DOW JONES
Hedge Fund Trades

CHARTING THE STRATEGIES OF ABSOLUTE RETURN MANAGERS — JUNE 12, 2006

EQUITY

Hola Hedge Funds: Playing The Univision Sale

The Spanish language broadcaster is a hot property: Two private equity groups are wooing it, and analysts are looking for a possible premium to the $40-a-share reserve price. p. 2

EQUITY

Wireless Backhaul Draws Big Fund Following p.3

First Avenue Networks and XO Holdings have majority hedge fund investors who are betting that large carriers will need backhaul services as they carry more data.

Summer Blockbuster: Funds Flock To MOVI, BBI p.4

Ownership of Movie Gallery has shifted from mutual funds to hedge funds, which seem to be counting on the prospect that things won't get any worse.

Funds Took Big Positions In US Home Builders In 1Q p.5

The slide in the sector may well have caught funds with large positions. However, some may also see long-term value or a chance to press for share buy-backs.

REGULATORY

SEC Eyes UK Move To Separate Fund Trading Costs p.8

FOREX

Emerging Markets' Survival Of The Fittest p.9

COMMODITIES

Gold Participants Sniff Deeper Price Correction p.10

EQUITY

Pirate Capital Asks OSI To Spin Off Some Restaurants p.11

DEBT

Credit Protection And VIX Flashing Red p.12

EQUITY

Harbinger Sues To Block Granite Broadcast Station Sales p.13

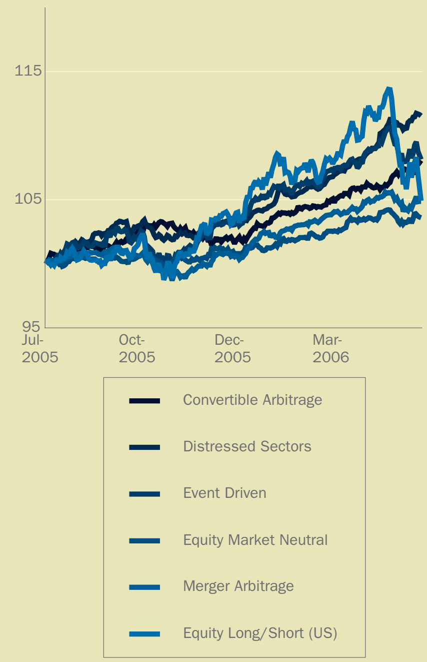
DEBT

As Emerging Markets Tumble, Credit Default Swaps Gain p.14

METRICS

Dow Jones Distressed Securities Index p.6

DJHFSB Daily Estimates (52 wk)*



DJHFSB Weekly Returns

Index	Value	Week (%)	YTD (%)	52-wk (%)
DJ Wilshire 5000	45.03	-1.2	1.95	8.83
DJ Corp Bond Index	185.65	0.56	-1.44	-2.5
Convertible Arbitrage	125.77	1	5.98	9.62
Distressed Securities	163.59	0.09	7.35	13.71
Equity Market Neutral	104.24	0.1	2.6	3.81
Event Driven	131.51	-0.41	4.55	10.55
Merger Arbitrage	118.31	0.21	4.18	5.58
Equity Long/Short	107.08	-2.37	1.3	6.74

As of 06/07/06

*** Estimates normalized to reflect $100 invested in each index at start of 52-week cycle.**

The above listing of Dow Jones Hedge Fund Strategy Benchmarks (DJHFSB) components is current as of the date stipulated.

Source: DJHFSB

Hola Hedge Funds: Playing The Univision Sale

The Spanish-language broadcaster is a hot property: Two private equity groups are wooing it, and analysts are looking for a possible premium to the $40-a-share reserve price.

BY MARA LEMOS STEIN

As private equity groups line up to bid for Univision Communications Inc., hedge funds are piling into the stock to capture the premium that the eventual sale would bring to the trade.

The rationale for the bet that a deal will be closed is straightforward: the Los Angeles-based company has great growth potential in an otherwise sluggish sector, and the eventual buyer would have room to cut costs and leverage the deal. Besides, one of the two bidding groups includes rival Mexican media company Grupo Televisa S.A., which already owns around 11% of Univision and has been keen on getting control of the largest Spanish-language media company in the U.S.

Owing to the company's market capitalization of around $11 billion, the stakes are high. Hedge funds have taken sizable positions in the hope that Univision will get more than its asking price of $40 per share.

"It's a prime property, and Univision is the Big Kahuna in Hispanic broadcasting so, based on scarcity value and market share, it should be worth a premium," said Roy Behren, a portfolio manager at **Westchester Capital Management Inc.**, a Valhalla, N.Y.-based investment manager of several merger-arbitrage funds. "We are hoping for a deal north of $40 [per share]," he said.

Continued on page 17

Wireless Backhaul Draws Big Fund Following

■ *First Avenue Networks and XO Holdings have majority hedge fund investors who are betting that large carriers will need backhaul services as they carry more data.*

BY JOSEPH CHECKLER

If wireless backhaul is really the next big thing, it should be no surprise that hedge funds are the investors making the biggest bet on the technology. After all, they like to get in on the ground floor of any new or emerging technologies. Wireless backhaul involves the use of fiber-optic cables and microwave radios to "backhaul" data traffic from communications devices like cell phones to the wireless networks to which those devices are connected.

But in the case of two wireless backhaul companies - First Avenue Networks Inc. and XO Holdings Inc. - hedge funds aren't just making the biggest bets; they're practically the only ones making bets.

Rarely do competing companies have such hedge fund-dominant shareholder bases, but that's the case with First Avenue and XO, each of which is more than three-quarters owned by hedge funds. Some of the funds were creditors when the two companies - or the components from which they were formed - filed for bankruptcy, back when their technology was usually called "wireless spectrum."

The funds have just held onto the large stakes they got from the restructuring, and some hold board seats at the companies. Other funds have bought into the stocks more recently, hypothesizing that the time is near for First Avenue and XO to start forming key partnerships with major U.S. wireless carriers.

"The larger [hedge funds] that own the positions understand the market," said Seth Potter, an analyst at Punk Ziegel & Co., who doesn't own any shares of First Avenue. Wireless backhaul is needed because as communications companies offer more data services, more bandwidth becomes necessary.

First Avenue provides wireless network technology for Cingular Wireless LLC in New York, and Potter said such agreements are advantageous for carriers because, in other cases, carriers like Cingular would have to pay competing carriers to use their towers. First Avenue passed its first test in its Cingular partnership earlier this year, when none of its network links went down through the largest snow storm in New York City's history. Potter said the likelihood of similar partnerships in the future is what makes wireless backhaul such a hot area.

In looking at the investors in First Avenue, it might be quicker to list the hedge funds not involved than to list the ones that are. One that most certainly is involved is **Aspen Advisors LLC**, a subsidiary of **Georgica Advisors**. Aspen is the top shareholder, owning 33% of the company. It is followed by technology and communications hedge fund **TCS Capital Management**, which owns more than 15% after buying almost 1 million shares at prices between $13.07 and $13.41 from May 30 to June 1.

Quaker Capital Management and **Peninsula Capital Advisors** each owns more than 5% of the company, and they bought more shares as recently as May 16. Quaker and Peninsula are part of a group of creditors - along with **Ramius Capital Group** and TCS - that helped Advanced Radio Telecom Corp. emerge from bankruptcy as First Avenue on April 1, 2002. As a result, Mathew Teplitz of Quaker and Ted Wescholer of Peninsula serve on First Avenue's board. All of these hedge funds either declined to comment or did not return calls seeking comment.

First Avenue has seen its stock shoot up from less than $10 in April to as much as $15 since its May announcement that it was merging with rival FiberTower, a privately held San Francisco-based company that will help First Avenue get into rural markets. Once the combined company - which will be called FiberTower - is created, Potter said he expects some deals between it and wireless carriers.

Hedge Funds **Botti Brown Asset Management** and **Scoggin Capital**

Continued on page 18

Summer Blockbuster: Funds Flock To MOVI, BBI

Ownership of Movie Gallery has shifted from mutual funds to hedge funds, which seem to be counting on the prospect that things won't get any worse.

BY JOSEPH CHECKLER

Movie Gallery Inc.'s stock finally rallied last week, and some opportunistic hedge funds - rather than disenchanted mutual fund investors - were the beneficiaries.

Ever since the video retailer's stock started its tumble last spring from more than $30 a share down to single digits, mutual funds have been cutting their losses and hedge funds have been replacing them. On Sept. 30, 2005, according to filings, only one of the company's top 10 institutional owners - **Caxton Associates** - was a hedge fund. As of March 31, 2006, that number was up to four.

In the first quarter some funds began to take first-time positions in the stock, including Laurence Lebowitz's **HBK Management** - which bought 950,000 shares - and **Highland Capital Management** - which bought 605,000 shares. Neither firm would comment on their positions.

With some funds' also emerging as holders of Blockbuster Inc., "my guess is people who are taking positions are of the opinion that the stocks are down enough," said Stern Agee & Leach Inc. analyst Arvind Bhatia, whose firm makes a market in Movie Gallery shares.

