1

MAKING MONEY IN METALS

On a chilly spring morning in 1994, Julian Robertson, head of the Tiger Management, and his analysts were closeted in the firm's offices in midtown Manhattan, poring over reports and information from various commodities producers and users looking for the diamond in the rough. For Robertson, who had launched Tiger 14 years earlier as a hedge fund that used long/short equity strategies to extract profits from the market, the time had come to expand into bigger markets that offered greater profits. That year things had started off slowly for the firm, but as it rolled into the second half of 1994, the firm and its funds became a force in the market. Investors clawed their way for access to the hedge fund and the trading powerhouse, dumping nearly $4 billion into its coffers. It was clear by now that the 1990s was going to be the decade of the big cats.

Still, Robertson was troubled. There was a dark shadow around his consciousness, and the name of the shadow was George Soros. Soros had started his firm in the 1960s and was now a legend in international financial circles. He was the envy of money managers. Robertson felt that he could pick stocks and play the hedge fund game as well as Soros, but he had not yet had the big break that would take him from being a success-

STRACHMAN_01_pages 6/29/04 11:35 AM Page 2

ful name on Wall Street to an icon known around the world. That was the hunger that kept him searching for information from the reports that his associates brought to their weekly investment meetings.

But now something caught Robertson's eye that just might make a difference. He picked up a feeling of sorts from reading some information on the copper markets. He noticed that in the last few weeks, the prices of copper were increasing while demand had remained constant and showed signs it was decreasing. After discussing the market at length with his commodities analysts and talking to people he thought were in the know, he came to the conclusion that demand was, in fact, decreasing and that increases in demand did not seem to be on the horizon. In order for the trade to prove, Robertson needed more information–data from people on the ground. Mentally flipping through the massive Rolodex in his head, he began to assemble a list of people who would know what was going on in the copper markets and would be able to confirm that his hunch was right. He called a number of commodities brokers and spoke with some producers and was able to use the information to confirm his suspicions. Their data showed that mines were producing at normal levels and that producers seemed to be in the groove–production was humming along at a nice clip. Demand seemed to be weakening, and it looked like it was just a matter of time before prices would fall.

According to the research that his analysts had found from poring over reports from various sources, including brokerage firms, central banks, commodities merchants and the like, the price of the commodity contracts was overvalued. It was clear that the price was based on the current supply and demand of the commodity, and that if the demand decreased the price would fall. It was a basic supply-and-demand scenario. This told Robertson's analysts that they had what looked to be a very good short on their hands. The idea behind shorting is simple:

STRACHMAN_01_pages 6/29/04 11:35 AM Page 3

You believe that the price of a security is too high and that the price has to come down. Therefore, you enter into an agreement with an owner of the security to borrow it from them for a fee, and you sell it into the market. When the price falls, you buy back the security and give it back to the person you borrowed it from. The difference between what you sold and bought the security for, minus any costs associated with the transaction, is your profit.

Shorting was not something new to the folks at Tiger; it was the cornerstone of their operation and a significant portion of their success. They were comfortable with executing shorts and believed in their ability to spot good opportunities. Tiger was not the only group of investors who thought something was amiss in the copper markets, however. Other industry observers and participants, as well as some other hedge funds, could not understand why prices were increasing. They expected prices to level out.

Investor interest at Tiger was sparked by a spate of excellent performance. The firm had crossed a number of assets-under-management thresholds and was fast becoming one of the largest hedge funds in the industry. Robertson and his team knew that in order to maintain their position in the industry, they would need to maintain their performance. In order for a hedge fund to sustain its in flows of assets, it needs to continually put up solid performance numbers as well as prove to its existing and potential investors that it can maintain its performance as it attracts new assets. Therefore, Robertson and his team needed to continue to prove not only that they could manage money effectively but also that their skill set was scalable to handle the billions of dollars they were attracting from investors.

There was no room for error, and there was significant room for good ideas and good opportunities. Robertson drove the team hard, forcing them to look for and find opportunities that

STRACHMAN_01_pages 6/29/04 11:35 AM Page 4

were worthy of the portfolio. Tiger had to be number one–it needed to be the best and the biggest, and Robertson needed his team to make it happen. He was no longer content to be thought of as a small shop or caught behind the shadow of the Soros organization. Robertson wanted to be known in his own right for his own successes. He needed a good trade to get them to the top–and the research on copper looked to be that trade.

The key behind all of the firm's investments was the *story*. If the story made sense, then the investment made sense. If there was no story or it was not easily understood, then it had no place in the portfolio. When the story changed, the investment had to change as well–it was and is all about the story.

