CCI Healthcare Partners</b> , <i>Oliver Marti</i>	CCI Healthcare Partners, U.S.	Long/short	1.2	6.0	26.6
99 <b>BlueCrest Multistrategy Credit</b> , <i>Andy Silver</i>	BlueCrest Capital Mgmt., Guernsey	Multistrategy	2.4	5.9	9.0
– <b>Canyon Balanced</b> , <i>Joshua Friedman, Mitchell Julis</i>	Canyon Capital Advisors, U.S.	Event driven	3.0	5.9	20.2
– <b>Visium Balanced</b> , <i>Jacob Gottlieb</i>	Visium Asset Mgmt., U.S.	Long/short	3.8	5.9	18.6

And with more homeowners paying their mortgages, that gold is going platinum.

Hedge funds as a group had a horrendous 2014, with an average return of just 1.6 percent through October among the 2,400 funds that make up the Bloomberg Global Aggregate Hedge Fund Index. Until October, managers complained that volatility in stocks and bonds made it tough to make money. Then, many got spooked and sold during October's plunge, missing a quick profit as prices rebounded.

Some of the largest and best-known funds, caught up in crowded trades that went against them in October, lost the most. The preferred shares of U.S. government-controlled mortgage aggregators Fannie Mae and Freddie Mac were favorites among hedge funds, and they tumbled more than 50 percent when a court ruling went against investors. Merger-arbitrage managers lost big when drugmaker AbbVie Inc. dropped a plan to buy Shire Plc and Shire shed more than a quarter of its value in two days.

John Paulson, who had five funds in the top 100 in 2013, was among the biggest losers in 2014. His \$19 billion firm, Paulson & Co., lost money in both Fannie-Freddie and AbbVie-Shire trades. His Advantage fund plunged 14 percent in October and 25 percent for the year as of Oct. 31.

The flagship fund of Claren Road Asset Management, majority owned by private-equity firm Carlyle Group LP, dropped 9.1 percent in the 10-month period on the Fannie Mae and Freddie Mac trade.

Two funds that did not make the top 25 nevertheless were the most profitable. No. 26 Viking Global Equities led that list, pulling in \$573.3 million in incentive fees for the 10 months ended on Oct. 31. Israel "Izzy" Englander's Millennium International made \$389.5 million even though it tied for 75th in performance, with a 7.4 percent return.

Craig-Scheckman floated through October's volatility. He and Deer Park Road Chief Investment Officer Scott Burg, a former offensive guard on the University of Colorado football team, buy mortgage-backed bonds that pay a healthy yield, and they are ready to hold them long term. Even if prices decline, they clip their coupons.



**Michael Craig-Scheckman** gave up a career in astrophysics for structured finance.

And if it snows, they go skiing. Craig-Scheckman is in the midst of constructing a new office building for his 19 employees at the base of the gondola at Steamboat Springs. They all get lockers and a ski pass as perks. If fresh

movie *Wall Street*. In 1978, Craig-Scheckman left physics and joined them in finance. He traded gold, then mortgage bonds. In 1993, he went to work for Englander's Millennium Management. Craig-Scheckman started Deer Park Road in 2003, moving his family to Steamboat Springs that same year.

Mortgage bonds that were minted from 2004 to 2007 are among Craig-Scheckman's favorites. That's when lenders offered negative-amortization mortgages, in which the payments didn't cover all the interest, so the principal just kept growing. "These were the worst possible loans people could take," he says. Lately, they've been among the best for Deer Park Road. Bonds backed by them tumbled so much that a little improvement in payment on the underlying loans boosts their value.

Hildene Capital's Jefferson trades exotic stuff too, and he does it without a physics degree. He grew up in Rye, New York, the son of a container-ship captain. More jock than geek, he majored in English and played lacrosse for Syracuse University in 1988 when it won the national championship. He played on a club team while working on an MBA from the Kellogg School of Management at Northwestern University.

## BONDS BACKED BY NEGATIVE-AMORTIZATION LOANS ARE CRAIG-SCHECKMAN'S FAVORITES. 'THESE WERE THE WORST' FOR HOMEOWNERS, HE SAYS, AND THE BEST FOR HIS HEDGE FUND.

snow lures them out at midday, they bring their mobile phones to complete trades.

