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RECKONINGS / By PAUL KRUGMAN

A Hedge Fund Pruned

Only 18 months ago Julian Robertson's Tiger Management had $22 billion in capital, and could leverage that capital into huge speculative positions. Whole nations trembled at the prospect that the mighty hedge fund might attack their currencies or stock markets. But by last week, between heavy losses and withdrawals by disillusioned investors, Tiger was down to $6.5 billion; and on Friday Mr. Robertson announced he was closing up shop.

One need not cry for the humbled speculator, whose reduced personal fortune is still a 10-digit number. Indeed, quite a few people would like to see him suffer a bit more. Mr. Robertson is famed for his temper and his deliberate coarseness. And personal issues aside, Tiger's biggest successes involved profiting from economic distress, and -- if you believe the complaints of some Asian governments -- in some cases deliberately creating it.

But the reporting on Tiger's demise was surprisingly sympathetic. Some of the stories seemed to cast Mr. Robertson as a victim, the defender of genuine economic values against irrational hype. And that is apparently how he sees himself: he was withdrawing, he said, "from an irrational market, where earnings and price considerations take a backseat to mouse clicks and momentum."

In some ways he has a point. He bet heavily, and disastrously, against Japan. Japan's fundamentals still look very dubious, and the recent enthusiasm of Western investors for its stocks arguably reflects herd mentality more than rational assessment. He also bet heavily against "new economy" stocks, and the beating the Nasdaq
took last week, while too late to save Tiger, may provide some
intellectual vindication. Still, Mr. Robertson’s complaint about
irrational, momentum-driven markets is ironic because he himself
could not have thrived if markets were as rational as he now
complains they aren’t.

First, the whole reason for a hedge fund’s existence is the supposed
ability of its managers to spot market errors -- stocks, currencies and
so on that are priced either too high or too low given the
fundamentals. The idea then is to engage in arbitrage -- buying the
underpriced assets, selling the overpriced.

This strategy can make huge returns for the fund’s investors, but it
can’t work if markets get the prices right in the first place.

But there is also a deeper sense in which Mr. Robertson is a creation
of the momentum investing he now decries. The phenomenon of the
investor who suddenly, after years of incredible success, loses his
touch is a common one. A notable recent example was Victor
Niederhoffer, who went under just after publishing a best-selling,
self-congratulatory memoir. Each time the market wonders what
happened. And each time one possible answer is that he never had
that touch to begin with.

Imagine asking 10,000 people to guess the result of 10 coin-tosses in
a row. For sure several will have perfect scores, but that does not
reflect any special talent for coin-tossing. Now imagine giving
hundreds of money managers the chance to bet on market events
year after year, firing the ones who guess wrong. Those who remain
will have extraordinary forecasting records, even if they have no
special talent for forecasting.

I don’t want to say Mr. Robertson never knew what he was doing. In
the early days of Tiger, when it was small enough to research and
speculate in small companies, the story may have been different. But
by the 90’s, the inflow of money from eager investors who thought
past success guaranteed future gains made Tiger too big to play that
game. Mr. Robertson shifted his focus to "macro" bets -- attempts to
forecast the future of whole classes of stocks, even whole
economies. And there are no consistently good macroeconomic
forecasters -- only bad forecasters who get lucky.

(That includes me.) Fifteen years ago Mr. Robertson may have
known things about XYZ Inc. that the rest of us did not; but he’s no
more knowledgeable about Japan, or the future of tech stocks, than
thousands of other people.

And someone who repeatedly bets on what are, for all practical
purposes, random coin tosses is bound to be disappointed. He may
win several times in a row -- correctly guessing, for example, that Asian stocks are about to tumble -- but if he comes to believe in his own prescience, and stakes his whole capital on each toss, sooner or later he is bound to come to grief. And so he did.