Top Hedge Fund Managers Earn Over $240 Million

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James Simons, a 69-year-old publicity shy former math professor, uses complex computer-driven mathematical models to make bets on stocks, bonds and commodities, among other things.

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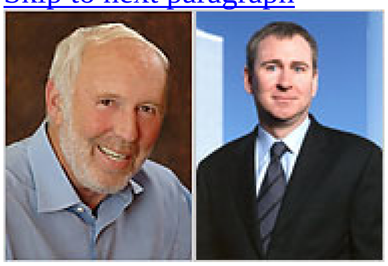
J.N. Bowles/Bloomberg News, right

James Simons, left, earned $1.7 billion in 2006, more than any other hedge fund manager. Kenneth Griffin, right, made $1.4 billion.

His earnings last year were $1.7 billion.

As one of the leading hedge fund managers, Mr. Simons makes a sum that dwarfs that of the top chiefs on Wall Street. The highest paid on the Street, Lloyd C. Blankfein of Goldman Sachs, earned $54.3 million in salary, cash, restricted stock and stock options last year. (Unlike the total for Mr. Simons, Mr. Blankfein's reported compensation does not include gains on investments.)

And Mr. Simons, the founder of Renaissance Technologies, is not the only member of the billion-dollars-a-year club.

Two other hedge fund managers, Kenneth C. Griffin and Edward S. Lampert, each took home more than $1 billion last year, with George Soros missing the hurdle by a hair, give or take $50 million, according to an annual ranking of the top 25 hedge fund earners by Institutional Investor's Alpha magazine, which comes out today.

The rewards for managing hedge funds — lightly regulated private investment pools for institutions like endowments and wealthy individuals — have been lucrative for some time. Yet the survey also shows that for the hedge fund elite, the rich are getting much richer in a hurry.

To make Alpha's list, a manager needed to earn at least $240 million last year, nearly double the amount in 2005. That is up from a minimum of $30 million in 2001 and 2002. Combined, the top 25 hedge fund managers last year earned $14 billion — enough to pay New York City's 80,000 public school teachers for nearly three years.

With the modern gilded age in full swing, hedge fund managers and their private equity counterparts are comfortably seated atop one of the most astounding piles of wealth in American history.

Their ascendancy has been aided by an inflow of money from pension funds and other big investors, robust markets and fee-based compensation that can produce staggering amounts of individual wealth.

Naturally, some look upon these masters of the new universe as this generation's robber barons, using wealth to create wealth, often in secretive ways, and leaving little that is tangible in their wake.

Others view them as new-economy financiers, evoking the likes of John D. Rockefeller or John Pierpont Morgan as they provide liquidity to the markets and broadly diversify risks in the banking and financial systems.

"You had railroads in the 19th century, which led to the opening up of the steel industry and huge fortunes being made," said Stephen Brown, a professor at the Stern School of Business of New York University. "Now we're seeing changes in financial technology leading to new fortunes being made and new dynasties created."

But as hedge funds and their private equity brethren begin to emerge more onto the public stage — playing increasingly bigger roles in art and cultural circles, tiptoeing into the Washington lobbying game, and even selling shares of their own firms to the public — all aspects of their activities, their own compensation in particular, are raising eyebrows.

"There is some question as to what the hell they are doing that is worth" that kind of money, said J. Bradford DeLong, an economist at the University of California, Berkeley. "The answer is damned mysterious."

Indeed, to some, it is difficult to see the value and the risks created by a hedge fund that bets billions of dollars on movements in everything from global currencies, stocks and bonds to real estate, reinsurance and complex credit derivatives. Recently, for instance, the House Financial Services Committee held hearings focusing on the potential risks to pensioners and the financial system caused by hedge funds.

Yet many, including past and current Federal Reserve chieftains, argue that they are greasing the wheels of capitalism.