Like many mortgage managers, Craig-Scheckman has an academic background. In the 1970s, he was pursuing a doctorate in X-ray astrophysics at Columbia University, working on gas-scintillation technology for Geiger counters used in space probes, when it all started to feel like grunt work, he says. He had an uncle at Salomon Brothers. And his cousin, Asher Edelman, was a model for Gordon Gekko in the

Jefferson started his career in structured debt in 1997, when his bosses at Salomon Smith Barney asked him to figure out a new category of securities called collateralized loan obligations—bundles of corporate loans structured as securities. Back then, a little experience made him an expert, he says. He joined Marathon Asset Management in 2002 and ran the Marathon Structured Finance Fund until 2006. Under his watch, the fund never had a money-losing month, according to fund

documents. Even so, he and Marathon CEO Bruce Richards parted ways. “Mr. Richards and I had a disagreement,” Jefferson says, declining to say more.

Jefferson spent the next two years sitting out the excesses of the mortgage bubble. “I made the smartest investment decision of my life by not working in 2006 and 2007,” he says. He started Hildene in mid-2008 after subprime mortgages had collapsed and securities built from them, called collateralized debt obligations, plummeted. Of particular interest were bonds issued by banks and backed by trust-preferred securities. They’re called TruPS CDOs, and specializing in them is a little like being a connoisseur of wine from Canada: There isn’t much of it, and it’s hard to make, but it can be superb if the growing season is good. Or as Jefferson puts it: “When you’re dealing with mainstream products, it’s like shopping at the mall. Here, you’re showing up at a Turkish bazaar.”

TruPS CDOs are made from a kind of debt that U.S. banks started selling in earnest in 1996. That year, the Fed let bank holding companies raise capital by selling special securities to investors. The notes paid dividends, like preferred stock, and allowed the banks to treat those dividends like interest payments, which are tax deductible.

## WORLD'S LARGEST HEDGE-FUND FIRMS

Firm, Location	HEDGE-FUND ASSETS UNDER MANAGEMENT, IN BILLIONS
1 <b>Bridgewater Associates</b> , Westport, Connecticut	\$88.9
2 <b>JPMorgan Asset Mgmt.</b> , New York	62.9
3 <b>Och-Ziff Capital Mgmt.</b> , New York	47.1
4 <b>Man Group</b> , London	40.9
5 <b>Brevan Howard Asset Mgmt.</b> , London	37.0
6 <b>AQR Capital Mgmt.</b> , Greenwich, Connecticut	35.1
7 <b>D. E. Shaw &amp; Co.</b> , New York	34.0
8 <b>BlackRock Advisors</b> , New York	32.8
9 <b>Baupost Group</b> , Boston	28.8
10 <b>Winton Capital Mgmt.</b> , London	28.0

Figures are the latest available.  
Sources: Bloomberg, hedge-fund databases, investors

Better yet, the securities counted toward regulators’ strictest capital requirements.

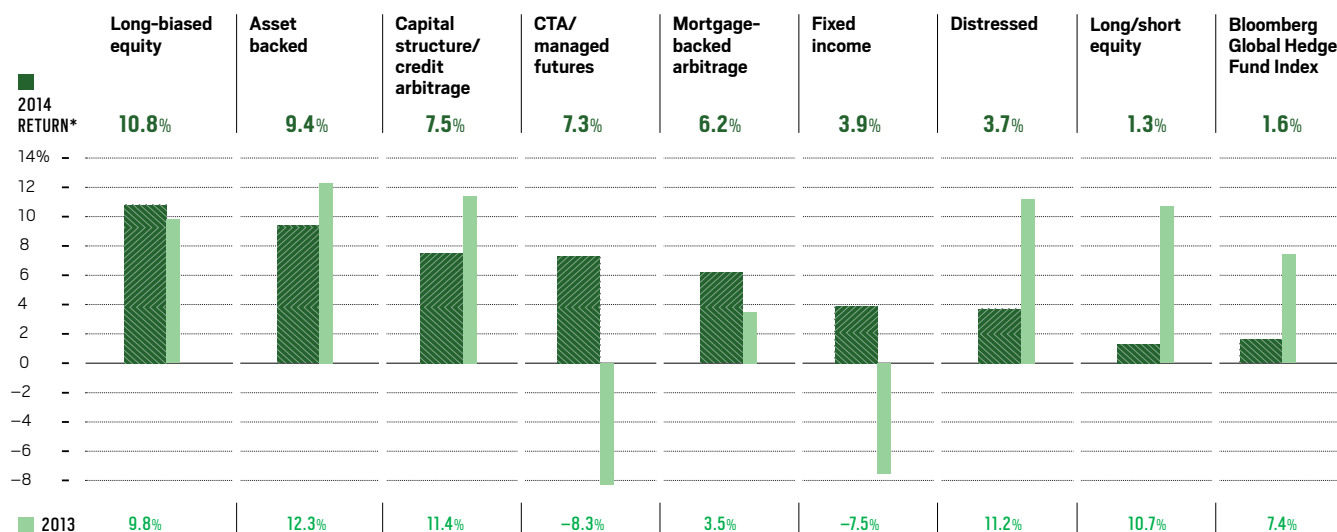
To participate, a bank would set up a subsidiary—the trust—to sell the securities to investors. The trust would then loan the proceeds of those sales to the bank and use the bank’s interest payments to provide dividends to investors.

