100 THE WORLD'S RICHEST HEDGE FUNDS 2

Captain of Complexity

BY ANTHONY EFFINGER AND MARY CHILDS

ILLUSTRATION BY EVGENY PARFENOV

ANDREW FELDSTEIN'S BLUEMOUNTAIN CAPITAL SAVED JPMORGAN FROM THE RAVAGES OF THE LONDON WHALE. NOW, HE'S OFFERING TO RESCUE OTHER BANKS FROM THEIR BAD BETS ON DERIVATIVES.

100 THE WORLD'S RICHEST HEDGE FUNDS

Andrew Feldstein, the Harvard-educated lawyer who leads BlueMountain Capital Management LLC, has had a good run.

His firm boasts just one losing year since it was started in 2003. Assets had swelled to $12.7 billion as of mid-December. He now has 150 people in New York and London helping him manage the abstruse derivatives contracts he likes to trade: credit-default swaps, collateralized debt obligations, synthetic CDOs, mortgage bonds, swaptions—the alphabet soup of stuff that went bad in 2008.

Feldstein is best known for his June coup, when he bet against the London Whale—JPMorgan Chase & Co. trader Bruno Iksil—who was long and wrong on $100 billion in credit derivatives. That play reaped $300 million for BlueMountain, according to people familiar with the matter, even as JPMorgan lost $6.2 billion. Feldstein did more than just make money trading against the Whale. He also helped Chief Executive Officer Jamie Dimon unwind JPMorgan's trades, earning points with America's most powerful banker.

Feldstein's $5.1 billion flagship fund, BlueMountain Credit Alternatives, rose 13.3 percent through October, making it No. 51 in BLOOMBERG MARKETS' annual ranking of the top 100 large hedge funds. Credit Alternatives was the 20th-most-profitable fund, producing $134.7 million for BlueMountain. Since its inception in late 2003, the fund has returned an average of 10 percent a year.

Without BlueMountain's help, losses at **Jamie Dimon**'s JPMorgan could have been much greater.

Feldstein, 48, who declined to be interviewed for this story, expects the good times to keep rolling. In October, BlueMountain started soliciting new investors for Credit Alternatives through UBS AG, Switzerland's biggest bank. By pooling their money, UBS's wealthy clients can each put in $250,000, far less than the $1 million–plus that hedge funds typically demand.

That could be a dangerous proposition, says Peter Rup, chief investment officer at Artemis Wealth Advisors LLC in New York. He says credit markets are poised for a fall. "The good rates of return in this market have been had," Rup says. "The unsophisticated buyer is going to get hurt." (For more on UBS, see "The Young and the Reckless," page 68, and "Humbled Giants," page 78.)

'YOU'D HAVE THOUGHT ANYTHING WITH A C IN FRONT OF IT WOULD BE TOXIC,' A DOUBLELINE FUND MANAGER SAYS. 'BUT THE BID SEEMS TO BE NEVER ENDING.'

BlueMountain is raking money into a new fund, too. It raised $1.5 billion for the BlueMountain Credit Opportunities Master Fund I in October, twice what it expected, BlueMountain co-founder Stephen Siderow said in an interview with Bloomberg Television. Feldstein is betting that BlueMountain can make money on assets that banks no longer want to own and on loans that banks no longer want to make, according to an October marketing document for the new fund obtained by BLOOMBERG MARKETS. As banks shed risky assets, Feldstein is making money picking through these flea markets of finance. "This market will continue to grow," says Paul Rowady, a senior analyst at research firm Tabb Group LLC in New York. "Their intuition to be a leader is spot on."

BlueMountain has purchased securities backed by a film library and subprime car loans and has looked at bonds built from time shares, according to the pitch for its new fund. It also buys CDOs—pools of mortgages and other loans that, pre-2007, banks assembled, cut into tranches according to risk and sold to investors. Synthetic CDOs are made of CDSs that insure bonds; the swaps pay the holder if a company defaults on its debt. Originally, banks used them to extend credit to corporations. Then they became tools for speculation.

