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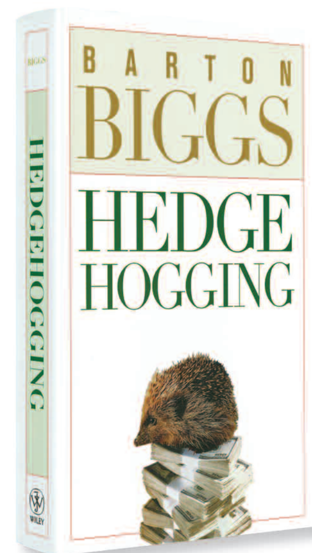
Personal Finance

An Insider's View of the Highly Competitive, Lucrative World of Hedge Fund Management

Hedgehogging



By Barton Biggs

THE SUMMARY IN BRIEF

Professional investors, or hedgehogs, are intriguing animals, and hedgehogging, the never-ending search for investment acorns, often reveals the best and the worst characteristics of the species. They operate in a world of mystery and mistrust, both praised and reviled for the amount of money they make and the manner in which they make it.

Hedge funds are blamed for every spasm in the financial markets, and there is a perception that they often act together in vicious conspiracies to destabilize the world.

Everyone knows hedge funds have had dramatic growth. What is not fully understood is how volatile and market sensitive the hedge fund business really is.

In *Hedgehogging*, Barton Biggs shares some of his own experiences in starting a hedge fund and describes the way others have maneuvered for investment survival. He gives an inside view of the investment business in general and hedgehogs in particular, and helps the reader to understand the intensity, stress, foibles and insecurities of the men and women who manage other people's money.

The hedgehogging world is resplendent with billion dollar portfolios. It's a place where private jets are common and owning three homes is the norm. Biggs takes us inside where he profiles the players and their game with the practiced eye of one who has seen it all, done it all, and lived to tell the story.

IN THIS SUMMARY, YOU WILL LEARN:

- What it takes to be a hedgehog.
- How to look at investing as an art more than a science.
- Whether to concentrate on growth stock investing or value investing.
- What makes a great investment manager.
- Why groupthink is a disease that plagues every committee.
- Why it's prudent not to go hedgehogging alone.

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THE COMPLETE SUMMARY: **HEDGEHOGGING**

By Barton Biggs

The authors: **Barton Biggs**, former chief global strategist for Morgan Stanley, retired in 2003 to become a consultant to the firm and with two other colleagues formed Traxis Partners, which soon became the largest new hedge fund of 2003.

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The New Hedgehogs, Once Golden Boys

For every hedge fund rags-to-riches story, there are at least two to three rags-to-rags or rags-to-riches-to-rags tales. In 2004, an estimated 1,000 funds went out of business in a slow, lingering death.

Typically, a couple of guys start a hedge fund and raise $10 million or even $50 or $100 million. Their fee is 1.5 percent fixed on assets and 20 percent of the profits, but they can't survive on the fixed fee. They have a lot of overhead in space, accounting, computers, back office and technology. Then they have three analysts and a trader to pay salaries, plus hard dollars to fork out for Bloomberg terminals and research services. The fixed fee doesn't even cover the overhead, so there is no money left for the partners. Unless the partners have some money to begin with, they have nothing to live on. So their future depends completely on the fund's performance over the first couple of years.

If the fund does well, the partners earn the 20 percent, get more money and wear smiles to bed. If they really blow it in the first year, everybody redeems their money, and they're gone with barely a ripple. But if they just dog along for a couple of years with mediocre performance, then no new money comes in, and it's tough at the office and austere at the home: 20 percent of nothing is nothing.

Grinning Gilbert

There was a manager, known as Grinning Gilbert, who was always grinning when he talked to you. He could be telling you that his best analyst had just quit or that his biggest investment had missed on earnings, and he would be saying it with a huge, beaming smile. In 1996, Grinning Gilbert was maybe in his early forties and laboring as a portfolio manager at Lord Abbett when he quit to form his own hedge fund.