Wall Street eventually got involved and started bundling the trust securities into CDOs, as they did with every other kind of debt. Citigroup Inc. created the first TruPS CDO in 2000. It was a big development for small banks. Before the CDO deals, a little bank couldn’t sell enough TruPS to attract an investor. The CDOs, by contrast, pooled diverse TruPS from around the country to limit the risk of default for the entire CDO.

Citigroup, Merrill Lynch & Co., Credit Suisse Group AG and other investment banks sold \$60 billion of TruPS CDOs from 2000 to 2007. That year, the housing bubble popped, the mortgage market collapsed, and banks—especially smaller ones—began to look like dead lenders walking.

Jefferson’s Hildene started buying TruPS CDOs in May 2008, before the worst months of the financial crisis. His thesis was that fewer banks would fail than people thought and that the survivors would all have to repay their debts. If he was right, he’d make a killing. Jefferson lived on the West Side of Manhattan then, and he says before he started buying the supercheap TruPS CDOs he would walk his dog, Luna, around the American Museum of Natural History, asking himself, “What am I missing?” He concluded it was other

## BEST-PERFORMING STRATEGIES



\*As of Oct. 31. Source: Bloomberg



TOP

25 MIDSIZE  
HEDGE FUNDS

	Fund, Manager(s)	Management Firm, Location	Strategy	ASSETS, IN MILLIONS	2014 RETURN*	2013 RETURN
1	<b>India Capital</b> , <i>Jon Thorn</i>	India Capital Mgmt., Mauritius	Long biased	\$305	47.2%	-21.7%
2	<b>Okumus Opportunistic Value</b> , <i>Ahmet Okumus</i>	Okumus Fund Mgmt., U.S.	Long biased	498	45.6	35.8
3	<b>Rhenman Health Equity Long/Short ICI Class</b> , <i>Henrik Rhenman</i>	Rhenman & Partners Asset Mgmt., Sweden	Long/short	370	32.2	55.3
4	<b>ISAM Systematic</b> , <i>Darren Upton</i>	ISAM (Europe), U.K.	Systematic	250	26.8	-10.7
5	<b>Segantii Asia-Pacific Equity Multi-Strategy</b> , <i>Simon Sadler, Kurt Ersoy</i>	Segantii Capital, Hong Kong	Multistrategy	885	25.3	-1.7
6	<b>Harvest Small-Cap Partners</b> , <i>Jeff Osher</i>	Harvest Capital Strategies, U.S.	Long/short	421	25.1	13.8
7	<b>Chenavari-Toro Capital</b> , <i>Benoit Pellegrini, Frederic Couderc</i>	Chenavari Investment Managers, U.K.	Asset backed	529	24.0	32.9
-	<b>ZP Utility</b> , <i>Stuart Zimmer</i>	Zimmer Partners, U.S.	Long/short	850	24.0	35.2
9	<b>Anson Investments Master</b> , <i>Bruce Winsan, Moez Kassam, Adam Spears</i>	Frigate Ventures, U.S.	Long/short	274	23.5	2.7
10	<b>Lynx Bermuda 1.5</b> , <i>Jonas Bengtsson, Svante Bergstrom</i>	Lynx Asset Mgmt., Sweden	Managed futures	374	21.7	16.7
-	<b>Saemor Europe Alpha</b> , <i>Sven Bakker, Sven Bauman</i>	Saemor Capital, Netherlands	Market neutral	728	21.7	5.9
12	<b>Maestro Managed Futures Strategy</b> , <i>Bruno Pannettier, Karim Laidi</i>	Old Park Capital, U.K.	Managed futures	300	20.5	5.3
13	<b>NTAsian Discovery</b> , <i>Kenneth Ng</i>	NTAsset, Thailand	Long biased	814	20.4	13.4
14	<b>Mangrove Partners</b> , <i>Nathaniel August</i>	Mangrove Partners, U.S.	Long/short	421	19.5	5.1
15	<b>Acadian Global Leveraged Market Neutral Equity</b> , <i>Alexandre Voitenok</i>	Acadian Asset Mgmt., U.S.	Market neutral	356	18.7	1.0
16	<b>Everest Capital Emerging Markets</b> , <i>Marko Dimitrijevic</i>	Everest Capital, U.S.	Emerging markets	435	18.6	13.1
17	<b>Welton Global Direct'l Port.</b> , <i>Patrick Welton, Brent Hankins, Justin Balas</i>	Welton Investment Partners, U.S.	Managed futures	412	18.4	-5.7
