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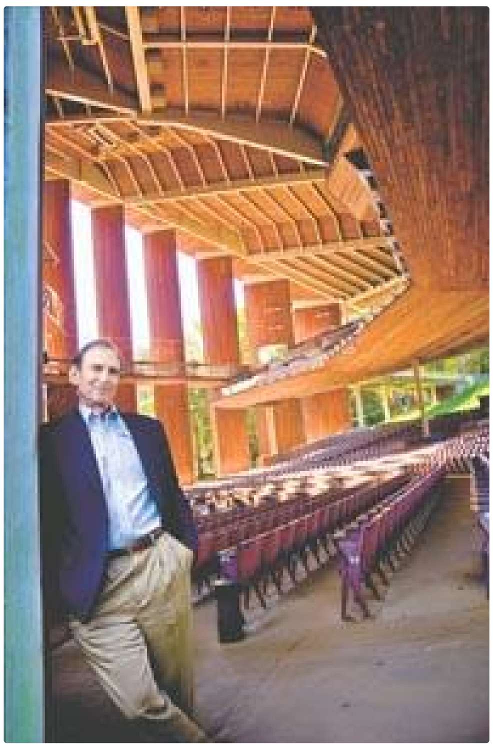
PROFILE

From Pain to Profits

By Brian Blackstone Oct. 27, 2008 12:01 am ET

BEING AN AVID TRIATHLETE HAS HAD ITS ADVANTAGES for hedge-fund founder and manager John Jacquemin. For one thing, he thought in terms of three -- that is, the meltdowns in housing, commercial real estate and junk bonds -- in crafting a strategy for his **Mooring Intrepid Opportunity** Fund. Competing in some 25 triathlons taught him a few things about pain, too.

Because of that strategy, investors in Intrepid Opportunity and the manager's other funds have suffered relatively little pain in the past year or two, even as credit markets seized up and equity prices tumbled.



Triathlete Jacquemin knows all about endurance -- for money managers and bear markets.
Nicholas McIntosh for Barron's

Jacquemin, 62, shorted, or bet against, the real-estate market, financial stocks, consumer spending and even oil -- a departure from a quarter-century's worth of bargain-hunting as head of Vienna, Va.-based Mooring Financial. (He's shown at left at Vienna's famed Wolf Trap theater, where he is on the board of directors.)

Now he expects his gloomy macroeconomic bet to keep generating profits for Mooring Intrepid Opportunity, which has returned more than 124% since its inception 19 months ago, notwithstanding a rare decline in September.

"These past two years were the first time we've decided to try to profit from recognizing bubbles," Jacquemin says.

His investment thesis, laid out in 2006, was predicated on three developments: the bursting of the housing bubble, with its ripple effect on consumer spending; a steep slump in commercial real estate; and a pullback in the high-yield market, where the average yield on junk-bond issues now approaches an astronomical 15%.

Jacquemin started the $50 million Intrepid Opportunity Fund in March 2007, when investors in his nearly decade-old **Mooring Capital** Fund -- mostly wealthy individuals in the Washington area who must invest a minimum of $250,000 -- balked at this strategy, which uses volatile derivatives contracts. In the larger Mooring Capital Fund, with $70 million of assets, the manager holds distressed debt and long and short equity positions.

Starting in early 2006, Jacquemin "looked for companies [with] the biggest portfolios of subprime or lower-quality home mortgages." Initial short positions included Washington Mutual and Countrywide Financial, when shares of both where in the 40s. He also shorted bond insurers MBIA (ticker: MBI) and Ambac Financial Group (ABK).

The combination of distressed debt and long/short equity positions has helped Mooring Capital Fund post average annual returns of about 12% for nearly a decade. But in late 2006 and early '07, Jacquemin saw a chance for even greater returns.

Indexes had been created that gave investors the ability to bet on credit-default risk in residential mortgages, junk bonds and commercial-real-estate loans, and those indexes -- the ABX for housing, CMBX for commercial real estate and CDX for junk bonds -- seemed like the "perfect vehicles for a pure play on a repricing of risk," he says.

All three, which trade over the counter, essentially allow investors to buy or sell insurance against defaults. Buyers of such insurance, like Jacquemin, benefit when defaults, or expectations of defaults, rise. Jacquemin says his firm is one of the smaller players in this market, which is dominated by larger hedge funds and investment banks.

MOORING CLOSED OUT ITS ABX index investment a few months ago -- at a profit of about $6.3 million. Jacquemin thinks there was more to be made, but the carrying cost didn't justify the limited gains that remained. That's not true, however, for his short CMBX and CDX bets, which now make up about 80% of his Intrepid Opportunity Fund.

"Commercial real estate is just starting to be recognized as a trouble area," Jacquemin says. "We're amazed it has taken this long."