Grinning Gilbert didn't have any money to speak of, but he hired three young analysts. He was a story stock, momentum investor, and he alone made all the investment decisions.

In the hot markets of the late 1990s, he increasingly concentrated on tech and Internet stocks. Performance was volatile, but 1997 was huge. By 1999, Gilbert was running around $500 million and making some serious money; which he plowed back into his capital account in the fund.

Grinning Gilbert's wife Sharon is known for her aggressive, ambitious personality. She performed a full cannonball into the Greenwich social pool, which is not easy. Most of all, she began to pour money into their new $10 million mansion on Round Hill Road.

The family moved in on July 1, 2000. Grinning Gilbert was a little nervous about the new overhead, but as long as the fund kept cranking, he figured they would be okay. Meanwhile, the firm had accumulated some additional overhead as well. There were now five analysts, a chief operating officer, a client-relations person, an office manager and four secretaries. The straws were mounting on the camel's back even as dark clouds were gathering.

For the year 2000, Grinning Gilbert's fund was down 15 percent. By the summer of 2001, the retreat in tech stocks and Internet stocks had turned into a full-scale rout and Gilbert's investors began to assail him even as they withdrew their money.

One Tuesday in October, Gilbert drove home, went up to his bedroom, drew the curtains, and went to bed. He

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Rebecca Clement: Publisher, **James McWhinney:** Contributing Writer, **Joanne Merenda:** Art and Design, **Sarah Dayton:** Senior Editor, **Melissa Ward:** Managing Editor

put in wax earplugs, pulled the covers over his head and stayed there for the rest of the week and through the weekend. Overhead at home, overhead at the office, leverage, redemptions and a declining portfolio must have been gotten to him. The following Tuesday, Sharon went to the office and told Grinning Gilbert's traders to close all his positions (locking in a 30 percent decline) and liquidate the fund. She generally took charge talking to the lawyers and accountants. The investors were notified the following week. Grinning Gilbert never came to the office again.

Short Selling Oil

(Editor's note: Barton Biggs' hedge fund, Traxis Partners, was started at the end of 2002, with Madhave Dhar and Cyril Moulle-Berteaux, two friends he had worked with at Morgan Stanley Asset Management.)

Since there is no magic formula for investment success, the Traxis Partners' goals when they put their newfound money to work on June 2, 2003 was not to lose money in the first few months. Losing money early in the game can set a fund back by years, as the manager works to recover the losses and build up a winning track record in order to build enough credibility to make another effort at attracting new money.

The partners were tortured unmercifully by a short position (betting the price would fall) they took in oil in May 2004, when the price was about $40 a barrel. They did all their usual analytical work and model building. Their reasoning went like this: Other than a brief war-related spike in 1990, both the nominal and real price of oil were back to the highest levels since the early 1980s. World production and inventories were rising, and the strategic oil reserve was nearing peak capacity. Consumption, they postulated, was probably decelerating as both the world and the Chinese economy slowed. The regression model that the partners constructed showed the fair price of oil as $32.48. Most energy experts maintained it was even lower, pricing out somewhere in the high 20s.

Deep Analysis Can Get You in Trouble

The analysis was for naught, they misjudged demand, failed to anticipate the intensity of the hurricane season and political developments, and were less respectful than they should have been of market psychology and its effect on price momentum. Oil rallied to over 42, then later fell to 36. The partners' analysis indicated that oil was still materially overpriced and they didn't want to lose their position. But, they were wrong. Oil prices proceeded to climb as terrorism and sabotage in Iraq, a tax dispute in Russia, a strike in Nigeria, and a presidential recall vote in Venezuela roiled the market for crude. Convinced that these were temporary disruptions, they increased the size of their short position.

In the partners' process, when the price of an investment goes against bias by more than 15 percent in the case of a commodity, it triggers an automatic review of the fundamentals. Following that review they either have to add to the position or close it. As value investors, if the fundamentals have not changed, their inclination is to add to the position, not close it, because the price change has actually made it more attractive, not less.