18	<b>WF Asian Smaller Cos.</b> , <i>Scobie Ward, Vineet Mittra</i>	Ward Ferry Mgmt., Hong Kong	Long biased	310	18.1	15.5
19	<b>Barneгат Investments</b> , <i>Robert Treue</i>	Barneгат Fund Mgmt., U.S.	Fixed-income arbitrage	714	17.7	6.8
20	<b>Millburn Diversified</b> , <i>Team managed</i>	Millburn Ridgefield, U.S.	Managed futures	794	17.1	-6.0
21	<b>Cheyne Total Return Credit</b> , <i>David Peacock, John Weiss</i>	Cheyne Capital Mgmt., U.K.	Fixed income	596	17.0	49.2
22	<b>Sphera Global Healthcare</b> , <i>Doron Breen</i>	Sphera Global Healthcare Mgmt., Israel	Long/short	430	16.9	31.2
23	<b>Tulip Trend</b> , <i>Daniel van Allmen</i>	Progressive Capital Partners, Switzerland	Systematic	366	16.5	0.0
24	<b>Kayne Anderson Midstream Institutional</b> , <i>J.C. Frey</i>	Kayne Anderson Capital Advisors, U.S.	Long biased	530	16.4	25.5
-	<b>Lynas Asia</b> , <i>David Devine, Andrew Henderson</i>	Lynas Capital, Hong Kong	Long biased	301	16.4	-3.9
-	<b>Pharo Trading</b> , <i>Guillaume Fonkenell</i>	Pharo Global Advisors, U.K.	Systematic	450	16.4	19.7
-	<b>WF Asian Reconnaissance</b> , <i>Scobie Ward, Vineet Mittra</i>	Ward Ferry Mgmt., Hong Kong	Long biased	289	16.4	14.4

Includes only funds with \$250 million to \$1 billion in assets. \*As of Oct. 31. Sources: Bloomberg, hedge-fund databases and firms, investors

investors who were failing to pick some low-hanging fruit. "If you did the work, you could understand it," he says.

One confusing feature of the securities: Banks are allowed to defer payments to debtholders at any time for up to five years. Prices plunged when banks deferred, because many investors assumed

they had defaulted. Jefferson knew better and snapped them up.

When the financial crisis deepened at the end of 2008, Jefferson kept buying TruPS CDOs, in some cases paying less than a penny on the dollar. Soon, they were all he bought.

Then he learned that it wasn't just buy

and hold. When the worst of the credit crisis passed, other investors went trolling for TruPS. Instead of buying CDOs, like Jefferson, some tried to pry the best TruPS out of the CDOs at bargain prices, which would hurt investors such as Hildene. Banks also tried to buy back TruPS they had issued, offering pennies on the dollar.

When forced to honor the debt, some banks pleaded hardship, saying they were too busted to pay off the TruPS, Jefferson says. He took a hard line: "If you're going to live, you're going to pay me," he says he told them. He has gone to court multiple times to protect his investments. There are still cases pending. He says he and his staff watch the film *Braveheart* to get fired up.

Today, Jefferson says he's probably the biggest holder of TruPS CDOs. At a deep discount, the debt securities invented during the go-go years are a precious and rare commodity, he says.

Jefferson and Craig-Scheckman say they always get the same question from investors: How long can they keep finding jewels among the wreckage of 2008? In Jefferson's case, it could be a while. His TruPS could be paying dividends for another two decades because most have 30-year terms. Beyond that, he's not fussed. "I like investing," he says. "But I may not be a distressed investor if there aren't distressed opportunities. I might go coach lacrosse."

Craig-Scheckman isn't fretting either. As long as there are people concocting new financial products on Wall Street, no matter how smart they are, they will make mistakes, he says. And when he's not skiing a foot of fresh powder on Triangle 3, a steep pitch in the trees at Steamboat Springs, he'll be waiting for them.

