

Media Modeling and Budgeting at DMI

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What was LTCM?

Founded in February 1998 by John D. Coates and Stephen W. Scholtes.

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

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



LTCM's Strategies

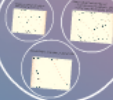
Using the volatility of interest rates, LTCM's strategies were based on the following:

- Interest rate derivatives
- Fixed income derivatives
- Commodity derivatives
- Equity derivatives

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LTCM's Major Trades

1998-1999



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 by Credit Derivatives on Assets

- Return: 5.21% vs 2.40%
- Consolidating Off-Balance Sheet Positions
- 3% or lower
- 30-40 leverage ratio
- Double leverage ratios



LTCM Minimized Their Use of Equity

They can see the use of equity in the following chart:



Media Modeling and Budgeting

Long Term Modeling

Long Term Modeling

Catalysts of LTCM's Failure

1. Over-leveraging

2. Ignoring the risk of a global financial crisis

3. Ignoring the risk of a global financial crisis

4. Ignoring the risk of a global financial crisis

5. Ignoring the risk of a global financial crisis

Global Financial Crisis

Conclusion

- Quick Review
- What lessons can we learn?
- Two critical lessons 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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