
September 20, 2006

Hedge Fund Shifts to Salvage Mode

By [GRETCHEN MORGENSON](#) and [JENNY ANDERSON](#)

A day after disclosing that a disastrous bet on natural gas prices had produced losses of more than \$3 billion, Amaranth Advisors, once among the nation's largest and hottest hedge funds, was scrambling yesterday to salvage something from its battered portfolio of energy trades.

Last night, as it had been since the weekend, Amaranth was locked in negotiations with several Wall Street banks and other hedge funds in an effort to sell its energy portfolio to try to keep the fund company afloat.

At the same time, it was working with commodity exchange officials to reassign trades to try to minimize disruptions to the market.

The fund's investors, locked into their holdings by Amaranth's stringent liquidation terms, awaited further word on the status of the fund's holdings, while regulators and traders watched for signs that the hedge fund's losses might disrupt markets beyond those relating to energy.

The losses at Amaranth have followed another blowup in natural gas at a smaller fund, MotherRock, but financial markets have hardly felt a murmur, largely because the volatility has been contained — so far — to a corner of the energy market, and is not tied to markets in stocks and bonds. And with so much investment money pouring into energy, it is likely that others profited from the billion-dollar losses.

Indeed, the effects have been fairly limited, confined mostly to the natural gas market. Amaranth's portfolio, valued at \$9.25 billion as recently as a few weeks ago, was apparently halved by a wrong-way wager that natural gas prices would rise, a bet that had produced enormous gains for the fund in recent years. Amaranth traders had reckoned that the difference, or spread, between the prices of gas futures in the months of March and April in coming years would increase. But rising gas inventories caused prices to decline, putting Amaranth on the wrong side of a brutal and accelerating market trend.

Officials at the [New York Mercantile Exchange](#), where natural gas futures contracts trade, were matching up Amaranth's trades with holdings of other market participants, neutralizing their positions. The exchange would say only that Amaranth's account and the firm that cleared its trades were in good standing.

"The market seems to have recovered a little bit from the fall in price we had over the weekend," said Kent Bayazitoglu, head quantitative analyst at Gelber & Associates, referring to natural gas

prices. "It's leveling out a little bit at \$5, and the volume has fallen. It's slowing down and accepting the prices."

Last week, the market fell to \$4.80, the lowest level since September 2004, according to Mr. Bayazitoglu.

But reflecting the liquidation of Amaranth's positions, the spread on some gas futures declined further yesterday. The spread on prices for March and April 2009, a position held by Amaranth, fell 11 percent, to \$1.55. In late August that spread had reached \$2.85.

Amaranth had apparently not anticipated that natural gas storage capacity was rising, said David A. Pursell, a partner at Pickering Energy, a research firm based in Houston. Companies operating storage caverns have expanded capacity recently, and last week, government weather forecasters noted the development of El Niño, a weather pattern in the Pacific Ocean that usually augurs a warmer winter.

Officials at Amaranth, based in Greenwich, Conn., declined to comment yesterday on the status of the fund's holdings.

Nicholas M. Maounis, Amaranth's founder and chief executive, advised investors in an e-mail message on Monday that the fund had lost 35 percent of its assets and that it was liquidating energy holdings.

While hedge funds like Amaranth do not typically disclose the identities of their investors, some became apparent yesterday. Amaranth was a favorite of so-called hedge funds of funds, investment pools that buy into various portfolios to try to minimize risk.

For example, funds of funds operated by [Morgan Stanley](#), Credit Suisse, [Bank of New York](#), [Deutsche Bank](#) and Man Investments all had stakes in Amaranth, as of June 30, the most recent figures available. Those holdings, which ranged from 4 percent to 7 percent of the assets of the funds, are worth far less now than their stated values in June. Officials at those funds declined to comment yesterday.

Returns at Amaranth have been high in recent years. From September 2000 to November 30, 2005, a January offering memorandum states, the compound annual return to investors, net of all costs, was 14.72 percent.

Officials at Wall Street firms suggest that Amaranth has liquidated a significant amount of its positions in securities that are relatively easy to sell: convertible bonds, leveraged loans and even so-called blank check companies, or special purpose acquisition companies. Liquid investments have sold at a small discount; others, like portfolios of mortgage-backed securities, have commanded a steeper discount, people involved in these negotiations say.

Amaranth is still negotiating to sell its natural gas book, where the biggest losses are. [Goldman Sachs](#) was interested but pulled out. [J. P. Morgan](#) and other hedge funds appear to be looking at the books. Representatives from both banks declined to comment.