BlueMountain has company around the bargain bin, particularly when it comes to collateralized loan obligations, or CLOs, which are securities built out of loans. "You'd have thought anything with a C in front of it would have been toxic after 2008," says Bonnie Baha, a fund manager at DoubleLine Capital LP in Los Angeles, which oversees $50 billion. "But the bid seems to be never ending. It's been a nice ride, but it's not going to go on forever."

BlueMountain says that in 2011 it bought a portfolio of synthetic CDOs and CDSs from Montrouge, France–based Credit Agricole SA. The sale cut Agricole's risk-weighted assets—which must be protected by a capital buffer—by $18 billion, the bank says. "We think there will be more of those types of transactions," Siderow said in his Bloomberg Television interview.

For banks such as Credit Agricole,

ANDREW HARRER/BLOOMBERG

tapping Feldstein is like having a tall, green monster on the rampage and calling in Dr. Frankenstein to deal with it. He was on the JPMorgan team that helped create the credit derivatives market in the early 1990s. BlueMountain often exploits tiny, intermittent differences in price among bonds and the swaps that insure them. It uses custom algorithms to arbitrage those swaps and the indexes that London-based Markit Group Ltd. owns and manages.

Even so, none of the eight men who run BlueMountain are quantitative traders. Michael Liberman, BlueMountain's chief risk officer, who has a master's degree in math from Brandeis University, comes closest.

Rather, Feldstein, Siderow and the others are mostly MBAs and lawyers. A law degree helps when you're dealing with CDO prospectuses, which run to 350 pages and make stock-offering documents read like spy thrillers.

Feldstein grew up far from the world of finance, in Flagstaff, Arizona. His father, Murray, a urologist, was elected to the Flagstaff City Council as a Libertarian in 1980, giving the party, founded in 1971, one of its first victories.

Andrew went east for school and graduated magna cum laude from Georgetown University in Washington. He then worked at consulting firm Bain & Co., where he met Jane Veron, a Yale University graduate—also magna cum laude—whom he married after leaving Bain to attend Harvard Law School, according to a 1989 announcement in the *New York Times*.

At Harvard, he played pickup basketball with classmate Barack Obama. Feldstein said he can tell a lot about people by how they play the game. "He was a leader," he said in a 2008 *Financial Times* video interview. "He could have scored or he could have passed, and he passed."

In the 2008 election, Feldstein gave $4,600 to Obama, $6,900 to Hillary Clinton and $2,300 to fellow Arizonan John McCain, his only donation to a Republican that cycle, according to the Center for Responsive Politics. He gave nothing to Obama in 2012.

Feldstein hired on at JPMorgan in 1992 and spent the next decade finding new ways to make money with derivative products. In 2003, Feldstein started BlueMountain with Siderow, whom he knew from Harvard Law. Siderow had been working at McKinsey & Co. in New York.

The pair tapped their networks for talent. Chief risk officer Liberman also worked at JPMorgan before joining BlueMountain in 2004, as did Peter Greatrex, who signed up in 2007. Alan Gerstein, another friend of Feldstein's from the bank, joined in 2004 after a stint at Goldman Sachs Group Inc., where he knew Bryce Markus, who joined BlueMountain in 2005, and Derek Smith, who came onboard in 2008. David Rubenstein, another Harvard Law grad, knew Siderow at McKinsey and came to BlueMountain in 2006.

All have equity in the company, and ownership is lucrative. In 2010, Markus, 35, bought a Park Avenue apartment from Goldman Sachs Chief Executive Officer Lloyd Blankfein for $12.2 million, according to real estate records.

