EUROPEAN BUSINESS NEWS

# Hedge Funds Try 'Career Trade' Against Euro

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Some heavyweight hedge funds have launched large bearish bets against the euro in moves that are reminiscent of the trading action at the height of the U.S. financial crisis.

The big bets are emerging amid gatherings such as an exclusive "idea dinner" earlier this month that included hedge-fund titans SAC Capital Advisors LP and Soros Fund Management LLC. During the dinner, hosted by a boutique investment bank at a private townhouse in Manhattan, a small group of all-star hedge-fund managers argued that the euro is likely to fall to "parity"—or equal on an exchange basis—with the dollar, people close to the situation say.

The currency wagers signal that big financial players spot a rare trading opening driven by broader market gyrations. The euro, which traded at $1.51 in December, now trades around $1.35. With traders using leverage—often borrowing 20 times the size of their bet, accentuating gains and losses—a euro move to $1 could represent a career trade. If investors put up $5 million to make a $100 million trade, a 5% price move in the right direction doubles their initial investment.

"This is an opportunity...to make a lot of money," says Hans Hufschmid, a former senior Salomon Brothers executive who now runs GlobeOp Financial Services SA, a hedge-fund administrator in London and New York.

George Soros, head of the $27-billion asset fund manager, warned publicly last weekend that if the European Union doesn't fix its finances, "the euro may fall apart." *European Pressphoto Agency*

**Journal Community**

It is impossible to calculate the precise effect of the elite traders' bearish bets, but they have added to the selling pressure on the currency—and thus to the pressure on the European Union to stem the Greek debt crisis.

There is nothing improper about hedge funds jumping on the same trade unless it is deemed by regulators to be collusion. Regulators haven't suggested that any trading has been improper.

Through small gatherings, hedge funds can discuss similar trades that can feed on each other, in moves similar to those criticized by some investors and bankers in 2008. Then, big hedge-fund managers, such as Greenlight Capital Inc. President David Einhorn, who also was at this month's euro-dominated dinner, determined that the fortunes of Lehman Brothers Holdings and other firms were dim and bet heavily against their securities, accelerating their decline.

David Einhorn, president of Greenlight Capital *SIPA*

An SAC manager, Aaron Cowen, who pitched the group on the bearish bet, said he viewed all possible outcomes relating to the Greek debt crisis as negative for the euro, people familiar with the matter say. SAC's trading position on the euro is unclear.

George Soros, head of the $27-billion asset fund manager, warned publicly last weekend that if the European Union doesn't fix its finances, "the euro may fall apart." Through a spokesman for Soros Fund Management, he declined to comment for this article.

A Greek finance ministry official declined comment. A European Commission spokeswoman said the Commission doesn't comment on market rumors, adding that the EU's executive arm is working toward developing rules to tighten regulation and risk.

Few traders expect the value of the euro to totally collapse, the way the British pound did in 1992 amid a large bearish bet by Mr. Soros. In that famous trade—which traders say led to a $1 billion profit—selling led by Mr. Soros pushed the pound's value so low that Britain was forced to withdraw its currency from the European Exchange Rate Mechanism, causing the pound to drop even more sharply. The euro is an extremely deep market, with at least $1.2 trillion in daily trading volume, dwarfing the British pound's daily trading volume in 1992.

Again, derivatives, known as credit default swaps, are playing a part in the current trading. Some of the largest hedge funds, including Paulson & Co., which manages $32 billion, have bought such swaps, traders say, which act as insurance against a default by Greece on its sovereign debt. Traders view higher swaps prices as warning signs of potential default.

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Since December, the prices of such swaps have more than doubled, reflecting investors concerns

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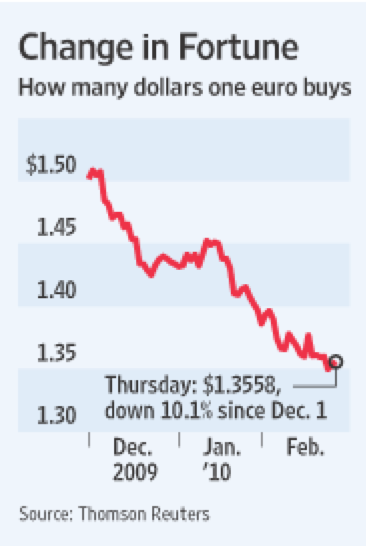
about a default by Greece. Paulson had built a large bearish position on Europe, people familiar with the matter say, including swaps that will pay out if Greece defaults on its debt within five years.

Paulson since has closed out that position and has taken the other side of the bet, leaving the firm with a bullish stance now, a person familiar with the matter says.