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## WORLD'S MOST-PROFITABLE HEDGE FUNDS

	Fund, Manager(s)	Management Firm, Location	PROFIT, IN MILLIONS*
1	<b>Viking Global Equities</b> , Team managed	Viking Global Investors, U.S.	\$573.3
2	<b>Millennium International</b> , Israel Englander	Millennium Mgmt., U.S.	389.5
3	<b>Citadel Wellington</b> , Team managed	Citadel Advisors, U.S.	376.1
4	<b>Pershing Square International</b> , Bill Ackman	Pershing Square Capital Mgmt., U.S.	362.3
5	<b>D. E. Shaw Composite</b> , Team managed	D. E. Shaw Group, U.S.	248.4
6	<b>Tiger Global</b> , Feroz Dewan	Tiger Global Mgmt., U.S.	240.8
7	<b>BZC Investment Partners</b> , Denys Grossmann	BlueZone Capital Mgmt., Bahamas	201.1
8	<b>Glenview Capital Partners</b> , Larry Robbins	Glenview Capital Mgmt., U.S.	192.3
9	<b>The Children's Investment</b> , Christopher Hohn	The Children's Invst. Fund Mgmt., U.K.	180.3
10	<b>Triam Partners</b> , Nelson Peltz, Peter May, Ed Garden	Triam Fund Mgmt., U.S.	165.6
11	<b>Winton Futures</b> , David Harding	Winton Capital Mgmt., U.K.	161.1
12	<b>Citadel Global Equities</b> , Team managed	Citadel Advisors, U.S.	159.9
13	<b>King Street Capital</b> , Francis Biondi, Brian Higgins	King Street Capital Mgmt., U.S.	153.0
14	<b>Elliott Associates</b> , Paul Singer, Jan Pallock	Elliott Mgmt., U.S.	146.9
15	<b>Stratus</b> , Team managed	Capital Fund Mgmt., France	139.5
16	<b>AHL Evolution</b> , Tim Wong, Matthew Sargaison	AHL Partners, U.K.	133.4
17	<b>Lansdowne Developed Markets</b> , Peter Davies, Stuart Roden	Lansdowne Partners, U.K.	127.3
18	<b>Goldman Sachs Invst. Partners Offshore</b> , Raanan Agus, Kenneth Eberts	Goldman Sachs Asset Mgmt., U.S.	126.5
19	<b>Dymon Asia Macro</b> , Danny Yang	Dymon Asia Capital, Singapore	124.0
20	<b>Two Sigma Spectrum Cayman</b> , Team managed	Two Sigma Investments, U.S.	120.2

\*Based on returns for the 10 months ended on Oct. 31. Sources: Bloomberg, hedge-fund firms and databases, investors

### HOW WE CRUNCHED THE NUMBERS

Our rankings of hedge-fund managers are based on data compiled by Bloomberg hedge-fund specialist Anibal Arrascaue and information supplied by hedge-fund research firms, hedge funds and investors. We have three lists of top performers: 100 funds with assets of \$1 billion or more, 25 funds with assets between \$250 million and \$1 billion and the 20 most-profitable funds. (Due to ties, there are 101 large funds and 27 midsize funds listed.) Assets and returns were for the 10 months ended on Oct. 31.

The first step in calculating profits was dividing a fund's net figure by 100 percent minus the sum of the management-fee and the incentive-fee percentages. If a fund didn't report its fees, we used the average of funds in our universe: a 2 percent management fee and a 20 percent incentive fee.

Using gross returns, we were able to reconstruct approximately what the assets were at the start of the year. (Because we didn't have inflows or outflows, the asset numbers did not take asset flows into account.) We

subtracted original assets from current assets and multiplied the result by each fund's performance fee to derive the profit figures. Management fees aren't included; we assumed they were used for the day-to-day operations of the fund.

Several funds appearing on the most-profitable ranking do not show up on our lists of top performers. That is because the size of a fund can trump returns when calculating profits.

Because hedge-fund returns can be difficult to obtain, our lists are not

all-inclusive. In addition, some of the numbers were difficult to verify. Unless the information came from Bloomberg or the hedge-fund firm itself, we tried to verify it with other sources, including investors and other fund databases.

Onshore and offshore assets and returns were combined for a number of funds, while figures for other funds were only for the larger or better-performing class of the fund.

Bloomberg Rankings  
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