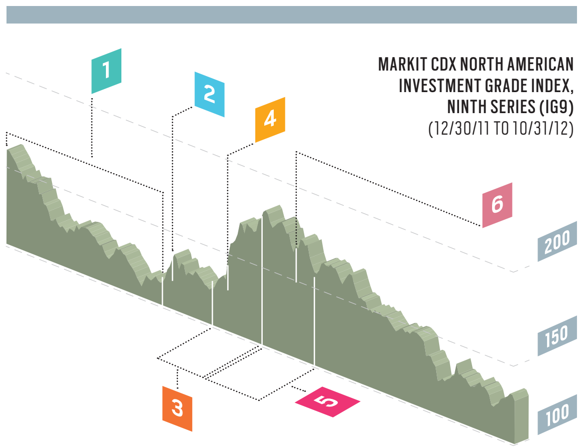
In its first few years in business, BlueMountain practiced a strategy known on Wall Street as crossing dealers, according to three people familiar with the firm's trading. In one example, BlueMountain would call a handful of banks and ask for prices on bespoke securities—CDOs that had been cut into custom tranches by the banks that bought and sold them. It would buy from the bank quoting low and sell to the one quoting high. The move rankled some bankers, but BlueMountain's defenders say it was just taking advantage of inefficiencies in the market for the benefit of its clients.

Feldstein and Siderow declined to comment on the matter.

Such stratagems aside, BlueMountain

TO THE RESCUE

BlueMountain boosted returns by betting against JPMorgan's Bruno Iksil, who had sold vast amounts of derivatives index IG9, driving down the price. The price shot up on May 10 after JPMorgan announced a $2 billion trading loss, a signal that the bank would unwind Iksil's huge trades.



JANUARY TO MARCH: A trader dubbed the London Whale sells IG9 index contracts relentlessly, driving the price down. BlueMountain bets against him.

APRIL 5: Bloomberg News reports Iksil's identity for the first time, saying his trades are distorting markets.

MAY: The price of IG9 soars as traders, including BlueMountain, bet that JPMorgan will sell off Iksil's positions.

MAY 10: JPMorgan CEO Jamie Dimon announces "egregious" loss of $2 billion.

JUNE: BlueMountain accumulates trades on IG9 that offset losing ones held by JPMorgan.

JUNE 19: Trading volume in the IG9 10-year contract surges to $31 billion from the three-month average of $2.4 billion as BlueMountain sells a block of IG9 contracts to JPMorgan that helps the bank stem losses.

Source: Bloomberg

became a coveted customer for banks that trade derivatives, people familiar with the firm's relationships say. By mid-2008, it was turning over billions in assets and paying millions in commissions. That year, BlueMountain was Goldman Sachs's fourth-largest counterparty in credit derivatives, according to a 2011 report by the Financial Crisis Inquiry Commission.

Then prices plunged, and the banks panicked. Goldman and Morgan Stanley asked BlueMountain to put up more collateral, according to five people familiar with the matter. On the other side, hedge funds such as BlueMountain worried about the stability of their prime brokers. By the end of 2008, BlueMountain had less than $1 billion left at Goldman, according to a person familiar with the matter.

One bank still welcomed BlueMountain: JPMorgan, Feldstein's alma mater. It became, and remains, BlueMountain's biggest prime broker.

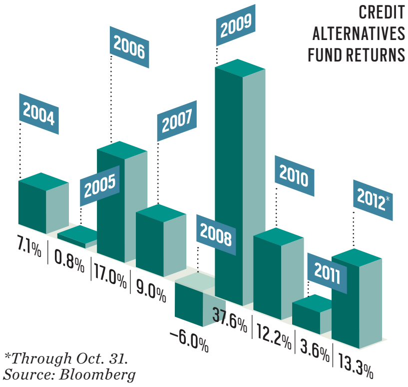
BlueMountain's investors also got nervous in 2008, and some asked for their money back. Feldstein invoked the terms of the investors' contracts and refused, saying he'd have to hold a fire sale to raise the money. "We are not comfortable with this state of affairs," Feldstein told investors in a letter dated Nov. 3, 2008.