On August 19, the price of oil hit 48, equity markets were reeling, and the partners were down 7 percent for the year. The next day *The New York Times* ran a story that reported Traxis was suffering substantial losses from its oil short.

Immediately a storm broke. One of the largest investors, who had committed to Traxis right at the beginning, called to say he was withdrawing. A fund of funds e-mailed the partners to say that they were crazy and were violating their fiduciary responsibilities. A woman, whose money had been successfully managed by one of the partners for 30 years, called to say she couldn't take the volatility and wanted out.

Thirty years of confidence went down the drain in a couple of months, even though in 2003 the fund had performed really well.

The Odyssey Of Starting A Hedge Fund

Morgan Stanley graciously offered to assist in the start of Traxis Partners, both with the back office operations and in the marketing of the fund. At the start of the long climb up the hedge fund mountain, there was a strong suspicion by the partners that there would be an abundance of stress, strain, anxiety and maybe ecstasy.

Starting a new hedge fund is a desperate, frantic adventure. The founders have to spend their own money to acquire office space and create the administrative, trading, accounting and legal infrastructure of a business, hire analysts, traders and a chief administrative officer. However, their primary objective must be to meet prospective investors and raise capital.

Big-Time Money Raising at The Breakers

On March 2, 2003, the odyssey of raising money began in Palm Springs, Fla. at Morgan Stanley's famous hedge fund conference at The Breakers. This confer-

ence is widely considered the prime event at which to raise money because it attracts the biggest, richest collection of hedge fund buyers in the world. The intensity and hustle level were incredibly high. Everybody was on the make.

The presentations were grindingly repetitious. The audience members included the professionals, who came from the big funds of funds, foundations, endowments and pension funds. The rest were amateurs, mostly wealthy individuals and small, wannabe funds of funds.

Superstar hedge fund guys have a surfeit of capital and don't deign to appear at conferences. It is only the struggling mortals who want money who come hat in hand. The superstars have marketing managers who organize their own annual meeting with investors, complete with elaborate presentations by the messiah himself and his entourage.

The money managed by hedge funds grew from $36 billion in 1990 to more than $1 trillion by the end of 2004. Many new entrants try to buy their way into the business by poaching people. Some large hedge funds, in an effort to spread the wealth around, have more than one prime broker.

The Fund of Funds is a Tough Customer

A fund of funds typically selects and manages a diversified portfolio of hedge funds that it sells to individuals or institutions that don't feel capable of making the choices and monitoring the funds themselves. They run all kinds of analytics on the individual hedge funds and on their overall portfolio to monitor risk and exposures.

The funds of funds employ sophisticated quantitative analytics to add value by strategically allocating among the different hedge fund classes. The hedge fund universe is usually broken down in seven broad investment style classifications. These are: event driven, fixed-income arbitrage, global convertible bond arbitrage, equity market-neutral, long/short equity, global macro, and commodity trading funds. Each has its own, unique performance cycle. Each year the allocation among classifications will be different.

Most funds of funds focus not just on the raw performance numbers, but also on the sociological factors. They monitor whether the successful hedge fund managers are getting lazy as they get richer. They watch for divorces, third homes and falling golf handicaps.

The professionally managed funds of funds are worth the double fee they charge. For amateur dabblers, they are essential. The numbers show that the funds of funds do a good job of picking the better horses and avoiding the losers. To a certain extent, the funds of funds have to make life difficult for the hedge funds they invest in to justify their fees.

Professional investing is about performance, just as professional sports is about winning. However, the obsession with short-term performance is never good, either for investors' returns or for investment managers' performance. There is an element of luck in the investing game. Even the best investors have slumps. In fact, the best time to invest in a good fund is after it has had a bad patch — as long as nothing has changed.