Movie Gallery, which traded at less than $3 in early March, jumped above $7 last week for the first time this year. With no specific news accompanying the jump, analysts at the time attributed it to rumors about a possible sale of Movie Gallery to Blockbuster Inc.

But a distinct possibility is that investors selling Movie Gallery shares short were squeezed and had to cover their shares.

"I think the last few days we had a short squeeze," said Bhatia. "I don't think the trends have really changed that much to warrant that kind of move." He was referring to the 20%-plus rise in the stock June 5 and the further climb June 6 to a $7.02 closing price.

Short interest in Movie Gallery, which represented more than half the company's 32 million outstanding shares as of March 13, decreased by more than 2 million shares in both April and May, thanks in part to stronger earnings and restructuring of debt covenants.

Whatever the reason for the seemingly temporary pop in Movie Gallery's stock price, an interesting hedging strategy seems to have emerged in video retailing: go long Movie Gallery and Blockbuster - both of which are still trading near all-time lows - and hope that one or both of them gets hot.

One hedge fund that was employing that strategy but seems to have abandoned it was **Prentice Capital Management**, an "SAC cub" fund formed by former **SAC Capital Advisors** retail/consumer portfolio managers Michael Zimmerman and Jonathan Duskin. Prentice, as of the end of the first quarter, owned 8.5% of Movie Gallery, 7.7% of Blockbuster's Class A shares and 5.7% of Blockbuster's Class B shares.

> **"If regulators didn't allow [Blockbuster] to buy just Hollywood, I don't know how the regulators would allow them to buy [the combined] Hollywood and Movie Gallery."**
>
> *Arvind Bhatia, analyst, Stern Agee & Leach Inc.*

But anonymous sources said Prentice sold all of its 2.7 million shares of Movie Gallery some time in May. It appears **Schultze Asset Management** is the fund that bought those shares - either directly from Prentice or otherwise - because, according to filings, Schultze purchased 2.7 million shares between April 1 and May 11. Schultze is now the largest institutional shareholder of Movie Gallery, and the fund also owns some of the debt-laden retailer's convertible bonds. Schultze said it would not comment on its positions, and an e-mail to Duskin of Prentice

Continued on page 16

Funds Took Big Positions In US Home Builders In 1Q

The slide in the sector may well have caught funds with large positions. However, some may also see long-term value or a chance to press for share buybacks.

BY MARIETTA CAUCHI

Shares in U.S. home builders have fallen sharply so far this quarter, a period that began with large hedge funds holding some of the biggest stakes in the beleaguered sector.

Sophisticated investors such as **D.E. Shaw & Co.**, **Citadel Investment Group LLC** and **Lone Pine Capital LLC** bought shares even as commentators warned of a slowdown in the sector, leaving them among the largest holders of shares in companies such as Toll Brothers Inc., Pulte Homes Inc., D.R. Horton Inc. and Centex Corp.

It's hard to know how exposed the funds were to the share-price moves. Many use complicated strategies, and it's unknown whether their home-builder holdings were part of broader, balanced positions or otherwise hedged. It also isn't known how many of the shares the funds may already have sold off. Still, the positions were large, and the shares have sunk.

Citadel, for example, held more than 9.4 million shares in D.R. Horton on March 31 - the latest date for which data are publicly available - after adding about 2.7 million shares in the first quarter, according to FactSet Research. The position was worth $313 million on March 31. At June 16's close, it was worth $92 million less. U.S. funds **Glenview Capital Management LLC** and David M. Knott Partnership also featured in D.R. Horton's top 10 holders.

D.E. Shaw, meanwhile, more than doubled its position in Centex in the first quarter and held more than 1.1 million shares on March 31, according to FactSet. The value of those shares has fallen by more than $18 million, to about $52 million at June 16's close. The fund also held significant positions in Toll Brothers, Pulte and Beazer Homes USA Inc.

Meanwhile, smaller outfit **Tontine Associates**, which had a total of $7.2 billion in its equity portfolio as at March 31, counts seven home builders among its top 13 holdings.

Tontine bought nearly 4.7 million shares of Toll Brothers in the fourth quarter and boosted that position to about 6.9 million shares as of March 31, according to FactSet. At that date, the fund also held more than 6.6 million shares in Centex, up more than 70% in the first quarter, and nearly 8.2 million shares in Pulte, up more than 20%.

Altogether, the value of those holdings was worth more than $717 million at June 16's close, down from more than $965 million on March 31.

None of the individual funds would comment on current positions or specific strategies employed. Each is variously described as a "growth" or "value" fund, which essentially means their managers go long on stocks seen as undervalued while shorting those they perceive as overvalued or otherwise hedging in other markets or with derivatives.

> **"These deep-value guys hang onto stocks because they still look cheap, the companies are better run, and the industry is mostly consolidated."**
>
> *Jim Bitzer, senior portfolio manager, EGM Capital LLC*

Experts say these players still may view the stocks as cheap because of the companies' inherent earnings power and feel they won't return to the dismal prices of 20 or so years ago. Shares in the sector are trading below six or even five times this year's earnings, according to FactSet.

"These deep-value guys hang onto stocks because they still look cheap, the companies are better run, and the industry is mostly consolidated," says JimBitzer, senior portfolio manager at **EGM Capital LLC**, a San Francisco based hedge fund with some $200 million under management.

Bitzer thinks the earnings power of home builders is vastly inflated and

Continued on page 16

METRICS

Dow Jones Distressed Securities Index

as of 06/07/06

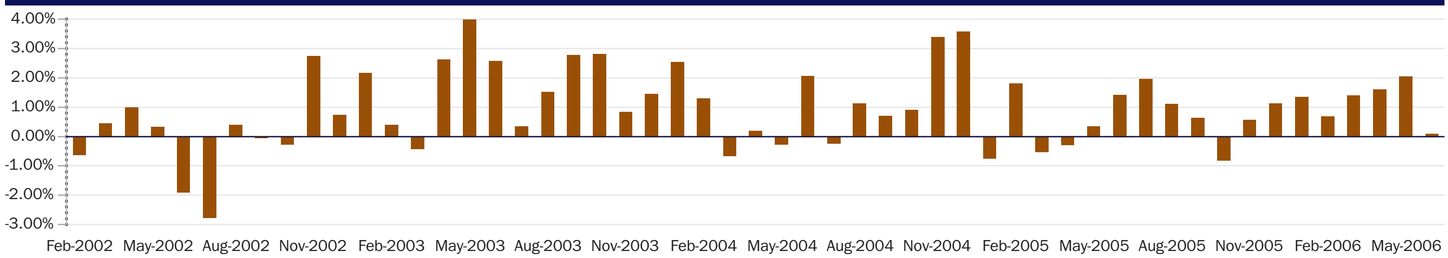
Each week, *Dow Jones Hedge Fund Trades* highlights one of six hedge fund investment strategies, compiled and tracked by *Dow Jones Hedge Fund Indexes*. Additional performance and information on the methodology can be found at www.djhedgefundindexes.com

Performance[1]

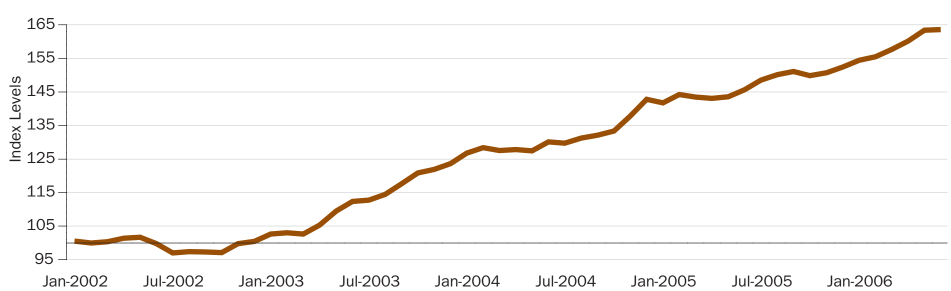
Index	One Month (%)	YTD (%)	2005 (%)	Since Inception (%)*	Vol. Since Incept.(%)*	Correl. w/DJW 5000	Correl. w/DJ CBI
DJHFSB: Distressed Securities	0.97	7.35	6.73	11.56	4.65	0.59	0.31
DJ Wilshire 5000 Float (DJW 5000)	-5.62	1.95	6.38	5.47	12.95	1.00	0.04
DJ Corporate Bond Index (DJ CBI)	0.19	-1.44	1.33	5.96	6.32	0.04	1.00

*12/31/01

Monthly Returns After Fees[1]