If Wall Street is not reeling from Amaranth's woes, the fund's investors surely are. As is common among hedge funds, Amaranth severely restricts investors' ability to cash in their holdings. For example, investors can withdraw money only on the anniversary of their investments and then, only with 90 days' notice. If they try to withdraw at any point outside that time frame, they face a 2.5 percent penalty.

Even more draconian, if investors redeem more than 7.5 percent of the fund's assets, Amaranth can refuse further withdrawals, one investor said. The fund plans to conduct a conference call with investors this week, this investor said.

Investors said they were baffled by the apparent lack of risk management at the fund.

Officials at the [Commodity Futures Trading Commission](#), the agency that regulates commodities markets, said they were "aware of what's going on and taking the proper necessary steps to step up our surveillance."

The commission collects information daily on trades and positions from clearing firms that operate on the Nymex. It also requires traders with large positions to report their holdings and can demand disclosure if it believes a trader is using several different accounts.

But depending on where Amaranth conducted its trades, the C.F.T.C. may get limited information on the hedge fund's trading and holdings in over-the-counter markets. Regulators can require investment firms and traders with large positions in commodities to disclose their positions if they trade on the Nymex and other large futures exchanges. But Congress passed the Commodity Futures Modernization Act in 2000, limiting regulators in collecting information on over-the-counter markets, which have grown markedly in recent years.

Several lawmakers have sought to impose more oversight on energy trading but their efforts have not gained much ground.

As Amaranth grappled with its losses, résumés from its employees flooded Wall Street. And HedgeBay, a company that creates markets for hedge fund investors trying to buy or sell hedge fund stakes, has started a market for Amaranth positions.

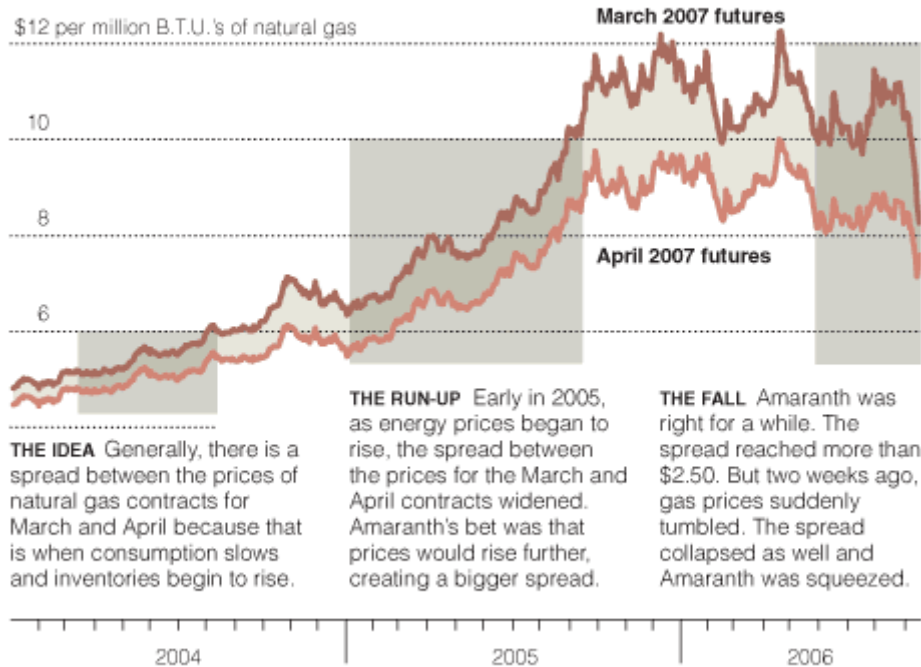
The spread in that market — the difference between what a buyer would pay for Amaranth's holdings and a seller would accept for them — was wide yesterday. Sellers were demanding 35 cents to 40 cents for every \$1 invested while buyers offered to pay 10 cents to 20 cents.

No trades have been done yet. "People are trying to wait for the dust to settle," said Jared Herman, the co-founder of HedgeBay. "It's a fluid situation, and the phones are ringing off the hook."

Vikas Bajaj contributed reporting.

A Big Bet Gone Bad

Amaranth Advisors' problems arose after it made a bet on the difference between the prices of natural gas futures contracts for March 2007 and April 2007.



Source: Bloomberg Financial Markets

The New York Times