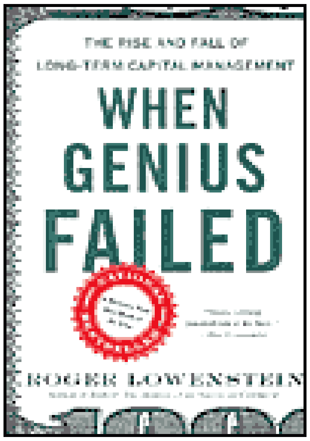

<u>When Genius Failed: The Rise and Fall of Long-Term Capital Management</u>, by Roger Lowenstein, 2000.

"In late summer the partners were among America's most prosperous, most successful, and most highly esteemed investors. Their fund had $3.6 billion in capital, of which two fifths was personally theirs. It would take only five weeks for them to lose it all."

This story is a classic treatise on the dangers of the heavily leveraged derivatives markets, the belief in diversification as the means to reduce risk, and using past volatility as the measure for future volatility.

"The securities might be unrelated, but the same investors owned them, implicitly linking them in times of stress. The very concept of safety through diversification – the basis of LTCM's own security – would merit rethinking." *Pg. 42*

"LCTM's traders knew the historic volatility – that is, how much bonds had fluctuated in the past. But this was a highly mechanistic way of evaluating risk. It relied on past volatilities as a gauge of the future: as usual, the partners driving LTCM had their eyes on the rearview mirror. The correlations had gone to one. They had forgotten that people moved by greed or fear are capable of extreme behavior and swings of mood so often observed in crowds. The belief that tomorrow's risks can be inferred from yesterday's prices and volatilities was LTCM's basic mistake, and its stunning losses betrayed the flaw at the very heart – the very brain – of modern finance." *Pgs. 63, 68, 173, 235*

"When the spreads widened by 12 to 20 times what they expected LTCM was caught off guard. True, it had happened in 1987 and again in 1992. But LTCM's models didn't go back that far." *Pg 146*

At its zenith, "Long Term (LTCM) boasted $134 billion is assets. In just over four years, an investment in the fund had quadrupled." *Pg. 131*

In September of 1998, "LTCM's equity was down to $1.5 billion. In that one month, LTCM had lost six tenths of its capital, one of Wall Street's epic collapses. 181 It wasn't just LTCM that was on the hook – it was all of Wall Street. 189 With just under a billion dollars, the fund still had more than $100 billion in assets. Thus, even omitting derivatives, its leverage was greater than 100 to 1. The markets tumbled again, knocking LTCM's capital down to $400 million – 91 percent below its level of January 1." *Pgs. 181, 189, 191, 210*

"Recapitalized with a fresh $3.65 billion [from 14 banks the Fed had arranged to bail them out], LTCM continued to plummet until Fed Chief Alan Greenspan cut rates for a second time." *Pgs. 221 & 222*

"Greenspan's more serious and longer-running error has been to consistently shrug off the need for regulation and better disclosure with regard to derivative products. Deluded as to the banks' ability to police themselves before the crises, Greenspan called fro a *less burdensome* regulatory regime barely six months after it. Banks have repeatedly shown that they will exceed the limits of prudence if they can. The Fed's two-headed policy – head in the sand before crisis, intervention after the fact – is more misguided when viewed as one single policy." *Pg. 231*