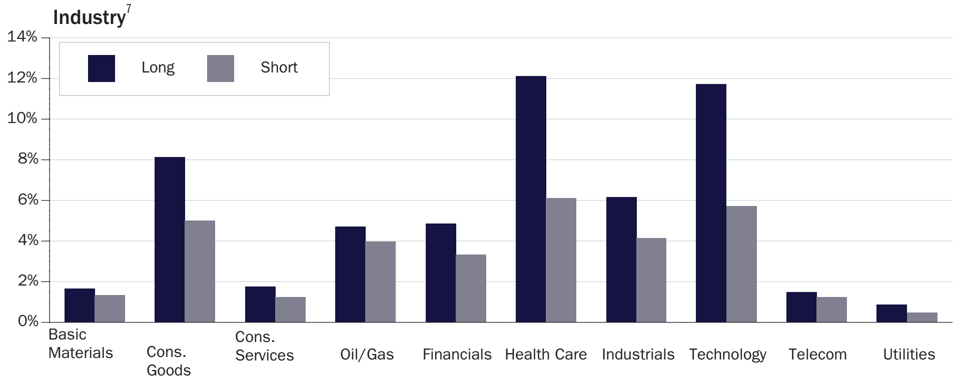


Benchmark Time Series[1]



Exposure: US Stocks and Corporate Bonds[6]

Industry[7]



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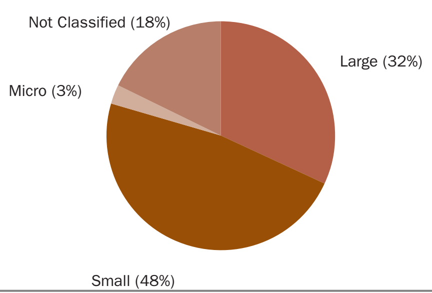

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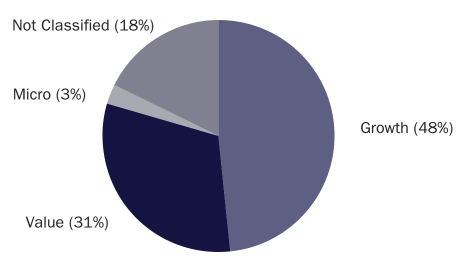


Characteristics

Pre-Fee Reduction (PFR) NAV: †	267.6 M
Exposure-based Leverage:[2]	87.8%
Liquidation-based Leverage:[2]	82.2
Non-Third Party Pricing Exposure:[3,4]	25.6
Non-US Exposure:[3,5]	4.9

† estimate

Asset Class Exposure

	Long (%)	Short (%)	Total (%)
Stocks	15.7	0.4	16.1
Bonds	47.9	4.0	51.9
Futures/Options	2.1	2.0	4.1
Cash/Other	22.3	3.4	25.7
Mutual Funds	2.2	0.0	2.2
Total	90.2	9.8	100.0

Notes

1 Performance is net of fees and is based upon estimates and is subject to change.
2 Exposure-based Leverage = (Long Position Value + Short Position Value) / Net Assets. Liquidation-based Leverage = Long Position Value / Net Assets. Both calculations measure the use of borrowed funds; the former from a risk perspective, and the latter from an accounting perspective.
3 Gross exposure (i.e. long position values + short position values).
4 Exposure to assets that are not priced by independent third parties.
5 Exposure to assets not traded in the U.S.
6 U.S. Stocks/Corporate Bonds represent approximately 52.17% of the gross exposure.
7 Uses the Industry Classification Benchmark (ICB). No ICB industry classification available for approximately 64.89% of U.S. Stocks/Corporate Bonds.
8 DJ Wilshire 5000 Index (DJW 5000) size and style classification. Not Classified implies not in the DJ Wilshire 5000 Index universe.

METRICS CONTINUED

Commentary

Distressed securities hedge funds have been the best performing funds among the six categories so far in 2006, according to the Dow Jones Hedge Fund Strategy Benchmark. Performance stands at 7.35% for the year, and over the past 52 weeks, returns are 13.71%, also top among the six strategies.

Obviously seeing more opportunities, distressed securities managers in the index have deployed more of their assets recently: May marked the fourth consecutive month that the funds lowered their exposure to cash/other and increased their leverage, which now stands at 80 - meaning they're deploying 80% of their assets.

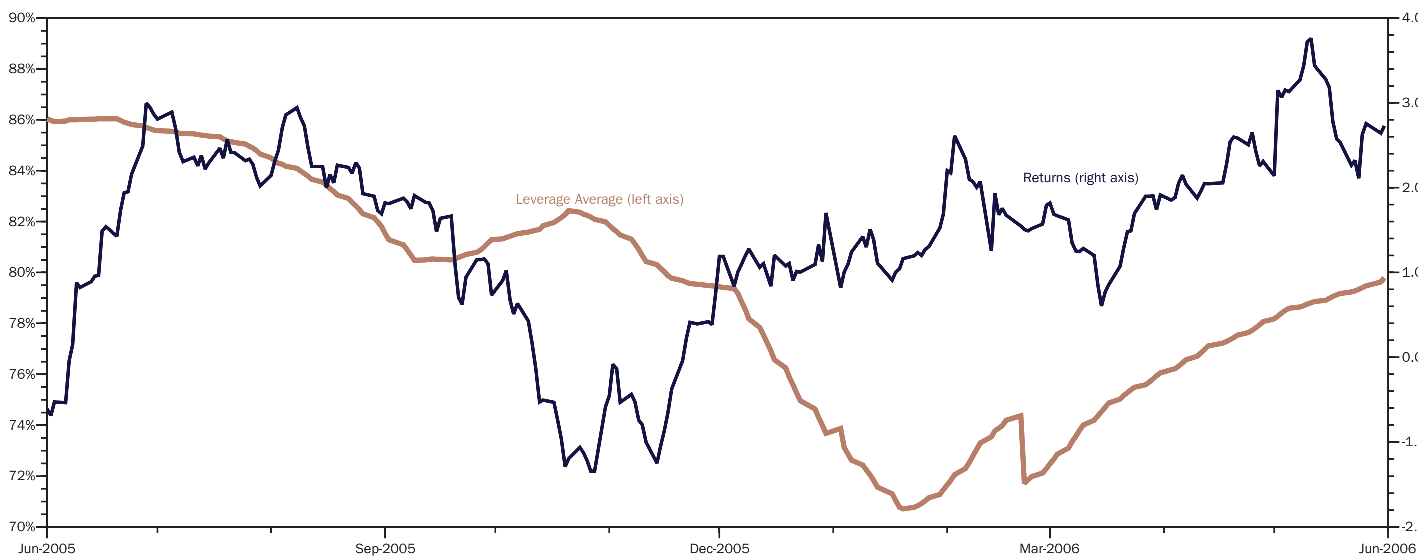
What the funds are doing with that money is another indication they're seeing more opportunities. The funds increased to a 12-month high their long exposure to both bonds and stocks during May.

Especially considering the recent prolonged slide in stock prices, distressed hedge funds might find even more opportunities as the year goes on. They're currently seeing the fruits of their labor in wireless backhaul companies like First Avenue Networks Inc. and XO Holdings Inc., stocks that have risen this year and that are majority owned by the hedge funds that took them out of bankruptcy (see story, page 3).

However, the fact that the funds are still not deploying all their assets seems to be a sign that the near future isn't being considered an empty-net goal. Los Angeles-based Dalton Investments in May closed down its two distressed-debt hedge funds and returned $300 million to investors, saying opportunities in the space had dried up.

One distressed debt hedge fund manager said, "What goes up can go down."

30 Day Rolling Returns And Leverage



Monthly Asset Class Exposure And Leverage†

	Stocks (%)				Bonds (%)				Futures/Options (%)				Cash/Other (%)				Mutual Funds (%)				Leverage (%)	
Date	Long		Short		Long		Short		Long		Short		Long		Short		Long		Short			
Aug 05	13.1	-	1.6	-	45.8	-	4.4	+	3.4	+	3.4	+	25.8	+	1.9	-	0.7	-	0.0	-	81	-
Sep 05	12.5	-	1.5	-	41.4	-	4.1	-	3.6	+	3.6	+	31.2	+	1.5	-	0.6	-	0.0	-	82	+
Oct 05	13.4	+	1.9	+	44.3	+	4.4	+	3.4	-	3.3	-	26.5	-	2.2	+	0.6	+	0.0	-	81	-
Nov 05	14.2	+	1.9	+	44.2	-	4.7	+	2.3	-	2.2	-	27.8	+	2.2	-	0.6	+	0.0	-	79	-
Dec 05	11.4	-	0.6	-	43.0	-	3.3	-	2.8	+	2.8	+	33.0	+	2.5	+	0.6	+	0.0	-	77	-
Jan 06	12.9	+	0.3	-	42.8	-	3.4	+	2.6	-	2.6	-	31.9	-	2.9	+	0.6	-	0.0	-	73	-
Feb 06	14.0	+	0.4	+	44.0	+	3.8	+	2.0	-	2.0	-	29.5	-	3.7	+	0.6	-	0.0	-	74	+
Mar 06	14.2	+	0.6	+	46.3	+	3.3	-	1.6	-	1.6	-	27.2	-	4.6	+	0.6	-	0.0	-	77	+
Apr 06	14.7	+	0.6	+	48.5	+	3.4	+	2.0	+	2.0	+	24.7	-	3.3	-	0.6	-	0.0	-	79	+
May 06	15.7	+	0.6	-	48.6	+	3.4	-	2.1	+	2.2	+	23.7	-	3.1	-	0.7	+	0.0	-	80	+
Change In Levels *(Percentage Points)*																						
12 months	2.0		-1.7		1.6		-0.7		-1.2		-1.1		0.5		0.5		0.0		0.0		-6	
12 Months																						
Avg	13.6		1.2		45.3		3.8		2.7		2.7		27.3		2.7		0.6		0.0		79	

Notes

† All exposures are expressed as a percent of gross exposures (i.e. long position + short position values) and based on the aggregated positions of component managers and are averages of the daily exposures over the month. Leverage = Long Position Value / Net Assets. The leverage calculation measures the use of borrowed funds from a liquidation perspective.

