

Media Modeling and Budgeting at DMI

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What was LTCM?

Founded in February 1998 by John D. Coates and Edward D. Kane

Over 100 employees, \$100 billion assets from LTCM hedge fund, and a portfolio of 1,200

By 2000, LTCM had become one of the largest hedge funds in the world, with \$120 billion in assets



LTCM's Strategies

Using the volatility of interest rates, foreign exchange, and commodities

Using sophisticated financial models to predict market movements

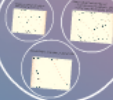
Using a combination of long and short positions in a wide range of assets



LTCM's Major Trades

Long-Term Capital Management (LTCM) was a hedge fund that used complex financial models to predict market movements. It was founded in 1998 by John D. Coates and Edward D. Kane. LTCM's major trades included:

- Long positions in Russian government bonds
- Short positions in Russian government bonds
- Long positions in Russian government bonds
- Short positions in Russian government bonds



Contribution to Efficient Markets

- Provided liquidity
- Markets needed buyers and sellers
- Took positions no one else would
- Targeted market inefficiencies



Despite all the success

- Media hype created unrealistic expectations
- Over-leveraged
- Overly concentrated
- Overly leveraged
- Overly concentrated



LTCM Minimized Their Use of Equity

They used very little equity to fund their operations. Instead, they relied heavily on debt, which allowed them to take on much larger positions than they could have otherwise.



Why LTCM Failed

Over-leveraged

Overly concentrated

Overly leveraged

Overly concentrated

Catalysts of LTCM's Failure

The Russian financial crisis in August 1998 was a major catalyst for LTCM's failure. The crisis led to a sharp decline in the value of Russian government bonds, which LTCM had heavily invested in. This led to a massive loss of capital and a loss of confidence in LTCM's ability to manage risk.



Conclusion

- Quick losses
- What lessons can we learn?
- Two distinct phases of the period model

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Long-Term Capital *Mismanagement*



HOW THE PERFECT FORMULA TO ELIMINATE RISK
MADE PHENOMENAL PROFITS . . .
AND LOSSES . . .

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What was LTCM?

Founded in February, 1994 by John Meriwether and 11 other principals

Over three years, \$ 1Billion in capital that LTCM began with had grown to \$7.1 Billion

By 1998, LTCM was bankrupt and at one point managed to loose \$4.5 Billion in less than two months

Unique Characteristics of LTCM's Rise and Fall

No laws were broken and no-one went to prison
No-one was fined or censured
No LTCM employee was indicted for fraud
No internal or regulatory authority audit report ever highlighted any risk, or operational concerns

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LTCM's Strategies

- “Not trying to find a needle in the haystack; Rather, it was trying to find a haystack of needles”
- Identify Imperfections in the market
- Exploit spreads of asset prices and Yields
- Create a market-neutral portfolio
- Minimal use of Equity Capital Risk taker

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Major Trades

Convergence Trades

Securities were incorrectly priced relative to one another
LTCM would take long positions on the under priced security and short positions on the overpriced security

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The four main types of trades:

- Convergence among U.S., Japan, and European Sovereign bonds;
- Convergence among European sovereign bonds;
- Convergence between on-the-run and off-the-run U.S. government bonds;
- Long positions in emerging markets sovereigns, hedged back to dollars

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