Robertson's mantra was, as long as the story around the investment remained the same, the position should get bigger. As soon as the story changed, it was time to get out. His traders and analysts all knew this was the way that Tiger operated, and knew that this is what made Robertson and the firm such a huge beast in the hedge fund industry. It was a simple and smart way to do business.

To understand the concept of *story*, consider this example. Say you are interested in a solid oak wooden table. The analyst could tell you that he had checked out the market for tables, evaluated the information, and come to the conclusion that the table was a good buy at $100 because it was well made, solidly built, and would not fall apart. This is the story. So you go to the shop, prepared to buy the table. And then, just as you are running your hand over the table, a corner falls off. Well, now the seller is desperate to get rid of the broken table and is willing to sell it for $20. To the analyst, this seems like a steal. He sees an incredible opportunity to buy something for $20 that is really worth $100 and needs just a bit of fixing to get it there. But in Robertson's eyes, the *story* is now flawed, and now he would say that you should want no part of the deal. How could something

STRACHMAN_01_pages 6/29/04 11:35 AM Page 5

so well built, made of the finest oak, break? Robertson would say that more than the table is broken. The credibility of the research is now called into question. The story is broken; it is time to move on to something else.

Robertson's uncanny ability to believe in himself and others was and continues to remain a characteristic that sets him apart from most other hedge fund managers. He understands his strengths and his weaknesses and understands how to compensate for both. He has the ability to stick to something when everyone else has bailed out, and has the ability to make incredibly important decisions almost in an instant. Most people do not possess this trait. It has proved successful for him time and again throughout Tiger's unique run.

This uncanny ability to stick to his belief is what led him and his team in 1995 to an unbelievable opportunity in the copper markets.

When Robertson and his team started looking at copper, they had no idea of the riches that the opportunity offered. They thought it was going to be a good trade for them, because they understood the story, the opportunity, and how profitable the trade could be, but they had no idea of the recognition that they would receive from their peers for sticking with the trade during copper's wild ride. At the time, all they knew was that the story made sense and, as such, it was a trade that was worthy of being in the portfolio. For Robertson, getting into copper was no different than any other investment the hedge fund made–at the end it was more than just any other trade. It was Tiger's sterling trade.

This was, however, *not* the case during 1994 as prices increased dramatically. By early 1995, prices started to level off a bit; by the end of the year, prices were back in line with expectations at around $1.10 a pound. The ride was a rough one for many investors, and a number of people lost significantly as

STRACHMAN_01_pages 6/29/04 11:35 AM Page 6

prices seesawed for the better part of the year. But Robertson believed in the story, believed that it had not changed, and, more importantly, believed that he was right.

The price of the commodity remained in this range for the first few months of the year 1995, but the spring brought new price hikes. This caused many people to cover their shorts and get out of the trade. They believed that the market was going to run higher, leaving them with significant losses. This early spring rally wreaked havoc on many hedge fund managers, who saw their profits plummet.

Copper increased to more than $1.25 a pound, and it looked like it could have gone higher. Nobody seemed to understand where the rally was coming from or what was sustaining it, but it seemed like it was real. Real, that is, until some very interesting information about one of the largest copper traders in the world made its way onto the tape. It seemed that one of Sumitomo's traders had been involved in some nefarious dealings in the copper market and that the Japanese investment conglomerate had amassed significant losses from trades that went awry. The losses and the potential for loss led Sumitomo's management to order its traders to dump the firm's positions in an attempt to get completely out of the market and wash their hands of the whole affair. At the time, Sumitomo was one of the largest owners and buyers of the metal. This action by the firm to dump its stake in copper was the catalyst for the price to fall dramatically. For Robertson and his team, who understood the market, and understood that the price had to fall, this was the action they needed to see their trade through successfully. The news of Sumitomo's massive and increasing losses caused all hell to break loose in the copper market, and by May 1996 the price had fallen more than 30 percent. By July, copper futures for September were trading at about 87.80 cents per pound.

What caused the gyration in the market? The answer was simple: A scandal rocked the copper market, causing in-

STRACHMAN_01_pages 6/29/04 11:35 AM Page 7

vestors/speculators to run for cover and dump as much of the metal as possible. It was a going out of business sale–literally. Robertson and his team were attracted to copper because their research told them that the price of the metal was too high. While their research proved that the prices had to come down, they did not know when this would happen. They just knew it would happen at some point. The folks at Tiger liked the copper story, it offered them an opportunity to go short a market that they knew was overpriced and was destined to correct itself like a markets eventually do. However, what they did not know was that something was amiss in the copper market. They did not know of Sumitomo's problem and that the large Japanese conglomerate's trader was artificially propping up the price of the metal.

