The Hedge-Fund King Is Getting Nervous

Inside billionaire Steven Cohen's hidden world
of massive trading and lavish art. Is the party over?
At home with Van Gogh, Gauguin and a skating rink

By SUSAN PULLIAM
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STAMFORD, Conn. -- It was the kind of day that can give a hedge-fund tycoon nightmares. As stocks fell on the afternoon of June 12, the largest holdings of Steven Cohen's more than $10 billion hedge fund were falling even harder.

Mr. Cohen, whose trading acumen, monumental compensation and sprawling art-laden home had made him a trailblazing star of the hedge-fund boom, watched the carnage unfold on eight computer screens arrayed around his desk. From time to time, he leaned back and rubbed his face. "Oh, boy," he said to himself.

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The 20,000-square-foot trading room at SAC Capital Advisors, chilled to 70 degrees to keep traders alert, was hushed. Mr. Cohen, who sits at its center, likes it that way. Phones blink rather than ring. Computer hard drives had been moved off the trading floor to eliminate hum. Rows of traders wearing SAC fleece jackets watched Mr. Cohen nervously, waiting for an order to sell shares.

But Mr. Cohen wasn't budging. Less than an hour before the stock markets closed, Mr. Cohen, biting his nails, compared his sinking stocks to a plunging department-store elevator. "There goes ladies lingerie," he said, to no one in particular. By day's end, his firm had lost $150 million, or 1.5% of its assets -- one of its worst one-day showings ever.

In years past, Mr. Cohen might have sold frantically as the market fell. He had achieved celebrity status in the hedge-fund world, overshadowing such influential managers as George Soros and Julian Robertson Jr., with a hair-trigger approach to trading that was extraordinarily profitable. When stocks appeared to be mispriced, Mr. Cohen would pounce, then he would bail out as soon as they ticked in the right direction. His success had inspired a generation of scrappy Wall Streeters -- some of them with no experience whatsoever handling other people's money -- to open their own hedge funds.

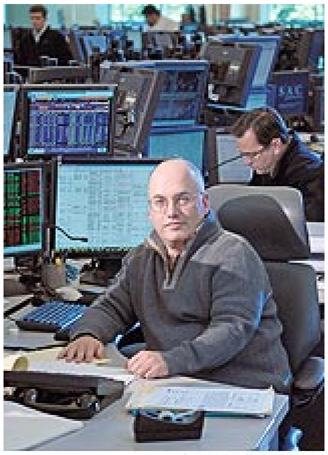
That quick-trading game is now over, says Mr. Cohen. With about 7,000 hedge funds competing for investment ideas, good stock investments are getting more scarce. "It's hard to find ideas that aren't picked over, and harder to get real returns and differentiate yourself," he says. "We're entering a new environment. The days of big returns are gone."

To make matters worse, the stock market, he says, is no longer as forgiving for investors. The tailwind of low interest rates, low inflation and strong corporate profits, he says, has been lost. There are no more easy pickings, he says.

SAC is among the most widely watched investment firms in the world. Mr. Cohen, who is 50 years old, has always guarded his privacy fiercely, keeping mum as attention was heaped upon his trading tactics, his voracious art collecting, and his expanding Greenwich, Conn., estate. Recently, in a series of interviews at his Stamford office, Mr. Cohen discussed the rise of SAC Capital, the suspicions of improper trading that have dogged his firm, and the big shift in his view of investing.

Mr. Cohen says he is now making bigger bets and holding the stocks longer. The throng of rival hedge funds could create a dangerous logjam, he says. Mr. Cohen worries that some of his largest holdings are also favored by other hedge funds. A rush for the exit could spell trouble. He says he expects that eventually there will be a sudden and sharp reversal in the stock market -- but he's not worried about that happening this year. "There will be a real decline that may devastate hedge funds that have crowded into the same stocks," he predicts.

"Hedge funds are bigger than they used to be. Their positions are bigger," he says. "I worry that if everyone were to sell, could we get out?"



David M. Russell

Steven Cohen at his trading desk in Stamford, Conn.

Hedge funds, private investment pools for institutions and well-heeled individuals, now hold about $1.2 trillion in assets, more than twice what they had five years ago. Fat returns are becoming more elusive. In 2005, the average hedge fund returned 9.3%, below the 11.4% average for the past decade, according to Hedge Fund Research Inc., a Chicago consultant. By comparison, the S&P 500 index returned 7.7% last year. A record 848 hedge funds closed up shop in 2005, many of them hobbled by poor performance, according to Hedge Fund Research.