Some investors who wanted their money out of the flagship Credit Alternatives fund had to wait until 2009. Bailing out, however, was a bad move. Credit Alternatives lost 6 percent in 2008. It then roared back, putting up a 37.6 percent return in 2009 as the panic subsided and credit markets recovered.

BlueMountain's 2012 returns had been lackluster—up 5.4 percent—until the London Whale came along. That trade was tailor-made for BlueMountain. JPMorgan's Iksil was trading in an esoteric security: the ninth series of the Markit CDX North American Investment Grade Index, known as IG9. The index tracks prices of CDSs on the debt of 121 companies, and it fell sharply from December to March. The reason: Iksil was selling swaps linked to the index.

A GOOD RUN

BlueMountain's returns have averaged 10 percent a year; it beat most credit funds in 2012.



*Through Oct. 31.
Source: Bloomberg

Feldstein and others saw that IG9 was trading below what they would pay if they bought swaps on the companies separately. Buying the index got you $1 of protection for 80 cents. BlueMountain bet against Iksil by buying IG9 and selling the constituent swaps, wagering they would converge.

For months, they were wrong. Iksil kept selling IG9, driving it downward. BlueMountain held on. Then, on May 10, JPMorgan ended the game by announcing a $2 billion loss, attributing it to bad bets in Iksil's unit. The index rocketed skyward, jumping from as low as 102 basis points in March to 175 basis points on June 5, or $175,000 a year to protect $10 million of debt, according to data provider CMA. (A basis point is 0.01 percentage point.)

JPMorgan had to get out of Iksil's position, which was huge relative to the daily volume in IG9. In the 14 weeks ended on April 6, outstanding bets on the index using swaps rose an unprecedented 65 percent to $148.2 billion, according to Depository Trust & Clearing Corp., which runs a central registry for the market.

BlueMountain owned contracts JPMorgan needed to offset its losses. Feldstein could buy more without attracting attention, because the firm traded so many derivatives already. BlueMountain picked up more IG9 positions and sold more than $20 billion worth of offsetting contracts to JPMorgan, according to people familiar with the trade.

Both BlueMountain and JPMorgan are careful to point out that the hedge fund was not acting as an agent of the bank. Hedge funds and their bank counterparties often form "strategic partnerships" that result in "win-win" situations for both, Markus, BlueMountain's senior portfolio manager and managing principal, said in an October interview. "You achieve the goals of the banks, and you achieve the goals of guys like ourselves."

In the six months after JPMorgan's May 10 announcement, returns on BlueMountain's flagship fund more than doubled. And the bank, even as it racked up $6.2 billion in losses, had Andrew Feldstein and his bailout crew to thank that the Whale did not sink its ship.

ANTHONY EFFINGER IS A SENIOR WRITER AT BLOOMBERG MARKETS IN PORTLAND. AEFFINGER@BLOOMBERG.NET
MARY CHILDS COVERS CDSs AND CORPORATE BONDS AT BLOOMBERG NEWS IN NEW YORK. MCHILDS5@BLOOMBERG.NET WITH ASSISTANCE FROM **PIERRE PAULDEN**, **SAIJEL KISHAN** AND **SHANNON D. HARRINGTON** IN NEW YORK.

To write a letter to the editor, send an e-mail to bloombergmag@bloomberg.net or type **MAG <Go>**.

Bloomberg Tips — DERIVATIVES

To learn more about functions related to derivatives on the Bloomberg Professional service, type **DRVD <Go>**. Type **DERV <Go>** for a real-time monitor of the best executable bid and ask prices available from permissioned dealers. Type **HFND <Go>** 9 <Go> to see funds of hedge funds ranked by one-year performance. Type **MARS <Go>** to perform stress testing, risk management and scenario analysis for derivatives strategies across asset classes. Type **BRIEF <Go>** and check the box next to Subscribe under Hedge Funds to receive Bloomberg's hedge-fund newsletter. **RICK LEVINSON**