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Short Selling in a Speculative Market

By Donald E. Besser

Short selling has become very difficult because of the price volatility caused by "momentum" investing, skyrocketing indexes, and wild speculation fueled by the new issue market. Even experienced managers have run into trouble selling short. Concentrating on fundamentals, accounting issues, and industry patterns has not been enough to prevent disaster for short sellers, since almost all stocks have had a moment of "irrational exuberance."

Here are some of the rules I have learned that have allowed me to survive and occasionally prosper in the current manic environment.

1. **Select Industries That Are Unwinding.** In selecting shorts, you want to concentrate on industries that are clearly unwinding because of unfavorable fundamentals. Good examples over the last 10 years were the bank stock collapse in 1990 after the real estate boom of the 1980s, the cost squeeze on the HMOs in 1996-97, the tobacco companies over the last few years, and now the Internet stocks. Once you identify an industry that has started to decline, select the second tier companies, defined as those with the worst management, business plans, financial backing, as well as the lowest margins.

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Secondary Market Offers Liquidity for Private Equity Investors

By Avner I. Hacohen

With adequate prior preparation, hedge fund managers can deploy a liquidity option for their private equity investments in a matter of weeks via the well-established private equity secondary market.

Hedge Funds and Private Equity

It is no wonder that many hedge fund managers, hoping to increase their overall returns, include a variety of private equity interests in their portfolios. The creation of thousands of new technology-based companies, the continued growth in the number of restructuring and buyout transactions, and the increase in the number and size of wildly successful venture capital and LBO funds are providing an unprecedented choice of investment opportunities for private equity investors.

Yet there are attendant challenges. Hedge fund managers who invest in private equity face the task of successfully managing complex portfolios consisting of a mix of public and private equity, each with unique risk/reward characteristics. In addition, managers must deal with specific hedge fund constraints, such as quarterly and annual redemptions, that make fund management even more challenging.

The option of achieving early liquidity through the secondary private equity market provides hedge fund managers with an important additional tool to manage their investment strategies, risks, investor needs and regulatory requirements.

Evolution of the Secondary Market

The formal secondary market was established in the early 1990s when Paul Capital and Landmark, two firms that continue to lead the market today with billions of dollars under management, purchased a few large private equity portfolios through investment funds