Mr. Cohen's reputation rests on an investing style altogether different from the buy-and-hold strategy espoused by influential investors such as Warren Buffett. Mr. Cohen believes that by scrutinizing trading patterns of a stock -- by "watching the tape" -- it is often possible to predict how the stock will move in the coming hours or even days. For years, he jumped in and out of stocks -- sometimes without any knowledge of a company's fundamentals, or even what it did. It was akin to picking out rocks in a river by watching the currents swirl around them.

Classic "value" investors such as Mr. Buffett insist that what other traders are thinking and doing is of no consequence to sound investing. Mr. Cohen is his polar opposite. He spends long days at the office in black jeans and worn sweaters, glued to his computer screens as he personally trades upwards of 300 stocks. SAC's trading floor bombards him with information about what's going on in the market. He soaks it all up. His eyes are often rimmed with fatigue.

On a typical day, SAC's trading accounts for 2% of overall stock-market activity. SAC pays securities firms an average of one cent for each share it trades, which adds up to more than $400 million in trading commissions each year, making SAC one of Wall Street's best clients.

For years, the relentless trading was highly effective. SAC Capital Management LP, Mr. Cohen's largest and oldest fund, launched in 1992, has generated an average annual return to investors of 43.5%, after he takes a sizable cut of profits. He and his partners keep 50% of that fund's gains, along with a 3% annual fee, far more than the 20% and 2% charged by most managers.

Mr. Cohen's colossal compensation inspired cocky traders who figured they could do the same, and dismayed others who disdained the frenetic momentum-style investing that underpinned the bull market of the 1990s. His net worth is estimated at about $3 billion, which SAC does not dispute.

In 1998, Mr. Cohen and his second wife, Alex, 42, bought his gated 1920s fieldstone estate for $14.8 million. They added a 12,000-square-foot annex with a basketball court and an indoor pool, and an outdoor skating rink. They constructed a 20-seat movie theater and decorated the ceiling of its lobby with the pattern of stars on their wedding night 16 years ago. Outside, they laid out a two-hole golf course, formal gardens and an organic vegetable plot.

They bought $700 million of art and adorned the estate with some of the pieces. A Keith Haring sculpture of three painted aluminum dancing figures stands out front. A $52 million Jackson Pollock hangs in the library. A Van Gogh and a Gauguin, both bought recently for a total of $100 million, grace the living room. An Andy Warhol and a Roy Lichtenstein hang in the foyer.

The spending spree fueled carping that new hedge-fund wealth was altering the fabric of Greenwich, long a home for the very rich. Mr. Cohen's inclination to keep to himself caused people to brand him a recluse.

Mr. Cohen, a self-described cynic, is given to self-deprecating humor. He describes himself as a regular guy who just wants to be left alone. He says he likes to eat grilled-chicken sandwiches at Top Dog, a local hot-dog stand, and to kick back at night in front of reality television shows. "I'm not reclusive," he says. "I'm out and about. I have seven kids. That takes time...I'm not an introvert. I'm media shy. They turn what should be an admirable trait into something bad."

David M. Russell

Steven Cohen and his wife, Alex, at the Top Dog restaurant in Cos Cob, Conn.

His wife Alex, who says she and her husband worry constantly about the safety of their children, shrugs off criticism of the house. "I don't need a house this big," she admits. "But you know what? Why not? I'd rather my kids have a playground here."

On the recent afternoon, their home was a whirl of activity. Mrs. Cohen's parents and a nephew were there, as were the four Cohen daughters, including twins, all of them school-aged. (Mr. and Mrs. Cohen have three older children by previous marriages.) There was a cook, a housekeeper, the couple's personal assistant, a caregiver for the children, Mr. Cohen's personal trainer and his driver, who doubles as a bodyguard. The driver minds the family's four dogs, one of them an imposing German Shepherd named Johnny that once worked as a police dog.

Mr. Cohen says his work week typically begins after dinner on Sunday night, when he talks to his portfolio managers to set his trading strategy for the coming week. On weekday mornings, he climbs into a black Chevrolet Suburban and is driven to SAC's headquarters -- a modern steel-and-concrete structure with a facade of terra cotta and glass that overlooks the Long Island Sound.

The art collection there contains edgy contemporary work. "Self," a sculpture of a human head carved from the frozen blood of the artist, Mark Quinn, is housed in a refrigerated plastic cube. A sculpture of an alien wearing a Japanese school uniform and carrying a book bag, by Takashi Murakami, stands next to a table in his office. A 11¾-inch working elevator by artist Maurizio Cattelan is built into a wall just outside. "I like things that make me laugh," says Mr. Cohen of the offbeat work. "I like seeing people's reactions. Art is a great diversion from looking at numbers."