EQUITY

Micron: Lexar Holder Glenview Capital To Support Merger

Micron Technology said Lexar Media shareholder **Glenview Capital Management** will vote in favor of Micron's sweetened offer for the memory chip firm.

Glenview has voting authority or control over 6.35 million Lexar shares, Micron said in a filing to the Securities and Exchange Commission.

Under terms of the agreement announced June 12, Micron will now offer Lexar stockholders 0.5925 of a share of its stock for each outstanding share they own, up from the initial offer of 0.5625 of a share. ■

EQUITY

Back Yard Burgers Rejected Funds' Takeover Proposal

Back Yard Burgers Inc. said that it rejected a takeover proposal from **BBAC LLC**, **Cherokee Advisors LLC** and Reid M. Zeising, who own a total of 428,757 shares, or 8.67%, of the company's stock.

According to a filing with the Securities and Exchange Commission, Zeising, who is chairman of BBAC and managing member of Cherokee, sent a letter to Back Yard Burgers Chief Executive Lattimore Michael in November saying that a BBAC unit would buy all outstanding shares for $5.75 to $6.10 a share.

Zeising, on behalf of BBAC and Cherokee, updated the offer to $6.00-$6.10 in December, and suggested the company's board hire a financial advisor to review BBAC's proposal.

The second proposal was followed by a meeting between Zeising, another BBAC director, Michael and

REGULATORY

SEC Eyes UK Move To Separate Fund Trading Costs

BY ARDEN DALE

Fund managers in the U.K. are moving to meet a June deadline to disclose separately the fees they pay for stock research and trading, and Wall Street is watching closely.

Rules adopted by the Financial Services Authority in the U.K. require fund managers to report trading and research costs separately, with June 30 as the date by which all must comply. Fund managers who use commissions to buy other services for their clients are affected, said FSA spokesman David Cliffe.

The disclosures may be a harbinger of things to come in the U.S., where the Securities and Exchange Commission has been considering what to do about the use of soft dollars by financial firms. In soft dollar arrangements, investment advisers get products or services over and above trading in exchange for directing brokerage transactions to broker-dealers.

"It's going to affect our market because U.S. clients of U.K. investors who are getting this disclosure may ask their U.S. advisers for similar disclosure," said Robert Plaze, the SEC's associate director of the division of investment management. "We're interested to see how that develops."

The SEC has been communicating with the FSA throughout its shift to separate disclosure and watching to see how the process goes, Plaze added.

At issue is the related practice of unbundling, by which firms separate trading costs from those paid for stock research. Unbundling has been reshaping the way Wall Street commissions are paid and is seriously eroding the stock-research business. Research fees have traditionally been included with stock-trading commissions, paid by shareholders in mutual funds at companies such as Fidelity Investments. But some institutional investors are striking deals to separate out the fees and pay for research from their own cash, reducing costs for their funds' shareholders.

Though unbundling isn't mandated in either the U.K. or the U.S., both countries have pushed in that direction in their own ways.

Impetus in the U.K. has come from the FSA, which adopted the disclosure rules effective January 1, with a transition period ending June 30.

In the U.S., market forces, rather than regulation, have been the word of the day. Last year, Fidelity announced unbundling agreements with Lehman Brothers Holdings Inc. and Deutsche Bank Securities. Lehman has also indicated it is talking to other firms about doing similar deals.

The new disclosures in the U.K. are being made by fund manages to their clients, many of whom are pension funds, according to Cliffe, of the FSA.

British firms have broken into two general camps, according to Stephen Parker, chairman of Rontech, a London firm that offers software that tracks trading and research costs. "There are those that have basically made the numbers up - some have said 'This is no big deal, we'll have a 50-50 split, with 50 percent for trading and 50 for research,' and

Continued on page 19

another Back Yard Burgers' director to discuss the proposed acquisition, according to the filing.

Zeising resubmitted the second proposal to the company in April, providing additional information about BBAC and Cherokee.

According to a filing, Zeising received an email from Michael on May 23 stating that the company's board had reviewed the proposal and resolved to reject it. ■

FUND NEWS

Polar Capital To Launch Global Macro Fund

Polar Capital LLP said it has launched a global macro fund that will mainly focus on currencies.

The Polar Capital Discovery Absolute Return Fund, which started trading in May, marks the London-based firm's first foray outside of equities and potentially could help broaden its appeal to investors before an expected initial public offering later this year.

Polar Capital Chief Executive Officer Mark Kary said the new fund, which will trade currencies, bonds and commodities, as well as equities, is a "logical diversification." He declined to comment on whether the firm will seek a public listing.

The macro fund is managed by Paul Lambert, former global head of currency at Deutsche Asset Management, who joined Polar Capital late last year. It initially was seeded with $20 million, and Kary said it has the capacity to potentially grow to $1 billion in size.

The fund will invest in developed and developing markets, with about 70% of the risk expected to come from currency market investments.

Kary noted currency markets have been "difficult" for many investors during the past 12 months, since

FOREX

Emerging Markets' Survival Of The Fittest

BY AZAM AHMED

While the party may not be over for emerging market currencies, the guest list could get more selective.

Emerging market currencies, stocks and bonds have been roiled in the past weeks as investors turn risk averse in the face of tighter liquidity.

But what started as a broad and indiscriminate sell-off in emerging market currencies will likely transform into something more scrutinized, particularly as emerging markets recover.

"The second wave will likely be a differentiation among fundamentals in various economies where typically investors will focus on external account performances and policy measures," said Lawrence Goodman, emerging markets strategist at Bank of America in New York.

In what has been an environment of cheap money, investors have parked liquidity in emerging economies with relative impunity, and asset values in those countries have skyrocketed. As a result, at the first whiff of risk aversion, investors started to head for the exits.

Now, attention will focus on current-account deficits, the broadest measure of investment and trade flows, as well as fiscal discipline. Those emerging market countries that sport large deficits on this measure and which don't have their fiscal houses in order will find recovery from the recent sell-off an arduous process as they struggle to attract the funds needed to fund their gaps.

These countries could include Turkey, South Africa and Hungary, whose deficits have ballooned recently - Turkey's for example is close to 7% of gross domestic product. In contrast, countries with strong current account surpluses could benefit in the wake of the sell-off.

"China, Korea, Malaysia and Russia, to a significant degree, will continue to experience a strong external account performance that will not only likely insulate those countries, but could even provide potential for further appreciation," said Bank of America's Goodman.

On a regional basis, analysts expect that Asian economies will be the quickest to recover, then Latin American economies, and bringing up the rear will be the economies in Central and Eastern Europe.

The last group lacks commodity exports to curtail trade imbalances, and as result analysts say that they could be the slowest to recover and the last place investors venture back into once the sell-off completes.

The lack of commodity support is "one of the big things working against the Eastern European currencies," said Paul Barrett, head of foreign exchange trading at J.P. Morgan Private Bank.

"I think we'll see a much quicker return in some of the Latin American emerging market currencies compared to Eastern Europe," he added.

Chile, for example, has enormous income streams from copper and runs a current account surplus. Brazil exports iron, steel and soy, all valuable commodities that have helped the economy in addition to the government's efforts to maintain fiscal discipline. Mexico has oil.

Continued on page 18

bets the dollar would fall proved premature.

"People see [currencies] as an awkward place but we think it will be a very interesting place going forward. Based on what happened in May, we assume that volatility will rise and that should give rise to more opportunities," he said.

Kary declined to say exactly how the fund performed in its first month - a tumultuous one for financial markets - but said it was "very much a bedding-down month, and if the result is around negative 1% or plus 1% that for us would be perfectly adequate when launching a new fund into that sort of market."

Polar Capital has built up assets of more than $2.7 billion across 14 funds since it was established in 2001. Investment trust Caledonia Investments PLC holds about a quarter of the company while the rest is owned by its managers and employees. ■

EQUITY

Harbinger Capital Reports 5.8% Dana Corp Stake

Harbinger Capital Partners Master Fund I Ltd. reported holding a 5.8% stake in Dana Corp., which is under Chapter 11 protection, saying it acquired the shares for investment.

Harbinger Capital said it reserves the right to be in contact with members of Dana's management, board or other significant shareholders regarding potential alternatives to significantly increase shareholder value.

In particular, the investor reserves the right to influence the Dana's reorganization under Chapter 11 protection, according to a Schedule 13D filed with the Securities and Exchange Commission.

Harbinger Capital beneficially owns

COMMODITIES

Gold Participants Sniff Deeper Price Correction

BY JAMES ATTWOOD

Gold's retreat from last month's quarter century high may be about to gain pace as investors reassess the drivers behind the preceding seven-week rally, analysts said.