Prime Brokers:

Prime brokers provide securities to cover short sales, make margin loans, clear trades, provide reporting services and custody assets, provide research and help with money raising. A fund's prime broker executes roughly 25 percent to 30 percent of its hedge fund clients' transactions.

Prime brokers earn from commissions and order flow, and hedge funds now account for about one-third of total trading volume. Hedge funds are also a captive source of demand for the lucrative securities and margin lending activities from which a prime broker locks in a fat spread.

Prime brokers legally can only introduce hedge funds to prospective investors; they can't actually make pitches or solicit clients.

Hedgehogs Come In All Sizes And Shapes

Being an investor — actually running other people's money — attracts men and women who tend to be intellectually self-confident and opinionated. A questing mind, the gambling instinct, and the ability to make tough decisions on inconclusive evidence are all essential characteristics.

Tim, a Top-Down Global Investor

Tim, a legend in the hedge-fund business, had the best record of any major hedge fund in the world for most of the 1990s. It is likely that he runs more than $1 billion, probably half of which is his. On his beautiful Chippendale desk sits a small plaque, which says *totis procis* — the whole hog. There is also a small porcelain pig with a label that reads, "It takes courage to be a pig." To get really big returns, you have to be a pig and ride your winners.

Tim is a macro or top-down global investor. He concentrates on asset classes, countries, and major groups of stocks. Tim uses immense leverage, practices enormous concentration, and has no investment organization. Leverage means volatility, and it means that you have a lot less margin of error. Tim could easily have his fund leveraged up four times. That means if he loses 10 percent on his portfolio, his equity is down 50 percent. Once you are down more than 20 percent, it's hard to recover because you are compounding off a much lower base. Suppose Tim was down 10 percent overall, but down 50 percent on his equity. If he was up 10 percent the next year, he would still be down 25 percent from inception, whereas on the same performance the unleveraged fund would be down only 1 percent.

Vince, the Bearded Prophet of the Apocalypse

Vince was the head trader for the biggest hedge fund in the late 1970s; he is now retired and runs his own hedge fund. Vince thinks of himself as a prophet of social and financial change. Prices and society gravitate around a central value and in the long run revert to the mean, he believes, but human nature is wildly emotional and thus prone to disorderly excesses that cause booms and busts. To him, the excesses of the 1990s have only begun to be purged, and the secondary consequences will be a social and financial revolution that will destroy another huge chunk of paper wealth and transform society.

Jake, a Superstar Investor

Jake's fund is around $5 billion, and he does the macro overlay. He has maybe seven or eight asset class (like biotech, Asia, junk bonds, Europe, emerging markets, etc.) portfolio managers who each run anywhere from $100 million to $400 million, depending on what Jake's view of their sector is. Jake creates performance by allocating between the asset classes, and, in theory, the other guys add additional alpha by doing even better than their sector index. Jake believes in effective time management and limiting babble. He is famous for short conversations with babblers. If somehow you get through to him, he just listens for a few minutes, says nothing back, then says, "Thanks" and hangs up.

The Violence Of Secular Market Cycles

What makes investing so difficult and dislocating is that it has violent, long boom/bust secular cycles, which can occur once in a generation.

A secular bear market is a decline in the major stock averages of at least 40 percent — and considerably more in secondary stocks — where the decline lasts at least three to five years. By contrast, a cyclical bear market is a fall of at least 15 percent but less than 40 percent that rarely lasts more than a year. A panic is a very short, sharp break.

The long cycles in the U.S. equity market in the last century could be defined like this: 1921 to 1929 – secular bull market; 1929 to 1949 – secular bear; 1949 to 1966 – secular bull; 1966 to 1982 – secular bear; 1982 to 2000 – secular bull. The new secular bear market began in 2000 and we are now in a cyclical bull market rally.

How long it will be this time before stocks begin a true, new secular bull market is very difficult to guess. The conditions for such a renaissance are that money should be cheap and amply available, the debt structure should be deflated, there should be pent-up demand for goods and services and, probably most important, stocks should be clearly cheap based on absolute valuation.