Although SAC now employs more than 600, Mr. Cohen still spends much of his time at the office trading. By 8 a.m., he is usually planted at his trading station, where he stays glued for most of the day. He monitors stock, bond, commodity and currency markets on his screens and taps out email and instant messages to some of SAC's 225 portfolio managers and analysts, as well as to traders outside SAC. Mr. Cohen's own trading still accounts for 15% of the firm's profits. Portfolio managers feed him investment ideas and fill him in on chatter about what other hedge funds are doing. "He is in the center and cherry-picks the best ideas," says a former SAC manager.

A video camera and microphone stay trained on Mr. Cohen so traders and managers who don't sit nearby can pick up what he is saying and doing, including his frequent sarcastic comments, known as "Steve-isms." Often the traders mimic his trades in their own portfolios. "On bad days, I leave it on all day so that when things get crazy, I can make sure we are doing everything we need to support Steve," says Thomas Conheeney, SAC's chief operating officer.

Mr. Cohen grew up middle-class in affluent Great Neck, N.Y. His father was a dress manufacturer in New York's garment district, and his mother was a piano teacher. There were eight Cohen children. He traces his ability to cull meaning from stock-market dissonance to the commotion in his crowded house. "I learned how to listen and concentrate," he says.

His relationship with his parents was sometimes difficult, he says. He began playing poker frequently as a high school student, he recalls, and would sometimes arrive home at 6 a.m. after an all-night game, hand the car keys to his father, then head to bed without saying a word. Mr. Cohen says his mother never acknowledged his success. She "thought I was smart but lazy," he says, and up until her death last year, considered his younger brother Donald to be the family's financial expert.

Mr. Cohen excelled in school and at the card table. "I'd look at his desk in the morning and see wads of $100 bills," says Donald, 47, now an accountant in Florida. The summer before his junior year, he quit his job cutting fruit at a local grocer for $1.85 an hour to concentrate on cards. Mr. Cohen says poker "taught me how to take risks."

At the University of Pennsylvania, he studied economics, played poker and took an intense interest in the stock market. An acquaintance helped him open a brokerage account at Gruntal & Co., he says, and he began trading with $7,000 he was supposed to use to pay tuition. He began watching the "tape" of stock-market action at a brokerage office near campus. Eventually, he sold enough of his positions to pay his overdue bills.

In 1978, he landed a job trading options at Gruntal, where he eventually managed a $75 million portfolio and six traders. His approach to investing stood out. "He was trading 50,000 shares at a time, which was unique [because it was so large], and he did it by watching the tape," says Gregg Frankel, who was Mr. Cohen's broker at Jeffries Group Inc. in the early 1980s.

On Oct. 20, 1987, one day after stocks plunged more than 22%, Mr. Cohen bet $50 million of the firm's money on stocks he thought were priced too low by New York Stock Exchange auctioneers, known as specialists. "He saw what was going on and said, 'I'm going to make my money back,' " recalls Jon Merriman, a trader who worked for him then. Stocks rallied that day, and Mr. Cohen's positions helped Gruntal recover losses.

In 1992, Mr. Cohen left Gruntal to launch a hedge fund with $20 million of his own money. During the 1970s, hedge funds had gained traction among wealthy investors, who jumped at the chance to have brainy commodities and currency traders manage a slice of their fortunes. By the early 1990s, managers such as Mr. Robertson, Mr. Soros and Michael Steinhardt had become financial-world stars by posting huge returns from risky, leveraged bets.

Mr. Cohen's timing was perfect. The hedge-fund industry was still relatively small in 1992. The big bull market of the 1990s, which eventually minted a new generation of star managers, was just beginning to gather steam.

Mr. Cohen was unknown outside Wall Street trading circles, and some investors balked at the fees he planned to charge. He initially attracted just $13 million from outside investors. He started with about a dozen traders and portfolio managers jammed back-to-back in a small office on Wall Street. During the first year, his assets doubled, and his investors earned a return of 17.5%.

By 1995, SAC's assets had more than quadrupled. Mr. Cohen moved its headquarters to Stamford and began to branch out. He hired two "quantitative" traders to work with computer models that scoured the markets for stocks that appeared underpriced or overpriced based on certain market data. SAC would bet that these price discrepancies wouldn't last.