"The funds are getting nervous," said Darren Heathcote, head of trading at Rothschild Australia.

From late-March to mid-May the price of gold rose by a third to a 26-year high of $730.50/oz, largely driven by concerns over the dollar, tensions surrounding Iran's nuclear ambitions and the inflationary impact of rising crude oil prices.

But a commodity-wide pullback triggered by questions raised over global growth has seen the precious metal and de facto currency give up nearly half of those gains.

Traders attributed the selling to more signs the U.S. will continue raising interest rates, combined with an easing of Iran-U.S. tensions and crude oil prices.

Federal Reserve comments on inflation over the last two weeks have resuscitated waning expectations that the Fed might raise interest rates, which increases the dollar's appeal and reduces that of gold.

In addition, concerns over Iran's nuclear standoff, which played into gold's status as a safe haven asset, were alleviated slightly after U.S. President George W. Bush said Iran's initial response to six-nation incentive package "sounds like a positive step".

Partly as a result, crude oil prices have eased back to about $71 a barrel, in turn damping the metal's appeal as an inflation fighter.

The recent news flow, combined with some red flags in the metal's chart patterns, suggests gold requires further correction to step back into line with its macroeconomic and geopolitical drivers, participants said.

"The volatility of the last weeks shows the level of uncertainty in the market, and that smells of a more serious correction," said Rothschild's Heathcote.

"I wouldn't be surprised if it broke through $610, then into the mid-$500s," he said.

Robert Rennie, chief currency strategist at Australia's Westpac bank, agreed a move back through the $620-610 level would create some "pretty horrible objectives" in terms of potential losses of up to $100.

Adding further weight to a near-term bearish view on gold is traditional investor weakness in the Northern Hemisphere summer months, as well as weak physical demand as fabricators wait for clearer signs of price direction in what is essentially an investor-driven market.

However, neither chart patterns nor fundamentals are clear cut, traders said.

Pockets of buying support, particularly at the $595-$600 level, may ward off a deeper correction, while a resumption of the dollar's long-term downtrend or further inflammatory comments by either side in the Iran issue could renew the appeal of safe haven assets like gold.

Technically, a recovery of the $640-

Continued on page 13

about 8.7 million Dana common shares, according to the filing.

Toledo, Ohio-based Dana, which makes axles, frames and other large components for cars and commercial trucks, filed for Chapter 11 protection March 3. ■

REGULATORY

Canada Senate Committee Asks For Review Of Hedge Funds

A Senate committee has asked the Canadian government to undertake a review of hedge funds.

The Standing Committee on Banking, Trade and Commerce recommended that the federal government should appoint an "eminent person" conduct the review.

"This review should include a focus on appropriate regulatory oversight, and should be tabled in Parliament no later than March 31, 2007," the Committee said in a report. ■

EQUITY

Steel Partners Offers To Buy Stratos International For $7.50/Share

Stratos International Inc. shareholder **Steel Partners II L.P.** proposed to acquire all the common stock of the Chicago-based company for $7.50 a share, according to a letter sent to Stratos President and Chief Executive Phillip Harris.

Steel Partners, which owns about 15% of Stratos common stock, said the offer represents a 23% premium to Stratos' current market price of $6.09 a share.

"We believe we have exhausted all our efforts to privately discuss with the Board of Directors a value enhancing transaction in any meaningful way," Steel Partners said in the letter dated.

The shareholder also said it would

EQUITY

Pirate Capital Asks OSI To Spin Off Some Restaurants

Pirate Capital LLC, a major shareholder of OSI Restaurant Partners Inc., has asked the company to spin off some of its restaurants into a separate, publicly traded company to "unlock long-term shareholder value."

The Tampa, Fla.-based owner of restaurant chains formerly known as Outback Steakhouse Inc., operates Outback Steakhouses outlets as well as restaurants under names such as Carrabba's Italian Grills, Bonefish Grills, Fleming's Prime Steakhouse & Wine Bars, Roy's, and Cheeseburger In Paradise. The holding company's name was changed to OSI Restaurant Partners in April.

Investor Pirate Capital asked the company to spin off its Carrabba's, Bonefish Grills and Fleming's restaurants into a new unit or company, saying that the price of OSI shares fails to reflect the value embedded in those three restaurant concepts.

Hedge fund manager Pirate Capital on June 5 reported holding a 5.3% stake in the company, with beneficial ownership of about 3.9 million shares, according to an original Schedule 13D filed with the SEC.

In a letter sent to OSI that was included in a filing with the Securities and Exchange Commission, Pirate Capital also suggested that the company cease new-unit growth of U.S. Outback Steakhouses and other fledgling restaurants and repurchase at least 15% of the company's outstanding shares.

Pirate Capital said it is "troubled by the fact that OSI is quietly building Blue Coral, a new upscale seafood concept, continuing the build-out of the unprofitable Cheeseburger In Paradise concept, and continuing to grow domestic Outback units in the face of declining customer counts and key operating metrics."

Shares of OSI closed June 5 at $39.20 each, finishing up 5% or $1.92 from June 3's close, but still well below the 52-week high of $42.80 reached on Feb. 2. The stock soared June 5 after the SEC filing from Pirate Capital was released around 2:45 p.m. EDT.

OSI recently reported a 2.6% drop in its May same-store sales after a decline in first-quarter profit for the period ended March 31. The company has said its April and May results didn't meet expectations and, as a consequence, it will revise its guidance for 2006 earnings and same-store sales.

The company had expected income of $1.70 to $1.79 per share for 2006, compared with 2005 net income of $1.95 a share. OSI Restaurant said last week that it expects to provide revised guidance in late July when it reports its second-quarter results.

The company previously announced it was studying possible restructuring moves, including the spinoff of some brands, leveraging its real estate holdings and a potential share-repurchase program.

On May 23, the company sent a letter to Pirate Capital, saying that the review and implementation of these options may require much of the remainder of 2006. ■

nominate five candidates to the Stratos board.

As of Jan. 31, Stratos had about 13.9 million common shares outstanding. ■

EQUITY

DIS Shareholder Elliott Demands AGM Is Held Again

BY GORAN MIJUK AND ALEXANDER BECKER

U.S. hedge fund **Elliott Management Corp.** said it is demanding the recent annual general meeting of Deutscher Industries Service AG is held again and warned that it would ask for an extraordinary meeting if its demand wasn't met.

Elliott, which holds more than 10% in DIS, criticized the company's decision to delist its shares on the German stock exchange.

The delisting plan comes after temporary employment firm Adecco SA of Switzerland bought a near 83% stake in the German staffing company.

"The delisting decision is illegal because it was taken after midnight," a spokesman for Elliott told Dow Jones .

DIS AGM started on the morning of June 8. But because many minority shareholders took the opportunity to lash out against DIS's board, the AGM last around 15 hours and the key decision about the delisting was taken in the early hours of June 9.

Many shareholders criticized that DIS prematurely accepted Adecco's takeover offer. They also said that the delisting plan ran counter to shareholder interests.

As part of its delisting efforts DIS is offering the remaining DIS minority shareholders less than what Adecco offered other DIS shareholders who accepted the takeover terms.

Earlier, a lawyer representing

DEBT

Credit Protection And VIX Flashing Red

BY MICHAEL MACKENZIE

The bumpier things get for equities, so the pressure increases for a credit market that is now primarily driven by derivatives trading.

During the past few years, the explosive growth of credit derivatives has been extolled by Wall Street and many investors in helping them unlock and trade a company's stock and credit valuations.

Now with stock prices sinking amid uncertainty surrounding the outlook for Federal Reserve policy and the economy, the link between equities and credit derivatives is strong. Unless the situation stabilizes, corporate cash bonds, which remain relatively tight despite some softening in recent weeks, will have little choice but to follow the path being set by equity volatility and credit protection.

In trade Thursday, June 8, the Dow Jones CDX index of 125 credit default swaps that reference investment-grade companies, broke above the 43.00 basis point barrier, reaching a peak of 44.75 basis points. That move was sparked by a 13.93% jump in VIX to 202.8, a key measure of equity volatility traded on the Chicago Board Options Exchange CBOE.

Noting the bulk of credit activity now takes place in derivatives rather than cash bonds, Kevin Cronin, portfolio manager at Putnam Investment Management in Boston, said it's no surprise the CDX index is reacting first. "Corporate bond spreads will catch up," he said.

Since early May, when the index was trading at a record tight level of 34 basis points, pressure in equities and higher volatility had driven the CDX index to peaks of 43 basis points. Now with VIX moving above its previous intra-day peak of 19.87 on May 24, buyers of credit protection in the form of an index are dictating flows.

The source of this is twin-edged, centered on the Fed and the economy.

The current uncertainty surrounding just how far the Fed will keep tightening policy amid signs of a slower economy, has investors "reviewing their credit positions," said Cronin.

At stake is the nature of the recent moderation seen in some measures of economic activity, such as job hires, housing, manufacturing and retail activity.

