MarketWatch

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To Say Goodbye

If you thought getting into a hedge fund was tough, try getting out of one. With the markets sputtering, some high-profile hedge funds are rejecting withdrawal requests, with some telling investors that it could be years before they will see all their cash again. And it isn't just big institutions and the wealthy that are getting rebuffed. Some smaller investors who took advantage of lower minimum investments by putting their cash into so-called funds of funds, which invest in numerous hedge funds, are also getting blocked.

The funds justify the moves by saying that if they sold positions to return the money to some investors, it would cause deep losses for all. Some funds putting up "gates" – or measures that prevent their investors from withdrawing all their money at once -- haven't lost very much this year, yet worry that if some investors pull out, the rest will, too.

To be sure, so-called lockup policies are standard fare among hedge funds, with many firms reserving the right to restrict redemptions for periods of one year or longer. But there is concern in the industry that some funds could be dragging their feet on returning money to keep their businesses going, enabling them to continue to charge often-hefty fees. Many hedge funds charge management fees of about 2% and take 20% or more of any gains.

"It's a double-edged sword: You have to be able to ride out difficult markets, and a gate helps a fund do that," says **Brad Alford**, founder of Alpha Capital Management, an investment-advisory firm in Atlanta that invests in hedge funds. "But they're also protecting their franchises, their businesses and livelihoods."

In the last month or so, billion-dollar hedge funds managed by D.B. Zwirn & Co., Pardus Capital Management LP, Drake Capital Management LLC and Tisbury Capital Management have told investors that they can't have all of their money back just yet.

Meanwhile, Russell Investments has told investors in two of its funds of funds that they can have only 10% of their money back right now, with the rest available down the road, after losses and investor withdrawals forced the huge investment firm to close the funds.

The moves by the funds are legal. When investors sign up, they usually give a hedge fund the right to bar the exits, or limit the amount that can be withdrawn. But the gates are still catching some people by surprise.
Investors who signed those papers "never for a moment" thought they wouldn't be able to get out, says **Daniel Alpert**, managing director of Westwood Capital LLC, a New York investment bank. But when a number of hedge funds were hit Asset Spike hard in the market turmoil of recent months, they quickly learned otherwise. "It's a beautiful model," says Mr. Alford. "I wish I could tell my clients they can't leave."

It is a painful reminder of the dangers of investing in hedge funds, which are more lightly regulated than mutual funds and other investments. More individuals have turned to hedge funds in recent years as their wealth grew and they became eligible to invest in these vehicles. Under Securities and Exchange Commission rules, investors are judged able to make riskier investments, such as place money in a hedge fund, if they have assets of at least $1 million or income of more than $200,000 in each of the two most recent years. Those with joint income with a spouse exceeding $300,000 also are eligible to invest. In recent years, more firms have set up funds of funds, giving individuals more options in this area.

Hedge funds are hanging on to money as more have suffered problems. The average fund has lost 2.8% this year through the end of March, according to Chicago data tracker Hedge Fund Research Inc. That is much better than the Standard & Poor's 500's loss of 9.4% in that same period, but worse than the 2.2% gain in Lehman Brothers' main bond index.

Yet many hedge funds have moved into real estate, private equity, hard-to-trade debt and other investments that are difficult to sell on a dime at a reasonable price, particularly in a jittery market. So when investors ask for their money back, it can create difficulties.

Some investors have moved to withdraw money even from secure funds as fears grow about all kinds of financial firms.

Some funds are trying to slow the redemptions to avoid the type of situation that felled brokerage firm Bear Stearns Cos., which ran into deep problems after nervous clients bolted.

Polygon Investment Partners, for example, has seen an increase in exit notices in the past month at its $8 billion Polygon Global Opportunities Fund, even though it was down only 4% through the end of March, hurt by losses on investments tied to merger deals.

The Anglo-U.S. firm is looking to move investors into a new share class that would have more-favorable rules on redemptions, rather than the first-come, first-served system that currently limits withdrawals. This could reassure investors that they can get their money back down the line, rather than feel pressure to place a withdrawal request to beat other investors to the exits.

As more funds block the door to investors, there seems to be less of a stigma attached to it, some say, potentially encouraging others to do the same. Some view this as plain wrong. "Once you invoke a gate, you should become a pariah," Westwood's Mr. Alpert says.