By shorting the CDX index, Jacquemin is betting that the gap between Treasury and junk-bond yields will widen further. When he first established the position, junk bonds were trading at just 240 basis points, or 2.4 percentage points, above Treasuries. Now they're yielding around 1,000 basis points above Treasury yields, and the gap could grow when "substantial" defaults come through, he says.

Jacquemin founded Mooring Financial in 1982, after graduating from Penn State and then the Tuck School of Business at Dartmouth, where he sits on the board of overseers.

He focused first on commercial-equipment leasing, moving into the distressed-asset-management business in the 1990s almost by accident. In 1991, Mooring had an equipment deal in place with a bank that was taken over by the Federal Deposit Insurance Corp. He lost the equipment contract, but the experience led him to pursue purchasing loan portfolios at a discount.

Mooring Capital Fund has seen declining revenues in recent years from that distressed-debt portfolio. But Jacquemin has compensated by taking short positions in financial stocks, credit-card issuers and even oil, when it was at $140 a barrel.

Distressed debt still accounts for about 75% of the Capital Fund's assets, down from as much as 95%. Including tax-lien funds (which purchase liens on real estate with unpaid tax obligations), Jacquemin manages about $350 million to $400 million of assets.

A CORNERSTONE OF Jacquemin's economic outlook is a bearish view on consumption, which he doesn't expect to get back on track until home prices stabilize. That forecast, alas, was supported by disastrous automobile and retail-sales reports for September -- which could worsen in coming months.

For a consumer recovery to gain traction, home prices need to strike a better balance with incomes to improve affordability; Jacquemin reckons it will take another 15% drop in average home prices to do that.

Meanwhile, expect credit-card defaults to keep rising, he says. In the past six months he has taken short positions in American Express (AXP), Capital One Financial (COF) and Discover Financial Services (DFS).

Even as Washington injects hundreds of billions of dollars into the banking system to spur new lending, Jacquemin sees no end yet to the credit crisis engulfing the economy and the financial markets. "Friends asked me, 'Should I buy Wachovia?' three months ago, or this or that financial stock," Jacquemin says. "I've said 'No' consistently, it's not over yet. And I still feel that way."

The hedge-fund manager has learned to live with added market volatility, as have other investors. That's a by-product of the unprecedented efforts by Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson to thaw out the frozen credit markets.

Jacquemin, whose offices sit only about 20 miles from the Fed and Treasury buildings, has high praise for these financial chiefs. "What the Fed and the Treasury are doing maintains liquidity and prevents panic, and that's healthy for all of us," he says. "But what the public and many investment professionals seem to think is that this is going to solve the economy's problems. I don't believe that."

During a recent *Barron's* interview with Jacquemin, the Dow Jones Industrial Average climbed about 350 points, led by financials. CDX index prices jumped, pulling the Intrepid Fund down about 5% in one day.

Such volatility "affects our positions day-to-day dramatically, depending on what the 10% movement du jour is," Jacquemin says, letting a tiny bit of his native French slip in. His family moved to the Philadelphia suburbs from Paris when Jacquemin was six, and he still has family in France. A foundation he set up focusing on early education also helps provide scholarships to Penn State students studying abroad.

Although Mooring employs about 45 people, mostly in the distressed-debt and tax-lien businesses, Jacquemin relies on a small circle of four or five advisers for his economic and market strategy. He also counts heavily on anecdotal evidence, which served him well two years ago, when he thought housing would go belly-up. The fast-growing outer-D.C. suburbs in Virginia, where Jacquemin lives and works, were home to some of the frothiest housing bubbles in the region.

Jacquemin explained why he bought dollars this summer -- a profitable move -- this way: "My wife and I and one of our daughters went to Paris in late July, and I couldn't believe how expensive everything was." He didn't make a killing on that trade, but it paid for the trip, he jokes.

NOT ALL OF JACQUEMIN'S predictions have panned out: "I predicted that, by late 2007, we'd have plenty of opportunities to buy distressed assets. It hasn't happened." Abundant liquidity, coupled until recently with a growing number of hedge funds bidding on distressed assets, along with the slow pace of bank closures in this downturn, have kept distressed-asset prices too high for Jacquemin's taste.

The manager also failed to pull the trigger on a hunch that shipping rates would tumble along with the global economic outlook. Jacquemin may come back on the buying end by investing in shipping companies. "I think we'll be on the lookout, if and when" the global economy deteriorates further, he says.

In Jacquemin's view, it could take another two years for the U.S. economy to recover fully, and the distressed-debt arm of his business may prove the leading indicator of a turnaround. "We'll continue to bid [on distressed assets], and when we start winning deals, that will be an important sign that the market is turning," he says.

At this juncture, the U.S. has finished only the swimming leg of the economic triathlon. A monster uphill bike ride and a difficult run are still to come.

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