The crisis in copper reached its boiling point when Sumitomo Corporation fired Yasuo Hamanaka. This star copper trader, who was often called "Mr. Five Percent" by those who participated in the markets because of the huge positions he amassed, was found to have been improperly trading the copper markets, resulting in a scandal that cost his employer more than $2.6 billion in losses. This, as any trader who has ever held a short position will tell you, was music to Robertson's ears. It is one thing to make an assumption that the price of something is overvalued and see the price fall because it is truly overvalued by the market, and the market corrects itself. It is something completely different to make the assumption that something is overvalued and find out that the route of the overpricing is fraud. That just makes the trade even that much more enjoyable and, of course, profitable.[1]

In order to understand why Robertson and the folks at Tiger profited so handsomely from the copper trades, one first needs to understand the story behind the scandal that ended up rocking the market.

For the decade leading up to his firing in June of 1996,

STRACHMAN_01_pages 6/29/04 11:35 AM Page 8

Hamanaka had an iron grip on a significant portion of the copper market. His trading prowess was legendary, and he was a force to be reckoned with when it came to this metal. He had an uncanny ability to time the market and reap what were thought to be enormous profits for his employer.

And while many believe that the company uncovered his problems in the spring and early summer of 1996 when it first made its accusations of wrongdoing, a number of metal traders and speculators that were involved with the copper during this time said that they had suspected something was not quite right with the way Hamanaka was operating. Some people close with the organization say that in 1990, Hamanaka was responsible for significant losses at the company because of some bad trades and that during an investigation of sorts, the powers that be at Sumitomo had all the right answers and satisfied various regulatory inquiries, which allowed the trader to keep his job and the company to save face, and it set the markets up for what was to come a few years later. The losses in 1990 were much less than the estimated $2.6 billion the company got hit with in 1996, and this time management was left with no alternative but to go public with its rogue trader.

Like another rogue trader, Nick Leeson of Baring's fame, Hamanaka believed that he could trade his way out of the losses and win back all of the profits that vanished when the bets he made went against him. His problem, it turned out, was that the drawer where he was hiding his trading tickets was only so big, and when there was no more room in which to stuff the tickets, the whole scheme fell apart–literally.

Some information suggests that early on in his efforts, Sumitomo officials worked with Hamanaka to help him cover his losses by orchestrating a number of off-the-book transactions that were shielded from anyone on the outside. But as the losses grew, so did the off-the-book trades–he was able to hide his efforts because he falsified documents, forged signatures,

STRACHMAN_01_pages 6/29/04 11:35 AM Page 9

and destroyed business records. He pled guilty to these crimes in December 1996, and the company was left with no alternative but to go public with the scandal.[2]

In the end, what caused the house of cards to fall was Hamanaka's inability to manage his huge physical position in the market, coupled with having huge long positions causing him to be extremely vulnerable to short sales. Many believe that what got Hamanaka into such a bind was his belief that his physical position was so big that he was able to drive prices up at will. Having this belief led him to sell over-the-counter put options to producers and cash in on the premiums. Put options give producers the right to sell copper at a set price in the future. If prices continue to move upward, the seller of the put makes money because the buyer does not exercise the option. Unfortunately, as traders and speculators started to learn about the size and scope of Hamanaka's positions, they forced the price of the metal lower, which meant that the puts he had sold would be exercised, resulting in massive losses.

The vulnerability was brought on by Hamanaka's effort to buy physical copper in order to boost world copper prices. This effort, coupled with Sumitomo's inability to get rid of short sellers by desperately dumping long positions on the market, forced down the price of copper. Sumitomo's lack of internal controls, poor management, and bad oversight was the root of the problem, but exposing the misdeeds was the work of hedge funds.

During the months and weeks before Sumitomo's announcement of Hamanaka's misdeeds, its massive positions, and soon-to-be massive losses, many in the hedge fund world had believed that something in the markets was amiss. Nobody could put their finger on what was going on in the market, but everyone who had looked at the price of copper knew the metal was priced inappropriately. They also knew that when something is priced inappropriately on the high side, the only thing to do is short the hell out of it.

STRACHMAN_01_pages 6/29/04 11:35 AM Page 10

Even before the hint of problems at Sumitomo, it is estimated that in 1995 through mid-1996 shortsellers collectively borrowed as much as a million tons of copper to dump on the market in hopes of driving the price down. Many believed that while fundamentally the trade made sense, forces beyond their control could have allowed Hamanaka to get out of the mess and force prices is higher. To their delight, no such forces existed.