The Bliss of Starting Fresh

An investor, hedge fund or otherwise, with nothing but cash, is forced to focus on fresh opportunities and is compelled to buy the 20 or 30 most attractive positions to be found as of that moment. Hedge funds that survive do best in their first year.

In contrast, when you are working with an existing portfolio and reshaping it, there are unrecognized, subconscious, emotional hang-ups that block you from impartial, cold-blooded investment actions like selling. Your baggage is what you already own, and it gets in the way of excellence.

Investors often personalize and become emotionally involved with positions when the investment decision-making process should be completely intellectual and rational. There is no reward for being a faithful holder. It is the holds that are too cheap to sell but not attractive enough to buy that make a portfolio stale and retard performance.

The Battle For Investment Survival

Private equity and venture capital have sustained their allure. Pension funds and fiduciaries are still scrambling to get more money into venture capital, even though at the end of 2004 there was an overhang of $54 billion of allocated — but uninvested — money in the hands of venture capitalists.

There is so much money looking for deals that valuations are once again ridiculous. This is good for the United States and great for innovation because entrepreneurs will get funded, but bad for the investors because high entry valuations mean low exit returns.

Global private equity firms were estimated to raise $200 billion in 2005, four times what they took in the previous year. Returns were speculated to reach 15 percent to 20 percent. Why would any fiduciary do anything else with their money?

David Swenson of the Yale Endowment maintains that in private equity the poor and mediocre performers stay that way. Just being in the asset class won't do it. It's very important to be with the real pros.

Since its inception in 1973, Yale has earned an astounding 30.6 percent per annum from its private equity program, but there has been immense volatility in both the one- and five-year returns. When there were years of red ink, and the conventional wisdom was that private equity was caput as a high-return asset class, that was the time to double commitments, proving that staying power is absolutely essential.

The Five Basic Principles that Yale Endowment Manager David Swenson and Co-Worker Dean Takahashi Stick to:

1. They strongly believe in equities. As investors, they want to be owners, not lenders.
2. They want to hold a diversified portfolio. Their conviction is that Yale can more effectively reduce risk by limiting aggregate exposure to any single asset class rather than by attempting to time markets. No attempt is made to fine-tune allocations until valuations become very extreme.
3. Greater incremental returns are achievable in selecting superior managers in nonpublic markets that are characterized by incomplete information and illiquidity.
4. They are convinced Yale should use outside managers for all but the most routine or indexed investments. The staff knows its investment managers very well.
5. Swenson is disinclined to use investment management firms associated with investment banks and mutual funds because of the potential conflicts. He wants his investment firms to be owned and managed by the people who are doing the actual investing.

Swenson argues that LBO (leveraged buy out) firms that concentrate on improving the operating performance of their portfolio companies consistently do far better than those that just leverage up troubled businesses. He makes the point that the investor in LBO firms in general is not compensated for the extreme risk of leverage and the immense nonliquidity.

It is hard to structure an investment organization that can adapt to the ebb and flow of investment talent over even a couple of generations, much less centuries. The message derived from the Yale endowment history is that the main individual (or perhaps individuals) who run the portfolio is the absolutely crucial choice. A committee can't do it. A committee can be instrumental in picking the individual, but it can't get involved in actually managing the asset allocation of the portfolio. Their consensus wisdom is bound to be wrong.

Nature's Mysticism And Groupthink Stinks

Groupthink is the disease that plagues every committee. Investment teams and committees, when they disagree about the proper course of action, can become paralyzed by respect and politeness.

In a big investment management firm that has to function through an investment policy committee, the chances for good decisions are best with a leader who meets regularly but informally with a small group of trusted advisers (three to five is the right number). The small group chews over the issues and the leader may poll it, but, in the end, the leader makes the decisions and is responsible.

A large group that votes democratically sounds good because it encourages participation, but in investing, democracies don't work. In fact, they invariably fail. Decision making and responsibility has to be located in an individual.