When Long-Term Capital Management, a big hedge fund, collapsed in 1998 and the price of many securities sank, Mr. Cohen pounced. From late August until mid-October, he stayed up late making bullish bets via the Globex 24-hour trading system, routinely arriving at the office with exhaustion etched on his face. For the year, SAC had returns of 49.2%, compared to an average of 2.6% among hedge funds, according to Hedge Fund Research. "At the end of that year, people began to realize he had something special going on," says George Fox, who has allocated money to SAC for

10 years through a fund-of-funds, which invests in hedge funds.

SAC's assets ballooned to nearly $1 billion in 1999. Mr. Cohen hired dozens of new traders and analysts to introduce new trading strategies and investment themes: health care, bond trading and "macro," which involves betting on global economic factors such as shifting currency rates.

He installed a psychiatrist, Ari Kiev, part-time in an office off the trading floor, and told traders Dr. Kiev could help them overcome such weaknesses as fear of taking trading risks. "Most people trade with a notion of avoiding failure," says Dr. Kiev, who says he teaches traders "skills for mastering their own discomfort."

Some portfolio managers who didn't cut it were fired. SAC traders began betting on who would survive.

In 1999 and 2000, during the technology boom, SAC generated returns to investors of 68.1% and 73.4%, respectively, and copycat funds began to spring up.

Mr. Cohen and the growing hordes of rapid in-and-out speculators sparked debate. Shareholders who bailed at the first sign of trouble forced companies to focus on short-term performance. When hedge funds bought and sold huge blocks, small investors sometimes got whipsawed -- leaving some with the impression that a mysterious game was being played outside of their view.

Muttering began that fast-trading managers like Mr. Cohen enjoyed an unfair advantage over Main Street investors -- that they were, in essence, playing cards with a rigged deck. The substantial business they brought to Wall Street trading desks, critics speculated, gave them access to morsels of information unavailable to small-time investors -- confidential information about what companies and other investors were planning to do.

As Mr. Cohen's star was rising, some established hedge funds, including Mr. Robertson's Tiger Management and Mr. Soros's Quantum Fund, were losing their luster. They had prospered by making large bets on stocks, bonds and currencies based on deep research. Now they were eclipsed by a new breed of speculators. In 2000, Mr. Robertson returned money to investors, and Mr. Soros scaled back his involvement with his fund.

"The old guard wasn't crazy about me," says Mr. Cohen. "I used to hear it all the time." Some old-school managers disdained any investing that wasn't based on corporate fundamentals. "We were trading more than investing, and people frowned on it," Mr. Cohen says. "They looked at it and didn't want to partake. Finally, they said, 'Shoot. He's making money.' And they started copying me."

Some critics raised more serious questions. Two years ago, Mr. Robertson spoke to a group of interns at **UBS** AG, the Swiss banking giant. In response to a question, Mr.

Robertson told them he had the impression that some of Mr. Cohen's trading practices were improper, although he didn't provide specifics.

SAC was dogged by chatter that it pays hefty trading commissions in exchange for preferential access to market-moving information, an accusation SAC officials contest. Others suspected it of "front-running" -- finding out from outside brokers about other investors' planned trades, then buying or selling before those trades caused stock prices to move.

"People took shots at me," says Mr. Cohen. "SAC has a lot of people. We're active in the marketplace and people assume we know something....People thought I front-ran everything." SAC denies it has ever engaged in front-running.

Mr. Cohen regularly invited Wall Street officials to his offices to show them his operation. At one such meeting, a senior UBS stock-sales executive said: "We know the type of guys you are," Mr. Cohen recalls. "The inference was we were not trustworthy guys." Mr. Cohen says he asked the executive to leave, and didn't trade much with UBS for months afterward.

In 2001, the SEC began probing whether an SAC trader, Michael Zimmerman, had attempted to profit from advance knowledge of stock-research reports published by Lehman Brothers Holdings Inc., where his then-fiancé, Holly Becker, worked, according to a regulator familiar with the matter. The SEC also informally looked into whether SAC profited by front-running, this person says. The commission ultimately closed the Zimmerman probe without taking action, and it dropped the latter issue, this person says.

In February of this year, **Biovail** Corp., a Canadian pharmaceutical company, sued SAC and other hedge funds, alleging they conspired to drive its stock down by influencing analysts to put out negative research reports. The suit, filed in New Jersey state court, claims SAC "ghost wrote" the negative reports put out by a research firm, helping SAC to make money on a bet it had made that Biovail's stock would decline. The suit alleges a pattern of such behavior. An SAC spokesman calls the allegations "outrageous and defamatory."

SAC has never been accused by regulators or other authorities of any wrongdoing.