"The big question for markets and the Federal Reserve is whether the economy is experiencing a soft patch, due to energy prices, or the late-term dynamics of the business cycle that represents a marked slowing of growth," said Gerald Lucas, trading strategist at Banc of America Securities in New York.

Still, with the Fed banging the table over inflation risks, despite also saying the economy is slowing, the odds of a 25 basis-point rate hike when the Federal Open Market Committee meets June 28 and 29 are around 80%. This suggests, barring a surprisingly benign May consumer price index reading next week, the central bank will push the federal funds rate to 5.25% from 5.00%.

That has only heightened concerns the FOMC risks overtightening policy

Continued on page 19

minority shareholders of DIS also said he would challenge the company's plan to delist its shares on the German stock exchange.

"We will challenge this plan and take it to court," Peter Dreier of Duesseldorf-based law firm Dreier & Riedel told Dow Jones. ■

EQUITY

Children's Investment Fund Boosts Stake In Chinese Toll Road

British hedge fund **The Children's Investment Fund** paid HK$250 million (US$32 million) this month to nearly double its stake in Chinese toll-road operator Zhejiang Expressway Co., Hong Kong stock-exchange data show.

The fund, with a reputation for shaking up management, notified the exchange that it had bought a total of 60.68 million Zhejiang Expressway shares at average prices of HK$3.996 to HK$4.321 (51 to 56 U.S. cents) each, according to the exchange.

The acquisition lifts TCI's interest in the company to 9.23% from 4.99% in May. ■

INDUSTRY NEWS

Currency Funds Show Growth For First Time In Four Months

Currency hedge funds posted gains in April after four consecutive months of losses, with the Parker FX Index reporting the sector's returns grew 0.50%.

For April, the index tracked the performance of 61 funds, of which 37 reported positive results and 24 incurred losses, the Stamford, Conn.-based currency fund-of-fund manager said in a statement.

Parker Global Strategies LLC's statement said April's gains came as the dollar declined broadly, falling after the finance ministers of the Group of Seven leading nations requested Asian currencies be

EQUITY

Harbinger Sues To Block Granite Broadcast Station Sales

BY PEG BRICKLEY

Distressed debt investor **Harbinger Capital** Master Fund moved for a court order to block Granite Broadcasting Corp. from going through with the planned sale of TV stations in San Francisco and Denver.

Owner of 38.6% of Granite Broadcasting's debt-exchangeable preferred stock, Harbinger says the deal is improperly structured to evade restrictions on the preferred debt issue.

The noteholder also says in court papers that the proposed sale of KBWB in San Francisco and WDWB in Detroit is a desperate effort to "stave off the looming event of default and inevitable bankruptcy" by New York-based Granite.

Granite, which has a history of losses, has said in filings with the Securities and Exchange Commission that its liquidity problems are severe.

In recent days, both Standard & Poor's and Moody's Investors Service cut ratings on $400 million worth of 9 3/4% senior notes due 2010.

A $19.7 million interest payment on the notes went unpaid when it came due June 1, and according to Harbinger, Granite has until June 30 to make good on the bond interest, or face default.

After earlier efforts to sell the stations for as much as $200 million fell through, Granite is now racing to put a $155 million deal in place with a consortium of private equity investors, including D.B. Zwirn.

D.B. Zwirn is identified in court papers as a major source of financing for two other Granite TV stations, a position that Harbinger says makes its role in the proposed buy of the San Francisco and Denver stations questionable.

"Harbinger believes that Granite was under duress to accept the first buyer that it could find," the investor's lawyers wrote. "Not surprisingly, a consortium that includes a major inside financing party was what Granite found."

The preferred stockholder asked Delaware's Court of Chancery to block the "extraordinarily hasty fire sale" of the two stations.

The way the deal is structured, Harbinger alleges, it would violate laws meant to keep insolvent companies from placing assets out of reach of creditors, as well as breach protections creditors bargained for.

Large debt issues usually include restrictions on major asset sales, designed to protect creditors from ill-advised moves that diminish the value of collateral. ■

Gold Price Correction

Continued from page 10

$645 level would go a long way to alleviate the pressure on gold, Rennie said.

And even if gold does backtrack to its pre-rally level around $550, its five-year overall uptrend is widely expected to remain intact.

In a report last week, Citigroup raised its price forecasts for gold, predicting the yellow metal would return to around $675/oz in the fourth quarter this year.

Gold could average $700/oz next year, up from a previous estimate of $560/oz, and $750/oz in 2008, up $580/oz earlier, Citigroup said. ■

allowed to appreciate and Federal Reserve Chairman Ben Bernanke implied that the Fed could be close to pausing in its two-year rate hike campaign.

The Parker FX Index tracks the performance, or value-added, managers have generated from positioning long or short foreign currencies. It includes 66 programs with over $16 billion in currency assets, managed by 45 firms located in the U.S., Canada, UK, Ireland, and Switzerland.

The top three performing funds in the index for the month of April, on a reported basis, were: the John W. Henry Dollar Program, up 9.68%, the Foreign Exchange Management Currency Portfolio, up 8.68, and the Richmond Global Currency Program, up 8.31%. The statement did not name the worst performing funds.

The uptick in April's results followed losses of 1.27% in March and 0.75% and 0.40% for February and January, respectively. It also came after the Parker Index showed returns of just 0.02% in the whole of 2005. That was up from a loss of 0.61% in 2004.

The Parker FX Index is a performance-based benchmark that measures both the reported and the risk adjusted returns of global currency managers. The 244-month compounded annual return since inception (January, 1986 through April, 2006) is up 13.91% on a reported basis and up 3.38% on a risk-adjusted basis. ■

PEOPLE NEWS

Citi's Chappuis To Head Morgan Stanley Unit

Morgan Stanley has hired Jacques Chappuis from Citigroup Inc. to run alternative investments in its global wealth management group, the retail brokerage unit that is expanding into hedge fund and private equity products for wealthy clients.

DEBT

As Emerging Markets Tumble, Credit Default Swaps Gain

BY MATTHEW COWLEY

When emerging market bonds succumbed to a bout of global risk aversion in May, investors turned to credit default swaps to protect their holdings.

These complex instruments, designed to provide bond investors with insurance against default, have become increasingly popular across all asset classes. With a shrinking pool of overseas emerging market debt due to buybacks and amortizations, the more liquid CDS market offers a valuable synthetic alternative.

"In many cases now the CDS market has more liquidity than the cash market," said New-York based hedge fund manager Hari Hariharan, who oversees about $2 billion in mostly emerging market assets for NWI Management. "It is a much more facile way for people to gain exposure to credits."

Investors holding bonds that are rarely traded know they probably won't get a decent price for them in a bear market, so they turn to CDS as a hedge, said Gautam Jain, a research analyst for Barclays Capital in New York. Or if they believe this is a temporary correction and don't want to sell bonds but nevertheless want a hedge, they may also look to CDS, he said.

When it comes to betting against the market, CDS are cheaper and more convenient than bonds, said Ricardo Simone, director of Brazilian hedge fund Multi Commercial Bank DTVM. Whereas in the traditional sense, investors have to borrow bonds and then sell them short, CDS packages that transaction together, he said.

But the rise in popularity of CDS has coincided with a more volatile environment in that market.

"In the last week we've seen wild swings," said Jain. On June 5, Brazil's CDS started out tighter by 10 basis points and then by midday were 10 basis points wider, which is "not trivial," Jain said.

As they move into the mainstream of emerging markets, CDS are still giving investors pause for thought, especially as they tend to offer different reads on the status of the market compared to more traditional gauges of risk.

"A vexing thing is the relationship between bond spreads and CDS spreads," NWI's Hariharan said. "At times you have disparities which don't really make sense. There has been some risk taking in the market which at times has been bewildering."

The most commonly-traded maturity for CDS is for five years. Brazil's five-year credit protection started May at around 125 basis points, meaning investors would pay $125,000 per year to insure $10 million of bonds. As the selling took hold, Brazil's CDS spread ballooned out to 220 basis points on May 24, according to GFI Group, an inter-dealer brokerage.

By comparison, Brazil's spread on JPMorgan's Emerging Markets Bond Index Plus has been less volatile, but remains considerably wider. The EMBI+ spread started May at 214 basis points over U.S. Treasurys, widened to 289 basis points by May 24.

Continued on page 19

Chappuis, who held a similar post at Citigroup, will report to Doug Ketterer, head of the wealth management group's managed money products team, according to an internal memo. He is expected to join in August.

Chappuis joined Citigroup in 2002 and was elevated to run alternative investments in its wealth management division last year. Alex Samuelson, a Citigroup spokesman, declined to comment on Chappuis' successor at the bank.

Before Citigroup, Chappuis was a strategy consultant with Boston Consulting Group and an investment banker at the former Bankers Trust New York Corp. ■

INDUSTRY NEWS

Emerging Market, Tech Hedge Funds Get Hit In May

BY ALISTAIR BARR

Hedge funds lost money in May as sharp declines in emerging markets and technology stocks hit managers focused on those sectors.

Volatility in commodity markets also buffeted other hedge funds and prompted one $250 million fund to shut down after losing 29% during the first five months of 2006.

