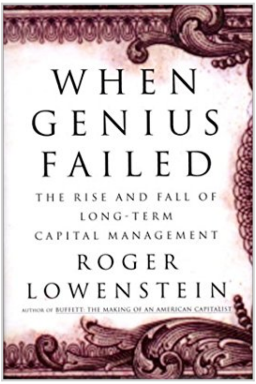

When Genius Failed: The Rise and Fall of Long-Term Capital Management

By Roger Lowenstein

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John Meriwether, a famously successful Wall Street trader, spent the 1980s as a partner at Salomon Brothers, establishing the best--and the brainiest--bond arbitrage group in the world. A mysterious and shy midwesterner, he knitted together a group of Ph.D.-certified arbitrageurs who rewarded him with filial devotion and fabulous profits. Then, in 1991, in the wake of a scandal involving one of his traders, Meriwether abruptly resigned. For two years, his fiercely loyal team--convinced that the chief had been unfairly victimized--plotted their boss's return. Then, in 1993, Meriwether made a historic offer. He gathered together his former disciples and a handful of supereconomists from academia and proposed that they become partners in a new hedge fund different from any Wall Street had ever seen. And so Long-Term Capital Management was born.

In a decade that had seen the longest and most rewarding bull market in history, hedge funds were the ne plus ultra of investments: discreet, private clubs limited to those rich enough to pony up millions. They promised that the investors' money would be placed in a variety of trades simultaneously--a "hedging" strategy designed to minimize the possibility of loss. At Long-Term, Meriwether & Co. truly believed that their finely tuned computer models had tamed the genie of risk, and would allow them to bet on the future with near mathematical certainty. And thanks to their cast--which included a pair of future Nobel Prize winners--investors believed them.

From the moment Long-Term opened their offices in posh Greenwich, Connecticut, miles from the pandemonium of Wall Street, it was clear that this would be a hedge fund apart from all others. Though they viewed the big Wall Street investment banks with disdain, so great was Long-Term's aura that these very banks lined up to provide the firm with financing, and on the very sweetest of terms. So self-certain were Long-Term's traders that they borrowed with little concern about the leverage. At first, Long-Term's models stayed on script, and this new gold standard in hedge funds boasted such incredible returns that private investors and even central banks clamored to invest more money. It seemed the geniuses in Greenwich couldn't lose.

Four years later, when a default in Russia set off a global storm that Long-Term's models hadn't anticipated, its supposedly safe portfolios imploded. In five weeks, the professors went from mega-rich geniuses to discredited failures. With the firm about to go under, its staggering $100 billion balance sheet threatened to drag down markets around the world. At the eleventh hour, fearing that the financial system of the world was in peril, the Federal Reserve Bank hastily summoned Wall Street's leading banks to underwrite a bailout.

Roger Lowenstein, the bestselling author of Buffett, captures Long-Term's roller-coaster ride in gripping detail. Drawing on confidential internal memos and interviews with dozens of key players, Lowenstein crafts a story that reads like a first-rate thriller from beginning to end. He explains not just how the fund made and lost its money, but what it was about the personalities of Long-Term's partners, the arrogance of their mathematical certainties, and the late-nineties culture of Wall Street that made it all possible.

When Genius Failed is the cautionary financial tale of our time, the gripping saga of what happened when an elite group of investors believed they could actually deconstruct risk and use virtually limitless leverage to create limitless wealth. In Roger Lowenstein's hands, it is a brilliant tale peppered with fast money, vivid characters, and high drama.

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Editorial Review

Amazon.com Review
On September 23, 1998, the boardroom of the New York Fed was a tense place. Around the table sat the heads of every major Wall Street bank, the chairman of the New York Stock Exchange, and representatives from numerous European banks, each of whom had been summoned to discuss a highly unusual prospect: rescuing what had, until then, been the envy of them all, the extraordinarily successful bond-trading firm of Long-Term Capital Management. Roger Lowenstein's *When Genius Failed* is the gripping story of the Fed's unprecedented move, the incredible heights reached by LTCM, and the firm's eventual dramatic demise.