Solothink is where one very strong, very successful individual dominates the investment decision making, and can be just as dangerous as groupthink because it can become authoritarian and tyrannical.

A firm is particularly vulnerable to solothink when the predominate investor is also the rainmaker and the boss, but even committees can be dominated by a strong individual who others are reluctant to challenge.

As business organizations, investment management firms and hedge funds are particularly vulnerable to solothink. As long as the investment messiah can keep walking on water, everything is fine, but if the messiah loses

his touch, performance is so measurable that he can lose his halo very quickly.

In general, all investment organizations work best when they are relatively small, and when the principals like and trust each other. Decision making is the most important part of the investment process. Groupthink and solothink are elements to consider when organizing a group for effective decision making. It's not easy.

Once You Have A Fortune How Can You Hang On To It?

Preserving and enhancing your fortune is a demanding task that most people fail. Sam, who earned a lot of money selling his own company, has been successful at enhancing his fortune. His philosophy dictates that all returns should be looked at, above all, after taxes. Returns are reported pretax and thus are an illusion, because acheving high after-tax compounding is what the exercise is all about. Liquidity and transparency of the investment vehicle are critical. Sam likes to keep it simple. He invests in hedge funds that have active strategies — that go for it. He is willing to live with the volatility.

What has worked for Sam is finding a handful of great, enduring funds, knowing the managers well, concentrating on them, and staying with them. He looks for large funds with stable management that will outperform in up markets and protect capital in bad ones. You have to recognize they don't make money in down markets and they deliver a big tax bill.

Sam has two-thirds of his money in hedge funds. He does think every wealthy person ought to have a lifestyle reserve in high-grade tax exempts. How big that reserve should be depends on the age and wealth of the individual. "Ideally," he says, "it ought to be enough to support you in a basic, affluent lifestyle if the stock markets crashed and stayed busted."

If You Go Hedgehogging by Yourself

To have hedge funds as your core holding, you should have a portfolio of at least five funds and preferably 10 — five main managers and five on the farm team. You must spend serious time studying them, calling on the managers occasionally, and probably going to conferences. Doing hedge funds yourself is hard work. You must research your investments and understand their investment process. Unless you are willing to do this diligently, you should use a fund of funds to invest in hedge funds. Well-managed funds of funds keep up with the S&P 500 in good markets, preserve your capital in down markets, and do this with lower volatility.

Investing in Fine Art

Just as with equities, the returns from owning art depend mostly on how individual pictures stand the test of time and fashion. The bear market in art seems to be over, and prices in general are rising again, but the craziness has not come back — yet. With yields on financial assets so low, the income loss from owning art is much less of a deterrent than it was 10 years ago. On the other hand, CEO hubris and greed scandals have effectively eliminated the corporation as a collector in the United States and Europe. The bubble has been popped, and prices are rising again in a more orderly manner.

Hedgehogs are big buyers of art today. Some of the acquisitions are trophy collecting; a not so subtle form of bragging. Buy a picture because you love looking at it, not as a diversifier or as an investment.

Three Investment Religiong: Growth, Value And Agnostic

Growth stock believers argue for stock in companies whose earnings and dividends are consistently increasing. Ideally, growth stock investors want to hold shares in great businesses, and they sell only when the business itself falters, not because the price of the shares has risen.

By the time you can clearly identify a stock as a growth stock, it usually will already be valued accordingly. Therefore, you end up buying the expensive stocks of good companies.

Growth stock investors are also inclined to fall in love with their growth companies that have treated them well. Sell growth stocks when they become outrageously expensive.

Value investors want to own stocks that are cheap, not only in relation to other equities, but also in absolute terms. By buying cheap, a value investor creates a margin of safety for his investment. They search for the underowned, unloved and undervalued.

Value stocks, by definition, are cheap in relation to their assets and earning power because investors are pessimistic about them.