In the bear market that followed the technology-stock bust, the air of invincibility that had hovered over Mr. Cohen began to disperse. The stock market was tumbling. It was getting harder and harder to make a quick profit by darting in and out of stocks. Eventually, he found himself at a turning point.

The catalyst was an enormous loss. In October 2002, SAC lost $100 million on **Tenet Healthcare** after it bet that the company's regulatory problems concerning its Medicare pricing weren't as severe as perceived by the market. When Tenet disclosed it had overcharged the government for Medicare services, its stock tumbled to $15 from $50 within days. SAC's flagship fund notched a return of 11.5% in 2002, its lowest annual return ever.

The number of hedge funds was mushrooming, and many were pursuing short-term trading strategies similar to SAC's. To make matters worse, in 2001, the New York Stock Exchange began trading all stocks in one-cent increments, abandoning the fractional system in which stock prices moved in larger increments of 1/8 and 1/16 of a dollar. Mr. Cohen says the change made it more difficult to make money with rapid-fire trading because it got rid of some of the inefficiencies that traders had exploited.

One morning, Mr. Cohen woke up with numbness in his arm. A doctor told him he needed surgery on his neck, and in September 2003, he had a disk removed. After the operation, he says, he briefly stopped breathing. He was saved, he says, after a private nurse he had hired to be in his room noticed the problem.

"I think there was a change after his surgery," recalls Mrs. Cohen, who says her husband "came out and looked at everything differently." Mr. Cohen says he has since grown closer to his siblings, and for his 50th birthday, he and his wife took their first lengthy vacation without their kids.

Over the years, many styles of investing have proven to have finite shelf lives. When too many investors start doing the same thing, that tactic often stops working well.

SAC's difficulties, particularly its ill-fated Tenet investment, led Mr. Cohen to rethink his approach. As he recuperated at home, he says, he decided to move more decisively away from short-term trading. He set up an SAC unit called "Intrinsic" and staffed it with 30 analysts to hunt for longer-term investment ideas. Mr. Cohen began investing in small- and mid-cap companies in the health care, energy and technology sectors.

SAC took a big position in **Google** Inc., betting that its profits would grow faster than Wall Street expected. The investment, begun in late 2004, netted SAC a $100 million profit. SAC now owns just $11 million of the stock, according to a recent regulatory filing. In January, SAC bet that **Arcelor** SA, a Luxembourg steel company that trades in the U.S. as American depositary receipts, would be acquired. The wager made SAC $75 million when Arcelor announced on July 7 that it had agreed to be acquired by **Mittal Steel** Co. NV.

SAC now hangs onto stocks for an average of six to twelve months. That might not qualify as long-term investing to Mr. Buffett, but it far exceeds the norm of several years ago -- often just a few weeks.

The payoff, thus far, has been solid, although not as dazzling as in the boom years. In 2003, SAC's flagship fund yielded 18.1% for investors, less than the 19.6% average hedge-fund return reported by Hedge Fund Research. In 2004, the fund returned 22.9%, far exceeding the 9% industry average, and in 2005, it returned 18%, compared to 9.3% for the industry. Through August of this year, despite the market turmoil that cost the firm $150 million on June 12, the SAC fund notched an 18% return. The average hedge fund was up 7% over that period, while the S&P 500 rose 2.7%.

Because Mr. Cohen is still outpacing the market and his hedge-fund peers, his reputation with investors remains intact. Late last year, he launched a $2 billion fund. SAC only accepted a fraction of the money that investors wished to put in, according to people familiar with the situation.

Mr. Cohen concedes that holding investments longer and betting bigger could lead to lower returns. A year ago, SAC told investors the fund was aiming to return between 10% and 15% a year, people familiar with the matter say.

That isn't the only risk. These days, many of Mr. Cohen's big bets are popular with other hedge-funds. SAC's top holding in August, **Time Warner** Inc., is held by 79 other hedge funds, according to Goldman Sachs Group Inc. Atlanta-based energy company **Mirant** Corp., another big holding, is held by 97 hedge funds. If the funds tried to bail out of these stocks en masse, share prices would likely tumble.

Mr. Cohen says he worries about whether SAC's investments are beginning to look like those of any other hedge fund. What's worked for SAC in recent years, he says, may not work going forward.

On June 9, around midday, Mr. Cohen walked off SAC's trading floor and slumped into a chair. The markets had been choppy all week. He was growing more certain that stocks were in for a significant decline, but ventured that it was more than a year away.

"The hedge-fund run is not over," he said. "I think the game is changing, and if it is, I have to react. We won't go off the ledge with everyone else."

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