



H.S. Grace & Company, Inc.

Hedge Fund: Investment Concerns

Allegations

A Fine Arts (FA) Institution met and subsequently invested in a hedge fund which had been recommended to it. The professionals heading the hedge fund appeared to be accomplished, experienced individuals. The hedge fund presented results demonstrating a successful track record (above average returns), and explained that their proprietary trading programs enabled the achievement of these above average trading results. Within two years of its initial investment, the FA Institution sensed that problems were developing with their investment in the hedge fund, yet could get no clear answers from the hedge fund managers.

Analysis

H.S. Grace and Company, Inc. (HSG) was brought in by the FA Institution and its outside counsel to assist in evaluating the matter. HSG is quite familiar with hedge funds and, from the outset, was concerned about the professional backgrounds of the individuals as well as the type of investment program they purported to have in place. HSG examined the hedge fund's reported trading model, and evaluated the manner in which the hedge fund attempted to discern valuable insights from the mathematical analysis of trading data.

Early in the analysis undertaken by HSG, it was noted that a number of withdrawals had taken place in literally the second year of the hedge fund's existence. This was of concern, because if the hedge fund was highly successful, why was a significant portion of its initial capital being withdrawn in the subsequent year? HSG's examination of the individuals sponsoring the trading programs led to the identification of inaccuracies in their presentations regarding both their own professional backgrounds and the operation of the funds under their control. This was in addition to their "supposed" set of professional advisors. Substantial questions arose as the HSG analysis progressed, leading to a concern about whether the results presented as having been obtained by the hedge fund in the early days of its operations may have been fabricated.

Close examination of the hedge fund's proposed investment strategy enabled HSG to make clear to counsel that their strategy was simply dependent on timing - the identification of prices for a particular stock and various puts and calls related to that stock at a point in time. HSG became increasingly concerned that the hedge fund was not following the program they had put forward. Interestingly, the hedge fund labored in court to keep from having to identify their actual trading activity, taking the position that to do so would be to allow others to fully understand their proprietary trading model. HSG demonstrated that the proposed strategy was dependent only on timing, and any information viewed would be information viewed in hindsight without any damage being done to the hedge fund's investment strategies.

The court appointed a Master Receiver and HSG's concerns were confirmed. It was quickly determined that the hedge fund had invested in a wide range of vehicles far removed from the proposed program.

Shortly after the Master Receiver was appointed, the hedge fund offered to settle. HSG stressed its belief that a careful examination of the losses purported to have been experienced by the hedge fund was required to insure that there was a complete accountability for all invested funds. The apparent wide range of investment vehicles utilized by the hedge fund created the opportunity for the funds of investors to simply disappear down black holes. HSG joined counsel in stressing the need for a careful examination of the trading activities and a determination made of what actually happened to investors' funds placed into the hedge fund.

Result

A satisfactory settlement was achieved between the parties.

H.S. Grace & Company, Inc. is a team of senior executives who diagnose and resolve critical corporate problems in business governance, operations, finance and control. With more than 1,000 years of experience, our goal is to help companies enhance shareholder value, protect reputation and their long-term ability to succeed, avoid and manage litigation, and navigate major changes such as mergers and acquisitions or bankruptcies. We often serve as consulting and testifying experts, identifying and analyzing critical business issues.

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