Agnostics say that everything in the investment business is temporary. When growth stocks are relatively cheap and the economic environment favors them, agnostics will own growth. When value is cheap and growth is expensive, they will look for value. Sometimes they will own a little of both.

Growth investing, because of its bias toward a buy-and-hold strategy, is inherently more tax efficient. However, for tax-exempt investors, the hard evidence is that the actual portfolios of value managers beat those of growth managers.

It is interesting to note, that, during one of the great speculative growth stock bubbles of all time, only in 1998 and 1999 did growth absolutely bury value.

Bubbles And The True Beliver

Since time immemorial, the financial markets of the world have been prone to bubbles in everything from tulips and art to shares and houses. Therefore, obviously it is very important for investors to understand them.

All bubbles start as powerful fundamental developments and legitimate investment opportunities. They become bubbles or manias when investors in their euphoric optimism project future results, not based on the rational fundamentals, but on a continuation of past results.

There are two general varieties of bubbles. The happier varieties are bubbles in securities of productive assets like technology, railroads, and stocks and bonds. The bad kinds of bubbles are in nonproductive assets like tulips, Tokyo golf courses, real estate or collectibles when the bubble's assets are used as collateral for loans from banks.

The most dangerous of all is a bubble that sucks in a large percentage of the population of a country, such as a bubble in residential real estate. However, a housing bubble is slower moving because the price appreciation is not so readily apparent and because it spreads by word of mouth.

When a bubble in nonproductive assets financed by banks bursts, the consequences invariably are deflation and depression. It is very difficult to figure out when bubbles are going to burst. Valuation and overbought technical metrics invariably signal the bust far too early. Observing market action doesn't help either.

When a bubble finally bursts, the so-called fallacy of composition comes into play and inflames mob psychology. This theorem says that, in a crisis the action that is rational for each individual is irrational for the group as a whole and creates a disastrous outcome. In a financial panic, each individual is acting rationally when he sells his stocks, or would be were it not for the fact that others are doing the same thing. Each participant, by rationally trying to save himself, contributes to the ruin of all.

The True Believer: Disciple of Gold

Peter lives in Sun Valley, Idaho and runs an investment-management company/hedge fund that specializes in gold. He came up with gold because it was complex, misunderstood, under-researched and susceptible to his option-pricing theories. He became the most knowledgeable gold analyst in the world.

Gold has a negative yield because you have to pay for storing it, there is no intrinsic valuation equation, and its only worth is as expensive apocalypse insurance. But Peter's search for an asset class to immerse himself in led him to gold.

The stock market explains 88 percent of the weekly price fluctuations of gold over the past eight years. The long-term correlation with Treasury bonds is not as high but still very significant.

As Peter explains it, the so-called problem with gold, which causes its erratic price behavior, is that "the elasticity of a positively sloped investment demand function overwhelms the inelasticity of supply." Translated, only 18 percent of the gold mined throughout history is held in investment form, or slightly more than $200 billion. The investable capital markets of the world are estimated to be about $60 trillion. In a low return cycle for stocks and bonds, monetary and investment demand for gold turns positive, and there is a dramatic shortage of available metal. This large differential can only be solved by much higher prices. The point is that it is not inflation or deflation that is the principal driver of gold, but the return from other long-term financial assets, particularly equities.

How much you should have in gold as an investment, as opposed to a trading basis, depends on how long-term bullish or bearish you are. Owning some gold shares is a wonderful diversifier. Gold goes up when stocks and bonds go down. But there doesn't seem to be much point in owning gold, the metal, outright except as a trading sardine.

Conclusion

Intelligence, experience, diligence, a knowledge of history, an open mind and an obsessive nature are all important ingredients for the successful hedgehog — as are intuition, imagination, flexibility and maybe just a touch of the seeing eye. There is no checklist, no one single model for a long-only investor or hedgehog. But to flourish, the professional has to relish and be invigorated by intellectual competition and be able to handle stress and adversity.

It's hard to be a hedgehog and it's far from easy to be a user of hedgehogs. Good luck.