In a statement, Paulson declined to comment "on individual positions," saying it "does not manipulate or seek to destabilize securities in any markets."

Late last year, hedge funds bought swaps insuring the debt of Portugal, Italy, Greece and Spain, and began making bearish euro bets. More recently, the hedge funds have sold these swaps to banks looking to "hedge," or protect, their holdings of European government bonds, traders say.

In the past year, the overall value of swaps insuring against a Greek debt default has doubled, to $84.8 billion, according to Depository Trust & Clearing Corp. But the net amount that sellers would actually pay in a default rose just modestly over the same period, up only 4% to $8.9 billion, the DTCC says. This suggests that banks and others have bought and sold roughly equal amounts of swaps to hedge their positions, traders say.




The bigger bet against Europe these days is playing out in the vast foreign exchange markets, which offers a plethora of ways to trade.

The focus on the euro began on Dec. 4, when the currency swooned 1.5% following a jobs report in the U.S. that buoyed the dollar.

Between Dec. 9 and 11, some big European and U.S. banks made bearish calls on the euro by buying one-year euro "puts." Puts give the holder the right to sell an investment at a specified price by a set date.

The pressure on the euro soon began building. The currency fell another 1.3% on Dec. 16 when Standard & Poor's downgraded Greek sovereign debt. At that point, some large investors including asset manager BlackRock Inc. had bearish bets on the euro, believing that it couldn't sustain the levels at which it was then trading and that Europe's financial recovery would lag that of the U.S., according to people familiar with their position.

The concerns about Greece heightened on Jan. 20, when investors began to worry that the country would be unable to refinance its heavy debt load, causing the euro to fall another 1.3%.

On Jan. 22 Greece said it planned a five-year 8 billion euro bond sale in the coming days. To stave off speculators, Greece and its investment-bank advisors limited what could be allocated to hedge funds, said a person familiar with the sale.

By Jan. 28, the value of the new bond had fallen 3.5%, which left investors unhappy.

On Jan. 28 and 29, analysts from Goldman Sachs Group Inc. took a group of investors on a field trip to meet with banks in Greece. The group included representatives from about a dozen different money managers, say attendees, including Chicago hedge-fund giant Citadel Investment Group, the New York hedge fund Eton Park Capital Management, and Paulson, which sent two employees, say people who were there. Eton Park declined to comment.

During meetings with the Greek deputy finance minister and executives from the National Bank of Greece, among other banks, some investors raised tough questions about the state of the country's economy, according to these people.


At the Feb. 8 "idea dinner" hosted by Monness, Crespi, Hardt & Co., a boutique research and brokerage firm, three portfolio managers spoke about investment themes related to the European debt crisis.

During the dinner—featuring lemon-roasted chicken and filet mignon at a private townhouse in Manhattan—a Soros manager predicted that interest rates are going up, people close to the situation say.

Donald Morgan, head of hedge-fund Brigade Capital, told the group he believed Greek debt is an early domino to fall in a contagion that eventually will hit U.S. companies, municipalities and Treasury securities. Mr. Einhorn, meanwhile, who was among the earliest and most vocal bears on Lehman, said he is bullish on gold because of inflation concerns. Mr. Einhorn declined to comment.

By the week of the dinner, the size of the bearish bet against the euro had risen to record levels of 60,000 futures contracts—the most recently available data and the highest level since 1999, according to Morgan Stanley. The data represents the volume of futures contracts that will pay off if the euro sinks to specific levels in the future.

Three days after the dinner, another wave of selling hit the euro, pushing the currency below $1.36.

These hedge funds are the financial hit-men of our economy. However, they expose themselves and everyone else to incredible risks. These are not good risks.

—Alexander Smith

In a separate move last week, traders from Goldman, Bank of America Corp. 's Merrill Lynch unit, and Barclays Bank PLC were helping investors place a particularly bearish bet on the euro, traders say.

The trade involved an inexpensive put option that will provide its holder a big payoff if the euro falls to the level of a single U.S. dollar within a year. Known as a "tail-risk" trade because its probability is low, the euro-dollar parity put is a cheap way of ensuring that if the euro sinks dramatically within a year, an investor will generate big returns.

A going price for the bet is around 7% of the amount that a parity-trade would pay off. So, for an investor seeking a $1 million bet, the cost is

$70,000. This means that the market currently assigns roughly 14-to-1 odds that parity will be reached. In November, the odds were around 33-to-1, said a person who has seen the trade's pricing.

—Tom McGinty and Jenny Strasburg contributed to this article.

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