To the folks at Tiger, this trade was fast becoming a once-in-a-lifetime opportunity. It seemed that all their data showed the prices had to fall and that they just had to hold on in order to reap the benefits from their research. In early May, the team realized they were really going to make a windfall when a strike at a large Chilean copper mine was averted, and the stores of copper at the London Metal Exchange warehouse failed to fall. The analysts knew that the bet was the right one, and Robertson saw the profits adding up in his head. The team worked the numbers out through the night and decided they should increase the short–prices were going to fall, and fall hard. It was clear now, more than ever, that because prices remained strong, there was too much capacity in the market. It was simple economics and a good opportunity. Just how good the opportunity was would take close to 18 months to realize–but in the end, the heartache and pain were clearly worth it.

Throughout the summer and fall, Tiger began to add to its existing copper positions. Eventually, this led to the hedge fund amassing a position of more than a billion dollars in the metal by June 1995. Throughout the year, the team continued to research the markets and furthered their conviction that they were right and that prices were going to fall. Although the idea had come to them from various sources, including a number of hedge fund friends, Robertson did not operate on tips. In order for him to commit capital, the team would have to see and touch the industry first hand. It was dirt-under-your-fingernails

STRACHMAN_01_pages 6/29/04 11:35 AM Page 11

type of work. Robertson sent his analysts on planes and trains to get as much information as possible on the global state of copper, its uses, and its expected uses. In the early 1990s before information was readily available online, the only way to research something was to get out there and kick the tires. And while times have clearly changed, and information and data are just a click away, all serious investors continue to go into the field to gather their data on whether to go long or short a position.

The team met with metals producers and saw first hand the charts and diagrams that outlined production from new and existing mines. They met with users and saw their stock rooms full to the brim. They held meetings on the side of road and in boardrooms and continued to get the same answers–there was too much capacity. The metal was being pulled out of the ground faster than it could be used. It was clear that things did not add up–in fact, they added down. Robertson and his team knew there was no place for the price to go *but* down. Even though the price was remaining steady and, in fact, rising a bit, which meant that they were losing money on their shorts, they were confident in their research and that in time it would prove out. For the folks at Tiger, it was time to short the metal in a very big way. They knew their research had been right and they were ready to reap the benefits of their work.

Robertson instructed his traders to put on a series of short positions that were completely against everything that seemed to be going on in the market. The market was moving higher, and Robertson did not understand why. His analysts told him that the market was overvalued, and the supply was greater than the demand–the story had not changed–the market had it wrong.

Robertson believed in his team. He believed that they understood what was going on in the market, and he believed that price of copper would eventually fall. More importantly, he believed that Tiger as a result of his conviction in his research and

STRACHMAN_01_pages 6/29/04 11:35 AM Page 12

in his positions would reap enormous profits from sticking to its knitting so to speak and held onto its short positions. It was clear that Robertson saw something that others who were trading the market missed. He did not buy into the prices that were being printed on the tape. He believed something was wrong with the way the market was trading, and he was not willing to miss an opportunity.

His conviction in the trade and, more importantly, the people who worked for him led him to great results. In the spring of 1996, in the wake of a copper hording scandal that was led by discovery of Hamanaka's misdeeds, the price of the commodity fell significantly. In one day in the end of May 1996 the firm saw its position in copper move to the tune of a profit of $300 million. This was probably the single biggest day of profits in the firm's history, and it solidified Robertson's place as one of the greatest money managers of all time. It was his conviction and belief that he was right while everyone else was wrong that led him to rack up these profits.

Robertson enjoyed the profits, but what he enjoyed more was a call he got from Stan Druckenmiller, the trader who made George Soros the world's greatest investor when the fund broke Great Britain's Central Bank (see Chapter 9). During the call, which came a few days after Tiger's profits were realized, Druckenmiller praised Robertson's ability to stick with the position and ride it all the way down. The Soros organization had gotten squeezed out of its copper position in April 1996 and did not reap any of the benefits that the folks at Tiger did by sticking with their trade; in fact, they lost money in copper. To Robertson, it was not simply about the money, it was about being right. It was the idea that his research worked and that he had the ability to stick with what he knew was right, regardless of what was going on in the markets and what his contemporaries were doing. He had the information, he had the conviction, and now he had the profits–which together got him a title.[3]

STRACHMAN_01_pages 6/29/04 11:35 AM Page 13

Now more than ever, Robertson and Tiger were clearly a force to be reckoned with. His copper trade was one of a few macro trades that put him on the map–the map outside of the hedge fund industry–the map of the greatest traders/speculators/money managers of all time.