An index of hedge funds compiled by Chicago-based Hedge Fund Research fell 1.16% in May, while another run by Hedgefund.net dropped 0.90%. The indexes are still up 6.72% and 6.66% so far this year.

Emerging markets hedge funds, which have been among the hottest this year, suffered in May as stock markets slumped in countries such as India, Russia and Turkey.

Emerging markets managers tracked by HFR lost 3.98% on average last month, but are still up more than 10% so far this year. Hedgefund.net's emerging markets index dropped 4.66% in May, leaving it up 9.51% so

FUND NEWS

Venture Capitalist Chiruvolu Raising $150M Fund

BY MICHELLE TSAI

Seeking quicker returns than typical venture capital deals, Ravi Chiruvolu, former managing director at Charter Venture Capital, plans to raise a hedge fund to invest in undervalued public companies.

Now a venture partner at GKM Ventures, Chiruvolu is recruiting two partners to join **Top Shelf Capital**, his new Palo Alto, Calif.-based hedge fund, and will approach institutional investors in mid-2007 to raise at least $150 million to $200 million.

The venture capitalist started down the hedge fund path when he saw Niku, the Nasdaq-listed software company whose board he joined in October 2002 when it had a market cap of $15 million, he said, sell to Computer Associates International Inc. in June 2005 for $350 million.

"There's less supply of capital for these fallen companies than for traditional private companies," said Chiruvolu, a software expert who joined GKM Ventures in July 2005. Though he has brought deals like Ellie Mae Inc., the mortgage software company, to GKM, Chiruvolu plans to leave after 2006 to raise his new fund. Charter Venture Capital, where Chiruvolu worked from 2000 to 2005, shifted to an all-life science focus a couple years ago.

For someone accustomed to 10-year partnerships and exit events five to seven years after initial investments, perhaps the best part about hedge funds is how quickly the returns come. Chiruvolu estimates that his next fund will distribute cash to investors in two to four years.

The VC plans to make big bucks on companies that went public prematurely in the late 1990s and have managed to survive but are undervalued. Chiruvolu expects to do diligence on these public entities much as he has on private startups, then take active roles on boards of directors. Top Shelf Capital will invest an average of $5 million in each company and hold onto each investment for three to five years.

Chiruvolu isn't leaving the start-up world behind, however. He said Top Shelf will also invest in private companies at all stages, with a focus on on-demand software and Web 2.0 companies ■

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far this year.

Managers focused on technology also lost money in May as the Nasdaq Composite index dropped more than 5%.

HFR's Technology hedge fund index dropped 5.1% in May, leaving it up 4.44% so far in 2006.

Volatility in metals and energy prices in May also hurt some hedge funds.

An index of Commodity Trading Advisers compiled by The Barclay Group dipped 0.33% in May, leaving it up 4.39% for the first five months of 2006.

"May started off on a positive note for most traders," said Sol Waksman, founder and president of The Barclay Group. "But by midmonth, prices for precious metals, industrial metals, and energy all turned sharply lower."

Volatility in commodity markets has claimed one victim, the $250 million Ospraie Point fund.

Ospraie Management LLC, a $4 billion New York hedge fund group run by Dwight Anderson, has decided to shut the commodity fund, a spokesman said.

Ospraie Point lost 29% in 2006 by betting that a rally in commodities such as copper would end, according to published reports.

Investors in the fund have been offered the chance to invest in the firm's main, much larger Ospraie Fund.

That fund, which has also lost money this year, is offering investors the chance to put money in at the current high water mark.

A high water mark is the point at which a hedge fund's returns most recently peaked. If a fund loses money, hefty annual performance fees of at least 20% aren't usually levied unless managers improve returns and breach the high water mark again. ■

US Home Builders

Continued from page 5

doesn't rule out a return to much lower prices for the stocks. As a result, EGM Capital has been short on home builders for the last few years, although the fund recently has covered some of its positions just in case there is a short-term bounce.

"We called the market a little bit early so [we] got hit in 2004 and were flat last year," he said. "If the Fed doesn't raise rates at its next meeting, there may be a bit of a bounce back, especially after the recent precipitous fall, but the underlying fundamentals haven't changed."

Others say hedge funds could be buying into the struggling home builders with the intention of forcing management to pursue share-buyback programs rather than investing more in land at a time when real estate values cool on higher interest rates.

Over the last eight months or so, many companies in the sector have been beefing up their buyback programs, including Pulte Homes, Centex and Beazer Homes - the latter following pressure from Tontine, which last October disclosed a 10% stake in the company and urged it to pursue a repurchase program.

And while some may be hanging on to their long positions, many hedge funds may be unraveling positions in home builders, contributing to the falling prices across the sector.

Early indications from Chicago-based Hedge Fund Research show that hedge funds focused on real estate may be down as much as 2% or more in May - the first monthly decline in eight months.

While many hedge funds play across sectors, poor returns in the real estate focused funds could have a knock-on effect on the multistrategy funds and long/short equity players, HFR president Josh Rosenbererg said. ■

MOVI

Continued from page 4

Capital was not answered.

Like Prentice, HBK, which possesses $4.1 billion in its equity book, is a significant owner of both stocks. The fund owns 7.4% of Blockbuster's Class B shares, even after having trimmed its position significantly in 2005, and last quarter it bumped its smaller stake in Blockbuster's Class A shares.

When asked about whether the rumors of a Blockbuster merger with Movie Gallery might be a possible reason that for hedge funds are buying both companies' stock - especially considering they each trade at a huge discount to online DVD rental retailer Netflix Inc.'s $25-plus per share and $1.5 million market capitalization, even amid a high price/earnings ratio - Bhatia said it's unlikely, given the antitrust hurdles Blockbuster would have to clear.

"If regulators didn't allow them to buy just Hollywood [Video, which Movie Gallery merged with last year], I don't know how the regulators would allow them to buy [the combined] Hollywood and Movie Gallery," Bhatia said.

Carl Icahn, whose hedge fund vehicles own 16% of Blockbuster, has urged the company to cut some costs, which a merger with fellow debt-laden Movie Gallery would most certainly not do.

As separate companies, though, both Blockbuster and Movie Gallery have seen their stock prices rise from 52-week lows hit in March - Blockbuster at $2.95 on March 20 and Movie Gallery at $1.68 March 9. Bhatia said that since the second half looks brighter for both companies and their prices are still low, perhaps hedge funds are betting that "any kind of news will move them up." ■

Univision Sale

Continued from page 2

Behren declined to disclose Westchester's current stake in Univision but, according to the latest regulatory filings, the firm had close to 890,000 shares in Univision as of March 31, worth around $32 million at last week's average market price.

Univision closed last Thursday at $35.60, after hitting a 52-week high of $36.61 on June 2. At the end of the first quarter, the stock stood at $34.47, so a sale at $40 would imply a premium of at least 16% for shareholders. But the existence of at least two bidding groups justifies expectations for a higher bid, analysts said, even though some believe the valuation is already rich.

Analysts at hedge funds said they are confident the sale will go through because of both the asset quality and the abundant cash in the hands of private equity firms looking for an investment opportunity. With two bidders in place, the hedge funds playing the arbitrage game are likely to reap some profits from the deal.

On the one side there is the Televisa-led group, which joined forces with private equity heavyweights Bain Capital LLC, Blackstone Group, Carlyle Group L.P. and Kohlberg Kravis Roberts & Co., as well as Bill Gates' investment firm Cascade Investments LLC.

On the other side, equally powerful private equity firms Texas Pacific Group, Thomas H. Lee Partners, Madison Dearborn Partners Inc. and Providence Equity Partners have aligned with Hollywood billionaire Haim Saban, who controls German TV company ProSiebenSat.1 Media AG, according to people close to the deal.

The hedge fund with the largest stake in Univision is **Citadel Investment Group**, which had around 3.4% of the company at the end of the first quarter, valued at $286 million. The Chicago-based fund, which has an equity portfolio worth $24.34 billion, has been a long-time investor in Univision, filings show, but it has been bulking up its position significantly over the past year, increasing it fourfold to over 8 million shares. A Citadel spokesman said it is the firm's policy not to comment on its investments.

A host of other hedge funds jumped in the trade in the first quarter after Univision's announcement in February that it had put itself on the block.

Event-driven hedge fund **Halcyon Asset Management Co.** invested around $105 million in the first quarter, according to filings, making it the fourth largest holding in its long equity portfolio of $1.76 billion. **Taconic Capital Advisors**, a New York-based merger-arbitrage fund, also took a significant position of around $92 million in the first quarter.

The list of hedge fund newcomers includes **Amber Capital**, with a position worth nearly $62 million; **Eton Park Capital Management**, with a $59.2 million stake; and **Tudor Investment Corp.**, which parked $52.4 million in the name, filings show.

Those investing between $40 million and $50 million following the sale announcement included **Empyrean Capital Partners**, **SAC Capital Advisors**, **KR Capital Advisors**, **Staro Asset Management**, and **Seneca Capital Advisors** - all first-time holders of Univision setting a trade to capture the sale premium.

