Top hedge-fund managers average $540 million in income

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An article in Institutional Investor's *Alpha* magazine this week reports that the 25 highest-paid hedge-fund managers in the US had an average income of $540 million in 2006, with the top three pulling in over $1 billion each.

The sums racked in by hedge-fund managers dwarf even the incomes of top corporate CEOs and Wall Street bankers The average among them earned nearly $1.5 million a day, every day, for the entire year—or over $1,000 every minute.

Incomes for these managers of largely unregulated and secretive investment companies have soared in recent years. The average compensation for the top 25 increased 57 percent from 2005 and 127 percent from 2004. To get on the top 25, a hedge fund manager had to have an income of at least $240 million, twice the cutoff in 2005 and six times greater than the cutoff in 2002.

In total, the top 25 pulled in nearly $14 billion in one year. According to the International Monetary Fund, this is more than the total gross domestic product of Bahrain, Jordan, Ethiopia, Jamaica, and many other countries. As one media report noted, the sum would be enough to pay all of New York City's 80,000 public school teachers for nearly three years.

This is a portrait of an aristocracy of wealth that is unlike any other period in American history. A tiny layer of society—the top one-tenth, or even one-hundredth or one-thousandth percent of the population—has amassed unimaginable wealth while wages for the majority of the population, in the US and internationally, continue to stagnate or decline.

What have these individuals done to justify their incomes? In a word, nothing. Their wealth derives overwhelmingly from financial speculation, short-term bets on stocks or derivatives, and similar operations that produce no real value. Others have specialized in pressuring corporations to cut costs, slash wages, and downsize in order to increase share value. The hedge fund managers typify an American ruling class that has become increasingly divorced from any direct relationship to the productive process, making its money through parasitism and fraud.

Hedge funds are investment companies that typically have restrictions on who is allowed to invest, only allowing large institutional investors or the extremely wealthy. The managers of these funds typically receive income as a percentage of their fund's assets (usually 2 percent), plus a percentage of the funds' gains in a given year (typically 20 percent).

By this formula, a fund with large assets and significant gains can pull in enormous sums of money. Investors are willing to keep pouring money into them, however, because of the high returns that many are able to make. Because hedge funds are largely unregulated, it is impossible to know exactly how the returns are made.

Representative of the group of top managers is James Simmons, manager for Renaissance Technologies Corporation. In 2006, Simmons pulled in an astonishing $1.7 billion. It was the second straight year that he was at the top of the list of hedge fund managers. Renaissance owns a fund called Medallion, which has assets of $6 billion and returns of 44 percent last year.

According to *Alpha* magazine, "Medallion, which is closed to outside investors, uses sophisticated computer programs to identify price anomalies, trading everything from equities and commodities to futures and options." In other words, the fund makes its money through arbitrage—the employment of complex mathematical models to make bets on the movements of different securities.

In justifying the exorbitant incomes for managers such as Simmons, Stephen Brown, professor at the Stern School of Business at NYU, said, "You had railroads in the 19th century, which led to the opening up of the steel industry and huge fortunes being made. Now we're seeing changes in financial technology leading to new fortunes being made and new dynasties created."

In fact, other than their salaries, the new tycoons share little in common with the robber barons of old. While the latter created industries, the former do little more than bet on market moves or benefit from corporate cost cutting.

Also typical of the top hedge fund earners was David

Tepper, who came in at number nine with "only" $670 million as manager of Appaloosa. If Simmons is a prototype arbitrageur, Tepper is the modern-day incarnation of the corporate raider—scouring the market for companies to buy up, strip of their assets, and sell off for a profit. Tepper also personifies the increasingly close collaboration between hedge funds and private equity firms, the latter generally playing a more direct role in corporate management.

Alpha magazine writes, "Appaloosa and New York-based private equity and hedge fund shop Cerberus Capital Management are leading a group that has offered as much as $3.4 billion to rescue auto-parts giant Delphi Corp. from bankruptcy. They're playing hardball: In February the investors extended the date by which Appaloosa, Cerberus or Delphi can terminate the agreement, which stipulates that the auto-parts maker must reach tentative deals with key labor unions and settle legacy issues with ex-parent General Motors Corp."

In other words, Appaloosa and Cerberus are pressuring Delphi and the United Auto Workers union to agree to concessions contracts to massively reduce labor costs. Cerberus is managed by Stephen Feinberg and has former Bush Treasury Secretary John Snow as its chairman. Feinberg himself worked for Drexel Burnham Lambert during the era of leveraged buyouts and junk bond financing.

Coming in at number 10 was Carl Icahn, whose hedge fund earned him $600 million last year. Icahn is another corporate raider who buys up stock and pressures management to cut costs and pursue other policies that will increase share value (such as stock buyback programs). Icahn has invested in a number of major companies in recent years, including TimeWarner and auto-supplier Lear Corporation, and he is considered a possible investor in Chrysler. Icahn won a name for himself as a corporate raider in the 1980s, when he bought up Trans World Airlines, initiating a cost-cutting campaign in the airline industry that continues to this day.

Also on the top ten were Kenneth Griffen of Citadel Investment Group ($1.4 billion), Edward Lampert of ESL Investments ($1.3 billion), George Soros of Soros Management Fund ($950 million), Steven Cohen of SAC Capital Advisors ($900 million), Bruce Kovner of Caxton Associates ($715 million), Paul Tudor Jones II or Tudor Investments ($690 million) and Timothy Barakett of Atticus Capital ($675 million).

Soros and Kovner represent the two poles of the political establishment in the United States. Soros is a long-time Democratic Party supporter, who spent millions in 2004 trying to unseat Bush. Kovner, on the other hand, is chairman of the Board of Trustees of the American Enterprise Institute, the right-wing think tank behind much of Bush administration policy.

Referring to Soros, *Alpha* magazine notes that he "is proof that money trumps politics." In spite of his support for the Democrats in 2004, "last year he bought 1.9 million shares in the oil-field services company Halliburton Co., whose KBR subsidy is the US military's biggest contractor in Iraq." Vice President Dick Cheney was once the CEO of Halliburton. The magazine continues, "So far the 76-year old [Soros] has kept his options open for the 2006 presidential campaign, although he sent the maximum $2,100 personal contribution to Illinois Senator Barack Obama. But he recently told the *Houston Chronicle* that he'll play a less activist role in the upcoming election."

The political power of hedge fund managers was highlighted in an article in the *New York* magazine this month ("The Running of the Hedgehogs," by Duff McDonald). McDonald notes that hedge funds have begun campaigning to prevent any government regulation of their actions.

"In a sign of hedge funds' growing clout in other spheres," McDonald writes, in late January, Senator Chuck Schumer [the Democratic chairman of the Senate Finance Committee] called twenty or so of the top hedge-fund managers and invited them to the Upper East Side Italian restaurant Bottega del Vino. It was supposed to be a friendly chat—Schumer's message was, you talk to us about what's going on, and nobody has to worry about too much interference from regulators." Among the attendees were many of the top hedge fund managers, including Jones and Tepper.

Hedge funds have benefited in recent years from a flood of cash in search of profitable investments. As this has become more and more difficult to find in industries engaged in production, investors have turned to financial speculation. While this offers high returns, it also poses great risks for investors and highlights the underlying instability in world financial markets.