Lowenstein, a financial journalist and author of *Buffett: The Making of an American Capitalist*, examines the personalities, academic experts, and professional relationships at LTCM and uncovers the layers of numbers behind its roller-coaster ride with the precision of a skilled surgeon. The fund's enigmatic founder, John Meriwether, spent almost 20 years at Salomon Brothers, where he formed its renowned Arbitrage Group by hiring academia's top financial economists. Though Meriwether left Salomon under a cloud of the SEC's wrath, he leapt into his next venture with ease and enticed most of his former Salomon hires--and eventually even David Mullins, the former vice chairman of the U.S. Federal Reserve--to join him in starting a hedge fund that would beat all hedge funds.

LTCM began trading in 1994, after completing a road show that, despite the Ph.D.-touting partners' lack of social skills and their disdainful condescension of potential investors who couldn't rise to their intellectual level, netted a whopping $1.25 billion. The fund would seek to earn a tiny spread on thousands of trades, "as if it were vacuuming nickels that others couldn't see," in the words of one of its Nobel laureate partners, Myron Scholes. And nickels it found. In its first two years, LTCM earned $1.6 billion, profits that exceeded 40 percent even after the partners' hefty cuts. By the spring of 1996, it was holding $140 billion in assets. But the end was soon in sight, and Lowenstein's detailed account of each successively worse month of 1998, culminating in a disastrous August and the partners' subsequent panicked moves, is riveting.

The arbitrageur's world is a complicated one, and it might have served Lowenstein well to slow down and explain in greater detail the complex terms of the more exotic species of investment flora that cram the book's pages. However, much of the intrigue of the Long-Term story lies in its dizzying pace (not to mention the dizzying amounts of money won and lost in the fund's short lifespan). Lowenstein's smooth, conversational but equally urgent tone carries it along well. The book is a compelling read for those who've always wondered what lay behind the Fed's controversial involvement with the LTCM hedge-fund debacle. --*S. Ketchum*

From Publishers Weekly
In late September 1998, the New York Federal Reserve Bank invited a number of major Wall Street investment banks to enter a consortium to fund the multibillion-dollar bailout of a troubled hedge fund. No sooner was the $3.6-billion plan announced than questions arose about why usually independent banks would band together to save a single privately held fund. The short answer is that the banks feared that the fund's collapse could destabilize the entire stock market. The long answer, which Lowenstein (Buffett) provides in undigested detail, may panic those who shudder at the thought of bouncing a $200 check. Long-Term Capital Management opened for business in February 1994 with $1.25 billion in funds. Armed with the cachet of its founders' stellar credentials (Robert Merton and Myron Scholes, 1997 Nobel Prize laureates in economics, were among the partners), it quickly parlayed expertise at reading computer models of financial

markets and seemingly limitless access to financing into stunning results. By the end of 1995, it had tripled its equity capital and total assets had grown to $102 billion. Lowenstein argues that this kind of success served to enhance the fund's golden legend and sent the partners' self-confidence off the charts. As he itemizes the complex mix of investments and heavy borrowing that made 1994-1997 profitable years, Lowenstein also charts the subtle drift toward riskier (and ultimately disastrous) ventures as the fund's traditional profit centers dried up. What should have been a gripping story, however, has been poorly handled by Lowenstein, who obscures his narrative with masses of data and overwritten prose. Agent, Melanie Jackson. Author tour. (Sept.)

From Library Journal
This is a marvelous, unauthorized chronicle of the rise, fall, and re-emergence of Long-Term Capital Management, a private hedge fund that in September 1998 benefited from a Federal Reserve-orchestrated $3.6 billion bailout. Based primarily on interviews with key players from the six banks that participated in the rescue of the firm, Lowenstein, who previously wrote Buffett: The Making of an American Capitalist, presents a well-crafted, easy-to-follow text. Readers will better appreciate the inner workings of the firm; the nuances of the individual partners; primary differences among investing in stocks, bonds, and derivatives; the fallacy of the efficient market hypothesis; the impact of computers on financial trading; and the importance of moderation. Recommended for both academic and public libraries.
-DNorman B. Hutcherson, Kern Cty. Lib., Bakersfield, CA

Users Review

From reader reviews:

Donald Sams:

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