

# Managing Romance in the Office

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### What was LTCM?

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

Top management: J. Michael Steele (CEO), Robert E. Mercer (COO), John D. Coates (Chairman)

By 1998, LTCM employed over 400 people, managed approximately \$120 billion in assets



### LTCM's Strategies

Developed the concept of "Global Macro" investing, which involved trading a wide range of assets, including stocks, bonds, commodities, and currencies

Used sophisticated mathematical models to identify and exploit market inefficiencies

Employed a highly leveraged strategy, using derivatives to amplify returns




### LTCM's Major Trades

Long-Term Capital Management (LTCM) was known for its highly leveraged trades, which often involved derivatives and other complex financial instruments

Some of the most notable trades included:

- Long positions in Russian government bonds
- Short positions in Asian emerging market currencies
- Long positions in U.S. Treasury 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

- Median Return Strategy on Assets
- Return: 5.21% vs 2.40%
- Consolidating Off-Balance Sheet Positions
- 3% or lower
- 30-1 Leverage Ratio
- Double leverage strategy



### LTCM Minimized Their Use of Equity

Highly leveraged strategy



### Long-Term Capital Management

Long-Term Capital Management (LTCM) was a hedge fund that was founded in 1998 by John D. Coates and Edward D. Kane



### Catalysts of LTCM's Failure

The Russian financial crisis in 1998 was a major catalyst for LTCM's failure

The crisis led to a sharp decline in the value of LTCM's Russian government bond positions

The fund's highly leveraged strategy amplified the losses



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### Conclusion

- Quick Review
- What lessons can we learn?
- Two critical lessons of the period model

### Long-Term Capital Management

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### Major Trades

Major trades of LTCM



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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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