"It is a unique asset, it has a unique distribution platform, and no one else in the sector has the growth potential that Univision has," said one analyst at a hedge fund who requested anonymity. He referred to the growth of the Spanish population in the U.S., which has rising spending power and is therefore attracting more and more advertisers.

Already Univision has been included in the Nielsen's National Television Index - a first for a Spanish-language network. The NTI is used by advertisers to measure audience reach. In the May sweep, Univision was the second most-watched network in the 18-24 age group during prime time, and the fourth-largest broadcast network with the 18-34 audience on primetime weeknights.

For the private equity buyers, Univision has little enough debt on its balance sheet that more leverage wouldn't necessarily be a problem, said the analyst.

Univision had $1.2 billion in long-term debt as of March 31, according to its 10Q regulatory filing. Credit-rating agency Standard & Poor's put Univision's triple-B-minus rating on watch in February, warning that a leveraged buyout would likely result in a downgrade to junk status. Although that action raises the cost of borrowing, interest rates are relatively low even for speculative grade companies, and the private equity groups aren't deterred by that.

The analyst, in fact, expects a more indebted Univision even if the sale doesn't go through because the majority owner, Jerrold Perenchio, has signaled he may do a recapitalization of the company if he doesn't get the asking price, which values the company at $13.5 billion. That would entail borrowing to buy back shares and forcing foreign owners such as Televisa to reduce their stakes because of federal rules that prohibit foreign companies from owning more than 25% of a U.S. broadcaster.

That rule is also behind Televisa's joining with private equity groups to get

Continued on page 18

Wireless Backhaul

Continued from page 3

Management took new positions in the stock during the first quarter and, if they held on, made some nice profits. The stock fell back to around $13 last week, still near its 52-week high. None of the funds would comment on their wireless backhaul bets.

XO is majority-controlled by Carl Icahn, though Icahn, who is also chairman of XO's board, was recently rebuffed in an attempt to purchase XO's wire-line business. XO's stock has more than doubled this year, and while it dropped under $5 last week, its market capitalization of $926 million is actually higher than First Avenue's, which is valued at $835 million. When the First Avenue merger with FiberTower is completed, the combined company will be worth $2 billion.

Icahn was joined in the first quarter by new hedge fund investors, including, among others, **Third Point Management** and **Artemis Advisors**, which bought 2.95 million and 1.1 million shares, respectively. In April XO officially launched its backhaul unit, NextLink, which will provide broadband wireless services for cellular carriers and government offices.

Of course, wireless backhaul is a business with a lot of question marks, and it's easy to make the bear case. Not only have First Avenue and XO already gone through bankruptcies, but they're being valued at $2 billion and $1 billion, respectively, when neither of them is profitable or earning much revenue. Plus, they have to rely on forging partnerships with the cellular carriers, and while those carriers are running out of space on their T1 lines, they do have other options: IDT Corp.'s wireless backhaul unit IDT Spectrum, for one.

But Potter said he has a buy on First Avenue's stock and a target of $17 because he believes that more partnerships - like the one it has with Cingular - are "going to happen sooner rather than later." He said that once the merger with FiberTower is closed, there's a good chance for some partnerships with carriers.

"In my view, this will be the year for us to see contracts and some major commitments on the carrier side to do this. He added: "Hopefully, carriers will start assigning them larger deals. That's what we're waiting to see: a carrier to really start committing in a larger fashion." ■

Emerging Markets

Continued from page 9

In addition to the lack of commodity support, the Eastern European currencies could suffer from a lack of interest-rate support, according to Barrett. Investors often park money in economies where interest rates are high to benefit from the higher yield.

But over the past two years, many of the region's central banks have been slashing rates. Hungary has cut rates by 857 basis points since June 2004, and rates are currently at 6.0%. Slovakia's rates are at 3.5%, after a cut of 150 basis points in the same time frame. Rates in the Czech Republic are now at 2%.

"You have big deficits, no commodities and short-term interest rates lower than rates in the U.S.," noted Barrett. "It won't attract as much speculative money."

Conversely, Brazil's rates fetch 15.25%, while Mexico's are 7.0%. And besides the support from commodity prices, Latin America economies are running healthy fiscal balances and are effectively targeting inflation.

Asian currencies, meanwhile, have managed to outperform nearly all other emerging market counterparts over the past month. Barrett expects investors to re-enter Asia before either Latin America or Eastern Europe. "The key issue will be current-account surpluses and strong growth in a low-inflation environment," noted B of A's Goodman. "Countries in Asia are uniquely well positioned to ride out the near-term volatility."

And if China undertakes further steps to revalue its currency, the yuan, Asian currencies will also gain. ■

Univision Sale

Continued from page 17

control of Univision.

Televisa's express interest in adding Univision to its empire - it is the largest Spanish-language media company - provides investors with much of the confidence that the deal will be done.

"I wasn't surprised to see the other networks backing away, because none of them are nearly as great a fit as Televisa," said another analyst at a hedge fund that is also involved in the trade. Televisa already provides much of the content of Univision's programming, and that gives room for cost-cutting.

The other set of bidders, however, is armed with the argument of less regulatory uncertainty because of the absence of foreign participants, said the first analyst.

"The downside is limited, and there are multiple ways to win," said the analyst.

In a more bearish scenario - Univision would be taken out at $39 per share in a deal that would take about a year to clear - the stock would trade at current levels when considering the time value of money, he added.

The first round of bids is expected around June 20, people close to the situation said recently. ■

Credit Protection/VIX

Continued from page 12

against the backdrop of a slowing economy.

"The next rate hike is unnecessary, it's just [Fed Chairman Ben] Bernanke establishing his inflation hawk credentials," said Michael Kastner, portfolio manager at SterlingStamos in New York.

Notably, the current rally in Treasurys, led by long-dated maturities, inverted the yield curve between the two-, and 10-year yields Thursday. Historically an inverted Treasury curve has sparked wider credit spreads as it has indicated a recession and weaker company cash flow is brewing.

A look at eurodollar interest rate futures reveals roughly half of a 25 basis point rate cut is priced into the 2006 and 2007 curve of quarterly futures. Since the beginning of last week, the difference between the September 2006 and 2007 eurodollar contracts has moved out to around -15.0 from -11.5 basis points. That move has also been repeated between the December 2006 and 2007 contracts.

Other observers fret that the Fed and credit investors could soon face the worst of both worlds, higher inflation pressures and weaker growth.

Such an environment would be "ugly for credit" and "the catalyst for much wider spreads," said Putnam's Cronin. Heading into the June FOMC meeting Cronin expects trading in the CDX index will remain febrile.

All of which raises a key question for credit investors: Will demand from investors in structured credit save the day? Wider credit protection levels help boost the initial value of credit structures such as tranches of credit and synthetic collateralized debt obligations, making them more attractive to investors.

In recent years, the ease of increasing credit risk via synthetic derivative structures has capped previous periods of spread widening, notably in May 2005 when the U.S. auto sector began its journey from investment- to junk-grade status.

"There is a lot of money sitting on the sidelines, and we are not on the verge of a wholesale widening in credit," said SterlingStamos's Kastner.

Once equities and VIX stabilize, that would suggest the CDX index will lead the way tighter as the synthetic machine cranks into life.

All well and good for a short-term bounce, but a sharply slowing economy buckling under excessive monetary tightening will warrant much wider credit spreads. It's a move that will only accelerate if investors holding the huge amount of synthetic credit structures produced in recent years decide to head for the exit. ■

Credit Default Swaps

Continued from page 14

"I think the main point is that CDS has been used as a hedging vehicle, as opposed to a risk-taking vehicle, for the better part of the year," said Michele Nicoletta, an emerging markets credit trader at Lehman Brothers in New York. "As a result, the spread differentials between CDS and bonds have remained very wide."

Furthermore, much of the investments in emerging markets' local instruments have been hedged through CDS, she said. "It's most notable where the exposures are the largest, like Brazil and Mexico, but it pretty much persists through most of the credits."

"So while spreads have been widening, this is the first time in history that I can remember that there actually have been sellers of protection in the market as spreads are widening. And that's caused basis to hold in pretty well," she said.

As the CDS market develops for emerging market assets, a host of new structured products are being offered to dedicated investors.

The creation of an emerging markets index for CDS, called CDX, allows investors to hedge entire emerging market portfolios using a basket of CDS from different countries and maturities. According to Barclay's Jain, the index is becoming a very attractive option.

"Real money investors that are not normally active in CDS are using the index as a convenient way to hedge their portfolios," he said.

(Wailin Wong contributed to this report) ■

Fund Trading Costs

Continued from page 8

another set of firms that have taken this very seriously."

The first group, Parker added, "will wait for the reaction of their trustees to come back to them say 'What are these numbers?'"

Business has boomed for Rontech in the U.S., with domestic firm rushing to track the separate costs of their research and trading. Parker spends every other week in the U.S. meeting with interested firm, he said.

If unbundling continues to move forward, brokerage firms will find it increasingly difficult to make money from trading stocks, as hedge funds and other big clients insist on paying lower commissions. In a report published late last year, former CIBC analyst Ken Worthington, now at J.P. Morgan, predicted that unbundling will enable firms with the best trading desks to benefit, and compel others to reshape their operations. ■