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Hedge Funds Banking on Social and Moral Issues

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Wealthy British scion Zak Goldsmith and investment activist Max Keiser want to take down Coca-Cola Co., and they have added a new twist to the age-old tactic of boycotting: They have opened a hedge fund designed to profit from any decline in the soft drink conglomerate's stock price.

"We're simply picking up on a trend and giving people the tools to use," Keiser said. "The Internet allows people, activists, from all over the world to gather, or swarm, and hit a company where it hurts most -- in their stock price."

Hedge funds are a popular investment option for the wealthy. But creating a hedge fund with a specific social agenda, like the one promoted by Goldsmith and Keiser, is a recent development, according to Doug Wheat, director of business development at SRI World Group, a financial news and data monitoring service in Vermont.

"There are only five or six hedge funds like that," Wheat said. "Meanwhile, there are like 8,000 hedge funds."

A hedge fund is a type of private investment vehicle for wealthy investors who choose to pool their money and invest in securities. Many hedge funds invest in unusual securities in unusual ways. They sometimes assume substantial risks on speculative strategies. This sometimes includes "hedging," or leveraging investments to get the most gain.

Hedge funds are subject to few regulations. The Securities and Exchange Commission requires only that the investors be accredited, meaning that they must earn more than \$200,000 per year or have a net worth of more than \$1 million. Hedge fund managers are not currently required to register with the SEC.

"We don't get into who's investing," said SEC spokesman John Heine.

But that hands-off approach may change. Regulators started eyeing hedge funds after the 1998 near-collapse of Long-Term Capital Management LP, which lost billions in derivatives trading and created a financial market disaster, necessitating a private-sector bailout organized by the Federal Reserve Bank of New York.

In October, the SEC voted 3 to 2 to increase hedge fund oversight by mandating that hedge fund managers register by February 2006. But on Monday, the head of a New York-based hedge fund, Opportunity Partners LP, sued the SEC in an effort to block the registration requirement.

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In public comments dissenting from the adoption of the proposed registration rule, the two Republican commissioners, Cynthia A. Glassman and Paul S. Atkins, questioned whether the registration requirement would be too rigorous on certain issues and too lax on others.

Heine said that requiring hedge funds to register with the commission "will not have any effect on the suitability requirement for hedge fund investors."

Even within the context of traditional stock and bond investing, hedge funds sometimes seek out esoteric niches, such as interest rate swaps and collateralized mortgage obligations, according to Todd Goldman, managing principal at Walnut Creek, Calif., accounting firm Rothstein Kass, which serves hedge funds.

"The whole point of hedge fund investing is the ability to specialize," Goldman said, pointing out that there are hedge funds producing steady returns that strictly invest in credit card debt and funds that invest in tax liens.

To date, specialization among hedge funds has meant inventing new investment strategies within a core group of publicly traded securities -- stocks, bonds, currencies, futures and options. But some investors are expanding beyond what most people would even consider investments.

Billionaire Mark Cuban, owner of the NBA's Dallas Mavericks, for example, said in November that he is preparing to launch a hedge fund focused on gambling.

"This hedge fund won't invest in stocks or bonds, or any type of business. It's going to be a fund that only places bets," Cuban said in a posting on his Web log, MarkCuban.com.

He promised in his posting to hire top professional gamblers to figure out what bets to place or what games to play. Their performance of gambling wins and losses, of course, will generate the return for investors, Cuban said. He declined to comment further on his hedge fund plans in response to an e-mail message from The Washington Post on the subject.

Some funds already invest in the gaming sector, albeit through trading shares of companies operating in that industry. The Vice Fund, based out of Texas, for example, is a mutual fund that invests only in companies with ties to weaponry, smoking, drinking and gambling.

Other funds take great pains to avoid so-called "sin" stocks. Shariah Funds, managed by Meyer Capital Partners of New Canaan, Conn., invests according to Islamic law, avoiding companies associated with gambling, alcohol, tobacco and food processing (because of dietary restrictions).

"We look at a company's primary business first, and then we look at their financials," said Sheikh Yusuf Talal DeLorenzo, an Islamic scholar and adviser to the fund.

DeLorenzo noted that although Islamic law prevents the taking of interest and allows investments only in tangible assets, he has configured a way to hedge using futures and options. The money behind Shariah Funds comes from wealthy investors in the Middle East and Asia, DeLorenzo said.

Other groups with religious affiliations have also launched hedge funds. Last year, Catholic Institutional Investors, a coalition of five Catholic health care organizations, launched the Good Steward Fund. And the Church of Jesus Christ of Latter-day Saints has a private investment fund -- Ensign Peak Advisors -- to serve its Mormon constituents.

Mission-oriented hedge funds fall into a category known as "socially responsible" investments that permit investors to grow financially while still adhering to their own individual social or moral preferences. Investment managers typically screen potential investments so that they match a client's beliefs.

Socially responsible investing is one of the fastest-growing sectors in the financial services industry, with more than \$2 trillion of assets being managed in such fashion, according to the Social Investment Forum, a District-based nonprofit organization providing research and education.

The anti-Coke campaign has been called by its founders a "smart boycott." Goldsmith said he believes he can push Coca-Cola shares to as low as \$22. They closed at \$41.51 in Thursday trading on the New York Stock Exchange. U.S. financial markets were closed yesterday.

"Coke represents the cutting edge of a global monoculture that is undermining real human diversity," said Goldsmith, 29, who is the son of a famed British corporate raider, the late Sir James Goldsmith.

With a reported inheritance of about \$700 million, Goldsmith could wage a formidable battle against Coca-Cola via his family's magazine, the Ecologist, where he is founding editor.

Coca-Cola has issued numerous statements clarifying its positions on the corporate issues at which Goldsmith and Keiser are taking aim.

"This so-called campaign is based on blatant falsehoods," said Ben Deutsch, a Coca-Cola spokesman. "It's unfortunate that anyone would attempt to hurt Coke shareholders . . . without the facts."

Investors in the unnamed anti-Coca-Cola fund will get a stated annual return akin to a long-term Treasury bond. But, after a 2 percent management fee, the rest of profits will go to aid disaffected farmers in India, AIDS organizations in Africa and human rights monitoring groups in Central and South America.

"We're now focused on closing a \$100 million fund by the end of 2005," said Keiser, who founded Karmabanque.com, the Web site through which the anti-Coca-Cola campaign is being managed.

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