While the debate rages, the new financiers are building up piles of money not seen since the heady days of the Internet boom. But unlike the wealth of many dot-com billionaires, who saw their fortunes collapse with the technology bubble, the gains of hedge funds are not simply returns on paper that fluctuate with the direction of the stock market. Instead the gains are huge cash payouts that most managers then reinvest in their funds, betting that they will continue to beat the markets.

Still, the performance of these managers is as varied as their strategies, ranging from complex computer models to the more old-fashioned version of betting the farm on a few stocks. None of the managers contacted for this article returned calls or would comment.

For its rankings on compensation, Alpha magazine includes the managers' share of the firm's management fees, usually 2 percent, and performance fees, or a share of the profits, which typically start at 20 percent.

That structure means that some hedge fund managers can still earn a huge income even with mediocre returns because of the huge size of the assets under management. Raymond T. Dalio, head of Bridgewater Associates, which has more than $30 billion in hedge fund assets, for example, took home $350 million last year even though his flagship Pure Alpha Strategy fund posted a net return of just 3.4 percent for the second consecutive year.

The magazine also includes gains made on hedge fund managers' own capital in their funds. Mr. Simons, for instance, has more than $1 billion of his own money invested in his funds.

Topping Alpha's list for the second consecutive year, Mr. Simons, a former code breaker for the Defense Department, uses computer-driven models to detect pricing anomalies in stocks, commodities, futures and options.

Even though he has some of the highest fees in the business — 5 percent of assets under management and 44 percent of profits — he trounces most of his competitors year after year. In 2006, the $6 billion Medallion fund posted gross returns of 84 percent; 44 percent after fees, explaining his $1.7 billion take.

Some investors do not blink at paying those startling fees. "If you pay peanuts, you get monkeys," said Jim Dunn, a managing director with Wilshire Associates, an investment advisory firm. "We don't concern ourselves with fees. If you can provide Alpha, I'm less concerned about what you bring home." (Alpha is producing returns that are not tied to a market benchmark like the Standard & Poor's 500-stock index.)

While Mr. Simons makes his mark using algorithms, the two other billionaires on this year's list are building distinctive institutions.

Mr. Griffin's Citadel Investment Group of Chicago is often cited as a budding Goldman Sachs, and Mr. Griffin himself is playing an increasingly public role in Chicago, with causes ranging from art to education.

Citadel employs 1,000 people, more than half of them in technology, and runs businesses serving hedge funds and another making markets. Mr. Griffin's funds, with returns of more than 30 percent, helped net him a nifty $1.4 billion.

Compare that with the elusive Mr. Lampert, who has $11 billion of his $14.6 billion ESL fund in the retailer Sears Holdings. Last year, Sears stock rose and with it, Mr. Lampert's fortune by about $1.3 billion.

And if the Internet age was defined by youth, the hedge fund age illustrates that experience indeed pays.

The average age of Alpha's top 25 was 51, with only four thirty-somethings on the list. Among them is John Arnold, the 32-year-old from Centaurus Advisors who amassed net gains of 200 percent last year.

Mr. Arnold hails from Enron's energy desk, where he received a lifetime of trading and other experiences. His $3 billion fund, among the largest energy funds in the world, racked up huge gains by taking the other side of a natural gas bet that caused Amaranth to lose more than $6 billion in a week.

But older, more familiar names dominate Alpha's list. Boone Pickens, the 78-year-old oil tycoon, made $340 million on the back of strong returns at his energy funds and Carl C. Icahn, 71, the reborn activist investor, made $600 million.

With a greater proportion of the assets in the hedge fund industry controlled by fewer managers, some investors worry that managers are at a turning point. The same young and brash managers who achieved huge successes are now controlling vast sums of assets, and the incentive may be to protect their wealth rather than take risks to increase it.

"I think one of the significant issues of this business that we are all struggling with is that there is an inverse correlation between compensation and drive," said Mark W. Yusko, president of Morgan Creek Capital Management, an investment advisory firm. "In many cases the incredible wealth that is created by this incentive compensation structure has a propensity to dull the senses and dull the drive."